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## Consultation Paper on Proposals for Unfair Contracts Relief

Prepared by the  
Unfair Contracts  
Relief Project  
Committee

December 2010

Supported by:



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The British Columbia Law Institute was created in 1997 by incorporation under the Provincial *Society Act*. Its strategic mission is to be a leader in law reform by carrying out:

- the best in scholarly law reform research and writing; and
- the best in outreach relating to law reform.

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## Unfair Contracts Relief Project Committee

The British Columbia Law Institute formed the Unfair Contracts Relief Project Committee in November 2009. The committee's mandate is to study how the law of contracts treats issues relating to unfairness, as made manifest in the concepts of unconscionability, duress, undue influence, good faith, and misrepresentation, to consider the leading options for reform of this body of law, and to make recommendations on whether legislation is needed to improve the law and, if so, what provisions should be included in that legislation. The committee's recommendations for reform will be contained in its final report, which is scheduled for publication in fall 2011.

The members of the committee are:

Prof. Joost Blom, Q.C.—chair  
*(professor, Faculty of Law,  
University of British Columbia)*

Margaret Easton  
*(principal, The Meridian Aging Project;  
former credit-union executive)*

Russell Getz  
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Do-Ellen Hansen  
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Allan Parker, Q.C.  
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Peter Rubin  
*(partner, Blake, Cassels &  
Graydon LLP)*

Tony Wilson  
*(associate counsel, Boughton Law  
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Kevin Zakreski (staff lawyer, British Columbia Law Institute) is the project manager.

**For more information, visit us on the World Wide Web at:  
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## Call for Responses

We are interested in your response to this consultation paper. It would be helpful if your response directly addressed the tentative recommendations set out in this consultation paper, but it is not necessary. We will also accept general comments on reform of how the law of contracts addresses contractual unfairness.

The best way to submit a response is to use a response booklet. You may obtain a response booklet by contacting the British Columbia Law Institute or by downloading one at <http://www.bcli.org/bclrg/projects/unfair-contracts-relief>. You do not have to use a response booklet to provide us with your response.

Responses may be sent to us in one of three ways—

by mail:       British Columbia Law Institute  
                  1822 East Mall  
                  University of British Columbia  
                  Vancouver, BC V6T 1Z1  
  
                  Attention: Kevin Zakreski

by fax:         (604) 822-0144

by email:      ucr@bcli.org

If you want your response to be considered by us as we prepare the final report for the Unfair Contracts Relief Project, then we must receive it by **31 May 2011**.

Your response will be used in connection with the Unfair Contracts Relief Project. It may also be used as part of future law-reform work by the British Columbia Law Institute or its internal divisions. All responses will be treated as public documents, unless you expressly state in the body of your response that it is confidential. Respondents may be identified by name in the final report for the project, unless they expressly advise us to keep their name confidential. Any personal information that you send to us as part of your response will be dealt with in accordance with our privacy policy. Copies of our privacy policy may be downloaded from our website at: <http://www.bcli.org/privacy>.

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## EXECUTIVE SUMMARY & LIST OF TENTATIVE RECOMMENDATIONS

### INTRODUCTION

The Unfair Contracts Relief Project is a two-year law-reform project. The project's focus is on general concepts in the law of contracts that address the problem of contractual unfairness. Its goal is to produce a final report that considers draft legislation containing reforms to these general concepts. This consultation paper sets out tentative recommendations for reform. These tentative recommendations contain policy positions that may form the foundation for a proposed *Contract Fairness Act* for the project's final report. The BCLI invites public comment on these tentative recommendations, to help shape the final recommendations for the project.

The Unfair Contracts Relief Project has been made possible by funding from the Law Foundation of British Columbia.

### UNFAIR CONTRACTS RELIEF PROJECT COMMITTEE

The Unfair Contracts Relief Project is being carried out with the assistance of an all-volunteer project committee. The project committee was formed shortly after the commencement of the project, and it has met regularly since November 2009. The members of the committee are:

Prof. Joost Blom, Q.C.—chair  
*(professor, Faculty of Law,  
University of British Columbia)*

Margaret Easton  
*(principal, The Meridian Aging Project;  
former credit-union executive)*

Russell Getz  
*(legal counsel, Ministry of Attorney  
General for British Columbia)*

Do-Ellen Hansen  
*(partner, Borden Ladner Gervais LLP)*

Allan Parker, Q.C.  
*(associate executive director, Access  
Pro Bono Society of British Columbia)*

Lisa Peters  
*(partner, Lawson Lundell LLP)*

Peter Rubin  
*(partner, Blake, Cassels  
& Graydon LLP)*

Tony Wilson  
*(associate counsel, Boughton Law  
Corporation)*

Kevin Zakreski (staff lawyer, British Columbia Law Institute) is the project manager.

## THE STRUCTURE OF THE CONSULTATION PAPER

The consultation paper focusses on five general concepts in contract law and one type of contract term that has caused ongoing problems for contractual fairness. These topics are: (1) unconscionability; (2) duress; (3) undue influence; (4) good faith; (5) misrepresentation; and (6) exclusion clauses. These concepts were selected from among the many that could have been addressed in this consultation paper for three reasons. First, they were seen as best representing how legal doctrine grapples with the idea of fairness in contracting. Second, they were amenable to analysis as a group, in relation to one another. Third, they were seen to be ripe for consolidation and modernization.

The bulk of the consultation paper is taken up with considering issues for reform for these six topics. Many of these issues are complex. Many of them have attracted numerous, thoughtful proposals for reform. In order to do the issues justice, the committee has pursued them in some detail. This detailed approach is also necessary to lay the foundations for the draft legislation that may emerge from this project.

This executive summary is intended to give readers a brief description of the issues and options that faced the committee. Integrated with this summary is a list of the committee's tentative recommendations for reform. After each tentative recommendation, boldface numbers are set out to direct readers who wish to examine the issue in full to the pages in the consultation paper where the issue is considered.

## GENERAL CONSIDERATIONS & THE NEED FOR LEGISLATION

The consultation paper begins with a chapter that covers a range of topics. This chapter provides a historical overview of the role fairness plays in the law of contracts. It also explains the committee's approach to reform, which is focussed on the general rules of contract law. This discussion leads into the first issue for reform, which is the overarching issue of whether reform should be pursued in this area of the law at all.

The committee approached this overarching issue by analyzing it in two steps. First, it concluded that conflicting court decisions and uncertainty in practice justify reform aimed at clarifying or consolidating the law. Second, it considered whether the courts or the legislature are better placed to deliver the needed reforms, concluding that the needed reforms are of such a scale as to require legislative action, because they would be difficult to impossible to implement via case-by-case litigation.

*1. British Columbia should enact a Contract Fairness Act. (20-23)*

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## UNCONSCIONABILITY

Unconscionability is one of the major concepts that contract law has developed to control contractual unfairness. But courts and commentators have had some difficulty in defining the precise nature of this concept. The British Columbia Court of Appeal has issued two landmark decisions on unconscionability. One described the concept as combining procedural and substantive elements. In this view, unconscionability occurs when a contracting party exploits an inequality of bargaining power arising from the ignorance, need, or distress of the other contracting party in order to produce a substantively one-sided contract. The other judgment said that unconscionability is found whenever there is a marked departure from standards of commercial morality in contracting. This conception of unconscionability is more attuned to judicial discretion and potentially more far-reaching than the first.

The committee began its consideration of unconscionability with the basic issue of whether the *Contract Fairness Act* should include legislation on unconscionability. The advantages of such legislation are that it could clarify the basic requirements for unconscionability, fill in gaps in the existing law, and deal comprehensively with issues such as remedies. In the committee's view, these advantages outweighed the potential disadvantages of freezing development of the law and promoting unmeritorious litigation.

### *2. The Contract Fairness Act should contain an unconscionability provision. (32–34)*

As noted earlier, there are two basic approaches to unconscionability that are found throughout the jurisprudence and the commentary. In the first approach, courts consider the case at issue by reviewing the procedural and substantive elements of a test of unconscionability. In the second, courts take a more expansive and discretionary approach to the issues. The committee favours legislation based on the first approach. In its view, this approach better captures the dominant current of the jurisprudence in British Columbia and other Canadian jurisdictions and helps to clarify the law. It also promotes certainty and ease of administration.

### *3. The Contract Fairness Act should require both an inequality between the parties and substantive unfairness as elements of a test of unconscionability. (34–36)*

A series of consequences flow from the decision to structure the unconscionability provision in this manner. The first is that a litigant cannot obtain a remedy under the proposed unconscionability provision for substantive unfairness alone. Some form of exploitation must also be present. This requirement limits the danger of courts

simply reviewing transactions to determine whether they were bad deals for the contracting parties.

*4. The Contract Fairness Act should not permit a remedy for cases of substantive unconscionability alone. (36–38)*

Implicit in the element of procedural unfairness is the idea that the stronger contracting party know that it is taking advantage of the weaker contracting party. The committee proposes making this point explicit in the legislation. This would help to clarify the law. But the committee would not go so far as to impose any duty of inquiry on stronger contracting parties.

*5. The Contract Fairness Act should require that a defendant know of a plaintiff's material disadvantage in order for the plaintiff to obtain a remedy for an unconscionable contract. Knowledge in this context includes actual knowledge, recklessness, and willful blindness. (38–39)*

An issue related to the previous one has caused some uncertainty in the jurisprudence in British Columbia. This issue concerns the time when unconscionability should be assessed. Some courts have taken an expansive view, looking at developments that occur after the agreement is made. The committee favours limiting this review to facts that were known to the parties at the time the contract was made. This approach is consistent with the leading view in British Columbia. It enhances certainty in contracting relationships. And it ensures that unconscionability does not expand to the point where it could crowd out other concepts, such as good faith.

*6. The Contract Fairness Act should contain a timing element that limits review of a contract on the ground of unconscionability to facts that were known by the parties at the time the contract was made. Knowledge in this context includes actual knowledge, recklessness, and willful blindness. (39–41)*

In the committee's view, adding a non-exclusive list of factors to the legislation helps to clarify the application of the unconscionability provision. There are numerous examples of such lists in the case law and commentary. They run the gamut from terse instructions to consider a contracting party's "ignorance, need, or distress" to more expansive enumerations of factors to no list of factors at all. The committee reviewed these proposals and decided that the New Zealand Law Commission had come up with the best list. It fits well with existing British Columbia case law and with the committee's vision of integrating unconscionability, duress, and undue influence.

7. *The Contract Fairness Act should contain the following non-exclusive list of factors proposed by the New Zealand Law Commission for use by the court in applying the unconscionability provision: (a) a contracting party's material disadvantage due to being unable to appreciate adequately the provisions or the implications of the contract by reason of age, sickness, mental, educational or linguistic disability, emotional distress, or ignorance of business affairs; (b) a contracting party's material disadvantage due to being in need of the benefits for which he or she has contracted to such a degree as to have no real choice whether or not to enter into the contract; (c) any other reason in the opinion of the court that puts a contracting party at a material disadvantage. (41–45)*

Legal or other professional advice is often a key factor in unconscionability cases. It is hard to characterize a contract as exploitative if the weaker party received advice before entering into it. Consistent with earlier law-reform studies, the committee favours including a factor in the legislation relating to professional advice. The committee does not favour making the existence of professional advice a bar to obtaining a remedy in unconscionability.

8. *The Contract Fairness Act should direct the court to consider legal or other professional advice as a factor in deciding unconscionability cases. (45–46)*

Some commentators have suggested that consideration of contracting parties' insurance arrangements should be a factor in determining the outcome of an unconscionability case. But in the committee's view, consideration of insurance should not become a factor to be routinely considered. Insurance arrangements are fact-specific and often complex. Even if the legislation is silent on this matter, courts can still address it in appropriate cases.

9. *The Contract Fairness Act should not direct the court to consider the parties insurance arrangements as a factor in deciding unconscionability cases. (46)*

There is a view in British Columbia's unconscionability jurisprudence that holds that, once a plaintiff has demonstrated procedural and substantive unfairness, the burden shifts to the defendant to prove that the bargain was fair, just, and reasonable. Consumer-protection legislation goes even further, requiring defendants to disprove allegations of unconscionability. These extraordinary measures appear to be justified by the imbalance in power and resources between the parties. But the committee concluded that this was not a sufficient public-policy rationale to justify distorting the civil-litigation process outside the consumer realm.

*10. The Contract Fairness Act should not shift the burden of proof in unconscionability cases. (47–48)*

Under traditional rules, courts were limited to rescission as the sole remedy for unconscionability. Rescission is a dramatic remedy, essentially undoing a contract and putting the parties back into the positions they occupied before the contract came into being. In recent years, courts have chafed against this lack of flexibility and have begun to use less sweeping remedies in appropriate cases. The committee supports this development, and proposes legislation that gives courts a broad range of remedies.

*11. The Contract Fairness Act should allow the court to make any order that it thinks is just, including any of the following orders on the list recommended by the New Zealand Law Commission: (a) declaring the contract to be valid and enforceable in whole or in part or for any particular purpose; (b) rescinding the contract; (c) declaring that a term of the contract is of no effect; (d) varying the contract; (e) awarding restitution or compensation to any party to the contract; (f) vesting any property in any party to the proceedings, or direct any party to transfer or assign any property to any other party to the proceedings; (g) ordering that an account be taken, and reopening any account already taken, in respect of any transaction between the parties. (49–50)*

For the sake of clarity, the *Contract Fairness Act* should take a position on whether contracting parties can modify or exclude its unconscionability provisions. A permissive approach could be seen as consistent with the general freedom contracting parties have to shape their contracts. But the committee found it difficult to reconcile this position with the level of protection that the unconscionability provision is intended to provide. The liberal approach leaves weaker contracting parties open to abuse.

*12. The Contract Fairness Act should not allow parties to modify or exclude its legislative rules relating to unconscionability in their contract. (50–51)*

The committee gave consideration to whether certain types of contracts should be excluded from the scope of unconscionability legislation. The rationale for such an approach would be that certain contracting parties may value finality over legislative protection. There are many ways to achieve such a result. The legislation could be limited to transactions under a certain monetary value or involving non-corporate contracting parties. The committee concluded that no such limit could compete with the clearer and more direct approach of simply providing that the unconscionability rules apply to all contracts. Highly sophisticated contracting parties would not likely feel much of a constraint from this approach, for the common-sense



reason that it is very unlikely such a contracting party could frame a successful unconscionability case.

*13. The Contract Fairness Act's unconscionability provision should apply to all types of contracts and contracting parties. (51–52)*

## **DURESS**

Duress guards against a person being coerced against his or her will into agreeing to a contract or a modification of a contract. It has traditionally been concerned with the use of violence or threats of violence in the bargaining process. Within the last generation, the courts have expanded its scope to include the misuse of economic power.

This recent advent of economic duress has prompted a rethinking of the fundamental principles of the concept. There has been a series of important appellate-level decisions in the United Kingdom and Canada. These decisions have tackled some major issues and have clarified key aspects of the law of duress. But they have also sown some uncertainty by articulating a number of different approaches to duress which are inconsistent with one another. In the committee's view, it is time to consolidate and clarify the law of duress by enacting legislation.

*14. The Contract Fairness Act should contain a duress provision. (60–61)*

Pressure on a person to submit to a contract is a key concern of duress. A major issue that courts have tried to resolve is when ordinary hard bargaining crosses the line and becomes duress. Early economic duress cases said that this occurred when one contracting party's will was totally overborne by another. This standard originated in the United Kingdom, where it has been overtaken by subsequent developments. But it still has some support in Canadian jurisprudence. The committee considered adopting it as an element of duress but ultimately declined to take this step. This decision was made in view of concerns that this standard is too vague. It could set the bar too high. It could also be ignored in practice, as it seems to direct a court to inquire into a contracting party's subjective state of mind.

*15. The Contract Fairness Act should not require a contracting party to show that its will was overborne in order to obtain a remedy for duress. (61–63)*

The other leading approach to pressure has been to examine whether or not it is illegitimate. As the law of duress has developed, the illegitimate-pressure standard has overtaken the overborne-will standard as the major element of duress. Its now-

dominant position in the case law was a factor in the committee's proposal to adopt it as part of its duress provision. This standard also avoids diverting the court's attention to a subjective inquiry and is better suited to the committee's overall legislative framework.

*16. The Contract Fairness Act should require a contracting party to show that it was induced into a contract by illegitimate pressure in order to obtain a remedy in duress. (63–66)*

Many of the leading duress cases have endorsed a list of factors for courts to consider in determining whether the pressure applied to a contracting party resulted in a severe limitation on that contracting party's will. The key factor on this list is whether or not the contracting party had a practical alternative to submission to the other party's will. In the committee's view, there is a practical benefit in providing courts with this form of guidance on the resolution of duress cases.

*17. The Contract Fairness Act should contain the following list of factors for duress cases: (a) whether the victim protested; (b) whether, at the time the victim was being coerced, the victim had a practical alternative course open to pursue; (c) whether, after entering into the contract, the victim took steps to avoid it. (66–67)*

Typically, the list of factors has included a consideration of whether the victimized contracting party received independent legal advice. The committee favours excluding this factor from its legislative list. The factor has been criticized as providing little to no helpful information. If a contracting party were really confronted with no practical alternative but to submit to illegitimate pressure, then independent legal advice would simply confirm that this is the case.

*18. The Contract Fairness Act should not include independent legal advice as a factor for consideration in duress cases. (67–68)*

One of the concerns about economic duress is that its standard of illegitimate pressure may be too vague to assist courts and litigants in actual disputes. A proposed solution is to adopt a legislative list of actions that would amount to illegitimate pressure for the purposes of the statute. There is an American precedent for such a list. While the committee is sympathetic to this idea, it found that it was unworkable in practice. Simply adopting the American list would not work, because it relies on concepts that are specific to American law. The range of fact patterns in which illegitimate pressure may arise makes it difficult to impossible to craft a list that is neither overly restrictive nor couched in unhelpful generalities.

19. *The Contract Fairness Act should not include a list of actions that amount to illegitimate pressure. (68–71)*

A recent case from New Brunswick has raised the possibility of creating a special standard of duress that would be applicable only to cases involving contractual modifications. The impetus for the New Brunswick court's revised approach to duress was concern about the doctrine of consideration, but the court framed its proposal in terms broad enough to encompass duress generally. In examining this issue the committee considered the New Brunswick decision both in its specific and its general aspect. It concluded that a special rule for contractual modifications would represent an unacceptable fragmentation of duress. And the committee was reluctant to endorse a wide-ranging change in the law of duress that was at odds with the law outside New Brunswick.

20. *The Contract Fairness Act should not adopt a special standard for duress in cases of contractual modifications. (71–74)*

The traditional remedy for duress is rescission. As is the case for unconscionability, the remedial rules applying to duress are somewhat restrictive. In the committee's view, it is beneficial for the courts to have a wider range of tools to address issues that may arise in the course of a duress case.

21. *The Contract Fairness Act should allow the court to make any order that it thinks is just, including any of the following orders on the list recommended by the New Zealand Law Commission: (a) declaring the contract to be valid and enforceable in whole or in part or for any particular purpose; (b) rescinding the contract; (c) declaring that a term of the contract is of no effect; (d) varying the contract; (e) awarding restitution or compensation to any party to the contract; (f) vesting any property in any party to the proceedings, or direct any party to transfer or assign any property to any other party to the proceedings; (g) ordering that an account be taken, and reopening any account already taken, in respect of any transaction between the parties. (74–76)*

Currently, duress applies to all types of contracts. Its all-embracing nature has not attracted negative commentary. The committee sees no need to change the law to restrict the scope of duress. Retaining duress as a general principle is in better harmony with the committee's proposals on unconscionability and undue influence.

22. *The duress provision in the Contract Fairness Act should apply to all types of contracts and contracting parties. (76)*

## UNDUE INFLUENCE

Like duress, undue influence is concerned with whether a person freely consented to a contract. Unlike duress, undue influence protects against the subtle exercise of pressure that may occur in a special relationship that leaves one party vulnerable to the manipulation of the other. Some examples of special relationships that may bring undue influence into play include lawyer–client, physician–patient, and parent–child.

The law on undue influence is complex. Despite a leading Supreme Court of Canada decision, it still contains uncertainties and loose ends. Legislation on undue influence provides an opportunity to clarify the law and to develop it in a coherent fashion.

### *23. The Contract Fairness Act should contain an undue-influence provision. (84–85)*

Undue influence operates primarily by presumptions. If the contract at issue is between individuals in certain types of relationships (which are marked by heightened trust and the potential for domination), then the court presumes that undue influence has occurred. Recent case law has developed a complex classification scheme for managing undue-influence presumptions. The committee wrestled with this issue. It was reluctant to propose a change to the law that could have the effect of reducing the protection afforded to vulnerable people. But it could not get past the complex and often out-of-date nature of the law as it stands. The committee did not see a clear and straightforward way to craft a rational set of presumptions. Other jurisdictions and other areas of the law have operated successfully without presumptions. Doing away with these presumptions will make undue influence clearer and more accessible.

### *24. The Contract Fairness Act should not provide that undue influence is presumed in any cases. (85–91)*

A major unresolved issue in undue influence is whether a contract that is not disadvantageous to the weaker party can in any event be set aside because it was obtained by the exercise of undue influence. In the committee’s view, it would be undesirable to enact an undue-influence provision without a substantive-unfairness component. It would potentially create a far-reaching jurisdiction to set aside contracts, even in cases that an outside observer would find difficult to classify as unfair. Including a substantive-unfairness element also assists in integrating undue influence with unconscionability and duress.

25. *The Contract Fairness Act should provide that proof of substantive unfairness in the transaction is necessary to obtain a remedy for undue influence. (92–96)*

Similar to cases of unconscionability or duress, undue-influence cases have traditionally featured one remedy—rescission. The committee favours expanding the scope of the remedies that the legislation extends to the courts. This approach will give the courts more flexibility in resolving disputes.

26. *The Contract Fairness Act should allow the court to make any order that it thinks is just, including any of the following orders on the list recommended by the New Zealand Law Commission: (a) declaring the contract to be valid and enforceable in whole or in part or for any particular purpose; (b) rescinding the contract; (c) declaring that a term of the contract is of no effect; (d) varying the contract; (e) awarding restitution or compensation to any party to the contract; (f) vesting any property in any party to the proceedings, or direct any party to transfer or assign any property to any other party to the proceedings; (g) ordering that an account be taken, and reopening any account already taken, in respect of any transaction between the parties. (96–98)*

There may be a rationale to excluding certain types of contracts, such as high-dollar-value agreements between sophisticated commercial parties, from the scope of undue influence. The difficulty inherent in this approach lies in finding an appropriate dividing line. In the committee’s view, there is no obvious legislative standard that clearly excludes only those contracting parties that should not be subject to undue influence and does not also end up excluding parties that should benefit from the legislation’s protection. The rules will be clearer if undue influence is treated as a general principle.

27. *The undue-influence provision in the Contract Fairness Act should apply to all types of contracts and contracting parties. (98)*

## **INTEGRATION OF UNCONSCIONABILITY, DURESS, AND UNDUE INFLUENCE**

Unconscionability, duress, and undue influence apply to related, though distinct, sets of circumstances that may be present at the formation of a contract. The committee examined two earlier law-reform proposals for the integration of the three concepts. The first proposal involved greatly expanding the scope of unconscionability to the point that it embraces fact patterns that are now covered by duress and undue influence. The second involved combining the three concepts as distinct components of a single statutory provision. This approach would preserve the substantive distinctions among unconscionability, duress, and undue influence, but would allow for integration at the level of procedure and remedies. The committee also considered a

third approach, which would treat unconscionability, duress, and undue influence as completely separate concepts for the purposes of the *Contract Fairness Act*.

The committee favours the second approach, which is essentially a compromise between the first and third approaches. This approach provides some consolidation and simplification, but retains consistency with established concepts.

*28. The Contract Fairness Act should contain a general test of unfairness that embraces unconscionability, duress, and undue influence as its component parts. The draft legislation should integrate unconscionability, duress, and undue influence with respect to remedies, procedure, burden of proof, and limiting factors. (100-09)*

## GOOD FAITH

With good faith, the focus shifts from looking just at the events leading up to a contract to looking at the course of a contractual relationship. Good faith is traditionally a consideration at three points in a contract's lifespan: (1) the negotiations that take place before a contract is formed; (2) the performance of rights and obligations under a contract; and (3) the enforcement of remedies on a contract breaking down. The current law requires a complex analysis be performed to determine whether a contract is subject to a duty of good faith.

The lion's share of the case law on good faith in Canada has focussed on good faith performance. Many of these cases have applied the traditional rules governing when the courts may imply a term in a contract and have ended up implying a duty of good faith performance in the contracts at issue. The committee has concluded that the time has come to make the duty to perform a contract in good faith the default starting point. In its view, this reform would clarify and simplify the law, bringing it more into line with the expectations of contracting parties and moving it closer to the position of major trading partners, such as the United States.

*29. The Contract Fairness Act should provide for an implied duty of good faith in the performance of contracts. (128-31)*

The committee examined good faith enforcement as a duty in its own right and not (as it is typically analyzed) as an adjunct of good faith performance. There is a significant difference between applying a duty of good faith to the performance of a contract and applying that duty after contractual relations have broken down. The committee concluded that Canadian law has not yet established a foundation for an implied duty of good faith enforcement. Adopting such a duty in the *Contract Fairness Act* would run too great a risk of creating uncertainty and mischief.

*30. The Contract Fairness Act should not provide for an implied duty of good faith in the enforcement of contracts. (132–34)*

Good faith negotiation has attracted a large amount of commentary, but there are few examples of the duty being applied in Canadian jurisprudence. Past law-reform studies that have examined the idea of implying a general duty of good faith in contract negotiation have rejected it. The reasons for this decision include the concept's intrusiveness, potential to spawn unmeritorious litigation, and overlap with other contract-law and tort-law concepts. The committee agrees with these points.

*31. The Contract Fairness Act should not provide for an implied duty of good faith in the negotiation of contracts. (134–36)*

The committee considered three options for crafting the scope of the implied duty of good faith performance. The first was to apply the duty to all contracts and contracting parties. The second involved restating the current law, so that the statutory duty would only apply to contracts that the case law had already identified as attracting an implied duty of good faith performance. The third was to identify a broader range of contracts than currently attract the duty of good faith performance but stopping short of general application of the duty. In the committee's view, the second and third approaches are too complex and are apt to be overtaken by events. The first approach is the clearest and most direct.

*32. The Contract Fairness Act should provide for a duty of good faith as an implied term in the performance of all types of contracts. (136–37)*

Defining good faith in contractual performance is a longstanding issue in the jurisprudence and commentary. The committee examined four options: (1) a purely subjective definition; (2) a definition that combines subjective and objective elements; (3) a three-part definition that a law professor synthesized from the leading Canadian cases; and (4) adopting no legislative definition at all. The committee favoured option (3). In its view, this option was the best of the four in promoting clarity and commercial certainty.

*33. The Contract Fairness Act should define good faith as the duty (a) to exercise discretionary powers conferred by contract reasonably and for the intended purpose, (b) to cooperate in securing performance of the main objects of the contract, and (c) to refrain from strategic behaviour designed to evade contractual obligations. (138–41)*

The current law on whether the duty of good faith performance can be modified or excluded by contract is somewhat uncertain. Some commentators say that contracting parties have a free hand to modify or exclude the duty; others argue that the courts will impose limitations in a contested case. The committee examined this issue from first principles and settled on a proposal that falls between these two extremes. In its view, a too-liberal approach to contracting out would be an invitation to strong contracting parties to routinely oust the duty. But, since the duty is an implied term of a contract, some scope has to be left to contracting parties to structure that duty by spelling out its content in the express terms of a contract.

*34. The Contract Fairness Act should provide that contracting parties may not modify or exclude the duty to perform a contract in good faith, but the parties may, by agreement, determine the standards by which performance of their good-faith obligations is to be measured if such standards are not manifestly unreasonable. (141-43)*

In some cases, formalities are used as an added level of protection for weaker contracting parties confronted with the possibility of bargaining away beneficial statutory provisions. The category *formalities* is rather open-ended, encompassing, for example, writing and witnessing requirements. The committee favours not imposing any formalities in these circumstances. It does not want to create a situation in which a formal breach has occurred, but no abuse has been taken of the weaker contracting party.

*35. The Contract Fairness Act should not impose any formalities on how contracting parties determine the standards by which performance of their good-faith obligations is to be measured. (143-44)*

### **MISREPRESENTATION**

Misrepresentation is a complex area of the law, which straddles the boundaries of the law of contracts and the law of torts. The committee's focus was strictly on the contractual aspects of misrepresentation. In order to yield a remedy in the law of contracts, a misrepresentation must be a false statement of a past or present fact that induces a contracting party to enter into a contract. The misrepresentation takes place before the contract is entered into and does not itself form part of the contract. The law of misrepresentation suffers from many uncertainties and frustrating limitations, particularly in the areas of its scope and the remedies it offers.

The first issue considered was whether to expand the scope of misrepresentation to include statements of law. The main rationale for excluding statements of law is that they are a type of opinion, and as such cannot be proved true or false. Another ra-



tionale occasionally advanced is the proposition that everyone should be taken to know the law, so no one should have to rely on another person's statement of law. The committee was not persuaded by these points. It noted that, in practice, it can be difficult to draw the line between statements of fact and statements of law. Misrepresentation would be clearer and easier to apply if this distinction were removed. This approach is also consistent with the recommendations of all previous Canadian law-reform agencies that have examined the issue.

*36. The Contract Fairness Act should provide that a misrepresentation includes a misrepresentation of law. (157–58)*

Some commentators have proposed expanding the scope of misrepresentation even more, to take in all types of opinions and sales talk. Sometimes this proposal is qualified by requiring that a contracting party at least rely on the opinion or sales talk in circumstances in which it was reasonable to do so. The committee does not favour expanding the scope of misrepresentation to this degree. It could become a trap to the unwary, actually breeding unfairness in its own way. It is also straining the concept of misrepresentation to apply it to opinions, which by definition can be neither true nor false.

*37. The Contract Fairness Act should not provide that a misrepresentation includes a misstatement of opinion or any misstatement that has the capacity to induce reasonable reliance and that did induce such reliance in the misrepresentee. (158–59)*

An especially vexing area of misrepresentation involves when non-disclosure of information amounts to an actionable misrepresentation. The basic rule is that parties negotiating a contract are not obliged to disclose information to one another. But this rule is subject to a long list of common-law exceptions. The committee examined three options for reform. The first involved attempting to rationalize the common-law exceptions by using broadly based principles. This option has a basis in American law. The committee found this approach to be too close for comfort to creating a duty of good faith negotiation. The second option would be simply not to address this area of the law. The committee found this to be an undesirable approach. It favoured a third option, which is to restate the common-law exceptions in the *Contract Fairness Act*. This approach would not change the law, but it would make it clearer and more accessible.

*38. The Contract Fairness Act should contain a restatement of the current common-law position on when the courts may treat non-disclosure as a misrepresentation. (160–63)*

For remedial purposes, the law of misrepresentation distinguishes among fraudulent, negligent, and innocent misrepresentations. Traditionally, a victim of innocent misrepresentation has not been able to obtain an award of damages. Due to the vagaries of the law of rescission, this traditional position has sometimes left such a victim without a remedy at all. The inflexibility of the traditional position has been questioned by the courts. The committee supports this development, and proposes legislation to encourage flexibility.

*39. The Contract Fairness Act should enable courts to award damages to a representee who was induced to enter into a contract by a misrepresentation in lieu of rescission. (163–65)*

There is a general consensus among law-reform agencies on the desirability of extending a remedy in damages to victims of innocent misrepresentation. There is also a surprising level of divergence on the means to be used to implement this policy. The committee examined the following four options taken from previous law-reform reports: (1) take a limited approach and simply fix the problem for innocent misrepresentation by creating a supplemental damages remedy; (2) go somewhat farther and address problems with rescission as well as giving the courts the scope to award damages for innocent misrepresentation; (3) effect a major change in contract law by abolishing the distinction between misrepresentations and contract terms for the purpose of remedies; and (4) abolish the distinction between misrepresentations and contract terms for the purpose of remedies and give the courts the power to award damages on a reliance or restitutionary measure. The committee favours option (2). It provides for constructive changes. Its modesty in comparison to options (3) and (4) is actually a strength, as the sweeping changes proposed by those two options would have effects beyond the law of contracts.

*40. The Contract Fairness Act should create an enhanced right of rescission coupled with a discretionary damages remedy for non-fraudulent misrepresentation. (165–69)*

Another area in which remedial inflexibility has been a problem is in connection with rescission. Traditional rules create so-called bars to rescission in a number of circumstances. Some of these bars are necessary in view of the sweeping nature of rescission. One that has been questioned is the bar created once a contract has been executed, or performed. This rule has its roots in contracts involving the sale of land, but Canadian law has expanded it to cover other types of contracts. Consistent with past law-reform reports and legislation in other jurisdictions, the committee proposes doing away with this rule. This approach will give the courts enhanced remedial flexibility.

41. *The Contract Fairness Act should allow a representee to rescind a contract that has been induced by misrepresentation even though the contract has been wholly or partially performed and even though, in the case of a contract for the sale of an interest in land, the interest has been conveyed to the representee. (169–72)*

Another traditional rule creates a bar to rescission when the misrepresentation becomes a term of the contract. When this occurs, something that would have formed the basis for rescission of the agreement now will, in all likelihood, yield a remedy in damages. In the committee's view, the rigid application of this rule can lead to anomalous results. The law would be better served by giving the courts the flexibility to grant rescission in appropriate cases.

42. *The Contract Fairness Act should allow a representee to rescind a contract that has been induced by misrepresentation even though the misrepresentation has become a term of the contract. (172–73)*

The committee considered whether to allow contracting parties to modify or exclude its proposed statutory provisions on misrepresentation. Such a rule would give contracting parties more flexibility in shaping their agreements, which is a desirable goal. But it could only be achieved here at the risk of opening up weaker contracting parties to abuse. Further, it seemed counterintuitive to allow contracting parties to vary a legislative regime that is primarily directed at enhancing remedial flexibility for the courts.

43. *The Contract Fairness Act should not allow contracting parties to modify or exclude the misrepresentation provisions in the draft legislation. (174–75)*

## **SPECIAL LEGISLATIVE PROVISIONS FOR EXCLUSION CLAUSES**

In addition to addressing broad, general concepts in the law of contracts, the committee considered a specific type of contract term—the exclusion clause. An exclusion clause is a contract term designed to exclude or limit a contracting party's liability for damages for which, in the absence of the clause, the party would have been liable. A chapter on exclusion clauses has been included in the consultation paper because such clauses have for a long time posed special problems for the law of contracts.

The committee reviewed the rise and fall of the doctrine of fundamental breach in Canadian jurisprudence. This doctrine has been considered in a stream of Supreme Court of Canada cases, including one from earlier this year. That case concluded that

the doctrine should be laid to rest and replaced with a three-stage test. The committee also examined legislation in the United Kingdom that was enacted specifically to regulate exclusion clauses. The committee decided not to propose specific reforms tailored to exclusion clauses. In its view, the timing is not right. The latest Supreme Court of Canada decision should be given some time to operate, to see if it will have a beneficial impact on the law. In addition, the committee's general proposals in relation to unconscionability and good faith performance may ameliorate many of the problems caused by unfair exclusion clauses.

*44. The Contract Fairness Act should not contain provisions focussed on exclusion clauses. (187–90)*

### MISCELLANEOUS ISSUES

If it were enacted, the proposed *Contract Fairness Act* would not be the only legislation in British Columbia to address contractual unfairness. British Columbia has a large number of statutory provisions that articulate rules touching on unfairness for specific types of contracts or contracting parties. The committee considered how its proposals should relate to these other enactments. It examined two options. First, it could have the *Contract Fairness Act* provide that any conflict between its provisions and those of another enactment should be resolved in favour of the other enactment. Second, it could propose that the *Contract Fairness Act* should prevail over any other enactment in the event of a conflict. In the committee's view, the first option is the better option. It represents the more cautious approach, which will limit the possibility of the *Contract Fairness Act* having any unintended consequences.

*45. The Contract Fairness Act should provide that in the event of a conflict between a provision of the draft legislation and a provision of any other act or a regulation the provision of that other act or regulation prevails to the extent of the conflict. (191–94)*

Transitional issues always arise when new legislation is brought into force. Should the legislation apply just to transactions that occur after the date on which it comes into force, or should it reach back and also cover transactions occurring before the coming-into-force date? The committee proposes resolving this issue by having the *Contract Fairness Act* only apply to contracts entered into after its date of coming into force. This rule promotes predictability and certainty in the law. It also affords people an opportunity to plan for the changes to be introduced by the *Contract Fairness Act*.

46. *The Contract Fairness Act should apply only to contracts entered into after it comes into force. (194–96)*

### **CONCLUSION AND CALL FOR RESPONSES**

The committee is interested in receiving the public's views on its tentative recommendations. These comments will be considered in preparing the final report for the Unfair Contracts Relief Project.



## CHAPTER I. INTRODUCTION

### A. Background on the Unfair Contracts Relief Project

In November 2009, the British Columbia Law Institute commenced a major law-reform project to study how the law of contracts deals with unfairness and to recommend reforms where they are needed. The Unfair Contracts Relief Project has a two-year term. Its goal is the publication of a final report in fall 2011, which is intended to contain recommendations in the form of draft legislation to be called the *Contract Fairness Act*. This consultation paper is a milestone in the project. It sets forth the proposals of the project committee for public comment. These tentative recommendations contain the committee's considered policy choices, which are instrumental in creating the proposed *Contract Fairness Act*.

The courts have long had a jurisdiction that permits them to refuse to enforce contracts for reasons related to unfairness. This jurisdiction embraces contract-law concepts that first emerged in the distant past and that made up part of British Columbia's legal inheritance from the common-law and equitable courts of England. Since appearing on the scene in British Columbia, these concepts have continued to grow and evolve, with both the province's courts and its legislature taking a hand in their development. They have now reached a stage where their rationalization and integration is imperative.

This consultation paper is concerned with examining the following contract-law concepts: (1) unconscionability; (2) duress; (3) undue influence; (4) good faith; and (5) misrepresentation. These concepts have been selected because they can usefully be employed as themes for organizing consideration of more highly specific issues concerning contractual unfairness. They also serve to connect problems that are currently encountered by contracting parties with a longstanding body of jurisprudence and commentary. The consultation paper also considers the special problems posed by a particular type of contract term, called an exclusion clause.

The Unfair Contracts Relief Project has been made possible by a grant from the Law Foundation of British Columbia.

### B. The Unfair Contracts Relief Project Committee

This project has been carried out with the assistance of an all-volunteer project committee. The members of the committee are Joost Blom, Q.C. (who is the committee chair), Margaret Easton, Russell Getz, Do-Ellen Hansen, Allan Parker, Q.C., Lisa Peters, Peter Rubin, and Tony Wilson.

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Prof. Blom has been a member of the Faculty of Law, University of British Columbia, since 1972, serving as associate dean from 1982–85 and as dean from 1997–2003. He has published numerous scholarly articles on subjects ranging from the law of contracts to the law of torts to private international law.<sup>1</sup> Prof. Blom’s volunteer positions include currently serving as a bencher of the Law Society of British Columbia and a member of the British Columbia Law Institute.

Ms. Easton is currently the principal of The Meridian Aging Project. Previously, she worked in the financial-services industry. Among the positions she held were branch manager and assistant vice president, operations, for Westminster Savings Credit Union. Ms. Easton also has an interest in law and aging issues.

Mr. Getz is legal counsel for the Civil/Family Law Policy Office, Ministry of Attorney General for British Columbia. He is very active in law-reform issues, both in this position and in his volunteer positions. Those commitments include many years as the jurisdictional representative for British Columbia to the Uniform Law Conference of Canada, as well as positions on the executive of the conference, culminating in the conference presidency for 2009–10.

Ms. Hansen is a partner with the law firm Borden Ladner Gervais LLP. Her practice focusses on legal research, primarily in the corporate–commercial area. She is an active member of the legal research section of the Canadian Bar Association—BC Branch, has presented at legal conferences and continuing legal education seminars,<sup>2</sup> and is the author of a number of law-review articles.<sup>3</sup>

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1. See, e.g., Joost Blom, “Canadian Cases in Private International Law in 2004–05” (2005) 43 Can. Y.B. Int’l Law 636; Joost Blom & Elizabeth Edinger, “The Chimera of the Real and Substantial Connection Test” (2005) 38 U.B.C. L. Rev. 373; Joost Blom, “Whither Choice of Law? A Look at Canada and Australia” (2004) 12 Willamette J. Int’l L. & Dip. Resol. 211; Joost Blom, “Public Policy in International Law and its Evolution in Time” (2003) 50 Nethl. Int’l L. Rev. 373; Joost Blom, “Tort, Contract and Allocation of Risk” (2002) 17 Sup. Ct. L. Rev. 289.
  2. See Do-Ellen S. Hansen & Susan E. MacFarlane, “The Legal Research Plan: A Tool for Effective Legal Research,” in Lisa A. Peters, Marko Vesely, et al., eds., *Legal Research 2004: Materials Prepared for the Continuing Legal Education Seminar, Legal Research, Held in Vancouver, B.C. on December 10, 2004* (Vancouver: Continuing Legal Education Society of British Columbia, 2004) 1.1.
  3. See Do-Ellen Hansen, D. Bruce Garow & Meredith Parkes, “Damages for Personal Injury or Wrongful Death in Canada” (2004) 69 J. Air L. & Com. 233; Do-Ellen Hansen, “Developments in Commercial Agency Law in Canada” [1992] *Comparative Law Yearbook of International Business* 231.
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Mr. Parker is associate executive director of the Access Pro Bono Society of British Columbia and is a part-time mediator. He has served in various capacities with the social justice section of the Canadian Bar Association—BC Branch, and as an elected member of the Provincial Council. He has written and edited various legal materials including for the Legal Services Society and the Continuing Legal Education Society of British Columbia.<sup>4</sup>

Ms. Peters is a partner with Lawson Lundell LLP, and is head of that law firm's legal research and opinions department. She is the author of a number of publications on legal research and private law generally.<sup>5</sup> She has also served as a member of the British Columbia delegation to the Uniform Law Conference of Canada and as chair of the Legislation and Law Reform Committee of the Canadian Bar Association—BC Branch.

Mr. Rubin is a partner with the law firm Blake, Cassels & Graydon LLP. He practices with the firm's litigation and restructuring and insolvency groups. Mr. Rubin has contributed to continuing legal education seminars and legal textbooks.<sup>6</sup> He was until recently an elected member of the Provincial Council of the Canadian Bar Association—BC Branch.

Mr. Wilson is an associate counsel with Boughton Law Corporation, where his practice focusses on franchising, licensing, and intellectual-property law. He is the author

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4. See, e.g., Allan A. Parker, *Consumer Law and Credit/Debt Law* (Vancouver: Legal Services Society of British Columbia, 2009), online: Legal Services Society <<http://www.lss.bc.ca/assets/pubs/consumerLawAndCreditDebitLaw.pdf>>; Allan Parker *et al.*, "Poverty Law, Public Interest Law, and Access to Justice," in Susan Munro *et al.*, eds., *Annual Review of Law and Practice: Current to 1 January 2007* (Vancouver: Continuing Legal Education Society of British Columbia, 2007) 467.
  5. See, e.g., Heather M. Cane & Lisa A. Peters, "Researching Foreign Law," in Paul C. Dawson, Lisa A. Peters, *et al.*, eds., *Legal Research 2008: Materials Prepared for the Continuing Legal Education Seminar, Legal Research 2008, Held in Vancouver, BC, on December 11, 2008* (Vancouver: Continuing Legal Education Society of British Columbia, 2008) 3.1; Lisa Peters, "Recovery of Legal Research Expenses in Taxations and Assessments of Costs" (1997) 55 *Advocate* 79; Lisa Peters, "Contract Damages for Loss of Opportunity or Chance," in D. Bruce Gleig, Mark D. Andrews, *et al.*, eds., *Contract Damages: Materials Prepared for the Continuing Legal Education Seminar, Contract Damages '96, Held in Vancouver, B.C. on November 29, 1996* (Vancouver: Continuing Legal Education Society of British Columbia, 1996) 5.1.
  6. See, e.g., Peter Rubin & Jeff Langlois, "Insolvency Issues and Partnerships," in William S. Maclagan *et al.*, eds., *Working with Partnerships: Materials Prepared for the Continuing Legal Education Seminar, Working with Partnerships, Held in Vancouver, BC, on June 18, 2009* (Vancouver: Continuing Legal Education Society of British Columbia, 2009) 7.1; Peter L. Rubin & James Sullivan, "Procedure and Remedies Against the Crown," in Karen Horsman & Gareth Morely, eds., *Government Liability: Law and Practice*, looseleaf (Aurora, ON: Canada Law Book, 2009) 12-1.
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of numerous articles and a book on franchise law.<sup>7</sup> Mr. Wilson is also an adjunct professor at the School of Criminology, Simon Fraser University.

The committee has met twelve times since its formation in November 2009. After two meetings concerned with organizing the project and surveying the field, the committee's meetings have been in the main focussed on the substantive issues addressed in the tentative recommendations set out in this consultation paper.

### **C. The Structure of this Consultation Paper**

Most of this consultation paper is dedicated to setting out and explaining the committee's tentative recommendations for reform. These tentative recommendations are intended to focus a reader's attention on the major policy issues that must be addressed in order to create draft legislation for the project's final report. Each tentative recommendation is framed as a discrete declarative statement, which sets out the committee's current position on the issue being considered. Although this approach results in the statement of clear and definitive positions on the issues for reform, the recommendations in this consultation paper are "tentative" in the sense that the committee may change its position upon reflecting on the public's comments and any other further consideration before the publication of the final report.

Preceding each tentative recommendation is a discussion that touches on a consistent set of topics. First, it characterizes the issue to be considered and records critical academic and judicial commentary on that issue. Then, it sets out the leading options for reform in relation to that issue, and discusses the advantages and disadvantages of each option. Finally, it provides the committee's reasons for making its tentative recommendation for reform of the issue. In addition to this shorter, focussed commentary on the issues for reform considered in this consultation paper, each chapter begins with an extended discussion of the broader theme (such as, for example, good faith) under consideration. This discussion describes the current state of the law in British Columbia, in relation to each theme, typically by tracing the development of the law over the past 20 to 30 years.

Before considering the issues for reform in depth, the consultation paper begins by providing some general background information. These general considerations are largely focussed on providing readers with a brief orientation to topics that arise repeatedly in relation to many of the themes discussed in detail later in the consultation paper.

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7. See Tony Wilson, *Buying a Franchise in Canada: Understanding and Negotiating Your Franchise Agreement*, 2d ed. (North Vancouver, BC: Self-Counsel Press, 2009).

## CHAPTER II. GENERAL CONSIDERATIONS

### A. Introduction

This chapter is concerned with several topics. The main purpose of the chapter is to explain why the committee undertook this project. The chapter begins with a discussion that locates the law of contracts in relation to other branches of the law. Then, it moves on to a brief historical overview of certain aspects of the law of contracts. This overview is not intended to be a comprehensive analysis of the development of the law. Much of the focus in this consultation paper is on developments in the law over the past 30 years, but in order to grasp the significance of some of those developments a few historical details from English law need to be explained. This chapter then discusses contractual unfairness in general terms and provides a brief description of the five contract-law concepts relating to unfairness that make up the major themes of this consultation paper. Finally, this chapter concludes with a discussion of legislative reform of the law of contracts and sets out the consultation paper's first tentative recommendation.

### B. The Law of Contracts in Relation to Other Branches of the Law

Going back to at least the eighteenth century, legal scholars have attempted to analyze the law by dividing it into categories, branches, and concepts.<sup>8</sup> These component parts are typically arranged in relation to one another in a general classification scheme. The quest to articulate a coherent and all-embracing framework continues to this day to animate a great amount of scholarship.<sup>9</sup> Much of this scholarship is highly sophisticated, and it is not necessary to master its details for the purposes of this consultation paper. But some of its insights do illuminate problems that crop up repeatedly in this consultation paper.

The first major division that scholars typically make is between private and public law. While private law “is concerned principally with the mutual rights and obliga-

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8. See, e.g., Wayne Morrison, ed., *Blackstone's Commentaries on the Laws of England* (London: Cavendish, 2001); Robert Joseph Pothier, *Treatise on the Law of Obligations, or Contracts*, trans. by William David Evans (Philadelphia: R.H. Small, 1853); Mark DeWolfe Howe, ed., *The Common Law by Oliver Wendell Holmes* (Cambridge, MA: Belknap Press of Harvard University Press, 1967).

9. See, e.g., Stephen Waddams, *Dimensions of Private Law: Categories and Concepts in Anglo-American Legal Reasoning* (Cambridge: Cambridge University Press, 2003) [Waddams, *Dimensions of Private Law*]; Peter Birks, ed., *The Classification of Obligations* (Oxford: Clarendon Press, 1997) [Birks, *Classification of Obligations*]; Andrew Robertson, ed., *The Law of Obligations: Connections and Boundaries* (London: UCL Press, 2004).

tions of individuals,”<sup>10</sup> it also “takes its meaning partly from what it excludes, notably private international law, constitutional law, local government law, administrative law, criminal law, military law, and taxation.”<sup>11</sup> Private law can be further subdivided between the law of property and the law of obligations. The law of obligations is the real concern of this consultation paper, because it contains the law of contracts, as well as its relations, the law of torts and the law of restitution.<sup>12</sup>

Each category of the law of obligations protects different interests and adopts different approaches to remedies. “The basic animating principle of the law of contracts,” as a leading textbook explains it, is that “as a matter of general principle, promises ought to be performed.”<sup>13</sup> The classic contracts case involves a breach of a promise—for example, if a buyer under a contract for the sale of goods fails to pay the purchase price. In such cases, the law of contracts provides a remedy that aims “to place the victim of a breach of contract in as good a position as he or she would have been in if the contract had been performed.”<sup>14</sup> In most contracts cases, this remedy is compensation in the form of money damages.

The law of torts “enshrines the principle of equal concern and respect, which forbids one from harming important interests of one’s neighbours.”<sup>15</sup> A classic example of a torts case involves harm caused by someone to the person or property of another, as in, for instance, a motor-vehicle accident. Like the law of contracts, the remedial goal of the law of torts is to compensate the victim for losses with money damages. But, whereas the law of contracts is “forward-looking” in determining the measure of compensation, the law of torts is “‘backward-looking’ in the sense that [compensation is] calculated with the objective of restoring the victim to the position he or she was in before the tort occurred.”<sup>16</sup>

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10. Waddams, *Dimensions of Private Law*, *ibid.* at 1.

11. *Ibid.*

12. *See ibid.* at vi (“Since the nineteenth century it has been common to make distinctions in respect of Anglo-American law between public and private law, and within private law between property and obligations, and within obligations among contracts, torts, and unjust enrichment.”). Some legal scholars prefer the name *unjust enrichment* to *restitution*. *See, e.g.*, Peter Birks, *Unjust Enrichment*, 2d ed. (Oxford: Oxford University Press, 2005) at 277–81 [Birks, *Unjust Enrichment*].

13. John D. McCamus, *The Law of Contracts* (Toronto: Irwin Law, 2005) at 14 [McCamus, *Law of Contracts*].

14. *Ibid.*

15. Hugh Collins, “Legal Classifications as the Production of Knowledge Systems,” in Birks, *Classification of Obligations*, *supra* note 9 at 58.

16. McCamus, *Law of Contracts*, *supra* note 13 at 14–15.

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The law of restitution “deals with situations in which one person is accountable to another on the ground that otherwise he would unjustly benefit or the other would unjustly suffer loss.”<sup>17</sup> The classic restitution case involves “the mistaken payment of a non-existent debt.”<sup>18</sup> As in the law of torts, “the duties imposed by the law of restitution are essentially involuntary in nature.”<sup>19</sup> (This is in contrast to the law of contracts, which deals with duties that have been adopted by consent of the contracting parties.) In contrast to the law of contracts and the law of torts, the remedial goal of the law of restitution is not compensation, but rather “to effect a recovery of benefits unjustly acquired by the defendant.”<sup>20</sup>

Some legal scholars group the law of fiduciary duties with the law of restitution.<sup>21</sup> Others consider it to be a fourth branch of the law of obligations.<sup>22</sup> It isn’t necessary for this consultation paper to take a position on this dispute. For this consultation paper, it is only significant to note that “[a] fiduciary is a person who undertakes to act in the interests of another person.”<sup>23</sup> This is a high standard of conduct, and private law imposes its strictest duties on fiduciaries to support this high standard. Ordinary contracting parties are not held to such a high standard. The law of contracts generally allows contracting parties to pursue their own interests.

These categories are useful for analyzing the law, but they are not airtight. Life can be messy, and not all disputes conform to the contours of the classic cases used to illustrate the branches of the law of obligations. Some fact patterns will produce overlapping or concurrent liability in two or more branches of the law. It is important to bear this point in mind because disputes related to unfairness can often generate concurrent liability. But, even though some of the concepts considered in this consultation paper naturally lend themselves to a broader discussion of a number of branches of the law of obligations, this consultation paper is only concerned with proposals to reform the law of contracts. Although the committee often had to consider how the various branches of the law of obligations relate to one another in or-

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17. *Restatement of Restitution*, vol. 1, general scope note (1937).

18. Birks, *Unjust Enrichment*, *supra* note 12 at 3.

19. McCamus, *Law of Contract*, *supra* note 13 at 16.

20. *Ibid.*

21. *See, e.g., ibid.* at 17 (“The law of restitution is generally assumed to include the law relating to breaches of so-called fiduciary duties.”).

22. *See, e.g.,* Waddams, *Dimensions of Private Law*, *supra* note 9 at 11 (noting that “some [scholars] have proposed ‘trust’ or ‘fiduciary relationship’ as a separate category” [footnote omitted]).

23. Austin W. Scott, “The Fiduciary Principle” (1949) 37 Cal. L. Rev. 539 at 540.

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der to understand the current law governing an issue, it was always careful to tailor its tentative recommendations to apply to the law of contracts only and not to affect other branches of the law.

## C. Historical Overview

### 1. EARLY CONTRACT LAW AND THE EVOLUTION TO ENFORCEMENT OF PROMISES

Seen from today's vantage point, a law of contracts that protects people's interests in binding promises seems like a perfectly natural idea. In fact, it took several false starts and many hundreds of years for the law to reach this stage.

British Columbia's contract law, like the contract law that prevails in all the other English-speaking jurisdictions of Canada, derives from the law of England. The origins of the common law of contracts can be traced back as far as twelfth-century England. But it required a long, tortuous, and complex development over many hundreds of years<sup>24</sup> before something resembling the "modern law of contract," which is characterized by "the routine enforcement of promises that are intended to be binding,"<sup>25</sup> began to emerge in the late sixteenth and early seventeenth centuries.<sup>26</sup>

The contract law that emerged from this slow process of development had an important distinguishing feature: the law made it relatively difficult to assume contractual liability. Two or more contracting parties must assent to be bound by a contract and, in addition, for their promises to be enforceable at law there must be an exchange of something of value between them.<sup>27</sup> But, as a consequence of this feature, once con-

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24. See William Holdsworth, *A History of English Law*, 5th ed., vol. 3 (London: Methuen / Sweet & Maxwell, 1942) at 414–28; E. Allan Farnsworth, *Farnsworth on Contracts*, 2d ed., vol. 1 (New York: Aspen Law & Business, 1998) at §§ 1.5–1.7 [*Farnsworth on Contracts*].

25. John A. Humbach, "The Common-Law Conception of Leasing: Mitigation, Habitability, and Dependence of Covenants" (1983) 60 Wash. U. L. Q. 1213 at 1221.

26. Holdsworth, *supra* note 24, vol. 3 at 442–44.

27. See *Farnsworth on Contracts*, *supra* note 24, vol. 1 at § 1.1 ("[C]onventional learning is that a promisor's mere promise to do something—a 'bare' or 'naked' promise for which the promisee has given nothing in return—is not enforceable. So if nothing has been given in exchange for the promise, it has no legal consequences, there is no contract. The main concern of the law of contract, then, is with exchanges." [footnote omitted]). The law of contracts does allow for the enforcement of contracts in the absence of an exchange of value between the contracting parties in cases in which their promises are made under seal. Today, contracts under seal are rarely encountered.

tractual liability had been assumed, the law made it difficult for contracting parties to escape the consequences of this decision.<sup>28</sup>

Although the main energies of the law of contracts are directed toward upholding binding promises, there are occasions in which the law will depart from this endeavour. These occasions are limited in scope, but the prime examples of them occur in relation to the subject of this consultation paper, unfairness. This fact partly explains the enduring fascination of this subject, as it touches on fundamental questions of how the law of contracts should operate to the benefit of society.<sup>29</sup>

### 2. EARLY APPROACHES TO CONTRACTUAL UNFAIRNESS

Even though the courts have historically only acted on concerns about fairness in a narrow range of extreme cases, right from the advent of the law of contracts they have been willing to relieve contracting parties of their contractual obligations and liabilities in cases in which the contract has been determined to be unfair. “From the time promises under seal have been enforced at all,” as the legal scholar Roscoe Pound put it, “equity has interfered with contracts in the interests of weak, necessitous, or unfortunate promisors.”<sup>30</sup> The courts would “interfere” with an unfair contract by refusing to enforce it.

The jurisdiction that the courts took on in this area was actually broader than the quotation from Roscoe Pound indicates. For example, in a noteworthy case<sup>31</sup> involving the sale of land, the court made these telling remarks:

[A] Court of Equity will inquire whether the parties really did meet on equal terms; and if it be found that the vendor was in distressed circumstances, and that advantage was taken of that distress, it will avoid the contract. . . .

I consider, therefore, this Plaintiff entitled to relief . . . because the purchase was made at an inadequate price from vendors who were in great distress, and without the interven-

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28. See Robert E. Scott, “The Death of Contract Law” (2004) 54 U.T.L.J. 369 at 372 (“[C]lassical contract law is formal and acontextual. The classical common law rules make contractual liability hard to assume and hard to escape once it is assumed. Once a promise falls within the scope of legal enforcement, only a few gaps are filled, and they are filled with simple, binary default rules.”).

29. See Bradley E. Crawford, Case Comment, on *Morrison v. Coast Finance Ltd.* (1966) 44 Can. Bar Rev. 143 at 143 (“The fascinating and exasperating feature of these cases is their refusal to be harmoniously integrated into a general theory of the enforceability of promises given for good consideration. . . .”).

30. “Liberty of Contract” (1909) 18 Yale L.J. 454 at 482.

31. *Wood v. Abrey* (1818), 3 Madd. 417, 56 E.R. 558 (Ch.) [*Wood* cited to E.R.].

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tion of any other professional assistance than the purchaser's attorney; and because these circumstances are evidence that in this purchase advantage was taken of the distress of the vendors.<sup>32</sup>

In addition to protecting vulnerable contracting parties, the courts also saw fit to punish fraud, and to redress imbalances in the exchange of promises and property underlying the contract. To a much greater degree than is found in the law today, the historical law of contracts countenanced the judicial review of contracts on the ground of substantive unfairness. As one legal scholar has said, a "longstanding belief that the justification of contractual obligation is derived from the inherent justice or fairness of an exchange"<sup>33</sup> persisted in the law of contracts until well into the eighteenth century:

The most important aspect of the eighteenth century conception of exchange is an equitable limitation on contractual obligation. Under the modern will theory, the extent of contractual obligation depends upon the convergence of individual desires. The equitable theory, by contrast, limited and sometimes denied contractual obligation by reference to the fairness of the underlying exchange.<sup>34</sup>

These factors related to the bargain process, the vulnerability of a contracting party, disreputable conduct, and substantive fairness of exchange value continue to make up the bulk of jurisprudence related to fairness today. But today's jurisprudence tends to cast the emphasis on issues that were comparatively less emphasized in the past.

Another contrast between historical and contemporary jurisprudence is that, in the past, courts took a very broad view of unfairness and relied heavily on judicial discretion as a means to guard against injustice in specific cases. These qualities prevailed in the past because of the institutional make-up of the English court system in the period between the early seventeenth and late nineteenth centuries.

### 3. COMMON LAW AND EQUITY

Several of the quotations in the previous section refer to an "equitable" influence on the law of contracts. With this reference, they touch on a major historical division in the law, one that continues to have some influence today. "For outsiders to the common law system," a leading contract-law textbook explains,

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32. *Ibid.* at 560–61, *Sir John Leech V.C.*

33. Morton J. Horwitz, "The Historical Foundations of Modern Contract Law" (1974) 87 *Harv. L. Rev.* 917 at 917.

34. *Ibid.* at 923.



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it is no doubt a startling fact that until the latter part of the nineteenth century, the central institutional framework of the English legal system consisted of not one court system but two. The Royal Courts of common law—King’s Bench, Common Pleas and Exchequer—developed a body of jurisprudence that has come down to us as common law in the narrow sense. For much of the history of the common law, however there was a parallel court system, the Court of Chancery, which developed the jurisprudence referred to, at least for the past few centuries, as “equity.”<sup>35</sup>

Although legal writers can attach different meanings to the expression *common law* depending on the context in which it is used,<sup>36</sup> the common law is still intellectually the easier of the two concepts to grasp. This is because the common law existed prior to equity and because it forms a general body of rules that can function independently of equity. Equity, on the other hand, presupposes the existence of that body of rules called the common law. This passage from a textbook on equity gives a good account of what equity is and how it functions in relation to the common law:

Equity is thus a body of rules or principles which form an appendage to the general rules of law, or a gloss upon them. In origin at least, it represents the attempt of the English legal system to meet a problem which confronts all legal systems reaching a certain stage of development. In order to ensure the smooth running of society it is necessary to formulate general rules which work well enough in the majority of cases. Sooner or later, however, cases arise in which, in some unforeseen set of facts, the general rules produce substantial unfairness. When this occurs, justice requires either an amendment of the rule or, if (as in England some five or six centuries ago) the rule is not freely changeable, a further rule or body of rules to mitigate the severity of the rules of law. This new body of rules (or “equity”) is therefore distinguishable from the general body of law, not because it seeks to achieve some different end (for both aim at justice), nor because it relates necessarily to a different subject-matter, but merely because it appears at a later stage of legal development.<sup>37</sup>

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35. McCamus, *Law of Contracts*, *supra* note 13 at 9.

36. *See, e.g., ibid.* at 7–8 (noting that “[t]he term ‘common law’ has three distinct meanings,” which may be summarized as follows: (1) a legal system that developed in England and was exported to those jurisdictions that were originally colonized by England, such as the English-speaking parts of Canada, Australia, New Zealand, and the vast majority of the states of the United States, in distinction to the other major system of law—called the *civil law*—which applies in Continental Europe, South America, parts of Asia, and certain parts of North America, such as Mexico, Louisiana, and Québec; (2) law made by judges and expressed in court judgments as opposed to law made by legislatures and expressed in legislation; and (3) the legal rules that have their origins in the English common-law courts, in distinction to the equitable principles that developed in the Court of Chancery).

37. John McGhee, ed., *Snell’s Equity*, 31st ed. (London: Sweet & Maxwell, 2005) at para. 1-03 [footnotes omitted].

England no longer has separate courts dispensing common law and equity. Its historical courts were fused into a single High Court of Justice by legislation passed in the late nineteenth century.<sup>38</sup> Given the much later historical development of British Columbia's legal institutions, it is not surprising to note that this province has never had separate common-law and equitable courts. British Columbia's Supreme Court and Court of Appeal have always been able to apply rules from both bodies of jurisprudence.

Nevertheless, the source of a contract-law concept can be relevant. Most of the concepts in contemporary contract law that relate to contractual unfairness can trace their origins to equity. A smaller group derives from common-law principles.<sup>39</sup> These different sources can result in differences in the way in which the courts apply the concepts and the remedies available for each.

#### 4. REMEDIES IN THE LAW OF CONTRACTS

As noted earlier, the main remedy against breaches of contract is compensation in the form of money damages. The goal of contract damages is to put the innocent contracting party in the position it would have been in if the contract had been performed.<sup>40</sup> This is commonly referred to as protecting the expectation interest of contracting parties.<sup>41</sup>

Damages are available in some cases involving contractual unfairness, but they have played a relatively small role in this area of contract law. This may be due to the fact that historically the Court of Chancery had only a very limited jurisdiction to award damages.<sup>42</sup> It may also be due to a sense that money damages may not be the best remedy for contractual unfairness.

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38. See *Supreme Court of Judicature Act* (U.K.), 36 & 37 Vict. (1873), c. 66; *Supreme Court of Judicature Act* (U.K.), 38 & 39 Vict., c. 77 (1875).

39. See Horwitz, *supra* note 33 at 924 ("Supervision of the fairness of contracts was not confined to courts of equity.").

