

# Cancelling Contracts: The Power of Governments to Unilaterally Alter Agreements

by Bruce Pardy



## SUMMARY

- Government contracts are indeed contracts. In the normal course of events, their terms may be enforced and the Crown held liable for a breach.
- However, government contracts are not the ironclad agreements they appear to be because governments may change or cancel them by enacting legislation. This paper discusses the means by which governments can make unilateral changes to contracts by statutory enactment.
- Legislative supremacy is a central feature of the Canadian system of government. The federal Parliament and provincial legislatures may pass laws of any kind, including laws that change or cancel legally binding agreements, and even if the enactment has the effect of expropriating property or causing hardship to innocent parties who negotiated with government in good faith in entering into the contract in the first place.

- The powers of legislatures are limited only by the bounds of their constitutional jurisdiction and the existence of constitutional rights.
- In Canada, there is no constitutional right to compensation for expropriated property.
- Just because legislatures can enact an end to a contract does not mean that they should. Using that power erodes confidence in doing business with government, and thus impairs the credit of the Crown and economic conditions in the jurisdiction.
- On the other hand, if democratically elected governments are to establish their own policies, they require the ability to make unilateral changes to agreements made by previous governments. If they cannot legitimately do so, then their predecessors can control policy decisions beyond the terms of their democratic mandates.

# Cancelling government contracts

## Introduction

Government contracts are indeed contracts. In the normal course, their terms may be enforced and the Crown held liable for a breach.<sup>1</sup> But matters are not always in the normal course. Government contracts are not the ironclad agreements they appear to be because governments may change or cancel them by enacting legislation. The Liberals have been returned to a majority government in Ontario. The people of that province will not see whether and to what extent the provincial Tories and NDP would have pursued their campaign musings to revisit renewable energy deals that the Liberals put in place, but they certainly would have had the power to do so had they been elected. This paper discusses the means by which governments can make unilateral changes to contracts by statutory enactment—not merely with respect to agreements for electricity, but contracts of any kind. Note that this analysis does not consider the ability of foreign firms to seek compensation under NAFTA<sup>2</sup> or other foreign investment protection regimes when the terms of their deals are altered. These potential avenues of redress would not be available to domestic firms or individuals.

## Legislative supremacy

Legislative supremacy is a central feature of the Canadian system of government. The federal

---

<sup>1</sup> For example, for claims against the Ontario government, see the *Proceedings Against the Crown Act*, R.S.O. 1990, c. P-27, s. 3; but courts may not grant injunctions or order specific performance against the Crown: s. 14.

<sup>2</sup> Chapter 11 of NAFTA imposes obligations on the Canadian, US, and Mexican governments, and gives private investors the ability to enforce NAFTA's investment provisions through the Chapter 11 arbitration process.

Parliament and provincial legislatures may pass laws of any kind, including laws that change or cancel legally binding agreements. This power exists even if the enactment has the effect of expropriating property or causing hardship to innocent parties who negotiated with government in good faith in entering into the contract in the first place. As Mr. Justice Riddell of the Ontario High Court of Justice stated in *Florence Mining Co v. Cobalt Lake Mining Co*:

the Legislature within its jurisdiction can do everything that is not naturally impossible, and is restrained by no rule human or divine. If it be that the plaintiffs acquired any rights, which I am far from finding, the Legislature had the power to take them away. The prohibition, “Thou shalt not steal,” has no legal force upon the sovereign body. (paragraph 18)

The Court of Appeal, in affirming the High Court decision, added:

where there is jurisdiction over the subject matter, arguments founded on alleged hardship or injustice can have no weight. As said by Lord Herschell, in *The Attorney-General of Canada v. The Attorney-General of the Provinces*, [1898] A.C. 700, when discussing the question of the relative legislative powers and authority of the Parliament of Canada and the Legislatures of the Provinces under the British North America Act (p. 713): “The suggestion that the power might be abused so as to amount to a practical confiscation of property does not warrant the imposition by the Courts of any limits upon the absolute power of legislation conferred. The supreme legislative power in relation to any subject matter is always capable of abuse, but it is not to be assumed that it will be improperly

# Cancelling government contracts

used, if it is, the only remedy is an appeal to those by whom the Legislature is elected.” (paragraph 56)

The powers of legislatures are limited only by the bounds of their constitutional jurisdiction and the existence of constitutional rights. Legislating on intra-provincial electricity production is clearly a provincial power, as are “property and civil rights” (*Constitution Act, 1867*: ss. 91, 92, 92A). Of course, if these were not provincial powers, then the Ontario green energy tariff program would itself be *ultra vires*, which is not the case. Statutes that cancelled contracts have on occasion been declared unconstitutional, not because they cancelled contracts

.....

