Guarantee Co. of North America v. Gordon Capital Corp.

178 D.L.R. (4th) 1 Reversing 157 D.L.R. (4th) 643
Supreme Court of Canada

Summary:
Guarantee Co entered into a contract under which they would provide fidelity insurance to Gordon Capital Corp. Under the contract Gaurantee would cover losses incurred by Gordon as a result of "dishonest and fraudulent acts committed by an employee". In it's application for the insurance the insured (Gordon) indicated that all accounts would be reviewed monthly by an employee not involved with the account under review. This would provide an internal checking mechanism to detect misconduct early and minimize losses. After there was misconduct and a loss resulted, it became evident that the monthly checks had not been done on the particular account on which the loss occurred. On these grounds the insurer (Gaurantee) rescinded the contract. The insurer relied on the following words in the contract to support the rescission: "Any misrepresentation, omission, concealment or incorrect statement of a material fact, in the application or otherwise, shall be grounds for the rescission of this bond."

The contract further stated that a claim for "any loss hereunder shall not be brought . . . after the expiration of 24 months from the discovery of the loss". Furthermore: "Discovery occurs when the Insured first becomes aware of facts which would cause a reasonable person to assume that a loss of a type covered by this bond has been or will be incurred, regardless of when the act or acts causing or contributing to such loss occurred, even though the exact amount or details of loss may not then be known."

There was evidence that the loss was discovered by the insured on June 26, 1991. The insured notified the insurer that would like to claim for the loss on June 28, 1991. On August 5, 1992, the insurer advised the broker that it was rescinding the bond on the basis that the insured had made misrepresentations in its application i.e. the monthly audits had not been done as it was indicated they would be. The insured denied the validity of the rescission.

It was not until July, 1993 that the two parties commenced actions against one another i.e. more than 24 months after the loss was discovered (June 26, 1991). Putting aside the question of whether or not the rescission was valid, the insurer successfully brought a motion for summary judgment as to whether the limitations defence was valid i.e. it was agreed for the purposes of the summary judgment that the rescission had been illegal, and the legal question of whether the limitation period defence applied was considered. The trial judge held that the limitations defence did apply. The Ontario Court of Appeal allowed the appeal saying that the limitation period clause could not be enforced after rescission. The Supreme Court of Canada (SCC) held that the appeal should be allowed, and that the limitation clause would be valid even in the case of an illegal rescission.

The SCC said that it was not necessary to know the exact date of discovery of the full magnitude of the loss flowing from the misconduct, but that one must consider the point in time when there were sufficient facts available to cause a reasonable person to assume that a loss of a type covered under the contract would occur. The SCC held that since the insured had known before June 26, 1991 that the partner had lied and had had him suspended. The insured had known at that time that a claim would likely lie, and that is when the 24 month limitation would start to run.

The court went on to explain the difference between rescission and repudiation. Rescission is a remedy available upon a misrepresentation, and is independent of whether or not the guilty party accepts the rescission. The conract is void ab initio because of the misrepresentation. Repudiation, on the other hand, occurs when one of the parties chooses, with no basis, not to continue the contract. The effect of repudiation depends on the attitude of the non-repudiating party. If the non-repudiating party agrees that the contract should be dissolved, then the contract is at an end and there are no further obligations, but if the non-repudiating party wants to continue the contract, they can reject the repudiation and sue for damages.

When the misrepresentation is included as a term of the contract, the right to rescind depends upon whether the breach is considered "substantial" or "material" i.e. does it go to the root of the contract. In this case the clause indicated that rescission would be available for misrepresentation of "material fact" in the application. Therefore the parties intended that only misrepresentations which were substantial and went to the root of the contract would permit rescission. However, the main question before the court was whether the parties had intended the limitation period to survive a wrongful rescission.

If the clause was not intended to survive wrongful rescission, then the insurer would be exposed to a longer period of uncertainty regarding claims from an insured who had given the insurer some reason to believe they had a right to rescind, than the insurer would be subjected to in a case where the insured had not engaged in behavior which led the insurer to believe they had the right to rescind. This absurd result meant that the limitations clause remained operative even in the event of an illegal rescission.

Full Judgment:
The judgment of the court was delivered by
¶ 1 **IACOBUCCI and BASTARACHE JJ.**:—This appeal deals with the appropriateness of using summary judgment proceedings and with the issue of whether a contractual limitation period survives a wrongful rescission of the contract in dispute. On February 17, 1997, O'Brien J. of the Ontario Court (General Division), sitting as a motions judge, granted summary judgment in favour of the Guarantee Company of North America ("Guarantee"). The judgment declared that Gordon Capital Corporation ("Gordon") had failed to commence legal proceedings for recovery of a loss under Financial Institution Bond No. 401642 (the "Bond") within 24 months from the discovery of "facts which would cause a reasonable person to assume that a loss of a type covered by this bond has been or will be incurred", pursuant to section 3 of the Bond. The Court of Appeal of Ontario set aside the judgment. It determined that Guarantee was precluded from

relying on section 3 because it had wrongfully rescinded the said Bond; it also determined that the question of when a loss within the meaning of the Bond was discovered was a triable issue and should be left for determination at trial.

¶ 2 There are therefore two issues before this Court. The first is whether the Court of Appeal should have interfered with the motions judge's determination that the record was sufficient to deal with Guarantee's summary judgment motion; the second issue is whether the Court of Appeal erred by finding that the limitation period in the Bond did not survive an affirmation by Guarantee that the Bond was rescinded.

I. Background

¶ 3 Gordon is an investment dealer and brokerage firm in Toronto and Montreal. It entered into a $25,000,000 fidelity insurance contract with Guarantee for a term commencing on December 31, 1990 and ending on December 30, 1991. Additional contracts for $10,000,000 of excess insurance each were entered into with Chubb and Laurentian.

¶ 4 The Bond provided coverage for "dishonest and fraudulent acts committed by an employee acting alone or in collusion with others", providing the employee acted with the "manifest intent" to obtain financial benefit for himself, other than that which he would earn in the normal course of employment.