40. See, e.g., *Bank of America Canada v. Mutual Trust Co.*, 2002 SCC 43, [2002] 2 S.C.R. 601 at para. 25, Major J. (for the court) ("Contract damages are determined in one of two ways. Expectation damages, the usual measure of contract damages, focus on the value which the plaintiff would have received if the contract had been performed. Restitution damages, which are infrequently employed, focus on the advantage gained by the defendant as a result of his or her breach of contract.").

41. See generally L.L. Fuller & William R. Perdue Jr., "The Reliance Interest in Contract Damages" (1936) 46 Yale L.J. 52 & 46 Yale L.J. 373.

42. See *Snell's Equity*, *supra* note 37 at para. 18-01.

The major remedy for contractual unfairness is rescission.<sup>43</sup> Rescission has been defined as a remedy that “terminates the contract, puts the parties in status quo ante and restores things, as between them, to the position in which they stood before the contract was entered into.”<sup>44</sup> It is primarily an equitable remedy, though the common law also has some scope to award rescission.<sup>45</sup>

A distinction is often drawn in cases involving rescission between *voidable* and *void* contracts. “A contract that is valid until rescinded is called a voidable contract,” explains a leading textbook, “and is to be distinguished from a void contract, which is an apparent contract that never comes into being.”<sup>46</sup> On the other hand, “[w]hen [a voidable contract] is rescinded, ‘the contract is treated in law as never having come into existence,’ albeit the law recognizes that there once was a contract.”<sup>47</sup>

An order for rescission can produce dramatic results in some cases. One commentator has described it as “the exercise of a power to destroy the contract and revest the thing transferred or the outcome of that exercise.”<sup>48</sup> In cases in which it is not possible to revest property<sup>49</sup> or otherwise unwind the consequence of the transaction, then rescission is not available and the victim of an unfair contract may go without a remedy. The inflexibility of remedies for unfairness has been criticized, and it provides a major spur to reform in this area of the law.<sup>50</sup>

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43. See Birks, *Unjust Enrichment*, *supra* note 12 at 299 (“The Latin word ‘*scindere*’ was a strong word, with overtones of force, for ‘to cut’ or ‘to cleave,’ and ‘*rescindere*’ meant ‘to haul back’ or ‘to hack down’ and, by transference, ‘to cancel’ or ‘to annul.’”).

44. *Guarantee Co. of North America v. Gordon Capital Corp.*, [1999] 3 S.C.R. 423 at para. 39, 178 D.L.R. (4th) 1, Iacobucci & Bastarache JJ. [*Gordon Capital* cited to S.C.R.] (quoting *Abram Steamship Co. v. Westville Shipping Co.*, [1923] A.C. 773 at 781 (U.K.H.L.), Lord Atkinson).

45. See Dominic O’Sullivan, Steven Elliott & Rafal Zakrzewski, *The Law of Rescission* (Oxford: Oxford University Press, 2008) at paras. 3.01–3.54.

46. *Ibid.* at para. 1.04.

47. *Ibid.* at para. 1.10 (quoting *Johnson v. Agnew* (1979), [1980] A.C. 367 at 393, [1979] 1 All E.R. 883 (U.K.H.L.), Lord Wilberforce).

48. Birks, *supra* note 12 at 300.

49. *E.g.*, because it has been transferred for value to a third party acting in good faith.

50. See P.D. Finn, “The Fiduciary Principle,” in T.G. Youdan, ed., *Equity, Fiduciaries and Trusts* (Toronto: Carswell, 1989) 1 at 56.

### 5. FREEDOM AND SANCTITY OF CONTRACT AND CONTRACTUAL UNFAIRNESS

During the nineteenth century most of the concepts that make up contemporary contract law began to crystallize into their familiar form.<sup>51</sup> The courts' approach to contractual unfairness was part of this general crystallization, as the courts moved from assessing claims of unfairness on a broad discretionary basis to dealing with them by the application of a more-or-less systematized set of legal rules.

The nineteenth century also saw the rise of the notion of freedom of contract,<sup>52</sup> and a related principle called sanctity of contract.<sup>53</sup> Under their influence, the law came to place "a heavy emphasis on stability, predictability, and certainty, with strict enforcement of written documents. . . ."<sup>54</sup> Freedom of contract and sanctity of contract have been linked to broad political movements (such as the rise of liberal democracy and individual rights)<sup>55</sup> and economic trends (such as the development of capital markets, the spread of industrialization, and increases in international trade)<sup>56</sup> that played out in the nineteenth century. But they also appeared to come about as part of a deliberate reform effort to clarify the law of contracts by purging it of concepts

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51. See M.P. Furmston, ed., *Cheshire, Fifoot and Furmston's Law of Contract*, 15th ed. (Oxford: Oxford University Press, 2007) at 13 ("The nineteenth century is usually regarded as the classical age of English contract law, and this [is] for two reasons. The first is that the century witnessed an extensive development of the principles and structure of contract law into essentially the form which exists today. . . . The second involves a change in the attitude of thinking lawyers to contract.").
52. See J. Beatson, ed., *Anson's Law of Contract*, 28th ed. (Oxford: Oxford University Press, 2002) at 4 ("The concept of freedom of contract has two meanings. The first is the freedom of a party to choose to enter into a contract on whatever terms it may consider advantageous to its interests. . . . But freedom of contract also referred to the idea that as a general rule there should be no liability without consent embodied in a valid contract. This second and negative aspect of freedom of contract was influential in narrowing the scope of those parts of the law of obligations which deal with liability imposed by law: tort and restitution." [footnote omitted]).
53. See *ibid.* at 7 (describing the concept by noting it corresponds to an attitude that "parties should be able to keep their bargain and that as few avenues as possible should be afforded for escape from contractual obligations").
54. S.M. Waddams, "Unconscionable Contracts: Competing Perspectives" (1999) 62 Sask. L. Rev. 1 at 13 [Waddams, "Competing Perspectives"].
55. See S.M. Waddams, *The Law of Contracts*, 5th ed. (Toronto: Canada Law Book, 2005) at para. 1 [Waddams, *Law of Contracts*]; H.G. Beale *et al.*, eds., *Chitty on Contracts*, 39th ed., vol. 1 (London: Sweet & Maxwell, 2004) at para. 1-011.
56. See *Anson's Law of Contract*, *supra* note 52 at 1-2; Horwitz, *supra* note 33 at 946-47.
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imported from the law of real property and refashioning its rules to deal more directly with contemporary issues.<sup>57</sup>

There is obviously a tension between certain conceptions of freedom and sanctity of contract and review of contracts for their fairness. This tension is exacerbated by attempts to push one set of values to an extreme position of dominance over another. Taking such an approach to contractual fairness would risk undercutting the values of stability, predictability, and certainty, all of which continue to be of importance in the contemporary law of contracts.<sup>58</sup>

By the same token, it is now widely held<sup>59</sup> that nineteenth-century courts took freedom and sanctity of contract to an excess.<sup>60</sup> This resulted in both a coarsening of the law in certain places and, ironically, an undercutting of the values of certainty and predictability in others. The latter phenomenon was caused by courts finding creative ways to strike down blatantly unfair contracts or contract terms within a framework that denied the possibility of granting such relief. The true bases of such rulings were essentially disguised as being mundane matters of contractual interpretation, which had the effect of creating uncertainty around the actual scope and application of certain interpretative tools.<sup>61</sup>

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57. See *Cheshire, Fifoot and Furmston's Law of Contract*, *supra* note 51 at 13 (“In previous years lawyers, in so far as they troubled themselves at all, conceived of contract law primarily as an adjunct to property law. In the nineteenth century a powerful school of thought, originating in the work of Adam Smith, saw in the extension of voluntary social cooperation through contract law, and in particular through ‘freedom of contract,’ a principal road to social improvement and human happiness, and one distinct from the static conditions involved in the possession of private property.” [footnote omitted]).
58. See, e.g., *Chitty on Contracts*, *supra* note 55, vol. 1 at para. 1-012.
59. See, e.g., *Cheshire, Fifoot and Furmston's Law of Contract*, *supra* note 51 at 21; *Anson's Law of Contract*, *supra* note 52 at 7.
60. See, e.g., *Printing & Numerical Registering Co. v. Sampson* (1875), L.R. 19 Ez. 462 at 465 (Eng. C.A.), Jessel M.R. (“[I]f there is one thing more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of Justice.”).
61. See Karl N. Llewellyn, Book Review of *The Standardization of Commercial Contracts in English and Continental Law* by Otto Prausnitz, (1938) 52 Harv. L. Rev. 700 at 703 (arguing that “[c]overt tools are never reliable tools”); *Cheshire, Fifoot and Furmston's Law of Contract*, *supra* note 51 at 21 (demonstrating that “[e]ven in the middle years of the nineteenth century the ideal [promoted by freedom and sanctity of contract] was one to which few could attain”).
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Nevertheless, there remains to this day a hotly contested debate, conducted largely on abstract or theoretical grounds, over whether the supposed conflict between the values of certainty and fairness can be resolved by placing one set of values in the ascendancy and the other in a clearly subordinate position. The committee often took note of this debate in considering options for reform, as the debate has generated some useful insights. That said, the debate is squarely in the background in the discussion of proposed reforms in this consultation paper. This decision was taken primarily to ensure that the focus of this consultation paper is on practical reforms to contract law in British Columbia. All too often, the theoretical debate leads to calls for change that are more sweeping or radical than would be possible or desirable in practice. This concern has even been recognized in recent years at the theoretical level, where there is a trend toward acknowledging that the law requires striking a balance between the values of fairness and certainty, stability, and predictability.<sup>62</sup> This trend has resulted a greater awareness of the unity of contract law and the desirability of promoting all its underlying values.<sup>63</sup> In approaching the issues in this project, the committee has striven to reconcile these underlying values.

### D. Approaches to Contractual Unfairness

#### 1. UNFAIRNESS DEFINED

The word *unfair* is not a legal term of art. It is a word used in everyday speech, meaning “[n]ot equitable, unjust; not according to the rules. . . .”<sup>64</sup> *Unfair*, then, describes one of those “vaguer sanctions of conscience,”<sup>65</sup> which may shape and support the law, but which do not form the content of legal doctrine itself. As a consequence, there are many ways to approach the subject of how the law of contracts seeks to restrain unfairness. For example, a project on contractual unfairness could focus on

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62. See, e.g., *Anson’s Law of Contract*, *supra* note 52 at 7 (“[T]he Draconian requirements of commercial convenience have to be reconciled with the moral qualifications introduced by the need to discourage the grosser forms of unfair dealing.”).

63. See Peter Benson, “The Unity of Contract Law,” in Peter Benson, ed., *The Theory of Contract Law: New Essays* (Cambridge, UK: Cambridge University Press, 2001) 118 at 122 (“How can contract law be conceived as a coherent and integrated whole? This challenge lies at the heart of the third fundamental question of modern contract theory, namely, the relation between contractual liberty and contractual fairness.”), 200 (“[B]oth freedom of contract and contractual fairness turn out to be distinct but mutually supportive aspects of the complete analysis of the same underlying conception of contract.”).

64. *The New Shorter Oxford English Dictionary*, s.v. “unfair.”

65. Oliver Wendell Holmes, “The Path of the Law” (1897) 10 Harv. L. Rev. 457 at 459.

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- developing existing general contract-law concepts,
- regulating specific types of contracts,
- studying the needs of specific types of contracting parties, or
- restricting specific types of contract terms.

These approaches have been adopted in a number of previous law-reform projects, including work by the British Columbia Law Institute.

### 2. PREVIOUS BCLI PROJECTS TOUCHING ON CONTRACTUAL UNFAIRNESS

The British Columbia Law Institute and its division the Canadian Centre for Elder Law have, over the past few years, tackled projects that illustrate two of these approaches.

In a project on unfair contract terms, the BCLI examined how specific types of provisions found in contracts can lead to unfairness in the form of gross imbalances in the substantive exchange that underlies the contract. This project also explored the possibility of enacting legislation focussed on such terms, which would restrain the use of these terms or ban them outright. After a public consultation, it was determined that publication of an interim report not containing draft legislation was a more appropriate outcome for the project.<sup>66</sup>

In a subsequent project, the CCEL examined the phenomenon of predatory and abusive lending tactics, primarily in relation to mortgage financing for older adults. The focus of this project was on detailed regulatory models intended to address this discrete issue in relation to a specific type of contract. The goal of the project was not to formulate recommendations for reform, but rather to raise awareness about the current state of the law and potential options for reform.<sup>67</sup>

### 3. THIS PROJECT'S EMPHASIS ON THE GENERAL LAW OF CONTRACTS AND THE GENERAL CONTRACT-LAW CONCEPTS AT THE CORE OF THIS PROJECT

In contrast to these two earlier projects, this project focusses largely on the general principles of contract law. Most of the chapters that follow in this consultation paper

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66. See British Columbia Law Institute, *Unfair Contract Terms: An Interim Report* (BCLI Rep. no. 35) (Vancouver: The Institute, 2005).

67. See Canadian Centre for Elder Law, *Study Paper on Predatory Lending Issues in Canada* (CCEL Rep. no. 4; BCLI Study Paper no. 3) (Vancouver: The Centre, 2008).

are concerned with broad concepts that apply across a wide range of contracts.<sup>68</sup> The law of contracts has developed a number of these broad concepts to deal with the multifaceted problems created by unfairness. One of the first tasks taken on by the committee at an early committee meeting was to select which concepts would form the main concern of this project. The committee decided to direct its attention to the concepts of unconscionability, duress, undue influence, good faith, and misrepresentation.

These five concepts are each defined in more detail below, but it is worthwhile to give a short introduction to them here. Unconscionability, duress, undue influence, and misrepresentation all apply to activities that take place during the formation of a contract. Unconscionability is concerned with abuses of the bargaining process that result in dramatically one-sided contracts. Duress and undue influence both have to do with ensuring that a contracting party's consent to enter into a contract has been freely given. Whereas duress focusses on threats of physical violence or the damaging use of economic power, undue influence guards against the subtler use of pressure by a person in a position of trust with a contracting party. Misrepresentation is concerned with misstatements of fact in the bargaining leading up to a contract. Good faith, in contrast, typically arises in connection with a contract that creates a long-term relationship between the contracting parties without defining the standards of behaviour that are to apply over the course of that relationship. In addition to these five concepts, the consultation paper also examines special issues that have arisen in connection with a particular type of contract term, the exclusion clause.

#### 4. REASONS FOR SELECTING THESE CONTRACT-LAW CONCEPTS AS THE FOCUS FOR THE PROJECT

There is some flexibility in determining the number and type of legal concepts that may be included in a study of contractual unfairness. This project could have included different concepts or a wider range of concepts. For example, a leading English contract-law textbook discusses unconscionability, duress, undue influence, and misrepresentation under the heading “factors tending to defeat contractual liability,” and also includes the concepts of incapacity, mistake, and illegality.<sup>69</sup> Other topics

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68. See McCamus, *Law of Contracts*, *supra* note 13 at 6 (“In a study of the general law of contracts, however, the objective is to identify and analyze principles that apply across many of the sub-fields or specialized areas of contract law.”).

69. See *Anson's Law of Contract*, *supra* note 56.



could also conceivably be included, such as public policy, penalties, forfeiture, and promissory estoppel.<sup>70</sup>

The committee had three reasons for selecting the above-noted concepts as the focus of this project. First, these concepts best represent how legal doctrine contends with the broader idea of unfairness in contracting. Unconscionability is so closely connected with unfairness that it is occasionally taken as being synonymous with it.<sup>71</sup> Duress, undue influence, and misrepresentation each have a bearing on the free exercise of individual consent, which is a core idea both for the law of contracts and everyday notions of fairness. Good faith gives an important new dimension to this inquiry by directing attention to ongoing contractual relationships, as opposed to events occurring just in the period of formation of a contract. Finally, exclusion clauses have provided many challenges over the years to judicial review of contracts based on unfairness.

In addition to the individual characteristics of these concepts, collectively they are amenable to consideration in relation to one another in a way that can be managed within a project to be carried out over a limited time. The development of a number of these concepts has also led to some overlapping areas of coverage. These overlaps provide an opportunity to consider possibilities for integrating and rationalizing the law.

Finally, these concepts have generated a sizable body of jurisprudence and have been the subject of legislation<sup>72</sup> in other common-law jurisdictions.<sup>73</sup> This body of

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70. See *Black's Law Dictionary*, 9th ed., s.v. "estoppel" ("[Promissory estoppel is the] principle that a promise made without consideration may nevertheless be enforced to prevent injustice if the promisor should have reasonably expected the promisee to rely on the promise and if the promisee did actually rely on the promise to his or her detriment.").

71. See, e.g., Waddams, *Law of Contracts*, supra note 55 at paras. 539–40 (arguing for judicial recognition of a general ground of relief from unfair bargains uniting the disparate strands of relief currently found in the jurisprudence under the name *unconscionability*).

72. See, e.g., U.C.C. § 2-302; *Contracts Review Act 1980* (N.S.W.); *Trade Practices Act 1974* (Cth.), ss. 51AA–51AC.

73. Although the committee's focus throughout this project has been on common-law jurisdictions, it is worthy of brief notice here that many of the concepts considered in this consultation paper are also well established in civil-law jurisdictions as fundamental principles held in common in the legal systems that make up the civil-law world. For example, the UNIDROIT principles published by the International Institute for Unification of Private Law touch on many of these concepts. See Art. 1.7 UNIDROIT Principles 2004 (good faith and fair dealing); Art. 2.1.20 UNIDROIT Principles 2004 (surprising terms); Art. 3.10 UNIDROIT Principles 2004 (gross disparity). See also *Farnsworth on Contracts*, supra note 24, vol. 1 at § 1.8a (further discussion of UNIDROIT principles).

case law is ripe for rationalization in British Columbia, and the legislation in other jurisdictions provides models for reform for this province with a practical track record for evaluation.<sup>74</sup>

Additional models for reform come from previous law-reform projects in Ontario<sup>75</sup> and New Zealand,<sup>76</sup> both of which considered legislative reforms of the general principles of contract law. Finally, the committee was able to draw on the work of the American Law Institute,<sup>77</sup> which combines both descriptive and law-reform elements in a publication that states common-law rules in a form similar to legislation.<sup>78</sup>

### E. The Need for Legislation

The specific details of the committee's proposals for reform are addressed in the chapters that follow, but it is useful to begin with the general question of whether reform is needed. There are two aspects to this question.

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74. Since it is often useful to examine the drafting style and the details of legislation, excerpts from the British Columbia and international legislation given extended consideration in this consultation paper are provided in Appendix A. When the main body of this consultation paper considers legislation, it will largely restrict the discussion to shorter quotations from the relevant statute.
  75. See Ontario Law Reform Commission, *Report on Amendment of the Law of Contract* (Toronto: Ministry of the Attorney General, 1987). The Ontario Commission's project considered many of the issues for reform considered as part of this consultation paper, but it was much broader in scope, entertaining a number of issues that do not form part of this consultation paper.
  76. See New Zealand Law Commission, *"Unfair Contracts": A Discussion Paper* (NZLC PP11) (Wellington: The Commission, 1990). The final report for this project was much more limited in scope than the discussion paper that preceded it. Unlike the discussion paper, the report did not address in detail any of the contract-law concepts considered in this consultation paper. See New Zealand Law Commission, *Report on Contract Statutes Review* (NZLC R25) (Wellington: The Commission, 1993).
  77. See *Restatement (Second) of Contracts* (1981).
  78. See Geoffrey C. Hazard Jr., "The American Law Institute is Alive and Well" (1998) 26 Hofstra L. Rev. 661 at 662 ("A Restatement is a synthesis of the evolving law in a specific subject that is cast in the a form similar to legislative rules."). The Restatements do not have the force of law in any American state (though they do have this status in a few U.S. territories). See Herbert P. Wilkins, "Forward: Symposium on the American Law Institute: Process, Partisanship, and the Restatements of Law" (1998) 26 Hofstra L. Rev. 567 at 568 ("[T]he work of the Institute does not have the force of law, except in the Northern Mariana and Virgin Islands where Restatement law is embraced." [footnote omitted]). Nevertheless, the Restatements have proved to be very influential in the U.S. courts, almost to the point of being a source of law in their own right. The emphasis in the Restatements is on describing the law, but there is a law-reform element to them, as they take positions on which version of a legal rule should prevail in cases where the rule is uncertain, due to conflicting decisions from state courts or other reasons.

First, the question has a bearing on the basic issue of whether the law is performing satisfactorily or if a change is needed. In a sense, this issue is really addressed in the sections of this consultation paper dedicated to considering issues for reform, which also weigh the pros and cons of specific options to reform the law. But in considering these specific issues, some problems do appear over and over, which help to make the general case for reform:

- there is confusion over the scope of the various concepts relating to unfairness, making it difficult to predict when they will apply;
- the legal tests used to determine whether certain concepts are applicable in a given case are often complex;
- even when it is clear that a given concept does apply in a specific case, there is uncertainty over the content of the rules that should be brought to bear on that case; and
- there is often no clear sense of how concepts related to unfairness are supposed to work together, leading to overlaps and confusion.

These points lead into the second issue, which concerns the best method to use to address deficiencies in the law. There are two distinct choices: the legislature could intervene with a statute, or the law could continue to develop in the courts.

The historical approach has been to leave reform to the courts. “The general principles and the detailed rules,” that make up the law of contracts, “are derived from the reasons for decision given by judges in the adjudication of contract disputes.”<sup>79</sup> This approach continues to prevail in common-law Canada.<sup>80</sup> Although there are numerous examples of legislation addressing specific types of contracts or contract terms, legislation addressing the general principles of contract law remains rare in British Columbia.<sup>81</sup> In addition to historical consistency, another argument in favour of leaving reform of this area to the courts is that the courts are perceived to be better able to craft flexible solutions that can apply in a broad range of situations.<sup>82</sup>

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79. McCamus, *Law of Contracts*, *supra* note 13 at 8.

80. *See ibid.* (“In Canada, provincial legislators are possessed of a constitutional authority to enact legislation setting forth or amending the general principles of the law of contract. With very few exceptions, however, they have refrained from doing so.”).

81. *See, e.g., Frustrated Contract Act*, R.S.B.C. 1996, c. 166.

82. *See* McCamus, *Law of Contracts*, *supra* note 13 at 22.

The committee has considered these points and decided that, on balance, legislation is necessary to address the concerns identified in this project. The courts are well positioned to resolve individual disputes, and, under the committee's proposals, the courts would continue to play the lead role in the resolution of contracts cases. But the courts are not well positioned to deliver comprehensive reforms to longstanding legal rules. Court-generated reforms would have to be worked up case by case, as it is highly unlikely that a single case would present all the issues that are being taken up in this project. This process can result in uneven and piecemeal progress. Court proceedings lack many of the tools for modern policy development and cannot easily lay hold of some of them (such as comparative research and public consultation) because their foremost institutional role is the resolution of disputes between litigants. All of these points make court-based reform one of the slowest, costliest, and most uncertain avenues to achieving law reform.<sup>83</sup>

Further, the Supreme Court of Canada, in a recent decision<sup>84</sup> that reviewed "the principles which govern judicial reform of the common law,"<sup>85</sup> has articulated a rather modest and restrictive position on when the courts should intervene to reform the law.<sup>86</sup> The court expressed a preference for retaining even archaic rules, to avoid the perception that the court's judgment had a broader basis than the limited issue at play between the litigants.<sup>87</sup> Such views from the top court in Canada serve

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83. See *Report on Amendment of the Law of Contract*, *supra* note 75 at 2–3 ("[T]here are important branches of contract law where the rules have ceased to keep pace with changing needs and perceptions and where remedial legislation is a more certain cure than the unpredictable and uneven path of judicial self-correction."). See also McCamus, *Law of Contracts*, *ibid.* at 18–19 ("[T]he fact that judicial responsibilities are being discharged by unelected judges in adjudicative processes that are not well suited to public policy formulation is likely to lead courts to be somewhat circumspect in exercising their undoubted capacity to reformulate and modify prior doctrine." [footnote omitted]).

84. *Friedmann Equity Developments Inc. v. Final Note Ltd.*, 2000 SCC 34, [2000] 1 S.C.R. 842 [cited to S.C.R.].

85. *Ibid.* at para. 42, Bastarache J. (for the court).

86. *Ibid.*, Bastarache J. ("A change in the common law must be necessary to keep the common law in step with the evolution of society, to clarify a legal principle, or to resolve an inconsistency. In addition, the change should be incremental, and its consequences must be capable of assessment." [citations omitted]).

87. *Ibid.* at para. 48, Bastarache J. ("In my view, to abolish one of the rules within this system because there no longer appears to be a rationale for it would necessarily call into question the validity of the other rules. For example, were this Court to abolish the rule that only the parties to a sealed contract can sue or be sued on such a contract, on the ground that it does not appear to have a rationale, the enforceability of a sealed contract without consideration could certainly be questioned for the same reason. The abolition of the sealed contract rule would thus amount to a fundamental reform of the common law rather than an incremental change.").

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to underscore the committee's judgment that the types of reforms needed to improve how contract law deals with unfairness are best delivered by the legislature.

The committee tentatively recommends that:

- 1. British Columbia should enact a Contract Fairness Act.*



## CHAPTER III. UNCONSCIONABILITY

### A. Historical Development

#### 1. MEANING OF UNCONSCIONABILITY

In everyday speech, *unconscionable* can be defined as “[s]howing no regard for conscience; not in accord with what is right or reasonable.”<sup>88</sup> Formulating a concise, abstract definition of the legal concept of unconscionability has proved more elusive. Most commentators instead take a functional approach to discussing unconscionability, illustrating aspects of the concept by tracking its development in the courts. This approach involves tracing unconscionability back to its origins and noting how it has changed over the years from a fairly limited concept to a much more broadly based one.

#### 2. EARLY HISTORY IN ENGLISH LAW

As noted earlier in this consultation paper, the jurisdiction to strike down a contract as being unconscionable (or otherwise unfair) extends back to the very origin of the modern law of contracts in the law of England.<sup>89</sup> Unconscionability derives from equity, as opposed to the common law.<sup>90</sup> These seventeenth-, eighteenth-, and nineteenth-century English cases mainly turn on their facts and a particular judge’s sense of conscience. Relief was tied to a large degree to belonging to certain groups of people, such as sailors or expectant heirs.<sup>91</sup> To the extent that these cases cohere into any sort of legal principle, that principle is articulated in this passage from a leading old English case:

I am called upon for principles upon which I decide this case; but where there are many members of a case, it is not always easy to lay down a principle upon which to rely. However, here, I say, the party was taken by *surprise*; he had not sufficient time to act with caution; and therefore though there was no actual fraud, it is something like fraud, for an undue advantage was taken of his situation. The cases of infants dealing with guardians, of sons with fathers, all proceed on the same general principle, and establish this, that if the party is in a situation, in which he is not a *free agent*, and is not *equal to protecting himself*, this Court will protect him. I do not know that the Court has drawn any line in this case, or said thus far we will go and no further; it is sufficient for me to

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88. *The New Shorter Oxford English Dictionary*, s.v. “unconscionable.”

89. *See*, above, at 9–10 (section II.C.2) (for more detail on the history of contract law).

90. *See*, above, at 10–12 (section II.C.3) (for more detail on the distinction between common law and equity).

91. *See* Arthur Allen Leff, “Unconscionability and the Code—The Emperor’s New Clause” (1967) 115 U. Pa. L. Rev. 485 at 528–41 (reviewing English and American equity cases).

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see that the party had not the protection that he ought to have had, and therefore the Court will harrow up the agreement.<sup>92</sup>

### 3. EQUITABLE FRAUD AND DISADVANTAGE

This quotation no longer represents an accurate description of the law,<sup>93</sup> but it does contain ideas that continue to be relevant for unconscionability today. First, the court distinguishes between “actual fraud” and “something like fraud.” Actual fraud, in this context, is common-law fraud, which is proved by showing that the defendant knowingly (with subjective intent) or recklessly tried to deceive the plaintiff.<sup>94</sup> “Something like fraud” is equitable or constructive fraud, which is not limited in scope to cases involving subjective intent to deceive or recklessness as to the truth of an assertion. Equitable fraud extends to cases in which a person’s conduct in making an assertion or carrying out an act falls below an objective standard of conduct. It been described by a leading recent case in the following terms:

“Fraud” in its equitable context does not mean, or is not confined to, deceit; “it means an unconscientious use of the power arising out of the circumstances and conditions of the contracting parties.” It is victimization, which can consist either of the active extortion of a benefit or the passive acceptance of a benefit in unconscionable circumstances.<sup>95</sup>

This is the standard of conduct that has to be met in unconscionability cases. It falls somewhere between the common-law fraud standard and the standard required in fiduciary relationships (where the stronger party is required to act in the best interests of the weaker). A contract may be set aside as unconscionable even if the defendant is able to show that it was only pursuing its own self-interest.

Second, the equitable court will only intervene in cases in which the plaintiff is under some sort of disadvantage (“he is not equal to protecting himself”). Defining the relevant types of disadvantage that will engage unconscionability is a difficult task, which has vexed the courts to the present day.

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92. *Evans v. Llewellyn* (1787), 1 Cox 334, 29 E.R. 1191 at 1194 (Ch.), Sir Lloyd Kenyon M.R. [emphasis in original].

93. The emphasis on surprise, lack of agency, and categories based on the type of litigant no longer form part of the law of unconscionability.

94. *See Derry v. Peek*, [1889] UKHL 1, 14 App. Cas. 337 at 374, Lord Herschell [*Derry* cited to App. Cas.].

95. *Hart v. O'Connor*, [1985] UKPC 1, [1985] 1 A.C. 1000 at 1024 [*Hart* cited to A.C.], Lord Brightman (quoting *Earl of Aylesford v. Morris* (1873), L.R. 8 Ch. App. 484 at 490).

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### 4. UNCONSCIONABILITY IN CANADA: THE MORRISON CASE

The Canadian courts inherited this jurisdiction from their English predecessors and, from an early date, started to develop unconscionability into a broader concept than was applied in England. An important early Ontario case dates from 1884.<sup>96</sup> In British Columbia, the seminal case of *Morrison v. Coast Finance Ltd.*<sup>97</sup> was decided in 1965. In *Morrison*, “an old woman 79 years of age, and a widow of meagre means”<sup>98</sup> was talked into mortgaging her home and turning over the proceeds of the loan to a boarder and his associate. These two men quickly defaulted on repaying the loan, and, as the plaintiff had no means to make the monthly payments, the finance company threatened to foreclose on the mortgage. She commenced an action to set the mortgage aside, which failed at trial.

On appeal, the Court of Appeal found that the trial judge focussed too narrowly on the related but distinct concept of undue influence<sup>99</sup> and allowed the plaintiff’s appeal. In coming to this conclusion, Davey J.A. articulated the leading British Columbia statement of principle on unconscionability:

The equitable principles relating to undue influence and relief against unconscionable bargains are closely related, but the doctrines are separate and distinct. . . . A plea of undue influence attacks the sufficiency of consent; a plea that a bargain is unconscionable invokes relief against an unfair advantage gained by an unconscientious use of power by a stronger party against a weaker. On such a claim the material ingredients are proof of inequality in the position of the parties arising out of the ignorance, need or distress of the weaker, which left him in the power of the stronger, and proof of substantial unfairness in the bargain obtained by the stronger. On proof of these circumstances, it creates a presumption of fraud which the stronger must repel by proving that the bargain was fair, just and reasonable or perhaps by showing that no advantage was taken.<sup>100</sup>

This passage spells out a step-by-step approach to unconscionability with the following elements:

- (1) the plaintiff shows that there is an inequality of bargaining power between the contracting parties;
- (2) that inequality is due to the ignorance, need, or distress of the weaker party (*i.e.*, the plaintiff);

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96. *Waters v. Donnelly* (1884), 9 O.R. 391 (Ch. Div.), *aff’d* (1884) 9 O.R. 400 (Div. Ct.).

97. (1965), 55 D.L.R. (2d) 710, 54 W.W.R. 257 (B.C.C.A.) [*Morrison* cited to D.L.R.].

98. *Ibid.* at 712.

99. *See*, below, at 77–98 (chapter V) (for consideration of undue influence).

100. *Supra* note 97 at 713 [citations omitted].

- (3) the plaintiff in some way abused<sup>101</sup> as a result of that inequality (that is, the plaintiff was “left in the power of” the defendant);
- (4) the contract that resulted from this abuse of the plaintiff’s weakness displays “substantial unfairness”—that is, the contract as a whole or a term of it substantively unconscionable, or extremely one-sided, harsh, or oppressive;
- (5) if the plaintiff proves elements (1) to (4), then the burden of proof shifts to the defendant to “prove that the bargain was fair, just, and reasonable” or “that no advantage was taken.”<sup>102</sup>

The other noteworthy quality of this passage from *Morrison* is that it takes the older notions of unconscionability’s role within the law of contracts and expands them into a much broader-based principle of relief.<sup>103</sup>

## 5. INEQUALITY OF BARGAINING POWER: THE BUNDY CASE

The next important development for unconscionability in Canada actually occurred in an English case: Lord Denning’s 1974 judgment in *Lloyds Bank Ltd. v. Bundy*.<sup>104</sup> This judgment is primarily significant for its attempt to unite various strands of the jurisprudence under one flexible standard, a topic that will be considered later in this consultation paper.<sup>105</sup> Lord Denning called this standard “inequality of bargaining power,” but it bears a family resemblance to the Canadian conception of unconscionability. Although Lord Denning’s approach did not find favour in the United Kingdom,<sup>106</sup> it has, along with similar ideas from academic commentary,<sup>107</sup> been influential on Canadian law. This influence has had less to do with its main thrust of unifying the diverse strands of jurisprudence relating to contractual unfairness and more to do with expanding the boundaries of one approach to unfairness, unconscionability.

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101. This element is the equitable fraud limb of the test.

102. *Morrison*, *supra* note 97 at 713, Davey J.A.

103. *See* Crawford, *supra* note 29 at 146.

104. [1974] EWCA Civ 8, [1975] Q.B. 326 [*Bundy* cited to Q.B.].

105. *See*, below, at 99–109 (chapter VI).

106. *See National Westminster Bank PLC v. Morgan*, [1985] UKHL 2, [1985] 1 A.C. 686 at 708 [*Morgan* cited to A.C.], Lord Scarman (“And even in the field of contract I question whether there is any need in the modern law to erect a general principle of relief against inequality of bargaining power.”).

107. *See* S.M. Waddams, “Unconscionability in Contracts” (1976) 39 Mod. L. Rev. 369 [Waddams, “Unconscionability in Contracts”].

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6. STANDARDS OF COMMERCIAL REASONABLENESS: THE HARRY CASE

The leading Canadian expression of this broader, general approach to unconscionability in British Columbia law is Lambert J.A.'s decision in *Harry v. Kreutziger*.<sup>108</sup> In *Harry*, the plaintiff, who was described as “a mild, inarticulate, retiring person . . . not widely experienced in business matters,”<sup>109</sup> sold his fishing boat and commercial fishing licence to the defendant at a significantly undervalued price. On appeal before a three-judge panel, one judge decided this case in favour of the plaintiff by restating and applying the principles set out in Davey J.A.'s judgment in *Morrison*.<sup>110</sup> Another judge, Lambert J.A., reached the same result, but he articulated an alternative test for unconscionability:

In my opinion, questions as to whether use of power was unconscionable, an advantage was unfair or very unfair, a consideration was grossly inadequate, or bargaining power was grievously impaired . . . are really aspects of one single question. That single question is whether the transaction, seen as a whole, is sufficiently divergent from community standards of commercial morality that it should be rescinded. To my mind, the framing of the question in that way prevents the real issue from being obscured by an isolated consideration of a number of separate questions. . . .<sup>111</sup>

The third judge on the panel agreed with both positions.<sup>112</sup>

On their face, Lambert J.A.'s comments are a significant departure from the step-by-step approach to unconscionability set out in *Morrison*. Lambert J.A.'s approach in *Harry* recommends merging the steps in *Morrison* into a single question about deviance from community standards of commercial morality. This is a very broad, flexible approach to unconscionability.

Subsequent British Columbia cases have tended to cite the *Morrison* test more often than the *Harry* test. On occasion, Lambert J.A.'s approach has been criticized.<sup>113</sup> But,

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108. (1978), 95 D.L.R. (3d) 231, 3 B.C.L.R. 348 (C.A.) [*Harry* cited to D.L.R.].

109. *Ibid.* at 231–32, McIntyre J.A.

110. *See ibid.* at 237, McIntyre J.A. (“Where a claim is made that a bargain is unconscionable, it must be shown for success that there was inequality in the position of the parties due to the ignorance, need or distress of the weaker, which would leave him in the power of the stronger, coupled with proof of substantial unfairness in the bargain. When this has been shown a presumption of fraud is raised and the stronger must show, in order to preserve his bargain, that it was fair and reasonable.”).

111. *Ibid.* at 241.

112. *See ibid.* at 239, Craig J.A.

even though on paper *Morrison* and *Harry* represent two quite different ways of dealing with unconscionability, in practice many cases have tried to apply both approaches and it is clear that both remain part of the law of British Columbia to this day.<sup>114</sup>

### B. Recent Developments

#### 1. INTRODUCTION

After the major statements of principle in *Morrison* and *Harry*, the case law in British Columbia has tended to concern itself with aspects of applying the tests set out in those cases.<sup>115</sup> There are two important developments to note from the period since the decision in *Harry*. They are the enactment of provisions dealing with unconscionability in consumer-protection legislation and the expansion of unconscionability to cover commercial contracts.

#### 2. CONSUMER-PROTECTION LEGISLATION

Since the enactment of the *Trade Practices Act*<sup>116</sup> in 1974, consumer-protection legislation in British Columbia has had a statutory version of unconscionability. In 2004, the *Business Practices and Consumer Protection Act*<sup>117</sup> was enacted. Most of this act was simply a consolidation of the previously existing consumer-protection legislation in this province, but one of the areas where new ground was struck was unconscionability. Notably, this act shifts the burden of proof: the defendant has to disprove an allegation of unconscionability.<sup>118</sup> In addition, in certain cases, the act expands the range of remedies available to the court beyond rescission of the contract.<sup>119</sup> As in previous versions of the legislation, the *Business Practices and Consumer Protection Act* also relaxes evidentiary rules to allow a court to consider the

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113. See *Gindis v. Brisbane*, 2000 BCCA 73, 72 B.C.L.R. (3d) 19 at para. 26 [*Gindis* cited to B.C.L.R.], Newbury J.A.

114. See *ibid.* at paras. 42–44, Prowse J.A. (Saunders J.A., concurring) (affirming the test in *Harry*). See also, e.g., *Rockwell v. Fay*, 2009 BCSC 935, 1 B.C.L.R. (5th) 161 at paras. 125–26, Verhoeven J. (example of a recent case applying both tests).

115. See, e.g., *Blackman v. Fedex Trade Networks Transport & Brokerage (Canada), Inc.*, 2009 BCSC 201, 57 B.L.R. (4th) 270 at paras. 81–105; *Fountain v. Katona*, 2007 BCSC 411, 158 A.C.W.S. (3d) 909.

116. S.B.C. 1974, c. 96 [now repealed].

117. S.B.C. 2004, c. 2. See, below, Appendix A at 199–206 (for excerpts from the act).

118. *Ibid.*, s. 9 (2).

119. *Ibid.*, s. 10.

circumstances surrounding a contract<sup>120</sup> and expands the timing element of the inquiry to include events that take place after a contract has been signed.<sup>121</sup>

On paper, these changes should add up to a more liberal application of unconscionability to consumer transactions. It is still too early to know whether this will actually come to pass, but there are some mixed early indications.<sup>122</sup> It is important to note that this legislation does not apply to all contracts. It only applies to those contracts that are consumer transactions, which the act defines primarily as “a supply of goods or services or real property by a supplier to a consumer for purposes that are primarily personal, family or household.”<sup>123</sup>

### 3. UNCONSCIONABILITY AND COMMERCIAL CONTRACTS

There has been a gradual expansion of the range of contracts that may be subject to being set aside as unconscionable. This was not an obvious development, as unconscionability’s origins are in cases involving a rather narrow range of individuals. Nevertheless, there now exists a number of Canadian appellate decisions that consider or apply unconscionability to purely commercial agreements. British Columbia could be seen as a leader in this development as *Harry* was, after a fashion, a commercial case. But the landmark judgment in this area is Dickson C.J.’s decision in the 1989 Supreme Court of Canada decision in *Hunter Engineering Co. v. Syncrude Canada Ltd.*<sup>124</sup> This judgment is somewhat flawed for the purposes of this discussion,<sup>125</sup> but it does clearly illustrate that the chief justice was willing to apply unconscionability to a commercial agreement involving two large, sophisticated corporate parties. A number of courts of appeal in other provinces have found commercial con-

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120. *Ibid.*, s. 8 (2), (3).

121. *Ibid.*, s. 8 (1).

122. See, e.g., *Murray v. Affordable Homes Inc.*, 2007 BCSC 1428, 61 R.P.R. (4th) 304 [*Murray* cited to R.P.R.] (relying on act for remedial flexibility; avoiding discussion of shifting burden of proof).

123. *Business Practices and Consumer Protection Act*, *supra* note 117, s. 1 (1).

124. [1989] 1 S.C.R. 426, 57 D.L.R. (4th) 321 [*Hunter Engineering* cited to S.C.R.]. See also *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*, 2010 SCC 4, [2010] 1 S.C.R. 69 at para. 122, Binnie J. (dissenting) [*Tercon Contractors* cited to S.C.R.] (affirming *Hunter Engineering* on the application of unconscionability to contracts generally). *Tercon Contractors* is considered in more detail in the discussion of special legislative provisions for exclusion clauses. See, below, at 184–86 (section IX.A.7).

125. For the following reasons: (1) the discussion of unconscionability was incidental to the decision and not very well developed; (2) only two judges (out of a bench of five) concurred in Dickson C.J.’s judgment, and two other judges were critical of Dickson C.J.’s approach; and (3) after a cursory examination, Dickson C.J. concluded that the agreement at issue was not unconscionable.

tracts to be unconscionable<sup>126</sup> or have considered the concept as generally applicable to commercial contracts, even though the specific contract at issue was not unconscionable.<sup>127</sup>

This expansion of the scope of unconscionability has attracted academic criticism.<sup>128</sup> The rationale for this criticism is that unconscionability is too uncertain a concept to import into commercial dealings. Nevertheless, it is clear that under the jurisprudence in Canada unconscionability is no longer considered a limited concept that only applies to certain contracts involving a narrow set of protected contracting parties, but is rather a general concept that applies across the whole range of contracts.

### C. Issues for Reform

The issues raised by this discussion of the history and current state of the law on unconscionability divide into three types. First, there is the basic issue of whether unconscionability should form part of the *Contract Fairness Act*. Second, in view of the differing statements in the jurisprudence on the elements of unconscionability, there are a series of issues related to the design of legislation dealing with unconscionability. Third, there are issues related to the proposed legislation's scope.

#### 1. SHOULD THE CONTRACT FAIRNESS ACT ADDRESS UNCONSCIONABILITY?

Apart from the *Business Practices and Consumer Protection Act*, which only applies to consumer transactions, British Columbia does not have legislation dealing with unconscionability. This means that development of unconscionability is left to the courts. There has been a considerable amount of academic comment on court-developed unconscionability. Much of this commentary is pitched at the level of values. Supporters of unconscionability tend to praise its flexibility, its moral fairness, and its forthrightness in setting out the real basis of a decision rather than resorting to technical or fictional reasoning. Opponents of unconscionability tend to emphasize freedom and certainty in contracting relations.

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126. See *Plas-Tex Canada Ltd. v. Dow Chemical of Canada Ltd.*, 2004 ABCA 309, 245 D.L.R. (4th) 650 [*Plas-Tex Canada* cited to D.L.R.] (attempt to rely on exclusion clause in the face of an implied warranty as to the merchantable quality and fitness for purpose of a supply of resin unconscionable); *Atlas Supply Co. of Canada Ltd. v. Yarmouth Equipment Ltd.* (1991), 103 N.S.R. (2d) 1, 37 C.P.R. (3d) 38 (C.A.) (exclusion clause in franchise agreement unconscionable).

127. See *Selkirk Petroleum Products Ltd. v. Husky Oil Ltd.*, 2008 MBCA 87, 295 D.L.R. (4th) 146; *Fraser Jewellers (1982) Ltd. v. Dominion Electric Protection Co.* (1997), 34 O.R. (3d) 1, 148 D.L.R. (4th) 496 (C.A.).

128. See Vern W. DaRe, "Atlas Unchartered: When Unconscionability 'Says It All' " (1996) 27 Can. Bus. L.J. 426 at 456-57 ("The court's implicit invitation in *Atlas Supply* to other courts . . . to resort more often in the future to unconscionability in commercial contracts, should be rejected.").

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It is worthwhile to pay some heed to this broader debate, as the points made in it can play a helpful role in shaping a legislative response to unconscionability. But this debate is also somewhat off topic for a discussion of legislating unconscionability. Since the concept already exists in the jurisprudence, it does not need legislation to establish it. On the other side, no critics of unconscionability have called for legislation to prevent the courts from employing this concept in deciding cases. So, the real issue underlying this topic is whether there is anything in the current state of the law that calls for the intervention of the legislature with respect to unconscionability.

The Ontario Law Reform Commission, in considering the same question, listed the following three reasons for recommending legislation on this subject:

- “the doctrine has not yet been clearly recognized by the Supreme Court of Canada, nor has it yet been uniformly applied by the lower courts”;<sup>129</sup>
- legislation could deal comprehensively with issues such as the remedies available for unconscionability;<sup>130</sup>
- “[s]tatutory recognition of a generalized doctrine of unconscionability would fill in the gaps in legislative intervention, and enable judges to direct their minds to the truly relevant criteria for decisions.”<sup>131</sup>

These points continue to carry some force in today’s British Columbia. The Supreme Court of Canada has only dealt with unconscionability in a collateral way, and it has so far refused to grant leave to appeal to cases that deal with the topic directly. There remain unresolved issues in British Columbia, both at the general level (*e.g.*, which test of unconscionability should apply?) and at the level of detail. Institutionally, it is difficult for the courts to formulate comprehensive reforms in areas such as remedies. By definition, the courts have to resolve these issues case by case. Existing British Columbia legislation on this topic is aimed at specific groups or types of contracts, which creates gaps in coverage.

There are potential disadvantages to adopting an unconscionability provision in the *Contract Fairness Act*. Legislation could freeze development of the law at an unsatisfactory stage. Conversely, legislation could also raise the profile of unconscionability and result in an increase in unmeritorious litigation. But in the committee’s view,

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129. *Report on Amendment of the Law of Contract*, *supra* note 75 at 127.

130. *See ibid.*

131. *Ibid.*

these potential disadvantages are outweighed by potential gains in terms of clarity and accessibility of the law.

The committee tentatively recommends that:

2. *The Contract Fairness Act should contain an unconscionability provision.*

### 2. WHAT BASIC ELEMENTS SHOULD A LEGISLATIVE TEST OF UNCONSCIONABILITY CONTAIN?

Proposing the creation of legislation dealing with unconscionability immediately raises the issue of the content of that legislation. There are a number of options for addressing this issue.

One approach that is used in other jurisdictions is to refer, either implicitly or explicitly, to the jurisprudence in the courts.<sup>132</sup> This option likely would not be the best fit for British Columbia because there are two distinct approaches in this province's jurisprudence which are, at least conceptually if not practically, very different. Further, the two approaches mirror in some respects a debate in the commentary about unconscionability. So the *Contract Fairness Act* has to be more explicit than legislation in other jurisdictions or it will create the potential to sow confusion.

As noted, the leading judgments in *Morrison* and *Harry* can be seen to represent the two poles of judicial and academic conceptions of unconscionability. Each approach has attracted supporters and detractors. For example, one justice of the British Columbia Court of Appeal has said that the *Harry* approach has shortcomings when it is compared with the *Morrison* approach:

[U]nfortunately, [*Harry*] appears to have grown in stature into an assumed separate, stand alone test of universal application. Undesirable considerations of a morally subjective nature have thereby been introduced into what had previously been a purely fact-finding exercise to ascertain whether that *Morrison v. Coast Finance* tests had been met.<sup>133</sup>

On the other hand, an English judge has issued a “warning” against the dangers of an easy reliance on the steps of an overly defined approach to the issues:

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132. See *Trade Practices Act 1974* (Cth.), s. 51AA; UCC § 2-302. See, below, Appendix A at 208–13 (for excerpts from this legislation).

133. *Smyth v. Szep*, [1992] 2 W.W.R. 673, 63 B.C.L.R. (2d) 52 at para. 73 (C.A.) [*Smyth* cited to B.C.L.R.], Gibbs J.A. (dissenting).



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A court in the exercise of this equitable jurisdiction is a court of conscience. Definition is a poor instrument when used to determine whether a transaction is or is not unconscionable: this is a question which depends upon the particular facts of the case.<sup>134</sup>

In stark terms, one approach favours certainty and ease of administration, while the other favours expansiveness and flexibility. These approaches generate two options for reform, based on the leading judgments in each case. The committee also considered a third option, which would involve combining the elements set out in *Morrison* and *Harry* into a single statutory approach to unconscionability.

Two law-reform agencies have examined this issue, and they came down somewhere between the *Morrison* and *Harry* approaches. The Ontario Law Reform Commission is closer to the *Harry* approach in recommending enacting a general unconscionability provision that would not distinguish between procedural and substantive unconscionability and would provide the courts with a non-exclusive list of factors to consider in deciding cases under the provision.<sup>135</sup> The New Zealand Law Commission proposed enacting a general test of unfairness that contained a number of factors, which leans closer to the *Morrison* approach.<sup>136</sup>

The advantages of adopting the *Morrison* approach as the core of a provision on uncertainty are twofold. First, it represents a clearer approach to the law. Second, it also represents the dominant strain in British Columbia jurisprudence and the approach that prevails in the rest of common-law Canada. The disadvantage is that this approach could prove to be unduly restrictive and inflexible. Flexibility is the main advantage of an approach based on *Harry*. The drawbacks of such an approach are its rather open-ended nature and the fact that adopting it in British Columbia would set this province's law on unconscionability at odds, somewhat, with the law in the rest of common-law Canada. A compromise position, based on combining the main elements of *Morrison* and *Harry*, has the potential to retain a high degree of flexibility within some structure, but it could also create confusion and uncertainty.

The committee favoured using the core of *Morrison's* step-by-step approach in its legislative provision on unconscionability. This would capture the key elements of unconscionability and help to clarify the law.

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134. *Morgan*, *supra* note 106 at 709, Lord Scarman. Lord Scarman actually made this remark after rejecting Lord Denning's broad and general concept of inequality of bargaining power in *Bundy*, *supra* note 104. Note that *Morgan* is largely concerned with the related contractual concept of undue influence, but this comment (which refers to unconscionability by name) is readily applicable to unconscionability.

135. *Report on Amendment of the Law of Contract*, *supra* note 75 at 136–37.

136. "Unfair Contracts": *A Discussion Paper*, *supra* note 76 at 33–39.

The committee tentatively recommends that:

*3. The Contract Fairness Act should require both an inequality between the parties and substantive unfairness as elements of a test of unconscionability.*

### 3. SHOULD A PERSON BE ABLE TO OBTAIN RELIEF FOR SUBSTANTIVE UNCONSCIONABILITY ALONE?

The committee's tentative recommendation for the previous issue implicitly resolves a debate in the jurisprudence and academic commentary over whether relief should be available in cases involving substantive unconscionability alone. Since this topic has on its own created a good deal of comment, it will be highlighted as separate issue and discussed expressly on its own merits. This will make explicit the committee's tentative position on a contentious matter and allow for public comment on it.

The debate on this issue turns on the question of whether extreme one-sidedness in the terms of a contract is ever enough, in and of itself, to justify a court's refusal to enforce the contract. On one view it is not, because some blameworthy conduct in the bargaining process is necessary before a contract can be characterized as unconscionable. The other view is that the courts should be able to set aside an unfair contract, even if it was arrived at without one contracting party exploiting the weakness of another.

This debate is often carried on with reference to the terms *procedural unconscionability* and *substantive unconscionability*. This distinction between procedural and substantive unconscionability goes back to early academic commentary on section 2-302 of the American Uniform Commercial Code.<sup>137</sup> This distinction was adopted in Commonwealth jurisprudence in the Privy Council's decision in *Hart*, using slightly different terminology:

If a contract is stigmatised as "unfair," it may be unfair in one of two ways. It may be unfair by reason of the unfair manner in which it was brought into existence; a contract induced by undue influence is unfair in this sense. It will be convenient to call this "procedural unfairness." It may also, in some contexts, be described (accurately or inaccurately)

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137. See Leff, *supra* note 91 at 487 (distinguishing between "bargaining naughtiness" and "evils in the resulting contract"). See also *Report on Amendment of the Law of Contract*, *supra* note 75 at 128 ("Procedural unconscionability would appear to refer to unconscionability in the process of making the contract. Substantive unconscionability would seem to refer to an unacceptable one-sidedness in the terms of the contract."). See, below, Appendix A at 208 (for the text of section 2-302).

rately) as “unfair” by reason of the fact that the terms of the contract are more favourable to one party than to the other. In order to distinguish this “unfairness” from procedural unfairness, it will be convenient to call it “contractual imbalance.”<sup>138</sup>

The common approach in current British Columbia law is to require both procedural and substantive unconscionability to be present in order for a court to make a finding of unconscionability. This is the clear implication of the step-by-step test in *Morrison*. But it should be possible under the single-question test from *Harry* to obtain a remedy for substantive unconscionability alone.

It is rare today for a court to rule that a contract is unconscionable for substantive reasons alone. The mere idea that it would be allowed under a broad theory of unconscionability has been strongly criticized by a number of academic commentators. The Ontario Law Reform Commission gave a good summary of the reasons underlying this criticism:

We recognize that it may be argued that to allow an attack on the basis of substantive unconscionability alone is to negate the concept of freedom of contract. It may be further argued that certain avenues of inquiry should be closed to the courts because the issues may be too complex, or inappropriate for handling by regular adjudicative methods.<sup>139</sup>

It could also be argued that, in the absence of some sort of disadvantage, the parties to a contract should be able to protect their own interests. In addition, contract terms that look one-sided in isolation can be the result of bargaining and compromises over other terms, particularly over the price of some good or service. Allowing a court to rule that the term is unconscionable would inject that court too deeply in the bargaining process. A subsidiary concern is that there may be another contract doctrine that covers at least part of this area—striking down contracts or contract terms for public-policy reasons, for instance.

Nevertheless, some people have said that the law should allow for remedies to be granted in the face of substantive unconscionability alone. Notably, the Ontario Law Reform Commission recommended that no legislative distinction be drawn between procedural and substantive unconscionability, which is effectively the same as expressly allowing courts to grant a remedy in cases of substantive unconscionability alone. The rationale underlying this recommendation was that it would give the courts the flexibility “to consider all aspects of the bargain.”<sup>140</sup>

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138. *Supra* note 95 at 1017–18, Lord Brightman.

139. *Report on Amendment of the Law of Contract*, *supra* note 75 at 128.

140. *Ibid.*

In the committee's view, procedural unconscionability should remain an integral part of any legislative test of unconscionability. Removing it from the picture would create the risk that courts would be asked to second-guess contracting parties and provide relief for cases that merely amount to bad deals. This position rules out allowing remedies for cases of substantive unconscionability alone.

The committee tentatively recommends that:

*4. The Contract Fairness Act should not permit a remedy for cases of substantive unconscionability alone.*

#### 4. SHOULD RELIEF BE AVAILABLE AGAINST A CONTRACTING PARTY WHO WAS UNAWARE OF THE OTHER PARTY'S DISADVANTAGE?

This issue is closely related to the preceding issue. It addresses the constructive-fraud element in the *Morrison* test. In effect, it is asking whether there should be a mental element in unconscionability cases. This question has not come up in any of the leading British Columbia cases, but it was the subject of a leading case from New Zealand.<sup>141</sup> At issue in *Hart* was a land transaction. The seller lacked the mental capacity to enter into a contract. The court found that the purchaser was unaware of this fact. The seller's heirs commenced an action to have the agreement set aside as an unconscionable transaction. This argument was successful in the New Zealand Court of Appeal, but that decision was reversed on appeal to the Privy Council. In the Privy Council's view, the jurisprudence would not permit a finding of unconscionability in the absence of some mental element:

Their Lordships have not been referred to any authority that a court of equity would restrain a suit at law where there was no victimisation, no taking advantage of another's weakness, and the sole allegation was contractual imbalance with no undertones of constructive fraud.<sup>142</sup>

The New Zealand Law Commission has incorporated this mental element in its draft legislation relating to unfair contracts by qualifying the list of factors set out in their draft statute with the following language: "and that the other party *knows or ought to know* of the facts constituting that disadvantage, or of facts from which that disadvantage can *reasonably be inferred*."<sup>143</sup> The italicized passages make clear that this

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141. *Hart*, *supra* note 95.

142. *Ibid.* at 1024, Lord Brightman.

143. "Unfair Contracts": *A Discussion Paper*, *supra* note 76 at 33 [emphasis added].

proposed test is objective rather than subjective. Unlike the test for common-law fraud, which requires proving that the defendant had actual knowledge of the facts that form the basis of the fraud, this test only requires proving that a reasonable person, in the position of the defendant, would have known of the plaintiff's disadvantage or reasonably could have inferred it. Similar provisions are found in Australia's *Trade Practices Act*<sup>144</sup> and in New South Wales's *Contracts Review Act*.<sup>145</sup>

An argument could be made that this type of requirement fits well with a conception of unconscionability that is limited to protecting vulnerable people by providing remedies in cases of exploitation. It is not as good a fit with broader unconscionability provisions. For example, the Ontario Law Reform Commission does not recommend such a requirement. It is also not found in the American Uniform Commercial Code.

In the committee's view, knowledge is a necessary element of unconscionability. Almost by definition, a person must have knowledge that he or she is committing an unconscionable act, or it is difficult to impossible to characterize that act as unconscionable. But, it should be emphasized the including a knowledge element in the *Contract Fairness Act* must not be taken as establishing a duty of inquiry on a stronger contracting party. Such a party should not be required to make inquiries to determine whether or not a weaker party is acting under some form of disability, if that disability is not readily apparent.

The committee tentatively recommends that:

*5. The Contract Fairness Act should require that a defendant know of a plaintiff's material disadvantage in order for the plaintiff to obtain a remedy for an unconscionable contract. Knowledge in this context includes actual knowledge, recklessness, and willful blindness.*

### 5. SHOULD RELIEF BE AVAILABLE ONLY IN CONNECTION WITH FACTS THAT WERE KNOWN AT THE TIME THE CONTRACT WAS MADE?

This issue continues the minor theme within unconscionability jurisprudence concerning knowledge and constructive fraud. It is also an issue that has come up a number of times in recent British Columbia case law. It has appeared most notably

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144. *Trade Practices Act 1974*, s. 51AC (6). See, below, Appendix A at 208–13 (for excerpts from this statute).

145. *Contracts Review Act 1980*, s. 9 (4). See, below, Appendix A at 213–19 (for excerpts from this statute).

in cases involving settlements of an action based on a motor-vehicle accident. Typically, a settlement is made and at some later point the plaintiff's injuries worsen. In light of this post-settlement development, the agreement appears to be substantively unfair.

This issue was first raised in British Columbia in the Court of Appeal's decision in *Cogle v. Maricevic*.<sup>146</sup> The court decided that unconscionability should only be determined based on the facts that were known, or that reasonably could be known, at the time the settlement agreement was entered into.<sup>147</sup> Unfortunately, *Cogle* was not reported until about ten years after it was decided. In the intervening years, a number of trial decisions strayed into considering post-agreement developments. A stream of Court of Appeal decisions followed, each affirming the approach in *Cogle*.<sup>148</sup> The New Zealand Law Commission has also recommended this approach, including the following provision in its draft legislation:

**7 Circumstances judged at time of contract**

The question whether a contract, or a term of a contract, is unfair shall be decided in the light of the circumstances in at the time the contract was made.<sup>149</sup>

Section 2-302 of the American UCC contains a similar timing element.<sup>150</sup>

Introducing a timing element into the test for unconscionability undoubtedly limits the scope of the concept. This limitation can be justified. It preserves an element of certainty in contracting relations. It also preserves some space for other contractual concepts—such as good faith—to operate.

But this limitation has not escaped criticism. In *Hunter Engineering*, Wilson J. referred to this timing limitation as one of the weaknesses of unconscionability.<sup>151</sup> And the *Business Practices and Consumer Protection Act* does not adopt a timing element in its unconscionability provisions.<sup>152</sup> Opening up contracts to review for uncon-

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146. (1983), [1992] 3 W.W.R. 475, 64 B.C.L.R. (2d) 105 (C.A.) [*Cogle* cited to B.C.L.R.]

147. *Ibid.* at para. 18, Hinkson J.A.

148. See *Smyth*, *supra* note 133 at para. 29, Taylor J.A.; *McCulloch v. Hilton* (1998), 63 B.C.L.R. (3d) 272 at para. 27, 7 C.C.L.I. (3d) 259 (C.A.), Esson J.A.; *Gindis*, *supra* note 113 at paras. 30, 38–40, Newbury J.A.

149. "Unfair Contracts": A Discussion Paper, *supra* note 76 at 39.

150. See, below, Appendix A at 208 (for the text of section 2-302).

151. *Hunter Engineering*, *supra* note 124 at 508, 516–17.

152. *Supra* note 117, s. 8 (1) ("An unconscionable act or practice by a supplier may occur before, dur-

scionability based on events that occur after the contract is entered into does pose some problems, though. It can operate as an inroad on contractual certainty. In addition, it can be difficult for contracting parties to plan for events occurring after a contract is entered into, and it may be unfair at some basic level to hold contracting parties accountable for such post-contractual events.

The committee tentatively recommends that:

*6. The Contract Fairness Act should contain a timing element that limits review of a contract on the ground of unconscionability to facts that were known by the parties at the time the contract was made. Knowledge in this context includes actual knowledge, recklessness, and willful blindness.*

6. WHAT FACTORS SHOULD THE CONTRACT FAIRNESS ACT PROVIDE TO GUIDE THE COURTS IN APPLYING THE TEST OF UNCONSCIONABILITY?

Both *Morrison* and *Harry* refer to guidelines or factors that the courts may draw on in determining whether a contract is unconscionable. Neither case provides much guidance on what these factors should be. *Harry* simply directs the courts to consider recent cases and legislation.<sup>153</sup> *Morrison* is more explicit. It lists the plaintiff's "ignorance, need, or distress" as factors to consider in applying the test.<sup>154</sup>

The first option for reform would be simply to restate this list in the *Contract Fairness Act*. It would only amount to a very modest reform, as the list from *Morrison* is a very limited list. Subsequent cases have been more expansive. For example, a recent judgment set out the following list of factors to consider:

In determining whether there was an inequality of bargaining power, a number of factors are of importance. They include the intelligence and sophistication of the plaintiff in relation to the defendant; whether the defendant was aggressive in the negotiation of the [contract], and whether the plaintiff was intimidated during the process; whether the plaintiff sought or was advised to seek independent legal advice; whether the plaintiff was in necessitous circumstances, and whether those circumstances compelled the plaintiff to enter into the bargain; and finally, and closely related to the first consideration, whether the plaintiff had experience in dealing with similar matters in the past.<sup>155</sup>

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ing or after the consumer transaction.").

153. See *supra* note 108 at 241.

154. *Supra* note 97 at 713.

155. *Warman v. Adams*, 2004 BCSC 1305, 17 C.C.L.I. (4th) 123 at para. 8, Barrow J. [citations omitted]

This approach, which focuses on individual characteristics or weakness, has been refined to a higher degree in Australian jurisprudence. Australia's conception of unconscionability turns on a finding of a special disadvantage. Adopting this element as part of the unconscionability provision is a second option for reform.

*Special disadvantage* is defined in the leading case as follows:

I qualify the word "disadvantage" by the adjective "special" in order to disavow any suggestion that the principle applies whenever there is some difference in the bargaining power of the parties and in order to emphasize that the disabling condition or circumstance is one which seriously affects the ability of the innocent party to make a judgment as to his own best interests, when the other party knows or ought to know of the existence of that condition or circumstance and of its effect on the innocent party.<sup>156</sup>

The notion underlying special disadvantage is to limit unconscionability to protection of the vulnerable, with vulnerability being conceived of in terms that resemble the fiduciary obligations sometimes owed to individuals as opposed to the self-interested behaviour that predominates in the commercial marketplace. In Canada, La Forest J.'s judgment in *Norberg v. Wynrib* contains a number of remarks that provide some support for something like the Australian approach.<sup>157</sup> At any rate, this special-disadvantage element is probably the closest possible thing to a bright-line test in this area of the law, and it has attracted some support in the commentary for that reason.<sup>158</sup> But if this approach does make gains for certainty, it achieves them by dramatically limiting the scope of unconscionability and effectively taking it out of play for corporate parties and commercial contracts. For this reason, apparently, Australia has enacted legislation that expressly extends unconscionability into these areas.