The United States Constitution provides the right to compensation for expropriated property, but in Canada no such constitutional right exists.

.....

per se, but because the legislating body did not have jurisdiction over the subject matter. For example, in *Reference Re Upper Churchill Water Rights Reversion Act 1980*, the Newfoundland legislature had enacted legislation purporting to cancel a contract for the supply of power to Hydro-Quebec. The Supreme Court of Canada held that the legislation was *ultra vires* the province because the statute was directed at contractual rights outside of the province, a matter that was beyond the territorial jurisdiction of the Newfoundland legislature. The Court acknowledged that a provincial legislature could validly expropriate intra-provincial contractual rights.

The *Canadian Charter of Rights and Freedoms* does not guarantee property or contract rights, and there are no obvious constitutional limitations on a provincial legislature’s ability to change any within-province energy agreements as it likes at any time.

## Compensation

The United States Constitution provides the right to compensation for expropriated property,<sup>3</sup> but in Canada no such constitutional right exists. When governments in Canada cancel contracts, compensation may or may not be required, depending on the method used. An agreement scrapped by administrative order would require compensation if the terms of the agreement so provided; if the Ontario Power Authority simply declared contracts under its Feed-In-Tariff to be terminated, the robust compensation clauses contained in those contracts would apply.<sup>4</sup> However, if instead the Ontario legislature passed a statute that explicitly denied the right to compensation, then no compensation would be payable.<sup>5</sup> Clear statu-

---

<sup>3</sup> U.S. CONST. amend. V: “nor shall private property be taken for public use, without just compensation.” Also note U.S. CONST. art. I, § 10: “No state shall . . . pass any law impairing the obligation of contracts”. This clause does not apply to the federal congress. The extinguishment of a contractual right against the government amounts to a taking of property.

<sup>4</sup> This is so if the FIT contract has proceeded past the Notice-to-Proceed (NTP) stage. Remedies for termination of pre-NTP contracts are limited. See the text of FIT contracts at <<http://fit.power-authority.on.ca/sites/default/files/version3/FIT-Contract-Version-3.0.pdf>>

<sup>5</sup> The same principle applies whether the claim is in contract or upon alternative causes of action such as negligent misrepresentation. If explicit, statutes can extinguish either or both.

# Cancelling government contracts

tory language would be required. Courts interpret expropriating statutes as implicitly requiring the payment of compensation unless the statute is explicit that no compensation shall be paid. In *Wells v. Newfoundland*, the Supreme Court of Canada stated:

While the legislature may have the extraordinary power of passing a law to specifically deny compensation to an aggrieved individual with whom it has broken an agreement, clear and explicit statutory language would be required to extinguish existing rights previously conferred on that party. . . . This follows *Manitoba Fisheries Ltd. v. The Queen*, [1979] 1 S.C.R. 101, which held that a statute is not to be construed so as to take away a person's property without compensation unless its wording clearly demands it. (paragraphs 41, 47)<sup>6</sup>

When statutes are clear, they can override contracts even where contractual provisions attempt to guarantee otherwise. Governments can swear on their grandmothers' graves that they will never abridge the terms of the agreements that they make, but such clauses are ineffective if a statute so declares, since clear statutory language trumps contractual provisions. Where a statute and a contract are in conflict, the statute prevails.

## The rule of law

It has been argued that cancelling agreements by legislation should be unconstitutional

because it violates certain tenets of the rule of law (Monahan, 1995: 411).<sup>7</sup> While the Supreme Court of Canada has acknowledged that unwritten constitutional principles, including the rule of law, are “capable of limiting government actions” (*Babcock v. Canada (Attorney General)*) at paragraph 54, per McLachlin C.J.C.), it has rejected the notion that breach of rule of law principles could be relied upon as a basis for invalidating a statute (*British Columbia v. Imperial Tobacco Canada Ltd.*; *Authorson v. Canada (Attorney General)*). In *British Columbia v. Imperial Tobacco*, the Court stated:

This Court has described the rule of law as embracing three principles. The first recognizes that “the law is supreme over officials of the government as well as private individuals, and thereby preclusive of the influence of arbitrary power . . . The second “requires the creation and maintenance of an actual order of positive laws which preserves and embodies the more general principle of normative order” . . . The third requires that “the relationship between the state and the individual . . . be regulated by law” . . . So understood, it is difficult to conceive of how the rule of law could be used as a basis for invalidating legislation.

The [appellants] submit that the rule of law requires that legislation (1) be prospective; (2) be general in character; (3) not confer special privileges on the government, except where necessary for effective governance; and (4) ensure a fair civil trial.