¶ 5 The insured is required, under section 5 of the Bond, to give to the underwriter notice of loss "at the earliest practicable moment, not to exceed 30 days, after discovery of the loss", and to provide sworn proof of loss within 6 months of the discovery. Legal proceedings for the recovery of "any loss hereunder shall not be brought prior to the expiration of 60 days after the original proof of loss is filed . . . or after the expiration of 24 months from the discovery of the loss".

¶ 6 The Bond contains a definition of "discovery" in section 3. It reads:

This bond applies to loss discovered by the Insured during the Bond Period. Discovery occurs when the Insured first becomes aware of facts which would cause a reasonable person to assume that a loss of a type covered by this bond has been or will be incurred, regardless of when the act or acts causing or contributing to such loss occurred, even though the exact amount or details of loss may not then be known.

¶ 7 Eric Rachar was a Gordon partner responsible for the Derivative Products Group in Toronto. He engaged in various securities lending and related transactions with Patrick Lett and companies under Lett's control, but led Gordon to believe that those transactions were in effect being carried out with a Designated Financial Institution ("DFI"), specifically National Trust ("National").

¶ 8 Between July 16, 1990 and May 22, 1991, Gordon loaned National $1.1 billion in Government of Canada bonds. As collateral for the loans, Gordon received Provincial Government Bonds and bonds from senior financial institutions in equivalent principal amounts with similar maturity dates and cash flow. The trading value of the commodity was inferior but regulatory obligations did not require Gordon to provide additional regulatory capital for a loan to a DFI.

¶ 9 Rachar also caused Gordon to enter into transactions with Lett and Citibank involving certificates of deposit, bearer deposit notes, bond forward purchase contracts and securities lending agreements. Because of Rachar's misrepresentations, Gordon accepted worthless collateral which exposed it to high risk.

¶ 10 On June 14, 1991, James Connacher, Chairman and Chief Executive Officer of Gordon received a telephone call from Jon Paysant of National, who expressed the concerns of National about "Account #2", the Rachar-Lett account. On June 17, 1991, a meeting of Gordon and National officers was held to question the unusual features of the transactions. At this meeting, National indicated that it was only acting as agent for Account #2. Gordon conducted a review between June 14 and June 19, 1991 of the collateral held in respect of Account #2. It was determined that the collateral was $51,000,000 less than the value of the Government of Canada bonds.

¶ 11 On June 19, Gordon retained the services of a law firm to determine the nature of the National account by looking at the documentation and interviewing Rachar. O'Brien J. found that Gordon relied on the firm to advise them as to the terms of section 5 of the Bond.

¶ 12 On June 20, Peter Bailey, the Gordon Compliance Officer, met Rachar, who denied any regulatory or other problem with the Account. On June 21, Bailey and a lawyer from the firm met with Rachar, who admitted knowing of Lett, but affirmed National was acting as principal on the account. On June 24, 1991, Bailey met Rachar again to discuss whether the account was in fact held by an individual rather than a DFI. On June 26, the date at which discovery was made according to the proof of loss filed, Bailey and Rachar met with Lett. Bailey determined Rachar had lied, suspended him and denied him access to Gordon's premises. Gordon notified the Toronto Stock Exchange, who notified the Ontario Securities Commission, that there had been misrepresentation by Rachar and that it had a margin deficiency. Gordon retained the Forensic Accounting Division of Peat Marwick Thorne and subsequently Lindquist Avey Macdonald Baskerville to conduct an investigation. Bailey advised senior people at Gordon that Gordon would have to put up in excess of $80,000,000 of regulatory capital.

¶ 13 On June 27, 1991, Gordon took out a loan of approximately $90,000,000 to meet the regulatory capital obligations. It immediately began paying interest on the loan; this interest was claimed in the sworn proof of loss.

¶ 14 On June 28, 1991, Gordon notified Guarantee of a potential fidelity bond claim in relation to the activities of Rachar. During a meeting among representatives of Guarantee, the law firm and Peat Marwick, Brian Clarkin of Guarantee was told that the discovery of the loss by Gordon occurred on June 26, 1991.

¶ 15 Bailey testified that he was concerned, on July 1, 1991 "that there had to be some kind of relationship for . . . Rachar to proceed with these transactions". He assumed that there had been a relationship between Rachar and Lett. He concluded that Gordon would have to unwind the transactions arising from the dishonest conduct of Rachar and that it would suffer a substantial loss. On July 2, 1991, Guarantee provided Gordon with a proof of loss form. It directed Gordon's attention to the requirements of the Bond.

¶ 16 On July 2, 1991, Gordon learned about the irregularities with respect to the Citibank certificates of deposit. It learned of other irregularities on July 5 and July 8, 1991.

¶ 17 On July 10, 1991, Rachar agreed to an inspection of his personal records. On August 15, 1991, Gordon was informed that Rachar had obtained a personal benefit in connection with the transactions. In fact, National advised Gordon that it had discovered a cheque payable to Rachar for $800,000 in the account of Lett at National.