Law-reform agencies have taken a much more extensive and wide-ranging approach to this issue. They provide the third and fourth options for reform. First up, the On-

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156. *Commercial Bank of Australia Ltd. v. Amadio* (1983), 151 C.L.R. 447 at 462, 46 A.L.R. 402 (H.C.A.), Mason J.

157. [1992] 2 S.C.R. 226 at 247–48, 92 D.L.R. (4th) 449. *Norberg v. Wynrib* was actually not a contracts case (it concerned damages for sexual assault), and although two other judges concurred in La Forest J.'s judgment, three other judges disapproved of his approach.

158. See Rick Bigwood, "Antipodean Reflections on the Canadian Unconscionability Doctrine" (2005) 84 Can. Bar Rev. 171 at 183 ("It is of course unsurprising, given the interest that market economy societies have in the general security of contractual arrangements, that the law should circumscribe narrowly the situations of vulnerability or disadvantage that attract the peculiar jurisdiction to relieve against unconscionable dealing. We are constrained to think only in terms of 'exceptional' or 'abnormal' inequality.").

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## Consultation Paper on Proposals for Unfair Contracts Relief

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tario Law Reform Commission recommended enshrining the following factors in legislation:

- (a) the degree to which one party has taken advantage of the inability of the other party reasonably to protect his or her interests because of his or her physical or mental infirmity, illiteracy, inability to understand the language of an agreement, lack of education, lack of business knowledge or experience, financial distress, or because of the existence of a relationship of trust or dependence or similar factors;
- (b) the existence of terms in the contract that are not reasonably necessary for the protection of the interests of any party to the contract;
- (c) the degree to which the contract requires a party to waive rights to which he or she would otherwise be entitled;
- (d) gross disparity between the considerations given by the parties to the contract and the considerations that would normally be given by parties to a similar contract in similar circumstances;
- (e) knowledge by one party, when entering into a contract, that the other party will be substantially deprived of the benefit or benefits reasonably anticipated by that other party under the contract;
- (f) the degree to which the natural effect of the transaction, or any party's conduct prior to, or at the time of, the transaction, is to cause or aid in causing another party to misunderstand the true nature of the transaction and his or her rights and duties thereunder;
- (g) whether the complaining party had independent advice before or at the time of the transaction or should reasonably have acted to secure such advice for the protection of the party's interest;
- (h) the bargaining strength of the parties relative to each other, taking into account the availability of reasonable alternative sources of supply and demand;
- (i) whether the party seeking relief know or ought reasonably to have known of the existence and extent of the term or terms alleged to be unconscionable;
- (j) in the case of a provision that purports to exclude or limit a liability that would otherwise attach to the party seeking to rely on it, which party is better able to guard against loss or damages;
- (k) the setting, purpose and effect of the contract, and the manner in which it was formed, including whether the contract is on written standard terms of business; and
- (l) the conduct of the parties in relation to similar contracts or courses of dealing to which any of them has been a party.<sup>159</sup>

This list is noteworthy for expanding the circumstances in which unconscionability will be operable, in addition to trying to define how to apply the concept. This list is

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159. *Report on Amendment of the Law of Contract*, *supra* note 129 at 129–30.

framed as being open-ended; the courts may add to these factors in appropriate cases.

Another option was recommended by the New Zealand Law Commission. They took a similarly detailed approach (in the elements of its integrated proposal that relate to unconscionability), but with more emphasis on defining and limiting unconscionability:

A contract, or a term of a contract, may be unfair if a party to that contract is seriously disadvantaged in relation to another party to the contract because he or she:

- (a) is unable to appreciate adequately the provisions or the implications of the contract by reason of age, sickness, mental, educational or linguistic disability, emotional distress, or ignorance of business affairs; or
- (b) is in need of the benefits for which he or she has contracted to such a degree as to have no real choice whether or not to enter into the contract; or
- ...
- (f) is for any other reason in the opinion of the court at a serious disadvantage. . . .<sup>160</sup>

This list is also open-ended, but to a much greater degree than the Ontario Commission's list, it is concerned with illustrating and defining the expression *serious disadvantage*.

A fifth and final option to consider would be not to include a list of factors in the legislation. In this case, the standard for relief would be inequality of bargaining power alone. This approach would in theory leave unconscionability open to the widest variety of cases, but it could also invite the courts formulating their own restrictive list of factors to define and limit inequality of bargaining power.

The committee favours the approach taken by the New Zealand Law Commission. Doctrinally, it is the most consistent with the law in British Columbia. In addition, it represents the best fit with the committee's overall vision of integrating unconscionability, duress, and undue influence, which is discussed later in this consultation paper.<sup>161</sup>

The committee tentatively recommends that:

*7. The Contract Fairness Act should contain the following non-exclusive list of factors proposed by the New Zealand Law Commission for use by the court in ap-*

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160. "Unfair Contracts": A Discussion Paper, *supra* note 136 at 33.

161. See, below, at 99–109 (chapter VI).

*plying the unconscionability provision: (a) a contracting party's material disadvantage due to being unable to appreciate adequately the provisions or the implications of the contract by reason of age, sickness, mental, educational or linguistic disability, emotional distress, or ignorance of business affairs; (b) a contracting party's material disadvantage due to being in need of the benefits for which he or she has contracted to such a degree as to have no real choice whether or not to enter into the contract; (c) any other reason in the opinion of the court that puts a contracting party at a material disadvantage.*

7. SHOULD INSURANCE AND LEGAL OR OTHER PROFESSIONAL ADVICE BE FACTORS TO CONSIDER IN DECIDING UNCONSCIONABILITY CASES?

Professional advice and insurance are two topics that are frequently raised in commentary on unconscionability. Their presence or absence may affect whether a contract is viewed as unconscionable.

*(a) Legal or Other Professional Advice*

It is much harder to assert that a contract is unconscionable if the plaintiff had legal or other professional advice on that contract at some point before the contract was made. Even if the plaintiff failed to act on that advice, at least it would be possible to assert that the plaintiff was informed about its rights and about the dangers of entering into such a contract. On the other hand, the absence of such advice can be telling evidence of unconscionability. The New Zealand Law Commission proposed including a provision in the legislation directing courts to consider whether or not the plaintiff had legal or other professional advice:

**3 Professional advice**

In considering whether a contract, or a term of a contract, is unfair the court shall have regard, among other things, to whether the disadvantaged party received appropriate legal or other professional advice.<sup>162</sup>

The Ontario Law Reform Commission also listed this as a factor for the courts to consider in determining whether a contract is unconscionable.<sup>163</sup>

It is possible to go even further and set out in the legislation that legal or professional advice constitutes a bar on obtaining a remedy under the legislation. The rationale for this type of provision would be that receiving professional advice is in-

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162. "Unfair Contracts": A Discussion Paper, *supra* note 76 at 35.

163. Report on Amendment of the Law of Contract, *supra* note 75 at 137.

compatible with holding that a contract is unconscionable. This would provide contracting parties with a way to insulate their agreements from scrutiny under the act, which would promote certainty and finality in contractual relationships. Conversely, it could be pointed out that not all professional advice is of the same quality, and that it is not always possible for a plaintiff to act on that advice. A simple bar in the legislation cannot capture the complexity of a variety of differing fact patterns, and may, as a result, shut out deserving cases.

Another approach would be simply to avoid any mention of legal or professional advice in the legislation. This would leave it to the courts to decide whether or not such advice is relevant in a given case.

The committee tentatively recommends that:

*8. The Contract Fairness Act should direct the court to consider legal or other professional advice as a factor in deciding unconscionability cases.*

### *(b) Insurance*

Insurance is a more difficult issue to get a handle on than legal or professional advice. It could be argued that the parties' insurers have a real stake in the outcome, and that some consideration should be given to which party is in the best position to insure against a loss. On the other hand, these questions can be complex and may, in many cases, yield no insights on whether or not the contract at issue is unconscionable. Neither the Ontario Law Reform Commission nor the New Zealand Law Commission contained any proposals related to insurance. On the other hand, the United Kingdom *Unfair Contract Terms Act 1977* (which actually deals with the control of exclusion clauses and not with unconscionability generally) does direct courts to consider insurance arrangements as a factor in their analysis.<sup>164</sup>

In the committee's view, insurance should not be included as a factor to be considered in every unconscionability case under the *Contract Fairness Act*. If insurance arrangements are relevant to a particular case, however, their exclusion from a list of factors in the legislation would not prevent a court from considering them.

The committee tentatively recommends that:

*9. The Contract Fairness Act should not direct the court to consider the parties insurance arrangements as a factor in deciding unconscionability cases.*

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164. See *Unfair Contract Terms Act 1977*, (U.K.), 1977, c. 50, s. 11 (4) (b). See, below, Appendix A at 220–24 (for excerpts from this act).

8. WHICH PARTY SHOULD BEAR THE BURDEN OF PROOF IN UNCONSCIONABILITY CLAIMS?

The idea of shifting the burden of proof in unconscionability cases has come up on two distinct occasions in British Columbia law.

First, Davey J.A.'s test in *Morrison* expressly mentions shifting the burden to the defendant on the last element of the test of unconscionability, requiring the defendant to show "that the bargain was fair, just and reasonable" or that "no advantage was taken" of the plaintiff.<sup>165</sup> This element of the *Morrison* test has been criticized in two subsequent Court of Appeal decisions as being confusing and difficult to apply in practice. In *Smyth*, Taylor J.A. said:

The question of who bears the onus of proof is entirely unclear. If the weaker party must prove "substantial unfairness in the bargain" and the onus then falls on the other party to show "that the bargain was fair just and reasonable," that would seem to mean no more than that the party raising the issue of unconscionability has the burden of proving it. The other party has, of course, the opportunity to meet the case advanced by showing that there was no unfairness or unreasonableness.<sup>166</sup>

And in *Gindis*, Newbury J.A. commented:

I must confess to having some difficulty with this formulation, which requires as preconditions to a "presumption of fraud," proof of inequality between the parties and "substantial unfairness" in the bargain. The test then contemplates that the presumption can be displaced by proof that the bargain was "fair and reasonable." How that can be proven where the contract has already been found *prima facie* to be *substantially* unfair is difficult to understand.<sup>167</sup>

Most British Columbia cases have applied *Morrison* in the manner suggested by Taylor J.A., treating this part of the *Morrison* test as less of a separate element with a shift in the burden of proof and more of a restatement of the traditional way of proceeding in civil-court cases, with the plaintiff bearing the burden of proof and the defendant being permitted to call evidence to rebut the plaintiff's assertions.

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165. *Supra* note 97 at 713.

166. *Supra* note 133 at para. 23.

167. *Supra* note 113 at para. 22 [emphasis in original].

Second, the burden of proof is also an issue in proceedings under the *Business Practices and Consumer Protection Act*.<sup>168</sup> When this statute was enacted in 2004, it included a new provision that shifted the burden of proof in proceedings involving unconscionability.<sup>169</sup> The rationale for this provision would appear to be that the power inequality between a consumer and a supplier justifies shifting the burden of proof to the stronger party. Since this provision is relatively new, it has not yet been subjected to extensive consideration by the courts. The early record on the effectiveness of this provision appears to be mixed. One case has said that a remedy was granted because the stronger party “failed to disprove on a balance of probabilities that it engaged in unconscionability.”<sup>170</sup> In another case, the stronger party failed to call evidence, but the court appeared to engage in weighing the evidence it had before it from the weaker party in any event.<sup>171</sup>

Arguments may be made against shifting the burden of proof. It is a significant distortion of the traditional approach to civil litigation. A particularly strong public-policy rationale would be needed to support it, and it is not clear that the inequality between the parties could serve this role. Courts may be reluctant to decide that a contract is unconscionable solely on the basis of the burden of proof—they may want to have some evidence, even if it may not be required if the statute is followed strictly. Neither the Ontario Law Reform Commission nor the New Zealand Law Commission made this idea a feature of their proposals on unconscionability.

The committee tentatively recommends that:

*10. The Contract Fairness Act should not shift the burden of proof in unconscionability cases.*

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168. *Supra* note 117.

169. *Ibid.*, s. 9 (2) (“If it is alleged that a supplier committed or engaged in an unconscionable act or practice, the burden of proof that the unconscionable act or practice was not committed or engaged in is on the supplier.”).

170. *Nanaimo Shipyard Ltd. v. Keith*, 2008 BCSC 1150, [2008] B.C.J. No. 1613 at para. 58 (S.C.) (QL), Rice J.

171. *See Murray*, *supra* note 122 at paras. 36–39, 46–51, Brown J. *See also* Bruce MacDougall, “Contracts,” in Susan Munro *et al.*, eds., *Annual Review of Law & Practice: Current to January 1, 2008* (Vancouver: Continuing Legal Education Society of British Columbia, 2008) 133 at 135 (discussing the *Murray* case in relation to the shifting burden of proof under the act).

9. WHAT REMEDIES SHOULD BE AVAILABLE FOR UNCONSCIONABILITY?

Traditionally, rescission was the only remedy available in cases of unconscionability. Rescission is essentially an undoing of the unconscionable contract.<sup>172</sup> This remedy works well in relatively simple cases, but problems can arise if the facts are complex or if third parties enter the picture. So, modern legislation and law-reform proposals tend to provide the courts with a wide range of remedies for cases of unconscionability. For example, section 10 of the *Business Practices and Consumer Protection Act* gives the courts an expanded set of remedies in cases involving mortgage lending.<sup>173</sup>

The New Zealand Law Commission proposed going even further, extending the following powers to a court reviewing an unconscionable contract:

**12 Powers of court**

- (1) A court on reviewing under this scheme any contract, or any term of a contract . . . may grant such relief as it thinks just.
- (2) Without limiting the power of the court to grant relief, it may do one or more of the following things:
  - (a) declare the contract to be valid and enforceable in whole or in part or for any particular purpose;
  - (b) cancel the contract;
  - (c) declare that a term of the contract is of no effect;
  - (d) vary the contract;
  - (e) award restitution or compensation to any party to the contract;
  - ...
  - (g) vest any property in any party to the proceedings, or direct any party to transfer or assign any property to any other party to the proceedings;
  - (h) order that an account be taken, and reopen any account already taken, in respect of any transaction between the parties.<sup>174</sup>

One could oppose expanding the court's remedial powers for a number of reasons. First, it could be argued that the courts could use these powers to get too involved in reshaping the underlying agreement between contracting parties in ways they would not have intended. Second, it could be argued that these expanded remedies are appropriate for fiduciary situations (that is, situations in which the stronger

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172. See, above, at 12–13 (section II.C.4) (for more detail on rescission).

173. See *supra* note 117. See, below, Appendix A at 203 (for the text of this section).

174. "Unfair Contracts": A Discussion Paper, *supra* note 76 at 46–47.

party is obliged to act in the best interests of the weaker) than in contractual situations (where the parties may pursue their own interests, so long as the resulting contract is not unconscionable).

In the committee's view, if the extreme remedy of rescission is going to be available, then it only makes sense to allow the courts to apply more limited remedies to cases involving unconscionability. Further, extending greater remedial flexibility to the courts continues a development that is already occurring in the jurisprudence and has the potential to provide far-reaching practical benefits to contracting parties that have been victimized by unfairness.

The committee tentatively recommends that:

*11. The Contract Fairness Act should allow the court to make any order that it thinks is just, including any of the following orders on the list recommended by the New Zealand Law Commission: (a) declaring the contract to be valid and enforceable in whole or in part or for any particular purpose; (b) rescinding the contract; (c) declaring that a term of the contract is of no effect; (d) varying the contract; (e) awarding restitution or compensation to any party to the contract; (f) vesting any property in any party to the proceedings, or direct any party to transfer or assign any property to any other party to the proceedings; (g) ordering that an account be taken, and reopening any account already taken, in respect of any transaction between the parties.*

### 10. SHOULD IT BE POSSIBLE TO MODIFY OR EXCLUDE ANY LEGISLATIVE RULES ON UNCONSCIONABILITY BY CONTRACT?

The question naturally arises whether the parties should be able to contract out of any legislative rules on unconscionability. The New Zealand Law Commission noted that “[i]t would frustrate the central object of this scheme if it could be overridden by the insertion of a term to that effect in a contract.”<sup>175</sup> The commission proposed adding the following provision to the legislation:

#### **16 Scheme to override inconsistent provisions**

This scheme applies notwithstanding any provision in any contract.<sup>176</sup>

The Ontario Law Reform Commission came to a similar conclusion.<sup>177</sup> This is something of a common-sense position to take. If the parties have starkly unbalanced

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175. “Unfair Contracts”: A Discussion Paper, *supra* note 76 at 49.

176. *Ibid.*



bargaining strength, then it should be a simple matter for the stronger party to impose on the weaker party a term in which the weaker party, for instance, waives its rights under the legislation. If the legislation did not protect against such conduct, then the rights it extends to contracting parties could be seen as illusory.

On the other hand, one could argue that contracting parties should be free to come to any agreement they choose. Contracting parties may have legitimate reasons for wanting to shield their agreements from scrutiny under unconscionability legislation. The courts should respect those reasons.

In the committee's view, allowing contracting parties to modify or exclude the unconscionability provision would undercut the effectiveness of the legislation to too great a degree.

The committee tentatively recommends that:

*12. The Contract Fairness Act should not allow parties to modify or exclude its legislative rules relating to unconscionability in their contract.*

### 11. SHOULD ANY TYPES OF CONTRACTS OR CONTRACTING PARTIES BE EXCLUDED FROM THE UNCONSCIONABILITY PROVISION?

The last issue to consider in relation to unconscionability is whether any types of contracts or contracting parties should be expressly excluded from the scope of the legislation. The rationale behind such an exclusion is that there is a tremendous variety of contracts in existence. The abuses that the legislation is intended to curb may be encountered more often in certain types of contracts than in others. Conversely, certain contracting parties may value finality and certainty in their contracts over legislative protection. Excluding them from the legislation may actually serve to strengthen the legislation by making it more focussed and coherent.

The options for reform for this issue are rather more open-ended than was the case for the other issues taken up earlier in this chapter. The options explored below are suggestions, which may be supplemented by an almost infinite number of variations.

Two possible limitations turn on the monetary amount of the transaction at issue and the corporate status of the party. Both ideas are essentially proxies for the (presumed) sophistication of the parties to the contract at issue, and their ability to protect their own interests. A monetary limit is relatively straightforward. The legisla-

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177. *Report on Amendment of the Law of Contract*, *supra* note 75 at 134.

tion—or a regulation promulgated under its authority—would set a dollar value and transactions that involve amounts less than it would be subject to the unconscionability provision. The committee examined several versions of a corporate-party limit. One would be simply to declare that the legislation does not apply to corporations. But, given the relatively expansive definition of corporation in British Columbia law,<sup>178</sup> this approach would carve out parties that, it could be argued, should be among the prime beneficiaries of the unconscionability provision—parties such as small businesses, societies, and strata corporations. Other approaches examined included drawing the line at business corporations or at public companies.<sup>179</sup>

The last option suggested is that the draft legislation should say forthrightly that it applies to all contracts. This was the approach taken by the Ontario Law Reform Commission, which concluded that “certainty and finality should yield to flexibility and injustice” and that “unconscionability should be statutorily recognized as a basic and pervasive contract norm.”<sup>180</sup>

In the committee’s view, the last option is the clearest option, and on balance it is also the best one. The committee had some reservations about the application of unconscionability to contracts involving large commercial parties. In its discussion of this issue, the committee considered a number of devices to carve out these types of contracts, but concluded that these devices could not be implemented without sacrificing the clarity of the whole structure. Further, it is not apparent that legislation on unconscionability would pose much of a practical problem for sophisticated commercial entities dealing with one another. It is unlikely that such contracting parties could ever meet the provision’s requirements and obtain a remedy under it.

The committee tentatively recommends that:

*13. The Contract Fairness Act’s unconscionability provision should apply to all types of contracts and contracting parties.*

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178. See *Interpretation Act*, R.S.B.C. 1996, c. 238, s. 29 (“ ‘corporation’ means an incorporated association, company, society, municipality or other incorporated body, where and however incorporated, and includes a corporation sole other than Her Majesty or the Lieutenant Governor”).

179. See *Business Corporations Act*, S.B.C. 2002, c. 57, s. 1 (1).

180. *Report on Amendment of the Law of Contract*, *supra* note 75 at 132.

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## CHAPTER IV. DURESS

### A. Historical Development

#### 1. SOURCE AND DEFINITION OF DURESS

The courts have long refused to enforce a contract that was brought into existence by way of threats, coercion, or violence. Like unconscionability, the concept of duress can be traced all the way back to the origins of the English law of contracts in the sixteenth and seventeenth centuries. Unlike unconscionability and the concept of undue influence,<sup>181</sup> duress arose in and was developed by the common-law courts, rather than the courts of equity.<sup>182</sup> The significance of this fact is that duress historically had a much more limited scope of application than either unconscionability or undue influence.

Conceptually, duress can take two forms.<sup>183</sup> The first form involves someone (the coercer) using physical force or direct violence to compel a person (the victim) to give some indication of agreement to a bargain that the victim has no intention of agreeing to.<sup>184</sup> This is extremely rare.<sup>185</sup> The second form of duress is more important and more relevant for this consultation paper. This form involves a coercer “mak[ing] an improper threat that induces a party who has no reasonable alternative to manifesting his assent.”<sup>186</sup> In both cases, the remedy available to a victim of duress is an order that the contract is voidable (that is, it is void at the victim’s option) and restitution<sup>187</sup> of any money or property transferred under the void contract.

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181. See, below, at 77–98 (chapter V).

182. See, above, at 10–12 (section II.C.3) (for more detail on the distinction between common law and equity).

183. See *Restatement (Second) of Contracts* § 174 intro. note (1981).

184. Throughout this chapter, the word *coercer* is used to describe a person who uses violence or threats and the word *victim* to describe a person who submits to violence or threats. This is fairly standard terminology in academic discussions of duress, and it is even used in some judgments. These terms are used solely for economy of language. When the discussion in this chapter touches on whether a contract has been formed or modified because of duress, the use of these terms is not meant to imply a prejudgment of the issue at hand.

185. See *Restatement (Second) of Contracts* § 174 cmt. a, illus. 1 (1981) (“A presents to B, who is physically weaker than A, a written contract prepared for B’s signature and demands that B sign it. B refuses. A grasps B’s hand and compels B by physical force to write his name. . .”).

186. See *Restatement (Second) of Contracts* § 174 intro. note (1981).

187. See, above, at 5–8 (part II.B) (for more detail on restitution).

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The early history of duress is a combination of slow evolution, or even stagnation, for decades or centuries. Then, over the past 30 years, there has been a rapid development of the law that has led to a fundamental re-evaluation of the policy underpinnings of the concept. A series of cases, appearing first in the United Kingdom,<sup>188</sup> then in Canada,<sup>189</sup> has recognized that the misuse of commercial power can amount to duress. The advent of economic duress is the main reason for considering duress as part of this consultation paper.

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188. See *Occidental Worldwide Investment Corp. v. Skits A/S Aventi (The Siboen and the Sibotre)*, [1976] 1 Lloyd's Rep. 293 (Eng. Q.B.) (charterers threatening to breach agreement with ship owners if rates not adjusted to reflect market slump in oil prices—upon rise in price of oil, with charterers making substantial profits, owners suing for reinstatement of original contract rates); *North Ocean Shipping Co. Ltd. v. Hyundai Construction Co. Ltd.* (1978), [1979] Q.B. 705, [1978] 3 All E.R. 1170 (Q.B.) [*The Atlantic Baron* cited to Q.B.] (ship builders under fixed-price contract threatening to breach contract unless purchaser agrees to premium to compensate for currency devaluation—purchaser agreeing to avoid breach of obligations to third parties); *Pao On v. Lau Yiu Long*, [1979] UKPC 2, [1980] A.C. 614 [*Pao On* cited to A.C.] (seller in complex share-exchange agreement giving defective guarantee—defect discovered on eve of closing—buyer threatening to walk away from agreement unless new guarantee given—seller giving guarantee and later seeking to set it aside when price of shares declines sharply); *Universe Tankships Inc. of Monrovia v. International Transport Workers Federation (The Universe Sentinel)*, [1981] UKHL 9, [1983] 1 A.C. 366 [*Universe Tankships* cited to A.C.] (union refusing to allow ship sailing under flag of convenience to leave port until owners make, among other payments, contribution to union's welfare fund—owners suing for restitution of contribution); *Dimskal Shipping Co. S.A. v. International Transport Workers Federation (The Evia Luck)* (1991), [1992] 2 A.C. 152, [1991] 4 All E.R. 871 [*The Evia Luck* cited to A.C.] (U.K.H.L.) (union refusing to allow ship sailing under flag of convenience to leave port in Sweden unless certain payments made—owners suing for restitution of payments); *CTN Cash and Carry Ltd. v. Gallaher Ltd.*, [1993] EWCA Civ. 19, [1994] 4 All E.R. 714 (seller delivering consignment of cigarettes to wrong warehouse, where they are stolen, and threatening to withdraw credit facility from buyer if invoice for stolen cigarettes not paid) [*CTN Cash and Carry* cited to All E.R.].

189. See *Ronald Elwyn Lister Ltd. v. Dunlop Canada Ltd.* (1979), 27 O.R. (2d) 168, 105 D.L.R. (3d) 684 at 694–95 (C.A.) [*Lister* cited to D.L.R.] (franchisor and creditor seizing assets of franchisee and demanding personal guarantees from franchisee's principals before releasing assets), *rev'd on other grounds*, [1982] 1 S.C.R. 726, 135 D.L.R. (3d) 1; *Stott v. Merit Investment Corp.* (1988), 63 O.R. (2d) 545, 48 D.L.R. (4th) 288 (C.A.) [*Stott* cited to D.L.R.] (investment firm demanding dealer guarantee debts of client); *Gordon v. Roebuck* (1992) 9 O.R. (3d) 1, 92 D.L.R. (4th) 670 (C.A.) [*Gordon* cited to D.L.R.] (on eve of closing of real-estate transaction, defendant refusing to discharge mortgage unless payment made to third party); *Techform Products Ltd. v. Wolda* (2001), 56 O.R. (3d) 1, 206 D.L.R. (4th) 171 (C.A.) [*Wolda* cited to D.L.R.] (independent consultant agreement silent on ownership of inventions—company insisting that consultant assign to it rights in invention created by consultant in the course of consultancy), *leave to appeal to the S.C.C. refused*, [2001] S.C.C.A. No. 603 (QL); *Greater Fredericton Airport Authority Inc. v. Nav Canada*, 2008 NBCA 28, 290 D.L.R. (4th) 405 [*Nav Canada* cited to D.L.R.] (airport authority redeveloping facility—Nav Canada insisting on purchase of new equipment as condition of relocating its facility—airport authority agreeing to keep overall redevelopment project on track).

## 2. EARLY DURESS CASES FOCUS RESTRICTIVELY ON VIOLENCE AND THREATS OF VIOLENCE

For much of the history of duress, the common-law courts adopted a very restrictive interpretation of the types of threats that would amount to an *improper* threat. Essentially, the category of improper threats was only seen to encompass threats of physical violence against the victim, a spouse, a child, or a near relative.<sup>190</sup> For this reason, early duress cases tend not to be very sophisticated in developing legal principles. The cases turn mostly on their facts, and it is usually glaringly obvious whether violence has been threatened and, if it has, whether it was the reason for the contract's existence.<sup>191</sup> In addition, there were not many cases because people who are willing to use or threaten violence in contract negotiations usually do not turn to the courts to try to enforce the resulting contracts.<sup>192</sup>

By the eighteenth century, the courts began to recognize that, in addition to threats of physical violence, threats to a person's economic interests could also be considered improper threats. But at this time the courts were only willing to expand the category of improper threats in a very limited way. A contract would be set aside for duress if it had been obtained by the actual or threatened wrongful seizure or detention of a victim's property.<sup>193</sup> A classic example of this type of duress was goods held by a pawnbroker who refused to return them except upon payment of an exorbitant rate of interest.<sup>194</sup> Other examples include the wrongful distress of the goods of a tenant, or the wrongful seizure of a deed, an insurance policy, or a bond.<sup>195</sup> As was the case with the older form of duress, this newer form did not require a great deal of legal reasoning from the courts, so these cases tend not to be very helpful in identifying the underlying policy rationale for duress. But by recognizing that economic

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190. See G.H.L. Fridman, *The Law of Contract in Canada*, 5th ed. (Toronto: Thomson Carswell, 2006) at 306 [Fridman, *Law of Contract*].

191. See *Barton v. Armstrong*, [1973] UKPC 2, [1976] A.C. 104 at 118, Lord Cross of Chelsea (for the majority) ("It is hardly surprising that there is no direct authority on the point, for if A threatens B with death if he does not execute some document and B, who takes A's threats seriously, executes the document it can be only in the most unusual circumstances that there can be any doubt whether the threats operated to induce him to execute the document.").

192. See Angela Swan, *Canadian Contract Law*, 2d ed. (Markham, ON: LexisNexis Canada, 2009) at § 2.153 ("For obvious reasons, actions by (or against) robbers are rare so that the duress that comes within the courts' non-criminal purview is generally more subtle." [footnote omitted]).

193. See Gareth Jones, ed., *Goff & Jones on the Law of Restitution*, 6th ed. (London: Sweet & Maxwell, 2002) [Goff & Jones] at §§ 10-011–10.012.

194. See *Astley v. Reynolds* (1731), 2 Str. 915, 93 E.R. 939 (K.B.).

195. See *Goff & Jones*, *supra* note 193 at § 10-012.

interests may be susceptible to improper threats, they do set the stage for what was to come in the law of duress.

### 3. THE ADVENT OF ECONOMIC DURESS

The key development in the law of duress was the advent of the idea of *economic duress* in the twentieth century. This idea extends the concept of duress into commercial contracts generally by positing that there is conduct that goes beyond hard bargaining but falls short of physical violence, threats of physical violence, or actual or threatened detention of property, which can justify setting a contract aside. Economic duress entails a significant expansion in the scope of duress, so it requires careful thinking about the rationale for and the range of duress.

Among common-law jurisdictions, the United States was the first to embrace this expanded conception of duress. By the 1940s, one American commentator was arguing that “no basic difference exists between economic duress and physical duress” for the purposes of the legal theory.<sup>196</sup> By mid-century, economic duress—or *business compulsion*, as it is sometimes called—was well established in American contract law. The consensus in American case law is reflected in the *Restatement*, which holds that “duress by threat” will make a contract “voidable” when the following elements are in place: (1) the victim’s “manifestation of assent,” (2) is “induced by an improper threat,” which (3) left the victim “with no reasonable alternative” but to submit to the coercer’s demands.<sup>197</sup> But this development did not have much of an impact in Canada. The conception of duress in Canadian law has been much more heavily influenced by developments in the United Kingdom.

### 4. DURESS IN THE UNITED KINGDOM COURTS

The English courts first recognized economic duress in the 1970s in a pair of trial-level decisions in maritime-law cases.<sup>198</sup> Shortly thereafter, one of the United Kingdom’s top-level appellate courts confirmed that economic duress was a part of English law in the *Pao On* case.<sup>199</sup>

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196. John Dalzell, “Duress by Economic Pressure I” (1942) 20 N.C. L. Rev. 237 at 237. *See also* John Dalzell, “Duress by Economic Pressure II” (1942) 20 N.C. L. Rev. 341; John P. Dawson, “Economic Duress—An Essay in Perspective” (1947) 45 Mich. L. Rev. 253.

197. *Restatement (Second) of Contracts* § 175 (1981). *See, supra*, note 78 (for general information on the American Law Institute’s *Restatements*).

198. *The Siboen and the Sibotre*, *supra* note 188; *The Atlantic Baron*, *supra* note 188.

199. *See supra* note 188 at 636, Lord Scarman (“In their Lordships’ view, there is nothing contrary to principle in recognising economic duress as a factor which may render a contract voidable. . .”).

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Quickly, the courts realized that recognizing economic duress entails giving much more thought to devising a way to distinguish between conduct that crosses the line into improper threats that justify setting a contract aside for duress and the ordinary type of competitive bargaining that characterizes commercial dealing. This task was made more difficult by the courts' recognition that improper threats need not amount to criminal or tortious behaviour.<sup>200</sup> Sometimes, an improper threat may be the result of a person just pursuing self-interested goals. In contrast to earlier types of duress, it likely will not be glaringly apparent on the facts of a given case whether conduct comes within this new understanding of economic duress.

So, from the earliest cases on economic duress the courts have attempted to articulate the conceptual boundaries and policy rationales underlying this development in the law, as a way to ensure consistency in subsequent cases. In the result, and similar to the experience with unconscionability, a series of positions have been staked out, each in theory quite distinct from the other.

The first approach implicitly drew on the overriding concern for duress to the person and concluded that a finding of duress required that the victim's will be so completely overborne that it could not be said that the victim was acting voluntarily in entering into the contract.<sup>201</sup> This line of thought was picked up<sup>202</sup> in the leading judgment in *Pao On* by Lord Scarman, where his Lordship defined duress as follows: "Duress, whatever form it takes, is a coercion of the will so as to vitiate consent."<sup>203</sup>

But Lord Scarman took this simple standard and added the following set of four factors, or questions to ask, in order to determine whether duress may be found in a given case:

In determining whether there was a coercion of will such that there was no true consent, it is material to inquire whether the person alleged to have been coerced did or did not protest; whether at the time he was allegedly coerced into making the contract, he did or did not have an alternative course open to him such as an adequate legal remedy;

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200. See *Universe Tankships*, *supra* note 188 at 401, Lord Scarman (dissenting) ("Duress can, of course, exist even if the threat is one of lawful action. . .").

201. See *The Siboen and the Sibotre*, *supra* note 188 at 336, Kerr J.

202. See *Pao On*, *supra* note 188 at 636 (describing *The Siboen and the Sibotre*, *ibid.*, and *The Atlantic Baron*, *supra* note 188, as requiring "that the pressure must be such that the victim's consent to the contract was not a *voluntary* act on his part" [emphasis added]).

203. *Pao On*, *ibid.* at 635.

whether he was independently advised; and whether after entering the contract he took steps to avoid it.<sup>204</sup>

Lord Scarman implied that this list was more a flexible and open-ended set of evidentiary elements and less a rigid, step-by-step test that applies in all circumstances. But, in posing these questions, he also opened up a new approach to economic duress.

A few years later, and perhaps reacting to criticism of this overborne-will standard,<sup>205</sup> Lord Scarman made another attempt to get at the essential nature of duress. In this later case, called *Universe Tankships*, he appeared to take a different and more expansive approach:

The authorities . . . reveal two elements in the wrong of duress: (1) pressure amounting to compulsion of the will of the victim; and (2) the illegitimacy of the pressure exerted. There must be pressure, the practical effect of which is compulsion or the absence of choice. Compulsion is variously described in the authorities as coercion or the vitiation of consent. The classic case of duress is, however, not the lack of will to submit but the victim's intentional submission arising from the realization that there is no other practical choice open to him.<sup>206</sup>

In this passage, the language of “coercion of the will” from *Pao On* has softened into “pressure amounting to compulsion of the will” and a new focus on the illegitimacy of the pressure has been added.

### B. Recent Developments

The Canadian courts quickly adopted the English approach to economic duress,<sup>207</sup> bringing with it the uncertainty over the precise nature of duress and the confusion over the standard to apply to these cases. As was the case for unconscionability, the Supreme Court of Canada has had little to nothing to say about the recent developments in the law of duress. The leading judgments have come from the provincial courts of appeal. Unlike the key role it has played in developing unconscionability, the British Columbia Court of Appeal has not played a major role in considering the law applicable in cases of economic duress. It has only decided one major case, *Byle*

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204. *Ibid.*

205. *See, e.g.*, P.S. Atiyah, “Economic Duress and the ‘Overborne Will’ ” (1982) 98 L.Q.R. 197 at 202 (arguing that overborne-will standard “divert[s] attention into quite irrelevant inquiries into psychological motivations of the party pleading duress”).

206. *Supra* note 188 at 400.

207. *See Lister, supra* note 189 at 644, Weatherston J.A. (Lacourciere J.A., concurring).



*v. Byle*,<sup>208</sup> and it concerned duress by threats of violence to the person. Nevertheless, the court adopted Lord Scarman's approach from *Pao On*,<sup>209</sup> which may indicate an openness to applying the new law on economic duress, should an appropriate case come along.<sup>210</sup>

Among the leading cases from other provinces, it is noteworthy how many of them have been concerned with variations of existing contracts, rather than the formation of a new contract.<sup>211</sup> This has not stopped most of these cases from being decided on the basis of the English authorities, but a recent case has concluded that a fourth approach is needed for these types of cases.<sup>212</sup> The proposed approach contained the following elements:

a finding of economic duress is dependent *initially* on two conditions precedent. First, the promise (the contractual variation) must be extracted as a result of the exercise of "pressure," whether characterized as a "demand" or a "threat." Second, the exercise of that pressure must have been such that the coerced party had no practical alternative but to agree to the coercer's demand to vary the terms of the underlying contract. However even if these two conditions precedent are satisfied, a finding of economic duress does not automatically follow. Once these two threshold requirements are met, the legal analysis must focus on the ultimate question: whether the coerced party "consented" to the variation. To make that determination three factors should be examined: (1) whether the promise was supported by consideration; (2) whether the coerced party made the promise "under protest" or "without prejudice"; and (3) if not, whether the coerced party took reasonable steps to disaffirm the promise as soon as possible.<sup>213</sup>

Another noteworthy aspect of the case law in Canada is that the vast majority of economic-duress cases involve commercial, as opposed to consumer, contracts. In many of these cases, the contracting parties are relatively sophisticated. This suggests that the courts are using duress to deal with disputes that are not amenable to

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208. (1990), 65 D.L.R. (4th) 641, 46 B.L.R. 292 (B.C.C.A.) [*Byle* cited to D.L.R.].

209. *Ibid.* at 650–51, Macdonald J.A. (for the court).

210. *See also Gotaverken Energy Systems Ltd. v. Cariboo Pulp & Paper Co.* (1993), 9 C.L.R. (2d) 71 at paras. 125–63, 38 A.C.W.S. (3d) 66 (B.C.C.A.) (discussing economic duress and applying the test in *Pao On*).

211. *See Stott, supra* note 189 at 303, Finlayson J.A. (Krever J.A., concurring) (alteration to securities dealer's contract of employment to include term to cover liabilities of a client); *Gordon, supra* note 189 (variation of agreement of purchase and sale of real estate on eve of closing); *Wolda, supra* note 189 (modification of independent contractor agreement to assign ownership of invention).

212. *See Nav Canada, supra* note 189 at para. 51, Robertson J.A. (for the court).

213. *Ibid.* at para. 53, Robertson J.A. [emphasis in original].

resolution using unconscionability, undue influence, or other concepts that have traditionally been geared more to consumer transactions.

### C. Issues for Reform

The issues raised by this review of the law relate to the need for legislation on duress and the design of that legislation. Most of the options for reform come from the recent case law on duress, with the American *Restatement* also providing some useful ideas.<sup>214</sup> Unlike the case of unconscionability, there is no legislation in force in British Columbia (or the rest of Canada) dealing with duress to draw on in formulating options for reform. In addition, there is little to no sustained consideration of duress as a freestanding subject from law-reform agencies.

#### 1. SHOULD THE CONTRACT FAIRNESS ACT INCLUDE A PROVISION ON DURESS?

The considerations discussed earlier in the consultation paper in connection with legislation on unconscionability are relevant to a discussion of legislation on duress.<sup>215</sup> The previous chapter quoted the Ontario Law Reform Commission,<sup>216</sup> which set out the following three reasons for enacting legislation relating to unconscionability:

- “the doctrine has not yet been clearly recognized by the Supreme Court of Canada, nor has it yet been uniformly applied by the lower courts”<sup>217</sup>
- legislation could deal comprehensively with issues such as the remedies available for unconscionability<sup>218</sup>
- “[s]tatutory recognition of a generalized doctrine of unconscionability would fill in the gaps in legislative intervention, and enable judges to direct their minds to the truly relevant criteria for decisions.”<sup>219</sup>

These considerations apply with equal, if not greater, force to duress. In the one appeal that reached the Supreme Court of Canada with an economic-duress component

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214. See *supra* note 78 (for general information on the American Law Institute’s *Restatements*).

215. See, above, at 32–34 (section III.C.1).

216. *Report on Amendment of the Law of Contract, supra* note 75.

217. *Ibid.* at 127.

218. *Ibid.*

219. *Ibid.*

the court declined to address it.<sup>220</sup> More recently, the Supreme Court of Canada refused to grant leave to appeal to another case involving economic duress.<sup>221</sup> Further, the leading judgments from the United Kingdom and Canada have staked out several approaches to resolving cases involving economic duress. These approaches may often lead to the same result in practice, but they are conceptually inconsistent in key areas. For example, it is not clear whether a requirement that a victim's will be overborne by a coercer remains part of the law in Canada. Despite this uncertainty, the concept of duress appears to be filling a need in commercial litigation that is not being met by the current approaches to other contractual concepts, such as unconscionability or good faith.

The case against legislation relating to duress would appear to rest less on the merits of recent developments in the case law and more on timing. Unlike proposals to expand the boundaries of unconscionability, which have generated controversy, there appear to be no commentators who have gone on the record as opposing the expansion of duress into economic duress. But by the same token there does not appear to be a groundswell of calls for legislation relating to duress. An argument could be made that the time is not ripe for legislation, as the courts still need to sort out some of the basic features of duress.

Having considered these arguments, the committee decided that legislation on duress is desirable to clarify the law.

The committee tentatively recommends that:

*14. The Contract Fairness Act should contain a duress provision.*

### 2. SHOULD A REQUIREMENT TO SHOW AN OVERBORNE WILL BE AN ELEMENT OF THE DURESS PROVISION?

Pressure on a person to submit to an agreement lies at the core of duress. So, it is not surprising that courts and commentators have taken some care in describing the nature of the pressure that must be exerted in order for duress to be engaged. An early English decision on economic duress concluded that “the Court must in every case at least be satisfied that the consent of the other party was overborne by compulsion so as to deprive of him of any *animus contrahendi*.”<sup>222</sup> As was noted earlier,<sup>223</sup> this

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220. See *Lister*, *supra* note 189.

221. See *Wolda*, *supra* note 189.

222. *The Siboen and the Sibotre*, *supra* note 188 at 336, Kerr J. *Animus contrahendi* is “the intention of the contracting parties.” See *Black’s Law Dictionary*, 9th ed., s.v. “*animus contrahentium*.”

type of language was adopted by Lord Scarman in *Pao On*, the leading early English case on economic duress.<sup>224</sup> But *Pao On* appears to be the high-water mark of the overborne-will standard, at least in English law. A number of subsequent decisions by English appellate courts, including one authored by Lord Scarman himself, did not adopt this language.<sup>225</sup> Instead, they adopted more neutral language.

Some of the leading Canadian cases have used the stricter language found in the earlier English cases,<sup>226</sup> but it has been suggested that this has been done in a rote way that does not reflect a definitive settling of the issue.<sup>227</sup> Nevertheless, there appears to be a live policy issue here that requires resolution in order to determine how legislation relating to duress should be fashioned.

Supporters of the stricter overborne-will standard argue that a high standard is needed in order to avoid unsettling the certainty of contractual relations. Duress should only come into play in very few cases, where truly shocking conduct has occurred. A law professor has pursued this argument in detail:

Contractual obligations, once established, are amongst the strongest forms of obligation known in the law. They impose strict liability and they require not just that a person refrain from harming another, but that a person benefit another. . . . Thus it is appropriate that the test of consent for contractual obligation is a strict one. The quality of “will” that is required to form a contract is, comparatively speaking, very high. . . . [I]t is not unintelligible, though sometimes overdramatic, for courts in contract cases to say that a defendant’s will “was overborne” or that there was “coercion of the will” or that consent was “vitiating,” even where it was not impossible for the defendant to resist the pressure in question. Words must be understood in context.<sup>228</sup>

A high standard, in this view, works well in practice.

The bulk of the commentary, however, is largely critical of the overborne-will standard. A number of arguments have been raised against this approach. An obvious complaint is that it sets the bar too high. If the overborne-will requirement is meant

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223. See, above, at 56–60 (section IV.A.4).

224. *Supra* note 188 at 635.

225. See *Universe Tankships*, *supra* note 188 at 402; *The Evia Luck*, *supra* note 188 at 165–66, Lord Goff of Cheiveley; *CTN Cash and Carry*, *supra* note 188 at 717–18, Steyn L.J.

226. See, e.g., *Stott*, *supra* note 189 at 305, Finlayson J.A.

227. See Hamish Stewart, “Economic Duress in Canadian Law: Towards a Principled Approach” (2003) 82 Can. Bar Rev. 359 at 374–75.

228. Stephen A. Smith, “Contracting Under Pressure: A Theory of Duress” (1997) 56 Cambridge L.J. 343 at 364–65 [footnotes omitted].

to be something like criminal law's voluntariness requirement,<sup>229</sup> then it is difficult to see how most cases involving economic duress could ever meet this standard. Of course, some flexibility could be built into this standard. This flexibility may be implied from the willingness of courts adopting this approach to focus on a series of factors in order to answer the main question. But this willingness suggests that the main question may have the potential to lead the analysis astray, if it is focussed on too closely.<sup>230</sup> And if it were made the main focus of the inquiry, then it would cause the courts to have to embark on a difficult investigation into the victim's subjective state of mind.<sup>231</sup> Finally, given the trend away from this standard in the United Kingdom and elsewhere in Canada,<sup>232</sup> adopting it in legislation runs the risk of setting British Columbia law at odds with the law in other jurisdictions.

The committee tentatively recommends that:

*15. The Contract Fairness Act should not require a contracting party to show that its will was overborne in order to obtain a remedy for duress.*

### 3. SHOULD A REQUIREMENT TO SHOW ILLEGITIMATE PRESSURE BE AN ELEMENT OF THE DURESS PROVISION?

The notion of *illegitimate pressure* as a major element in determining whether an agreement has been tainted by duress entered the Anglo-Canadian law of duress in the majority and dissenting judgments in *Universe Tankships*.<sup>233</sup> This criterion is used to draw the line between conduct that does and does not amount to duress. In this sense, it picks up the role that was played in earlier judgments by the overborne

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229. See Stewart, *supra* note 227 at 366 ("the theory suggests that the plea of duress cannot succeed unless [the contracting party advancing it] has been reduced to a state of automatism").

230. See *ibid.* ("The theory of the overborne will seems either to restrict the scope of duress to a very small group of situations, or to be aimed at the wrong target." [footnote omitted]).

231. See M.H. Ogilvie, "Economic Duress in Contract: Departure, Detour or Dead-End?" (2000) 34 Can. Bus. L.J. 194 at 194-95 [Ogilvie, "Economic Duress"] ("as the subsequent evolution of the English case law especially has demonstrated, the overborne will theory was too subjective to have exclusive evidentiary value and required support from other criteria to determine whether a will has been truly overborne." [footnote omitted]); Rick Bigwood, "Coercion in Contract: The Theoretical Constructs of Duress" (1996) 46 U.T.L.J. 201 at 207 ("Certainly, the rejection of the overborne will theory has been pivotal to the articulation of a sound conceptual rationale for the modern law of duress. . .").

232. See *Nav Canada*, *supra* note 189 at para. 40, Robertson J.A.

233. *Supra* note 188 at 384, Lord Diplock ("The rationale [for duress] is that [a contracting party's] apparent consent was induced by pressure exercised upon him by that other party which the law does not regard as legitimate. . ."); at 400, Lord Scarman (dissenting).

will. It shifts the focus from a subjective inquiry into the victim's will to an inquiry into the type of pressure exerted and the effect of that pressure on the victim's legal rights and obligations.<sup>234</sup> As Lord Scarman put it in *Universe Tankships*:

In determining what is legitimate two matters may have to be considered. The first is as to the nature of the pressure. In many cases this will be decisive, though not in every case. And so the second question may have to be considered, namely, the nature of the demand which the pressure is applied to support.<sup>235</sup>

His Lordship goes on to explain that when what is threatened is unlawful action directed “to life or limb, or to property,” then it will amount to illegitimate pressure, whatever the nature of the demand.<sup>236</sup> This covers cases where the threat is clearly unlawful—for example, duress to the person cases, duress by detention of property, and some cases of economic duress. But contract law has recognized that duress may occur even when the actions threatened are lawful. In these types of cases, it is necessary to examine the nature of the demand in order to determine whether pressure is illegitimate.<sup>237</sup>

The standard of illegitimate pressure has become the dominant approach in English law to cases of duress. It has also been adopted in many of the leading appellate decisions—though in Canada it has occasionally been mixed with the older, overborne-will standard. Finally, the illegitimate-pressure approach is similar to the approach used in American law. The *Restatement* sets out the approach to duress typically used in American courts:

### § 175. When Duress by Threat Makes a Contract Voidable

(1) If a party's manifestation of assent is induced by an improper threat by the other party that leaves the victim no reasonable alternative, the contract is voidable by the victim.

(2) If a party's manifestation of assent is induced by one who is not a party to the transaction, the contract is voidable by the victim unless the other party to the transaction in good faith and without reason to know of the duress gives value or relies materially on the transaction.<sup>238</sup>

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234. See Stewart, *supra* note 227 at 360 (“This approach . . . focusses not on the victim's will, but on the legitimacy of the stronger party's threat and on the effect of that threat on the weaker party's choices. . .”).

235. *Supra* note 188 at 401.

236. *Ibid.*

237. *Ibid.*

238. *Restatement (Second) of Contracts* § 175 (1981).

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Subsection (2) addresses a situation that has not come up in the leading English or Canadian cases. Subsection (1), on the other hand, essentially corresponds to Lord Scarman’s two elements of duress—“(1) pressure amounting to compulsion of the will of the victim; and (2) the illegitimacy of the pressure exerted”<sup>239</sup>—with different terminology and word order (“pressure amounting to compulsion of the will” = “leaves the victim no reasonable alternative”; “illegitimacy of the pressure exerted” = “improper threat”).

The main argument in favour of the illegitimate-pressure approach is the leading position it occupies in the current jurisprudence. Supporters of this approach have developed other arguments in its favour. For example, Hamish Stewart cites the following three characteristics as desirable features of what he calls the “formal approach”:

First, duress is treated normatively: the question of whether [the victim] acted under duress is inseparable from the question of what [both contracting parties’] rights were in circumstances. Second, for the formal approach the important empirical fact about [the victim] is not whether his or her will was overborne, but whether his or her opportunities were meaningfully impaired by [the other contracting party’s] actions. Third, the formal approach does not attempt to encompass all potential grounds of contractual relief; it is concerned with a particular class of situations, leaving open the possibility that other situations may be handled with other legal tools (such as unconscionability or undue influence).<sup>240</sup>

There are criticisms of the illegitimate-pressure standard. The most noteworthy crop up in the decision in the *Nav Canada* case, in which the New Brunswick Court of Appeal rejected the standard in a case involving a modification to an executory contract. Robertson J.A., who gave the judgment of the court, explained the court’s concerns as follows:

In my view, the criterion of illegitimate pressure adds unnecessary complexity to the law of economic duress, and presently lacks a compelling juridical justification. . . . The law does not provide a workable template for distinguishing between legitimate and illegitimate pressure. . . .

My concern is that just as the courts developed legal fictions to enforce otherwise gratuitous promises, so too will they spend too much time trying to explain the difference between illegitimate and legitimate pressure. . . . Moreover, I am afraid that the distinction between legitimate and illegitimate pressure will soon lead to the understanding

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239. *Universe Tankships*, *supra* note 188 at 400.

240. *Supra* note 227 at 370.

that a plea of economic duress can be defeated by a plea of “good faith” on the part of the coercer. . . .<sup>241</sup>

The committee took note of these concerns, but it decided that the illegitimate-pressure standard occupies a central place in the jurisprudence and should be reflected in the *Contract Fairness Act*.

The committee tentatively recommends that:

*16. The Contract Fairness Act should require a contracting party to show that it was induced into a contract by illegitimate pressure in order to obtain a remedy in duress.*

#### 4. SHOULD THE DURESS PROVISION CONTAIN A LIST OF FACTORS?

One of the main questions that a court must answer in a duress case is whether the pressure applied to a victim resulted in a severe limitation of the victim’s will-power—either to the point of being a will-less automaton or to the point where the victim had no practical alternative but to act in the way insisted upon by the coercer. In the *Pao On* case, Lord Scarman offered the following list of evidentiary factors as a way to assist courts in answering this question:

- (1) Did the victim protest?
- (2) At the time the victim was being coerced, did the victim have an alternative course open to pursue (such as, for instance, an adequate legal remedy)?
- (3) Was the victim independently advised?
- (4) After entering into the contract, did the victim take steps to avoid it?<sup>242</sup>

This list of factors has been applied in most of the leading Canadian duress cases.<sup>243</sup> The appeal of this approach is that it takes what is a difficult inquiry into the victim’s subjective state of mind and re-orientates it toward objective, evidentiary matters. This approach may help to allay concerns about the scope of duress, and its potential to

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241. *Supra* note 189 at paras. 47–48.

242. *See supra* note 189 at 635.

243. *See Stott, supra* note 189 at 305–06, Finlayson J.A.; *Byle, supra* note 208 at 651, 653, Macdonald J.A.; *Gordon, supra* note 189 at 672–74, McKinlay J.A. (for the court); *Wolda, supra* note 189 at paras. 32–38, Rosenberg J.A. (for the court).



unsettle commercial contracts. It also may make the resolution of cases involving duress a more straightforward task for the courts.

The list of factors from *Pao On* have been criticized by a few commentators.<sup>244</sup> The main concerns are that, despite qualifiers issued in *Pao On* and the cases that follow it that these factors are evidential considerations intended to assist the court in answering the main question, these factors have proved in practice to be too rigidly applied<sup>245</sup> and too distracting.<sup>246</sup> One leading critic of this approach has also argued that the only relevant factor on the list is number (2), the absence of practical alternatives, and the other factors add nothing to the analysis.<sup>247</sup>

The committee sees a benefit in providing the courts with some guidance in deciding duress cases. The factors set out in the jurisprudence provide a good starting point. The key factor is the lack of a practical alternative. In the committee's view, it is particularly important for courts to consider this point if the overborne-will standard is not to be a feature of duress.

The committee tentatively recommends that:

*17. The Contract Fairness Act should contain the following list of factors for duress cases: (a) whether the victim protested; (b) whether, at the time the victim was being coerced, the victim had a practical alternative course open to pursue; (c) whether, after entering into the contract, the victim took steps to avoid it.*

### 5. SHOULD INDEPENDENT LEGAL ADVICE BE INCLUDED IN THE LIST OF FACTORS?

Independent legal advice merits consideration as a separate issue because it is the item on the list of *Pao On* factors that has taken the most criticism. The focus of this criticism has been on the usefulness of considering independent legal advice as a factor in many cases. Interestingly, this point has appeared in some of the cases subsequent to *Pao On*. In *Gordon*, the court dispensed with the factor quickly by observing that independent advice in the circumstances of the case would have simply con-

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244. Notably, the list of factors was not applied in *Nav Canada*, *supra* note 189.

245. See Ogilvie, "Economic Duress," *supra* note 231 at 202 ("In these cases [*i.e.*, several leading Canadian duress cases], the same reasoning process is employed: the *Pao On* checklist is recited and applied mechanically to produce the result that no economic duress was present").

246. See *ibid.* at 201 (arguing that "Canadian courts have applied a checklist to come to the unrelated conclusion of an overborne will," while making "no separate assessment of consent").

247. See *ibid.* ("the checklist devolves to a single determinant, the absence of practical alternatives to the victim other than to acquiesce").

firmed that the victim had no practical alternative to submission to the coercer's demands.<sup>248</sup> And in *Nav Canada*, the court declined to incorporate independent legal advice into its test, for the following reasons:

Indeed, one cannot help but speculate that it would be rare for sophisticated commercial parties, such as those before us, not to consult legal counsel and have their solicitors draft correspondence to bolster their clients' respective positions in anticipation of a possible plea of economic duress. The fact of the matter is that access to independent legal advice on the part of the victim is not sufficient to overcome the finding that he or she had no alternative but to submit to the contractual variation demanded by the coercer. . . . it seems to me that the notion of "independent legal advice" is more amenable to cases where a person has entered into an improvident bargain which is attacked on the grounds of unconscionability, undue influence and duress. . . . I am hesitant to embrace the notion of independent legal advice as an integral component of the economic duress doctrine.<sup>249</sup>

Although independent legal advice is frequently applied as part of the *Pao On* list of factors, its place on that list is rarely given separate justification. Independent legal advice could be seen as supporting the overall inquiry into whether a victim had practical alternatives, as the advice would likely aid the victim in identifying these alternatives, if they exist.

In the committee's view, the criticisms of independent legal advice have some force. Although its existence is relevant to the determination of cases involving unconscionability or undue influence, it typically should not be relevant in cases involving duress. For this reason, it should be left off the list of factors.

The committee tentatively recommends that:

*18. The Contract Fairness Act should not include independent legal advice as a factor for consideration in duress cases.*

### 6. SHOULD THE DURESS PROVISION CONTAIN A LIST OF ACTIONS THAT AMOUNT TO ILLEGITIMATE PRESSURE?

As was noted above,<sup>250</sup> one of the criticisms of the judicial focus on the illegitimacy of the pressure applied to the victim in cases of duress is that illegitimacy can be a vague standard for determining when the bargaining and use of economic power

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248. *Supra* note 189 at 674, McKinlay J.A.

249. *Supra* note 189 at para. 60, Robertson J.A.

250. *See, above*, at 63–66 (section IV.C.3).

that is expected in forming a commercial agreement crosses the line into unacceptable coercion. The American *Restatement* addresses this concern by setting out a list of actions that amount to illegitimate pressure for the purposes of duress. The list contains the following items:

### § 176. When a Threat is Improper

- (1) A threat is improper if
  - (a) what is threatened is a crime or a tort, or the threat itself would be a crime or a tort if it resulted in obtaining property,
  - (b) what is threatened is a criminal prosecution,
  - (c) what is threatened is the use of civil process and the threat is made in bad faith, or
  - (d) the threat is a breach of the duty of good faith and fair dealing under a contract with the recipient.
- (2) A threat is improper if the resulting exchange is not on fair terms, and
  - (a) the threatened act would harm the recipient and would not significantly benefit the party making the threat,
  - (b) the effectiveness of the threat in inducing the manifestation of assent is significantly increased by prior unfair dealing by the party making the threat, or
  - (c) what is threatened is otherwise a use of power for illegitimate ends.<sup>251</sup>

The basic terminology of this passage may require some explanation. The *Restatement* uses the words *improper threat* where Anglo-Canadian judges have used *illegitimate pressure*. *Threat* is used here in a fairly expansive way. For instance, the authors of the *Restatement* consider that, in every contractual negotiation, there is an “implied threat” not to enter into the contract if the parties cannot agree on acceptable terms.<sup>252</sup> So, threats (or pressure) are equivalent to the typical use of economic power in negotiations. This section in the *Restatement* is intended to clarify when threats transform into improper threats. The guiding rationale for the categories in this section is described in the following terms in the commentary to the section:

The rules stated in this Section recognize as improper both the older categories and their modern extensions under developing notions of “economic duress” or “business compulsion.” The fairness of the resulting exchange is often a critical factor in cases involving threats. The categories within Subsection (1) involve threats that are either so shocking that the court will not inquire into the fairness of the resulting exchange (see

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251. *Restatement (Second) of Contracts* § 176 (1981).

252. *Restatement (Second) of Contracts* § 176 cmt. a (1981).

Clauses (a) and (b)) or that in themselves necessarily involve some element of unfairness (see Clauses (c) and (d)). Those within Subsection (2) involve threats in which the impropriety consists of the threat in combination with resulting unfairness. Such a threat is not improper if it can be shown that the exchange is one on fair terms.<sup>253</sup>

Clauses (1) (a), (b), and (c) are relatively straightforward expressions of aspects of the traditional common-law conception of duress. Clause (1) (d) is aimed at the thorny problem of threatened breach of contract. In general, the law allows a contracting party to breach a contract—but it will be liable in damages for doing so. So, a threat to breach a contract is not necessarily improper. But this threat is often the vehicle for economic duress. Under the *Restatement* the threat to breach a contract crosses the line to become an improper threat “if it amounts to a breach of the duty of good faith and fair dealing imposed by the contract.”<sup>254</sup> The comment goes on to explain that a modification would have to have a “legitimate commercial reason” to meet this standard.<sup>255</sup> Clause (2) (c) is designed as a catchall provision, to ensure that emerging improper threats are not frozen out. Nevertheless, the commentary to the section notes that “hard bargaining” between persons of “relatively equal power” should not be discouraged under the section, indicating that the courts should take a conservative approach to applying its provisions to commercial contracts.<sup>256</sup>

The main argument in favour of including a list similar to the one set out in the *Restatement* is that it answers a criticism often made of the Anglo-Canadian jurisprudence, which is that its key standard, illegitimate pressure, is unclear in scope. By setting some—or conceivably all—of the actions that constitute illegitimate pressure the legislation provides contracting parties with guidance and certainty.

The disadvantages to this approach include the general concerns that come with including lists of specific items in legislation. There is a danger that the list will detract from, or narrow, the general principle. The issues of the moment may get set in stone and serve to hinder the courts’ later attempts to deal with emerging issues. A concern that is specific to the list in the *Restatement* is its reliance on a particular conception of good faith.

The committee wrestled with this issue. It recognized that a statutory list of actions that amount to illegitimate pressure would have attractive qualities. Anglo-Canadian

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253. *Restatement (Second) of Contracts* § 176 cmt. a (1981).

254. *Restatement (Second) of Contracts* § 176 cmt. e (1981) [citation omitted]. Note that § 205 of the *Restatement* imposes a general contractual duty of good faith and fair dealing in contracts.

255. *Restatement (Second) of Contracts* § 176 cmt. e (1981).

256. *Restatement (Second) of Contracts* § 176 cmt. f (1981).

law has not articulated a clear standard for determining when pressure becomes illegitimate pressure. Courts are simply directed to consider “the nature of the pressure” and the “nature of the demand which the pressure is applied to support.”<sup>257</sup> A more definitive set of criteria would be helpful. But this issue cannot be remedied by adopting the list from the *Restatement*. That list is too tied into other aspects of American law (notably the expanded concept of good faith). It would have to be modified for British Columbia. The challenge is to modify it in such a way as to go beyond obvious generalities but to stop short of being too specific and unduly restrictive. The committee was unable to formulate a set of propositions that struck this balance. Ultimately, it determined that it may not be possible to craft a legislative provision that covers all of this highly fact-driven area.

The committee tentatively recommends that:

*19. The Contract Fairness Act should not include a list of actions that amount to illegitimate pressure.*

### 7. SHOULD THE DURESS PROVISION CONTAIN A SPECIAL RULE FOR CONTRACTUAL MODIFICATIONS?

The notion of formulating a distinct test for duress in cases involving a modification of an existing contract—as opposed to duress that leads to the formation of a contract—was raised in the recent decision of the New Brunswick Court of Appeal in *Nav Canada*.<sup>258</sup> This case involved a dispute between Nav Canada, a federal not-for-profit corporation that operates this country’s civil air-navigation service, and the Greater Fredericton Airport Authority. Under an agreement, Nav Canada had the exclusive right to provide aviation services and equipment to the airport authority.<sup>259</sup> The authority decided to extend one of its runways and asked Nav Canada to relocate some of its equipment. Nav Canada wanted the equipment to be replaced with new equipment instead.<sup>260</sup>

A dispute broke out over who was responsible to pay for the new equipment. Initially, the airport authority took the position that nothing in the existing agreement required it to pay, but ultimately it made the payment, expressly under protest, in

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257. *Universe Tankships, supra* note 188 at 401, Lord Scarman.

258. *Supra* note 189 at para. 51, Robertson J.A. (for the court).

259. *Ibid.* at para. 2.

260. *Ibid.*

order to move ahead with its runway project.<sup>261</sup> The parties took their dispute to arbitration and, eventually, to two levels of the New Brunswick courts, and in each case it was clear that nothing in the original agreement entitled Nav Canada to the payment it received from the authority.<sup>262</sup> The issue, first in arbitration, then through two levels of the courts, was whether the payment amounted to an enforceable modification of the existing agreement.

Many of the earlier leading cases on economic duress concern similar contractual modifications,<sup>263</sup> but the statements of principle set out in them were framed to apply to all contracts, not just modifications. One possible reason for the court in *Nav Canada* drawing this distinction is that it wanted to make a number of changes to the existing law of economic duress, but it also wanted to be careful to confine those changes to cases like the one at hand, to guard against accusations of overreaching. But the doctrinal reason offered by the court related to the doctrine of consideration.

