

When is a Contract between Family Members Enforceable?

By: Evaristus Oshionebo

Case Commented On: *Hole v Hole*, [2016 ABCA 34](#)

At common law a contract is not enforceable unless the parties intended the contract to create legal relations. Whether or not the parties intended to create legal relations is determined objectively by examining the circumstances existing at the time of execution of the contract. However, there is a general presumption that contracts between family members are not intended to create legal relations. This presumption “derives from experience of life and human nature which shows that in such circumstances men and women usually do not intend to create legal rights and obligations, but intend to rely solely on family ties of mutual trust and affection” (*Jones v Padavatton*, [1969] 2 All ER 616 at 621 (CA)). The presumption is equally based on the reality that agreements between family members are usually not bargained or negotiated. However, the presumption is rebuttable by evidence. Thus, a contract between family members is enforceable where there is evidence that the parties intended the contract to create legal relations. The presumption could be rebutted by evidence showing that, although the parties are family members, the contract was reached or executed in commercial circumstances. As Professor John McCamus puts it, “[c]ommercial arrangements between family members may obviously be intended to create enforceable agreements” (John D. McCamus, *The Law of Contracts*, 2nd ed at 133).

The recent case of *Hole v Hole*, [2016 ABCA 34](#), raises an issue regarding enforcement of a contract between family members. In this case, the individual Appellant, James F. Hole, is the owner of the corporate Appellant, Hole Consultants Ltd. The individual Respondents own the Respondent companies as follows: James D. Hole owns Hole Engineering Ltd; Jack Hole owns Kessa Holdings Ltd.; Harry Hole owns EloH Enterprises Ltd.; and Douglas Hole owns 512725 Alberta Ltd. The individual Appellant and the individual Respondents are members of the same family. Jack Hole and Douglas Hole are sons of the individual Appellant, while James D. Hole and Harry Hole are the individual Appellant’s brother and nephew, respectively.

These parties reached several agreements including the 1980 Transition Agreement, the 1993 Transition Agreement and the Letter of Understanding (LOU). Prior to the 1980 Transition Agreement, the individual Appellant and three members of the Hole family were shareholders in a company called Lockerbie and Hole Western Ltd. The individual Appellant held 25% interest in Lockerbie and Hole Western Ltd. while the three other family members held the remaining 75% interest. These original shareholders subsequently assigned their shares in Lockerbie and Hole Western Ltd. to two companies, Hole Consultants Ltd. (owned by the individual Appellant) and Hole Engineering Ltd. (owned by the Respondent, James D. Hole). The result was that Hole Consultants Ltd. held 80% of the shares while Hole Engineering Ltd. held 20% of the shares.

Pursuant to the 1980 Transition Agreement, Hole Consultants Ltd. and Hole Engineering Ltd. carried out joint venture projects in the name of a new company, Lockerbie and Hole Co. Ltd. Hole Consultants Ltd. held 80% equity in the joint ventures while Hole Engineering Ltd. held

20% equity. The 1980 Transition Agreement contained a retirement provision requiring all individuals involved in the joint ventures to sell their shares and cease being directors within a year of turning 60 years old. The individual Appellant turned 60 in November 1987 but as of 1991 he had yet to sell his shares and retire as director.

In 1991, the individual Appellant used his position as chair of the board of Westcan Malting Ltd. to procure a contract for Lockerbie and Hole Co. Ltd., Hole Consultants Ltd. and Hole Engineering Ltd. to build a malting plant on behalf of Westcan Malting Ltd. In keeping with the joint venture arrangements, Hole Consultants Ltd. and Hole Engineering Ltd. participated in this contract on an 80/20 equity interest basis. The malting plant was completed in 1993. Profits accruing from this contract, estimated to be \$3.4 million, are the subject of the dispute between the parties.

