

# Can an entire agreement clause bar reliance on the surrounding circumstances? ONCA says “no”.

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The Supreme Court of Canada has been clear: surrounding circumstances play an important role in contractual interpretation<sup>1</sup>. The Court of Appeal for Ontario recently reinforced this principle in *Project Freeway Inc. v. ABC Technologies Inc.*, recognizing that entire agreement clauses cannot constrain the role of factual matrix evidence. Contracting parties thus face a dilemma. If entire agreement clauses cannot bar factual matrix evidence, can non-binding and preliminary iterations or analysis of terms impact interpretation? According to *Project Freeway*, the answer is yes.

## What you need to know

- **Entire agreement clauses do not bar consideration of the surrounding circumstances.** These circumstances may include non-binding negotiation documents if they are adduced to explain what was or reasonably ought to have been within the knowledge of the contracting parties.
- **Contracting parties should approach letters of intent understanding that they could play a role in contractual interpretation.** Parties should ensure that any detailed legal provisions or terminology reflect their intentions and explicitly identify if circumstances have caused those intentions to change subsequent to the letter of intent.
- **Deference remains high when seeking to challenge a lower court’s interpretation of a contract.** While contractual interpretation is usually a question of mixed fact and law, which attracts an onerous standard of review, extricable errors of law are subject to correctness review. If these errors are not present, appellate intervention is less likely.

## Background for the dispute

### The agreement in dispute

Project Freeway Inc. (Project Freeway) sold shares of a business to ABC Technologies Inc. (ABC) for cash consideration and an earn-out. An immediate payment of the full earn-out amount could be triggered based on three events in the Share Purchase Agreement (SPA). One triggering event arose if ABC sold a “material portion” of the assets of the business to a non-affiliated purchaser without the written consent of Project Freeway. The SPA also included an entire agreement clause that expressly excluded reliance on the prior letter of intent between the parties.

After the purchase, ABC sold a large percentage of the business's assets to a non-affiliated purchaser without Project Freeway's written consent. The sale permitted ABC to continue to lease and operate the assets (the Sale Leaseback) and sold its accounts receivable (the Factoring Agreement).

Project Freeway claimed the Sale Leaseback and the Factoring Agreement triggered the earn-out provisions. ABC disagreed. In response, Project Freeway sued ABC for breach of contract.

## The trial judge held that the SPA was not breached

The trial judge concluded that ABC did not breach its obligations under the SPA. The earn-out provisions were not triggered as the Sale Leaseback and the Factoring Agreement were not sufficiently "material to the operation of the earn-out". This standard was not met because the transaction did not impact the business's ability to hit the financial performance targets used to calculate any earn-out owed.

To reach this conclusion, the trial judge relied on a non-binding letter of intent between the parties. Project Freeway argued that reliance on the letter of intent was precluded by the SPA's entire agreement clause. The trial judge disagreed, noting that the letter of intent could be relied on as evidence of the surrounding circumstances for the SPA and inform what the parties intended to be "material" for the purposes of the earn-out provision.

## The Court of Appeal upholds the trial decision

The Court of Appeal dismissed Project Freeway's appeal at the close of the appellant's oral submissions. Its subsequent Reasons for Decision noted that Project Freeway's grounds of appeal took issue with the trial judge's interpretation of the contract and involved questions of mixed fact and law entitled to deference.

The Court affirmed the trial judge's decision to rely on the parties' letter of intent. The Court concluded that the letter of intent was rightly part of the circumstances that informed the meaning of "material" in the earn-out regime. It was necessary to rely on this document to identify what the agreement between the parties was, so that the entire agreement clause could be applied to resolve the dispute. The trial judge's conclusion on the principles that could be drawn from the letter of intent was an issue of fact attracting deference.

## Implications

*Project Freeway* maintains the modern approach to contractual interpretation, while demonstrating the limits of entire agreement clauses. Three implications of this decision are noteworthy.

- 1. Surrounding circumstances are impactful even where there is an entire agreement clause.** Entire agreement clauses will not bar consideration of the surrounding circumstances. Following *Project Freeway*, even express restrictions on the use of prior negotiation documents (e.g., letters of intent) in entire agreement clauses do not alter this principle. This is consistent with prior appellate authorities<sup>2</sup>.
- 2. Letters of intent may inform the meaning of subsequent agreements (even when non-binding).** Non-binding letters of intent may impact the interpretation of subsequent agreements as part of the factual matrix. *Project Freeway* demonstrates this impact, as a non-binding letter of intent helped to inform a core term in dispute. As a result, contracting parties should ensure that any detailed terms or clauses set out in non-binding preliminary negotiation documents are given due consideration, and explicitly reflect any specific changes in their intentions should those arise subsequent to the letter of intent.

3. **Deference remains high when challenging a lower court’s contractual interpretation exercise (absent extricable questions of law).** Deference in contractual interpretation disputes continues to reign supreme. The Supreme Court in *Corner Brook (City) v. Bailey* was clear that “contractual interpretation is a fact specific exercise” that is owed deference, absent extricable questions of law<sup>3</sup>. The Court of Appeal’s decision in *Project Freeway* reflects an application of this deference; in the absence of an error of law, appellate intervention becomes less likely.

#### FOOTNOTES

- <sup>1</sup>. See e.g., *Earthco Soil Mixtures Inc. v. Pine Valley Enterprises Inc.*, 2024 SCC 20, at para. 63; *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SC 53, at para. 47; *Corner Brook (City) v. Bailey*, 2021 SCC 29, at para. 19.
- <sup>2</sup>. *Ontario First Nations (2008) Limited Partnership v. Ontario Lottery and Gaming Corporation*, 2021 ONCA 592, at para. 62; *IFP Technologies (Canada) v. EnCana Midstream and Marketing*, 2017 ABCA 157, at para. 124.
- <sup>3</sup>. *Corner Brook*, 2021 SCC 29, at para. 44.

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