The doctrine of consideration is one of the traditional building blocks of the common-law conception of contract. It essentially provides an answer to the fundamental question of what types of promises should be enforced by the courts. If the promises are gratuitous—that is, if nothing of value changes hands on a promise—then, in the vast majority of cases,<sup>264</sup> it is not enforceable at law. If there is consideration for the promise, then it is enforceable.<sup>265</sup> The doctrine of consideration is not concerned with fair value—the consideration may be a trivial item or sum of money (*e.g.*, one dollar) and it will be acceptable for the purposes of this rule. Since fairness is not directly at issue here, the doctrine of consideration falls outside the scope of the Unfair Contracts Relief Project.

But it is important for the discussion of this issue to note that the doctrine of consideration has often in the past been used by the courts in creative ways to address situations like the one in *Nav Canada*. As the court in that case noted, this approach has been strongly criticized in recent years as being a strained and artificial way to

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261. *Ibid.*

262. *Ibid.* at para. 3.

263. A common fact pattern involves one party threatening to breach a contract at a particularly inopportune time for the other unless that other party makes new concessions on certain terms.

264. The exception here is for contracts made under seal.

265. Unless one of the limited exceptions to enforceability applies—for example, if the contract were unconscionable, it would not be enforceable, even though consideration changed hands.

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address the issue.<sup>266</sup> Economic duress appears to offer a clearer and more direct approach. But the court was concerned with some aspects of the jurisprudence, and proposed asking the following questions as a kind of test for duress in cases of contractual modification:

- (1) Has the contractual modification been extracted by pressure?
- (2) Has the exercise of that pressure been so forceful that it has given the victim no practical alternative but to agree to the contractual modification proposed by the coercer?

These two questions are the conditions precedent to the inquiry. If they are answered in the affirmative, then the following question must also be considered.

- (3) Did the victim consent to the contractual modification? In order to decide whether the victim has consented, the court is directed to look at the following three factors:
  - (a) was the modification supported by consideration?
  - (b) did the victim agree to the modification under protest or without prejudice? and
  - (c) if the answer to (3) (b) is *no*, then did the victim take reasonable steps to disaffirm the variation as soon as possible?<sup>267</sup>

Since *Nav Canada* is a very recent decision, there is not much commentary on its proposed reforms to the law of duress. There are two ways to evaluate the reform proposed by the New Brunswick court. First, it could be considered for contractual modifications alone. In this case, the proposed reform would have to contend with the undesirability, on the surface at least, of setting out two distinct standards in the legislation for two types of contractual situations. Second, this proposed reform could be considered on its merits for all contracts, as a new standard to be applied in all cases of duress.

The committee could not find a strong rationale that would justify adopting a special approach to deal with contractual modifications. In the absence of such a rationale, it is undesirable to fragment the law on this point. It would also be undesirable to adopt this approach generally, as it is out of step with the current jurisprudence on duress and it was not designed for general application.

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266. *Supra* note 189 at paras. 28–32, Robertson J.A.

267. *See ibid.* at para. 53, Robertson J.A.

The committee tentatively recommends that:

*20. The Contract Fairness Act should not adopt a special standard for duress in cases of contractual modifications.*

## 8. WHAT REMEDIES SHOULD BE AVAILABLE IN CASES OF DURESS?

The traditional remedy for a contract obtained by duress is an order that the contract is voidable. There was some doubt in the law at one time over whether the proper order was that the contract was voidable or that it was void, but these doubts have been resolved in favour of the contract being voidable.<sup>268</sup> The significance of this distinction lies in the fact that an order that a contract is void is essentially a declaration that the law will treat the “contract” at issue as if it never existed. An order that the contract is voidable means that the contract will be void if the victim elects for it to be void. So, a victim has the option to affirm a voidable contract and it will, at law, continue to be binding on the parties, but a victim cannot affirm a void contract—it is as if that contract never existed.

What happens if money or other property has been transferred under the contract and the victim elects to treat it as void? Since a void contract is, in the eyes of the law, something that never existed, the victim cannot have a remedy in damages. Damages are a contractual remedy—that is, they require a contract to support the remedy. This does not mean that the coercer is able to keep any money or property taken from the victim on the strength of duress. Instead, it means that the victim’s remedy comes from another branch of the law—the law of restitution.<sup>269</sup>

As this summary suggests, the range of remedies for duress is quite limited. In this respect, duress resembles the traditional conception of unconscionability, which also provided only for a limited range of remedies. But the difference between the two is that it is a staple of modern commentary and law-reform efforts relating to unconscionability to propose expanding the courts’ range of remedies to deal with unconscionability. Duress, on the other hand, does not appear to have attracted these types of proposals. This comparative silence may be an indication that the traditional remedies are working adequately for duress. But since remedies forms an important topic for all of the concepts in this project, it is worthwhile to consider whether the traditional remedies are all that the courts need to deal with duress.

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268. See *Byle*, *supra* note 208 at 650, Macdonald J.A. (overruling trial judge and concluding that contract obtained by duress is voidable, not void).

269. See, above, at 5–8 (part II.B) (for more detail on restitution).

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It would be possible to adopt a broad approach, similar to the one recommended by a number of commentators for unconscionability. For example, the New Zealand Law Commission proposed a provision for unconscionability that would empower the court to make any order that it thought just in the circumstances, including, but not limited to, the following:

- (a) declare the contract to be valid and enforceable in whole or in part or for any particular purpose;
- (b) cancel the contract;
- (c) declare that a term of the contract is of no effect;
- (d) vary the contract;
- (e) award restitution or compensation to any party to the contract;
- ...
- (g) vest any property in any party to the proceedings, or direct any party to transfer or assign any property to any other party to the proceedings;
- (h) order that an account be taken, and reopen any account already taken, in respect of any transaction between the parties.<sup>270</sup>

The rationale for an expansive list of remedies is that it gives the courts the tools to address problems that may emerge after the legislation is enacted. The general disadvantage of an expansive list is that it could be used effectively to rewrite a contract and impose terms on the parties that they would never have agreed to in the first place.

In the committee's view, the advantages of remedial flexibility far outweigh any potential disadvantages.

The committee tentatively recommends that:

*21. The Contract Fairness Act should allow the court to make any order that it thinks is just, including any of the following orders on the list recommended by the New Zealand Law Commission: (a) declaring the contract to be valid and enforceable in whole or in part or for any particular purpose; (b) rescinding the contract; (c) declaring that a term of the contract is of no effect; (d) varying the contract; (e) awarding restitution or compensation to any party to the contract; (f) vesting any property in any party to the proceedings, or direct any party to transfer or assign any property to any other party to the proceedings;*

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270. "Unfair" Contracts: A Discussion Paper, *supra* note 76 at 46–47.

*(g) ordering that an account be taken, and reopening any account already taken, in respect of any transaction between the parties.*

9. SHOULD ANY TYPES OF CONTRACTS OR CONTRACTING PARTIES BE EXCLUDED FROM THE DURESS PROVISION?

Under the current law, duress applies to all types of contracts and contracting parties. In fact, many of the leading cases in duress have involved large-scale corporate parties to sophisticated commercial contracts.

Unlike unconscionability,<sup>271</sup> duress has not attracted calls from commentators to limit its scope. Indeed, it is difficult to see how a limiting factor could be imposed on duress without undercutting the concept's purpose and rationales.

In the committee's view, it would be undesirable to change the current law and limit the scope of duress. In addition, an unrestricted legislative provision on duress would be in closer harmony with the committee's proposals for unconscionability and undue influence.

The committee tentatively recommends that:

*22. The duress provision in the Contract Fairness Act should apply to all types of contracts and contracting parties.*

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271. *See, above, at 51–52 (section III.C.11) (for a discussion of proposals to limit the scope of unconscionability).*

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## CHAPTER V. UNDUE INFLUENCE

### A. General Background

#### 1. DEFINITION OF UNDUE INFLUENCE

Prof. Farnsworth has written a good description of undue influence:

The concept of undue influence developed in the courts of equity to give relief to victims of unfair transactions that were induced by improper persuasion. In contrast to the common law notion of duress, the essence of which was simple fear induced by threat, the equitable concept of undue influence was aimed at the protection of those affected with weakness, short of incapacity, against improper persuasion, short of misrepresentation or duress, by those in a special position to exercise such persuasion.<sup>272</sup>

As this quotation indicates, undue influence is closely related to unconscionability and duress, the two contract-law concepts that were considered earlier in this consultation paper. The key to undue influence is that it mainly (if not always) applies to cases of pressure that do not have the dramatic force of duress, because the pressure appears in the course of a special, intimate relationship in which one party is effectively subservient to the other.

#### 2. COMPLICATING FACTORS

Although some of the following material will seem familiar after the previous chapters' discussions of unconscionability and duress, it is important to grasp at the start that undue influence has some special complications<sup>273</sup> that do not apply either to unconscionability or duress.

First, the name *undue influence* suffers from a level of ambiguity that does not affect *unconscionability* or *duress*. Although the legal concepts that go by those names have their subtleties and complexities, in everyday speech those two words have a visceral impact that conveys the immediate impression that they are concerned with extreme conduct. *Influence* lacks this punch, and its modifier, *undue*, is a rather

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272. *Farnsworth on Contracts*, *supra* note 24, vol. 1 at § 4.20 [footnote omitted].

273. See Rick Bigwood, "Undue Influence in the House of Lords: Principles and Proof" (2002) 65 Mod. L. Rev. 435 at 435 ("Few areas of the law have struggled so unsuccessfully for satisfactory doctrinal exposition and analysis as the equitable jurisdiction to relieve against undue influence in the procurement of an *inter vivos* transaction.") [Bigwood, "Principles and Proof"].

vague word, which can mean either *wrongful* or *excessive*.<sup>274</sup> This ambiguity can lead to problems in accurately defining the scope of the concept.<sup>275</sup>

Second, undue influence appears as a concept in two distinctive bodies of law: contract law and the law of wills and estates. It is readily understandable that the same types of coercive conduct could raise issues with respect to both contracts and wills, but it is unfortunate that the same name is used for both concepts. Testamentary undue influence and contractual undue influence differ on a key legal issue for undue influence. This issue there should be a presumption of undue influence in cases in which the parties are in a special relationship that creates a heightened danger that one party may dominate the other.<sup>276</sup> Testamentary undue influence does not form part of this project, and the committee has taken care to ensure that its tentative recommendations do not affect testamentary undue influence.

Third, even the contract-law concept of undue influence has been shaped to a surprising degree by other bodies of law. A number of the leading cases on contractual undue influence turn out to involve gratuitous *inter vivos* transfers of property (that is, gifts) rather than transfers of property or services for valuable consideration (that is, contracts). And the law of fiduciary duty provides an important source for basic concepts used in defining a key issue for undue influence. The committee has been careful to avoid affecting these areas of the law in formulating tentative recommendations for reform of the law of contracts.

Fourth, the identity of the litigants in an undue-influence case has a significant bearing on the case's outcome. As will be explained more fully below, the law divides undue-influence cases into at least two classes. The division is made by analyzing the relationship between the dominant person and the subservient person. Certain relationships obtain the benefit of a presumption, which effectively shifts the burden of

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274. See *The New Shorter Oxford English Dictionary*, s.v. "undue" ("2 That ought not to be done; inappropriate, unsuitable, improper; unrightful, unjustifiable. 3 Going beyond what is warranted or natural; excessive, disproportionate.").

275. See Peter Birks & Chin Nyuk Yin, "On the Nature of Undue Influence," in Jack Beatson & Daniel Friedmann, eds., *Good Faith and Fault in Contract Law* (Oxford: Clarendon Press, 1995) 55 at 86–87.

276. See A.H. Oosterhoff, *Oosterhoff on Wills and Succession*, 6th ed. (Toronto: Thomson Carswell, 2007) at 225 ("With respect to *inter vivos* gifts, if the person who receives the gift was in a position to exert undue influence over the donor and stood in a fiduciary or confidential relationship to him or her, a presumption of undue influence is raised. However, even though the court will jealously scan the evidence in the case of a will if undue influence is alleged, the onus of proof (or disproof) does not rest on such a fiduciary, but remains with those alleging undue influence.").

proof to the dominant person to disprove that the transaction at issue was not tainted by undue influence.

## B. Historical Development

### 1. ORIGINS OF UNDUE INFLUENCE

Like unconscionability, undue influence finds its origin in the equity jurisprudence of the English Court of Chancery.<sup>277</sup> One of the maxims of equity is that equity supplements the law. In this case, its supplementary jurisprudence is in relation to the common-law concept of duress. For much of its history, duress was defined in very limited terms. The common-law courts essentially restricted its scope to threats of violence. Cases involving subtler forms of pressure wound up in the Court of Chancery.

These cases tended to involve coercion from family members or close confidants exercised upon vulnerable individuals. They were dealt with as part of the general equity jurisdiction to protect vulnerable people from exploitation. A distinct role for undue influence emerged as the modern conception of unconscionability was developed in the eighteenth and nineteenth centuries. Even so, the courts continued to resist defining the concept in precise terms. A judge in a leading early case captured this approach well, noting that “the Courts have always been careful not to fetter this useful jurisdiction by defining the exact limits of its exercise.”<sup>278</sup>

### 2. FORMATION OF THE MODERN CONCEPTION OF UNDUE INFLUENCE IN THE NINETEENTH CENTURY

The seminal undue-influence case is a late nineteenth-century English decision called *Allcard v. Skinner*.<sup>279</sup> This case, which concerned a series of gifts, established the place of undue influence among the tools that the law uses to deal with contractual unfairness:

What then is the principle? Is it that it is right and expedient to save persons from the consequences of their own folly? or is it that it is right and expedient to save them from being victimised by other people? In my opinion the doctrine of undue influence is

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277. See, above, at 10–12 (section II.C.3) (for more detail on the distinction between common law and equity).

278. *Tate v. Williamson* (1866), L.R. 2 Ch. App. 55 at 61, Lord Chelmsford L.C.

279. (1887), 36 Ch.D. 145 (Eng. C.A.) [*Allcard*] (A donating cash and shares upon joining convent with strict ethos of poverty—after leaving convent, A suing its spiritual director seeking to set aside certain gifts made to convent—court finding A was subject to undue influence, but claim barred due to her delay in bringing it and her acquiescence in the gift).

founded upon the second of these two principles. Courts of Equity have never set aside gifts on the ground of the folly, imprudence, or want of foresight on the part of donors. . . . On the other hand, *to protect people from being forced, tricked or misled in any way by others into parting with their property* is one of the most legitimate objects of all laws; and the equitable doctrine of undue influence has grown out of and been developed by the necessity of grappling with insidious forms of spiritual tyranny and with the infinite varieties of fraud.<sup>280</sup>

The highlighted part of the above passage points to the evil that is addressed by undue influence. This evil is coercion that, as it is put by another judge on the panel, prevents “the free exercise of the donor’s will.”<sup>281</sup> This sounds similar to duress, except that undue influence is potentially more expansive in the cases that come within its scope and that the law treats certain types of relationships differently from others.

### 3. DIFFERENT CLASSES OF UNDUE INFLUENCE

As Lindley L.J. explained in *Allcard*, there are two types of undue influence:

First, there are the cases in which there has been some unfair and improper conduct, some coercion from outside, some overreaching, some form of cheating, and generally, though not always, some personal advantage obtained by a donee placed in some close and confidential relation to the donor. . . .

The second group consists of cases in which the position of the donor to the donee has been such that it has been the duty of the donee to advise the donor, or even to manage his property for him. In such cases the Court throws upon the donee the burden of proving that he has not abused his position, and of proving that the gift made to him has not been brought about by any undue influence on his part.<sup>282</sup>

These two types of undue influence are sometimes called *actual* undue influence and *presumed* undue influence. As those terms are somewhat loaded and somewhat inaccurate, courts and academics have taken to using the more neutral descriptors *class (1)* and *class (2)* undue influence. A key question in *Allcard* was whether the plaintiff’s claim fell into class (1) or if, by virtue of the relationship between the litigants, it belonged in class (2). The tension between this rather schematic approach and the desire of some judges to leave undue influence in as open-ended a state as possible is important to keep in mind, as it crops up repeatedly in the leading cases decided in the past 30 years.

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280. *Ibid.* at 182–83, Lindley L.J. (emphasis added).

281. *Ibid.* at 171, Cotton L.J.

282. *Ibid.* at 181.

## C. Recent Developments

### 1. UNDUE INFLUENCE IN THE UNITED KINGDOM

As was the case for duress, undue influence has seen greater development in the United Kingdom than in Canada. The United Kingdom's leading appellate courts have issued a series of judgments in cases that typically concern the following fact pattern: a small business seeks financing from a financial institution (which, for the sake of brevity, will be referred to as a bank); the bank only makes financing available on the condition that the principal of the business personally guarantee its debts; the principal (who is a man in each case) has only one major asset—the family home, which is jointly owned with his wife; the wife takes no active part in the business, but is now asked to agree to the guarantee.<sup>283</sup> These cases raise issues that will be developed more fully in the options for reform below, but it is worthwhile to touch on three main issues now.

### 2. CLASSIFICATION, SUBSTANTIVE UNFAIRNESS, AND THIRD PARTIES

First, spousal relationships do not automatically fall within the list of relationships that always obtain the benefit of the presumption of undue influence. This has led to detailed and sophisticated consideration of how to classify the various types of undue influence. As noted earlier, there has been a schematic approach to undue influ-

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283. See *Morgan*, *supra* note 106 (borrowing by husband's company secured against family home—defaults putting home at risk—husband and wife turning to bank for “rescue operation”—bank official visiting home and explaining charge to wife in brief interview—wife alleging relation of confidence with bank that gives rise to presumption of undue influence—House of Lords rejecting claim); *Bank of Credit and Commerce International S.A. v. Aboody* (1989), [1990] 1 Q.B. 923, [1989] 2 W.L.R. 759 (Eng. C.A.) [*Aboody* cited to Q.B.] (wife meeting with bank regarding charge on family home to secure debts of husband's business—husband bursting into meeting and entering into shouting match with clerk—actual undue influence found—court affirming validity of charge as wife unable to show manifest disadvantage in transaction); *Barclays Bank Plc. v. O'Brien*, [1993] UKHL 6, [1994] 1 A.C. 180 [*O'Brien* cited to A.C.] (bank agreeing to raise overdraft limit for husband's company on condition that husband and wife grant second charge on family home—wife signing charge after perfunctory meeting at bank where she received no independent advice and husband was present—on default of company bank seeking possession of family home under charge—wife alleging agreement to charge induced by husband's undue influence—House of Lords affirming order to set aside charge); *C.I.B.C. Mortgages Plc. v. Pitt*, [1993] UKHL 7, [1994] 1 A.C. 200 [*Pitt* cited to A.C.] (husband pressuring wife to borrow money on strength of family home to invest in shares—actual undue influence found by court—charge not set aside—bank not having notice of potential of undue influence in case involving advance of funds jointly to husband and wife); *Royal Bank of Scotland Plc. v. Etridge (No. 2)*, [2001] UKHL 44, [2002] 2 A.C. 773 [*Etridge* cited to A.C.] (eight conjoined appeals each dealing with transactions in which a wife charges her interest in the family home as security for husband's borrowing).

ence that goes back to the *Allcard* case<sup>284</sup> from the nineteenth century, but it is worthwhile to set out in full the classification arrived at by the House of Lords, because aspects of this scheme will crop up in discussing options for reform.

In *O'Brien*, Lord Browne-Wilkinson (speaking for the court) approved of the following classification scheme from the *Aboody* decision<sup>285</sup> in the English Court of Appeal:

*Class 1: Actual undue influence*

In these cases it is necessary for the claimant to prove affirmatively that the wrongdoer exerted undue influence on the complainant to enter into the particular transaction which is impugned.

*Class 2: Presumed undue influence*

In these cases the complainant only has to show, in the first instance, that there was a relationship of trust and confidence between the complainant and the wrongdoer of such a nature that it is fair to presume that the wrongdoer abused that relationship in procuring the complainant to enter into the impugned transaction. In Class 2 cases therefore there is no need to produce evidence that actual undue influence was exerted in relation to the particular transaction impugned: once a confidential relationship has been proved, the burden then shifts to the wrongdoer to prove that the complainant entered into the impugned transaction freely, for example by showing that the complainant had independent advice. Such a confidential relationship can be established in two ways, viz.,

*Class 2(A)*

Certain relationships (for example solicitor and client, medical adviser and patient) as a matter of law raise the presumption that undue influence has been exercised.

*Class 2(B)*

Even if there is no relationship falling within Class 2(A), if the complainant proves the de facto existence of a relationship under which the complainant generally reposed trust and confidence in the wrongdoer, the existence of such relationship raises the presumption of undue influence. In a Class 2(B) case therefore, in the absence of evidence disproving undue influence, the complainant will succeed in setting aside the impugned transaction merely by proof that the complainant reposed trust and confidence in the wrongdoer without having to prove that the wrongdoer exerted actual undue influence or otherwise abused such trust and confidence in relation to the particular transaction impugned.<sup>286</sup>

But it should be noted that one judge in a subsequent House of Lords decision disapproved of the whole notion of classifying types of undue influence, finding that the

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284. *Supra* note 279.

285. *See Aboody, supra* note 283 at 953.

286. *O'Brien, supra* note 283 at 189.



effort “add[s] mystery rather than illumination.”<sup>287</sup> And the remainder of the panel in that case each had criticisms of various details of this classification structure.<sup>288</sup> These criticisms will be noted in the discussion of the issues for reform, but this structure still makes a good starting place for considering the options with respect to those issues.

Second, even when undue influence is presumed, the questions of whether proof of substantive unfairness is required and how to characterize that substantive unfairness have been vexing.<sup>289</sup>

Third, these United Kingdom cases squarely raise the issue of how a finding of undue influence affects a third party. The traditional remedy for undue influence is rescission of the contract obtained by the influence. But rescinding a guarantee in these circumstances can operate to the detriment of the bank and the benefit of the husband who wielded the influence.

### 3. UNDUE INFLUENCE IN CANADA

Undue influence has not figured as prominently in recent Canadian jurisprudence as it has in recent English jurisprudence. This may be due to the expanded role that unconscionability plays in Canadian law.<sup>290</sup> Nevertheless, unlike unconscionability and duress, undue influence has received extended consideration in the Supreme Court of Canada.<sup>291</sup> Although the *Geffen* case concerned a gift, not a contract, the court’s comments must be taken into account in discussing the law of contractual undue influence in Canada. In particular, *Geffen* contains a significant discussion of the types of relationships that receive the benefit of the presumption of undue influence and the requirement of showing substantive unfairness.

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287. *Etridge*, *supra* note 283 at para. 92, Lord Clyde.

288. *See ibid.* at para. 107, Lord Hobhouse; paras. 158–61, Lord Scott.

289. *See Morgan*, *supra* note 283 at 703–07, Lord Scarman (for the court); *Aboody*, *supra* note 283 at 954–62, Slade L.J. (for the court); *Pitt*, *supra* note 283 at 207–09, Lord Browne-Wilkinson (for the court); *Etridge*, *ibid.* at paras. 21–31, Lord Nicholls; paras. 155–56, Lord Scott.

290. *See, e.g., Canadian Imperial Bank of Commerce v. Ohlson* (1997), 154 D.L.R. (4th) 33, 57 Alta. L.R. (3d) 213 (C.A.). *See also* M.H. Ogilvie, “No Special Tenderness for Sexually Contracted Debt? Undue Influence and the Lending Banker” (1996) 27 Can. Bus. L.J. 365 at 393 [Ogilvie, “No Special Tenderness”] (“In contrast to the English focus on undue influence and fraudulent misrepresentation as the primary and secondary approaches, respectively, in dealing with the paradigm of banks taking security, the Canadian cases have utilized a number of doctrines, including unequal bargaining power, unconscionability, misrepresentation, fiduciary obligation, and, only occasionally, undue influence.”).

291. *See Geffen v. Goodman Estate*, [1991] 2 S.C.R. 353, 81 D.L.R. (4th) 211 [*Geffen* cited to S.C.R.].

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## D. Issues for Reform

The options for reform set out in this section have been drawn from the issues discussed most frequently in the leading Canadian and United Kingdom cases and in academic commentary. The focus initially is on the general question of legislating in this area. Then it shifts to consider the details of such legislation. Undue influence, in and of itself, has not been the subject of extended consideration from law-reform agencies. Both the American Law Institute<sup>292</sup> and the New Zealand Law Commission<sup>293</sup> touch on undue influence as part of larger publications, and their work provides some assistance, particularly in framing and refining the issues and options for reform.

### 1. SHOULD THE CONTRACT FAIRNESS ACT HAVE A PROVISION DEALING WITH UNDUE INFLUENCE?

In some respects the issue of whether the draft legislation should address undue influence presents similar considerations as whether the draft legislation should address unconscionability or duress. Legislation on undue influence could help to clarify aspects of the concept that are uncertain or difficult to apply. It may also serve to raise the profile of undue influence, which has been somewhat neglected in British Columbia. This greater awareness of undue influence could serve to clarify the interrelation of unconscionability, duress, and undue influence, and to direct litigants to framing their claims under the most appropriate concepts.<sup>294</sup>

In other respects, legislation regarding undue influence presents difficulties that did not apply to unconscionability or duress. One of the rationales for legislation in connection with those concepts was their lack of sustained consideration by the Supreme Court of Canada. This is not the case with undue influence, which received extensive consideration in *Geffen*.<sup>295</sup> Of course, since that case dealt with a gift, the court's comments on contractual undue influence should, strictly speaking, be considered *obiter dicta*. Nevertheless, *Geffen* does give a fairly good indication of how

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292. See *Restatement (Second) of Contracts* § 177 (1981). See, *supra*, note 78 (for general information on the American Law Institute's *Restatements*).

293. See "Unfair" Contracts: A Discussion Paper, *supra* note 76 at 33–35.

294. See Ogilvie, "No Special Tenderness," *supra* note 290 at 395 (describing "doctrinal confusion" among "breach of fiduciary duty, unequal bargaining power, unconscionability, and undue influence" as the "most noteworthy characteristic" of Canadian cases dealing banks' enforcement of guarantees obtained from debtors' family members).

295. *Supra* note 291.

the court would deal with a contractual undue-influence case.<sup>296</sup> In addition, there are the challenges of defining undue influence within the current jurisprudence. The courts have given a great deal of attention to a system for classifying cases for the purposes of shifting the burden of proof, but they have spent less time on formulating a test for undue influence, and have occasionally appeared hostile to the idea of setting a definitive test for the concept.<sup>297</sup>

The committee favours legislation on undue influence because it affords the opportunity to develop the common law in a logical and coherent fashion.

The committee tentatively recommends that:

*23. The Contract Fairness Act should contain an undue-influence provision.*

### 2. SHOULD A PRESUMPTION OF UNDUE INFLUENCE CONTINUE TO OPERATE AS PART OF THE CONTRACT FAIRNESS ACT?

#### (a) Introduction

The most difficult undue-influence issue is whether or not to retain the presumption that currently operates in the jurisprudence. This difficulty flows from the complex classification scheme that originated in English cases and was adopted into Canadian law in *Geffen*.<sup>298</sup> The existence of this classification scheme multiplies the options for reform. It is possible to retain the whole structure, dispense with it entirely, or refine parts of it.

As will be explained below, the committee's tentative recommendation is not to carry forward the presumption of undue influence in the *Contract Fairness Act*. In reaching this decision, the committee considered the options for and against retaining the class (2) presumption in its entirety, as well as options for and against retaining the class (2A) and class (2B) presumptions. These options are presented in the discussion that follows, to allow readers to consider the full range of possible recommendations for reform.

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296. See, e.g., Ogilvie, "No Special Tenderness," *supra* note 290 at 396–97 (noting that *Geffen* "thoroughly reconsidered the juridical nature of undue influence, and for that reason constitutes the contemporary Canadian counterpart to the *Morgan/O'Brien/Pitt* trilogy").

297. See, e.g., *Allcard*, *supra* note 279 at 183, Lord Lindley ("As no Court has ever attempted to define fraud so no Court has ever attempted to define undue influence. . ."); *Morgan*, *supra* note 283 at 709, Lord Scarman (asserting fact-based method of determining undue influence).

298. *Supra* note 291.

*(b) Class (2) Presumed Undue Influence as a Whole*

Class (2) undue influence is sometimes called presumed undue influence. In class (2) cases, the existence of undue influence is presumed by virtue of the relationship between the dominant and the subservient parties. As a result, the burden of proof shifts to the dominant party, who must disprove undue influence—that is, show that the subservient party entered into the transaction by the free exercise of his or her own judgment—in order to succeed.<sup>299</sup>

Class (2) is made up of two distinct subclasses. First, there is a group of defined relationships (such as solicitor and client) upon which the presumption always operates. Second, the presumption may apply to other relationships, not within the first group, if the subservient party can establish on the facts that the relationship was one in which “the potential for domination inheres in the nature of the relationship itself.”<sup>300</sup>

The rationale for the presumption of undue influence is that the concept is meant to protect subservient parties from subtle forms of pressure, which may be inherent in certain types of relationships. Unlike duress, which is concerned with remedying threats of violence or overwhelming misuse of economic power, undue influence provides a remedy in cases involving pressure that is difficult to impossible for an outside observer to discern. As one commentator put it, the type of influence that is at issue in class (2) cases “is that which is never established by the evidence,” because “undue influence often has a subtle operation and may be undetected or un-

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299. See *Etridge*, *supra* note 283 at para. 16, Lord Nicholls (“Generations of equity lawyers have conventionally described this situation as one in which a presumption of undue influence arises. This use of the term ‘presumption’ is descriptive of a shift in the evidential onus on a question of fact. When a plaintiff succeeds by this route he does so because he has succeeded in establishing a case of undue influence. The court has drawn appropriate inferences of fact upon a balanced consideration of the whole of the evidence at the end of a trial in which the burden of proof rested upon the plaintiff. The use, in the course of the trial, of the forensic tool of a shift in the evidential burden of proof should not be permitted to obscure the overall position. These cases are the equitable counterpart of common law cases where the principle of *res ipsa loquitur* is invoked. There is a rebuttable evidential presumption of undue influence.”); para. 153, Lord Scott (“First, the Class 2 presumption is an evidential rebuttable presumption. It shifts the onus from the party who is alleging undue influence to the party who is denying it. Second, the weight of the presumption will vary from case to case and will depend both on the particular nature of the relationship and on the particular nature of the impugned transaction. Third, the type and weight of evidence needed to rebut the presumption will obviously depend upon the weight of the presumption itself. . . . The onus will, of course, lie on the person alleging the undue influence to prove in the first instance sufficient facts to give rise to the presumption.”).

300. *Geffen*, *supra* note 291 at 378, Wilson J. (Cory J. concurring).

provable as a result.”<sup>301</sup> This difficulty in proving or disproving undue influence means that the operation of the presumption often ends up effectively deciding the case.<sup>302</sup> Anglo-Canadian law effectively favours the subservient party in these close cases. This has been the established position of the law since at least the late nineteenth-century *Allcard* case.<sup>303</sup>

Although class (2) undue influence appears to be firmly in place in Canadian law, it has attracted some criticism from commentators. M.H. Ogilvie, a Canadian law professor, has launched a sustained attack on the presumption, arguing it introduces needless complexity and distortion into the law:

The pursuit of this approach [*i.e.*, the approach to the presumption taken explicitly in *Morgan* and implicitly in *Geffen*] suggests that there may be no logical reason to retain the two classes of undue influence at all. . . . Less complicated is the one-step burden of proving a relationship of potential dominance as well as that the resulting transaction was manifestly disadvantageous and that no independent advice was either recommended and/or procured and/or understood. Less complicated still is the one-step burden of proof in actual undue influence of victimization causing the resulting transaction. Once there is no longer any valid reason to grant special protection to certain persons, there can no longer be an acceptable reason to presume the exercise of undue influence in relation to them.<sup>304</sup>

The presumption does not form a part of American law, at least as that law is described in the *Restatement*.<sup>305</sup> In addition to simplifying the law, eliminating the presumption would also have the effect of bringing undue influence into line with duress and (non-consumer) unconscionability, and with general standards of civil procedure.

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301. Robert Flannigan, “The Fiduciary Obligation” (1989) 9 O.J.L.S. 285 at 293 [Flannigan, “Fiduciary Obligation”].

302. See David Tiplady, “The Limits of Undue Influence” (1985) 48 Mod. L. Rev. 579 at 581 (“The presumption that a dominant party used his influence improperly will often be decisive, since the typical undue influence case is one in which that dominance is of so subtle and insidious a kind that it is impossible to prove it was not in fact at work.”).

303. *Supra* note 279.

304. *Supra* note 290 at 386. See also *Longmuir v. Holland*, 2000 BCCA 538, 81 B.C.L.R. (3d) 99 at para. 124, Southin J.A. (dissenting in part) (casting doubt on “public utility” of presumption in case involving an *inter vivos* gift from an older adult to her niece).

305. See *Restatement (Second) of Contracts* § 177 rep. note, cmt. a (“The existence alone of a confidential relationship between parties to a transaction does not raise a presumption of undue influence.”) (1981).

(c) *Class (2A) Undue Influence*

In class (2A) cases, undue influence is presumed because the relationship between the dominant and the subservient parties falls into one of a listed group of relationships. Determining which relationships fall into this group is actually not as simple a matter as might be expected. The origins of class (2A) reach back to a series of nineteenth-century English cases involving parents and children.<sup>306</sup> Later, a number of professional relationships, such as solicitor–client and doctor–patient, became established in this group. Then, *Allcard* added the relationship of spiritual advisor–penitent.<sup>307</sup> The definitive list, for the purposes of Canadian law, is the one set out in Wilson J.’s judgment in *Geffen*:

Equity has recognized that transactions between persons standing in certain relationships with one another will be presumed to be relationships of influence until the contrary is shown. These include the relationship between trustee and beneficiary; solicitor and client; doctor and patient; parent and child; guardian and ward; and future husband and fiancée.<sup>308</sup>

The word *include* in this quotation is meant to indicate that these categories are not closed. In fact, recent cases involving the husband–wife and banker–customer relationships which failed in attempts to get the courts to expand class (2A) show that there is a reluctance to include new relationships in class (2A).<sup>309</sup>

The rationale for the existence of class (2A) appears to be to ensure that certain sensitive relationships should be subject to a high level of scrutiny.<sup>310</sup> This rationale has been implemented by means of a “legal short-cut” that makes status (in this case, the type of relationship) override the need to prove certain facts that would otherwise have to be proved to obtain a remedy.<sup>311</sup> This resort to status gives the subservient party in these cases a considerable advantage in litigation, as that party is not re-

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306. See Ogilvie, “No Special Tenderness,” *supra* note 290 at 385.

307. *Supra* note 279 at 185–86, Lindley L.J.

308. *Supra* note 291 at 370 [citations omitted]. See also *Etridge*, *supra* note 283 at para. 18, Lord Nicholls (“Examples of relationships within this special class are parent and child, guardian and ward, trustee and beneficiary, solicitor and client, and medical adviser and patient.”).

309. See Ogilvie, “No Special Tenderness,” *supra* note 290 at 385 (“Attempts to enlarge this category to include other relationships, such as banker–customer, have largely failed.”).

310. See *Etridge*, *supra* note 283 at para. 18, Lord Nicholls (“The law has adopted a sternly protective attitude towards certain types of relationships in which one party acquires influence over another who is vulnerable and dependent and where, moreover, substantial gifts by the influenced or vulnerable person are not normally to be expected.”).

311. Flannigan, “Fiduciary Obligation,” *supra* note 301 at 294, n. 45.

quired to prove that the potential for dominance inheres in the relationship or that undue influence occurred in fact, in order to obtain a remedy.

Although class (2A) appears to be firmly entrenched in Anglo-Canadian law, since the highest courts in both jurisdictions have affirmed its continued existence, it is not invulnerable to criticism. As a general point, the reliance on status appears to be out of step with modern trends in the law, which focus attention more on whether the facts of a given case justify a remedy from the court. The American conception of undue influence, for instance, does not single out certain relationships for special treatment based on status.<sup>312</sup> Some of the relationships included in the Anglo-Canadian class (2A), such as guardian–ward and future husband–fiancée, only serve to underscore the old-fashioned character of the class. Further, it is open to question why some relationships, such as the professional relationships of solicitor–client and doctor–patient, are located in class (2A) while other relationships, such as husband–wife, which seem to have a greater potential for subtle manipulation, are left out.<sup>313</sup> It can be argued that, if class (2) is going to be retained as part of undue influence, then that class would operate more simply and coherently if it were treated as a unified whole and all litigants aspiring to it were required to show that the relationship at issue met the test of dominance set out in *Geffen*.<sup>314</sup>

*(d) Class (2B) Undue Influence*

The idea of class (2B) undue influence originated in a series of English cases from the 1980s and 1990s.<sup>315</sup> These cases each concerned a wife agreeing to a mortgage over the family home to secure the debts of the husband’s business. In practical terms, the courts faced a dilemma: they were reluctant to add the spousal relationship to class (2A) because they feared it would cause too great a disruption to credit-granting practices,<sup>316</sup> but they also did not want to set the bar too high in litigation

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312. See *Restatement (Second) of Contracts* § 177 (1981).

313. See Ogilvie, “No Special Tenderness,” *supra* note 290 at 385 (“it may be wondered why the less emotionally and psychologically charged relationships of solicitor–client or doctor–patient justify the presumption”).

314. See *ibid.* at 386 (“[I]f the category is to retain meaning and purpose at all, it should consist of an undivided single class of presumed undue influence to which any complainant may aspire, by proving that a relationship of dominance or influence existed, with the exception of persons lacking legal capacity who might claim independently that their transactions are void or voidable for lack of capacity. Thus, all cases of presumed undue influence would be of the *de facto* variety. . . .”).

315. See *Morgan*, *supra* note 283; *Aboody*, *supra* note 283; *O’Brien*, *supra* note 283; *Pitt*, *supra* note 283.

316. See *O’Brien*, *ibid.* at 188, Lord Browne-Wilkinson (“[I]t is important to keep a sense of balance in

by requiring spouses to show actual undue influence in every case to obtain a remedy. The result was the creation of the class (2B) presumption, which embraces any relationship in which a potential for dominance may occur.

The Supreme Court of Canada decided *Geffen* in the midst of this series of English cases, and the court picked up on the idea of class (2B), without using that term.<sup>317</sup> Wilson J. said that the following question would have to be answered positively for the presumption of undue influence to apply when it is not operative due to status:

What then must a plaintiff establish in order to trigger a presumption of undue influence? In my view, the inquiry should begin with an examination of the relationship between the parties. The first question to be addressed in all cases is whether the potential for domination inheres in the nature of the relationship itself.<sup>318</sup>

This complicated picture was made even more complicated by a another development in the United Kingdom. In a subsequent decision, the House of Lords overruled the earlier English cases and effectively eliminated class (2B) from the English law of undue influence:

For my part, I doubt the utility of the Class 2B classification. Class 2A is useful in identifying the particular relationships where the presumption arises. The presumption in Class 2B cases, however, is doing no more than recognizing that evidence of the relationship between the dominant and subservient parties, coupled with whatever other evidence is for the time being available, may be sufficient to justify a finding of undue influence on the balance of probabilities. The onus shifts to the defendant. Unless the defendant introduces evidence to counteract the inference of undue influence that the complainant's evidence justifies, the complainant will succeed. In my opinion, the presumption of undue influence in Class 2B cases has the same function in undue influence cases as *res ipsa loquitur* has in negligence cases. It recognizes an evidential state of affairs in which the onus has shifted.<sup>319</sup>

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approaching these cases. It is easy to allow sympathy for the wife who is threatened with the loss of her home at the suit of a rich bank to obscure an important public interest, viz., the need to ensure that the wealth currently tied up in the matrimonial home does not become economically sterile.”).

317. See Ogilvie, “No Special Tenderness,” *supra* note 290 at 397 (“Wilson J. further accepted the distinction between Class 2A and Class 2B cases of presumed undue influence. . .”).

318. *Supra* note 291 at 378. The second part of this test concerns substantive unfairness, which is discussed in the next issue for reform. See also *Geffen, ibid.*, at 392, La Forest J. (McLachlin J. concurring) (“Wilson J. concludes that such a presumption will arise only when the parties are in a relationship of ‘influence,’ where one person is in a position to dominate the will of another. I agree with this.”).

319. *Etridge, supra* note 283 at para. 161, Lord Scott. See also *Etridge* at para. 107, Lord Hobhouse (“In agreement with what I understand to be the view of your Lordships, I consider that the so-called class 2(B) presumption should not be adopted.”).

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The effect of this passage is to make the distinction between class (2A) and class (2B) “not substantive but forensic only.”<sup>320</sup> In light of the evidence required to raise the presumption, it is open to question whether retaining the presumption in these cases is worth the complexity that it creates in the law.

*(e) Tentative Recommendation*

The committee found this issue to be especially vexing. The presumptions have made the law very complex and uncertain. They are an old-fashioned and clumsy way to extend protection to vulnerable contracting parties. No one today would set out to design a system that mirrored the elements that have been steadily added in the jurisprudence. But the committee was given pause by the thought that doing away with the presumptions would leave vulnerable parties with less protection than is currently afforded to them. Any reforms made to remedy problems arising from unfair contracts should not have the effect of making vulnerable people more vulnerable to abuse.

Despite its reservations about the effect of reform, the committee has concluded that society will be better served by clarifying and simplifying the law than by retaining the law in its current state or by attempting to work out a new, rationalized structure for the presumptions. It is noteworthy that a number of English judges have positively compared the presumptions of undue influence to the tort-law presumption of *res ipsa loquitur* (= “the thing speaks for itself”).<sup>321</sup> Several years ago the Supreme Court of Canada abrogated this presumption in Canadian law.<sup>322</sup> This decision has not had a negative effect on the law of negligence. Further, the fact that undue influence appears to operate satisfactorily in other jurisdictions (such as the United States) that get along without the use of presumptions gave the committee some comfort that its proposed reforms will not have unintended negative consequences.

The committee tentatively recommends that:

*24. The Contract Fairness Act should not provide that undue influence is presumed in any cases.*

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320. Bigwood, “Principles and Proof,” *supra* note 273 at 439.

321. See *Etridge*, *supra* note 283 at para. 107, Lord Hobhouse; para. 161, Lord Scott.

322. See *Fontaine v. British Columbia (Official Administrator)* (1997), [1998] 1 S.C.R. 424 at paras. 26–27, 156 D.L.R. (4th) 577, Major J. (for the court).

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3. SHOULD THE UNDUE-INFLUENCE PROVISION CONTAIN A SUBSTANTIVE-UNFAIRNESS COMPONENT?

The second controversy raised by the jurisprudence is whether substantive unfairness<sup>323</sup> is a necessary component of undue influence. As long ago as the *Allcard* case, Lindley L.J. made the common-sense point that a small gift would not attract the heightened scrutiny that a large gift would.<sup>324</sup> In the contractual realm, this observation would seem to imply that some element of substantive unfairness is a necessary part of undue influence, just as it plays a necessary role in unconscionability and duress. But it has proved incredibly troublesome for the courts to define just what this substantive element is and how it should operate.

The controversy over substantive unfairness and undue influence can be traced to Lord Scarman's judgment in *Morgan*. In that case, Lord Scarman declared:

... I know of no reported authority where the transaction set aside was not to the manifest disadvantage of the person influenced. ... Whatever the legal character of the transaction, the authorities show that it must constitute a disadvantage sufficiently serious to require evidence to rebut the presumption that in the circumstances of the relationship between the parties it was procured by the exercise of undue influence. In my judgment, the Court of Appeal erred in law in holding that the presumption of undue influence can arise from the evidence of the relationship of the parties without also evidence that the transaction itself was wrongful in that it constituted an advantage taken of the person subjected to the influence which, failing proof to the contrary, was explicable only on the basis that undue influence had been exercised to procure it.<sup>325</sup>

Almost immediately, this manifest-disadvantage requirement attracted fierce criticism,<sup>326</sup> but the initial reaction of the English courts was to expand its reach. The quotation from *Morgan* set out above makes it clear that this requirement applied to class (2) (presumed) undue influence cases, but it left open the question of whether it applies to class (1) (actual) undue influence cases. Litigants who were concerned about the difficulty of showing a manifest disadvantage (particularly in cases involv-

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323. *Substantive unfairness* is not the standard terminology for what is at issue here. To the extent that there is a standard term, it is *manifest disadvantage*. But that term has become so fraught with controversy that it could not be used in any draft legislation, so this consultation paper uses a neutral term. The cases and academic commentary make it clear that manifest disadvantage and its equivalent terms in undue influence are functionally the equivalent of substantive unfairness in unconscionability and duress.

324. *Supra* note 279 at 185.

325. *Supra* note 106 at 704.

326. See Tiplady, *supra* note 302 at 581; Rick Bigwood, "Undue Influence: 'Impaired Consent' or 'Wicked Exploitation'?" (1996) 16 O.J.L.S. 503 at 513 [Bigwood, "Impaired Consent"].

ing a wife agreeing to a mortgage over the family home to secure the debts of the husband's business), began to argue that the manifest-disadvantage requirement did not apply if the subservient party could prove that undue influence had occurred in fact. The English Court of Appeal rejected this argument in *Aboody*.<sup>327</sup>

This conclusion did not stand for long in the United Kingdom. A few years later, the House of Lords revisited the issue in *Pitt* and overruled *Aboody*.<sup>328</sup> Lord Browne-Wilkinson, who delivered the leading judgment, gave the following reasons for this decision:

Whatever the merits of requiring a complainant to show manifest disadvantage in order to raise a Class 2 presumption of undue influence, in my judgment there is no logic in imposing such a requirement where actual undue influence has been exercised and proved. Actual undue influence is a species of fraud. . . . A man guilty of fraud is no more entitled to argue that the transaction was beneficial to the person defrauded than is a man who has procured a transaction by misrepresentation. The effect of the wrongdoer's conduct is to prevent the wronged party from bringing a free will and properly informed mind to bear on the proposed transaction which accordingly must be set aside in equity as a matter of justice.<sup>329</sup>

In its latest judgment on undue influence, the House of Lords offered still more consideration of the manifest-disadvantage requirement. The two leading judgments in *Etridge*<sup>330</sup> each commented on the requirement. Lord Nicholls said that criticisms of the requirement really just point up problems with its vague label and that these problems can be solved by getting rid of the label and applying a substantive-unfairness requirement that is more in line with past authority.<sup>331</sup> Lord Scott provided this reinterpretation of the substantive-unfairness requirement:

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327. *Supra* note 283 at 964, Slade L.J. (“[E]ven a party who affirmatively proves that a transaction was induced by the exercise of undue influence is not entitled to have it set aside in reliance on the doctrine of undue influence without proving that the transaction was manifestly disadvantageous to him or her.”).

328. *Supra* note 283 at 208, Lord Browne-Wilkinson (“My Lords, I am unable to agree with the Court of Appeal’s decision in *Aboody*. I have no doubt that the decision in *Morgan* does not extend to cases of actual undue influence.”).

329. *Ibid.* at 209.

330. *Supra* note 283.

331. *Ibid.* at para. 29 (“Which, then, is the correct approach to adopt in deciding whether a transaction is disadvantageous to the wife: the narrow approach, or the wider approach? The answer is neither. The answer lies in discarding a label which gives rise to this sort of ambiguity. The better approach is to adhere more directly to the test outlined by Lindley L.J. in *Allcard*. . .”).

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Where, however a Class 2 presumption of undue influence is said to arise, the nature of the impugned transaction will always be material, no matter what the relationship between the parties. Some transactions will be obviously innocuous and innocent. A moderate gift as a Christmas or a birthday present would be an example. . . . It is, in my opinion, the combination of relationship and the nature of the transaction that gives rise to the presumption and, if the transaction is challenged, shifts the onus to the transferee.<sup>332</sup>

In Canada, the leading case on this point is *Geffen*,<sup>333</sup> which was decided after *Morgan* and *Aboody* but before *Pitt* and *Etridge*. Wilson J. noted that the manifest-disadvantage requirement had “come under heavy criticism,”<sup>334</sup> and said that the court “should take heed of the debate which followed *Morgan*.”<sup>335</sup> Nevertheless, Wilson J. was unwilling to discard some form of substantive-unfairness requirement:

With respect to contractual relations, however, it has long been the view of the courts that the sanctity of bargains should be protected unless they are patently unfair. I cannot think of any situation in which a contract has been rescinded on the sole basis that the process leading up to the bargain was somehow tainted. Something more, such as detrimental reliance, must be shown.<sup>336</sup>

Wilson J.’s solution to the issue was set out as the second part of her test for determining when to apply the presumption of undue influence. She distinguished between gifts (which she felt should not be subject to this requirement) and *commercial* contracts, which should be subject to the following substantive-unfairness requirement:

Having established the requisite type of relationship to support the presumption, the next phase of the inquiry involves an examination of the nature of the transaction. When dealing with commercial transactions, I believe that the plaintiff should be obliged to show, in addition to the required relationship between the parties, that the contract worked unfairness either in the sense that he or she was unduly disadvantaged by it or that the defendant was unduly benefited by it. From the court’s point of view this added requirement is justified when dealing with commercial transactions because, as already mentioned, a court of equity, even while tempering the harshness of the common law, must accord some degree of deference to the principle of freedom of contract and inviolability of bargains. Moreover, it can be assumed in the vast majority of commercial transactions that parties act in pursuance of their own self-interest. The mere fact,

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332. *Ibid.* at para. 156.

333. *Supra* note 291.

334. *Ibid.* at 374.

335. *Ibid.*

336. *Ibid.* at 376.

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therefore, that the plaintiff seems to be giving more than he is getting is insufficient to trigger the presumption.<sup>337</sup>

This part of Wilson J.'s test did not carry the majority of the court, as the other three members of the panel preferred not to address the issue.<sup>338</sup> Wilson J.'s test also fails to state clearly whether the substantive-unfairness requirement applies to class (1) undue influence or whether it applies at all if a *non-commercial* contract is at issue, and it has been criticized for these lapses.<sup>339</sup>

The policy rationales for the various positions on the substantive-unfairness requirement are canvassed quite well in the passages set out above. Enacting a substantive-unfairness requirement could create real difficulties for some subservient parties, but leaving it out of the *Contract Fairness Act* could create, at least on paper, a sweeping jurisdiction to set aside contracts.

A final consideration to bear in mind is how the decision on this issue places undue influence in relation to unconscionability and duress. The House of Lords' decision in *Etridge* was apparently well received in Australia because it harmonized nicely with the Australian conception of unconscionability, which is focussed entirely on procedural unfairness.<sup>340</sup> On the other hand, in jurisdictions where those other concepts ordinarily have a substantive-unfairness component, there may be a greater

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337. *Ibid.* at 378.

338. *Ibid.* at 394, La Forest J. (McLachlin J. concurring) ("It is unnecessary for us to choose between these two opposing positions in the context of this case, which does not even concern a commercial transaction, and I think it is unwise to do so. . . . Nor would I want to be taken as agreeing with the proposition that the law will never interfere with a contract that does not necessarily lead to a material disadvantage, even where it is clear that the process leading up to the contract has been tainted."); at 395–96, Sopinka J. ("In my view, given the positive finding by the trial judge, supported by the evidence, that there was no undue influence, the existence of a presumption is immaterial and any discussion of it by the trial judge and the Court of Appeal was unnecessary and *obiter*. The same applies to the consideration of the matter here.").

339. See Ogilvie, "No Special Tenderness," *supra* note 290 at 399 ("The net effect of *Geffen* is to leave unresolved the precise nature of undue influence in Canada, as the confusion in the resulting cases demonstrates. In contrast to *O'Brien/Pitt*, no progress beyond *Morgan* was made in respect to such matters as the purpose of undue influence; the requirements, especially manifest disadvantage; and how the presumption might be rebutted." [footnotes omitted]).

340. See Bigwood, "Impaired Consent," *supra* note 326 at 513 ("In exploring the conceptual dimensions of undue influence, I should like finally to applaud the gradual diminution, in recent times, of the 'manifest disadvantage' criterion in undue influence cases. Such a requirement has of course been strongly eschewed in the context of unconscionable dealings (and indeed in undue influence cases) in Australia, at least as a substantive precondition to equitable relief." [footnotes omitted]).

willingness to apply this requirement to undue influence. For instance, the New Zealand Law Commission, subjected its proposed undue-influence provision to the same substantive-unfairness requirement that it proposed for unconscionability and duress:

#### **4 Result must be unfair**

- (1) Notwithstanding clause 2 [general test of unfairness], a contract is not unfair unless in the context of the contract as a whole:
  - (a) it results in a substantially unequal exchange of values; or
  - (b) the benefits received by the disadvantaged party are manifestly inappropriate to the his or her circumstances; or
  - (c) the disadvantaged party was in a fiduciary relationship to the other party.
- (2) A grossly unequal exchange of values may create a presumption that the contract is unfair.<sup>341</sup>

In the committee's view, a substantive-unfairness component is desirable because it helps to better integrate undue influence with unconscionability and duress.

The committee tentatively recommends that:

*25. The Contract Fairness Act should provide that proof of substantive unfairness in the transaction is necessary to obtain a remedy for undue influence.*

#### **4. WHAT REMEDIES SHOULD BE AVAILABLE FOR CASES OF UNDUE INFLUENCE?**

This issue arises for undue influence in much the same manner as it arose for unconscionability and duress.<sup>342</sup> Once again the main concern is the limited range of remedies traditionally available in undue-influence cases. The primary remedy for undue influence is rescission, which effectively involves undoing the contract and returning the contracting parties to the positions they occupied before they entered

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341. *“Unfair Contracts”: A Discussion Paper*, *supra* note 76 at 36. See also the commentary on subsection (1) (c) at 37 (“There is some uncertainty whether the position is the same in undue influence cases [as in fiduciary cases], but it seems not to be. In any event, there is no good reason for maintaining such an exception—if there has been a fair exchange of values, the presence of a strong influence should not matter.”).

342. See, above, at 49–50 (section III.C.9); 74–76 (section IV.C.8) (for discussion of remedies in relation to unconscionability and duress).

into the contract.<sup>343</sup> Rescission can have a dramatic effect on contracting parties. It will not be available if third-party interests are affected.

Law reformers have proposed expanding the scope of remedies available in undue-influence cases. An example that has been considered previously in this consultation paper is a proposal from the New Zealand Law Commission. For convenient reference, this proposal is repeated here:

**12 Powers of court**

- (1) A court on reviewing under this scheme any contract, or any term of a contract . . . may grant such relief as it thinks just.
- (2) Without limiting the power of the court to grant relief, it may do one or more of the following things:
  - (a) declare the contract to be valid and enforceable in whole or in part or for any particular purpose;
  - (b) cancel the contract;
  - (c) declare that a term of the contract is of no effect;
  - (d) vary the contract;
  - (e) award restitution or compensation to any party to the contract;
  - ...
  - (g) vest any property in any party to the proceedings, or direct any party to transfer or assign any property to any other party to the proceedings;
  - (h) order that an account be taken, and reopen any account already taken, in respect of any transaction between the parties.<sup>344</sup>

The main argument against expanding the remedial powers of the court is that it has the potential to give the court too much leeway to rewrite the parties' contract. The committee has concluded that this concern does not outweigh the benefit of equipping the courts with greater flexibility to resolve disputes.

The committee tentatively recommends that:

*26. The Contract Fairness Act should allow the court to make any order that it thinks is just, including any of the following orders on the list recommended by the New Zealand Law Commission: (a) declaring the contract to be valid and enforceable in whole or in part or for any particular purpose; (b) rescinding the*

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343. See, above, at 12–13 (section II.C.4) (for more information on rescission).

344. "Unfair Contracts": A Discussion Paper, *supra* note 76 at 46–47.

*contract; (c) declaring that a term of the contract is of no effect; (d) varying the contract; (e) awarding restitution or compensation to any party to the contract; (f) vesting any property in any party to the proceedings, or direct any party to transfer or assign any property to any other party to the proceedings; (g) ordering that an account be taken, and reopening any account already taken, in respect of any transaction between the parties.*

5. SHOULD ANY TYPES OF CONTRACTS OR CONTRACTING PARTIES BE EXCLUDED FROM THE UNDUE-INFLUENCE PROVISION?

This issue is a companion to similar issues discussed previously for unconscionability<sup>345</sup> and duress.<sup>346</sup>

The rationale for limiting the scope of undue influence is similar to the rationale for limiting the scope of unconscionability. Conceptually, undue influence is more in tune with transactions involving individuals than with commercial transactions involving corporations. It may make the law clearer if undue influence is limited to these types of transactions.

The difficulty with such an approach is that is difficult to find an appropriate bright-line limitation to enshrine in legislation. Using a dollar limit as a proxy for sophistication is problematic, as it opens the possibility of leaving abusive high-value transactions outside the scope of the provision. Corporate status is more promising as limiting factor. But using it in this fashion raises the question of whether it is even necessary to build such a feature into the *Contract Fairness Act*. If the elements of an undue-influence provision effectively limit its use by corporations or other sophisticated commercial parties, then it should not be necessary to add another provision confirming this. In fact, the assistance of such an additional provision could detract from the unity and integrity of the legislation.

The committee tentatively recommends that:

*27. The undue-influence provision in the Contract Fairness Act should apply to all types of contracts and contracting parties.*

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345. See, above, at 51–52 (section III.C.11).

346. See, above, at 76 (section IV.C.9).

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## CHAPTER VI. INTEGRATION OF UNCONSCIONABILITY, DURESS, AND UNDUE INFLUENCE

### A. Background

The previous three chapters have reviewed the history of unconscionability, duress, and undue influence in some detail, and that background information will not be repeated here. It is sufficient simply to note that unconscionability and undue influence had a common origin in the jurisdiction of the English Court of Chancery to relieve against unfair bargains. Duress originated in the common-law courts, but it was very narrowly defined, so cases that could not be accommodated within its scope often ended up being pursued in the Court of Chancery under undue influence.

The historical development of unconscionability, duress, and undue influence over the course of the nineteenth and twentieth centuries pulled the three concepts apart. Distinct conceptions of the three appeared in the law of contracts. The basic features of the concepts may be summarized in a chart.

Concept	Origin	Purpose	Remedy
unconscionability	equity	to protect against substantially unfair contracts that result from the abuse of an inequality of bargaining power	rescission
duress	common law	to protect against contracts obtained by the application of illegitimate pressure that leaves the victim with no practical alternative but to submit to the contract	rescission
undue influence	equity	to protect against (substantively) unfair transactions induced by improper persuasion exercised by someone in a special relationship with the victim	rescission

There continues to be theoretical overlap among these three concepts. They all serve the purpose of protecting against vulnerability. They all lead to essentially the same remedy. Functionally, too, there is some overlap. All three concepts tend to relate to

events that occur at the time a contract is formed (or modified). Recent cases have blurred some traditional boundaries drawn around the three concepts. Duress has been expanded to embrace economic pressure. Unconscionability has been applied to contracts between commercial parties.

On the other hand, some differences do remain in the application of these concepts. The leading cases on duress still tend to involve large commercial parties, while the leading undue-influence cases tend to play out among family and other special relationships. Unconscionability generally occupies a middle area, straddling consumer and small-business transactions, where some inequality of bargaining power is present.

## **B. Issues for Reform**

The only issue taken up in this chapter is how to integrate unconscionability, duress, and undue influence. This topic has been addressed by past law-reform studies<sup>347</sup> and by academic commentators.<sup>348</sup> Both sources have been of assistance in formulating options for reform.

### **1. HOW SHOULD UNCONSCIONABILITY, DURESS, AND UNDUE INFLUENCE BE INTEGRATED IN THE CONTRACT FAIRNESS ACT?**

In reviewing the leading commentary on this issue, the committee determined that there were three approaches to consider as options for reform:

- (a) unconscionability, duress, and undue influence can be folded into an expanded conception of unconscionability;
- (b) unconscionability, duress, and undue influence can be brought together as distinct elements that make up a single ground for relief of unfair contracts;
- (c) unconscionability, duress, and undue influence can be treated as separate parts of the *Contract Fairness Act*.

#### *(a) Expand Unconscionability*

The first approach to integration of unconscionability, duress, and undue influence has been pressed by some academic commentators and by at least one law-reform

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347. See *Report on Amendment of the Law of Contract*, *supra* note 75; “Unfair” Contracts: A Discussion Paper, *supra* note 76.

348. See, e.g., Waddams, “Unconscionability in Contracts,” *supra* note 107.

body. But its most influential articulation probably appears in Lord Denning's judgment in *Lloyds Bank Ltd. v. Bundy*.<sup>349</sup> In a seminal passage, Lord Denning drew out a "single thread" uniting cases dealing with unconscionability, duress (which he considered separately as duress of goods, undue pressure, and unfair salvage agreements), and undue influence:

Gathering all together, I would suggest that through all these instances there runs a single thread. They rest on "inequality of bargaining power." By virtue of it, the English law gives relief to one who, without independent advice, enters into a contract upon terms which are very unfair or transfers property for a consideration which is grossly inadequate, when his bargaining power is grievously impaired by reason of his own needs or desires, or by his own ignorance or infirmity, coupled with undue influences or pressures brought to bear on him by or for the benefit of the other. When I use the word "undue" I do not mean to suggest that the principle depends on proof of any wrongdoing. The one who stipulates for an unfair advantage may be moved solely by his own self-interest, unconscious of the distress he is bringing to the other. I have also avoided any reference to the will of the one being "dominated" or "overcome" by the other. One who is in extreme need may knowingly consent to a most improvident bargain, solely to relieve the straits in which he finds himself. Again, I do not mean to suggest that every transaction is saved by independent advice. But the absence of it may be fatal. With these explanations, I hope this principle will be found to reconcile the cases.<sup>350</sup>

This passage proposes uniting the various contract-law concepts that have been applied by the courts to unfair bargains into a single concept with a single test.

Lord Denning did not use the word *unconscionability* to describe his "single thread," but in Canada Lord Denning's reasoning merged with a conception of unconscionability contained in cases such as *Morrison*<sup>351</sup> which was already broader in scope than the common understanding of the concept in English law. This development in the courts was given influential support in a widely cited article by Prof. Waddams.<sup>352</sup> This article argued that a series of disparate contract-law concepts (including duress and undue influence, among others) were really species of an unacknowledged general principle of relief. In his view, unconscionability was best placed to be the foundation of such a general principle.<sup>353</sup>

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349. *Supra* note 104.

350. *Ibid.* at 339.

351. *Supra* note 97.

352. *See* Waddams, "Unconscionability in Contracts," *supra* note 107.

353. *See ibid.* at 390-91.

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Prof. Waddams's article contemplated the courts as the engine of reform that would bring about his proposed changes. But his views were picked up in a law-reform project focussed on legislative change—the Ontario Law Reform Commission's *Report on Amendment of the Law of Contract*.<sup>354</sup> It is worthwhile quoting the Ontario Commission's proposal in full, as it gives a good indication of how this approach would ultimately appear in language that approximates legislation.<sup>355</sup>

The Commission makes the following recommendations:

1. Legislation should be enacted expressly conferring on the courts power to grant relief from contracts and contractual provisions that are unconscionable.
2. The proposed legislation should not distinguish between procedural and substantive unconscionability.
3. The proposed legislation should include a non-exclusive list of decisional criteria to guide the courts in determining questions of unconscionability.
4. In determining whether a contract or part thereof is unconscionable in the circumstances relating to the contract at the time it was made, the court may have regard, among other factors, to evidence of:
  - (a) the degree to which one party has taken advantage of the inability of the other party reasonably to protect his or her interests because of his or her physical or mental infirmity, illiteracy, inability to understand the language of an agreement, lack of education, lack of business knowledge or experience, financial distress, or because of the existence of a relationship of trust or dependence or similar factors;
  - (b) the existence of terms in the contract that are not reasonably necessary for the protection of the interests of any party to the contract;
  - (c) the degree to which the contract requires a party to waive rights to which he or she would otherwise be entitled;
  - (d) gross disparity between the considerations given by the parties to the contract and the considerations that would normally be given by parties to a similar contract in similar circumstances;
  - (e) knowledge by one party, when entering into a contract, that the other party will be substantially deprived of the benefit or benefits reasonably anticipated by that other party under the contract;
  - (f) the degree to which the natural effect of the transaction, or any party's conduct prior to, or at the time of, the transaction, is to cause or aid in causing another party to misunderstand the true nature of the transaction and his or her rights and duties thereunder;

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354. *Supra* note 75. Prof. Waddams was a project director for the Ontario Law Reform Commission's project.

355. The Ontario Commission did not include draft legislation in its report, but its proposals are detailed enough to require little imagination to see how they would look in a statute.