<sup>6</sup> See *Attorney General v. De Keyser's Royal Hotel*: “The recognized rule for the construction of statutes is that, unless the words of the statute clearly so demand, a statute is not to be construed so as to take away the property of a subject without compensation” (542).

<sup>7</sup> Of course, the rule of law can be defined in different ways. Strayer J.A. observed in *Singh v. Canada (Attorney General)*, [2000] 3 F.C. 185 (C.A.) at para 33 that “[a]dvocates tend to read into the principle of the rule of law anything which supports their particular view of what the law should be.”

# Cancelling government contracts

And they argue that the Act breaches each of these requirements, rendering it invalid. . . . A brief review of this Court's jurisprudence will reveal that none of these requirements enjoy constitutional protection in Canada. (paragraphs 58, 59, 63, 64, per Major J.)

.....

Governments can swear on their grandmothers' graves that they will never abridge the terms of the agreements that they make, but such clauses are ineffective if a statute so declares, since clear statutory language trumps contractual provisions.

.....

In particular, the Court rejected the notion that valid statutes must be prospective in application.<sup>8</sup>

---

<sup>8</sup> *British Columbia v. Imperial Tobacco Canada Ltd.* at para 69:

Except for criminal law, the retrospectivity and retroactivity of which is limited by s. 11(g) of the *Charter*, there is no requirement of legislative prospectivity embodied in the rule of law or in any provision of our Constitution. Professor P. W. Hogg sets out the state of the law accurately (in *Constitutional Law of Canada* (loose-leaf ed.), vol. 1, at p. 48-29): "Apart from s. 11(g), Canadian constitutional law contains no prohibition of retroactive (or ex post facto laws). There is a presumption of statutory interpretation that a statute should not be given retroactive effect, but, if the retroactive effect is clearly expressed, then there is no room for interpretation and the statute is effective according to its terms. Retroactive statutes are in fact common."

## Exercising the power to cancel contracts

Just because legislatures can enact an end to contracts does not mean that they should. Courts do not endorse or encourage the practice, but merely observe that the power exists. In Canada, legislatures have used it on occasion<sup>9</sup> but not as a matter of course,<sup>10</sup> presumably because it erodes confidence in doing business with government, and thus impairs the credit of the Crown and economic conditions in the jurisdiction. It erodes consistency and predictability in the law, and thus interferes with the ability of citizens and private businesses to order their affairs in accordance with rules "fixed and announced beforehand" (Hayek, 1944: 72).

On the other hand, if democratically elected governments are to establish their own policies, they require the ability to make unilateral changes to agreements made by previous governments.<sup>11</sup> If they cannot legitimately do

---

<sup>9</sup> See, e.g., *Re Canada Assistance Plan* (upholding a federal statute reducing transfer payments promised by Canada to the provinces under federal-provincial agreements); *Authorson v. Canada (Attorney General)* (upholding a federal statute extinguishing veterans' rights to interest on funds held by the federal Crown on their behalf); *Clitheroe v. Hydro One* (upholding a provincial statute extinguishing a contractual pension right); *Bacon v. Saskatchewan Crop Insurance Corp* (upholding a statute denying compensation for statutory changes to contracts of crop insurance).

<sup>10</sup> It is difficult to know how many statutes have been passed by legislatures in Canada with the intent or effect of changing or terminating contracts. Reported court cases identify only those statutes whose validity was challenged by an affected party.

<sup>11</sup> As Sopinka J. stated in *Canada Assistance* at paragraph 64:

[I]t is fundamental to our system of government

# Cancelling government contracts

so, then their predecessors can control policy decisions beyond the terms of their democratic mandates. Signing long-term contracts that reflect their policy preferences would ensure that those policies remain in place well after the governing party has been relegated to opposition benches. Such agreements would set things in stone, as it were, for 20 years rather than for four.

Government contracts are just contracts indeed, but they are also unique. One party has the power to alter the agreement without the consent of the other.<sup>12</sup> No negotiated conditions can eliminate the risk of future legislated changes. Those who prefer to avoid this slim “sovereign risk” should make their agreements elsewhere. That choice is feasible when there are other deals to make. However, when the state controls the market, as the Ontario government does with electricity production, the

---

that a government is not bound by the undertakings of its predecessor. . . . I adopt the words of King C.J. of the Supreme Court of South Australia, in banco, in *West Lakes Ltd. v. South Australia* (1980), 25 S.A.S.R. 389, at p. 390, a case strikingly similar to this one: “Ministers of State cannot, however, by means of contractual obligations entered into on behalf of the State fetter their own freedom, or the freedom of their successors or the freedom of other members of parliament, to propose, consider and, if they think fit, vote for laws, even laws which are inconsistent with the contractual obligations.”