¶ 18 Gordon continued to investigate the activities of Rachar. Lindquist presented a report in February 1992. Gordon then delivered a sworn proof of loss to Guarantee on March 31, 1992, after having obtained two extensions of time for its filing. The report of the forensic investigators was appended to the proof of loss, which affirmed that the date of discovery was June 26, 1991.
¶ 19 On August 5, 1992, Guarantee advised Gordon that, pursuant to a provision in the Bond, it was rescinding the Bond, which had in effect expired on December 31, 1991, on the basis that Gordon had made misrepresentations in its application for the bond. In its application for insurance, Gordon represented to Guarantee that for the purposes of internal control, customer accounts would be reviewed on a monthly basis by a partner, officer or other designated employee not involved with the relevant account. The proof of loss submitted by Gordon, however, revealed that Rachar had sole responsibility for the National accounts, and that the accounts were not subject to review. After various meetings between the parties, an agreement was reached to allow Guarantee to pursue its investigation. On August 7, 1992, Gordon refused to accept the return of premiums from Guarantee and denied the validity of the rescission. The parties agreed to pursue negotiations without prejudice to their legal positions.
¶ 20 On June 30, 1993, Bailey advised Guarantee that Gordon had not commenced an action prior to June 26, 1993. On July 15, 1993, Gordon commenced an action in Quebec, and on July 16 in Ontario. On July 21, 1993, Guarantee set out its position on the limitation period. Guarantee commenced an action in Ontario on July 29, 1993. On August 4, 1993, Gordon filed a notice of intent to defend.
¶ 21 On August 20, 1993, Bailey swore an affidavit stating that the monetary benefit which Rachar received was not known on June 26, 1991, "which may result in the date of discovery being after June 26, 1991".
¶ 22 Ground J. refused Gordon's motion to stay the Ontario action on January 17, 1994 [reported 22 C.C.L.I. (2d) 304 (Gen. Div.)]. On April 25, 1994, Montgomery J. refused to grant leave to appeal that decision [reported 24 C.P.C. (3d) 277 (Gen. Div.)]. This Court refused a further application for leave to appeal [noted 29 C.P.C. (3d) 148n]. On November 21, 1994, Gordon filed its statement of defence. In January of 1997, Guarantee made a motion for summary judgment relying only on the limitation period contained in the Bond. Meanwhile, the Quebec Court of Appeal had stayed the Quebec action pending the determination of the Ontario action [summarized 57 A.C.W.S. (3d) 738].
II. Judicial History
(1) The Motion for Summary Judgment (1997), 32 O.R. (3d) 428
¶ 23 The relevant portion of O'Brien J.'s decision deals with the argument that Guarantee's rescission prevented reliance on the limitations provision, and the argument that the conditions for summary judgment were not met.
¶ 24 On the first issue, O'Brien J. held that assuming the rescission was wrongful, it did not prevent reliance on the limitation period contained in the Bond. On the second issue, the motions judge first noted that Gordon had conceded some of the interest expense on money borrowed to meet the margin requirements predated July 16, 1991, and that it constituted "some loss at that time" (at p. 437). He rejected the argument by Gordon that the limitation period did not commence to run until a loss was "incurred" by Gordon. It was his view that there is no ambiguity regarding the word "loss", which must

refer to the loss as described in the "Discovery" section of the Bond. This, he said, is not an actual loss.

¶ 25 Dealing with the conditions applicable to summary judgment, O'Brien J. said there were no significant issues requiring trial, whether legal or factual. He specifically rejected the argument that the different affidavits of Bailey raised a credibility issue requiring trial.

(2) The Decision of the Court of Appeal (1998), 38 O.R. (3d) 563, 157 D.L.R. (4th) 643

¶ 26 Noting that "this is a very difficult issue and one in which there is little guidance in the jurisprudence of this jurisdiction", Carthy J.A. concluded that the Ontario action was not barred by virtue of the limitation period in the Bond because Guarantee had rescinded the Bond. He reasoned that the limitation period was similar to the filing of a proof of loss provision, and that the latter could not be enforced after rescission on the authority of Ross v. Scottish Union and National Insurance Co. (1918), 58 S.C.R. 169 at p. 182, 46 D.L.R. 1. In his view, only the neutral features of a contract could survive rescission. On the other issue, Carthy J.A. found that "should this judgment be reversed on further appeal . . . the question of when the loss was discovered within the meaning of the bond should be left for determination at trial" (at p. 573). He based his conclusion on the finding that "[t]here are serious factual disputes about when there was discovery of the type of loss covered by the bond" (at p. 573), but gave no indication of the nature of those disputes.

III. Analysis

(1) Were the Conditions for Summary Judgment Met?

¶ 27 The appropriate test to be applied on a motion for summary judgment is satisfied when the applicant has shown that there is no genuine issue of material fact requiring trial, and therefore summary judgment is a proper question for consideration by the court. See Hercules Managements Ltd. v. Ernst & Young, [1997] 2 S.C.R. 165, 146 D.L.R. (4th) 577, at para. 15; Dawson v. Rexcraft Storage and Warehouse Inc. (1998), 164 D.L.R. (4th) 257 (Ont. C.A.), at pp. 267-68; Irving Ungerman Ltd. v. Galanis (1991), 4 O.R. (3d) 545 at pp. 550-51, 83 D.L.R. (4th) 734 (C.A.). Once the moving party has made this showing, the respondent must then "establish his claim as being one with a real chance of success". Hercules, supra, at para. 15.

¶ 28 The limitation period defence raises mixed questions of fact and law. O'Brien J. found that the only disputes were on the application of the law. We find no reason to disturb this finding.

¶ 29 Under section 3 of the Bond, all that is required for discovery of loss are sufficient facts to cause a reasonable person to assume that a loss of a type covered by the Bond will be incurred. A loss need not be conclusively determined to be covered in order for discovery to occur. Having accepted that Gordon knew its employee had acted fraudulently before July 16, 1991 and that Gordon had already incurred interest charges in respect of a $90,000,000 loan to meet its regulatory capital obligations, O'Brien J. inferred that it could reasonably be assumed that a loss of the type covered by the policy was or would be incurred. Although O'Brien J. regarded as significant that Gordon had actually incurred interest charges without questioning whether they were in fact covered by the Bond, he clearly rejected the argument that a loss had to be incurred before the limitation period would commence to run.

¶ 30 We are of the view that the undisputed facts in this case lend strong support to the motions judge's inference. Without repeating all that is said in the background section, we would note that Gordon had, on or before June 26, 1991, found out that Account #2 was not held by a DFI and that Rachar had lied concerning the account; it had borrowed $90,000,000 to meet regulatory capital requirements, hired forensic accountants and instructed its law firm, notified the Toronto Stock Exchange, suspended Rachar and prevented him from entering their premises. Shortly thereafter, Gordon filed a notice of loss and became suspicious of a Rachar-Lett relationship. The filing of a notice of loss in itself is a strong indication that Gordon reasonably assumed that a loss covered by the Bond had been or would be incurred. The fact that the interest paid on account of the loan may eventually not be covered under the Bond is immaterial since a reasonable person would assume it fits within the definition of "a loss of a type covered by the Bond". Likewise, suspicion in itself is not sufficient to constitute discovery, but coupled with all other material facts it would cause a reasonable person to assume a loss has been or will be incurred and a personal benefit is involved.