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- (g) whether the complaining party had independent advice before or at the time of the transaction or should reasonably have acted to secure such advice for the protection of the party's interest;
  - (h) the bargaining strength of the parties relative to each other, taking into account the availability of reasonable alternative sources of supply and demand;
  - (i) whether the party seeking relief know or ought reasonably to have known of the existence and extent of the term or terms alleged to be unconscionable;
  - (j) in the case of a provision that purports to exclude or limit a liability that would otherwise attach to the party seeking to rely on it, which party is better able to guard against loss or damages;
  - (k) the setting, purpose and effect of the contract, and the manner in which it was formed, including whether the contract is on written standard terms of business; and
  - (l) the conduct of the parties in relation to similar contracts or courses of dealing to which any of them has been a party.
5. The proposed legislation should expressly authorize the court to raise the issue of unconscionability of its own motion.
  6. The proposed provisions on unconscionability should apply to all types of contracts.
  7. The term "contract" in the proposed provisions on unconscionability should be defined to include any enforceable promise.
  8. The proposed legislation should incorporate a provision . . . [allowing a court] in the case of an unconscionable contract to
    - (a) refuse to enforce the contract or rescind it on such terms as may be just;
    - (b) enforce the remainder of the contract without the unconscionable part; or
    - (c) so limit the application of any unconscionable part or revise or alter the contract so as to avoid any unconscionable result.
  9. The courts should be empowered, at the behest of the Attorney General or other provincial Minister, to issue injunctions against conduct leading to unconscionability, either in the formation of or in the execution of contracts.
  10. A provision . . . preventing a party from excluding liability or waiving rights under the provisions dealing with unconscionability, should be included in the proposed legislation.<sup>356</sup>

By expanding the scope of unconscionability, and by enhancing the remedies available under it and the procedure to be used in applying it, these proposals either effectively assimilate related contractual concepts such as duress and undue influence

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356. *Supra* note 75 at 137–38.

to unconscionability or leave them very little space in which to operate independently of unconscionability.

*(b) Combine Unconscionability, Duress, and Undue Influence as Distinct Components of a Single Statutory Provision*

The second approach represents a middle ground to pursuing reform. Similar to the first approach, the second approach uses a general concept as its basis for relief. Unlike the first approach, this general concept is a neutral concept, rather than an expansion of an already existing concept. Within the general concept, unconscionability, duress, and undue influence can be seen as its component parts.

This level of integration would be difficult to achieve through court decisions, so, unlike the case for the first option, there is no real history of the courts considering it. An example of how the second approach could be implemented in legislation is found in the New Zealand Law Commission's discussion paper.<sup>357</sup> The integration of the three concepts is found in section 2, which sets out a general test of unfairness. (For greater clarity, marginal notes not found in the New Zealand Commission's publication have been added to the quotation below.) The other characteristic to notice is how this approach binds the three concepts together so that they share the same remedies, the same procedure, and the same limiting factors (see section 4 and section 7, below, for examples). In order to bring out these qualities, it's necessary to provide an extensive quotation from the New Zealand Commission's proposals.

### **1 Purposes**

The purposes of this scheme are to:

- (a) clarify and extend the circumstances in which the courts may review contracts, and terms of contracts, as being unconscionable, oppressive, or unfair;
- (b) provide remedies for the abuse of a superior bargaining position by one party, without impairing general freedom and certainty of contract;
- (c) make certain contractual terms invalid, and to make certain other contractual terms invalid unless they are reasonable in the circumstances;
- (d) require minimum standards of fair dealing by the parties in the performance of contracts;
- (e) clarify and extend the relief that the courts can give upon reviewing unfair contracts and contractual terms, and unfair exercise of contractual powers.

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357. "Unfair Contracts": A Discussion Paper, *supra* note 76.

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### 2 General test of unfairness

A contract, or a term of a contract, may be unfair if a party to that contract is seriously disadvantaged in relation to another party to the contract because he or she:

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|--------------------------|--|
| <b>unconscionability</b> | (a) is unable to appreciate adequately the provisions or the implications of the contract by reason of age, sickness, mental, educational or linguistic disability, emotional distress, or ignorance of business affairs; or |
| <b>unconscionability</b> | (b) is in need of the benefits for which he or she has contracted to such a degree as to have no real choice whether or not to enter into the contract; or   |
| <b>undue influence</b>   | (c) is legally or in fact dependent upon, or subject to the influence of, the other party or persons connected with the other party in deciding whether to enter into the contract; or                                       |
| <b>undue influence</b>   | (d) reasonably relies on the skill, care or advice of the other party or a person connected with the other party in entering into the contract; or   |
| <b>duress</b>            | (e) has been induced to enter into the contract by oppressive means, including threats, harassment or improper pressure; or  |
| <b>residual</b>          | (f) is for any other reason in the opinion of the court at a serious disadvantage;   |

and that other party knows or ought to know of the facts constituting that disadvantage, or of facts from which that disadvantage can reasonably be inferred.

### 3 Professional advice

In considering whether a contract, or a term of a contract, is unfair the court shall have regard, among other things, to whether the disadvantaged party received appropriate legal or other professional advice.

### 4 Result must be unfair

- (1) Notwithstanding clause 2, a contract is not unfair unless in the context of the contract as a whole:
  - (a) it results in a substantially unequal exchange of values; or
  - (b) the benefits received by a disadvantaged party are manifestly inappropriate to his or her circumstances; or
  - (c) the disadvantaged party was in a fiduciary relationship with the other party.
- (2) A grossly unequal exchange of values may create a presumption that the contract is unfair.

### 5 Harsh and oppressive terms

- (1) A term of a contract is also unfair if, in the context of the contract as a whole, it is oppressive.
- (2) A term of a contract is oppressive if it:
  - (a) imposes a burdensome obligation or liability which is not reasonably necessary to protect the interests of the other party; and

(b) is contrary to commonly accepted standards of fair dealing.

- (3) A transaction that consists of two or more contracts is to be treated as a single contract if it is in substance and effect a single transaction.

### **6 Context of the contract**

- (1) In considering the context of the contract as a whole, the Court may, among other things, take into account the identity of the parties and their relative bargaining position, the circumstances in which it was made, the existence and course of any negotiations between the parties, and any usual provisions in contracts of the same kind.
- (2) In relation to commercial contracts the court shall take into account reasonable standards of commercial practice.

### **7 Circumstances judged at the time of contract**

The question whether a contract, or a term of a contract, is unfair shall be decided in light of the circumstances at the time the contract was made.

...

### **12 Powers of court**

- (1) A court on reviewing under this scheme any contract, or any term of a contract, or the exercise of a power or discretion or the refusal to waive any right under a contract, may grant such relief as it thinks just.
- (2) Without limiting the power of the court to grant relief, it may do one or more of the following things:
- (a) declare the contract to be valid and enforceable in whole or in part or for any particular purpose;
  - (b) cancel the contract;
  - (c) declare that a term of the contract is of no effect;
  - (d) vary the contract;
  - (e) award restitution or compensation to any party to the contract;
  - (f) annul the exercise of a power, discretion or right under the contract, or direct that it be exercised in a particular way;
  - (g) vest any property in any party to the proceedings, or direct any party to transfer or assign any property to any other party to the proceedings;
  - (h) order that an account be taken, and reopen any account already taken, in respect of any transaction between the parties to the contract.

...

### **14 Relief may be subject to conditions**

Any order may be made on such conditions as the Court thinks just.



### 15 Other legal doctrines preserved

- (1) Nothing in this scheme limits or affects the law relating to breach of fiduciary duty, duress, estoppel, or undue influence in cases to which the scheme does not extend.
- (2) Nothing in this scheme limits or affects the law of mistake (including the provisions of the Contractual Mistakes Act 1977) or the provisions of the Fair Trading Act 1986.

### 16 Scheme to override inconsistent provisions

This scheme applies notwithstanding any provision in any contract.<sup>358</sup>

As the first section sets out, the purpose of the New Zealand Commission's proposals is primarily to restate and clarify the common law—though, the proposals do also have the effect of expanding the common law's scope, particularly in the area of remedies. By building unconscionability, duress, and undue influence into the general test of unfairness, these proposals preserve some core elements of the three concepts. But the proposals also break down distinctions between the concepts in other areas. Notice, for instance, that all three concepts are subject to limiting factors relating to professional advice (section 3), substantive unfairness (section 4), and timing (section 7). In addition, these proposals do not contain special provisions to shift the burden of proof, as has been suggested for unconscionability and undue influence.

### *(c) Create Distinct Unconscionability, Duress, and Undue Influence Provisions*

The third option is conceptually in tune with the current law, which contains separate concepts called unconscionability, duress, and undue influence. Adopting this approach does not entail accepting the current law as it stands; it merely means that any reforms proposed have to be geared to three separate concepts.

There are no law-reform projects that carry out this approach in a comprehensive way. Nevertheless, it is probably not too difficult to imagine how it would be implemented in a final report. The *Contract Fairness Act* would contain different sections that set out the basic elements for unconscionability, duress, and undue influence. Any reforms proposed to subjects such as, for example, remedies, burden of proof, or limiting factors could be tailored to unconscionability, duress, or undue influence. For instance, a different approach could be taken to the issue of the burden of proof for undue influence than is adopted for duress.

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358. *Ibid.* at 51–56.

*(d) Strengths and Weaknesses of Each Approach*

The strength of the first approach is its simplicity: a group of concepts, each with different tests, different limitations, and different remedies, is merged into one ground for relief. Expanding unconscionability also builds on trends already present in the jurisprudence. So, an argument can be made that this approach represents a modernization of the law, by replacing several older concepts with a concept that is at the forefront of the new jurisprudence. On the other hand, some flexibility and subtlety is obviously lost by making unconscionability do the work of the traditional concepts of unconscionability, duress, and undue influence. There is some strain inherent in expanding unconscionability to cover commercial contracts—this appears to account for the resiliency of duress, which the courts have expanded over the past 30 years to embrace economic duress. This approach could also be taken as a radical break with the past, which would cost the law (at least in the short term) the certainty that comes from the guidance found in settled precedents.

The second approach is something of a compromise between the first and the third. It has the strengths and weakness inherent in compromises. It allows for the distinctive qualities of unconscionability, duress, and undue influence to be preserved. Preserving qualities would mainly entail keeping in place the tests for these concepts that the courts have developed. It allows for integrating the concepts at the level of scope and remedy. This approach should allow for some incremental development though it would be anchored in the current jurisprudence. The downsides would include increased complexity in the legislation and the potential for some redundancy or confusion in applying the legislation. It could also result in preserving the three contract-law concepts in legislation right at the point when the courts may be moving beyond them.

The strength of the third approach is that it can be tailored to match the conceptual differences between unconscionability, duress, and undue influence. This allows for the most flexibility, in terms of tests, scope, and remedies. It also forges the tightest connection between the legislation and the case law. This would provide some gains in certainty, and some comfort about the reach of the legislation. On the other hand, this approach would require the longest and most complex legislative provisions. It has the greatest danger of being backward-looking. And, the legislation could result in gaps between the concepts, which might have to be filled in by the courts.

*(e) Tentative Recommendation*

In the committee's view, the second option is the best option for reform. The committee preferred this option's compromise approach. It allows for some consolidation and simplification of the current law, but retains a desirable level of consistency

with established concepts. An integrated provision also makes the law more accessible and easier to navigate.

The committee tentatively recommends that:

*28. The Contract Fairness Act should contain a general test of unfairness that embraces unconscionability, duress, and undue influence as its component parts. The draft legislation should integrate unconscionability, duress, and undue influence with respect to remedies, procedure, burden of proof, and limiting factors.*



## CHAPTER VII. GOOD FAITH

### A. Introduction and Approach to Good Faith

Unconscionability, duress, and undue influence are primarily concerned with issues that arise during the formation of a contract. With the concept of good faith, this consultation paper's focus shifts to issues that arise typically in the course of acting on rights and obligations in a contractual relationship that endures over a period of time.

Good faith in contracts is a subject that is sweeping in scope. Most commentators have divided it into three separate topics that each relate to different points in the lifespan of a contract.<sup>359</sup> These points are:

- (1) good faith in the *negotiations* that may (or may not) lead up to the formation of a contract;
- (2) good faith in the *performance* of the rights and obligations created in a contract;
- (3) good faith in the *enforcement* of remedies flowing from a contract.

This chapter will begin by considering each of these topics in turn. Its starting point is good faith performance, which has attracted the most commentary and has created the largest body of case law. This discussion will also allow for comments on the concept of good faith generally. After discussing good faith performance, the chapter will move on to consider good faith enforcement and good faith negotiation.

### B. Good Faith Performance

Although it is common to note that the idea of good faith in contracts can be traced back to Roman law<sup>360</sup> and that it showed up in a number of early English deci-

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359. See, e.g., Shannon Kathleen O'Byrne, "The Implied Term of Good Faith and Fair Dealing: Recent Developments" (2007) 86 Can. Bar Rev. 193 at 194 ("The role of good faith has traditionally been understood in relation to three distinct areas: contractual negotiations; contractual performance or execution; and contractual enforcement.") [O'Byrne, "Implied Term"]; Edward P. Belobaba, "Good Faith in Canadian Contract Law," in *Commercial Law: Recent Developments*, Special Lectures of the Law Society of Upper Canada, 1985 (Don Mills, ON: De Boo, 1985) [*Commercial Law: Recent Developments*] 73 at 80–87.

360. See, e.g., John D. McCamus, "Abuse of Discretion, Failure to Cooperate and Evasion of Duty: Unpacking the Common Law Duty of Good Faith Contractual Performance" (2004) 29 *Advocates' Q.* 72 at 72 [McCamus, "Abuse of Discretion"].

sions,<sup>361</sup> the concept's historical development is not particularly germane to the task of considering options for reform.<sup>362</sup>

Over the past 30 years, there has been a large number of court cases that consider aspects of good faith performance. Although the British Columbia courts have issued several judgments that touch on good faith performance,<sup>363</sup> almost all of the leading Canadian cases have been decided by the courts of other provinces (particularly Ontario).<sup>364</sup> So the focus in the sections that follow will be on how these non-British Co-

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361. See, e.g., *Carter v. Boehm* (1766), 3 Burr. 1905, 94 E.R. 1162 (K.B.).

362. See Finn, *supra* note 50 at 10 (“While it has echoes, usually faint, in the common law’s past, ‘good faith’ is very much an idea of the present in our systems.” [footnote omitted]).

363. See, e.g., *No. 151 Cathedral Ventures Ltd. v. Gartrell*, 2003 BCSC 1801, 15 R.P.R. (4th) 219 [*Gartrell* cited to R.P.R.]; *Schluessel v. Maier*, 2001 BCSC 60, 85 B.C.L.R. (3d) 239 [*Schluessel* cited to B.C.L.R.], *rev’d on other grounds*, 2003 BCCA 405, 15 B.C.L.R. (4th) 209.

364. See *CivicLife.com Inc. v. Canada (A.G.)* (2006), 215 O.A.C. 43, 149 A.C.W.S. (3d) 417 (C.A.) [*CivicLife.com* cited to O.A.C.] (court finding government department secretly and deliberately undermined Internet software-development contract with provider); *TSP-Intl Ltd. v. Mills* (2005), 74 O.R. (3d) 461, 2 B.L.R. (4th) 89 (S.C.J.) [*Mills* cited to O.R.] (breach of implied duty of good faith by independent contractor in agreeing to provide services directly to plaintiff’s major client), *rev’d on other grounds* (2006), 81 O.R. (3d) 266, 19 B.L.R. (4th) 21 (C.A.); *Transamerica Life Canada Inc. v. ING Canada Inc.* (2003), 68 O.R. (3d) 457, 234 D.L.R. (4th) 367 (C.A.) [*Transamerica Life* cited to D.L.R.] (arguing breach of good faith in failure to disclose knowledge of problems before closing share-purchase transaction); *Shelanu v. Print Three Franchising Corp.* (2003), 64 O.R. (3d) 533, 226 D.L.R. (4th) 577 (C.A.) [*Print Three* cited to D.L.R.] (application of duty of good faith to dispute between franchisee and franchisor over royalties); *Wallace v. United Grain Growers Ltd.*, [1997] 3 S.C.R. 701, 152 D.L.R. (4th) 1 [*Wallace* cited to S.C.R.] (employee entitled to compensation from employer for bad-faith conduct in dismissal); *GATX Corp. v. Hawker Siddeley Canada Inc.* (1996), 1 O.T.C. 322, 27 B.L.R. (2d) 251 (Gen. Div.) [*Hawker Siddeley* cited to B.L.R.] (breach of duty of good faith in defendant structuring share-purchase agreement to avoid application of plaintiff’s right of first refusal); *MDS Health Group Ltd. v. King Street Medical Arts Centre Ltd.* (1994), 12 B.L.R. (2d) 209, 55 C.P.R. (3d) 360 (Ont. Gen. Div.) [*MDS Health* cited to B.L.R.] (landlord breaching implied obligation of good faith by facilitating doctors to side-step restrictive covenant in lease); *Mesa Operating Ltd. v. Amoco Canada Resources Ltd.* (1994) 19 Alta. L.R. (3d) 38, 13 B.L.R. (2d) 310 (C.A.) [*Mesa* cited to B.L.R.] (implied duty to exercise in good faith discretion to pool production from natural-gas wells), *leave to appeal to S.C.C. refused* (1994), 21 Alta. L.R. (3d) xxxvii (S.C.C.); *Gateway Realty Ltd. v. Arton Holdings Ltd.* (1991), 106 N.S.R. (2d) 180, 29 A.C.W.S. (3d) 262 (S.C.) [*Gateway Realty* cited to N.S.R.] (defendant inducing anchor tenant in plaintiff’s shopping centre to relocate to defendant’s mall and taking assignment of tenant’s lease—court finding defendant owed plaintiff a duty of good faith in locating suitable tenant for empty premises), *aff’d on other grounds* (1992), 112 N.S.R. (2d) 180, 32 A.C.W.S. (3d) 1161 (C.A.); *LeMesurier v. Andrus* (1986), 54 O.R. (2d) 1, 25 D.L.R. (4th) 424 (C.A.) [*LeMesurier* cited to D.L.R.] (purchaser wrongfully repudiating agreement of purchase and sale over trivial deficiencies), *leave to appeal to S.C.C. dismissed*, [1986] 2 S.C.R. v; *Greenberg v. Meffert* (1985), 50 O.R. (2d) 755, 18 D.L.R. (4th) 548 (C.A.) [*Greenberg* cited to D.L.R.] (contract granting employer “sole discretion” to determine whether dismissed employee

lumbia cases relate to two key background issues. These issues are (1) the various definitions of good faith found in the cases and commentary and (2) when a duty of good faith is likely to arise under current Canadian contract law.

### 1. WHAT IS THE DEFINITION OF GOOD FAITH?

#### (a) Introduction

The point is often made that “ ‘good faith’ is too vague a term”<sup>365</sup> or that “[t]he obligation of good faith and fair dealing is incapable of precise definition.”<sup>366</sup> As Prof. Farnsworth has pointed out, this difficulty may stem from North American law having “too many meanings of good faith.”<sup>367</sup> According to Prof. Farnsworth, there are three main interpretations of the duty of good faith that command support from sections of the jurisprudence and commentary: (1) good faith is an interpretative tool, used to imply terms and fill gaps in contracts; (2) good faith is an excluder of bad-faith conduct; and (3) good faith prevents contracting parties from using discretionary powers to recapture opportunities foregone by entering into a contract.<sup>368</sup> There is a good deal of overlap in these three interpretations, as will be illustrated below by tracing their appearances in a single judgment—Kelly J.’s judgment in *Gateway Realty*,<sup>369</sup> which is widely acknowledged<sup>370</sup> to be one of the leading Canadian authorities (if not *the* leading Canadian authority) on good faith performance.

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may receive commissions—court holding that discretion must be exercised in good faith), *leave to appeal to S.C.C. dismissed*, [1985] 2 S.C.R. ix.

365. *Mesa*, *ibid.* at para. 18, Kerans J.A. (for the court).

366. *Wallace*, *supra* note 364 at para. 98, Iacobucci J. (Lamer C.J., Sopinka, Gonthier, Cory, and Major JJ. concurring).

367. E. Allan Farnsworth, “Good Faith in Contract Performance,” in *Good Faith and Fault in Contract Law*, *supra* note 275, 153 at 161.

368. *Ibid.* at 161–63.

369. *Supra* note 364 (Z was the anchor tenant in G’s shopping centre under a long-term lease—A induced Z to move to A’s nearby shopping centre and took an assignment of the remaining 17 years of Z’s lease—A agreeing with G to use its best efforts to find suitable tenant for (now) empty space—court finding that A made insignificant effort to locate new tenants in order to limit competition with its own shopping centre—court finding breach of implied duty of good faith—granting G order terminating A’s leasehold rights and permanent injunction restraining A from interfering in shopping-centre space).

370. *See, e.g.*, Don Clark, “Some Recent Developments in the Canadian Law of Contracts” (1993) 14 *Advocates’ Q.* 435 at 438; McCamus, “Abuse of Discretion,” *supra* note 360 at 77.

*(b) Interpretative/Gap-Filling Tool*

Good faith can be seen as “an interpretive tool.”<sup>371</sup> Using this tool, courts can fill in gaps in the parties’ contract.<sup>372</sup> According to Prof. Farnsworth, who has championed this definition of good faith, this approach to good faith is “simply a rechristening of fundamental principles of contract law”<sup>373</sup> and, as such, is “[t]he most restrictive answer”<sup>374</sup> to the question, what is good faith?

Kelly J. provides a good account of the rationale for this approach in *Gateway Realty*:

To insist that parties to a contract not act in bad faith can be based on more than the pursuit of some ethical values in business relationships. Surely it is of commercial value to the business community to have their commercial relationships, their contractual drafting, and their contractual performance guided by some good faith requirement. They can then rely on such a legal principle rather than incur costs in an attempt to protect themselves from bad faith conduct. In an era of changing commercial circumstances, long-term contracts cannot always anticipate future economic commercial and merchandising trends. These make it difficult for the businesses and their counsel to incorporate into a contract protection from uncertain risks. A climate of law where counsel are urging their clients to act fairly, or at least not in “bad faith,” is a climate where business disputes will more likely be resolved, and such disputes and the costs arising from them more likely avoided.<sup>375</sup>

Under this approach, the courts are able to assist contracting parties that fail to anticipate every possible wrinkle of their contracting relationship by relying on the duty of good faith to imply terms consistent with the contract’s express terms and generally understood notions of good faith.

*(c) Excluder of Bad-Faith Conduct*

The second approach conceives of the duty of good faith as an excluder of bad-faith conduct. According to this view, “[t]he doctrine of good faith can only really be understood by reference to the bad faith conduct that it polices and excludes.”<sup>376</sup> On

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371. *Mills*, *supra* note 364 at para. 79, Wilson J.

372. *See Transamerica Life*, *supra* note 364 at para. 103, Laskin J.A. (dissenting in part) (“Perhaps, in the appropriate case, a court may consider using good faith as a tool to imply terms more readily than under the existing rules laid down by the Supreme Court of Canada.”).

373. *Supra* note 367 at 161 (quoting *Tymshare Inv. v. Covell*, 727 F. 2d 1145 at 1152 (D.C. Cir. 1984), Scalia J.).

374. *Ibid.*

375. *Supra* note 364 at para. 66.

376. *Belobaba*, *supra* note 359 at 79.



the surface, this approach just seems to shift the problem from defining one difficult concept (good faith) to defining another (bad faith). But proponents of this approach insist that it makes “the good faith doctrine much more workable and, ironically, more precise.”<sup>377</sup> Conceptually, it may be more comforting to use good faith as a tool to punish bad behaviour, rather than as a standard of good behaviour that contracting parties must strive to meet.

This approach has found favour in a large section of the Canadian case law. Kelly J.’s comments in *Gateway Realty* have been particularly influential:

The law requires that parties to a contract exercise their rights under that agreement honestly, fairly and in good faith. This standard is breached when a party acts in a bad faith manner in the performance of its rights and obligations under the contract. “Good faith” conduct is a guide to the manner in which the parties should pursue their mutual contractual objectives. Such conduct is breached when a party acts in “bad faith”—a conduct that is contrary to community standards of honesty, reasonableness or fairness.<sup>378</sup>

This appears to be the approach to good faith that is most favoured by Canadian courts.<sup>379</sup>

#### (d) *Foregone Opportunity Analysis*

The third definition of good faith is probably the most difficult to grasp. Here is how Prof. Farnsworth explained it:

“Good faith . . . limits the exercise of discretion in performance conferred on one party by the contract,” so it is bad faith to use discretion “to recapture opportunities forgone upon contracting” as determined by the other party’s expectations—in other words, to refuse “to pay the expected cost of performance.”<sup>380</sup>

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377. *Ibid.*

378. *Supra* note 364 at para. 38.

379. *See, e.g., Wallace, supra* note 364 at para. 98, Iacobucci J. (“at a minimum, I believe that in the course of dismissal employers ought to be candid, honest and forthright with their employees and should refrain from engaging in conduct that is unfair or is in bad faith by being, for example, untruthful, misleading or unduly insensitive”); *MDS Health, supra* note 364 at paras. 29–30, Haley J. (citing passage from *Gateway Realty*). *See also* O’Byrne, “Implied Term,” *supra* note 359 at 197, n. 12 (citing other cases that have approved of Kelly J.’s definition of good faith).

380. *Supra* note 367 at 162 (quoting Steven J. Burton, “Breach of Contract and the Common Law Duty to Perform in Good Faith” (1980) 94 Harv. L. Rev. 369).

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In *Gateway Realty*, Kelly J. described this interpretation of good faith as “[t]he concept that one party to a contract should not act in such a way as to deprive the other party of the anticipated benefits of the contract. . . .”<sup>381</sup>

The key to this interpretation appears to consist in the reference to “the other party’s expectations.” This type of language—often modified by *reasonable* and sometimes modified by *legitimate*—crops up repeatedly in judgments applying a duty of good faith. For example, in *Gateway Realty*, Kelly J. held that:

What will constitute bad faith . . . will depend on the terms of the contract and the circumstances of the case. In most cases, bad faith can be said to occur when one party, without reasonable justification, acts in relation to the contracts in a manner where the result would be to substantially nullify the bargained objective or benefit contracted for by the other, or to cause significant harm to the other, contrary to the original purpose and expectation of the parties.<sup>382</sup>

### (e) Summary

As Prof. Farnsworth has noted, courts have “looked to all three of these views for support” without drawing sharp lines between them, because “the meaning of good faith may turn on which of its several functions is in issue.”<sup>383</sup> With this picture of the definitions of good faith in mind, it is now possible to move on to the other vexing question relating to good faith in Canadian law, which is when the duty of good faith applies.

## 2. WHEN DOES A DUTY OF GOOD FAITH ARISE IN CANADIAN CONTRACT LAW?

### (a) Introduction

It is a commonplace that “. . . Canadian courts have not recognized a stand-alone duty of good faith that is independent from the terms expressed in a contract or from the objectives that emerge from these provisions.”<sup>384</sup> In this respect, common-

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381. *Supra* note 364 at para. 40.

382. *Ibid.* at para. 60. *See also Mesa*, *supra* note 364 at para. 19, Kerans J.A. (“In my view, as a matter of fact, this contract created certain expectations between the parties about its meaning, and about performance standards. If those expectations are reasonable, they should be enforced because that is what the parties had in mind. They are reasonable if they were shared. Of course, those expectations must also, to be reasonable, be consistent with the express terms agreed upon. This contract should be performed in accordance with the reasonable expectations created by it.”).

383. *Supra* note 367 at 163.

384. *Transamerica Life*, *supra* note 364 at para. 53, O’Connor A.C.J. (Sharpe J.A. concurring). *See also Gartrell*, *supra* note 363 at para. 197, Koenigsberg J. (“the general consensus of the case law in

law Canada is similar to several common-law jurisdictions, such as the United Kingdom<sup>385</sup> and Australia,<sup>386</sup> but is different from other common-law jurisdictions, such as the United States,<sup>387</sup> and civil-law jurisdictions, such as Québec.<sup>388</sup> This does not mean that a duty of good faith does not exist in common-law Canadian contract law, but it does make it more of a challenge to state exactly when it applies.

The starting point for this analysis is suggested in the quotation set out at the beginning of the previous paragraph. A contract will be subject to the duty of good faith if the parties expressly incorporate it within the terms of their contract or if it should be implied into their contract. A term may be implied into a contract by legislation<sup>389</sup> or by the courts.

### (b) *Implied Terms—General*

It is relatively clear when a contract creates an express duty of good faith or a statute implies a duty of good faith into a contract, but it takes some analysis to know

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Canada is that there is no general implied term of duty of good faith in contract law”); *Schluessel*, *supra* note 363 at paras. 129, 132, Harvey J. *But see Hawker Siddeley*, *supra* note 364 at para. 72, Blair J. (“This is an illustration of the application of the good faith doctrine in contractual performance, which in my view is a part of the law of Ontario.”).

385. *See Interfoto Picture Library Ltd. v. Stiletto Visual Programmes Ltd.*, [1987] EWCA Civ 6, [1989] Q.B. 433 at 439, Bingham L.J. (“In many civil law systems, and perhaps in most legal systems outside the common law world, the law of obligations recognizes and enforces an overriding principle that in making and carrying out contracts parties should act in good faith. . . . English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness.”).

386. *See* L.J. Priestley, “A Guide to a Comparison of Australian and United States Contract Law” (1989) 12 U.N.S.W. L.J. 4 at 17–18 (“A feature of . . . much United States contract law is the explicit recognition and statement of the obligation of good faith upon contracting parties in the performance and enforcement of contracts. This seems to be a marked distinction from the Australian position, where the authoritative cases and commonly used texts have never recognized the good faith component in the common law of contract.” [footnote omitted]).

387. *See Restatement (Second) of Contracts* § 205 (1981) (“Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.”). *See also* U.C.C. § 1-304 (2001) (“Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement.”).

388. *See* art. 1375 C.C.Q. (“The parties [to a contract] shall conduct themselves in good faith both at the time the obligation is created and at the time it is performed or extinguished.”).

389. *See, e.g., Insurance (Marine) Act*, R.S.B.C. 1996, c. 230, s. 18 (“A contract of marine insurance is a contract based on the utmost good faith, and if the utmost good faith is not observed by either party the contract may be avoided by the other party.”); *Partnership Act*, R.S.B.C. 1996, c. 348, s. 22 (1) (“A partner must act with the utmost fairness and good faith towards the other members of the firm in the business of the firm.”).

when the courts will imply a duty of good faith into a contract. The starting place is the general test for implying a term into a contract. The Supreme Court of Canada has concluded that courts may imply terms into contracts for any of the following three reasons:

- (1) based on custom or usage;
- (2) as the legal incidents of a particular class or kind of contract; or
- (3) based on the presumed intention of the parties. . . .<sup>390</sup>

Courts very rarely (if ever) rely on custom or usage as a basis for implying a duty of good faith in a contract, so the first category is not relevant to this inquiry. Courts do rely frequently on the other two categories as bases for implying a duty of good faith. This is significant because the two categories have different rationales and tests.<sup>391</sup>

### (c) *Terms Implied in Law*

The Supreme Court's category (2) is sometimes referred to as implying a term in law.<sup>392</sup> The test for terms implied in law is *necessity*.<sup>393</sup> The Supreme Court of Canada has explained that this test of necessity does not mean that a term may only be implied in law if the "very existence" of the contract turns on it.<sup>394</sup> Instead, "the question is whether the term sought to be implied is a 'necessary condition' of the contractual relationship."<sup>395</sup>

This test is still a rather high one to meet, but it has been met for a number of types of contracts. The leading case is *Wallace*,<sup>396</sup> a major employment-law case that also

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390. *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.*, [1999] 1 S.C.R. 619 at para. 27, 170 D.L.R. (4th) 577, Iacobucci J. (for the court) [*Defence Construction* cited to S.C.R.], citing *Canadian Pacific Hotels Ltd. v. Bank of Montreal*, [1987] 1 S.C.R. 711 at 774–75, 40 D.L.R. (4th) 385, Le Dain J. (Estey, McIntyre, Lamer, and Wilson JJ. concurring) [*Canadian Pacific* cited to S.C.R.].

391. The discussion in the sections that follows is largely based on the analysis in O'Byrne, "Implied Term," *supra* note 359 at 200–37 and McCamus, "Abuse of Discretion," *supra* note 360.

392. See, e.g., *Machtinger v. HOJ Industries Ltd.*, [1992] 1 S.C.R. 986 at 1008, 91 D.L.R. (4th) 491, McLachlin J. [*Machtinger* cited to S.C.R.].

393. See *Canadian Pacific*, *supra* note 390 at 776, Le Dain J.; *Machtinger*, *ibid.* at 1010, McLachlin J.

394. See *Machtinger*, *ibid.*, McLachlin J. ("The test for 'necessity' . . . is not whether the term is 'necessary' for the very existence of the contract.").

395. *Ibid.* at 1011, McLachlin J. (citing *Romford Ice and Cold Storage Co. v. Lister*, [1956] UKHL 6, [1957] A.C. 555 at 576, Viscount Simonds).

396. *Supra* note 364.

contains some important comments on when a duty of good faith should be implied in law. Although Iacobucci J.'s majority decision in this case did not go so far as to imply a duty of good faith in dismissing employees in all contracts of employment, it did conclude that "employers ought to be held to an obligation of good faith and fair dealing in the manner of dismissal, the breach of which will be compensated for by adding to the length of the notice period."<sup>397</sup> The way in which Iacobucci J. reached this conclusion has exerted a major influence on implying in law a duty of good faith in certain types of contracts. After noting that a "power imbalance . . . informs virtually all facets of the employment relationship"<sup>398</sup> and that employees are considered "as a vulnerable group in society,"<sup>399</sup> Iacobucci J. concluded that a duty of good faith is needed to "encourage conduct that minimizes the damage and dislocation (both economic and personal) that result from dismissal."<sup>400</sup>

Later cases have seen this reasoning as providing a template for when to imply a duty of good faith in law. For example, the Ontario Court of Appeal has remarked:

. . . Iacobucci J. held that contracts of employment have unique characteristics that set them apart from ordinary commercial contracts. He described three special characteristics of employment contracts: (1) the formation of the contract is not the result of the exercise of bargaining power between two equals; (2) the person in the weaker position is unable to achieve more favourable contractual terms because of, for example, that person's inability to access information; (3) the power imbalance continues to affect other facets of the relationship after the contract has been entered into.<sup>401</sup>

The court went on to apply this analysis to a franchise contract and concluded that "[i]t is hardly surprising, therefore, that a number of courts . . . have recognized that a duty of good faith exists at common law in the context of a franchisor-franchisee relationship."<sup>402</sup> There is also longstanding and high authority that insurance contracts contain an implied duty of good faith.<sup>403</sup>

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397. *Ibid.* at para. 95, Iacobucci J. (Lamer C.J., Sopinka, Gonthier, Cory, and Major JJ. concurring). *See also ibid.* at para. 136, McLachlin J. (dissenting in part) (La Forest and L'Heureux-Dubé JJ. concurring) ("I differ from my colleague, however, in that I see no reason why the expectation of good faith in dismissing employees that he accepts should not be viewed as an implied term of the contract of employment.").

398. *Ibid.* at para. 92.

399. *Ibid.* at para. 93.

400. *Ibid.* at para. 95.

401. *Print Three*, *supra* note 364 at para. 64, Weiler J.A. (for the court).

402. *Ibid.* at para. 66, Weiler J.A.

403. *See Fidler v. Sun Life Assurance Co. of Canada*, 2006 SCC 30, [2006] 2 S.C.R. 3 at para. 63, McLach-

(d) *Terms Implied in Fact*

The Supreme Court's category (3) is often referred to as implying terms in fact.<sup>404</sup> The test for this category is based on the parties' *intention*. On its face, intention seems like a lower threshold to meet than necessity, but still judges have said that "[c]ontractual terms should not be implied lightly"<sup>405</sup> and that courts "must be careful not to slide into determining the intentions of *reasonable* parties."<sup>406</sup> Out of this sense of caution, courts do not imply a term in fact unless it has "a certain degree of obviousness to it. . ."<sup>407</sup> "Obviousness" is determined by considering whether the term is "necessary to give business efficacy to a contract" or whether an "officious bystander" would recognize the term "as a term which the parties would say, if questioned, that they had obviously assumed."<sup>408</sup>

Contracts in which the duty of good faith has been implied in fact form a much more diffuse group than contracts in which the duty of good faith has been implied in law. This is because implying good faith in fact turns on an analysis of the parties' intentions, and not on the general characteristics of a given type of contractual relationship.<sup>409</sup> As a result, there is an *ad hoc* quality to the legal reasoning used to determine when a duty of good faith should be implied in fact. One commentator has concluded that the field is "united by four constant factors":

- the contract at bar gives the parties obligations which cannot be instantaneously performed;
- subsequent to the creation of the contract, one of the parties finds itself in a position to exercise a contractual power—typically a discretion of some sort—in a manner that severely disadvantages the other side;

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lin C.J. & Abella J. (for the court) (referring to "the independent contractual obligation to deal with the [insured's] claim in good faith").

404. See, e.g., *Machtinger*, *supra* note 392 at 1008, McLachlin J.

405. *Mills*, *supra* note 364 at para. 98, Wilson J.

406. *Defence Construction*, *supra* note 390 at para. 29, Iacobucci J. [emphasis in original].

407. *Ibid.*, Iacobucci J.

408. *Canadian Pacific*, *supra* note 390 at 775, Le Dain J. See also *Defence Construction*, *ibid.*, Iacobucci J. ("It is unclear whether these are to be understood as two separate tests. . .").

409. See O'Byrne, "Implied Term," *supra* note 359 at 204 ("If it were argued that the contract in question fit within the second category, this itself would be the subject of contention since contracts in the second category are not of a type. Categorization is currently done on a case by case basis. . . . Accordingly, and unlike established category one contracts, not all contracts of the same type will necessarily contain an implied term of good faith, and its presence or absence will be a matter of debate based on the parties' intent.").

- the party exercising its contractual power does so unfairly or unreasonably; and
- at issue is whether this harsh exercise of a contractual power is at odds with the bargained-for standard of conduct governing the contract.<sup>410</sup>

As the first point in this list notes, good faith tends to be more of an issue “where performance is rendered over time.”<sup>411</sup> Some examples of contracts in which a duty of good faith was implied in fact include commercial leases,<sup>412</sup> independent contractor agreements,<sup>413</sup> resource royalty contracts,<sup>414</sup> construction contracts,<sup>415</sup> and contracts for the purchase and sale of real estate.<sup>416</sup>

### (e) Summary

As this discussion has illustrated, determining whether a duty of good faith in the performance of a contract exists can involve an extensive examination of the terms of the contract and the relationship between the parties, as well as any applicable statutory provisions and leading court cases considering the implication of contract terms.

## C. Good Faith Enforcement

In contrast to good faith performance, good faith enforcement occupies a rather low-profile place in the jurisprudence and commentary on contractual unfairness. As a result, the concept’s scope and purpose can be somewhat obscure.

In discussing good faith enforcement it is necessary first to step back and get a handle on what amounts to enforcement of a contract. Enforcement terms obviously include a contracting party’s remedies for breach of the contract, whether stated expressly in the contract or flowing from common-law rules. The category of terms that make up enforcement terms is somewhat broader than just remedies. One commentator has crafted the following description of the types of contract terms that make up the class of enforcement terms:

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410. *Ibid.* at 229.

411. *Ibid.* at 228.

412. See *Gateway Realty*, *supra* note 364.

413. See *Mills*, *supra* note 364.

414. See *Mesa*, *supra* note 364.

415. See, e.g., *TNL Paving Ltd. v. British Columbia (Ministry of Transportation & Highways)* (1999), 46 C.L.R. (2d) 165 at paras. 318–24, 90 A.C.W.S. (3d) 216 (B.C.S.C.), Beames J.

416. See *LeMesurier*, *supra* note 364.

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enforcement terms represent mechanisms to help secure a party's expectation of receiving the primary benefit of the bargain. Such terms are not limited by the boundaries of conventional remedies. They include any express condition whose purpose is to protect one's interest in the performance of a contract.<sup>417</sup>

Commentary on good faith tends to emphasize the close relationship of enforcement and performance.<sup>418</sup> Performance terms “most commonly take the form of an express or implied promise that an event shall occur, failing which the promisor will be liable for breach unless excused or discharged.”<sup>419</sup> In most cases, it is not hard to tell enforcement terms and performance terms apart, as the following examples illustrate:

If one contracts to deliver certain goods at a given time and place, keeping that promise is part of the performance of the contract. If one is held liable to pay damages after unjustifiably failing to keep the promise, the injured party's lawsuit and the resulting court order are enforcement of the contract. The distinction may be equally obvious when the remedy is based on a term of the agreement rather than on the common law. If a contract for the sale of goods provides that the seller must pay a specified sum of money upon breach by failure to deliver the goods as agreed, the buyer enforces the contract by invoking that provision in response to the seller's breach.<sup>420</sup>

In a few places, the line between enforcement terms and performance terms can become obscure.<sup>421</sup>

Good faith enforcement differs in focus from good faith performance, and from unconscionability, duress, and undue influence. “The central issue for good faith enforcement,” as explained by an American textbook, “is whether an enforcement term is *available* to the party invoking it.”<sup>422</sup> The question for resolution in a typical good faith enforcement case is whether a contracting party is able to use the enforcement term in the circumstances in which it was invoked. Unlike a finding of bad faith in

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417. Eric G. Anderson, “Good Faith in the Enforcement of Contracts” (1988) 73 Iowa L. Rev. 299 at 306 [footnote omitted].

418. See *Restatement (Second) of Contracts* § 205 (1981) (pairing performance and enforcement in articulating a duty of good faith and fair dealing).

419. Anderson, *supra* note 417 at 304.

420. *Ibid.* at 302 [footnote omitted].

421. See *ibid.* (providing examples of distributorship agreement that may be terminated at will and “an agreement between a real estate broker and a seller of property [that] provides for payment of a commission if the property is withdrawn from the market”).

422. Steven J. Burton & Eric G. Anderson, *Contractual Good Faith: Formation, Performance, Breach, Enforcement* (Boston: Little, Brown, 1995) at § 7.2.2.2 [emphasis in original].



performance, a finding of bad faith in enforcement does not amount to a breach of contract that may be remedied with damages. Unlike unconscionability, duress, and undue influence, bad faith in enforcing a contract cannot form the basis for rescission of the contract, or even for striking down the enforcement term at issue. The enforcement term could still be invoked at an appropriate occasion.<sup>423</sup>

There are few to none Canadian cases that expressly discuss good faith enforcement. There are some cases<sup>424</sup> that adopt the reasoning used to imply a duty of good faith performance to an enforcement term.<sup>425</sup> These cases provide some insight into how good faith should be applied in relation to enforcement, but they do not really grapple with the special challenges of applying good faith in an enforcement setting.

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423. See *ibid.* (“The result of a finding of bad faith is simply that the party in question is disabled from using the term under the circumstances. It remains part of the contract for use in appropriate settings.”)

424. See, e.g., *Bank of Montreal v. Korico Enterprises Ltd.* (2000), 50 O.R. (3d) 520, 190 D.L.R. (4th) 706 (C.A.) [*Korico Enterprises* cited to D.L.R.] (bank suing debtor company and guarantors after company defaults in payment of loan—guarantors defending on basis that bank acted improvidently on selling its security—motion judge rejecting on basis of wording of guarantee giving bank right to deal with security as it sees fit—appeals court reversing motion judge), *leave to appeal to S.C.C. refused*, [2000] S.C.C.A. No. 546 (QL); *Ceapro Inc. v. Saskatchewan*, 2008 SKQB 237, 45 B.L.R. (4th) 35 [*Ceapro* cited to B.L.R.] (government agency investing in shares of subsidiary of plaintiff—investment secured by retraction rights and take-control agreement—government agency subsequently lending funds to subsidiary—after defaults in loan agreement, government agency exercising take-control agreement—plaintiff alleging breach of duty of good faith—court finding implied duty of good faith in agreement, but concluding that it was not breached on the facts of the case). See also *Doman Forest Products Ltd. v. GMAC Commercial Credit Corp.—Canada*, 2007 BCCA 88, 65 B.C.L.R. (4th) 1 at paras. 40–47, Southin J.A. (dissenting) (considering application of good-faith requirement in s. 68 of *Personal Property Security Act* to rights under a loan agreement).

425. See *Korico Enterprises, ibid.* at para. 18, the court (“Admittedly, the language in question could be construed as authorizing the bank to wilfully, recklessly or negligently sell off the secured assets at bargain basement prices that bear no relation to their true market value. In theory, it could even be construed as authorizing the bank to give the securities away or destroy them. On the other hand, it can just as readily be interpreted as imposing a standard of reasonableness and good faith on the bank. Indeed, in our view, of the two possible interpretations, the latter accords with commercial reality and produces a much fairer result than the former.”); *Ceapro, ibid.* at para. 210, Popescul J. (“I agree with Professor McCamus’s categorization of the situations in which an implied duty of good faith ought to be recognized. Accordingly, I find that [the government agency] did have a duty, based upon the intention of the parties at the time the contract was made, that the 1993 agreement be interpreted so that the objectives of the contract are respected and that the conduct that has the effect of defeating rights under the agreement, albeit conduct not strictly prohibited by the precise wording of the contract, is not condoned.”).

Since the case law in Canada does not provide much in the way of illustrating how a duty of good faith enforcement operates in practice, it is helpful to draw on the American experience.<sup>426</sup> The *Restatement (Second) of Contracts* sets out a duty of good faith enforcement, which “extends to the assertion, settlement and litigation of contract claims and defenses.”<sup>427</sup> The commentary goes on to explain when the duty has been found to be breached:

The obligation is violated by dishonest conduct such as conjuring up a pretended dispute, asserting an interpretation contrary to one’s own understanding, or falsification of facts. It also extends to dealing which is candid but unfair, such as taking advantage of the necessitous circumstances of the other party to extort a modification of a contract for the sale of goods without legitimate commercial reason. Other types of violation have been recognized in judicial decisions: harassing demands for assurances of performance, rejection of performance for unstated reasons, willful failure to mitigate damages, and abuse of a power to determine compliance or to terminate the contract.<sup>428</sup>

As these examples suggest, good faith enforcement is, like good faith performance, concerned with abuses of discretion and unfair behaviour in the course of a long-term relationship. The difficulty for this topic is deciding whether or how to apply standards of good faith once such a relationship has effectively come to an end.

### D. Good Faith Negotiation

Unlike good faith enforcement, good faith negotiation has been the subject of extensive consideration, both by the courts and by academic commentators. As one commentator has observed, good faith negotiation “has two aspects”: (1) “the obligation to *bargain in good faith*,” which is “more negative in content, serving to prohibit certain forms of bargaining behaviour”; and (2) “the obligation to *bargain*,” which is “more positive, requiring parties actually to negotiate with a view to concluding an agreement.”<sup>429</sup>

There are many examples of conduct that could breach one or the other of these aspects. For instance, “withholding of information that would disabuse the other nego-

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426. *But see Contractual Good Faith*, *supra* note 422 at § 7.2 (noting that good faith enforcement “is overtly applied in relatively few cases” in the United States, despite the greater familiarity of the concept in that jurisdiction).

427. *Restatement (Second) of Contracts* § 205, cmt. e (1981). *See, supra*, note 78 (for general information on the American Law Institute’s *Restatements*).

428. *Restatement (Second) of Contracts* § 205, cmt. e (1981).

429. Jamie Cassels, “Good Faith in Contract Bargaining: General Principles and Recent Developments” (1993) 15 *Advocates’ Q.* 56 at 56 [emphasis in original].

tiating party of a mistake concerning an important fact,”<sup>430</sup> “bargaining with no intention of reaching agreement or otherwise misleading the other party with respect to one’s intentions, reneging on a promise given in the course of negotiations, refusal to make reasonable efforts to reach agreement, breaking off negotiations in order to accept a more attractive proposal from a third party,”<sup>431</sup> and “entering into a contract without having the intent to perform, entering a deal recklessly disregarding prospective inability to perform, failing to disclose known defects in goods being sold, and taking undue advantage of superior bargaining power to strike an unconscionable contract,”<sup>432</sup> would all be examples of conduct that may amount to a breach of either the first or second aspect of a duty of good faith negotiation.

Although the duty of good faith negotiation has been argued in a number of recent court cases, “the evidence in support of the proposition that such a duty has been recognized [by the common-law Canadian courts] is very slender indeed.”<sup>433</sup> This point is illustrated by one of the acknowledged<sup>434</sup> high points in the (potential) recognition of a duty of good faith negotiation, which is La Forest J.’s concurring judgment in the *Lac Minerals* case.<sup>435</sup> In *Lac Minerals*, a case which was not argued on the basis of contract law before the Supreme Court of Canada,<sup>436</sup> La Forest J. remarked that “[t]he institution of bargaining in good faith is one that is worthy of legal protection in those circumstances where that protection accords with the expectations of the parties.”<sup>437</sup> This comment indicated some openness at the highest judicial levels to developing a general common-law duty of good faith negotiation. A few years after *Lac Minerals* was decided, however, a differently constituted Supreme Court of Canada in the *Martel Building* case poured cold water on this notion that the court

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430. McCamus, *Law of Contracts*, *supra* note 13 at 138. Prof. McCamus rightly follows up this point by noting that, at common law, there is “no *general duty* of disclosure on contracting parties” [emphasis added; footnote omitted].

431. *Ibid.*

432. Robert S. Summers, “Good Faith in General Contract Law and the Sales Provisions of the Uniform Commercial Code” (1968) 54 Va. L. Rev. 195 at 220.

433. McCamus, *Law of Contracts*, *supra* note 13 at 140.

434. *See* Cassels, *supra* note 429 at 70.

435. *Lac Minerals Ltd. v. International Corona Resources Ltd.*, [1989] 2 S.C.R. 574, 61 D.L.R. (4th) 14 [*Lac Minerals* cited to S.C.R.].

436. The case was framed and decided on the basis of misuse of confidential information and breach of fiduciary duty. *See ibid.* at 594–95, Sopinka J. (dissenting in part). Contract-law issues were raised at trial. *See ibid.* at 593, Sopinka J.

437. *Ibid.* at 672.

would be receptive to creating a general duty of good faith negotiation.<sup>438</sup> Although *Martel Building* was, like *Lac Minerals*, not a contract-law case,<sup>439</sup> and although the court even took pains to say that its conclusions did not apply to a duty of good faith negotiation framed in contract law,<sup>440</sup> its disparaging comments on the value of a tort-law duty of care in negotiation left little doubt about how it would treat an argument to fashion a general duty of good faith negotiation.<sup>441</sup>

The issue of a general duty of good faith negotiation has squarely arisen in a few cases decided in the lower courts. One leading case found the idea of such a duty to be “unrealistic and unsupported by authority” under the current law and undesirable as a reform because it “introduces an element of paternalism that is totally unjustified in such a relationship.”<sup>442</sup> The court in another leading case noted that “[g]enerally, parties negotiating a contract expect that each will act entirely in the party’s own interests,” and concluded that “[a]bsent a special relationship, the common law in Canada has yet to recognize that in the negotiation of a contract, there is a duty to have regard to the other person’s interests, namely, to act in good faith.”<sup>443</sup> The courts have also emphasized the importance of drawing a “bright line” between the duty of good faith performance and enforcement on the one hand and good faith

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438. *Martel Building Ltd. v. Canada*, 2000 SCC 60, [2000] 2 S.C.R. 860 at paras. 67–72, Iacobucci & Major JJ. (for the court) [*Martel Building* cited to S.C.R.].

439. The case was argued and decided by the Supreme Court of Canada in terms of a proposed expansion of the duty of care under the tort of negligence to cover economic loss in pre-contractual negotiation. See *ibid.* at para. 31. Breach of a duty to negotiate flowing from the law of contract was argued at an earlier stage in the litigation, but this argument was not pursued in the Supreme Court of Canada. See *ibid.* at para. 73. See, above, at 5–8 (part II.B) (for more detail on the distinction between contract law and tort law).

440. *Martel Building*, *ibid.* at para. 73, Iacobucci & Major JJ. (“Whether or not negotiations are to be governed by a [contractual] duty of good faith is a question for another time.”).

441. See *ibid.* at paras. 67–70, Iacobucci & Major JJ. (“It would defeat the essence of negotiation and hobble the marketplace to extend a duty of care to the conduct of negotiations. . . . [T]o impose a duty in the circumstances of this appeal could inject tort law as the after-the-fact insurance against failures to act with due diligence or to hedge the risk of failed negotiations through the pursuit of alternative strategies or opportunities. . . . [T]o extend the tort of negligence into the conduct of commercial negotiations would introduce the courts to a significant regulatory function, scrutinizing the minutiae of pre-contractual conduct.”).

442. *Peel Condominium Corp. No. 505 v. Cam-Valley Homes Ltd.* (2001), 53 O.R. (3d) 1, 196 D.L.R. (4th) 621 at paras. 40, 43 (C.A.), Finlayson J.A. (Labrosse J.A. concurring) [*Peel Condominium* cited to D.L.R.].

443. *978011 Ontario Ltd. v. Cornell Engineering Co.* (2001), 53 O.R. (3d) 783, 198 D.L.R. (4th) 615 at para. 32 (C.A.), Weiler J.A. (for the court) [*Cornell Engineering* cited to D.L.R.] [citations omitted].

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negotiation on the other, separating developments with respect to the law on one side of the bright line from potential developments on the other.<sup>444</sup>

Similar to their treatment of an implied duty of good faith performance, the courts have been more willing to carve out specific areas in which a duty to negotiate in good faith arises than they have been to endorse a general duty of good faith negotiation. These areas have included options to renew either a commercial lease or similar long-term contract, and requests for proposals and other tendering situations.<sup>445</sup> These specific duties are much more limited than their equivalent duties of good faith performance. As one commentator put it, where the duty of good faith negotiation exists, it exists “on an exceptional basis.”<sup>446</sup>

An example of how the courts tend to treat these specific duties to negotiation in good faith can be seen by looking closer at the renewal cases. These cases involve an agreement to renew a commercial lease (or similar long-term contract) at a rental rate to be agreed upon by the parties at the time of renewal. This fact pattern has generated two leading decisions from the British Columbia Court of Appeal.<sup>447</sup>

In the *Empress Towers* case, the majority held that the contract term at issue contained an “objective” component by virtue of its reference to the “prevailing market rental” and this saved the term from being too uncertain to enforce.<sup>448</sup> The majority went on to hold that the reference to “mutual agreement” in the contract term at issue “carries with it, first, an implied term that the landlord will negotiate in good faith with the tenant with the objective of reaching an agreement on the market rental rate and, second, that agreement on a market rental will not be unreasonably withheld.”<sup>449</sup> This conclusion seemed to open up a new area for the development of a duty of good faith to negotiate with a view to completing an agreement.<sup>450</sup>

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444. *Peel Condominium*, *supra* note 442 at para. 38, Finlayson J.A.

445. See *Elite Bailiff Services Ltd. v. British Columbia*, 2003 BCCA 102, 10 B.C.L.R. (4th) 264; *Buttcon Ltd. v. Toronto Electric Commissioners* (2003), 65 O.R. (3d) 601, 38 B.L.R. (3d) 106 (S.C.J.).

446. O’Byrne, “Implied Term,” *supra* note 359 at 194.

447. *Empress Towers Ltd. v. Bank of Nova Scotia* (1990), 73 D.L.R. (4th) 400, 50 B.C.L.R. (2d) 126 (C.A.) [*Empress Towers* cited to B.C.L.R.]; *Mannpar Enterprises Ltd. v. Canada*, 1999 BCCA 239, 67 B.C.L.R. (3d) 64 [*Mannpar Enterprises* cited to B.C.L.R.].

448. *Empress Towers*, *ibid.* at 130, Lambert J.A. (Taggart J.A. concurring).

449. *Ibid.*

450. See Cassels, *supra* note 429 at 87–91.

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A few years later, the court had an opportunity to revisit *Empress Towers* in the *Mannpar Enterprises* case.<sup>451</sup> The court distinguished this case from *Empress Towers* because the renewal clause at issue did not “provide an objective benchmark” to determine the rent.<sup>452</sup> The court also drew a distinction between cases involving “a review process [that] was provided for in the context of a continuing leasehold arrangement”<sup>453</sup> and those in which the negotiation of a new lease or contract is at issue.<sup>454</sup> These distinctions have the effect of significantly limiting to scope of the duty announced in *Empress Towers*.

### E. Issues for Reform

The sections that follow begin by considering good faith performance, good faith enforcement, and good faith negotiation in turn as discrete issues. Then, a series of issues relating to good faith generally are discussed.

Two law-reform reports on the general law of contracts have also considered good faith. It was the subject of a chapter in the Ontario Law Reform Commission’s report.<sup>455</sup> The concept was also considered in a discussion paper by the New Zealand Law Commission.<sup>456</sup> In addition, the American *Restatement (Second) of Contracts*<sup>457</sup> and Uniform Commercial Code are useful sources of ideas on legislative reform involving good faith performance and enforcement.

#### 1. SHOULD THE CONTRACT FAIRNESS ACT HAVE A PROVISION DEALING WITH GOOD FAITH PERFORMANCE?

As the discussion earlier in this chapter has shown, contracts are often subject to a duty of good faith performance under Canadian law. This duty may arise because the parties have expressly agreed to it, because a statute implies the duty, or because one of the common-law tests for implying the duty has been met. This issue is concerned with whether a general duty of good faith should be enacted in legislation.

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451. The renewal clause in this case concerned a permit to remove sand and gravel, rather than a commercial lease.

452. *Supra* note 447 at para. 61, Hall J.A. (for the court).

453. *Ibid.* at para. 36.

454. *Ibid.* at paras. 36–48.

455. *Report on Amendment of the Law of Contract*, *supra* note 75.

456. “Unfair” Contracts: A Discussion Paper, *supra* note 76.

457. *See, supra*, note 78 (for general information on the American Law Institute’s *Restatements*).

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Prof. McCamus has helpfully canvassed the main arguments found in the academic and law-reform literature for and against a legislative duty of good faith performance.<sup>458</sup> A summary of his findings for the leading arguments in favour of a duty is as follows:

- (1) A legislative duty of good faith would amount, in essence, to a restatement and clarification of the common law;<sup>459</sup>
- (2) A legislative duty of good faith “would bring the law more into accord with the expectations of contracting parties”;<sup>460</sup>
- (3) A legislative duty of good faith “would simply bring our system into line with other jurisdictions.”<sup>461</sup>

These arguments in favour of explicit recognition of good faith performance have some prominent academic<sup>462</sup> and judicial<sup>463</sup> support. The appeal of this approach is that, in restating the law on a broader legislative footing, gains can be made both by creating a clearer and simpler set of rules and by modernizing areas such as remedies.<sup>464</sup> The case law currently provides that a large number of contracts are subject to an implied duty of good faith, and one of the tests turns on the courts’ interpretation of the parties’ intention, which creates a somewhat unpredictable standard for future expansion of the duty to embrace still more contracts. This was the view of

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458. McCamus, “Abuse of Discretion,” *supra* note 360. It should be noted that Prof. McCamus’s focus in his article is on judicial reform, but his review of the arguments for and against the duty of good faith applies equally well to legislative reform.

459. *Ibid.* at 75.

460. *Ibid.* See also B.J. Reiter, “Good Faith in Contracts” (1983) 17 Val. U. L. Rev. 705 at 707 (“Empirical research has concluded universally that good faith always has been, and remains, a critical part of the real world of contracts. Parties do not live only to the letter of their contracts (or pre-contractual legal rights), except where living to the letter is accepted as constituting appropriate behaviour.” [footnote omitted]).

461. McCamus, “Abuse of Discretion,” *ibid.* at 76.

462. See Belobaba, *supra* note 359 at 73 (“I argue that good faith and fair dealing are already a *de facto* doctrine. . . . I conclude that explicit recognition would not only give long overdue doctrinal status to a norm that pervades the modern law of contract, but would also provide a more workable remedial vocabulary and thus a more functional body of law.”).

463. See Mills, *supra* note 364 at para. 78, Wilson J. (“Presently in Ontario there is no generalized duty of good faith applying to all contracts. That day may come, and would simplify the law.”).

464. See Belobaba, *supra* note 359 at 78 (“[T]he explicit adoption of a good faith doctrine would not impose any new contractual obligations or responsibilities. It would simply consolidate existing doctrinal approaches and provide a more precise remedial vocabulary.”).

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the New Zealand Law Commission<sup>465</sup> and the Ontario Law Commission,<sup>466</sup> both of which recommended adoption of a legislative duty of good faith performance. The Ontario Commission gave the following reasons to support its conclusion:

In our view, an unsettled and incoherent body of law, particularly in an area as pervasively important as good faith in contracting, is unsatisfactory. Predictability in contract planning, as well as in contract dispute resolution, is an important value that may be compromised when a relevant doctrine is unclear. . . .

In contrast to the slow and unpredictable pace of common law developments, it is a relatively easy matter to frame legislation clarifying and rationalizing a contractual doctrine of good faith. We believe that a legislated obligation of good faith, to apply in specified circumstances, would be conducive to greater certainty and more straightforward judicial reasoning.<sup>467</sup>

Prof. McCamus notes that detractors of the duty of good faith have relied on the following two arguments:

- (1) “[T]he fear that recognition of the good faith duty will bring an unattractive degree of uncertainty to the law”;<sup>468</sup>
- (2) Comparisons to other jurisdictions hold no water because differences in legal systems make it difficult to impossible to translate their experience with a duty of good faith to common-law Canada.<sup>469</sup>

Critics of a general duty of good faith performance have tended to rely on the first argument. One critic has argued forcefully that the large number of cases invoking good faith show that the courts are able to address any concerns that arise in practice already, so introducing a general legislative standard can only cause mischief:

A reading of all of these cases in the area of performance and “enforcement” suggests that the difficulties they resolve are easily capable of being resolved by rules of interpretation and implied terms: good and fair dealing, as a standard, appears to add very little if anything at all. . . . With such a standard, individual decisions on good faith would appear to have very little predictive value in gauging the role of good faith in different contexts. Moreover, good faith becomes vague to the point of meaninglessness, and quite possibly destructive in the hands of a court that does not know how to handle it but

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465. See “Unfair Contracts”: A Discussion Paper, *supra* note 76 at 45.

466. See *Report on Amendment of the Law of Contract*, *supra* note 75 at 176.

467. *Ibid.* at 169.

468. McCamus, “Abuse of Discretion,” *supra* note 360 at 76.

469. *Ibid.*



does not feel free to ignore it. Can it therefore be said that any good comes from introducing into contract law a standard of good faith?<sup>470</sup>

Similar concerns are found in other academic commentary,<sup>471</sup> and even in the occasional judgment.<sup>472</sup>

The weight of numbers appears to favour those arguing in support of a general duty of good faith in contractual performance. This may be the result of the increasing number of courts that have found a duty of good faith inherent in a type of contract or a specific contract. As these decisions add up, articulating a general duty of good faith seems like less of a bold new step and more of a consolidation of an ongoing trend.

The committee struggled with this issue. It was wary of leaping far ahead of the current position of the common law, but noted that both the United States and Québec had embraced a general duty of good faith performance and it had served to clarify and simplify those jurisdictions' contract law. The current law in British Columbia, which draws on complex tests for implying a contract term in a contract, is neither clear nor simple, and this point had considerable influence with the committee. In addition, a general duty of good faith performance would provide an important level of protection to contracting parties that is not available under the concepts of unconscionability, duress, or undue influence.

The committee tentatively recommends that:

*29. The Contract Fairness Act should provide for an implied duty of good faith in the performance of contracts.*

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470. Michael G. Bridge, "Does Anglo-Canadian Law Need a Doctrine of Good Faith?" (1984) 9 Can. Bus. L.J. 385 at 396-97.

471. See Warren Grover, "A Solicitor Looks at Good Faith in Commercial Transactions," in *Commercial Law: Recent Developments*, *supra* note 359, 93 at 107 ("It is my belief that 'good faith' normally remains within the contract and can be avoided by proper drafting. The worry is that 'good faith' may become another rule of public policy that operates outside the contract itself.").

472. See *Mesa*, *supra* note 364 at para. 18, Kerans J.A. ("The argument the other way is that 'good faith' is too vague a term. It might be said that it would encourage judges to wander unnecessarily far into the thicket of extra-contractual rules of conduct.").

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2. SHOULD THE CONTRACT FAIRNESS ACT HAVE A PROVISION DEALING WITH GOOD FAITH ENFORCEMENT?