<sup>12</sup> Of course, governments may also legislate changes to contracts between private parties (as has been done, for example, to agreements between mobile phone companies and their customers), and therefore not even private contracts can be considered “ironclad”. However, with private contracts neither party holds the power to alter the contract by statute. Therefore, neither can act unilaterally and both are subject to the risk that the contract might be altered by legislation.

only real options are to accept the risk or pursue a different kind of venture altogether.

## Legal citations

*Attorney General v. De Keyser’s Royal Hotel*, [1920] A.C. 508.

*Authorson v. Canada (Attorney General)*, [2003] 2 S.C.R. 40, 2003 S.C.C. 39.

*Babcock v. Canada (Attorney General)*, [2002] 3 S.C.R. 3, 2002 S.C.C. 57.

*Bacon v. Saskatchewan Crop Insurance Corp.*, [1999] 11 W.W.R. 51 (Sask. CA).

*British Columbia v. Imperial Tobacco Canada Ltd.*, [2005] 2 S.C.R. 473, 2005 S.C.C. 49.

*Canadian Charter of Rights and Freedoms*, Part I of the *Constitution Act*, 1982, being Schedule B to the *Canada Act 1982* (U.K.), 1982, c. 11.

*Clitheroe v. Hydro One Inc.* (2009), 96 O.R. (3d) 203 (Sup. Ct. J.), aff’d 2010 O.N.C.A. 458 (C.A.), application for leave to appeal dismissed [2010] S.C.C.A. No. 316.

*Constitution Act*, 1867 (U.K.), 30 & 31 Vict., c. 3, reprinted in R.S.C. 1985, App. II, No. 5.

*Florence Mining Co v. Cobalt Lake Mining Co.*, [1908] O.J. No. 265, 12 O.W.R. 297, aff’d [1909] O.J. No. 196, 18 O.L.R. 275, aff’d (1910), 43 O.L.R. 474 (U.K.P.C.).

*North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States*, 17 December 1992, Can. T.S. 1994 No. 2, 32 I.L.M. 289.

*Proceedings Against the Crown Act*, R.S.O. 1990, c. P-27.

*Reference Re Canada Assistance Plan* (B.C.), [1991] 2 S.C.R. 525.

# Cancelling government contracts

Reference Re Upper Churchill Water Rights Reversion Act 1980, [1984] 1 S.C.R. 297.

*Singh v. Canada (Attorney General)*, [2000] 3 F.C. 185 (C.A.).

U.S. CONST.

*Wells v. Newfoundland*, [1999] 3 S.C.R. 1999.

## References

Ontario Power Authority (2013). *Feed-in Tariff Contract (FIT Contract)*. Ontario Power Authority. <<http://fit.powerauthority.on.ca/sites/default/files/version3/FIT-Contract-Version-3.0.pdf>>, as of July 23, 2014.

Hayek, Friedrich A. (1944). *The Road to Serfdom*. University of Chicago Press.

Monahan, P.J. (1995). Is the Pearson Airport Legislation Unconstitutional? The Rule of Law as a Limit on Contract Repudiation by Government. *Osgoode Hall Law Journal* 33, 3: 411–452.



**Bruce Pardy** is a professor of law at Queen's University. He has written extensively on environmental governance, ecosystem management, climate change, water policy and civil liability. His research focuses on the theoretical and principled foundations of environmental law, challenging orthodoxies found within that discipline. Professor Pardy has taught environmental law at law schools in Canada, the United States and New Zealand. He practiced litigation at Borden Ladner Gervais LLP in Toronto, and served for almost a decade as an adjudicator and mediator on the Ontario Environmental Review Tribunal.

## Acknowledgments

The author would like to thank Matthew Kersten for his excellent research assistance. Any errors are the responsibility of the author. He welcomes comments at [bruce.pardy@queensu.ca](mailto:bruce.pardy@queensu.ca). As the researchers have worked independently, the views and conclusions expressed in this paper do not necessarily reflect those of the Board of Trustees of the Fraser Institute, the staff, or supporters.

Copyright © 2014 by the Fraser Institute. All rights reserved. Without written permission, only brief passages may be quoted in critical articles and reviews.

ISSN 2291-8620

**Media queries:** call 604.714.4582 or e-mail: [communications@fraserinstitute.org](mailto:communications@fraserinstitute.org)

**Support** the Institute: call 1.800.665.3558, ext. 586, or e-mail: [development@fraserinstitute.org](mailto:development@fraserinstitute.org)

Visit our **website:** [www.fraserinstitute.org](http://www.fraserinstitute.org)