¶ 31 Gordon objected that the various affidavits of Bailey raised a credibility issue sufficient to require a trial. O'Brien J. disagreed. Reading the various affidavits, he was of the view that Bailey's reversal of position after a limitation period defence had been asserted did not create a genuine issue for trial. We agree with that finding. The reversal was based on Bailey's opinion that actual knowledge that Rachar had benefited from his transactions was determinative. The affidavit of November 22, 1995 states that the June 26, 1991 date was used only because this was the date at which Gordon knew it had to meet a capital requirement, not because it believed that a loss of the type covered by the Bond had occurred. O'Brien J. looked at this in the context of the proceedings, taking into account the sophistication of the parties and the fact that they had been discussing their problem with forensic accountants and outside legal counsel. We do not find his conclusion to be unreasonable, especially in view of the fact that the true test of discoverability is an objective one under the terms of section 3 of the Bond. We would add that the trial judge's ruling on this point is entirely consistent with previous decisions holding that a self-serving affidavit is not sufficient in itself to create a triable issue in the absence of detailed facts and supporting evidence. See Rogers Cable TV Ltd. v. 373041 Ontario Ltd. (1994), 22 O.R. (3d) 25 (Gen. Div.); Confederation Trust Co. v. Alizadeh, [1998] O.J. No. 408 (QL) (Gen. Div.) [summarized 77 A.C.W.S. (3d) 295].

¶ 32 Gordon insists that the facts known to Gordon did not suffice to cause a reasonable person to assume a loss "of a type" covered by the Bond. O'Brien J. did not discuss this issue except to say that the loss he contemplated was the one described in the "Discovery" section. We believe that on a proper reading of the Bond, a loss of the type covered is simply a loss resulting from employee dishonesty with the presumption that the manifest intent of such behaviour was personal gain. This is the only interpretation that accords with the nature of the fidelity bond and which makes commercial sense. To require evidence of an actual benefit would defeat the purpose of an early notification provision which specifically excludes the need to establish an actual loss. It would also expose the insurer to "long tail" claims (evidence of a personal benefit could come years after evidence of a loss), as argued by the respondent Chubb,

and contradict the normal assumption that dishonesty, fraud and deceit are usually associated with personal benefit.

¶ 33 Gordon also argues that the question of law is uncertain. In his factum, counsel for Gordon argues that discovery is only established when there is knowledge of a "real loss", or knowledge of all of the facts which the insured must prove in order to entitle him or her to judgment. In fact, the issue is simply one regarding the interpretation of the Bond.

¶ 34 Section 3 of the bond first requires that the insured "becomes aware of the facts". This simply means "being informed of" facts. It then provides that those facts "would cause a reasonable person to assume". This is an objective test that does not require a definitive finding, but an assumption. Another component is that those facts relate to a possible loss "of a type covered by the bond". These broad terms refer to the nature of the coverage involved, namely, fidelity insurance. The type of conduct contemplated is dishonest conduct. The section specifies that the loss "has been or will be incurred". This excludes the requirement of actual loss and introduces the notion that the insured may be subject to a loss. The last part of the section specifies the following: "regardless of when the act or acts causing or contributing to such loss occurred even though the exact amount or details of loss may not then be known"; this is also inconsistent with Gordon's argument that the loss must be incurred. It specifies that the limitation runs from the first evidence establishing discovery.

¶ 35 We agree that there is no legal issue to be resolved at trial. The application of the law as stated to the facts is exactly what is contemplated by the summary judgment proceeding. The motions judge found that the undisputed facts met the definition of discovery of loss under the Bond and that a reasonable person would have assumed that they were sufficient to establish that a loss of a type covered by the Bond had been or would be incurred. The Court of Appeal did not provide sufficient reasons on this issue for us to comment. It did not describe the factual disputes in the case, except to say that the interest paid on the loan of $90,000,000 before June 26, 1991 may not have been a covered loss. As mentioned earlier, this last comment is inconsistent with the fact that the Bond does not require that facts known by the insured be ultimately proved to relate to an actual recoverable loss. With regard to the alleged uncertainty of the term "loss", the Court of Appeal agreed with O'Brien J. We are also of the view that no issue for trial has been established in this regard.

¶ 36 We would therefore conclude that the motions judge committed no error in determining that this was a proper case for summary judgment. Gordon has not met the evidentiary burden to show there is a genuine issue for trial.

(2) Was Guarantee Precluded from Relying on the Limitations Clause in Section 5(d) of the Bond by Reason of Its Rescission of the Bond?

¶ 37 For the purposes of bringing a summary motion, Guarantee agreed to proceed on the basis that its rescission of the Bond was wrongful. Accordingly, the issue to be determined on the motion was the legal question of whether wrongful rescission precluded Guarantee from relying on the contractual limitation period contained in the Bond as a defence to Gordon's claim for coverage.

¶ 38 Given both parties' assumption that Guarantee's rescission was wrongful, it is not necessary to address the effect of the contract's limitation period assuming a valid rescission. However, we believe it is worthwhile, both as background and to eliminate

some apparent confusion, to address the distinction between rescission and repudiation. This done, we will turn to the question of whether a limitations clause can survive a wrongful rescission.