It is unusual to find separate consideration given to a duty of good faith enforcement. Typically, this duty is tacked on to the duty of good faith performance. Profs. Burton and Anderson, in a rare study dedicated to examining good faith enforcement in its own right, have argued that the key to understanding this concept lies in the fact that “enforcement terms are subordinate to, and in the service of, the performance interest.”<sup>473</sup> Once the contract term at issue has been classified as an enforcement term and the specific performance interest (or interests) it is meant to protect has been identified, then good faith enforcement resolves itself into the consideration of two issues: (1) “whether giving effect to an enforcement term in the circumstances of the case would primarily serve the relevant performance interest(s)”; and (2) “whether invoking the enforcement term would impose needless costs on the other party.”<sup>474</sup> Under this view, good faith enforcement is not concerned with an inquiry into the enforcing party’s subjective state of mind,<sup>475</sup> but rather is a device to ensure that the enforcement powers handed to that party under the contract are used in accordance with the objectives sketched out in the contract.<sup>476</sup>

Most commentators, and all law-reform agencies that have touched on the issue, have not taken this approach of finding an explicit independent rationale for good faith enforcement. Instead, they have relied on the implicit link between good faith enforcement with good faith performance and combined the two topics into a single recommendation.<sup>477</sup> This link adds another reason for adopting a general duty of good faith enforcement. The difficulty of distinguishing between performance terms and enforcement terms in some cases makes it desirable to bring contract enforcement along if a duty of good faith is going to be applied to contract performance. Otherwise, courts will be tempted (and likely be readily able) to reframe hard cases

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473. *Contractual Good Faith*, *supra* note 422 at § 7.2.2.1.

474. *Ibid.* at § 7.2.2.2.

475. *Ibid.* at § 7.2.4.1 (“In general, we believe, a finding of good or bad faith in enforcement should turn on the effect of invoking an enforcement term, not on the subjective motive of the person invoking it. If the invocation of an enforcement term would have the primary effect of advancing its target performance interest without imposing needless costs on the other party, the enforcing party acts in good faith even if that party is moved by malice, ill will, or negligence.”).

476. *See Andersen*, *supra* note 417 at 318 (formulating rationale for good faith enforcement “by referring to the competing goals of traditional contract remedies,” which are “protecting the enforcing party’s expectation interest without imposing needless costs on the other [party]”).

477. *See, e.g., Report on Amendment of the Law of Contract*, *supra* note 75 at 176.

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involving disputes over an enforcement issue as disputes over a performance in order to ensure that a deserving contracting party receives a remedy.

Opponents of creating a legislative duty of good faith have also tended not to focus on good faith enforcement as a topic needing independent consideration. Their arguments are directed at good faith generally, but, since good faith performance occupies far more of the courts' and commentators' attention, these arguments tend to be tailored to good faith performance. Implicitly, they can be applied to good faith enforcement too. The main arguments against a duty of good faith generally are that such a duty would increase the uncertainty of contract law by making contracting parties abide by a vague standard of behaviour and that the duty of good faith is a foreign innovation that is out of step with the traditional approach to the law of contracts in common-law Canada.<sup>478</sup>

Good faith enforcement vexed the committee even more than good faith performance. The difficulty was compounded by the lack of case law in this area, which makes it difficult to gauge the practical effect of proposed reforms.

The committee was also aware that past law-reform efforts in the United States, Canada, and elsewhere have all linked performance and enforcement in a single duty of good faith. There may be repercussions flowing from being the first project to decouple the two topics. In addition, coming out against good faith enforcement could reduce the level of protection afforded to vulnerable contracting parties.<sup>479</sup>

But the committee was wary of committing to a general duty in the absence of a clear track record. Some of its concerns are captured in the following passage from Profs. Burton and Anderson's textbook:

If not applied with common sense and practical judgment, requirements of good faith in enforcement analysis have the capacity to work mischief. If the enforceability of remedial terms could be challenged whenever invoked, the cost of contractual uncertainty might be high. An important reason contracts are made, after all, is to avoid disputes later on. A doctrine that invites defaulting parties to raise groundless defenses in order to squeeze better settlements out of their opponents should not be welcomed.<sup>480</sup>

It is significant that, when enforcement is being considered, by definition a breach has occurred and the contractual relationship is likely drawing to a close. Legislation

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478. *See ibid.*

479. *See ibid.* ("categorically denying all claims of bad faith in enforcement would be a clear invitation to abuse").

480. *Contractual Good Faith*, *supra* note 422 at § 7.2.4.2.

importing a duty of good faith at this point has the potential to create unfairness for the contracting party that is the innocent victim of that breach. Finally, the current law extends some limited, specific protection in discrete areas, such as enforcement of personal-property security agreements and bankruptcy and insolvency. This approach appears to provide all the protection that is necessary here. If it is found wanting in certain areas, then the better approach would be to enact legislation applicable only to a discrete area.<sup>481</sup>

The committee tentatively recommends that:

*30. The Contract Fairness Act should not provide for an implied duty of good faith in the enforcement of contracts.*

### 3. SHOULD THE CONTRACT FAIRNESS ACT HAVE A PROVISION DEALING WITH GOOD FAITH NEGOTIATION?

Proponents of a duty of good faith in contractual negotiation have tended to rely on the same arguments advanced by those in favour of duties of good faith in contractual performance and good faith in contractual enforcement. These arguments are founded mainly on the desirability of setting out a clear statement of the duty in legislation. Subsidiary rationales are bringing the law into accordance with the expectations of contracting parties and harmonizing the law of British Columbia with the law in other jurisdictions.

There are some differences in how these arguments are advanced in relation to good faith negotiation as opposed to good faith performance and enforcement. The advocates of good faith negotiation are fewer in number and more concentrated among academics. They have also had to face some difficulties in promoting good faith negotiation that were not faced by advocates of good faith performance and enforcement. For example, proponents of good faith negotiation do not have many positive comments about the proposed duty of good faith from the judiciary to call on in advancing the first argument. As a result, they have to rely to a greater degree on arguing that the application of “existing contract law”<sup>482</sup> or “traditional principles”<sup>483</sup> are, on closer inspection, unacknowledged examples of the courts invoking an effective

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481. See, e.g., *Franchises Act*, R.S.A. 2000, c. F-23, s. 7; *Arthur Wishart Act (Franchise Disclosure)*, 2000, S.O. 2000, c. 3, s. 3; *Franchises Act*, R.S.P.E.I. 1988, c. F-14.1, s. 3.

482. E. Allan Farnsworth, “Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations” (1987) 87 *Colum. L. Rev.* 217 at 285 [Farnsworth, “Precontractual Liability”].

483. Cassels, *supra* note 429 at 90.

duty of good faith in contract negotiation.<sup>484</sup> In addition, the number of jurisdictions that have legal rules establishing a duty of good faith negotiation is smaller than the number for good faith performance and enforcement, which limits the scope of the harmonization argument mainly to civil-law jurisdictions in Europe.<sup>485</sup>

Opponents of extending the duty of good faith to contractual negotiation also tend to rely on the same arguments used by opponents of an expanded role for good faith in contract performance and enforcement. The main focus of concern is on the uncertainty of the duty, which is enhanced by the fact that it is meant to apply to situations in which the parties have not reached an agreement.<sup>486</sup> The limited value of harmonization with other jurisdictions has also been advanced as a reason not to extend the duty of good faith into contract negotiation.<sup>487</sup> In addition to these arguments, the arguments considered in the *Martel Building* case<sup>488</sup> against creating a tort-law duty of care to cover negotiation should be borne in mind here. These arguments include the danger of involving the courts to too great a degree in regulating negotiation and the potential of encouraging would-be contracting parties to use litigation to try to secure benefits that could not be obtained through negotiation.<sup>489</sup>

The past law-reform projects that have considered the duty of good faith have declined to include a duty of good faith negotiation in their recommendations. The New Zealand Law Commission did not give any reasons for excluding the duty of good faith negotiation. The Ontario Law Reform Commission briefly touched on the duty of good faith negotiation and concluded that they were “not convinced of the

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484. See *ibid.* (“The open recognition of a principle of good faith will not finally resolve [all difficulties relating to defining *good faith* and balancing certainty and flexibility in the law], but may provide a renewed coherence to the law of contract formation, if only by making it more transparent.”). See also Friedrich Kessler & Edith Fine, “*Culpa in Contrahendo*, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study” (1964) 77 Harv. L. Rev. 401 at 448 (“the classical ideas of freedom of contract and arm’s length dealings are constantly being challenged and modified in response to the demands of good faith and fair dealing”).

485. See Kessler & Fine, *ibid.* at 401–09 (surveying doctrine of *culpa in contrahendo* in German, Swiss, and French law).

486. See, e.g., McCamus, *Law of Contracts*, *supra* note 13 at 141–43 (observing that the leading cases on good faith negotiation often turn on an analysis of certainty of terms). There is also uncertainty over whether such a duty would be founded on contract-law or tort-law principles. See *ibid.* at 140.

487. See Nili Cohen, “Pre-Contractual Duties: Two Freedoms and the Contract to Negotiate,” in *Good Faith and Fault in Contract Law*, *supra* note 275, 25 at 38.

488. *Supra* note 438.

489. See *ibid.* at paras. 67–70, Iacobucci & Major JJ.

need to legislate such an obligation specifically.”<sup>490</sup> The main reason for the Ontario Commission’s skepticism appears to be their sense that the duty of good faith negotiation overlaps to too great a degree with other contract-law and general-law concepts.<sup>491</sup> This consideration also seems to be the rationale for excluding good faith negotiation from the scope of the good-faith provision in the *Restatement*.<sup>492</sup>

In the committee’s view, the arguments against creating a legislative duty of good faith negotiation at this time are persuasive.

The committee tentatively recommends that:

*31. The Contract Fairness Act should not provide for an implied duty of good faith in the negotiation of contracts.*

#### 4. TO WHAT TYPES OF CONTRACTS SHOULD THE DUTY OF GOOD FAITH APPLY?

The first question that naturally arises if a duty of good faith is proposed is what the scope of that provision should be. Contract law in common-law Canada already implies a duty of good faith in certain contracts, based on the application of judicial tests relating to implied terms in contracts. When this topic has been considered in previous law-reform efforts by other agencies, the general duty has been formulated to apply to all contracts.<sup>493</sup> The range of options for consideration embraces and lies between these two benchmarks.

The first option is for the duty of good faith in the draft legislation to apply expressly to all contracts and contracting parties. As noted, this was the approach favoured by the Ontario Law Reform Commission and the New Zealand Law Commission. The duty of good faith in the American *Restatement* also applies to all contracts. The Ontario Commission cited the widespread “agreement among commentators” in favour

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490. *Report on Amendment of the Law of Contract*, *supra* note 75 at 174.

491. *Ibid.* See also *Martel Building*, *supra* note 438 at para. 70, Iacobucci & Major JJ. (“It is undesirable to place further scrutiny upon commercial parties when other causes of action already provide remedies for many forms of conduct. Notably, the doctrines of undue influence, economic duress and unconscionability provide redress against bargains obtained as a result of improper negotiation.”).

492. *Restatement (Second) of Contracts* § 205, cmt. c (“Particular forms of bad faith in bargaining are the subjects of rules as to capacity to contract, mutual assent and consideration and of rules as to invalidating causes such as fraud and duress.”).

493. See *Report on Amendment of the Law of Contract*, *supra* note 75 at 176; “*Unfair Contracts*”: A Discussion Paper, *supra* note 76 at 45.

of this position as one of the reasons supporting its recommendation.<sup>494</sup> Other points that weigh in favour of this option include its clarity and simplicity and that it seems to be in harmony with the underlying reasons for having a duty of good faith (why should the legislation carve out areas in which contracting parties do not have to act in good faith?). The main argument against this option is that it may be over-reaching. No one can anticipate the types of contractual arrangements that parties will enter into. A general duty may end up intruding in all kinds of areas in which it is inappropriate to introduce considerations of good faith.

The second option is simply to restate the current position on good faith found in the case law. There is a well-developed body of jurisprudence on good faith in the performance of contracts. It may be helpful to contracting parties to have it restated in legislation. This approach is also inherently cautious, as it draws on a time-tested set of judicial conclusions. The disadvantage of this option is that it does little to advance the law. If the law is currently marked by a developing trend in favour of finding duties of good faith, then restating the current position risks having the draft legislation overtaken by the march of the case law. In addition, the complexity of the tests for finding a duty of good faith would create a difficult drafting challenge when they are translated into legislative language.

The third option is to expand the duty of good faith beyond its current confines to a point that stops short of articulating a general duty of good faith that applies to all contracts. The advantage of this approach is that it presents the opportunity to craft solutions that are highly sensitive to current contracting realities in British Columbia. The disadvantage is that it would pose numerous difficulties—in selecting the contracts covered and justifying those selections, in ensuring that the resulting provision was not vulnerable to being overtaken by events and judgments in subsequent years, and in translating the proposals into legislation.

The committee viewed the second and third options as being too complex. The first option is the clearest of the three, and it fits well with the other proposals made on the topic of good faith.

The committee tentatively recommends that:

*32. The Contract Fairness Act should provide for a duty of good faith as an implied term in the performance of all types of contracts.*

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494. *Report on Amendment of the Law of Contract, ibid.* at 174.

## 5. HOW SHOULD GOOD FAITH BE DEFINED?

The duty of good faith in contract law has been called upon to play many roles. As discussed above, good faith has been seen to embrace three distinct, but also overlapping, ideas. It has been an interpretive tool, an excluder of bad-faith conduct, and a check on contracting parties pursuing foregone opportunities.

As would be expected, law-reform proposals have expended a good deal of analysis on the vexing question of trying to define good faith. These proposals have tried to walk a difficult line between being comprehensive enough to cover the various interpretations of good faith found in the case law and precise enough to assist future courts in applying the law. Four main contenders have emerged from this process.

The first approach is to define good faith in strictly subjective terms. This approach is most closely associated with the American Uniform Commercial Code. The Uniform Commercial Code originally defined good faith as “honesty in fact in the conduct or transaction concerned.” There is a certain logic to this approach. Questions about whether a person acted in good faith would seem to lend themselves to being resolved by examining the person’s intentions.<sup>495</sup> Nevertheless, this purely subjective definition of good faith has drawn some heavy criticism. Most critics have attacked it as watering down the duty of good faith. The Ontario Law Reform Commission derided it as a “‘pure heart and empty head’ criterion.”<sup>496</sup> Resolving issues of good faith under a purely subjective standard can also force the courts to embark on an investigation of a contracting party’s state of mind, creating difficulties in judicial application of the legislation. Finally, the most damning criticism of this approach may be that the Uniform Commercial Code has abandoned it.

The second approach is to define good faith in both subjective and objective terms. The Uniform Commercial Code originally contained a second definition of good faith that had an objective component. This higher standard applied only to merchants. A more-recent version of the Uniform Commercial Code now has a general definition of good faith that uses this approach for almost all contracts to which the Uniform Commercial Code applies: “‘good faith’... means honesty in fact and the observance of reasonable commercial standards of fair dealing.”<sup>497</sup> It is generally understood

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495. See McCamus, “Abuse of Discretion,” *supra* note 360 at 98 (“The notion of good faith may suggest to many observers a purely subjective standard. One who acts in good faith, from a lay perspective, may be someone who acts honestly and with good motivations.”).

496. *Report on Amendment of the Law of Contract*, *supra* note 75 at 173.

497. U.C.C. § 1-201 (b) (20) (2001). See, below, Appendix A at 208 (for the full text of this provision). This definition does not apply to letters of credit (Article 5 of the U.C.C.).

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that adding an objective component to the definition of good faith has the effect of broadening the reach of the duty.<sup>498</sup> An objective component of good faith also seems to be more in accord with the understanding of good faith among contracting parties and the application of the duty of good faith in the Canadian courts.<sup>499</sup> The downside of this approach is connected to its upside. The objective standard could be felt to be too vague and expansive.

The third approach was proposed in a recent law-review article from a Canadian law professor, John D. McCamus.<sup>500</sup> Prof. McCamus's definition involves "stitch[ing] together the existing rules of the common law which appear to implement the good faith duty."<sup>501</sup> His analysis of the cases results in a definition with the following three elements:

- (1) the duty to exercise discretionary powers conferred by a contract reasonably and for the intended purpose,
- (2) the duty to cooperate in securing performance of the main objects of the contract, and
- (3) the duty to refrain from strategic behaviour designed to evade contractual obligations.<sup>502</sup>

Prof. McCamus formulated this definition expressly in opposition to the "abstract and generalized statement of the duty" of good faith found in the Uniform Commercial Code.<sup>503</sup> In his view, his definition does a better job both at "captur[ing] the richness" of the case law<sup>504</sup> and at avoiding the pitfall of "vagueness or uncertainty"<sup>505</sup> than the Uniform Commercial Code definition. It should also be noted that Prof. McCamus's analysis has found some support in a recent court decision.<sup>506</sup>

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498. See, e.g., Farnsworth, "Precontractual Liability," *supra* note 367 at 164.

499. See McCamus, "Abuse of Discretion," *supra* note 360 at 98.

500. *Ibid.*

501. *Ibid.* at 97.

502. *Ibid.*

503. *Ibid.*

504. *Ibid.*

505. *Ibid.* at 101.

506. See *Ceapro*, *supra* note 425 at paras. 209–10, Popescul J.

There are disadvantages to Prof. McCamus's approach. First, it appears to be more restrictive in scope than the competing approaches.<sup>507</sup> Adopting it could freeze development of the notion of good faith in British Columbia at a particular moment, which could subsequently be overtaken by developments elsewhere. It is also an untested proposal—there is no legislative track record with respect to Prof. McCamus's approach. On a related point, adopting this approach in British Columbia would undercut whatever appeal there is in adopting a legislative duty of good faith as a way to harmonize the law of this province with other jurisdictions, such as the United States and Québec.

Finally, the fourth approach is simply not to define good faith in the legislation. This approach may seem at first like nothing more than avoiding a decision, but it should be taken seriously on its own terms. The words *good faith* appear frequently in British Columbia legislation, but they are very rarely given a statutory definition. The Ontario Law Reform Commission, which recommended adopting the *Restatement* provision on good faith, found the effective lack of a definition in the *Restatement* to be one of the positive features of that provision.<sup>508</sup> This approach gives the courts the maximum flexibility in applying the good-faith provision, which may be a real asset given the wide range of situations in which the provision may be at issue. This strength, of course, can also be seen as something of a weakness, particularly by those who would prefer a more focussed approach to defining good faith.

The committee was not attracted to the first option. It was felt to be too modest in scope. In addition, it was telling that the option had been abandoned in the American statute that had previously employed it. The committee also had concerns about the second option, particularly how it would be applied in a dispute.

Much of the committee's deliberations on this point concerned the strengths and weaknesses of the third and fourth options. In the end, the committee favoured the third option because it appeared to be the option that best promoted clarity and commercial certainty.

The committee tentatively recommends that:

*33. The Contract Fairness Act should define good faith as the duty (a) to exercise discretionary powers conferred by contract reasonably and for the intended purpose, (b) to cooperate in securing performance of the main objects of the con-*

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507. See *CivicLife.com*, *supra* note 364 at para. 49, Weiler J.A. (for the court).

508. *Report on Amendment of the Law of Contract*, *supra* note 75 at 172 ("The core of the [*Restatement's*] definition is simply 'good faith and fair dealing,' without further amplification.").

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tract, and (c) to refrain from strategic behaviour designed to evade contractual obligations.

6. SHOULD CONTRACTING PARTIES BE ABLE TO MODIFY OR EXCLUDE THE DUTY OF GOOD FAITH?

(a) *Modification or Variation of the Duty of Good Faith*

The current law is rather vague about whether contracting parties are free to contract out of an implied duty to perform a contract in good faith. For example, one commentator has confidently asserted that contracting parties are always free to modify or exclude an implied duty of good faith,<sup>509</sup> while another commentator has argued that the expansive logic of good faith would, if it were generally adopted, lead to courts simply ignoring the terms of contracts to impose a fair solution on any dispute.<sup>510</sup>

More than anything else, this issue poses a policy question. How it is resolved turns on striking a balance between the standards adopted under a legislative duty of good faith and the freedom of contracting parties to reach their own arrangements. There are three options to choose from.

First, the *Contract Fairness Act* could expressly allow contracting parties to modify or exclude of the duty of good faith. The main strength of this approach is that it respects the general idea of freedom of contract and allows the parties to structure their own bargain. The downside is the potential for abuse. Stronger contracting parties could routinely force weaker parties to agree to waive the duty to act in good faith, thereby undercutting the effectiveness of the *Contract Fairness Act*.

Second, the *Contract Fairness Act* could strictly forbid contracting out of the duty of good faith. This was the approach taken by the New Zealand Law Commission, which concluded that “[i]t would frustrate the central object of the scheme if it could be overridden by the insertion of a term to that effect in the contract.”<sup>511</sup> In other

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509. See O’Byrne, “Implied Term,” *supra* note 359 at 237 (“The general default rule is that parties can contract out of good faith, regardless of the contract at issue.”).

510. See David Stack, “The Two Standards of Good Faith in Canadian Contract Law” (1999) 62 Sask. L. Rev. 201 at 221 (“[A] general duty of good faith would serve the reliance approach brilliantly. It allows a result to be quickly reached for those who are not too concerned with how they got there. Under this rule, a court can ignore express terms, unilaterally amend the contract price, and do just about anything it deems fair and just.”).

511. “*Unfair Contracts*”: *A Discussion Paper*, *supra* note 76 at 49.

words, the duty must be “absolute” if it is to achieve its legislative purposes.<sup>512</sup> This approach does have the potential to be inflexible in practice and to alienate proponents of freedom of contract.

Third, a compromise approach could be adopted in the *Contract Fairness Act*. The leading example of a compromise is the one found in the Uniform Commercial Code, which does not allow contracting parties to “disclaim” the duty of good faith, but does allow “[t]he parties, by agreement, [to] determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable.”<sup>513</sup> The Ontario Law Reform Commission also recommended adopting this compromise.<sup>514</sup> The advantage of this approach is that ensures that the duty of good faith will play a baseline role in all contracts, but it recognizes that the range of contractual relationships to which it applies is so vast that some space should be given to contracting parties to define the scope of their obligations with more precision than the legislation is able to offer. The disadvantage is that it has the potential to displease adherents of the two other positions, by on the one hand creating the potential to water down the duty of good faith, and on the other by limiting freedom of contract and adding uncertainty about whether a given provision modifies the duty of good faith or simply defines its scope.

In the committee’s view, the third option is the best choice. If contracting parties are given a completely free hand to modify or exclude the duty of good faith, then this liberality would create the risk that stronger contracting parties would, in a routine way, oust the duty in contracts with weaker parties. This result would not be consistent with the conception of good faith as one of the core principles of fairness in contracts. But good faith does differ from the other concepts considered in this consultation paper. It operates as an implied term of a contract. Concerns about weak contracting parties being at the mercy of the strong should not be used to prevent equally matched contracting parties from structuring and refining the terms of their contractual relationship. The committee decided that the Ontario Law Reform Commission’s proposal on this issue strikes the best balance.

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512. *Ibid.*

513. U.C.C. § 1-302 (b) (2001).

514. *Report on Amendment of the Law of Contract*, *supra* note 75 at 173 (“[W]e recommend that legislation should provide that contracting parties may not vary or disclaim the statutorily imposed good faith obligations, but that parties should be able, by agreement, to determine the standards by which the performance of such good faith obligations is to be measured if such standards are not manifestly unreasonable.”).

In its deliberations on this issue, the committee also considered extending special protection to consumers, but decided that the better approach for this project was to make a general proposal that applies to all types of contracts. After the committee's proposals have been implemented and have been in force for a few years, it will be easier to determine if there are any concerns with how the rules on contracting out of the duty of good faith affect consumers. If there are any concerns that warrant special protection, then the legislature should be encouraged to amend the *Business Practices and Consumer Protection Act*<sup>515</sup> to provide this special protection for consumers.

The committee tentatively recommends that:

*34. The Contract Fairness Act should provide that contracting parties may not modify or exclude the duty to perform a contract in good faith, but the parties may, by agreement, determine the standards by which performance of their good-faith obligations is to be measured if such standards are not manifestly unreasonable.*

### *(b) Formalities*

Another subsidiary issue arises from the tentative recommendation to allow modification or variation of the duty of good faith. This issue concerns whether any formalities should be attached to agreements to modify or exclude the duty of good faith.

The argument in favour of formalities is that they focus the attention of the contracting parties on the fact that they are waiving certain legal rights. In this way, they limit the potential for abuse. They can also help to shed light on what contracting parties must do in order to ensure that they have complied with the provision.

An example of a protective formality would be requiring that contracting out of the duty of good faith must be done in writing. The rationale for such a requirement is that the written record would serve to focus the attention of the weaker party on what it was potentially giving up. The difficulty with this approach is that the duty of good faith applies to unwritten contracts. It would be anomalous to allow a contract to be concluded orally, but to require that a term relating to a modification of the duty of good faith to be in writing.

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515. *Supra* note 117.

A second concern is subtler in nature. Whenever legislation extends the right to contract out of a requirement, someone invariably asks what language must be used to effect a valid modification of the legislative duty. For example, the duty of good faith is often used to control the exercise of a contractual discretion. Would using an appropriate modifier before the grant of the discretion be effective to exclude the duty of good faith? There is a case holding that a contracting party that has been granted the “sole” discretion to determine an issue in the contractual relationship must nevertheless exercise that discretion in good faith.<sup>516</sup> Would it have made a difference in this context for the modifier to be “absolute” or “unconstrained” or, even, “arbitrary” or some other adjective that implies an intention contrary to being held to a duty of good faith? Or should contracting parties be required to put some express declaration in their contracts that they are modifying or excluding the duty of good faith?

The problem with requiring precision of contracting parties in contracting out of the duty of good faith is that it sets up a situation in which the formal requirements have clearly not been met, but just as clearly the parties intended to avail themselves of the right to contract out and no abuse has been taken. This situation would put a reviewing court in an especially awkward position. In the committee’s view, this issue should be dealt with by interpretation of the contract.

The committee tentatively recommends that:

*35. The Contract Fairness Act should not impose any formalities on how contracting parties determine the standards by which performance of their good-faith obligations is to be measured.*

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516. See *Greenberg*, *supra* note 364 at 761, Robins J.A. (for the court).

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## CHAPTER VIII. MISREPRESENTATION

### A. General Background

#### 1. SCOPE OF THIS CHAPTER

It does not take much investigation into the contract-law concept of misrepresentation to encounter evaluative statements such as “[t]he present law of contractual misrepresentation is quite complex.”<sup>517</sup> The law of misrepresentation is complex for two reasons, which relate both to the content of the technical legal rules that are applicable to a case involving misrepresentation and to the broader conceptual framework that sustains those rules.

First, the rules themselves are complicated. Second, misrepresentation occupies a conceptual focal point, or, to put it another way, “straddles many legal boundaries.”<sup>518</sup> “More than other topics in the law of contract,” misrepresentation “is an amalgam of common law and equity.”<sup>519</sup> The rules on misrepresentation were forged in the nineteenth century before the fusion of the English common-law and equitable courts and the interplay between these two distinct bodies of law continues to shape misrepresentation in contemporary common-law Canada.

Misrepresentation also “cuts across the three main areas of the law of obligations, namely, contracts, torts, and restitution.”<sup>520</sup> It can overlap with other contract-law concepts, such as mistake and certainty of terms.<sup>521</sup> And misrepresentation is often at play in cases involving the other concepts considered in this consultation paper. For instance, one commentator has grouped misrepresentation together with duress and undue influence.<sup>522</sup> Another commentator has examined misrepresentation in light of the other major concept applying to unfairness in contractual formation, unconscionability.<sup>523</sup> Further, the *American Restatement (Second) of Contracts* relies on

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517. *Report on Amendment of the Law of Contract*, *supra* note 75 at 235. See also Waddams, *Law of Contracts*, *supra* note 55 at para. 425.

518. *Cheshire, Fifoot & Furmston’s Law of Contract*, *supra* note 51 at 330.

519. *Ibid.* See, above, at 10–12 (section II.C.3) (for more detail on the distinction between common law and equity).

520. *Report on Amendment of the Law of Contract*, *supra* note 75 at 235. See, above, at 5–8 (part II.B) (for more detail on the main branches of private law).

521. See *Cheshire, Fifoot & Furmston’s Law of Contract*, *supra* note 51 at 330.

522. See *ibid.* at 329–403.

523. See Shannon Kathleen O’Byrne, “Culpable Silence: Liability for Non-disclosure in the Contractual

an implied duty of good faith and fair dealing in formulating a key provision in its section on misrepresentation.<sup>524</sup>

This chapter addresses law-reform issues that arise in connection with the contractual conception of misrepresentation. Its tentative recommendations focus largely on how misrepresentation is characterized in the law of contracts and on the contract-law remedies available in cases of misrepresentation. The committee was careful to tailor its tentative recommendations to the law of contracts. No tentative recommendations were made affecting other bodies of law. The committee also avoided making proposals on the issue of concurrent liability in the law of contracts and the law of torts. Although this is an important issue, it could not be adequately addressed in a project concerned with fairness in the law of contracts.

## 2. MEANING OF MISREPRESENTATION

In everyday speech, *misrepresentation* can be simply defined as a “wrong or incorrect representation.”<sup>525</sup> Misrepresentation as it is understood in the law of contracts, however, has a more technical and limited meaning. In its contract-law sense, *misrepresentation* has been defined as “a statement of fact which had induced the representee to enter into the contract but which did not form part of the contract.”<sup>526</sup> There are a number of elements of this definition that call for further comment.

### (a) A Statement of Fact

In order for a misrepresentation to yield a remedy under the law of contracts, the misrepresentation “must be a statement of present or past fact that is false.”<sup>527</sup> This requirement has the effect of limiting the scope of misrepresentation. The major category of representations that is left out by this requirement contains what the law of contracts typically labels as *sales talk*. Sales talk is aggrandizing language that is too vague and imprecise to convey any factual information about its subject.<sup>528</sup>

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Arena” (1998) 30 Can. Bus. L.J. 239 at 257–60 [O’Byrne, “Culpable Silence”].

524. *Restatement (Second) of Contracts* § 161 (b) (when non-disclosure is equivalent to an assertion) (1981). See, *supra*, note 78 (for general information on the American Law Institute’s *Restatements*).

525. *The New Shorter Oxford English Dictionary*, s.v. “misrepresentation.”

526. *Cheshire, Fifoot & Furmston’s Law of Contract*, *supra* note 51 at 331.

527. *McCamus, Law of Contracts*, *supra* note 13 at 326.

528. See *ibid.* at 327.



This requirement also excludes statements of law,<sup>529</sup> statements of opinion,<sup>530</sup> and statements of future intention<sup>531</sup> from the scope of misrepresentation.

### *(b) Inducing the Representee to Enter into the Contract*

There are two aspects to consider in order to determine whether a misrepresentation induced the representee to enter into the contract. First, the misrepresentation must be of a material fact. In other words, if the misrepresentation relates to a trivial matter or “a factual matter that is not of great consequence . . .”<sup>532</sup> it will not form the basis of a remedy. *Materiality*, a key concept in the law of misrepresentation, has been described as follows in a leading case:

A misrepresentation, to be material, must be one necessarily influencing and inducing the transaction and affecting and going to its very essence and substance. Misrepresentations which are of such a nature as, if true, to add substantially to the value of property, or are calculated to increase substantially its apparent value, are material. The test, therefore, of material inducement is not whether the person’s conduct *would*, but whether it *might* have been different if the misrepresentation had not been made.<sup>533</sup>

Second, the misrepresentation must also have induced the representee to enter into the contract. This does not mean that the misrepresentation formed the sole reason the representee entered into the contract,<sup>534</sup> but simply that the representee placed some reliance on the misrepresentation in deciding to enter into the contract.

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529. See, e.g., *Mayer v. Mayer Estate* (1993), 106 D.L.R. (4th) 353 at 366, 83 B.C.L.R. (2d) 87 (C.A.), Taylor J.A. (Hinkson J.A. concurring) (“An obvious weakness of the proposed new argument, it seems to me, is that the statement concerning the law made by counsel for the defendants was obviously one of opinion. . . . It has long been the law that an erroneous statement of opinion honestly held by a person qualified to hold such an opinion cannot found an action for rescission for innocent misrepresentation.” [citation omitted]).

530. See, e.g., *Kingu v. Walmar Ventures Ltd.* (1986), 10 B.C.L.R. (2d) 15 at 25, 38 C.C.L.T. 51 (C.A.), McLachlin J.A. (for the court) [*Walmar Ventures* cited to B.C.L.R.].

531. See, e.g., *Punto e Pasta Manufacturing Inc. v. Henderson Development (Canada) Ltd.*, 2009 BCSC 37, 79 R.P.R. (4th) 210 at para. 114, Slade J. (“In order to give rise to legal consequences, a representation must be one of fact. Expressions of opinion or intention will not suffice.” [citation omitted]).

532. McCamus, *Law of Contracts*, *supra* note 13 at 330.

533. *Hinchey v. Gonda* (1954), [1955] O.W.N. 125 at 127 (H.C.J.), Schroeder J. [emphasis in original]. See also Paul M. Perell, “The Fraud Elements of Deceit and Fraudulent Misrepresentation” (1996) 18 *Advocates’ Q.* 23 at 27–28.

534. See McCamus, *Law of Contracts*, *supra* note 13 at 331.

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(c) *But Not Forming Part of the Contract*

It is important to keep in mind that misrepresentation deals with representations that do not become terms of the contract between the parties. As one textbook puts it, “[t]he basic problem in misrepresentation is the effect of pre-contractual statements.”<sup>535</sup> This point shapes much of the law in this area, particularly in relation to the remedies that the law affords to victims of misrepresentation.

3. REMEDIES

(a) *Introduction*

The major area of difficulty in the law of misrepresentation involves remedies. This complexity is the result of differing legal rules that apply based on three classes of misrepresentation. It is compounded by the interplay of rules that trace their sources either to common law or equity.

The representor’s state of mind is not relevant to determining whether or not a representation is a misrepresentation.<sup>536</sup> In order to make this determination, it is only necessary to compare the representation with the fact that it purports to represent. Whether the representor was acting fraudulently, recklessly, carelessly, or innocently in making the representation is irrelevant for this task. But, classifying a misrepresentation along these lines is relevant to determining whether a remedy will be granted and what the nature of that remedy will be. For the purposes of remedies, there are three types of misrepresentations: (1) fraudulent; (2) negligent; and (3) innocent. The main remedies available to a victim of misrepresentation are rescission<sup>537</sup> and damages.<sup>538</sup>

(b) *Fraudulent Misrepresentations*

The leading nineteenth-century English case of *Derry v. Peek*<sup>539</sup> contained the following discussion of the ingredients of fraud at common law:

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535. *Cheshire, Fifoot & Furmston’s Law of Contract*, *supra* note 51 at 330.

536. *See ibid.* at 331.

537. In simple terms, *rescission* is an undoing of a contract. The goal of the remedy is to return the contracting parties to their positions before they entered into the contract. *See*, above, at 12–13 (section II.C.4) (for more information on rescission).

538. Damages are not payable here under the law of contract, but rather under the torts of deceit or negligence.

539. *Supra* note 94 (defendants issuing prospectus for sale of shares in a company to operate a steam-powered tram—use of steam power in the area requiring third-party approval—approval

fraud is proved when it is shewn [*sic*] that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless as to whether it be true or false. Although I have treated the second and the third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states. To prevent a false statement being fraudulent, there must, I think, always be an honest belief in its truth. And this probably covers the whole ground, for one who knowingly alleges that which is false, has obviously no such honest belief.<sup>540</sup>

Proof of fraud is one element of an action based on fraudulent misrepresentation. A commentator has set out the following steps in a fraudulent misrepresentation claim:

Judges typically break down the claims into the following five elements: (1) a false statement by the defendant; (2) the defendant knowing that the statement is false or being indifferent to its truth or falsity; (3) the defendant having an intent to deceive the plaintiff; (4) the false statement being material and the plaintiff being induced to act[;] and, where damages are sought (5) the defendant suffering damages.<sup>541</sup>

If a plaintiff can establish the first four of these elements, then the plaintiff is entitled to the remedy of rescission at common law.<sup>542</sup> The court could also order restitution of any money paid or property transferred under the rescinded contract. As element (5) indicates, a plaintiff is also in the position to claim for damages, if the plaintiff has suffered damages. Damages are available in this context under the tort of deceit.

### (c) *Negligent Misrepresentations*

The distinction between fraudulent and non-fraudulent misrepresentations is significant for reasons related to the historical development of the two main remedies in this area, rescission and damages. As one contract-law textbook put it, “[t]he common law came to give rescission for fraudulent misrepresentation and to grant damages in the tortious action of deceit.”<sup>543</sup> Non-fraudulent misrepresentation was subject to the same remedy—rescission—but it came from a different body of law—

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not granted—company wound up—House of Lords reversing lower court decisions and finding that the misrepresentation was not fraudulent).

540. *Ibid.* at 374, Lord Herschell.

541. Perell, *supra* note 533 at 23.

542. This right is subject to several limitations. *See*, below, at 151 (subsection VIII.A.3.(e)).

543. *See Cheshire, Fifoot & Furmston’s Law of Contract, supra* note 51 at 331.

equity.<sup>544</sup> The leading case is the late nineteenth-century decision *Redgrave v. Hurd*,<sup>545</sup> which confirmed that rescission in equity extends to cases not covered by common-law rescission.<sup>546</sup> As explained in *Redgrave*, the rationale for extending rescission to non-fraudulent misrepresentations rests on one or the other of the following two reasons: (1) a person should not be allowed to profit from the person's own misrepresentation; or (2) this situation is a form of equitable fraud, which the courts should not countenance.<sup>547</sup>

For a long time it was not necessary to draw a distinction between types of non-fraudulent misrepresentations, as the remedy available was the same in all cases. Courts would not award damages for non-fraudulent misrepresentations. The situation changed in 1963 with the landmark English decision in *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*<sup>548</sup> This case established that damages are available in tort for negligent misrepresentations. This position was quickly adopted in Canada, and has been confirmed a number of times by the Supreme Court of Canada.<sup>549</sup>

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544. See *ibid.* (“During the nineteenth century, equity also developed a general remedy of rescission for all misrepresentations inducing contracts.”).

545. (1881), 20 Ch. D. 1, 51 L.J. 113 (Eng. C.A.) [*Redgrave* cited to Ch. D.] (sale of suburban residence and law practice—plaintiff stating business brought in revenue of £300 a year—prior to sale, plaintiff showing defendant three summaries indicating revenue of £200 a year and stating that remainder of revenue made up from business not shown on summaries—defendant taking possession then discovering that revenue in fact not in excess of £200 a year—defendant refusing to complete—plaintiff suing for specific performance—held, on appeal, defendant entitled to rescission of contract).

546. See *ibid.* at 12–13, Jessel M.R. (“As regards rescission of a contract, there was no doubt a difference between the rules of Courts of Equity and the rules of Courts of Common Law. . . . According to the decisions of Courts of Equity it was not necessary, in order to set aside a contract obtained by material false representation, to prove that the party who obtained it knew at the time when the representation was made that it was false. . . . As regards the rule of Common Law there is no doubt it was not quite so wide.”).

547. See *ibid.*, Jessel M.R. (“One way of putting the case was, ‘A man is not to be allowed to get a benefit from a statement which he now admits to be false. He is not to be allowed to say, for the purpose of civil jurisdiction, that when he made it he did not know it to be false; he ought to have found that out before he made it.’ The other way of putting it was this: ‘Even assuming that moral fraud must be shewn [*sic*] in order to set aside a contract, you have it where a man, having obtained a beneficial contract by a statement which he now knows to be false, insists upon keeping that contract. To do so is a moral delinquency: no man ought to seek to take advantage of his own false statements.’ The rule in equity was settled, and it does not matter on which of the two grounds it rested.”).

548. [1963] UKHL 4, [1964] A.C. 465.

549. See *Hercules Management Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165, 146 D.L.R. (4th) 577; *Queen v. Cognos Inc.*, [1993] 1 S.C.R. 87, 99 D.L.R. (4th) 626.

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*(d) Innocent Misrepresentations*

With the rise of tort-law liability for negligent misrepresentations, it becomes necessary to distinguish between two types of non-fraudulent misrepresentations, which are (1) negligent misrepresentation and (2) innocent misrepresentations. Innocent misrepresentations are misrepresentations of a material fact that cannot be found to breach the standard of care applicable to the representor. Since the representor was not negligent in making the misrepresentation, the victim of the misrepresentation is not able to claim damages as a result of the misrepresentation. The victim may be able to obtain the remedy of rescission of the contract induced by the innocent misrepresentation.

*(e) Bars to Rescission*

There are limits to when the remedy of rescission is available. These limits have traditionally been called bars to rescission. At common law, “rescission may be barred by inability to restore benefits under the contract, by intervention of third party rights, or by affirmation.”<sup>550</sup> As noted above, common-law rescission applies only to cases of fraudulent misrepresentation. Equitable rescission applies more broadly, embracing cases of negligent or innocent misrepresentation as well as fraudulent misrepresentation. But equitable rescission is also subject to more bars to relief. The three bars noted above apply to equitable rescission as well. In addition, rescission in equity may be barred by execution of the agreement,<sup>551</sup> laches,<sup>552</sup> or merger in a subsequent warranty.<sup>553</sup>

*(f) Summary*

Prof. McCamus has helpfully summarized the remedies for misrepresentation in a table.<sup>554</sup>

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550. *Report on Amendment of the Law of Contract*, *supra* note 517 at 237.

551. *See Redican v. Nesbitt* (1923), [1924] S.C.R. 135, [1924] 1 D.L.R. 536 [*Redican* cited to S.C.R.].

552. *See McCamus, Law of Contract*, *supra* note 13 at 345–46. *Laches* is “[u]nreasonable delay in bringing a claim. . .” *See ibid.* at 345.

553. *See ibid.* at 346 (“In the drafting of commercial agreements, it is not uncommon for the parties to repeat in the agreement itself representations that have been made during the course of the negotiation of the agreement. . . . When the former representation becomes a term of the agreement, the falsity of the representation becomes a breach of contract, entitling the misrepresentee to the normal remedies for breach of contract.” [footnote omitted]).

554. *Ibid.* at 360.

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## Consultation Paper on Proposals for Unfair Contracts Relief

Nature of Misrepresentation	Remedies at Common Law	Remedies in Equity
Fraudulent	contract voidable— rescission (with restitution)  compensatory damages for the tort of deceit	contract voidable— rescission (with restitution)
Innocent		
(a) careless	compensatory damages for the tort of negligence	contract voidable— rescission (with restitution)
(b) non-careless	—	contract voidable— rescission (with restitution)

As Prof. McCamus pointed out, “the least attractive remedial position for a misrepresentee is to be the victim of a non-careless, innocent misrepresentation.”<sup>555</sup> Damages in tort are not available as a remedy for this person; rescission is, but it may be barred by the application of traditional limits on the remedy. As a result, “ameliorating techniques” used by the courts and reform efforts by legislatures have often focused on assisting people in this category.<sup>556</sup> These “ameliorating techniques” have, to a degree, complicated the tidy picture of the law presented in Prof. McCamus’s table; in practice, the courts’ approach to misrepresentation is messier but, at the same time, more flexible.

#### 4. COLLATERAL CONTRACT/WARRANTY

“[T]he most important ameliorating device,” in Prof. McCamus’s view, “is that of transforming the representation of fact into a contractual promise. . . .”<sup>557</sup> As the Ontario Law Reform Commission has noted “[t]he test for determining when a statement is a term of a contract is generally said to be whether the statement is made with contractual intention.”<sup>558</sup> Although this test of intention has been disparaged as “an elusive test,” in the Ontario Commission’s view “[i]t has, however, the merit of

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555. *Ibid.*

556. *Ibid.*

557. *Ibid.*

558. *Report on Amendment of the Law of Contract, supra* note 75 at 235.

flexibility. . . .”<sup>559</sup> This flexibility has had a noteworthy impact on this area of the law, as “the courts have, in practice, quite often found a remedy in cases they consider deserving by categorizing the statement as a contractual term or warranty, while refusing to find the necessary intention when damages are claimed that the courts consider extravagant.”<sup>560</sup> The Ontario Commission’s analysis is supported by the following candid comments from an English judge:

Ever since *Heilbut, Symons & Co. v. Buckleton* [in 1913] we have had to contend with the law as laid down by the House of Lords that an innocent misrepresentation gives no right to damages. In order to escape from that rule, the pleader used to allege—I often did it myself—that the misrepresentation was fraudulent, or alternatively a collateral warranty. At the trial we nearly always succeeded on collateral warranty. We had to reckon, of course, with the dictum of Lord Moulton [in *Heilbut, Symons & Co. v. Buckleton*] that “such collateral contracts must from their very nature be rare.” But more often than not the Court elevated the innocent misrepresentation into a collateral warranty: and thereby did justice—in advance of the Misrepresentation Act 1967. I remember scores of cases of that kind, especially on the sale of a business. A representation as to the profits that had been made in the past was invariably held to be a warranty. Besides that experience, there have been many cases since I have sat in this Court where we have readily held a representation—which induces a person to enter into a contract—to be a warranty sounding in damages.<sup>561</sup>

As this quotation notes, the situation in the United Kingdom has changed with the enactment of reform legislation,<sup>562</sup> but such legislation does not exist in British Columbia, which may lead courts here to resort to this “ameliorating device.”<sup>563</sup>

## 5. NON-DISCLOSURE AS MISREPRESENTATION

Some of the most difficult issues in this area of the law turn on the treatment of non-disclosure of material facts. The baseline principle is that contracting parties are not under an obligation to disclose information to each other in the course of negotiating a contract. But this position is subject to a number of exceptions “in which silence or non-disclosure is treated, in effect, as misrepresentation and provides a basis for re-

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559. *Ibid.*

560. *Ibid.*

561. *Esso Petroleum Co. Ltd. v. Mardon*, [1976] EWCA Civ 4, [1976] Q.B. 801 at 817, Lord Denning M.R. [citations omitted].

562. *See Misrepresentation Act 1967* (U.K.), 1967, c. 7. *See also*, below, Appendix A at 219–20 (for excerpts from this legislation).

563. *See, e.g., No. 2002 Taurus Ventures Ltd. v. Intrawest Corp.*, 2007 BCCA 228, 281 D.L.R. (4th) 420; *Gallen v. Allstate Grain Co.* (1984), 9 D.L.R. (4th) 496, [*sub nom. Gallen v. Butterley*] 53 B.C.L.R. 38 at 50–52 (C.A.). Lambert J.A.

scission of the ultimate agreement.”<sup>564</sup> This subject has received extensive academic attention.<sup>565</sup> The leading common-law exceptions described in the commentary are the following:

- cases of “supervening falsification”<sup>566</sup>—that is, cases “where changing circumstances affect the truth of an earlier statement”;<sup>567</sup>
- cases involving half-truths—“that is, partial disclosure of true facts that creates a misleading impression”;<sup>568</sup>
- cases in which “silence [is] equivalent to assertion”—“in some circumstances silence may amount to an assertion that there is nothing of significance to reveal”;<sup>569</sup>
- cases involving “conduct typically referred to as ‘active concealment’ of the truth”—for example “conceal[ing] a crack [in a building] by covering it over with matching bricks”;<sup>570</sup>
- cases involving “contracts of utmost good faith”—for example, insurance contracts, in which “both parties are required to disclose material facts to the other . . .”;<sup>571</sup>
- cases in which disclosure is an incident of a fiduciary relationship between the parties;<sup>572</sup>

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564. McCamus, *Law of Contracts*, *supra* note 13 at 331–32 [footnote omitted].

565. *See, e.g.*, S.M. Waddams, “Pre-contractual Duties of Disclosure,” in Peter Cane & Jane Stapleton, eds., *Essays for Patrick Atiyah* (Oxford: Clarendon Press, 1991) 237 [Waddams, “Pre-contractual Duties of Disclosure”]; E. Allan Farnsworth, “Comments on Professor Waddams’ ‘Precontractual Duties of Disclosure’ ” (1991) 19 *Can. Bus. L.J.* 351 [Farnsworth, “Comments”]; O’Byrne, “Culpable Silence,” *supra* note 523; Rick Bigwood, “Pre-contractual Misrepresentation and the Limits of the Principle in *With v. O’Flanagan*” (2005) 64 *Cambridge L.J.* 94 [Bigwood, “Pre-contractual Misrepresentation”].

566. *See* Bigwood, “Pre-contractual Misrepresentation,” *ibid.* at 94.

567. McCamus, *Law of Contracts*, *supra* note 13 at 332.

568. *Ibid.*

569. Waddams, “Pre-contractual Duties of Disclosure,” *supra* note 565 at 240.

570. McCamus, *Law of Contracts*, *supra* note 13 at 332 (describing *Gronau v. Schlamp Investments Ltd.* (1974), 52 D.L.R. (3d) 631 (Man. Q.B.)).

571. McCamus, *Law of Contracts*, *ibid.* at 332. *See also* Waddams, “Pre-contractual Duties of Disclosure,” *supra* note 565 at 242–43 (noting that “[t]his category of contracts of ‘utmost good faith’ is surprisingly inexact”).

572. *See* O’Byrne, “Culpable Silence,” *supra* note 523 at 241 (giving contracts of partnership as an ex-



- other one-off, unclassifiable cases.<sup>573</sup>

There does not appear to be a consistent principle that unites all these instances in which non-disclosure has been treated as misrepresentation.<sup>574</sup>

### 6. LEGISLATION

The *Business Practices and Consumer Protection Act*<sup>575</sup> contains a division dealing with misrepresentation, which the statute labels as “deceptive acts or practices.”<sup>576</sup> This legislation, which only applies to consumer transactions,<sup>577</sup> performs two key tasks worth noticing. First, it expands the number of representations that may amount to actionable misrepresentations beyond the common-law focus on statements of past or present fact, bringing into its scope opinions and all sorts of sales talk.<sup>578</sup> Second, the act gives the courts greater remedial flexibility than is available under the traditional common-law rules relating to misrepresentation.<sup>579</sup> Finally, though it is outside the scope of this project, the legislation also creates a quasi-

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ample).

573. See McCamus, *Law of Contracts*, *supra* note 13 at 333 (citing as an example *Bank of British Columbia v. Wren Developments Ltd.* (1973), 38 D.L.R. (3d) 759 (B.C.S.C.)).

574. See Waddams, “Pre-contractual Duties of Disclosure,” *supra* note 565 at 237 (“duties of disclosure are in practice imposed by a variety of judicial techniques . . .”). *But see* O’Byrne, *supra* note 523 at 241 (“It is difficult to extract from the case law a general set of principles establishing when the obligation to speak will arise. However . . . three common factors appear consistently in the cases where just such an obligation is found. They are: (1) a pronounced informational asymmetry between the parties; (2) silence by the party with the greater information which, while falling short of fraud, is profoundly misleading because the existence of undisclosed information is both consequential and unexpected; and (3) a concomitant and express judicial focus on equitable values as the referent against which that lesser party’s conduct is measured.”).

575. *Supra* note 117.

576. *Business Practices and Consumer Protection Act*, *ibid.*, ss. 4–6. See, below, Appendix A at 199–206 (for excerpts from this legislation).

577. See *Business Practices and Consumer Protection Act*, *ibid.*, s. 1 (1).

578. See *Business Practices and Consumer Protection Act*, *ibid.*, s. 4 (3). See also *Rushak v. Henneken* (1991), 84 D.L.R. 87, 59 B.C.L.R. (2d) 250 at para. 23, Taylor J.A. (for the court) (“While it used to be said that what is described in general terms as ‘puffery’ on the part of a salesman does not give rise to legal consequences, I am not satisfied that the same can necessarily be said today in light of the provisions of the *Trade Practice Act* [the predecessor to the *Business Practices and Consumer Protection Act*].”).

579. See *Business Practices and Consumer Protection Act*, *ibid.*, ss. 171 (making damages recoverable in cases involving deceptive acts or practices), 172 (other orders in court actions involving consumer transactions).

criminal offence that may be prosecuted by the Business Practices and Consumer Protection Authority.<sup>580</sup>

In addition to British Columbia's *Business Practices and Consumer Protection Act*, there is also federal legislation applicable to misrepresentation. The *Competition Act*<sup>581</sup> contains a provision dealing with false or misleading representations.<sup>582</sup> This legislation does allow for the recovery of damages,<sup>583</sup> but it is more broadly focussed and regulatory<sup>584</sup> than purely contractual in nature.<sup>585</sup>

## B. Issues for Reform

Misrepresentation has been the subject of many law-reform studies. The Ontario Law Reform Commission included a chapter on misrepresentation generally in the law of contracts in their *Report on Amendment of the Law of Contract*.<sup>586</sup> An earlier report by the Ontario Commission addressed the narrower subject of misrepresentation in relation to consumer contracts.<sup>587</sup> The Manitoba Law Reform Commission has published a wide-ranging report on contract- and tort-law issues in this area, which included draft legislation.<sup>588</sup> Overseas, law-reform bodies in the United Kingdom<sup>589</sup> and New Zealand<sup>590</sup> have made recommendations for reform of the law of misrepresentation. These recommendations have led to the enactment of legislation in those two jurisdictions,<sup>591</sup> and the United Kingdom report has also influenced leg-

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580. See *Business Practices and Consumer Protection Act*, *ibid.*, ss. 5 (1) (prohibition of deceptive acts and practices), 189 (2) (a) (offence), 190 (penalty), 192 (compensation to consumer).

581. R.S.C. 1985, c. C-34. See, below, Appendix A at 206–07 (for excerpts from this legislation).

582. See *Competition Act*, *ibid.*, s. 52.

583. See *Competition Act*, *ibid.*, s. 36.

584. See *Competition Act*, *ibid.*, s. 52 (5) (creating offence).

585. See, e.g., *Maritime Travel Inc. v. Go Travel Direct.Com Inc.*, 2009 NSCA 42, 276 N.S.R. (2d) 327 (affirming trial decision awarding damages to competitor of business that knowingly made a misleading representation to the public).

586. See *supra* note 75.

587. See *Report on Consumer Warranties and Guarantees in the Sale of Goods* (Toronto: Department of Justice, 1972).

588. *Report on Pre-contractual Misstatements* (Rep. No. 82) (Winnipeg: The Commission, 1994).

589. See United Kingdom, Law Reform Committee, *Report on Innocent Misrepresentation* (Rep. no. 10) (London: HMSO, 1962).

590. See New Zealand, Contracts and Commercial Law Committee, *Report on Misrepresentation and Breach of Contract* (Wellington: Government Printer, 1967).

591. See *Misrepresentation Act 1967*, *supra* note 562; *Contractual Remedies Act 1979* (N.Z.), 1979/11.

isolation in Australia.<sup>592</sup> Finally, American law, as represented in the *Restatement (Second) of Contracts*, contains several ideas that are worthy of consideration in relation to reform of the law in British Columbia.

The focus of these reports and statutes tends to be on one or both of the following subjects: (1) expanding the scope of representations that may be actionable misrepresentations; and (2) increasing the flexibility of the courts in granting remedies for misrepresentation. The issues for reform that follow are concentrated on considering aspects of those two subjects.

1. SHOULD THE CONTRACT FAIRNESS ACT ENABLE COURTS TO TREAT A STATEMENT OF LAW AS A MISREPRESENTATION?

Misrepresentations are only actionable (in the sense that they can yield a remedy in contract law) if they relate to statements of past or present facts. This rule can be seen as being somewhat restrictive, so it is not surprising that several law-reform efforts have considered ways in which the category of actionable misrepresentations can be expanded. The distinction between statements of fact and statements of law has been a prime area of consideration. For an example of a statement of law in this context, Prof. McCamus cites “a vendor of a land warrant who misrepresented the legal effect of the document because he was unaware of a recent legislative change. . . .”<sup>593</sup>

The distinction between statements of law and those of fact “is normally explained on the basis that a statement of law is essentially one of opinion and, as such, is unlikely to induce reliance by the representee.”<sup>594</sup> Another “rationale for the denial of relief for representations of law has often been said to be the proposition that everyone should be taken to be cognisant of the law.”<sup>595</sup> These explanations have not stood the test of time particularly well, as “the distinction between fact and law has been notoriously difficult to apply. . . .”<sup>596</sup> This has resulted in a somewhat inconsistent and confusing body of law.<sup>597</sup>

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See, below, Appendix A at 219–20 and 224–28 (for excerpts from these acts).

592. See *Misrepresentation Act 1972* (S.A.); *Civil Law (Wrongs) Act 2002* (A.C.T.), ss. 172–79 (formerly *Law Reform (Misrepresentation) Act 1977* (A.C.T.) (repealed)).

593. *Supra* note 527 at 329 (citing *McKenzie v. Dwight* (1885), 11 O.A.R. 381 (C.A.)).

594. *Report on Pre-contractual Misstatements*, *supra* note 588 at 5.

595. McCamus, *Law of Contracts*, *supra* note 13 at 329.

596. *Ibid.*

597. See *Report on Pre-contractual Misstatements*, *supra* note 588 at 5–6.

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A number of law-reform agencies have recommended expanding the scope of actionable misrepresentations to take in statements of law. For the Ontario Law Reform Commission, this reform was almost self-justifying, “[s]ince misrepresentations of law can be as misleading as misrepresentations of fact. . . .”<sup>598</sup> The Manitoba Law Reform Commission took a similar approach, arguing that the case law already shows some support for including statements of law within the scope of actionable misrepresentations.<sup>599</sup>

The committee was somewhat ambivalent on this issue. The rationale for including statements of law within the scope of actionable misrepresentations seems clear. It can often be difficult for courts to draw the line between statements of law and those of fact. The misrepresentation jurisprudence would be more straightforward if this distinction were removed. Still, the committee was wary that removing this distinction could have the effect of unduly shifting the burden of due diligence from a purchaser (or other similarly situated contracting party) to a vendor.

In the end, the committee looked favourably upon the trend among other law-reform agencies in making similar recommendations.

The committee tentatively recommends that:

*36. The Contract Fairness Act should provide that a misrepresentation includes a misrepresentation of law.*

### 2. SHOULD THE CONTRACT FAIRNESS ACT ENABLE COURTS TO TREAT A STATEMENT OF OPINION AS A MISREPRESENTATION?

The traditional rules on misrepresentation also exclude statements of opinion from the scope of actionable misrepresentations. The justification for this rule is that opinions are not something “upon which the misrepresentee would . . . reasonably rely.”<sup>600</sup> This rationale was spelled out in more detail in the following passage from a leading Canadian case:

It is, of course, well settled that a representation, to be of effect in law, should be in respect of an ascertainable fact as distinguished from a mere matter of opinion. A representation which amounts merely to a statement of opinion, judgment, probability or ex-

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598. *Report on Amendment of the Law of Contract*, *supra* note 75 at 242.

599. *See Report on Pre-contractual Misstatements*, *supra* note 588 at 60.

600. *McCamus, Law of Contracts*, *supra* note 13 at 327.

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pectation, or is vague and indefinite in its nature and terms, or is merely a loose, conjectural or exaggerated statement goes for nothing, though it may not be true, for a man is not justified in placing reliance on it.<sup>601</sup>

As this passage makes clear, the types of statements that get swept into the category of statements of opinion can be very diverse. It is perhaps for this reason that, outside the area of consumer transactions,<sup>602</sup> there has been little legislative reform recommended or implemented in connection with statements of opinion. One notable exception is the Manitoba Law Reform Commission, which recommended adopting reliance in the place of the traditional classification system as the standard for deciding cases involving statements of opinion, because reliance is the “crucial factor which defines responsibility” for a misrepresentation.<sup>603</sup> In the Manitoba Commission’s view, there is already some support in the jurisprudence for expanding the category of actionable misrepresentations to include those statements that have “the capacity to induce reasonable reliance” and that have been relied on by the misrepresentee.<sup>604</sup> The proposal would simplify and rationalize the law, but, in the Manitoba Commission’s opinion, it would not open the floodgates to liability, because “such statements must have the capacity to induce reasonable reliance and must be *relied on* by the misrepresentee. These conditions will protect the speaker from responsibility for casual or off-hand statements.”<sup>605</sup>

The committee sees the broader rule excluding statements of opinion from the scope of misrepresentation as being sound. Expanding the law of misrepresentation to this degree could actually breed unfairness. In addition, evaluating opinions for their truth is something of a contradiction in terms.

The committee tentatively recommends that:

*37. The Contract Fairness Act should not provide that a misrepresentation includes a misstatement of opinion or any misstatement that has the capacity to induce reasonable reliance and that did induce such reliance in the misrepresentee.*

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601. *Hinchey*, *supra* note 533 at 127, Schroeder J. [citations omitted].

602. *See Business Practices and Consumer Protection Act*, *supra* note 117, s. 4 (3).

603. *Report on Pre-contractual Misstatements*, *supra* note 588 at 60.

604. *Ibid.*

605. *Ibid.* [emphasis in original].

3. SHOULD THE CONTRACT FAIRNESS ACT ADDRESS WHEN COURTS SHOULD TREAT NON-DISCLOSURE AS A MISREPRESENTATION?

A particularly difficult area for the law of misrepresentation is when non-disclosure should amount to a representation that can form the basis of a remedy under the rules applicable to misrepresentation. The basic common-law position in Canada is that parties negotiating a contract are under no general obligation to disclose information to each other, but there are numerous exceptions that apply in specific circumstances and cause the law in those circumstances to treat non-disclosure as a misrepresentation.<sup>606</sup>

Although this is a complex body of law, it has not received much attention in previous law-reform studies. The Ontario Law Reform Commission did not address non-disclosure in its recommendations on misrepresentation.<sup>607</sup> The Manitoba Law Reform Commission addressed non-disclosure in the following provision in its draft legislation:

**Deemed misrepresentation**

**1(2)** Where a person contravenes a legal duty to disclose a material fact before or at the time that person makes a contract, that person is deemed to make a misrepresentation that the material fact does not exist.<sup>608</sup>

The comment on this provision notes that “[t]he concept of ‘deemed misrepresentation’ is used to prevent an inconsistency between the remedies for a failure to disclose information where one is under a legal duty to do so and the remedies for making a positive misrepresentation.”<sup>609</sup> In the result, this section integrates non-disclosure into the statutory scheme for misrepresentation, without effecting any substantive reforms to the existing common-law rules regarding when non-disclosure is treated as a misrepresentation.

American law has taken a different approach to this issue, one that is “more ‘open-textured’ than the more limited exceptions thus recognized to date in Canadian

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606. In addition to the common-law exceptions, there are also a number of statutory regimes covering discrete areas such as securities regulation that require disclosure in circumstances in which the common-law would have allowed non-disclosure. These regimes will not be considered as part of this issue for reform.

607. *Report on Amendment of the Law of Contract*, *supra* note 75 at 242–43.

608. *Report on Pre-contractual Misstatements*, *supra* note 588 at 65.

609. *Ibid.*

common law.”<sup>610</sup> The American position is captured in the following section from the *Restatement (Second) of Contracts*:

**§ 161. When Non-Disclosure Is Equivalent to an Assertion**

A person’s non-disclosure of a fact known to him is equivalent to an assertion that the fact does not exist in the following cases only:

(a) where he knows that disclosure of the fact is necessary to prevent some previous assertion from being a misrepresentation or from being fraudulent or material.

(b) where he knows that disclosure of the fact would correct a mistake of the other party as to a basic assumption on which that party is making the contract and if non-disclosure of the fact amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing.

(c) where he knows that disclosure of the fact would correct a mistake of the other party as to the contents or effect of a writing, evidencing or embodying an agreement in whole or in part.

(d) where the other person is entitled to know the fact because of a relation of trust and confidence between them.

The departure in the law, from the Canadian point of view, is found in paragraph (b), which imports a standard of good faith and fair dealing into this area. The commentary to this section sets out a number of examples (which are based on decided American cases) that illustrate how this provision is intended to work. These illustrations include the following:

- A, seeking to induce B to make a contract to buy land, knows that B does not know that the land has been filled with debris and covered but does not disclose this to B. B makes the contract. A’s non-disclosure is equivalent to an assertion that the land has not been filled with debris and covered, and this assertion is a misrepresentation. . . .
- A, seeking to induce B to make a contract to buy a food-processing business, knows that B does not know that the health department has given repeated warnings that a necessary license will not be renewed unless expensive improvements are made but does not disclose this to B. B makes the contract. A’s non-disclosure is equivalent to an assertion that no warnings have been given by the health department, and this assertion is a misrepresentation. . . .
- A, seeking to induce B to make a contract to sell land knows that B does not know that the land has appreciably increased in value because of a proposed shopping center but does not disclose this to B. B makes the contract. Since B’s mistake is not one as to a basic assumption . . . A’s non-disclosure is not equivalent to an assertion that

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610. McCamus, *Law of Contracts*, *supra* note 13 at 334.

the value of the land has not appreciably increased, and this assertion is not a misrepresentation.<sup>611</sup>

Supporters of this approach laud the enhanced flexibility it gives to courts.<sup>612</sup> For example, among the illustrations set out above, existing common-law rules in Canada would cover the first illustration, requiring disclosure under the “active concealment” rule.<sup>613</sup> But the existing rules would not appear to extend to the second illustration. In addition to flexibility, this approach could also simplify the law. In the place of numerous exceptions, developed ad hoc through the case law, this approach offers good faith as a connecting principle for when disclosure will be required to correct a contracting party’s misapprehension.