The 1993 Transition Agreement was signed after “nearly two years” of negotiations and after 20 drafts of the agreement had been circulated by the parties (at para 12). The purpose of the agreement was to induce the individual Appellant to retire from the joint ventures. The agreement also anticipated that, upon the individual Appellant’s retirement, the individual Respondents and the companies controlled by them would be assigned equity interest in the joint ventures. Regarding the sharing of profits from the Westcan project, the 1993 Transition Agreement acknowledged that Hole Consultants Ltd. “will continue to participate in the earnings and claims associated with the various existing and future contracts which comprise the ‘Westcan’ project.” The agreement also provided that the “Successor Companies covenant and agree to pay to Consultants a participation in the earnings relating to these contracts for the period ended February 28, 1993, a fixed amount of \$600,000.00.”

In order to encourage the individual Appellant to execute the 1993 Transition Agreement, the individual Respondents issued a ‘Letter of Understanding’ (LOU) to Hole Consultants Ltd. The LOU, which was addressed to the attention of the individual Appellant, stated that

We, as the new group, fully recognize your efforts and contribution to the success of the Westcan project. We also acknowledge that your profit share for this project would be \$1,600,000.00. In the Transition Agreement \$600,000 of this amount is to be paid by the agreement of the Successor Companies (at para 14).

Upon receipt of the LOU the individual Appellant signed the 1993 Transition Agreement. However, the Respondents failed to discharge their obligation under the LOU. Thus, the individual Appellant and his company, Hole Consultants Ltd., filed this action against the Respondents for breach of contract.

Three issues were raised before the trial court but this comment addresses only one of the issues: whether the parties intended the LOU to create legal relations? On this issue the trial judge held that the LOU is not binding because the plaintiffs failed to establish that the parties intended the LOU to create legal relations.

Decision of the Court of Appeal and Analysis of the Decision

The Court of Appeal of Alberta set aside the trial decision primarily on grounds that the trial judge applied incorrect principles in interpreting the LOU (at para 37). The Court held that the trial judge wrongly attached weight “to the *subjective* intentions of the parties and to circumstances which only came to light *after* the contract was formed” (at para 36, emphasis in

original). In the words of the Court, “Evidence regarding what occurred after the LOU was signed or the subjective intentions of the parties is irrelevant and does not form part of the ‘surrounding circumstances’ to be considered in contractual interpretation” (at para 37).

A contract is interpreted objectively and as a whole on the basis of the surrounding circumstances at the time of execution of the contract (*Humphries v Lufkin Industries Canada Ltd.*, 2011 ABCA 366 at para 13). In effect, a determination of whether the parties in this case intended the LOU to create legal relations is made on an objective basis in view of the surrounding circumstances at the time of execution of the LOU. Surrounding circumstances include the aim or objective of the contract and “the background commercial setting for the contract” (*Humphries* at para 19). Applying this objective standard, the Court of Appeal held at para 40 of *Hole* that:

... a reasonable person having knowledge of the admissible surrounding circumstances would have reasonably understood that the objective of the LOU was to defer payment of \$1 million until the business of the respondents became financially stable, and that the signatories had agreed to pay and had a continuing obligation to pay \$1 million plus interest to the appellants.

Thus, the “LOU was intended to create a legally enforceable obligation of the respondents to pay the appellants \$1 million, with interest, at a time that was dependent on the success and financial stability of the joint venture companies” (at para 44).

The decision of the Court of Appeal can hardly be faulted. The trial judge committed a palpable error “in law by applying incorrect principles in her interpretation of the LOU” (at para 37). Moreover, the trial judge’s interpretation of the LOU resulted in an outcome which is commercially absurd, thus defeating the clear intention of the parties. In *Consolidated-Bathurst Export Ltd. v Mutual Boiler and Machinery Insurance Co.*, [1980] 1 SCR 888 at 901, the Supreme Court of Canada held that, when interpreting a contract, the court should “search for an interpretation which, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time of entry into the contract.” The court should also avoid interpreting a contract in a manner that leads to commercially absurd or unreasonable outcomes. Thus, “an interpretation which defeats the intentions of the parties and their objective in entering into the commercial transaction in the first place should be discarded in favour of an interpretation of the [contract] which promotes a sensible commercial result” (*Consolidated-Bathurst* at 901).