(a) The Distinction Between Rescission and Repudiation

¶ 39 A fundamental confusion seems to exist over the meaning of the terms "rescission" and "repudiation". This confusion is not a new one, as it has plagued common law jurisdictions for years. Rescission is a remedy available to the representee, inter alia, when the other party has made a false or misleading representation. A useful definition of rescission comes from Lord Atkinson in Abram Steamship Co. v. Westville Shipping Co., [1923] A.C. 773 (H.L.), at p. 781:

Where one party to a contract expresses by word or act in an unequivocal manner that by reason of fraud or essential error of a material kind inducing him to enter into the contract he has resolved to rescind it, and refuses to be bound by it, the expression of his election, if justified by the facts, terminates the contract, puts the parties in statu quo ante and restores things, as between them, to the position in which they stood before the contract was entered into.

See similarly G.H.L. Fridman, The Law of Contract in Canada (3rd ed., 1994), at p. 807.

¶ 40 Repudiation, by contrast, occurs "by words or conduct evincing an intention not to be bound by the contract. It was held by the Privy Council in Clausen v. Canada Timber & Lands, Ltd. ([1923] 4 D.L.R. 751), that such an intention may be evinced by a refusal to perform, even though the party refusing mistakenly thinks that he is exercising a contractual right" (S.M. Waddams, The Law of Contracts (4th ed., 1999), at para. 620). Contrary to rescission, which allows the rescinding party to treat the contract as if it were void ab initio, the effect of a repudiation depends on the election made by the non-repudiating party. If that party treats the contract as still being in full force and effect, the contract "'remains in being for the future on both sides. Each [party] has a right to sue for damages for past or future breaches'" (emphasis in original): Cheshire, Fifoot and Furmston's Law of Contract (12th ed., 1991), by M.P. Furmston, at p. 541. If, however, the non- repudiating party accepts the repudiation, the contract is terminated, and the parties are discharged from future obligations. Rights and obligations that have already matured are not extinguished: Furmston, supra, at pp. 543-44.

¶ 41 So much is relatively clear. Problems have arisen, however, from misuse of the word "rescission" to describe an accepted repudiation. In Keneric Tractor Sales Ltd. v. Langille, [1987] 2 S.C.R. 440 at p. 455, 43 D.L.R. (4th) 171, Wilson J., writing for the Court, addressed the distinction as follows:

The modern view is that when one party repudiates the contract and the other party accepts the repudiation the contract is at this point terminated or brought to an end. The contract is not, however, rescinded in the true legal sense, i.e., in the sense of being voided ab initio by some vitiating element. The parties are discharged of their prospective obligations under the contract as from the date of termination but the prospective obligations embodied in the contract are relevant to the assessment of damages: see Johnson v. Agnew, [1980] A.C. 367, [1979] 1 All E.R. 883 (H.L.), and Moschi v. Lep Air Services Ltd., [1973] A.C. 331, [1972] 2 All E.R. 393 (H.L.). [Emphasis added.]

See similarly Waddams, supra, at para. 629; Furmston, supra, at p. 287, note 12; G.H. Treitel, The Law of Contract (9th ed., 1995), at p. 341; S. Williston, A Treatise on the Law of Contracts, (3rd ed.,
1970), by W.H.E. Jaeger, vol. 12, 1454A, at p. 13; cf. Sail Labrador Ltd. v. "Challenge One" (The), [1999] 1 S.C.R. 265, 169 D.L.R. (4th) 1, at paras. 31 and 50.

¶ 42 However, merely clarifying the distinction between rescission and an accepted repudiation does not end the discussion. Since "rescission" has frequently been used to describe an accepted repudiation, courts must be sensitive to the potential for misuse. To that end, courts must analyze the entire context of the contract and give effect, where possible, to the intent of the parties. If they intended "rescission" to mean "an accepted repudiation", then the contract should be interpreted as such. For example, in Mills v. S.I.M.U. Mutual Insurance Association, [1970] N.Z.L.R. 602 (C.A.), the court held that a clause stating that in the event of false statements the policy "shall be void", was in fact a repudiation clause. Crucial to the court's reasoning in that case was the fact that the clause in question provided for forfeiture of premiums. Turner J. therefore concluded, at p. 609, that

. . . the policy does not provide that the consequences of an untrue statement shall be that the policy shall be deemed void ab initio, as if it had never come into existence, for the premium is to be forfeited . . . I therefore construe the clause to mean that an untrue statement shall entitle the respondent to repudiate liability under the policy, while keeping the premium.

Of course, contrary to the facts in this appeal, the actual term "rescission" was not used in Mills. Nonetheless, we must always examine whether the use of the word rescission is indeed consistent with the parties' intent.

¶ 43 Before turning to the issue of intent, however, one must determine whether rescission is even available. As Treitel, supra, notes regarding the law in England, at p. 347:

Before the Misrepresentation Act it was clear that a person could rescind a contract for a misrepresentation which did not form part of the contract; but it was doubtful whether this right to rescind survived where the misrepresentation was later incorporated into the contract as one of its terms. [Emphasis in original.]

However, the Misrepresentation Act 1967 (U.K.), 1967, c. 7, s. 1, cleared up that question in England, providing that "a person shall be entitled to rescind notwithstanding that the misrepresentation has become a term of the contract" (Treitel, supra, at p. 347).

¶ 44 In Canada, the issue is somewhat less clear. The state of the law is best summarized by Waddams, supra, at para. 427: If the [misrepresentation] is a term of the contract . . . the mistaken party is entitled to damages as for breach of contract. Whether the party is further entitled to set aside the transaction and demand restitution of the contractual benefits transferred will depend upon . . . whether the breach is "substantial" or "goes to the root of" the contract.