Critics of this approach have argued that it “provides little guidance for the disposition of actual disputes.”<sup>614</sup> In this view, the established categories provide more certainty for contracting parties. Prof. Waddams has also argued that the approach taken in the *Restatement* bears a confusing relationship to the related but distinct issue of a general duty of good faith in contract negotiation, saying that “[t]he effect [of the *Restatement’s* section] is to import a duty of good faith into pre-contractual negotiations, but then to alter what is usually taken to be the meaning of good faith in this context by announcing that it does not always require disclosure, even of facts known to be material.”<sup>615</sup>

A third approach to this issue lies between the proposals of the Manitoba Law Reform Commission and position set out in the *Restatement*. This approach involves restating the common-law position in the *Contract Fairness Act*. The advantage of taking such an approach is that it directly addresses one of the main problems with the current law, which is its complexity and obscurity. It could also make the law more accessible, particularly to people without legal training. The main disadvantage of this approach is that it does nothing to simplify and clarify the intellectual principles that underlie this area of the law.

The committee favours the third approach. The committee concluded that practical benefits will flow from restating this difficult area of the law in legislation. There are tools available for crafting such a restatement, in the form of extensive commentary

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611. *Restatement (Second) of Contracts* § 161, cmt. d, ill. 4, 6, 7 (1981).

612. See Farnsworth, “Comments,” *supra* note 565 at 355–56.

613. See, above, at 153–55 (section VII.A.5).

614. Waddams, “Pre-contractual Duties of Disclosure,” *supra* note 565 at 253.

615. *Ibid.*



on non-disclosure as misrepresentation.<sup>616</sup> In the committee's view, the American approach has the disadvantage of sharing too many elements in common with good faith negotiation, which the committee has declined to propose.<sup>617</sup>

The committee tentatively recommends that:

*38. The Contract Fairness Act should contain a restatement of the current common-law position on when the courts may treat non-disclosure as a misrepresentation.*

4. SHOULD THE CONTRACT FAIRNESS ACT ENABLE COURTS TO AWARD DAMAGES IN LIEU OF RESCISSION?

(a) *Jurisdiction to Award Damages*

With this issue the focus moves from the scope of misrepresentation to remedies for misrepresentation. Since some proposals to allow courts to award damages in lieu of rescission have also involved limitations to the scope of rescission, the discussion will begin with this issue before setting out the options for rescission itself.

The prime contract-law remedy for misrepresentation is rescission.<sup>618</sup> How it became the main remedy is due in part to historical factors. Rescission was developed as a general remedy for all misrepresentation cases in the English Court of Chancery, which applied a body of law known as equity. Equity only had a limited jurisdiction to award damages.<sup>619</sup> In addition, the remedy was awarded in cases in which the misrepresentation did not ultimately form part of the contract. It seemed anomalous to extend damages to cover this situation. Finally, in practice, tort law provides victims of most types of misrepresentation with a vehicle to obtain damages, through either the tort of deceit or of negligence.

The New Zealand Contracts and Commercial Law Committee set out the following two reasons for legislatively extending to the courts the power to award damages in lieu of rescission in misrepresentation cases:

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616. *See, e.g.,* George Spencer Bower, *The Law Relating to Actionable Non-disclosure and Other Breaches of Duty in Relations of Confidence, Influence and Advantage*, 2d ed. by Sir Alexander Kingcome Turner & Richard John Sutton (London: Butterworths, 1990).

617. *See, above*, at 134–36 (section VII.E.3).

618. *See, above*, at 12–13 (section II.C.4) (for more detail on rescission).

619. *See Snell's Equity, supra* note 37 at para. 18-01. *See, above*, at 10–12 (section II.C.3) (for more information on equity).

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- (1) Rescission alone is often too drastic a remedy; forfeiture of the contract is at times unwanted by the aggrieved party, and is often too extravagant a penalty upon the misrepresentor.
- (2) An award of damages is a more businesslike solution to many cases.<sup>620</sup>

The Ontario Law Reform Commission,<sup>621</sup> Manitoba Law Reform Commission,<sup>622</sup> and United Kingdom Law Reform Committee<sup>623</sup> each made similar recommendations. These reforms have been implemented in the United Kingdom<sup>624</sup> and Australian<sup>625</sup> misrepresentation legislation, as well as in New Zealand's *Contractual Remedies Act 1979*.<sup>626</sup>

There appear to be no commentators who have gone on the record opposing such reforms on the basis that the traditional, inflexible approach to remedies should be retained. It is possible to argue that legislative reform is not necessary, as the courts in British Columbia are already finding ways to show remedial flexibility.<sup>627</sup>

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620. *Report on Misrepresentation and Breach of Contract*, *supra* note 590 at 42.

621. *See Report on Amendment of the Law of Contract*, *supra* note 75 at 241 (“balancing [an] enlarged right to rescission, we recommend that, where a party to a contract would otherwise have a *prima facie* right to rescission, the court should have power to deny rescission, or to declare it ineffective, awarding damages in lieu thereof”).

622. *See Report on Pre-contractual Misstatements*, *supra* note 588 at 58–59 (recommending a judicial power to award damages).

623. *See Report on Innocent Misrepresentation*, *supra* note 589 at 7 (“[W]e recommend that wherever the court has power to order rescission it should, as an alternative, have a discretionary power to award damages if it is satisfied that these would afford adequate compensation to the plaintiff, having regard to the nature of the representation and the fact that the injury suffered by the plaintiff is small compared to what rescission would involve.”).

624. *See Misrepresentation Act 1967*, *supra* note 562, s. 2.

625. *See Misrepresentation Act 1972*, *supra* note 592, s. 7; *Civil Law (Wrongs) Act 2002*, *supra* note 592, ss. 174–75.

626. *See supra* note 591, s. 6.

627. *See, e.g., Dusik v. Newton* (1985), 62 B.C.L.R. 1 at 48, 31 A.C.W.S. (2d) 199 (C.A.), *per curiam* (“Since the agreement between Dusik and the board has been found to be unconscionable, and since rescission is not available in the circumstances, it is open to this court to shape an appropriate remedy.”); *415703 B.C. Ltd. v. JEL Investments Ltd.*, 2010 BCSC 202, [2010] B.C.J. No. 261 (QL) at paras. 181–221 (discussing remedial flexibility in the context of a complex case involving fraudulent misrepresentation).

The committee tentatively recommends that:

*39. The Contract Fairness Act should enable courts to award damages to a representee who was induced to enter into a contract by a misrepresentation in lieu of rescission.*

*(b) Method of Implementing the Jurisdiction to Award Damages*

The more challenging issue is how to implement any new jurisdiction in the courts to award damages. Although there is consistency among past law-reform reports in recommending that courts should be able to award damages in lieu of rescission in misrepresentation cases, there is a surprising amount of diversity in how each of the law-reform agencies that have studied this issue have decided to shape their proposed reforms.

The Manitoba Law Reform Commission has produced a comprehensive summary of the options for reform that have been recommended in past studies and, in some cases, implemented in legislation. The Manitoba Commission found that there are four distinct approaches for consideration.<sup>628</sup>

**(1) A supplemental remedy in damages for a non-fraudulent, non-negligent misrepresentation**

As the Manitoba Commission noted, “[t]his approach focusses on one particular deficiency in the law relating to pre-contractual statements and attempts to remedy it.”<sup>629</sup> The problem is that victims of an innocent misrepresentation may find themselves without a remedy, because rescission in the case at issue is barred and damages are unavailable due to the application of general contract- and tort-law principles. This proposal addresses that specific problem alone by making damages available, assessed on a restitutionary basis, in these cases. As such, this proposal would result in relatively modest reform of the law. On the one hand, this modesty would be a strength of this approach, as it would address only the most pressing concern in this area and “would not unduly dislocate established contract and tort principles.”<sup>630</sup> On the other hand, modesty of approach could be seen as a weakness, as “it does nothing to simplify or rationalize the law” and it may be too narrow in scope, as “it may be

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628. See *Report on Pre-contractual Misstatements*, *supra* note 588 at 55–59.

629. *Ibid.* at 55.

630. *Ibid.*

argued that, in respect of some pre-contractual statements, the measure of damages is too narrow and reliance or expectation damages may be more appropriate in some cases.”<sup>631</sup>

**(2) An enlarged right of rescission coupled with a discretionary damages remedy for non-fraudulent misrepresentation**

Expanding the scope of rescission is discussed below, in the next two issues for reform. This two-pronged approach was recommended by both the Ontario Law Reform Commission<sup>632</sup> and the United Kingdom Report.<sup>633</sup> The latter report’s recommendations largely formed the basis of United Kingdom<sup>634</sup> and Australian<sup>635</sup> misrepresentation legislation. The best summary of the policy choices that support this approach is found in the recommendations of the Ontario Commission:

1. Subject to Recommendation 2, a representee should be able to rescind a contract that has been induced by misrepresentation even though the contract has been wholly or partly performed and even though, in the case of a contract for the sale of an interest in land, the interest has been conveyed to the representee.
2.
  - (1) The courts should have the power to deny rescission for misrepresentation or declare it ineffective, awarding damages in lieu thereof.
  - (2) In exercising the power referred to in Recommendation 2 (1), the courts should take into consideration, *inter alia*,
    - (a) undue hardship to the representor or to third parties;
    - (b) difficulty in reversing performance or long lapse of time after performance;
    - (c) whether a money award would give adequate compensation to the representee;
    - (d) the nature and scope of the representation;
    - (e) the conduct of the representor; and

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631. *Ibid.*

632. See *Report on Amendment of the Law of Contract*, *supra* note 75 at 242–43.

633. See *supra* note 589 at 14–15.

634. See *Misrepresentation Act 1967*, *supra* note 562, ss. 1–2.

635. See *Misrepresentation Act 1972*, *supra* note 592, ss. 6–7; *Civil Law (Wrongs) Act 2002*, *supra* note 592, ss. 173–75.

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- (f) whether or not the representor was negligent in making the representation.

The main advantage of this approach is that it gives the greatest amount of flexibility to the courts. The proposal both expands the scope of the courts to order rescission and tempers this power by directing the courts to award damages in lieu of rescission in appropriate cases.<sup>636</sup> This approach also has the merit of having been implemented by legislation in a number of jurisdictions. The Manitoba Law Reform Commission summarized the disadvantages of this proposal as follows: (1) it “does little to simplify and rationalize the law”; (2) its expansion of the remedy of rescission “favours termination of the contract as a *prima facie* remedy”; and (3) it relies too much on “broad judicial discretionary powers.”<sup>637</sup>

### **(3) Abolition of the distinction between misrepresentations and terms for the purpose of remedies**

This approach has been used in consumer-protection legislation in Canada. It was also the approach favoured for general application by the New Zealand Contracts and Commercial Law Committee.<sup>638</sup> Their report’s recommendation was enacted as part of the *Contractual Remedies Act 1979*,<sup>639</sup> which provides a concrete example of how this proposal might be implemented in legislation:

#### **6 Damages for misrepresentation**

- (1) If a party to a contract has been induced to enter into it by a misrepresentation, whether innocent or fraudulent, made to him by or on behalf of another party to that contract—
- (a) He shall be entitled to damages from that other party in the same manner and to the same extent as if the representation were a term of the contract that has been broken; and
  - (b) He shall not, in the case of a fraudulent misrepresentation, or of an innocent misrepresentation made negligently, be entitled to damages from that other party for deceit or negligence in respect of that misrepresentation.

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636. See *Report on Pre-contractual Misstatements*, *supra* note 588 at 56.

637. *Ibid.*

638. See *Report on Misrepresentation and Breach of Contract*, *supra* note 590 at 44.

639. See *supra* note 591.

(Note that paragraph (b) addresses the separate issue of concurrent liability in tort.)

The main advantage of this approach is that it simplifies the law, primarily by doing away with the distinctions between contract terms and representations, and among types of misrepresentations. As a consequence of this simplicity, the law should be made clearer as well. In addition, this proposal favours maintaining contractual relations in place, by not providing for rescission of contracts based on misrepresentation.<sup>640</sup> The legislation also does have a relatively successful track record in New Zealand. The disadvantages of this approach are, in many respects, the mirror image of its strengths. By curtailing the availability of rescission for misrepresentation it limits the courts' remedial flexibility. In addition, by treating representations as contract terms, it leads to assessment of damages on an expectation basis, which could lead to onerous results in some cases.<sup>641</sup>

**(4) Abolition of the distinction between misrepresentations and terms for the purpose of remedies coupled with a judicial power to award damages on a reliance or restitutionary measure or to rescind the contract**

This final option is a compromise position formulated by, and ultimately recommended by, the Manitoba Law Reform Commission. Their goals in this proposal were “to capture the gains and advantages of an abolition of the dichotomy between representations and terms for the purposes of remedies and to avoid some of its disadvantages by coupling it with a residual discretion to award damages on a reliance or restitutionary measure or to order rescission of the contract where justice demands it.”<sup>642</sup> The strengths of this approach are a reflection of its nature as a compromise position: it allows for some progress to be made on simplifying and rationalizing the law, but also retains some judicial flexibility for difficult cases. The disadvantages include limiting the availability of rescission

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640. See *Report on Pre-contractual Misstatements*, *supra* note 588 at 57.

641. See *ibid.* at 58. See also *Report on Amendment of the Law of Contract*, *supra* note 517 at 241 (“A simple amalgamation of representations with contractual terms would, in our opinion, impose too great a liability on the innocent non-business representor.”).

642. *Report on Pre-contractual Misstatements*, *ibid.*

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and the uncertainty created by increasing the role of judicial discretion in the awarding of damages and the ordering of rescission.<sup>643</sup>

The committee noted that options (3) and (4) provide for sweeping changes to the law, affecting more than the law of contracts. For that reason, it was reluctant to take either of these approaches. The committee was somewhat ambivalent about the choice between options (1) and (2). It based its decision in favour of option (2) in part on the desirability of putting forward a clear tentative recommendation for public consultation. The details of how it proposes to expand the scope of rescission are explained in the next two issues for reform.

The committee tentatively recommends that:

*40. The Contract Fairness Act should create an enhanced right of rescission coupled with a discretionary damages remedy for non-fraudulent misrepresentation.*

### 5. SHOULD THE CONTRACT FAIRNESS ACT ALLOW RESCISSION OF CONTRACTS THAT HAVE BEEN PERFORMED OR EXECUTED?

Traditional contract-law rules bar access to rescission in a number of situations. Law-reform reports have tended to focus their attention on one of these bars, which prevents a victim of misrepresentation from obtaining rescission in cases in which the contract at issue has been performed or executed. This rule developed in cases involving contracts for the sale and purchase of land. The leading Canadian case articulated the rule in these terms:

The whole point is: At what stage does *caveat emptor* apply? The vendee may rely after completion upon warranty, contractual condition, error *in substantialibus*, or fraud. Once the conveyance is settled and the estate has passed, it seems a reasonable application of the rule to hold that as to warranty or contractual condition resort must be had to the deed unless there has been a stipulation at an earlier stage which was not to be superseded by the deed, as in the case of a contract for compensation. Representation which is not fraudulent, and does not give rise to error *in substantialibus*, could only operate after completion as creating a contractual condition or a warranty. Finality and certainty in business affairs seem to require that as a rule, when there is a formal conveyance, such a condition or warranty should be therein expressed, and that the acceptance of the conveyance by the vendee as finally vesting the property in him is the act which for this purpose marks the transition from contract *in fieri* to contract executed. . . .<sup>644</sup>

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643. *See ibid.*

644. *Redican, supra* note 551 at 146–47, Duff J. [citations omitted]. *See also Walmar Ventures, supra* note 530 at 21, McLachlin J.A.

The classic example of execution or performance of a contract for the sale and purchase of land is payment of the purchase price. This bar to rescission has been extended, somewhat controversially, to other types of contracts than those for the sale and purchase of land.<sup>645</sup>

This bar to rescission only applies to non-fraudulent misrepresentation. If it operates in relation to an innocent misrepresentation, then it serves to deny the victim any remedy, as damages in tort are not available for cases of innocent misrepresentation. For this reason, the courts have often found a way around applying the rule strictly by, for example, closely analyzing the issue of whether execution has occurred,<sup>646</sup> or by applying the device of error *in substantialibus* (= “error as to substantial things”). Error *in substantialibus* “is a concept borrowed from mistake law and permits rescission where the land is fundamentally different from what was represented.”<sup>647</sup> Canadian courts have expanded error *in substantialibus* into something more like an all-purpose device for softening the rigidity of the traditional rule. This development has attracted some academic criticism.<sup>648</sup>

The rationale for this rule is that it promotes “[f]inality and certainty in business affairs.”<sup>649</sup> The rationale for reform is typically presented in terms of relieving against the rigidity of this bar to rescission, giving the courts greater remedial flexibility and

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645. See *Seddon v. North Eastern Salt Co. Ltd.* (1904), [1905] 1 Ch. 326, 91 L.T. 793 (Eng. Ch. Div.) (contract for the sale of shares).

646. See, e.g., *Hemming v. Elder* (1998), 57 B.C.L.R. (3d) 182, 112 B.C.A.C. 305 (C.A.).

647. *Report on Pre-contractual Misstatements*, *supra* note 588 at 11.

648. See G.H.L. Fridman, “Error in Substantialibus: A Canadian Comedy of Errors” (1978) 56 Can. Bar Rev. 603 at 625 [Fridman, “Error in Substantialibus”] (“Where Canadian courts went wrong, if I may respectfully make such a suggestion, is when they adopted an approach to certain problems of mistake that was not supported by the common law, but purported to express that approach as a part of the common law. To do this, Canadian courts were compelled to engage in certain illogical ‘leaps’ in their reasoning: and to apply concepts and ideas out of context. There may be good reasons for seeking to qualify the strict common law of mistake. There may be good reasons for wanting to mitigate the rigours of the law by some more gentle, amenable equitable doctrine that would permit a court to relieve a party from an unconscionable, unprofitable bargain, entered into under a misapprehension, and to release him from a situation which would otherwise prove to be to his detriment. It is unfortunate that this should have been achieved by the invention of an anomalous doctrine such as that of error *in substantialibus*.” [footnote omitted]).

649. *Redican*, *supra* note 551 at 146, Duff J. See also *Report on Innocent Misrepresentation*, *supra* note 589 at 4–5 (“we think that in the case of sales of land finality should be the predominant consideration.”).



allowing them to address difficult cases directly rather than by using convoluted doctrines such as error *in substantialibus*.<sup>650</sup>

The law-reform bodies that have studied this issue have each come to different conclusions. The Ontario Law Reform Commission favoured doing away with this bar to rescission.<sup>651</sup> The United Kingdom Law Reform Committee favoured doing away with this bar for most contracts, but they recommended leaving it in place for contracts for the sale and purchase of land.<sup>652</sup> The New Zealand Contracts and Commercial Law Committee proposed taking a broader view of issues and replacing the traditional remedy of rescission with a new statutory remedy of cancellation.<sup>653</sup> The Manitoba Law Reform Commission favoured making damages the main remedy in this area and curtailing the availability of rescission, so it did not address removal of bars to rescission (which obviously expands the scope of rescission and would run counter to the Manitoba Commission's main recommendation).

Legislation removing this bar to rescission has been enacted in the United Kingdom,<sup>654</sup> Australia,<sup>655</sup> and New Brunswick.<sup>656</sup> The statutes are broadly similar in drafting. As an example of the provision, note the following section of the Australian Capital Territory act:

**173 Removal of certain bars to rescission for misrepresentation**

(1) This section applies if—

- (a) a person enters into a contract after a misrepresentation is made to the person; and

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650. See *Report on Amendment of the Law of Contract*, *supra* note 75 at 241. See also McCamus, *Law of Contracts*, *supra* note 13 at 344; Fridman, "Error in Substantialibus," *supra* note 648 at 609.

651. See *Report on Amendment of the Law of Contract*, *ibid.* at 242. This recommendation was qualified by a subsequent recommendation allowing courts to award damages in lieu of rescission. See *ibid.* at 243.

652. See *Report on Innocent Misrepresentation*, *supra* note 589 at 4.

653. See *Report on Misrepresentation and Breach of Contract*, *supra* note 590 at 43.

654. See *Misrepresentation Act 1967*, *supra* note 562, s. 1. The United Kingdom Parliament did not follow the recommendation in the *Report on Innocent Misrepresentation*, *supra* note 589, to restrict this provision to contracts other than those for the sale and purchase of land; as enacted, the provision is one of general application.

655. See *Misrepresentation Act 1972*, *supra* note 592, s. 1; *Civil Law (Wrongs) Act 2002*, *supra* note 592, s. 173.

656. See *Law Reform Act*, S.N.B. 1993, c. L-1.2, s. 6.

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- (b) the person would be entitled to rescind the contract without claiming fraud if 1 or more of the following matters (*former bars*) did not apply:
  - (i) the misrepresentation has become a term of the contract;
  - (ii) the contract has been performed;
  - (iii) a conveyance, transfer or other document has been registered under a territory law or a law of the Commonwealth, a State or another Territory because of the contract.
- (2) The person may rescind the contract even though 1 or more of the former bars apply.<sup>657</sup>

It should be noted that, in this legislation as in the proposals of the Ontario Law Reform Commission, other bars to rescission continue to operate, if they apply to the contract at issue.

The committee tentatively recommends that:

*41. The Contract Fairness Act should allow a representee to rescind a contract that has been induced by misrepresentation even though the contract has been wholly or partially performed and even though, in the case of a contract for the sale of an interest in land, the interest has been conveyed to the representee.*

### 6. SHOULD THE CONTRACT FAIRNESS ACT ALLOW RESCISSION OF CONTRACTS IN WHICH THE MISREPRESENTATION HAS BECOME A TERM OF THE CONTRACT?

The United Kingdom Law Reform Committee has given a good explanation of this issue.

Another minor anomaly, which will be accentuated if rescission becomes available as a remedy for misrepresentation after the contract has been executed, relates to representations first made independently and later incorporated into the contract. Where this happens the victim may actually be worse off, because there is some authority for saying that the remedy for misrepresentation which has attained the status of a contractual term is not the equitable one of rescission but the common law one of damages.<sup>658</sup>

This bar to rescission has been called *merger in a subsequent warranty*.<sup>659</sup>

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657. *Civil Law (Wrongs) Act 2002*, *supra* note 592, s. 173 [emphasis in original].

658. *Report on Innocent Misrepresentation*, *supra* note 589 at 8–9.

659. *See supra* note 553.

In the view of the United Kingdom Law Reform Committee, it was “clearly desirable”<sup>660</sup> to extend the possibility of courts ordering rescission in these cases. This view was adopted in the United Kingdom<sup>661</sup> and Australian<sup>662</sup> misrepresentation legislation.

The New Zealand Contracts and Commercial Law Committee took issue with this approach. Their report took a broader view of the issues, noting that under traditional contract-law rules a contracting party is entitled to repudiate a contract in the face of a breach of a contract term classed as a condition, but is only entitled to damages if the breach is of a contract term classed as a warranty. In the New Zealand Contracts and Commercial Law Committee’s view, the United Kingdom Law Reform Committee’s proposal muddied this picture.

Suppose a plaintiff wants rescission. At present he mounts a two-pronged attack to show either a misrepresentation or a condition. Now in the United Kingdom there will be a third prong—a warranty which began as a representation. The whole course of negotiations will be in issue regarding these terms of the contract, as they are in a misrepresentation case. The defendant, who wants to pay damages rather than lose the contract, will be side-stepped in his usual defence that the matter is simply a warranty, and will have to rely on the discretion of the Court.<sup>663</sup>

The New Zealand Contracts and Commercial Law Committee addressed this concern by recommending that the traditional remedy of rescission be replaced in these cases by a more broadly based statutory remedy.<sup>664</sup>

The committee tentatively recommends that:

*42. The Contract Fairness Act should allow a representee to rescind a contract that has been induced by misrepresentation even though the misrepresentation has become a term of the contract.*

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660. *Report on Innocent Misrepresentation*, *supra* note 589 at 9.

661. *See Misrepresentation Act 1967*, *supra* note 562, s. 1 (a).

662. *See Misrepresentation Act 1972*, *supra* note 592, s. 6 (1) (a); *Civil Law (Wrongs) Act 2002*, *supra* note 592, s. 173 (1) (b) (i).

663. *Report on Misrepresentation and Breach of Contract*, *supra* note 590 at 36.

664. *Ibid.* at 43.

7. SHOULD CONTRACTING PARTIES BE ABLE TO MODIFY OR EXCLUDE THE MISREPRESENTATION PROVISIONS IN THE CONTRACT FAIRNESS ACT?

The ongoing issue of contracting out of the legislation arises with respect to any legislation proposed to cover misrepresentation. Since part of the rationale for such legislation is to remedy unfairness that may result from abuses of the bargaining process, the argument may be made that contracting parties should not be able to agree that the legislation will not apply to their contracts. The concern is that if contracting parties have this freedom, then stronger parties will use their bargaining strength to routinely require modification or exclusion of the legislation, which would severely undercut the effectiveness of the legislation. On the other hand, misrepresentation covers a broader range of conduct than other concepts considered as part of this project. It runs the gamut from fraudulent to innocent misstatements. An argument based on fairness can sound less than plausible when it is applied to innocent or negligent conduct.

The law-reform agencies that have studied this issue in the past have arrived at different positions on it. None of the agencies has taken the position of completely preventing any modification of the statutory scheme. The Manitoba Law Reform Commission did come very close to this position, though. The Manitoba Commission's proposal was embodied in the following section from the draft legislation included in their report:

**No contracting out**

**3(1)** Subject to subsection (2), no person may vary or waive the provisions of this Act and any agreement that purports to do so is void.

**May vary remedies**

**3(2)** A person may agree to vary a remedy provided in sections 6 or 7.<sup>665</sup>

The Manitoba Commission concluded that its first provision was necessary "to prevent a wholesale avoidance of the provisions of the Act by a contracting party inserting a boiler-plate clause to that effect in standard form contract."<sup>666</sup> The Manitoba Commission's proposal would allow contracting parties to agree to favour one statutory remedy or the other (that is, damages or rescission) in the event of a breach.

The United Kingdom Law Reform Committee addressed this issue on a different basis. In their view, the issue was simply a species of the broader question of control-

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665. *Report on Pre-contractual Misstatements*, supra note 588 at 66.

666. *Ibid.*

ling unfair exclusion clauses. The report recommended that “it should not be possible to rely on a provision purporting to exclude liability for any misrepresentation made with the intention of inducing a contract unless the representor can show that up to the time the contract was made he had reasonable grounds for believing the representation to be true.”<sup>667</sup> This proposal was adopted as part of the legislation based on the United Kingdom Law Reform Committee.<sup>668</sup>

In the committee’s view, it is counterintuitive and counterproductive to allow contracting parties to agree to exclude the legislative remedial regime for misrepresentation.

The committee tentatively recommends that:

*43. The Contract Fairness Act should not allow contracting parties to modify or exclude the misrepresentation provisions in the draft legislation.*

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667. *Report on Innocent Misrepresentation*, *supra* note 590 at 12.

668. *Misrepresentation Act*, *supra* note 562, s. 3 (this provision was subsequently harmonized with the reasonableness test set out in the *Unfair Contract Terms Act 1977*, *supra* note 164). *See also Misrepresentation Act 1972*, *supra* note 592, s. 8; *Civil Law (Wrongs) Act 2002*, *supra* note 592, s. 176.



## CHAPTER IX. SPECIAL LEGISLATIVE PROVISIONS FOR EXCLUSION CLAUSES

### A. Background

#### 1. GENERAL

Up to this point this consultation paper has considered themes that are broad, general concepts that can apply across the whole range of contracts and contract terms. With this chapter, the consultation paper shifts to focus on one particular type of contract term. This narrowing of focus is appropriate because the control of exclusion clauses has posed special problems for the law of contracts. This perennial concern with exclusion clauses has generated a series of decisions since the mid-1970s from the Supreme Court of Canada on the proper approach to be taken by the courts in controlling abuses of exclusion clauses.<sup>669</sup> The most recent of these decisions, in the *Tercon Contractors* case, was just issued in February of this year.<sup>670</sup> Even though the committee ultimately decided not to propose any reforms in relation to exclusion clauses, it did want to make its research and decisions available for public comment.

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669. See *B.G. Linton Construction Ltd. v. Canadian National Railway Co.* (1974), [1975] 2 S.C.R. 678, 49 D.L.R. (3d) 548 [*Linton Construction* cited to S.C.R.] (telegram containing revised bid in tendering process delivered late due to CNR's negligence—results in tender being awarded to other bidder—CNR entitled to rely on exclusion of liability clause); *Beaufort Realties (1964) Inc. v. Chomedey Aluminum Co. Ltd.*, [1980] 2 S.C.R. 718, 116 D.L.R. (3d) 193 [*Beaufort Realties* cited to S.C.R.] (contract to supply aluminum windows to apartment building—contractor failing to make progress payments—subcontractor filing builders lien against property—property owner and contractor entitled to rely on clause waiving subcontractor's right to file lien); *Hunter Engineering, supra* note 124 (contracts for gearboxes for use in oil-sands production—cracks appearing in gearbox after use as a result of design flaws—one contract expressly excluding warranties under *Sale of Goods Act*—exclusion clause enforceable); *Gordon Capital, supra* note 44 (investment dealer entering into fidelity-insurance contract with insurer—contract containing 24-month limitation period on making claims—investment dealer's employee engaging in fraudulent activities causing losses—insurer purporting to rescind contract and returning premiums—investment dealer commencing action on claim after expiry of 24-month period from date of losses—limitation clause enforceable).

670. *Supra* note 124 (provincial government ministry issuing request for expressions of interest for construction of highway—ministry short listing and ultimately accepting non-conforming bid—other short-listed bidder claiming damages—ministry unable to rely on general exclusion of liability clause as it failed to expressly exclude liability for breach of implied duty to treat bids fairly).

It is important to have some sense of the development of the law relating to exclusion clauses in order to understand the current position of the law and the options for reform. What follows is a bare-bones summary of this lengthy, complicated history.<sup>671</sup>

### 2. DEFINITION OF EXCLUSION CLAUSE

An *exclusion clause* is “[a] contractual provision providing that a party will not be liable for damages which that party would otherwise have ordinarily been liable.”<sup>672</sup> These clauses are very common. They can be used for a range of purposes. Typically, they exclude or limit liability for a breach of the contract’s terms. They can also be used to limit or exclude liability flowing from a breach of a warranty or for deficient performance. Some go even further and exclude or limit liability in tort for the contracting party’s negligence.

There are some inherent restraints on exclusion clauses. An exclusion clause cannot be used to exclude liability for fraud,<sup>673</sup> nor can one be used to exclude liability for intentionally or recklessly committing a tort.<sup>674</sup> Finally, statutes can put limits on the use of exclusion clauses.<sup>675</sup>

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671. See Waddams, *Law of Contracts*, *supra* note 55 at paras. 468–87; Fridman, *Law of Contract*, *supra* note 190 at 511–30; Swan, *supra* note 192 at §§ 9.73–9.80; McCamus, *Law of Contracts*, *supra* note 13 at 749–78; M.H. Ogilvie, “Fundamental Breach Excluded But Not Extinguished: Hunter Engineering v. Syncrude Canada” (1990) 17 Can. Bus. L.J. 75 [Ogilvie, “Fundamental Breach”]; Robert Flannigan, “Hunter Engineering: The Judicial Regulation of Exculpatory Clauses” (1990) 69 Can. Bar Rev. 514 (each exploring this topic in detail).

672. *Black’s Law Dictionary*, 9th ed., s.v. “exemption clause.” Courts and commentators have not been consistent in naming what the text has been referring to as an *exclusion clause*. *Exemption clause*, *exculpatory clause*, *excluding clause*, and variations on these terms all crop up in one source or another. This consultation paper uses *exclusion clause* because it is the name used in what is now the leading Canadian case, *Tercon Contractors*, *supra* note 124. Note also that some courts have attempted to draw a distinction between clauses that exclude liability altogether those that merely limit liability to some agreed-upon figure. See Waddams, *Law of Contracts*, *ibid.* at para. 472 (concluding that “[a] sharp division between limitations and total exclusions, however, seems anomalous”). This consultation paper will not try to sustain that distinction. In this chapter, a reference to an *exclusion clause* should be read as including both clauses that limit liability and those that exclude it altogether.

673. See Fridman, *Law of Contract*, *supra* note 190 at 511 (“no clause of this kind (nor indeed any type of clause) can exempt a party from liability for fraud” [footnote omitted]).

674. See *Farnsworth on Contracts*, *supra* note 24, vol. 2 at § 5.2 (“A party clearly cannot exempt itself from liability in tort for harm that it causes intentionally or recklessly.” [footnote omitted]).

675. See, e.g., *Sale of Goods Act*, R.S.B.C. 1996, c. 410, s. 20.



### 3. JUDICIAL CONTROL OF EXCLUSION CLAUSES

As a general proposition, “[t]here is nothing inherently unreasonable about exclusion clauses.”<sup>676</sup> The issue is limited to “cases where extreme unfairness would result from the operation of an exclusion clause. . . .”<sup>677</sup> These cases occur when a contracting party “creates a situation that is radically different from that contemplated by the agreement as a whole,”<sup>678</sup> which allows that party to take its benefits under the contract, but also, thanks to the operation of the exclusion clause, to avoid its burdens under the contract. The courts have always been reluctant to enforce exclusion clauses in cases where their enforcement leads to an unfair result. The difficulties created by this reluctance are twofold: first, it is hard to draw a clear, consistent line between enforceable and unenforceable exclusion clauses; and second, it has been hard to formulate a rationale for striking down certain exclusion clauses that also respects the overriding principle of freedom of contract.<sup>679</sup>

### 4. CONTRACT INTERPRETATION

The period from about the mid-nineteenth century to the mid-twentieth century was the watershed of freedom of contract.<sup>680</sup> During this time courts were very reluctant to articulate any substantive rules that appeared to inhibit the paramount freedom of contracting parties to structure their agreements in any way they saw fit. So, during this time the courts tended to treat exclusion clauses as nothing more than problems of contractual interpretation. One approach was to interpret exclusion clauses strictly against the party that drafted the contract. If there was any ambiguity in the clause, then the benefit of the doubt was resolved in favour of the other party (which invariably would be the party with the weaker bargaining position in the transac-

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676. *Tercon Contractors*, *supra* note 124 at para. 82, Binnie J. (dissenting). It should be noted that although Binnie J. dissented in the result in *Tercon Contractors*, the majority expressly concurred in his “analytical approach that should be followed when tackling an issue relating to the applicability of an exclusion clause. . . .” *See ibid.* at para. 62, Cromwell J. *See also* Waddams, *Law of Contracts*, *supra* note 55 at para. 469 (“There is nothing inherently evil in such exclusionary provisions.”).

677. *Hunter Engineering*, *supra* note 124 at 456, Dickson C.J. (La Forest J. concurring).

678. Waddams, *Law of Contracts*, *supra* note 55 at para. 474.

679. It is worth noting that the courts have a longstanding equitable jurisdiction to relieve against penalties. In British Columbia, the jurisdiction has been codified. *See Law and Equity Act*, R.S.B.C. 1996, c. 253, s. 24. A penalty is essentially the mirror image of an unfair exclusion clause: a penalty requires a contracting party to pay an unreasonably high amount as a result of a breach of a contract term; an unfair exclusion clause allows a contracting party to pay an unreasonably low amount in the face of its default.

680. *See, above*, at 14–16 (section II.C.5) (for further discussion of freedom of contract).

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tion). Other cases could be resolved by the creative application of the traditional rules regarding offer and acceptance, or consideration.

There is a certain logic to treating this issue as an interpretative problem. If the exclusion clause at issue can be reasonably interpreted not to apply to the situation at hand, then the dispute between the parties can be resolved without having to resort to new principles that could have unintended consequences for freedom of contract. But this approach, standing alone, also caused a number of problems. Although a strictly interpretive approach to the control of exclusion clauses can work justice in any given case, it does also tend to lead to an inconsistent body of jurisprudence, made up of cases that are impossible to reconcile. This tempts contracting parties to try to achieve the same substantive results by using slightly different contractual language. All of which leads to uncertainty over the real principles guiding courts in this area of the law. Finally, social and commercial developments—particularly the rise of standard-form and consumer contracts—tended to undermine the argument that the courts should enforce all exclusion clauses because they are contract terms that the parties have freely negotiated.

## 5. FUNDAMENTAL BREACH IN THE UNITED KINGDOM

The problems listed in the preceding paragraph emboldened the English courts to launch a direct attack on unfair exclusion clauses by formulating a substantive rule that would apply to the question of whether or not the courts would enforce a given exclusion clause. In a seminal decision,<sup>681</sup> Denning L.J. explained the new approach as follows:

It is necessary to look at the contract apart from the exempting clauses and see what are the terms, express or implied, which impose an obligation on the party. If he has been guilty of a breach of those obligations in a respect which goes to the very root of the contract, he cannot rely on the exempting clauses.<sup>682</sup>

This approach unfortunately became known as the *doctrine of fundamental breach*.<sup>683</sup> The doctrine of fundamental breach is often called a rule of law—“that is

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681. *Karsales (Harrow) Ltd. v. Wallis*, [1956] EWCA Civ 4, [1956] 2 All E.R. 866 [*Karsales* cited to All E.R.].

682. *Ibid.* at 869.

683. The name is unfortunate because the law of contracts also uses *fundamental breach* to refer to a longstanding (and uncontroversial) rule about the types of breach of contract that entitle a contracting party to decline to perform its obligations under the breached contract. See McCamus, *Law of Contracts*, *supra* note 13 at 752–54. Although there can be some points of connection between the two senses of fundamental breach, they should be understood as completely separate concepts. See *ibid.* at 754 (“It is entirely possible that a breach could be of such a nature as to

[a rule] that would operate irrespective of the parties' intentions . . ."684—as opposed to a rule of construction (or interpretation)—“that is a *prima facie* presumption that would yield to a contrary intention if clearly expressed.”685

This approach proved to be immediately popular with the trial- and lower-appellate-level English courts. The doctrine of fundamental breach has some strengths. It is relatively clear, simple, and easy to apply. But the doctrine also has weaknesses that critics were quick to point out. First, it is rather artificial to remove exclusion clauses from the initial analysis of the contract, as they are contract terms like any other and may have been integral to the structure of the contract. Second, it is not at all clear when a breach of contract will rise to the level of being a fundamental breach and engage this rule. Finally, there was an underlying sense that, in formulating a new substantive rule of law, the courts were overreaching into areas that should be left to the legislature.

These concerns led the United Kingdom's highest court—at that time, the House of Lords—to rein in the doctrine of fundamental breach. In a decision issued in the mid-1960s, the court unanimously disapproved of applying the doctrine as a rule of law.<sup>686</sup> But, the decision was not directly concerned with exclusion clauses and the disapproval was expressed ambiguously. So, the lower courts quickly returned to applying fundamental breach as a rule of law.<sup>687</sup>

Two developments finally brought an end to the doctrine of fundamental breach in the United Kingdom. First, legislation was passed which addressed the worst abuses of exclusion clauses.<sup>688</sup> Second, the House of Lords issued a more forceful disapproval of fundamental breach as a rule of law,<sup>689</sup> leaving the lower courts with the

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give rise to the right to terminate but not be so severe as to preclude the guilty party from relying on the exculpatory clause in the agreement.”) Any references to *fundamental breach* in this consultation paper are intended only to refer to the doctrine that relates to control of exclusion clauses.

684. Waddams, *Law of Contracts*, *supra* note 55 at para. 474.

685. *Ibid.*

686. *See Suisse Atlantique Société d'Armement Maritime S.A. v. N.V. Rotterdamsche Kolen Centrale* (1966), [1967] A.C. 361, [1966] 2 All. E.R. 61 (U.K.H.L.).

687. *See Harbutt's "Plasticine" Ltd. v. Wayne Tank & Pump Co. Ltd.* (1969), [1970] 1 Q.B. 447, [1970] 1 All E.R. 225 (C.A.).

688. *Unfair Contract Terms Act 1977*, *supra* note 164.

689. *See Photo Production Ltd. v. Securicor Transport Ltd.*, [1980] UKHL 2, [1980] A.C. 827. *See also Hunter Engineering*, *supra* note 124 at 503, Wilson J. (“In England the issue was unequivocally resolved by the House of Lords in favour of the construction approach in the *Photo Production*

distinct impression that their options for controlling abuses of exclusion clauses were limited to applying the provisions of the statute (if it were applicable in a given case) or using the traditional interpretive doctrines.

## 6. FUNDAMENTAL BREACH IN CANADA

Up to the *Tercon Contractors* case,<sup>690</sup> the Canadian courts had tended to follow the English courts in formulating and applying the doctrine of fundamental breach. First, they enthusiastically embraced the doctrine.<sup>691</sup> Then, the Supreme Court of Canada began to express reservations and indicated that the Canadian courts should follow the lead of the House of Lords and stop applying fundamental breach as a rule of law.<sup>692</sup> But these decisions proved to be ambiguous on this point, which created some confusion and allowed the lower courts to carry on with using fundamental breach as a rule of law.<sup>693</sup>

The Supreme Court of Canada attempted to clarify this situation in *Hunter Engineering*. In that case, the court agreed that the time had come “to lay the doctrine of fundamental breach to rest ...”<sup>694</sup> but the court divided on the approach that was to take its place. Two judges favoured an approach made up of two distinct elements: (1) the courts’ traditional interpretive tools; and (2) the equitable jurisdiction to review contract terms for unconscionability at the time of formation of the contract.<sup>695</sup>

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case.”).

690. *Supra* note 124.

691. *See Hunter Engineering*, *supra* note 124 at 456, Dickson C.J. (“This rule of law was rapidly embraced by both English and Canadian courts.”).

692. *See Linton Construction*, *supra* note 669; *Beaufort Realities*, *supra* note 669.

693. *See Hunter Engineering*, *supra* note 124 at 457, Dickson C.J. (“The renunciation of the rule of law approach by the House of Lords and by this Court, however, has had little effect on the practice of lower courts in England or in Canada.”).

694. *Ibid.* at 462, Dickson C.J. *See also ibid.* at 506, Wilson J.

695. *See ibid.* at 462, Dickson C.J. (La Forest J. concurring) (“In light of the unnecessary complexities the doctrine of fundamental breach has created, the resulting uncertainty in the law, and the unrefined nature of the doctrine as a tool for averting unfairness, I am much inclined to lay the doctrine of fundamental breach to rest, and where necessary and appropriate, to deal explicitly with unconscionability. In my view, there is much to be gained by addressing directly the protection of the weak from over-reaching by the strong, rather than relying on the artificial legal doctrine of ‘fundamental breach.’ There is little value in cloaking the inquiry behind a construct that takes on its own idiosyncratic traits, sometimes at odds with concerns of fairness. This is precisely what has happened with the doctrine of fundamental breach. It is preferable to interpret the terms of the contract, in an attempt to determine exactly what the parties agreed. If on its true construction the contract excludes liability for the kind of breach that occurred, the party in breach will generally be saved from liability. Only where the contract is unconscionable, as might arise from situations of unequal bargaining

Two other judges favoured an approach made up of the following distinct elements: (1) the courts' traditional interpretive tools; and (2) a new jurisdiction to review exclusion clauses against a broad reasonableness standard at the time of the breach of contract.<sup>696</sup> The fifth judge on the panel declined to address this issue.<sup>697</sup>

Given this split in the court's opinion, *Hunter Engineering* was unable to chart a clear course for lower courts to follow on reviewing exclusion clauses. A subsequent decision of the court in a case that did not feature an exclusion clause<sup>698</sup> contained some brief comments on *Hunter Engineering* that appeared to be intended to minimize the differences between the two approaches.<sup>699</sup> These remarks arguably added to the confusion over how to approach this area and fuelled continued reliance on the doctrine of fundamental breach in the lower courts.<sup>700</sup>

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power between the parties, should the courts interfere with agreements the parties have freely concluded.”).

696. *See ibid.* at 510–11, Wilson J. (L'Heureux-Dubé J. concurring) (“Exclusion clauses do not automatically lose their validity in the event of a fundamental breach by virtue of some hard and fast rule of law. They should be given their natural and true construction so that the meaning and effect of the exclusion clause the parties agreed to at the time the contract was entered into is fully understood and appreciated. But, in my view, the court must still decide, having ascertained the parties' intention at the time the contract was made, whether or not to give effect to it in the context of subsequent events such as a fundamental breach committed by the party seeking its enforcement through the courts. Whether the courts address this narrowly in terms of fairness as between the parties (and I believe this has been a source of confusion, the parties being, in the absence of inequality of bargaining power, the best judges of what is fair as between themselves) or on the broader policy basis of the need for the courts (apart from the interests of the parties) to balance conflicting values inherent in our contract law (the approach which I prefer), I believe the result will be the same since the question essentially is: in the circumstances that have happened should the court lend its aid to A to hold B to this clause?”).

697. *See ibid.* at 481, McIntyre J.

698. *See Gordon Capital*, *supra* note 44.

699. *See ibid.* at para. 52, Iacobucci & Bastarache JJ. (for the court) (“[B]oth Dickson C.J. 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., or unfair, unreasonable or otherwise contrary to public policy, according to Wilson J.”).

700. *See* Richard F. Devlin, “Return of the Undead: Fundamental Breach Disinterred” (2007) 86 Can. Bar Rev. 1 (discussing confusion in the wake of the *Hunter Engineering* and *Gordon Capital* decisions).

7. TERCON CONTRACTORS AND THE CURRENT POSITION OF THE LAW

These twists and turns all formed the background to the Supreme Court of Canada's recent decision in *Tercon Contractors*.<sup>701</sup> This case was clearly intended to settle the outstanding issues left by *Hunter Engineering, Gordon Capital*, and the reception of those two cases in the lower courts. The court unanimously agreed on two key points. First, the doctrine of fundamental breach "should be laid to rest. . ."<sup>702</sup> Second, in its place, courts should apply a three-tiered analysis of exclusion clauses. This analysis was described as "a series of inquiries to be addressed when a plaintiff seeks to escape the effect of an exclusion clause or other contractual term. . ."<sup>703</sup> This means that the elements of the approach should be applied independently and, presumably, sequentially. The three elements are:

- (1) "whether as a matter of interpretation the exclusion clause even *applies* to the circumstances established in evidence";<sup>704</sup>
- (2) "whether the exclusion clause was unconscionable at the time the contract was made, 'as might arise from situations of unequal bargaining power between the parties' ";<sup>705</sup>
- (3) "[i]f the exclusion clause is held to be valid and applicable, the Court may undertake a third enquiry, namely whether the Court should nevertheless refuse to enforce the valid exclusion clause because of the existence of an overriding public policy, proof of which lies on the party seeking to avoid enforcement of the clause, that outweighs the very strong public interest in the enforcement of contracts."<sup>706</sup>

The apparently new aspect of this approach is the third element, which states a public-policy test—although this element could be characterized as making explicit the implicit basis of Wilson J.'s approach to exclusion clauses in *Hunter Engineering*.<sup>707</sup>

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701. *Supra* note 124.

702. *Ibid.* at para. 81, Binnie J. *See also ibid.* at para. 82, Binnie J. ("On this occasion we should again attempt to shut the coffin on the jargon associated with 'fundamental breach.'").

703. *Ibid.* at para. 121, Binnie J.

704. *Ibid.* at para. 122, Binnie J. [emphasis in original].

705. *Ibid.*, Binnie J. (quoting *Hunter Engineering*, *supra* note 124 at 462, Dickson C.J.).

706. *Tercon Contractors*, *ibid.* at para. 123, Binnie J.

707. *See supra* note 124 at 510–11 ("[I]n my view, the court must still decide, having ascertained the parties' intention at the time the contract was made, whether or not to give effect to it in the context of subsequent events such as a fundamental breach committed by the party seeking its enforcement through the courts. Whether the courts address this narrowly in terms of fairness as

The role of public policy in the law of contracts is a complex topic that is difficult to summarize.<sup>708</sup> A leading case has succinctly described public policy as “that principle of the law which holds that no subject can lawfully do that which has a tendency to be injurious to the public, or against the public good. . . .”<sup>709</sup> There are several traditional categories of public policy,<sup>710</sup> but these categories are not closed. In the opinion of two recent commentators, the residual character of public policy is gaining prominence in the jurisprudence, as “there is now [among the courts] an increasing recognition of the need for a fluid, vibrant public policy doctrine to supplement the more barbarous interstices of the common law.”<sup>711</sup> This wide-ranging conception of public policy appears to underlie the Supreme Court of Canada’s invocation of the doctrine in *Tercon Contractors*.

Nevertheless, and although it’s still somewhat premature to get a real sense of how *Tercon Contractors* will effect the development of this area of the law, the early indications are that the case has narrowed the courts’ jurisdiction to deal with unfair exclusion clauses.<sup>712</sup> This sense may be due to the court choosing a criterion—public policy—for controlling exclusion clauses that is based more on public order than on fairness. Further, Binnie J. used two hypotheticals<sup>713</sup> and cited one case<sup>714</sup> to illus-

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between the parties (and I believe this has been a source of confusion, the parties being, in the absence of inequality of bargaining power, the best judges of what is fair as between themselves) or on the broader policy basis of the need for the courts (apart from the interests of the parties) to balance conflicting values inherent in our contract law (the approach which I prefer), I believe the result will be the same since the question essentially is: in the circumstances that have happened should the court lend its aid to A to hold B to this clause?”).

708. See generally Brandon Kain & Douglas T. Yoshida, “The Doctrine of Public Policy in Canadian Contract Law,” in Todd L. Archibald & Randall Scott, eds., *Annual Review of Civil Litigation 2007* (Toronto: Carswell, 2007) 1.

709. *Egerton v. Earl of Brownlow* (1835), 4 H.L.C. 1 at 196, Lord Truro.

710. See Kain & Yoshida, *supra* note 708 at 15–31 (listing the following as the traditional categories: (1) contracts injurious to the state; (2) contracts injurious to the justice system; (3) contracts involving immorality; (4) contracts affecting marriage; and (5) contracts in restraint of trade). There is some disagreement over the identity and number of these categories. See *ibid.* at 17–18, n. 85.

711. *Ibid.* at 13 [footnote omitted].

712. See Cristin Schmitz, “‘Fundamental breach’ doctrine dead for exclusion clauses” *The Lawyers Weekly* (5 March 2010) 1 at 1 (“the Supreme Court’s recent decision effectively narrows the discretion of the courts to refuse to enforce exclusion of liability clauses because the defendant has breached the contract to those ‘rare’ cases where the ‘very strong’ public policy in favour of freedom to contract is outweighed by countervailing societal values that seek to curb abuses of the freedom to contract”).

713. One hypothetical involved “the case of a milk supplier who adulterates its baby formula with a toxic compound”; the other involved “people . . . who recklessly sold toxic cooking oil to unsus-

trate the workings of the public-policy test, and each example focussed on “[c]onduct approaching serious criminality or egregious fraud...”<sup>715</sup> This type of extreme conduct is not typically at issue in a case involving the enforcement of an exclusion clause. Typically, the court is asked to enforce the exclusion clause in the face of negligence or breach of contract. These are much more difficult cases to adjudicate, as Binnie J. acknowledged.<sup>716</sup> *Tercon Contractors* is itself an illustration of the challenges facing courts in this area of the law. When the Supreme Court of Canada came to apply its new test, the panel divided in the result, five judges to four.

## B. Issues for Reform

The major—indeed, only—issue considered in this chapter is whether legislation is needed to deal with problems posed by exclusion clauses.

The courts of Canada and the United Kingdom are somewhat unusual in having developed a specific doctrine—fundamental breach—to deal with the control of exclusion clauses. Among common-law jurisdictions, this doctrine has never caught on in the United States<sup>717</sup> or in Australia.<sup>718</sup> Those jurisdictions (especially the United States) have tended to address contractual unfairness by the articulation and development of highly general concepts, such as unconscionability and good faith. There is little question that cases involving exclusion clauses continue to be litigated in British Columbia and to pose challenges for—and to be resolved on a number of different legal bases by—the British Columbia courts.<sup>719</sup> But there is not much in the

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pecting consumers.” See *Tercon Contractors*, *supra* note 124 at para. 118.

714. *Plas-Tex Canada*, *supra* note 126. Binnie J. summarized this case as one in which “the defendant Dow knowingly supplied defective plastic resin to a customer who used it to fabricate natural gas pipelines.” See *Tercon Contractors*, *ibid.* at para. 119.

715. *Tercon Contractors*, *ibid.* at para. 120.

716. *Ibid.*

717. See James B. Niehaus, “Unconscionability and the Fundamental Breach Doctrine in Computer Contracts,” Note, (1982) 57 *Notre Dame Lawyer* 547 at 557 (“no United States court has explicitly adopted the fundamental breach doctrine” [footnote omitted]). See also M.P. Ellinghaus, “In Defense of Unconscionability” (1969) 78 *Yale L.J.* 757 at 797–800 (comparing fundamental breach with American concept of transactional essence).

718. See Ogilvie, “Fundamental Breach,” *supra* note 671 at 93, n. 55 (“In Australia where the doctrine of fundamental breach never gained acceptance. . .”).

719. See, e.g., *Salgado v. Toth*, 2009 BCSC 1515, [2009] B.C.J. No. 2230 (QL) (exclusion clause in home-inspection contract not enforceable due to failure to draw clause to customer’s attention and application of doctrine of *contra proferentum*); *Romfo v. 1216393 Ontario Inc.*, 2008 BCCA 179, 292 D.L.R. (4th) 692 (court ordering specific performance of contract of purchase and sale of land despite clause purporting to limit remedy for breach to return of deposit on the basis of



way of examples of law reform from other jurisdictions that tackle exclusion clauses directly. In fact, there is only one leading example—the United Kingdom’s *Unfair Contract Terms Act 1977*.<sup>720</sup> Both this act and the law-reform report that inspired it<sup>721</sup> play a pivotal role in the discussion that follows.

### 1. SHOULD THE CONTRACT FAIRNESS ACT CONTAIN PROVISIONS FOCUSED ON EXCLUSION CLAUSES?

The *Second Report on Exemption Clauses* contains a good, detailed statement of the case for reform in this area.

It is clear that exemption clauses are much used both in dealings with private individuals and in purely commercial transactions. We are in no doubt that in many cases they operate against the public interest and that the prevailing judicial attitude of suspicion, or indeed of hostility, to such clauses is well founded. All too often they are introduced in ways which result in the party affected by them remaining ignorant of their presence or import until it is too late. That party, even if he knows of the exemption clause, will often be unable to appreciate what he may lose by accepting it. In any case, he may not have sufficient bargaining strength to refuse to accept it. The result is that the risk of carelessness or of failure to achieve satisfactory standards of performance is thrown on the party who is not responsible for it or who is unable to guard against it. Moreover, by excluding liability for such carelessness or failure, the economic pressures to maintain high standards of performance are reduced.<sup>722</sup>

In summary, the case set out in this passage relies on the significant potential for abuse of exclusion clauses. This potential can appear in a number of ways. It can be the product of abuse of bargaining power,<sup>723</sup> shoddy performance of the agree-

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fundamental breach, unconscionability, and unfairness); *Zhu v. Merrill Lynch HSBC*, 2002 BCPC 535, [2002] B.C.J. No. 2883 (QL) (no meeting of the minds between parties to contract on exclusion clause in online trading facility agreement rendering clause unenforceable); *AT&T Capital Canada Inc. v. Globe Printers Ltd.*, 2001 BCSC 1215, [2001] B.C.J. No. 1708 (QL) (application of doctrine of fundamental breach rendering exclusion clause in equipment lease unenforceable).

720. *Supra* note 164. This act was recently given extensive consideration in Law Commission of England and Wales & Scottish Law Commission, *Report on Unfair Terms in Contracts* (Law Com. no. 292; Scot. Law Com. no. 199) (London: HMSO, 2005).

721. See Law Commission of England and Wales & Scottish Law Commission, *Exemption Clauses: Second Report* (Law Com. no. 69; Scot. Law Com. no. 39) (London: HMSO, 1975) [*Second Report on Exemption Clauses*].

722. *Ibid.* at 4.

723. See, e.g., *Prairie Petroleum Products Ltd. v. Husky Oil Ltd.*, 2006 MBQB 92, [2006] 11 W.W.R. 606 at paras. 105–06, Duval J. (“In the case at bar, the exclusion of liability clauses benefit one party, the large and commercially-sophisticated company which prepared the agreement, i.e., Mohawk (and its successor, Husky). Neither Prairie nor Selkirk was in an equal bargaining position with

ment,<sup>724</sup> or unfair surprise.<sup>725</sup> The challenges for reform in this area involve crafting legislative provisions that apply over this range of areas and that clearly draw a line between exclusion clauses that operate fairly and those that operate unfairly.<sup>726</sup>

In addition to this general case for reform, an argument may be added that draws on the special qualities of Canadian jurisprudence. This country's highest court has ruled repeatedly on the issue of how to control unfair exclusion clauses. It could be argued that each ruling has made the law more complex. Although it is difficult to predict how its latest ruling in the *Tercon Contractors* case<sup>727</sup> will be received in the lower courts, earlier attempts to resolve this issue have resulted in confusion and uncertainty. Legislation could assist in clarifying the law.

The arguments against reform in this area are somewhat more diffuse. The classic argument made against exclusion clauses emphasizes freedom of contract. According to this argument, the freedom of the contracting parties is paramount, and legislation relating to exclusion clauses runs too great a risk to interfere with that freedom. There is also a danger that the legislation could create uncertainty, which may inhibit contracting parties and cause damage in the marketplace. The better approach, in this view, is to leave contracting parties to their own devices, encouraging them to take steps to protect themselves.

While these concerns were definitely in the background of the committee's deliberations, two other considerations had a more immediate affect on the committee's decision.

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Mohawk... Enforcing the exclusion clauses, which benefit only the large, commercially-sophisticated company, a company which has, with due consideration, breached a fundamental term of the Supply Agreement would lead to an unfair and unreasonable result in the circumstances of this case.", *rev'd (sub nom. Selkirk Petroleum Products Ltd. v. Husky Oil Ltd.)*, 2008 MBCA 87, 295 D.L.R. (4th) 146.

724. See, e.g., *Plas-Tex Canada*, *supra* note 126 at paras. 52–55, Picard J.A. (for the court).

725. See, e.g., *Tilden Rent-A-Car Co. v. Clendenning* (1978), 18 O.R. (2d) 601, 83 D.L.R. (3d) 400 at 408–09 (C.A.), Dubin J.A. (Zuber J.A. concurring) ("In modern commercial practice, many standard form printed documents are signed without being read or understood. In many cases the parties seeking to rely on the terms of the contract know or ought to know that the signature of a party to the contract does not represent the true intention of the signer, and that the party signing is unaware of the stringent and onerous provisions which the standard form contains. Under such circumstances, I am of the opinion that the party seeking to rely on such terms should not be able to do so in the absence of first having taken reasonable measures to draw such terms to the attention of the other party. . . .").

726. See *Second Report on Exemption Clauses*, *supra* note 721 at 4.

727. *Supra* note 124.

The first consideration involves the fact that there is a recent Supreme Court of Canada decision on the issue. One of the main arguments in favour of considering legislation for unconscionability, duress, and good faith is that the Supreme Court of Canada has shown considerable reluctance in addressing those concepts, even in the face of conflicting decisions from provincial courts of appeal. The court clearly does not have this reluctance when it comes to dealing with exclusion clauses, as it has repeatedly addressed this issue over the course of the past 35 years. Its most recent decision was issued only a few months ago. There are two distinct ways to approach the *Tercon Contractors* case<sup>728</sup> in this context. First, it could be viewed as resolving all the outstanding issues relating to the control of exclusion clauses and thereby setting Canadian law on the right track and rendering legislation unnecessary. Second, and more cautiously, one could argue that it is premature to judge the effect of this case on the law and legislation should be held in abeyance until it is possible to get a better sense of how the law is going to develop in the courts. In the committee's view, this cautious approach has some force.

A second consideration is to note that the focus of this project has been on general concepts that apply across a range of contracts and contract terms, rather than on detailed regulation of specific types of contract terms. It could be argued that the committee's general proposals represent a complete and a better response to the problems posed by exclusion clauses than a response that is narrowly focused on exclusion clauses. There is already something of an acknowledgement of proceeding in a general manner in the Supreme Court of Canada's jurisprudence, which has since the *Hunter Engineering* case<sup>729</sup> recognized a role for unconscionability in controlling abuses of exclusion clauses. The court has also implicitly recognized that unconscionability alone cannot address all problems in this area. Some concept is needed that allows the court to review abuses that do not appear at the time of formation of the contract. Some commentators have argued that an implied duty of good faith performance is the best tool for this job.<sup>730</sup> Interestingly, the majority judgment in *Tercon Contractors*<sup>731</sup> is something of an illustration of one way in

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728. *Ibid.*

729. *Supra* note 669.

730. See Devlin, *supra* note 700 at 6 (arguing "that fundamental breach serves as an awkward and inchoate grasping for a larger (and admittedly controversial) underlying principle of contract law—the principle of good faith performance"), 30–38; Belobala, *supra* note 359 at 83–87. See also Grover, *supra* note 471 at 100–06; Clark, *supra* note 370 at 440–44 (both articles linking good faith and the judicial control of exclusion clauses in the course of arguing against the adoption of a duty of good faith performance).

731. *Supra* note 124.

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which the duty of good faith could work to control unfair exclusion clauses. Writing for the majority, Cromwell J. noted the trial judge's finding "that there was an implied obligation of good faith in the contract . . ."732 and returned to this point in applying the first (interpretive) limb of the Binnie J.'s test, concluding that "the words of this exclusion clause . . . are not effective to limit liability for breach of the Province's implied duty of fairness to bidders."733

This position does carry with it the inherent uncertainty over how future courts will choose to apply a general principle to specific cases. For example, the existence of a general duty of good faith performance in American law has not prevented some American courts from formulating specific rules applicable to exclusion clauses.<sup>734</sup> And, of course, the Supreme Court of Canada in *Tercon Contractors* did not find a role for good faith in its analytical framework applying to exclusion clauses, settling instead on public policy as one of its evaluative criteria.

In the committee's view, these two considerations militate against proposing any specific changes to the law of contracts to deal with exclusion clauses.

The committee tentatively recommends that:

*44. The Contract Fairness Act should not contain provisions focussed on exclusion clauses.*

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732. *Ibid.* at para. 58.

733. *Ibid.* at para. 63.

734. See *Tunkl v. Regents of University of California*, 383 P. 2d 441 (Cal. 1963). See also *Farnsworth on Contracts*, *supra* note 24, vol. 2 at § 5.2 (*Tunkl* court emphasizing the following six factors in reviewing exclusion clause: (1) whether contracting party relying on exclusion clause is of a type generally thought suitable for public regulation; (2) whether service offered is of great importance or of practical necessity to public; (3) whether contracting party relying on exclusion clause holds itself out as generally being willing to perform this service for public; (4) whether there is a disparity of bargaining strength; (5) whether standard-form contract of adhesion gives other contracting party option to obtain protection limited by exclusion clause by paying additional fee; (6) whether contracting party's person or property is placed under other party's control and is at risk due to other party's carelessness).

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## CHAPTER X. MISCELLANEOUS ISSUES

### A. Relation of the Contract Fairness Act to other Enactments

#### 1. EXAMPLES OF OTHER ENACTMENTS THAT ADDRESS CONTRACTUAL UNFAIRNESS

There are a number of existing statutes that address aspects of the concepts examined by the committee in this consultation paper. The most obvious examples that leap to mind are the provisions of the *Business Practices and Consumer Protection Act*<sup>735</sup> relating to deceptive acts or practices<sup>736</sup> and unconscionable acts or practices.<sup>737</sup> These provisions overlap respectively with misrepresentation and unconscionability, duress, and undue influence. There are other examples of legislation that has a bearing on one aspect or another of contractual unfairness. The *Family Relations Act*<sup>738</sup> contains a provision granting the courts the general jurisdiction to review marriage agreements for their fairness in dividing family property.<sup>739</sup> In a related vein, the *Legal Profession Act*<sup>740</sup> authorizes a registrar of the British Columbia Supreme Court to examine an agreement between a lawyer and a client for its fairness and reasonableness.<sup>741</sup>

These provisions are relatively general and open-textured in their approach, so they bear some similarity to the tentative recommendations made by the committee. Other statutory provisions are much more detailed and regulatory in nature. For instance, the *Securities Act*<sup>742</sup> contains extensive provisions on disclosure of information<sup>743</sup> and a provision on liability for misrepresentation.<sup>744</sup> These provisions are complex and more far-reaching than anything either the law of contracts or the committee's tentative recommendations would provide.

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735. *Supra* note 117. *See*, below, Appendix A at 199–206 (for excerpts from this legislation).