In this case the trial judge appears to have disregarded these hallowed rules of interpretation. The Court of Appeal observed correctly that:

... it is not commercially reasonable to interpret the LOU in a manner which would result in the appellants relinquishing their entitlement to a \$1 million payment obligation. It is further commercially unreasonable that the \$1 million obligation arising from the Westcan Project would be subject to a condition that the appellants bring new business to the respondents. Simply put, the appellants had already earned the \$1 million as their share of the profits of the Westcan Project, which they brought to the joint venture companies and financed for two years by paying 80% of the overhead costs (at para 43).

Aside from the application of incorrect principles, the trial judge erred in failing to consider and give appropriate weight to evidence which, on an objective basis, rebutted the presumption that the individual Appellant and the individual Respondents did not intend to create legal relations.

First, an objective reading of the language of the LOU shows that the parties intended it to bind them. In particular, the LOU refers to “obligation for payment of one million dollars” and states further that “We also acknowledge that your profit share for this project would be \$1,600,000.00.” The LOU also reveals that the Respondents requested “an extension of the obligation time period to pay you the balance of \$1,000,000.00”.

Second, although the parties are members of the same family, the Transition Agreements and the LOU were reached in commercial circumstances. Moreover, the subject-matter of the LOU is the sharing of profits from the Westcan project and as such, “the LOU was a business transaction” (at para 38(d)).

Third, the sharing of profits from the Westcan project was negotiated by the parties, culminating in the 1993 Transition Agreement and the LOU. In the course of negotiations the “respondents agreed that the appellants’ profit share in the Westcan Project would be \$1.6 million” (at para 38(a)). Furthermore, the “negotiation of the 1993 Transition Agreement was a lengthy process involving the exchange of over 20 drafts among the parties over the course of two years of negotiations” (at para 38(c)). Why would the parties engage in such protracted negotiations if they did not intend the transition agreement and the LOU to create legal relations?

Finally, the purpose of the LOU was partly to encourage the individual Appellant to sign the 1993 Transition Agreement and retire from the joint ventures so that equity in the joint ventures could be assigned to the individual Respondents and their companies (at para 11). The individual Appellant executed the 1993 Transition Agreement following receipt of the LOU (at para 14). The individual Appellant would not have executed the 1993 Transition Agreement if the Respondents had not assured him that profits from the Westcan project would be paid to him and his company, Hole Consultants Ltd. In effect, the individual Appellant relied on the enforceability of the LOU in executing the 1993 Transition Agreement. This is significant because “it is a common feature of the cases in which an intention to create legal relations is found to be present that the party seeking to enforce the agreement has detrimentally relied on the assumed enforceability of the agreement” (McCamus, *supra* at 133).

An Alternative Interpretation of the LOU

An alternative way to interpret the LOU is to say that the parties to the LOU are not family members. Rather, the parties to the LOU are the individual Respondents and Hole Consultants Ltd., a legal entity which is separate and distinct from its sole shareholder (that is, the individual Appellant). A fundamental principle of Canadian corporate law is that a company is a separate legal entity (*Salomon v Salomon & Co.*, [1897] AC 22 (House of Lords)). As a legal entity Hole Consultants Ltd. has the capacity, rights, powers and privileges of a natural person including the power to own assets (*Business Corporations Act*, [RSA 2000, c B-9](#), section 16(1)). The individual Respondents addressed the LOU to Hole Consultants Ltd. because they knew that the joint venture projects were executed jointly by Hole Consultants Ltd. and Hole Engineering Ltd.

They also knew that the individual Appellant acted for and on behalf of Hole Consultants Ltd. in negotiating its share of the profits from the joint ventures. Thus, the LOU ought to be viewed and interpreted as a contract between independent and unrelated parties. This issue appears not to have been raised by the Appellants' counsel; hence the Court of Appeal did not make any specific pronouncement on the issue.

To subscribe to ABlawg by email or RSS feed, please go to <http://ablawg.ca>
Follow us on Twitter [@ABlawg](https://twitter.com/ABlawg)