A breach that is "substantial" or "goes to the root of" the contract is often also described as a material breach; see, for example, Fridman, supra, at p. 293: "A misrepresentation is a misstatement of some fact which is material to the making or inducement of a contract". The misrepresentation in this case was in the application, and was thereby incorporated into the Bond. Specifically, the misrepresentation complained of was, as stated in Guarantee's August 5, 1992 letter to Gordon that:

. . . in respect of customer accounts a partner, officer or other designated responsible employee who has no other duties in connection with the account [would] review each account monthly checking for excessive or improper activity. The proof of loss discloses that no one other than Rachar was charged with reviewing the accounts in question.
The question, in light of the law as stated in Waddams, supra, and Fridman, supra, is whether the misrepresentation is "substantial", "material", or "goes to the root of" the contract. This brings us back to the issue of the parties' intent, for whether the rescission is warranted is at least in part a question of intent.
¶ 45 Whether the misrepresentation is material is a complicated question on which there is an extensive body of case law. However, these precedents are not entirely apposite, as they generally do not involve contracts, like this one, that use the term "rescission" to define the remedy for a misrepresentation in the application. The rescission clause in this appeal reads as follows:
The Insured represents that the information furnished in the application for this bond is complete, true and correct. Such application constitutes part of this bond.
Any misrepresentation, omission, concealment or incorrect statement of a material fact, in the application or otherwise, shall be grounds for the rescission of this bond. [Emphasis added.]
By stating that a misrepresentation in the application would be grounds for rescission, the parties effectively stated their intent that such a misrepresentation is "substantial" and "goes to the root of" the contract. The reference to misrepresentations of "material fact" suggests the same conclusion. These are sophisticated parties that can be expected to know the meaning of fundamental legal terms such as "rescission", and it is appropriate to give effect to their intent as expressed in the plain words of the contract. As stated by Wilson J. in Hunter Engineering Co. v. Syncrude Canada Ltd., [1989] 1 S.C.R. 426 at p. 505, 57 D.L.R. (4th) 321, "parties of equal bargaining power should be allowed to make their own bargains". See similarly, ibid., at p. 458, per Dickson C.J.C. This point is discussed more fully infra, at paras. 54-56.
¶ 46 Aside from our general reluctance to disturb the choice of terms by sophisticated commercial parties, we note in passing that the appellant not only rescinded the contract, but also tendered return of the insurance premiums. Their letter of August 5, 1992 stated their intention to rescind the policy, and they enclosed a cheque for $106,000.00, representing the premiums paid by Gordon under the policy. This distinguishes this case from Mills, supra, and demonstrates Guarantee's attempt to effect a restitution and restore the parties to the status quo ante, a crucial aspect of rescission. See Waddams, supra, at para. 424. While obviously not conclusive evidence of their contractual intentions, this evidence confirms the earlier conclusion that "rescission", as used in this contract, did indeed mean just that.
¶ 47 In summary, a misrepresentation, even one that was incorporated into the contract, gives the innocent party the option of rescinding the contract, i.e. to have it declared void ab initio. The misrepresentation must be "material", "substantial" or "go to the root of" the contract. We express no opinion on the availability of damages in such cases. Repudiation, by contrast, occurs when one party indicates its intention not to fulfill any future obligations under the contract. If the other party accepts the repudiation, the contract is terminated, not rescinded. To use "rescission" and "accepted repudiation" synonymously can lead only to confusion and should be avoided. Where there is some

doubt as to whether repudiation or rescission is intended, courts should look to such factors as the context of the contract, particularly the intent of the parties. For sophisticated parties, it will take strong evidence to displace the meaning suggested by the parties' choice of language in the contract itself. In this case, because both parties agreed to the word "rescission", and Guarantee acted in accordance with that intention, the consequence of a valid rescission based on Gordon's misrepresentation is the avoidance of the contract, and Guarantee's release from any liability thereunder.

(b) Effect of the Contractual Limitation Period Assuming Wrongful Rescission of the Bond by Guarantee

¶ 48 In the event that Gordon did not misrepresent the extent of the risk involved in applying for the fidelity bond, we can assume for the purposes of this part of the analysis that Guarantee wrongfully denied coverage to Gordonon the basis of misrepresentation. The issue then is to determine the legal consequences of a wrongful rescission. Both parties agree that a substantial failure of contractual performance, often described in other contexts as a fundamental breach, may relieve the non-breaching party from future executory obligations under the contract. The extent of disagreement between the parties concerns whether Guarantee's actions constituted a fundamental breach, and whether a time limitation provision is one such executory obligation from which the non-breaching party, here Gordon, is excused.

¶ 49 Guarantee submits that, in the event that its wrongful rescission amounts to fundamental breach, the legal consequences are governed by the decision of the Court in Hunter Engineering, supra. For the purposes of this appeal, the relevant portion of the decision dealt with the scope of an exclusion clause limiting liability in a contract between the purchaser, Syncrude Canada Ltd., and the vendor, Allis-Chalmers Ltd., for the supply of extraction gearboxes for Syncrude's synthetic oil plant. The supply contract included a warranty limiting Allis-Chalmers' liability to 24 months from the date of shipment or 12 months from the date the equipment was put into operation, whichever occurred first. In addition, the contract contained a clause excluding Allis-Chalmers' liability pursuant to statutory warranties or conditions. The extraction boxes were put into service in November, 1977. It was not until nearly two years later, in September, 1979, that the extraction boxes were found to be defective. Allis-Chalmers did not consider itself responsible for the costs of repair as the contractual warranty period had expired. Syncrude then sued Allis-Chalmers for breach of contract to cover the costs. At issue was whether Allis-Chalmers could enforce the clause excluding liability under the longer statutory warranty period.

¶ 50 The Court was called upon to consider the doctrine of fundamental breach, defined as a failure in the breaching party's performance of its obligations under the contract that deprives the non-breaching party of substantially the whole benefit of the agreement. Notwithstanding that in two separate minority reasons, Dickson C.J.C. (La Forest J. concurring) and Wilson J. (L'Heureux-Dube J. concurring) concluded that the seriousness of the defects in the extraction boxes did not amount to a fundamental breach, both Dickson C.J.C. and Wilson J. discussed the legal consequences in the event that a fundamental breach had occurred. As to the circumstances in which the doctrine applied, Wilson J., at pp. 499-500, noted that the distinction between a mere contractual breach and a breach that is more appropriately characterized as fundamental is the exceptional nature of the remedy; while the traditional remedy for

contractual breach is the obligation to pay damages, a fundamental breach permits the non-breaching party to elect instead to put to an end all remaining performance obligations between the parties. Given the exceptional nature of the remedy, Wilson J. rightly noted that the purpose of the restrictive definition of a fundamental breach is to limit the remedy to those circumstances where the entire foundation of the contract has been undermined.