736. *Ibid.*, ss. 4–6.

737. *Ibid.*, ss. 7–10.

738. R.S.B.C. 1996, c. 128.

739. *Ibid.*, s. 65.

740. S.B.C. 1998, c. 9.

741. *Ibid.*, s. 68.

742. R.S.B.C. 1996, c. 418.

743. *Ibid.*, ss. 61–72 (prospectus), 85–91 (continuous disclosure).

744. *Ibid.*, s. 132.1.

### 2. LEGAL RULES ON CONFLICTS BETWEEN ENACTMENTS

The question of how one statute relates to the other legislation on the books in a jurisdiction is a perennial one. “Normally, conflicts between statutes,” explains a leading textbook, “are resolved by recognizing a hierarchy between them, that is a primacy or paramountcy of one text over another.”<sup>745</sup> The courts have developed a number of interpretive rules that implicitly establish this hierarchy in cases of conflicts between statutes.<sup>746</sup> In this project, the committee has the opportunity to design its own draft legislation and to insert its own explicit rule respecting conflicts with other legislation. Formulating an explicit rule rather than relying on the body of implicit rules represents the better course because it allows the committee to avoid some of the complexity and ambiguity that may result in the application of the court-imposed implicit rules.<sup>747</sup>

### 3. OPTIONS FOR REFORM

There are, essentially, two versions of the conflicts rules that provide options for resolving this issue. The first option is to subordinate the *Contract Fairness Act* to other statutes. This approach is the equivalent of the implicit rule that a court applies when there is no explicit indication in the legislation of how conflicts are to be resolved and the court is confronted with a conflict between a general and a specific legislative provision.<sup>748</sup> The rationale for this option is that the provisions tentatively recommended for the *Contract Fairness Act* have tended to be general in nature, applying to all sorts of contracts. The existing legislative provisions, in contrast, are focussed on specific types of contracts or on specialized issues. They are often tailored to specific situations that only arise in certain transactions or crafted to fit within complex regulatory structures. Applying the *Contract Fairness Act*'s general rules in these areas runs the risk of disrupting the careful arrangements that already apply to them.

The other option is to provide that the *Contract Fairness Act* should prevail in cases of conflicts with other legislation. Such a rule would be the reverse of the rule that typically applies in these circumstances, but it would not be unprecedented. For example, there is a stream of cases that hold that the courts should give precedence to

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745. Pierre-André Côté, *The Interpretation of Legislation in Canada*, 3d ed. (Toronto: Carswell, 2000) at 355–56.

746. See *ibid.* at 358–62.

747. See *ibid.* at 358 (“[T]he situation is much more complex when it is the legislature’s implicit intention that must be discerned.”).

748. See *ibid.* at 358–62.

the general provisions set out in human-rights legislation over other specific legislative provisions, unless the legislature has expressly and clearly provided for the opposite result.<sup>749</sup> Although it would be extending this principle somewhat, it could be argued that, as a matter of policy, the *Contract Fairness Act* should be legislatively granted the same treatment.<sup>750</sup> The gist of this argument would be that the *Contract Fairness Act* deals with questions of basic fairness, which should be seen as forming part of the foundation of contract law. Since the *Contract Fairness Act* sets out the baseline standards of contractual fairness, these standards should apply across the board, and displace any particular standards that have been formulated for specific contracts, to the extent of any conflict between the *Contract Fairness Act* and the specific legislation at issue.

#### 4. TENTATIVE RECOMMENDATION

The committee gave extensive consideration to this issue. Many of the tentative recommendations in this consultation paper are remedial in character. It did not seem that they would likely fall into conflict with more specific legislation. Indeed, the *Contract Fairness Act* could be seen as supplementing these statutes focussed on specific issues, in the sense that they often draw on the general law of contracts as a baseline incorporated into their provisions. The committee examined various formulas for articulating a compromise position, between the two options for reform discussed above. One approach considered was to have the *Contract Fairness Act* state that it operated “without prejudice to remedies provided under any other en-

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749. See *Insurance Corporation of British Columbia v. Heerspink*, [1982] 2 S.C.R. 145 at 157–58, 137 D.L.R. (3d) 219, Lamer J. (Estey and McIntyre JJ. concurring) (“When the subject matter of a law is said to be the comprehensive statement of the ‘human rights’ of the people living in that jurisdiction, then there is no doubt in my mind that the people of that jurisdiction have through their legislature clearly indicated that they consider that law, and the values it endeavours to buttress and protect, are, save their constitutional laws, more important than all others. Therefore, short of that legislature speaking to the contrary in express and unequivocal language in the Code or in some other enactment, it is intended that the Code supersede all other laws when conflict arises. As a result, the legal proposition *generalia specialibus non derogant* cannot be applied to such a code. Indeed the *Human Rights Code*, when in conflict with ‘particular and specific legislation,’ is not to be treated as another ordinary law of general application.”); *Tranchemontagne v. Ontario (Director, Disability Support Program)*, 2006 SCC 14, [2006] 1 S.C.R. 513 at para. 33, Bastarache J. (McLachlin C.J. and Binnie and Fish JJ. concurring). See also Ruth Sullivan, *Sullivan on the Construction of Statutes*, 5th ed. (Markham, ON: LexisNexis Canada, 2008) at 340–41 (discussing the leading cases).

750. See, e.g., *Freedom of Information and Protection of Privacy Act*, R.S.B.C. 1996, c. 165, s. 79 (“If a provision of this Act is inconsistent or in conflict with a provision of another Act, the provision of this Act prevails unless the other Act expressly provides that it, or a provision of it, applies despite this Act.”).

actment.” Another approach considered was based on the foreign-divorce provisions of the *Divorce Act*.<sup>751</sup>

In the end, the committee determined that it could not predict how these approaches would interact with specific legislation already in force. It decided that the cautious approach would be to apply the traditional rule for dealing with conflicts between statutes.

The committee tentatively recommends that:

*45. The Contract Fairness Act should provide that in the event of a conflict between a provision of the draft legislation and a provision of any other act or a regulation the provision of that other act or regulation prevails to the extent of the conflict.*

## **B. Transitional Rules**

### **1. REASONS FOR INCLUDING A SECTION ON TRANSITIONAL RULES**

Another perennial issue for consideration in crafting new statutes is whether the statute should apply to transactions that were entered into before the statute came into force. Often, this issue is of a highly technical nature, so it is typically not included in public consultations for law-reform projects, as its presence may detract from the focus on broader public-policy questions. But it is worthwhile to consider transitional rules as part of this project for a number of reasons. Contracting parties can be highly sensitive to the legal landscape when they come to craft their legal arrangements. Further, readers of a consultation paper involving contract-law issues likely would legitimately expect the committee to express a view on whether their recommendations should or should not apply to contracts entered into before those recommendations acquire the force of law.

### **2. LEGAL RULES RELATING TO TRANSITION AND OPTIONS FOR REFORM**

The basic transitional rule is that “a statute applies to facts which arise from the moment it comes into force until its repeal.”<sup>752</sup> This basic rule implicitly applies to statutes that are silent on the issue of the transition from an older law to a newer one.<sup>753</sup> It is more typical for legislation to contain express transitional rules, but

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751. R.S.C. 1985 (2d Supp.), c. 3, s. 22 (3) (“Nothing in this section abrogates or derogates from any other rule of law respecting the recognition of divorces granted otherwise than under this Act.”).

752. Côté, *supra* note 745 at 124.

753. See *Interpretation Act*, *supra* note 178, s. 3.



these express rules tend, more often than not, to conform to the basic rule. The rationale for this approach is that it renders the law more certain and predictable.<sup>754</sup> It also complies with common-sense notions of fairness. It is obviously difficult for people to ensure that their transactions conform to the law if the law may change at a later date and affect the earlier transaction.<sup>755</sup>

The basic rule, of course, is not the only transitional rule that may be employed. A statute may affect transactions or legal rights existing before the statute comes into force, so long as it contains a provision that expressly provides for this result. There can be any number of reasons for taking this position. For example, an earlier BCLI report on the law of succession<sup>756</sup> provided in its draft legislation that its main provisions would be applicable to the wills of testators who die after the legislation comes into force, rather than wills made after the legislation comes into force.<sup>757</sup> (This is functionally the same as contract-law legislation that applies to contracts entered into before the legislation comes into force, in that it applies the provisions of the legislation to a document that may have been created before the legislation became law.) The rationale for this approach was that the draft legislation was in the main “remedial or curative” and that “as a will only comes effective on death, and a testator could live for a long time after making a will, two bodies of wills legislation would otherwise have to be applied for many decades into the future.”<sup>758</sup> Similar considerations could be used to support giving the committee’s draft legislation a retroactive effect. The draft legislation does provide for a considerable expansion of a litigant’s remedial options, but it also has other substantive elements that would alter some existing contract rules. A similar dynamic could play out in respect of two sets of rules applying to different types of contracts. Some contracts are relatively short in duration; others contemplate terms of years or decades.

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754. See Côté, *supra* note 745 at 125 (“Retroactive operation must be the exception rather than the rule. The need for predictability in the legal system is incompatible with the application of provisions to events that precede their enactment.”).

755. See Sullivan, *supra* note 749 at 667 (“At best retroactive law makes it impossible for people to know whether they are complying with the law; at worst it imposes negative consequences on them for attempting to do so.”).

756. See *Wills, Estates and Succession: A Modern Legal Framework* (BCLI rep. no. 45) (Vancouver: The Institute, 2006).

757. *Ibid.* at 301–02.

758. *Ibid.* at 300.

3. TENTATIVE RECOMMENDATION

The committee concluded that the basic transitional rule is the best choice for the *Contract Fairness Act*.

The committee tentatively recommends that:

*46. The Contract Fairness Act should apply only to contracts entered into after it comes into force.*

## CHAPTER XI. CONCLUSION

This consultation paper has set out the committee's tentative recommendations for reform of the law of contracts to address issues of unfairness. The tentative recommendations propose changes to the contract-law concepts of unconscionability, duress, undue influence, good faith, and misrepresentation. Not all of the changes proposed are sweeping in scope. Many of them amount to refinements of the law, or to attempts to clarify and consolidate the law. In addition, the committee has recorded its views on areas where it is not recommending any changes, such as, for example, whether specific legislative provisions are needed for exclusion clauses.

The committee encourages public comment on its proposals. This comment will be valuable as the committee moves ahead on the next phase of this project, which involves formulating its final recommendations and preparing a draft of the *Contract Fairness Act*.



## APPENDIX A

### *Selected Legislation*

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#### **BRITISH COLUMBIA**

#### **Business Practices and Consumer Protection Act, S.B.C. 2004, c. 2**

##### **Part 1 — Definitions and Application**

###### **Definitions**

**1** (1) In this Act:

...

“**consumer**” means an individual, whether in British Columbia or not, who participates in a consumer transaction, but does not include a guarantor;

...

“**consumer transaction**” means

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- (a) a supply of goods or services or real property by a supplier to a consumer for purposes that are primarily personal, family or household, or
- (b) a solicitation, offer, advertisement or promotion by a supplier with respect to a transaction referred to in paragraph (a),

and, except in Parts 4 and 5, includes a solicitation of a consumer by a supplier for a contribution of money or other property by the consumer;

...

**“supplier”** means a person, whether in British Columbia or not, who in the course of business participates in a consumer transaction by

- (a) supplying goods or services or real property to a consumer, or
- (b) soliciting, offering, advertising or promoting with respect to a transaction referred to in paragraph (a) of the definition of “consumer transaction”,

whether or not privity of contract exists between that person and the consumer, and includes the successor to, and assignee of, any rights or obligations of that person and, except in Parts 3 to 5 [*Rights of Assignees and Guarantors Respecting Consumer Credit; Consumer Contracts; Disclosure of the Cost of Consumer Credit*], includes a person who solicits a consumer for a contribution of money or other property by the consumer;

**“supply”** includes, in respect of the supply of goods or services or real property to a consumer, a sale, lease, assignment, award by chance or other disposition.

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### Part 2 — Unfair Practices

#### Division 1 — Deceptive Acts or Practices

##### Deceptive acts or practices

- 4 (1) In this Division:

**“deceptive act or practice”** means, in relation to a consumer transaction,

- (a) an oral, written, visual, descriptive or other representation by a supplier, or
- (b) any conduct by a supplier

that has the capability, tendency or effect of deceiving or misleading a consumer or guarantor;

**“representation”** includes any term or form of a contract, notice or other document used or relied on by a supplier in connection with a consumer transaction.

- (2) A deceptive act or practice by a supplier may occur before, during or after the consumer transaction.
- (3) Without limiting subsection (1), one or more of the following constitutes a deceptive act or practice:
  - (a) a representation by a supplier that goods or services

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- (i) have sponsorship, approval, performance characteristics, accessories, ingredients, quantities, components, uses or benefits that they do not have,
  - (ii) are of a particular standard, quality, grade, style or model if they are not,
  - (iii) have a particular prior history or usage that they do not have, including a representation that they are new if they are not,
  - (iv) are available for a reason that differs from the fact,
  - (v) are available if they are not available as represented,
  - (vi) were available in accordance with a previous representation if they were not,
  - (vii) are available in quantities greater than is the fact, or
  - (viii) will be supplied within a stated period if the supplier knows or ought to know that they will not;
- (b) a representation by a supplier
- (i) that the supplier has a sponsorship, approval, status, affiliation or connection that the supplier does not have,
  - (ii) that a service, part, replacement or repair is needed if it is not,
  - (iii) that the purpose or intent of a solicitation of, or a communication with, a consumer by a supplier is for a purpose or intent that differs from the fact,
  - (iv) that a consumer transaction involves or does not involve rights, remedies or obligations that differs from the fact,
  - (v) about the authority of a representative, employee or agent to negotiate the final terms of a consumer transaction if the representation differs from the fact,
  - (vi) that uses exaggeration, innuendo or ambiguity about a material fact or that fails to state a material fact, if the effect is misleading,
  - (vii) that a consumer will obtain a benefit for helping the supplier to find other potential customers if it is unlikely that the consumer will obtain the benefit,
  - (viii) that appears in an objective form such as an editorial, documentary or scientific report if the representation is primarily made to sell goods or services, unless the representation states that it is an advertisement or promotion, or
  - (ix) to arrange for the consumer an extension of credit for a fee, unless the fee is deducted from the advance, as defined in section 57 *[definitions]*;
- (c) a representation by a supplier about the total price of goods or services if
- (i) a person could reasonably conclude that a price benefit or advantage exists but it does not,

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- (ii) the price of a unit or instalment is given in the representation, and the total price of the goods or services is not given at least the same prominence, or
  - (iii) the supplier's estimate of the price is materially less than the price subsequently determined or demanded by the supplier unless the consumer has expressly consented to the higher price before the goods or services are supplied;
- (d) a prescribed act or practice.

### Prohibition and burden of proof

- 5
- (1) A supplier must not commit or engage in a deceptive act or practice in respect of a consumer transaction.
  - (2) If it is alleged that a supplier committed or engaged in a deceptive act or practice, the burden of proof that the deceptive act or practice was not committed or engaged in is on the supplier.

### Advertising

- 6
- (1) In this section, “**advertiser**” means a supplier who publishes advertisements.
  - (2) An advertiser who, on behalf of another supplier, publishes a deceptive or misleading advertisement is not liable under section 171 [*damages recoverable*], 172 [*court actions respecting consumer transactions*] or 189 [*offences*] if the advertiser proves that the advertiser did not know and had no reason to suspect that its publication would contravene section 5.
  - (3) An advertiser, for each advertisement accepted, must maintain a record of the name and address of the supplier who provides the advertisement.

## Division 2 — Unconscionable Acts or Practices

### Application of this Division

- 7 Nothing in this Division limits, restricts or derogates from a court’s power or jurisdiction.

### Unconscionable acts or practices

- 8
- (1) An unconscionable act or practice by a supplier may occur before, during or after the consumer transaction.
  - (2) In determining whether an act or practice is unconscionable, a court must consider all of the surrounding circumstances of which the supplier knew or ought to have known.
  - (3) Without limiting subsection (2), the circumstances that the court must consider include the following:
    - (a) that the supplier subjected the consumer or guarantor to undue pressure to enter into the consumer transaction;
    - (b) that the supplier took advantage of the consumer or guarantor's inability or incapacity to reasonably protect his or her own interest because of the consumer or guarantor's physical or mental infirmity, ignorance, illiteracy, age or



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inability to understand the character, nature or language of the consumer transaction, or any other matter related to the transaction;

- (c) that, at the time the consumer transaction was entered into, the total price grossly exceeded the total price at which similar subjects of similar consumer transactions were readily obtainable by similar consumers;
- (d) that, at the time the consumer transaction was entered into, there was no reasonable probability of full payment of the total price by the consumer;
- (e) that the terms or conditions on, or subject to, which the consumer entered into the consumer transaction were so harsh or adverse to the consumer as to be inequitable;
- (f) a prescribed circumstance.

### Prohibition and burden of proof

- 9 (1) A supplier must not commit or engage in an unconscionable act or practice in respect of a consumer transaction.
- (2) If it is alleged that a supplier committed or engaged in an unconscionable act or practice, the burden of proof that the unconscionable act or practice was not committed or engaged in is on the supplier.

### Remedy for an unconscionable act or practice

- 10 (1) Subject to subsection (2), if an unconscionable act or practice occurred in respect of a consumer transaction, that consumer transaction is not binding on the consumer or guarantor.
- (2) If a court determines that an unconscionable act or practice occurred in respect of a consumer transaction that is a mortgage loan, as defined in section 57 [definitions], the court may do one or more of the following:
  - (a) reopen the transaction and take an account between the supplier and the consumer or guarantor;
  - (b) despite any statement or settlement of account or any agreement purporting to close previous dealings and create a new obligation, reopen any account already taken and relieve the consumer from any obligation to pay the total cost of credit at a rate in excess of the prevailing prime rate;
  - (c) order the supplier to repay any excess that has been paid or allowed by the consumer or guarantor;
  - (d) set aside all or part of, or alter, any agreement made or security given in respect of the transaction and, if the supplier has parted with the security, order the supplier, to indemnify the consumer;
  - (e) suspend the rights and obligations of the parties to the transaction.

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### PART 10 — INSPECTIONS AND ENFORCEMENT

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#### Division 5 — Court Proceedings

##### Damages recoverable

- 171** (1) Subject to subsection (2), if a person, other than a person referred to in paragraphs (a) to (e), has suffered damage or loss due to a contravention of this Act or the regulations, the person who suffered damage or loss may bring an action against a
- (a) supplier,
  - (b) reporting agency, as defined in section 106 *[definitions]*,
  - (c) collector, as defined in section 113 *[definitions]*,
  - (d) bailiff, collection agent or debt pooler, as defined in section 125 *[definitions]*,  
or
  - (e) a person required to hold a licence under Part 9 *[Licences]*
- who engaged in or acquiesced in the contravention that caused the damage or loss.
- (2) A person must not bring an action under this section if an application has been made, on the person's behalf, to the court in respect of the same defendant and transaction under section 192 *[compensation to consumers]*.
- (3) The Provincial Court has jurisdiction for the purposes of this section, even though a contravention of this Act or the regulations may also constitute a libel or slander.

##### Court actions respecting consumer transactions

- 172** (1) The director or a person other than a supplier, whether or not the person bringing the action has a special interest or any interest under this Act or is affected by a consumer transaction that gives rise to the action, may bring an action in Supreme Court for one or both of the following:
- (a) a declaration that an act or practice engaged in or about to be engaged in by a supplier in respect of a consumer transaction contravenes this Act or the regulations;
  - (b) an interim or permanent injunction restraining a supplier from contravening this Act or the regulations.
- (2) If the director brings an action under subsection (1), the director may sue on the director's own behalf and, at the director's option, on behalf of consumers generally or a designated class of consumers.
- (3) If the court grants relief under subsection (1), the court may order one or more of the following:
- (a) that the supplier restore to any person any money or other property or thing, in which the person has an interest, that may have been acquired because of a contravention of this Act or the regulations;

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- (b) if the action is brought by the director, that the supplier pay to the director the actual costs, or a reasonable proportion of the costs, of the inspection of the supplier conducted under this Act;
  - (c) that the supplier advertise to the public in a manner that will assure prompt and reasonable communication to consumers, and on terms or conditions that the court considers reasonable, particulars of any judgment, declaration, order or injunction granted against the supplier under this section.
- (4) The director may apply, without notice to anyone, for an interim injunction under subsection (1) (b).
  - (5) In an application for an interim injunction under subsection (1) (b),
    - (a) the court must give greater weight and the balance of convenience to the protection of consumers than to the carrying on of the business of a supplier,
    - (b) the applicant is not required to post a bond or give an undertaking as to damages, and
    - (c) the applicant is not required to establish that irreparable harm will be done to the applicant, consumers generally or any class of consumers if the interim injunction is not granted.
  - (6) If the director applies, without notice to anyone, for an interim injunction under subsection (1) (b), the court must grant the interim injunction, on the terms and conditions it considers just, if the court is satisfied that there are reasonable grounds for believing there is an immediate threat to the interests of consumers dealing with the supplier because of an alleged contravention of this Act or the regulations in respect of a consumer transaction.
  - (7) In an action brought under subsection (1), or an appeal from it, the plaintiff is not required to provide security for costs.

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### PART 13 — OFFENCES AND PENALTIES

#### Offences

- 189 (1) ....
- (2) A person who contravenes subsection (5) or any of the following sections commits an offence:
  - (a) section 5 (1) [*deceptive act or practice*];
  - (b) section 6 (3) [*record of advertisement*];
  - (c) section 9 (1) [*unconscionable act or practice*];

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#### Compensation to consumer

- 192 (1) In addition to a penalty imposed under section 190 [*penalty*], a court that convicts a defendant of an offence under this Act may order, at the time the penalty is imposed, the defendant to pay to an aggrieved consumer or guarantor, as compensation for pecuniary loss suffered by the aggrieved consumer or guarantor as a result of the

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commission of the offence, an amount not greater than the monetary jurisdiction specified in the *Small Claims Act*.

- (2) An aggrieved consumer or guarantor, or the Crown prosecutor at the request and on behalf of the aggrieved consumer or guarantor, may apply for an order under subsection (1), unless the aggrieved consumer or guarantor has commenced an action against the defendant under section 171 [*damages recoverable*] in respect of the same transaction.
- (3) If the defendant does not comply with an order made under subsection (1)
  - (a) within the time ordered by the court, or
  - (b) within 30 days of the order being made, if no time is specified in the order,the aggrieved consumer or guarantor may enter judgment in the Provincial Court by filing the order with the registrar of the Provincial Court hearing matters under the *Small Claims Act* in or near the place where the conviction was entered.
- (4) A judgment entered in the Provincial Court under subsection (3) is enforceable against the defendant in the same manner as if it were a judgment rendered in that court in civil proceedings.

## CANADA

### Competition Act, R.S.C. 1985, c. C-34

#### Recovery of damages

- 36 (1) Any person who has suffered loss or damage as a result of
- (a) conduct that is contrary to any provision of Part VI, or
  - (b) the failure of any person to comply with an order of the Tribunal or another court under this Act,

may, in any court of competent jurisdiction, sue for and recover from the person who engaged in the conduct or failed to comply with the order an amount equal to the loss or damage proved to have been suffered by him, together with any additional amount that the court may allow not exceeding the full cost to him of any investigation in connection with the matter and of proceedings under this section.

...

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#### False or misleading representations

- 52 (1) No person shall, for the purpose of promoting, directly or indirectly, the supply or use of a product or for the purpose of promoting, directly or indirectly, any business interest, by any means whatever, knowingly or recklessly make a representation to the public that is false or misleading in a material respect.

#### Proof of certain matters not required

- (1.1) For greater certainty, in establishing that subsection (1) was contravened, it is not necessary to prove that

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- (a) any person was deceived or misled;
- (b) any member of the public to whom the representation was made was within Canada; or
- (c) the representation was made in a place to which the public had access.

### **Representations accompanying products**

- (2) For the purposes of this section, a representation that is
  - (a) expressed on an article offered or displayed for sale or its wrapper or container,
  - (b) expressed on anything attached to, inserted in or accompanying an article offered or displayed for sale, its wrapper or container, or anything on which the article is mounted for display or sale,
  - (c) expressed on an in-store or other point-of-purchase display,
  - (d) made in the course of in-store, door-to-door or telephone selling to a person as ultimate user, or
  - (e) contained in or on anything that is sold, sent, delivered, transmitted or made available in any other manner to a member of the public,

is deemed to be made to the public by and only by the person who causes the representation to be so expressed, made or contained, subject to subsection (2.1).

...

### **Deemed representation to public**

- (3) Subject to subsection (2), a person who, for the purpose of promoting, directly or indirectly, the supply or use of a product or any business interest, supplies to a wholesaler, retailer or other distributor of a product any material or thing that contains a representation of a nature referred to in subsection (1) is deemed to have made that representation to the public.

### **General impression to be considered**

- (4) In a prosecution for a contravention of this section, the general impression conveyed by a representation as well as its literal meaning shall be taken into account in determining whether or not the representation is false or misleading in a material respect.

### **Offence and punishment**

- (5) Any person who contravenes subsection (1) is guilty of an offence and liable
  - (a) on conviction on indictment, to a fine in the discretion of the court or to imprisonment for a term not exceeding 14 years, or to both; or
  - (b) on summary conviction, to a fine not exceeding \$200,000 or to imprisonment for a term not exceeding one year, or to both.

...

## UNITED STATES

### Uniform Commercial Code

#### § 1-201. General Definitions.

(a) Unless the context otherwise requires, words or phrases defined in this section, or in the additional definitions contained in other articles of [the Uniform Commercial Code] that apply to particular articles or parts thereof, have the meanings stated.

(b) Subject to definitions contained in other articles of [the Uniform Commercial Code] that apply to particular articles or parts thereof: . . .

(20) “**Good faith**,” except as otherwise provided in Article 5, means honesty in fact and the observance of reasonable commercial standards of fair dealing.

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#### § 1-304. Obligation of Good Faith.

Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement.

\*\*\*

#### § 2-302. Unconscionable Contract or Term.

(1) If the court as a matter of law finds the contract or any term of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable term, or it may so limit the application of any unconscionable term as to avoid any unconscionable result.

(2) If it is claimed or appears to the court that the contract or any term thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect to aid the court in making the determination.

## AUSTRALIA

### Trade Practices Act 1974 (Cth.)

#### Part IVA—Unconscionable conduct

##### 51AAB Part does not apply to financial services

- (1) Section 51AA does not apply to conduct engaged in in relation to financial services.
- (2) Section 51AB does not apply to the supply, or possible supply, of services that are financial services.

##### 51AA Unconscionable conduct within the meaning of the unwritten law of the States and Territories

- (1) A corporation must not, in trade or commerce, engage in conduct that is unconscionable within the meaning of the unwritten law, from time to time, of the States and Territories.
- (2) This section does not apply to conduct that is prohibited by section 51AB or 51AC.

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### 51AB Unconscionable conduct

- (1) A corporation shall not, in trade or commerce, in connection with the supply or possible supply of goods or services to a person, engage in conduct that is, in all the circumstances, unconscionable.
- (2) Without in any way limiting the matters to which the court may have regard for the purpose of determining whether a corporation has contravened subsection (1) in connection with the supply or possible supply of goods or services to a person (in this subsection referred to as the *consumer*), the court may have regard to:
  - (a) the relative strengths of the bargaining positions of the corporation and the consumer;
  - (b) whether, as a result of conduct engaged in by the corporation, the consumer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the corporation;
  - (c) whether the consumer was able to understand any documents relating to the supply or possible supply of the goods or services;
  - (d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the consumer or a person acting on behalf of the consumer by the corporation or a person acting on behalf of the corporation in relation to the supply or possible supply of the goods or services; and
  - (e) the amount for which, and the circumstances under which, the consumer could have acquired identical or equivalent goods or services from a person other than the corporation.
- (3) A corporation shall not be taken for the purposes of this section to engage in unconscionable conduct in connection with the supply or possible supply of goods or services to a person by reason only that the corporation institutes legal proceedings in relation to that supply or possible supply or refers a dispute or claim in relation to that supply or possible supply to arbitration.
- (4) For the purpose of determining whether a corporation has contravened subsection (1) in connection with the supply or possible supply of goods or services to a person:
  - (a) the court shall not have regard to any circumstances that were not reasonably foreseeable at the time of the alleged contravention; and
  - (b) the court may have regard to conduct engaged in, or circumstances existing, before the commencement of this section.
- (5) A reference in this section to goods or services is a reference to goods or services of a kind ordinarily acquired for personal, domestic or household use or consumption.
- (6) A reference in this section to the supply or possible supply of goods does not include a reference to the supply or possible supply of goods for the purpose of re-supply or for the purpose of using them up or transforming them in trade or commerce.
- (7) Section 51A applies for the purposes of this section in the same way as it applies for the purposes of Division 1 of Part V.

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### 51AC Unconscionable conduct in business transactions

- (1) A corporation must not, in trade or commerce, in connection with:
- (a) the supply or possible supply of goods or services to a person (other than a listed public company); or
  - (b) the acquisition or possible acquisition of goods or services from a person (other than a listed public company);
- engage in conduct that is, in all the circumstances, unconscionable.
- (2) A person must not, in trade or commerce, in connection with:
- (a) the supply or possible supply of goods or services to a corporation (other than a listed public company); or
  - (b) the acquisition or possible acquisition of goods or services from a corporation (other than a listed public company);
- engage in conduct that is, in all the circumstances, unconscionable.
- (3) Without in any way limiting the matters to which the court may have regard for the purpose of determining whether a corporation or a person (the **supplier**) has contravened subsection (1) or (2) in connection with the supply or possible supply of goods or services to a person or a corporation (the **business consumer**), the court may have regard to:
- (a) the relative strengths of the bargaining positions of the supplier and the business consumer; and
  - (b) whether, as a result of conduct engaged in by the supplier, the business consumer was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the supplier; and
  - (c) whether the business consumer was able to understand any documents relating to the supply or possible supply of the goods or services; and
  - (d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the business consumer or a person acting on behalf of the business consumer by the supplier or a person acting on behalf of the supplier in relation to the supply or possible supply of the goods or services; and
  - (e) the amount for which, and the circumstances under which, the business consumer could have acquired identical or equivalent goods or services from a person other than the supplier; and
  - (f) the extent to which the supplier's conduct towards the business consumer was consistent with the supplier's conduct in similar transactions between the supplier and other like business consumers; and
  - (g) the requirements of any applicable industry code; and
  - (h) the requirements of any other industry code, if the business consumer acted on the reasonable belief that the supplier would comply with that code; and
  - (i) the extent to which the supplier unreasonably failed to disclose to the business consumer:



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- (i) any intended conduct of the supplier that might affect the interests of the business consumer; and
  - (ii) any risks to the business consumer arising from the supplier's intended conduct (being risks that the supplier should have foreseen would not be apparent to the business consumer); and
  - (j) the extent to which the supplier was willing to negotiate the terms and conditions of any contract for supply of the goods or services with the business consumer; and
  - (ja) whether the supplier has a contractual right to vary unilaterally a term or condition of a contract between the supplier and the business consumer for the supply of the goods or services; and
  - (k) the extent to which the supplier and the business consumer acted in good faith.
- (4) Without in any way limiting the matters to which the court may have regard for the purpose of determining whether a corporation or a person (the **acquirer**) has contravened subsection (1) or (2) in connection with the acquisition or possible acquisition of goods or services from a person or corporation (the **small business supplier**), the court may have regard to:
- (a) the relative strengths of the bargaining positions of the acquirer and the small business supplier; and
  - (b) whether, as a result of conduct engaged in by the acquirer, the small business supplier was required to comply with conditions that were not reasonably necessary for the protection of the legitimate interests of the acquirer; and
  - (c) whether the small business supplier was able to understand any documents relating to the acquisition or possible acquisition of the goods or services; and
  - (d) whether any undue influence or pressure was exerted on, or any unfair tactics were used against, the small business supplier or a person acting on behalf of the small business supplier by the acquirer or a person acting on behalf of the acquirer in relation to the acquisition or possible acquisition of the goods or services; and
  - (e) the amount for which, and the circumstances in which, the small business supplier could have supplied identical or equivalent goods or services to a person other than the acquirer; and
  - (f) the extent to which the acquirer's conduct towards the small business supplier was consistent with the acquirer's conduct in similar transactions between the acquirer and other like small business suppliers; and
  - (g) the requirements of any applicable industry code; and
  - (h) the requirements of any other industry code, if the small business supplier acted on the reasonable belief that the acquirer would comply with that code; and
  - (i) the extent to which the acquirer unreasonably failed to disclose to the small business supplier:
    - (i) any intended conduct of the acquirer that might affect the interests of the small business supplier; and

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- (ii) any risks to the small business supplier arising from the acquirer's intended conduct (being risks that the acquirer should have foreseen would not be apparent to the small business supplier); and
  - (j) the extent to which the acquirer was willing to negotiate the terms and conditions of any contract for the acquisition of the goods and services with the small business supplier; and
  - (ja) whether the acquirer has a contractual right to vary unilaterally a term or condition of a contract between the acquirer and the small business supplier for the acquisition of the goods or services; and
  - (k) the extent to which the acquirer and the small business supplier acted in good faith.
- (5) A person is not to be taken for the purposes of this section to engage in unconscionable conduct in connection with:
  - (a) the supply or possible supply of goods or services to another person; or
  - (b) the acquisition or possible acquisition of goods or services from another person;by reason only that the first-mentioned person institutes legal proceedings in relation to that supply, possible supply, acquisition or possible acquisition or refers to arbitration a dispute or claim in relation to that supply, possible supply, acquisition or possible acquisition.
- (6) For the purpose of determining whether a corporation has contravened subsection (1) or whether a person has contravened subsection (2):
  - (a) the court must not have regard to any circumstances that were not reasonably foreseeable at the time of the alleged contravention; and
  - (b) the court may have regard to circumstances existing before the commencement of this section but not to conduct engaged in before that commencement.
- (7) A reference in this section to the supply or possible supply of goods or services is a reference to the supply or possible supply of goods or services to a person whose acquisition or possible acquisition of the goods or services is or would be for the purpose of trade or commerce.
- (8) A reference in this section to the acquisition or possible acquisition of goods or services is a reference to the acquisition or possible acquisition of goods or services by a person whose acquisition or possible acquisition of the goods or services is or would be for the purpose of trade or commerce.\*
- (12) Section 51A applies for the purposes of this section in the same way as it applies for the purposes of Division 1 of Part V.
- (13) Expressions used in this section that are defined for the purpose of Part IVB have the same meaning in this section as they do in Part IVB.
- (14) In this section, **listed public company** has the same meaning as it has in the *Income Tax Assessment Act 1997*.

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\* Subsections (9), (10), and (11) have been repealed.

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### 51ACAA Concurrent operation of State and Territory laws

It is the Parliament's intention that a law of a State or Territory should be able to operate concurrently with this Part unless the law is directly inconsistent with this Part.

## NEW SOUTH WALES

### Contracts Review Act 1980 (N.S.W.)

#### Part 1—Preliminary

\*\*\*

#### 4 Definitions

- (1) In this Act, except in so far as the context or subject-matter otherwise indicates or requires:

...

*unjust* includes unconscionable, harsh or oppressive, and *injustice* shall be construed in a corresponding manner.

...

\*\*\*

#### 6 Certain restrictions on grant of relief

- (1) The Crown, a public or local authority or a corporation may not be granted relief under this Act.
- (2) A person may not be granted relief under this Act in relation to a contract so far as the contract was entered into in the course of or for the purpose of a trade, business or profession carried on by the person or proposed to be carried on by the person, other than a farming undertaking (including, but not limited to, an agricultural, pastoral, horticultural, orcharding or viticultural undertaking) carried on by the person or proposed to be carried on by the person wholly or principally in New South Wales.

#### Part 2—Relief in respect of unjust contracts

#### 7 Principal relief

- (1) Where the Court finds a contract or a provision of a contract to have been unjust in the circumstances relating to the contract at the time it was made, the Court may, if it considers it just to do so, and for the purpose of avoiding as far as practicable an unjust consequence or result, do any one or more of the following:
- (a) it may decide to refuse to enforce any or all of the provisions of the contract,
  - (b) it may make an order declaring the contract void, in whole or in part,
  - (c) it may make an order varying, in whole or in part, any provision of the contract,
  - (d) it may, in relation to a land instrument, make an order for or with respect to requiring the execution of an instrument that:
    - (i) varies, or has the effect of varying, the provisions of the land instrument, or

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- (ii) terminates or otherwise affects, or has the effect of terminating or otherwise affecting, the operation or effect of the land instrument.
- (2) Where the Court makes an order under subsection (1) (b) or (c), the declaration or variation shall have effect as from the time when the contract was made or (as to the whole or any part or parts of the contract) from some other time or times as specified in the order.
- (3) The operation of this section is subject to the provisions of section 19.

### **8 Ancillary relief**

Schedule 1 has effect with respect to the ancillary relief that may be granted by the Court in relation to an application for relief under this Act.

### **9 Matters to be considered by Court**

- (1) In determining whether a contract or a provision of a contract is unjust in the circumstances relating to the contract at the time it was made, the Court shall have regard to the public interest and to all the circumstances of the case, including such consequences or results as those arising in the event of:
  - (a) compliance with any or all of the provisions of the contract, or
  - (b) non-compliance with, or contravention of, any or all of the provisions of the contract.
- (2) Without in any way affecting the generality of subsection (1), the matters to which the Court shall have regard shall, to the extent that they are relevant to the circumstances, include the following:
  - (a) whether or not there was any material inequality in bargaining power between the parties to the contract,
  - (b) whether or not prior to or at the time the contract was made its provisions were the subject of negotiation,
  - (c) whether or not it was reasonably practicable for the party seeking relief under this Act to negotiate for the alteration of or to reject any of the provisions of the contract,
  - (d) whether or not any provisions of the contract impose conditions which are unreasonably difficult to comply with or not reasonably necessary for the protection of the legitimate interests of any party to the contract,
  - (e) whether or not:
    - (i) any party to the contract (other than a corporation) was not reasonably able to protect his or her interests, or
    - (ii) any person who represented any of the parties to the contract was not reasonably able to protect the interests of any party whom he or she represented,because of his or her age or the state of his or her physical or mental capacity,
  - (f) the relative economic circumstances, educational background and literacy of:
    - (i) the parties to the contract (other than a corporation), and

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- (ii) any person who represented any of the parties to the contract,
  - (g) where the contract is wholly or partly in writing, the physical form of the contract, and the intelligibility of the language in which it is expressed,
  - (h) whether or not and when independent legal or other expert advice was obtained by the party seeking relief under this Act,
  - (i) the extent (if any) to which the provisions of the contract and their legal and practical effect were accurately explained by any person to the party seeking relief under this Act, and whether or not that party understood the provisions and their effect,
  - (j) whether any undue influence, unfair pressure or unfair tactics were exerted on or used against the party seeking relief under this Act:
    - (i) by any other party to the contract,
    - (ii) by any person acting or appearing or purporting to act for or on behalf of any other party to the contract, or
    - (iii) by any person to the knowledge (at the time the contract was made) of any other party to the contract or of any person acting or appearing or purporting to act for or on behalf of any other party to the contract,
  - (k) the conduct of the parties to the proceedings in relation to similar contracts or courses of dealing to which any of them has been a party, and
  - (l) the commercial or other setting, purpose and effect of the contract.
- (3) For the purposes of subsection (2), a person shall be deemed to have represented a party to a contract if the person represented the party, or assisted the party to a significant degree, in negotiations prior to or at the time the contract was made.
- (4) In determining whether a contract or a provision of a contract is unjust, the Court shall not have regard to any injustice arising from circumstances that were not reasonably foreseeable at the time the contract was made.
- (5) In determining whether it is just to grant relief in respect of a contract or a provision of a contract that is found to be unjust, the Court may have regard to the conduct of the parties to the proceedings in relation to the performance of the contract since it was made.

### 10 General orders

Where the Supreme Court is satisfied, on the application of the Minister or the Attorney General, or both, that a person has embarked, or is likely to embark, on a course of conduct leading to the formation of unjust contracts, it may, by order, prescribe or otherwise restrict, the terms upon which that person may enter into contracts of a specified class.

## Part 3—Procedural and other matters

### 11 Application for relief

- (1) The Court may exercise its powers under this Act in relation to a contract on application made to it in accordance with rules of court, whether in:
- (a) proceedings commenced under subsection (2) in relation to the contract, or
  - (b) other proceedings arising out of or in relation to the contract.

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- (2) Proceedings may be commenced in the Court for the purpose of obtaining relief under this Act in relation to a contract.

### **12 Interests of non-parties to contract**

- (1) Where in proceedings for relief under this Act in relation to a contract it appears to the Court that a person who is not a party to the contract has shared in, or is entitled to share in, benefits derived or to be derived from the contract, it may make such orders against or in favour of that person as may be just in the circumstances.
- (2) The Court shall not exercise its powers under this Act in relation to a contract unless it is satisfied:
- (a) that the exercise of those powers would not prejudice the rights of a person who is not a party to the contract, or
  - (b) that, if any such rights would be so prejudiced, it would not be unjust in all the circumstances to exercise those powers,

but this subsection does not apply in relation to such a person if the Court has given the person an opportunity to appear and be heard in the proceedings.

### **13 Intervention**

The Minister or the Attorney General, or both, may, at any stage of any proceedings in which relief under this Act is sought, intervene by an Australian legal practitioner or agent, and shall thereupon become a party or parties to the proceedings and have all the rights of a party or parties to those proceedings in the Court, including any right of appeal arising in relation to those proceedings.

### **14 Fully executed contracts**

The Court may grant relief in accordance with this Act in relation to a contract notwithstanding that the contract has been fully executed.

### **15 Arrangements**

In any proceedings in which relief under this Act is sought in relation to a contract, the Court may, if it thinks it proper to do so in the circumstances of the case, and it is of the opinion that the contract forms part of an arrangement consisting of an inter-related combination or series of contracts, have regard to any or all of those contracts and the arrangement constituted by them.

### **16 Time for making applications for relief**

An application for relief under this Act in relation to a contract may be made only during any of the following periods:

- (a) the period of 2 years after the date on which the contract was made,
- (b) the period of 3 months before or 2 years after the time for the exercise or performance of any power or obligation under, or the occurrence of any activity contemplated by, the contract, and
- (c) the period of the pendency of maintainable proceedings arising out of or in relation to the contract, being proceedings (including cross-claims, whether in the nature of set-off, cross-action or otherwise) that are pending against the party seeking relief under this Act.

### Part 4—Miscellaneous

#### 17 Effect of this Act not limited by agreements etc

- (1) A person is not competent to waive his or her rights under this Act, and any provision of a contract is void to the extent that:
  - (a) it purports to exclude, restrict or modify the application of this Act to the contract, or
  - (b) it would, but for this subsection, have the effect of excluding, restricting or modifying the application of this Act to the contract.
- (2) A person is not prevented from seeking relief under this Act by:
  - (a) any acknowledgment, statement or representation, or
  - (b) any affirmation of the contract or any action taken with a view to performing any obligation arising under the contract.
- (3) This Act applies to and in relation to a contract only if:
  - (a) the law of the State is the proper law of the contract,
  - (b) the proper law of the contract would, but for a term that it should be the law of some other place or a term to the like effect, be the law of the State, or
  - (c) the proper law of the contract would, but for a term that purports to substitute, or has the effect of substituting, provisions of the law of some other place for all or any of the provisions of this Act, be the law of the State.
- (4) This Act does not apply to a contract under which a person agrees to withdraw, or not to prosecute, a claim for relief under this Act if:
  - (a) the contract is a genuine compromise of the claim, and
  - (b) the claim was asserted before the making of the contract.
- (5) Without affecting the generality of subsection (1), the Court may exercise its powers under this Act in relation to a contract notwithstanding that the contract itself provides:
  - (a) that disputes or claims arising out of, or in relation to, the contract are to be referred to arbitration, or
  - (b) that legal proceedings arising out of, or in relation to, the contract are justiciable only by the courts of some other place.

#### 18 Offence

- (1) Where a person submits a document:
  - (a) that is intended to constitute a written contract,
  - (b) that has been prepared or procured by the person or on the person's behalf, and
  - (c) that includes a provision that purports to exclude, restrict or modify the application of this Act to the document,

to another person for signature by that other person, the person submitting the document is guilty of an offence and liable to a penalty not exceeding 20 penalty units.

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- (2) Proceedings for an offence against subsection (1) shall be disposed of summarily before the Local Court and may be commenced at any time within 2 years after the offence was committed.

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### 21 Application of Act to certain contracts of service and to existing contracts

- (1) This Act does not apply to a contract of service to the extent that it includes provisions that are in conformity with an award that is applicable in the circumstances.
- (2) In subsection (1), **award** means a State industrial instrument, or an award or industrial agreement made under the *Conciliation and Arbitration Act 1904* of the Commonwealth.
- (3) Schedule 2 has effect.

### 22 Operation of other laws

Nothing in this Act limits or restricts the operation of any other law providing for relief against unjust contracts, but the operation of any other such law in relation to a contract shall not be taken to limit or restrict the application of this Act to the contract.

### 23 Regulations

- (1) The Governor may make regulations, not inconsistent with this Act, for or with respect to any matter that by this Act is required or permitted to be prescribed or that is necessary or convenient to be prescribed for carrying out or giving effect to this Act.
- (2) A provision of a regulation may:
- (a) apply generally or be limited in its application by reference to specified exceptions or factors, or
  - (b) apply differently according to different factors of a specified kind,
- or may do any combination of those things.

## Schedule 1—Ancillary relief

(Section 8)

- 1 Where the Court makes a decision or order under section 7, it may also make such orders as may be just in the circumstances for or with respect to any consequential or related matter, including orders for or with respect to:
- (a) the making of any disposition of property,
  - (b) the payment of money (whether or not by way of compensation) to a party to the contract,
  - (c) the compensation of a person who is not a party to the contract and whose interest might otherwise be prejudiced by a decision or order under this Act,
  - (d) the supply or repair of goods,
  - (e) the supply of services,
  - (f) the sale or other realisation of property,
  - (g) the disposal of the proceeds of sale or other realisation of property,



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- (h) the creation of a charge on property in favour of any person,
- (i) the enforcement of a charge so created,
- (j) the appointment and regulation of the proceedings of a receiver of property, and
- (k) the rescission or variation of any order of the Court under this clause,

and such orders in connection with the proceedings as may be just in the circumstances.

**2** The Court may make orders under this Schedule on such terms and conditions (if any) as the Court thinks fit.

**3** Nothing in section 6 limits the powers of the Court under this Schedule.

**4** In this Schedule:

*disposition of property* includes:

- (a) a conveyance, transfer, assignment, appointment, settlement, mortgage, delivery, payment, lease, bailment, reconveyance or discharge of mortgage,
- (b) the creation of a trust,
- (c) the release or surrender of any property, and
- (d) the grant of a power in respect of property,

whether having effect at law or in equity.

*property* includes real and personal property and any estate or interest in property real or personal, and money, and any debt, and any cause of action for damages (including damages for personal injury), and any other chose in action, and any other right or interest.

### Schedule 2—Existing contracts

(Section 21 (3))

- 1** Subject to clause 2, this Act does not apply in respect of a contract made before the commencement of this Schedule.
- 2** Where the provisions of a contract made before the commencement of this Schedule are varied after that commencement, this Act applies in respect of the contract, but:
  - (a) no order shall be made under this Act affecting the operation of the contract before the date of the variation, and
  - (b) the Court shall have regard only to injustice attributable to the variation.

## UNITED KINGDOM

### Misrepresentation Act 1967 (U.K.), 1967, c. 7

**1. Removal of certain bars to rescission for innocent misrepresentation.**

Where a person has entered into a contract after a misrepresentation has been made to him, and—

- (a) the misrepresentation has become a term of the contract; or

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(b) the contract has been performed;

or both, then, if otherwise he would be entitled to rescind the contract without alleging fraud, he shall be so entitled, subject to the provisions of this Act, notwithstanding the matters mentioned in paragraphs (a) and (b) of this section.

### 2. Damages for misrepresentation

- (1) Where a person has entered into a contract after a misrepresentation has been made to him by another party thereto and as a result thereof he has suffered loss, then, if the person making the misrepresentation would be liable to damages in respect thereof had the misrepresentation been made fraudulently, that person shall be so liable notwithstanding that the misrepresentation was not made fraudulently, unless he proves that he had reasonable ground to believe and did believe up to the time the contract was made the facts represented were true.
- (2) Where a person has entered into a contract after a misrepresentation has been made to him otherwise than fraudulently, and he would be entitled, by reason of the misrepresentation, to rescind the contract, then, if it is claimed, in any proceedings arising out of the contract, that the contract ought to be or has been rescinded, the court or arbitrator may declare the contract subsisting and award damages in lieu of rescission, if of opinion that it would be equitable to do so, having regard to the nature of the misrepresentation and the loss that would be caused by it if the contract were upheld, as well as to the loss that rescission would cause to the other party.
- (3) Damages may be awarded against a person under subsection (2) of this section whether or not he is liable to damages under subsection (1) thereof, but where he is so liable any award under the said subsection (2) shall be taken into account in assessing his liability under the said subsection (1).

### 3. Avoidance of provision excluding liability for misrepresentation.

If a contract contains a term which would exclude or restrict—

- (a) any liability to which a party to a contract may be subject by reason of any misrepresentation made by him before the contract was made; or
- (b) any remedy available to another party to the contract by reason of such a misrepresentation,

that term shall be of no effect except in so far as it satisfies the requirement of reasonableness as stated in section 11 (1) of the Unfair Contract Terms Act 1977; and it is for those claiming that the term satisfies that requirement to show that it does.

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## Unfair Contract Terms Act 1977 (U.K.), 1977, c. 50

### PART I

#### AMENDMENT OF LAW FOR ENGLAND AND WALES AND NORTHERN IRELAND

##### *Introductory*

#### 1. Scope of Part I

- (1) For the purposes of this Part of this Act, “negligence” means the breach—
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- (a) of any obligation, arising from the express or implied terms of a contract, to take reasonable care or exercise reasonable skill in the performance of the contract;
  - (b) of any common law duty to take reasonable care or exercise reasonable skill (but not any stricter duty);
  - (c) of the common duty of care imposed by the Occupiers' Liability Act 1957 or the Occupiers' Liability Act (Northern Ireland) 1957.
- (2) This Part of this Act is subject to Part 111; and in relation to contracts, the operation of sections 2 to 4 and 7 is subject to the exceptions made by Schedule 1.
- (3) In the case of both contract and tort, sections 2 to 7 apply (except where the contrary is stated in section 6(4)) only to business liability, that is liability for breach of obligations or duties arising—
- (a) from things done or to be done by a person in the course of a business (whether his own business or another's); or
  - (b) from the occupation of premises used for business purposes of the occupier;
- and references to liability are to be read accordingly [but liability of an occupier of premises for breach of an obligation or duty towards a person obtaining access to the premises for recreational or educational purposes, being liability for loss or damage suffered by reason of the dangerous state of the premises, is not a business liability of the occupier unless granting that person such access for the purposes concerned falls within the business purposes of the occupier].
- (4) In relation to any breach of duty or obligation, it is immaterial for any purpose of this Part of this Act whether the breach was inadvertent or intentional, or whether liability for it arises directly or vicariously.

### *Avoidance of liability for negligence, breach of contract, etc.*

#### **2. Negligence liability**

- (1) A person cannot by reference to any contract term or to a notice given to persons generally or to particular persons exclude or restrict his liability for death or personal injury resulting from negligence.
- (2) In the case of other loss or damage, a person cannot so exclude or restrict his liability for negligence except in so far as the term or notice satisfies the requirement of reasonableness.
- (3) Where a contract term or notice purports to exclude or restrict liability for negligence a person's agreement to or awareness of it is not of itself to be taken as indicating his voluntary acceptance of any risk.

#### **3. Liability arising in contract**

- (1) This section applies as between contracting parties where one of them deals as consumer or on the other's written standard terms of business.
- (2) As against that party, the other cannot by reference to any contract term—
  - (a) when himself in breach of contract, exclude or restrict any liability of his in respect of the breach; or
  - (b) claim to be entitled—

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- (i) to render a contractual performance substantially different from that which was reasonably expected of him, or
- (ii) in respect of the whole or any part of his contractual obligation, to render no performance at all,

except in so far as (in any of the cases mentioned above in this subsection) the contract term satisfies the requirement of reasonableness.

#### 4. Unreasonable indemnity clauses

- (1) A person dealing as consumer cannot by reference to any contract term be made to indemnify another person (whether a party to the contract or not) in respect of liability that may be incurred by the other for negligence or breach of contract, except in so far as the contract term satisfies the requirement of reasonableness.
- (2) This section applies whether the liability in question—
  - (a) is directly that of the person to be indemnified or is incurred by him vicariously;
  - (b) is to the person dealing as consumer or to someone else.

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#### *Other provisions about contracts*

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#### 9. Effect of breach

- (1) Where for reliance upon it a contract term has to satisfy the requirement of reasonableness, it may be found to do so and be given effect accordingly notwithstanding that the contract has been terminated either by breach or by a party electing to treat it as repudiated.
- (2) Where on a breach the contract is nevertheless affirmed by a party entitled to treat it as repudiated, this does not of itself exclude the requirement of reasonableness in relation to any contract term.

#### 10. Evasion by means of secondary contract

A person is not bound by any contract term prejudicing or taking away rights of his which arise under, or in connection with the performance of, another contract, so far as those rights extend to the enforcement of another's liability which this Part of this Act prevents that other from excluding or restricting.

#### *Explanatory provisions*

#### 11. The "reasonableness" test

- (1) In relation to a contract term, the requirement of reasonableness for the purposes of this Part of this Act, section 3 of the Misrepresentation Act 1967 and section 3 of the Misrepresentation Act (Northern Ireland) 1967 is that the term shall have been a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made.
- (2) In determining for the purposes of section 6 or 7 above whether a contract term satisfies the requirement of reasonableness, regard shall be had in particular to the matters specified in Schedule 2 to this Act; but this subsection does not prevent the court or arbitrator from hold-

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ing, in accordance with any rule of law, that a term which purports to exclude or restrict any relevant liability is not a term of the contract.

- (3) In relation to a notice (not being a notice having contractual effect), the requirement of reasonableness under this Act is that it should be fair and reasonable to allow reliance on it, having regard to all the circumstances obtaining when the liability arose or (but for the notice) would have arisen.
- (4) Where by reference to a contract term or notice a person seeks to restrict liability to a specified sum of money, and the question arises (under this or any other Act) whether the term or notice satisfies the requirement of reasonableness, regard shall be had in particular (but without prejudice to subsection (2) above in the case of contract terms) to—
  - (a) the resources which he could expect to be available to him for the purpose of meeting the liability should it arise; and
  - (b) how far it was open to him to cover himself by insurance.
- (5) It is for those claiming that a contract term or notice satisfies the requirement of reasonableness to show that it does.

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### 13. Varieties of exemption clause

- (1) To the extent that this Part of this Act prevents the exclusion or restriction of any liability it also prevents—
  - (a) making the liability or its enforcement subject to restrictive or onerous conditions;
  - (b) excluding or restricting any right or remedy in respect of the liability, or subjecting a person to any prejudice in consequence of his pursuing any such right or remedy;
  - (c) excluding or restricting rules of evidence or procedure;and (to that extent) sections 2 and 5 to 7 also prevent excluding or restricting liability by reference to terms and notices which exclude or restrict the relevant obligation or duty.
- (2) But an agreement in writing to submit present or future differences to arbitration is not to be treated under this Part of this Act as excluding or restricting any liability.

### 14. Interpretation of Part I

In this Part of this Act—

“business” includes a profession and the activities of any government department or local or public authority;

“goods” has the same meaning as in the Sale of Goods Act 1979;

“hire-purchase agreement” has the same meaning as in the Consumer Credit Act 1974;

“negligence” has the meaning given by section 1(1);

“notice” includes an announcement, whether or not in writing, and any other communication or pretended communication; and

“personal injury” includes any disease and any impairment of physical or mental condition.

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**SCHEDULE 2**

Sections 11(2) and 24(2).

*“Guidelines” for Application of Reasonableness Test*

The matters to which regard is to be had in particular for the purposes of sections 6(3), 7(3) and (4), 20 and 21 are any of the following which appear to be relevant—

- (a) the strength of the bargaining positions of the parties relative to each other, taking into account (among other things) alternative means by which the customer’s requirements could have been met;
- (b) whether the customer received an inducement to agree to the term, or in accepting it had an opportunity of entering into a similar contract with other persons, but without having a similar term;
- (c) whether the customer knew or ought reasonably to have known of the existence and the extent of the term (having regard, among other things, to any custom of the trade and any previous course of dealing between the parties);
- (d) where the term excludes or restricts any relevant liability if some condition was not complied with, whether it was reasonable at the time of the contract to expect that compliance with that condition would be practicable;
- (e) whether the goods were manufactured, processed or adapted to the special order of the customer.

**NEW ZEALAND**

**Contractual Remedies Act 1979 (N.Z.), 1979/11**

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**4 Statements during negotiations for a contract**

- (1) If a contract, or any other document, contains a provision purporting to preclude a Court from inquiring into or determining the question—
  - (a) Whether a statement, promise, or undertaking was made or given, either in words or by conduct, in connection with or in the course of negotiations leading to the making of the contract; or
  - (b) Whether, if it was so made or given, it constituted a representation or a term of the contract; or
  - (c) Whether, if it was a representation, it was relied on—

the Court shall not, in any proceedings in relation to the contract, be precluded by that provision from inquiring into and determining any such question unless the Court considers that it is fair and reasonable that the provision should be conclusive between the parties, having regard to all the circumstances of the case, including the subject-matter and value of the transaction, the respective bargaining strengths of the parties, and the question whether any party was represented or advised by a solicitor at the time of the negotiations or at any other relevant time.

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- (2) If a contract, or any other document, contains a provision purporting to preclude a Court from inquiring into or determining the question whether, in respect of any statement, promise, or undertaking made or given by any person, that person had the actual or ostensible authority of a party to make or give it, the Court shall not, in any proceedings in relation to the contract, be precluded by that provision from inquiring into and determining that question.
- (3) Notwithstanding anything in section 56 or section 60(2) of the Sale of Goods Act 1908, this section shall apply to contracts for the sale of goods.
- (4) ...

### **5 Remedy provided in contract**

If a contract expressly provides for a remedy in respect of misrepresentation or repudiation or breach of contract or makes express provision for any of the other matters to which sections 6 to 10 of this Act relate, those sections shall have effect subject to that provision.

### **6 Damages for misrepresentation**

- (1) If a party to a contract has been induced to enter into it by a misrepresentation, whether innocent or fraudulent, made to him by or on behalf of another party to that contract—
  - (a) He shall be entitled to damages from that other party in the same manner and to the same extent as if the representation were a term of the contract that has been broken; and
  - (b) He shall not, in the case of a fraudulent misrepresentation, or of an innocent misrepresentation made negligently, be entitled to damages from that other party for deceit or negligence in respect of that misrepresentation.
- (2) Notwithstanding anything in section 56 or section 60(2) of the Sale of Goods Act 1908, but subject to section 5 of this Act, subsection (1) of this section shall apply to contracts for the sale of goods.

### **7 Cancellation of contract**

- (1) Except as otherwise expressly provided in this Act, this section shall have effect in place of the rules of the common law and of equity governing the circumstances in which a party to a contract may rescind it, or treat it as discharged, for misrepresentation or repudiation or breach.
- (2) Subject to this Act, a party to a contract may cancel it if, by words or conduct, another party repudiates the contract by making it clear that he does not intend to perform his obligations under it or, as the case may be, to complete such performance.
- (3) Subject to this Act, but without prejudice to subsection (2) of this section, a party to a contract may cancel it if—
  - (a) He has been induced to enter into it by a misrepresentation, whether innocent or fraudulent, made by or on behalf of another party to that contract; or
  - (b) A term in the contract is broken by another party to that contract; or
  - (c) It is clear that a term in the contract will be broken by another party to that contract.
- (4) Where subsection (3)(a) or subsection (3)(b) or subsection (3)(c) of this section applies, a party may exercise the right to cancel if, and only if,—
  - (a) The parties have expressly or impliedly agreed that the truth of the representation or, as the case may require, the performance of the term is essential to him; or

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- (b) The effect of the misrepresentation or breach is, or, in the case of an anticipated breach, will be,—
  - (i) Substantially to reduce the benefit of the contract to the cancelling party; or
  - (ii) Substantially to increase the burden of the cancelling party under the contract; or
  - (iii) In relation to the cancelling party, to make the benefit or burden of the contract substantially different from that represented or contracted for.
- (5) A party shall not be entitled to cancel the contract if, with full knowledge of the repudiation or misrepresentation or breach, he has affirmed the contract.
- (6) A party who has substantially the same interest under the contract as the party whose act constitutes the repudiation, misrepresentation, or breach may cancel the contract only with the leave of the Court.
- (7) The Court may, in its discretion, on application made for the purpose, grant leave under subsection (6) of this section, subject to such terms and conditions as the Court thinks fit, if it is satisfied that the granting of such leave is in the interests of justice.

### **8 Rules applying to cancellation**

- (1) The cancellation of a contract by a party shall not take effect—
  - (a) Before the time at which the cancellation is made known to the other party; or
  - (b) before the time at which the party cancelling the contract evinces, by some overt means reasonable in the circumstances, an intention to cancel the contract, if—
    - (i) it is not reasonably practicable for the cancelling party to communicate with the other party; or
    - (ii) the other party cannot reasonably expect to receive notice of the cancellation because of that party's conduct in relation to the contract.
- (2) The cancellation may be made known by words, or by conduct evincing an intention to cancel, or both. It shall not be necessary to use any particular form of words, so long as the intention to cancel is made known.
- (3) Subject to this Act, when a contract is cancelled the following provisions shall apply:
  - (a) So far as the contract remains unperformed at the time of the cancellation, no party shall be obliged or entitled to perform it further:
  - (b) So far as the contract has been performed at the time of the cancellation, no party shall, by reason only of the cancellation, be divested of any property transferred or money paid pursuant to the contract.
- (4) Nothing in subsection (3) of this section shall affect the right of a party to recover damages in respect of a misrepresentation or the repudiation or breach of the contract by another party.

### **9 Power of Court to grant relief**

- (1) When a contract is cancelled by any party, the Court, in any proceedings or on application made for the purpose, may from time to time if it is just and practicable to do so, make an order or orders granting relief under this section.
  - (2) An order under this section may—
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- (a) Vest in any party to the proceedings, or direct any such party to transfer or assign to any other such party or to deliver to him the possession of, the whole or any part of any real or personal property that was the subject of the contract or was the whole or part of the consideration for it:
  - (b) Subject to section 6 of this Act, direct any party to the proceedings to pay to any other such party such sum as the Court thinks just:
  - (c) Direct any party to the proceedings to do or refrain from doing in relation to any other party any act or thing as the Court thinks just.
- (3) Any such order, or any provision of it, may be made upon and subject to such terms and conditions as the Court thinks fit, not being in any case a term or condition that would have the effect of preventing a claim for damages by any party.
- (4) In considering whether to make an order under this section, and in considering the terms of any order it proposes to make, the Court shall have regard to—
- (a) The terms of the contract; and
  - (b) The extent to which any party to the contract was or would have been able to perform it in whole or in part; and
  - (c) Any expenditure incurred by a party in or for the purpose of the performance of the contract; and
  - (d) The value, in its opinion, of any work or services performed by a party in or for the purpose of the performance of the contract; and
  - (e) Any benefit or advantage obtained by a party by reason of anything done by another party in or for the purpose of the performance of the contract; and
  - (f) Such other matters as it thinks proper.
- (5) No order shall be made under subsection (2)(a) of this section that would have the effect of depriving a person, not being a party to the contract, of the possession of or any estate or interest in any property acquired by him in good faith and for valuable consideration.
- (6) No order shall be made under this section in respect of any property, if any party to the contract has so altered his position in relation to the property, whether before or after the cancellation of the contract, that, having regard to all relevant circumstances, it would in the opinion of the Court be inequitable to any party to make such an order.
- (7) An application for an order under this section may be made by—
- (a) Any party to the contract; or
  - (b) Any person claiming through or under any such party; or
  - (c) Any other person if it is material for him to know whether relief under this section will be granted.

### **10 Recovery of damages**

- (1) Subject to sections 4 to 6 of this Act, a party to a contract shall not be precluded by the cancellation of the contract, or by the granting of relief under section 9 of this Act, from recovering damages in respect of a misrepresentation or the repudiation or breach of the contract by an-

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other party; but the value of any relief granted under section 9 of this Act shall be taken into account in assessing any such damages.

- (2) Any sum ordered to be paid by any party to the contract to any other such party under section 9(2) of this Act may be set off against any damages payable by him to that other party.

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