¶ 51 As to the appropriate methodology, both Dickson C.J.C. and Wilson J. noted the existence of two competing views of the consequences of fundamental breach within both Canada and the United Kingdom. The traditional approach was to apply a rule of law whereby the legal effect of a fundamental breach is to bring the contract to an end. The result would be that the breaching party would be unable to rely on any contractual provisions excluding liability pursuant to common law doctrines or statutory regimes, given that the contract was treated as at an end. The alternative approach addressed the consequences of fundamental breach as a matter of construction of the terms of the contract rather than a categorical rule of law. Courts are required to determine whether the contract, properly interpreted, provides that exclusion clauses shall be enforceable in the event of fundamental breach. If, as a matter of contractual interpretation, the parties clearly intended an exclusion clause to continue to apply in the event of fundamental breach, courts were required to enforce the bargain agreed to by the parties, rather than applying a rule of law to rewrite the terms of the contract.

¶ 52 Noting that the contractual interpretation approach was adopted in England in Photo Production Ltd. v. Securicor Transport Ltd., [1980] A.C. 827 (H.L.), and in prior jurisprudence of the Court (see B.G. Linton Construction Ltd. v. Canadian National Railway, [1975] 2 S.C.R. 678, 49 D.L.R. (3d) 548; Beaufort Realties (1964) Inc. v. Chomedey Aluminum Co., [1980] 2 S.C.R. 718, 116 D.L.R. (3d) 193), both Dickson C.J.C. and Wilson J. affirmed that whether fundamental breach prevents the breaching party from continuing to rely on an exclusion clause is a matter of construction rather than a rule of law. The only limitation placed upon enforcing the contract as written in the event of a fundamental breach would be to refuse to enforce an exclusion of liability in circumstances where to do so would be unconscionable, according to Dickson C.J.C., or unfair, unreasonable or otherwise contrary to public policy, according to Wilson J.

¶ 53 Guarantee submits, pursuant to Hunter Engineering, supra, that it is entitled to enforce the contractual time limitation period based on the intent of the parties that the provision would survive a wrongful rescission. Gordon contends, however, that the differences between exclusion of liability clauses and time limitation provisions is sufficiently substantial that the reasoning in Hunter Engineering, supra, cannot be extended to apply to the factual circumstances of this appeal. We note that in Hunter Engineering, supra, at p. 463, Dickson C.J.C. expressly confined his reasons to the use of fundamental breach in the context of clauses excluding liability. In our opinion, however, the policy rationale in support of the construction approach as applied to exclusion clauses is equally applicable to provisions limiting the time in which an action can be initiated.

¶ 54 As discussed by Dickson C.J.C. in Hunter Engineering, supra, when the House of Lords rejected the rule of law approach to fundamental breach in its decision in Photo Production, supra, Lord Wilberforce articulated the underlying policy rationale in favour

of the construction approach as a matter of allowing the parties to make their own bargain, at p. 843, as follows:

At the stage of negotiation as to the consequences of a breach, there is everything to be said for allowing the parties to estimate their respective claims according to the contractual provisions they have themselves made . . .

At the judicial stage there is still more to be said for leaving cases to be decided straightforwardly on what the parties have bargained for rather than upon analysis, which becomes progressively more refined, of decisions in other cases leading to inevitable appeals.

¶ 55 Wilson J. noted that Lord Diplock, in his concurring reasons in Photo Production, supra, articulated a similar policy concern, stressing that in circumstances where the parties possess equal bargaining power, they should be permitted to make their own bargain and should be held to its terms accordingly, at p. 851:

In commercial contracts negotiated between business-men capable of looking after their own interests and of deciding how risks inherent in the performance of various kinds of contract can be most economically borne (generally by insurance), it is, in my view, wrong to place a strained construction upon words in an exclusion clause which are clear and fairly susceptible of one meaning only . . .

¶ 56 Contrary to Gordon's submission, our analysis is more properly focused not on formal comparisons between exclusion clauses and time limitation provisions, but on the underlying policy rationale that directs courts to the appropriate circumstances for intervention. In terms of negotiating the consequences of a breach of contract, including a fundamental breach, and the role of courts in upholding the bargain struck by commercial parties with equal bargaining power, we do not see any principled distinction between clauses excluding liability and those setting out the applicable limitation periods such that courts should respect the bargain made by the parties in the former case but not in the latter. Indeed, the argument for applying the construction approach may be even more compelling in the case of contractual limitation periods, as the subject matter directly relates to the parties' intentions in the event of non-performance. Given that no reason exists in terms of policy to limit the construction approach to fundamental breach to exclusion clauses alone, we consider the circumstances of this appeal appropriate for extending the relevant principles set out in Hunter Engineering, supra, to interpretation of contractual time limitation periods.

¶ 57 We find additional judicial support for our position in the reasons of the Privy Council in Port Jackson Stevedoring Pty. Ltd. v. Salmond and Spraggon (Australia) Pty. Ltd., [1981] 1 W.L.R. 138. An employee of the Port Jackson Stevedoring Property Ltd. had mistakenly delivered goods in the care of the consignee, Salmond and Spraggon (Australia) Pty. Ltd., to unauthorized persons such thatthe shipment was in effect stolen. The bill of lading contained a "Himalaya clause" extending the benefit of defences and immunities from the carrier to independent contractors employed by the carrier, as well as a contractual limitation period barring any action not initiated within one year after the delivery of the goods. The stevedore relied upon both of these provisions as a defence to the action by the consignee. The consignee argued, however, that owing to the fundamental nature of the breach, the stevedore was no longer entitled to rely on the time bar provision. The basis of the consignee's submission on this point was that the requirement to bring suit within one year was an executory obligation imposed upon the

non-breaching party, and that the stevedore's fundamental breach relieved the consignee of performing this obligation.

¶ 58 Delivering the judgment of the Privy Council, Lord Wilberforce dismissed the consignee's arguments on this point as both "unsound" and "unreal". He reasoned that a provision setting out a time limitation period for bringing a cause of action cannot be characterized as an executory obligation. Instead, the provision becomes relevant precisely at the point when performance becomes impossible, as it regulates the time period in which liability for breach of contract is to be established. Adopting the construction approach to fundamental breach from Photo Production, supra, Lord Wilberforce concluded at p. 145 that "on construction and analysis", the contractual limitation period "plainly operates to exclude the consignee's claim".

¶ 59 Given that the decision of the Privy Council in Port Jackson, supra, and that of the Court in Hunter Engineering, supra, share a common doctrinal antecedent in Photo Production, supra, we consider the decision in Port Jackson, supra, to be persuasive authority in support of Guarantee's submission that the principles in Hunter Engineering, supra, concerning fundamental breach can apply to determine the status of the contractual limitation period in the event of Guarantee's purported wrongful rescission of the Bond. There is no sound basis in policy, principle or existing jurisprudence in support of Gordon's submission that the construction approach to fundamental breach should be limited to cases of exclusion clauses alone.

¶ 60 Having established that the construction approach to fundamental breach as set out in Hunter Engineering, supra, can apply to circumstances involving a contractual limitation period, we must now decide whether, as a matter of contractual interpretation, Guarantee and Gordon intended section 5(d) of the Bond, limiting the time period for initiating an action to 24 months, to survive a wrongful rescission on the part of Guarantee. To answer this question, we do not find it necessary to decide whether a wrongful rescission constitutes a fundamental breach. If the wrongful rescission was just a simple breach, then the limitation period applies. Even if the wrongful rescission was a fundamental breach, then the limitation period will still apply, for the reasons we give below. Therefore, as the limitation period will apply in any event, it is unnecessary to decide whether the wrongful rescission constitutes a fundamental breach.

¶ 61 Applying the construction approach from Hunter Engineering, supra, to the present appeal, we conclude that the limitation period survives. In determining whether it was the intention of the parties that the contractual limitation period would survive a purported wrongful rescission by Guaranteesuch that the present action by Gordon is time-barred, commercial reality is often the best indicator of contractual intention in circumstances such as this. If a given construction of the contract would lead to an absurd result, the assumption is that this result could not have been intended by rational commercial actors in making their bargain, absent some explanation to the contrary.

¶ 62 We are also unable to accept Gordon's submission that the time limitation clause could not be invoked once Guarantee had taken steps to enforce the contractual provision permitting rescission on the basis of a purported misrepresentation by Gordon during the application process. This would lead to an absurd result in that Guarantee, when faced with a potential misrepresentation concerning the degree of risk it has agreed to underwrite, would be placed in the untenable position of subjecting itself to a longer statutory limitation period than would otherwise apply in circumstances where

coverage has been denied for other reasons. Commercial reality cannot accommodate the implication of Gordon's submission, which would be that Guarantee agreed to a bargain whereby it would be exposed to a longer period of uncertainty concerning future claims from an insured who has purportedly engaged in misrepresentation than one who has complied with all of the contractual terms.

¶ 63 We are also of the view that, notwithstanding Gordon's contention that the contractual limitations provision should be narrowly construed so as to exclude the present action from its scope, the language of section 5(d) in terms of "any loss hereunder" is unambiguous. While Gordon submits that the placement of the provision in the claims section of the Bond is dispositive of the matter, we attach more significance to the fact that the contractual limitation period was not subject to qualifying language of any kind limiting the scope of the phrase to the claims process alone. Instead, upon a true construction of the contract, and taking into account the stated purpose of a contractual limitation period as a device whereby the insurer can both quantify and limit risk, we conclude that the intention of the parties was that section 5(d), setting out the 24-month limitation period, was intended to include the process of bringing a claim against the insurer in circumstances of contractual breach, whether fundamental or otherwise.

¶ 64 At this point, we now turn to consider the additional qualification set out in Hunter Engineering, supra, whereby the parties are held to the terms of their agreement provided that the result is not unconscionable, as per Dickson C.J.C., or unfair, unreasonable or otherwise contrary to public policy, as per Wilson J. As we have already noted, the parties to this appeal, an insurance company and an investment dealer and brokerage firm, are sophisticated commercial actors. In addition, both parties were represented by counsel. In Hunter Engineering, supra, these factors were sufficient for both Dickson C.J.C. and Wilson J. to conclude that had the doctrine of fundamental breach applied, no reason existed for the Court to refuse to enforce the bargain made between the parties in terms of the clause governing exclusion of liability. Similarly, we conclude that it would not be unconscionable, unfair, unreasonable or otherwise contrary to public policy to uphold the intentions of the parties concerning the operation of the contractual limitation period in these circumstances.

IV. Disposition

¶ 65 We have concluded that the motions judge did not err in determining that the record was sufficient to deal with Guarantee's motion for summary judgment. O'Brien J. was correct in concluding, pursuant to section 3 of the Bond pertaining to discovery of loss, that it could reasonably be inferred from the record that a loss of the type covered by the policy was or would be incurred. We also see no reason to disturb his finding that a genuine issue of credibility did not exist. As to the legal consequences of a valid rescission, we have concluded that the limitation period is irrelevant because the contract would be treated as being void ab initio, releasing Guarantee from any liability thereunder. In addition, assuming that Guarantee's conduct amounted to wrongful rescission, upon a true construction of the time limitation provision, the parties intended the limitation period to govern the litigation process post-breach, whether fundamental or otherwise. To enforce the bargain made by the parties in these circumstances would not be unconscionable, unfair, unreasonable, or otherwise violate public policy.

¶ 66 Accordingly, we would allow the appeal, set aside the judgment of the Court of Appeal of Ontario, and restore the decision of O'Brien J. granting summary judgment in favour of Guarantee, with costs throughout.
Appeal allowed.