



BRITISH COLUMBIA LAW INSTITUTE

1822 East Mall, University of British Columbia

Vancouver, British Columbia V6T 1Z1

Voice: (604) 822 0142 Fax: (604) 822 0144 E-mail: bcli@bcli.org

Website: www.bcli.org

BRITISH COLUMBIA
LAW INSTITUTE UNFAIR CONTRACTS RELIEF PROJECT

Backgrounder

Introduction to the Unfair Contracts Relief Project

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INTRODUCTION

The British Columbia Law Institute has commenced a major law-reform project to study unfair contracts and recommend reforms where they are needed. The project has a two-year term. Its goal is the publication of a final report in fall 2011, which will contain recommendations in the form of draft legislation. The project—called the Unfair Contracts Relief Project—is being carried out by an all-volunteer project committee. The Unfair Contracts Relief Project has been made possible by a grant from the Law Foundation of British Columbia.

MEMBERS OF THE PROJECT COMMITTEE

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

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

Allan Parker
*(executive director, Western Canada
Society to Access Justice)*

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

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

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

Lisa Peters
(partner, Lawson Lundell LLP)

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

LEGAL BACKGROUND

Introduction

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.

This project is concerned with examining the following contract-law concepts: (1) unconscionability; (2) duress; (3) undue influence; (4) good faith; (5) exclusion clauses; and (6) misrepresentation. These concepts are selected because they can usefully be employed as themes for organizing consideration of more highly specific issues relating to contractual unfairness. They also serve to connect problems that are currently encountered by contracting parties with a longstanding body of jurisprudence. Although the precise contours of these concepts remains somewhat blurry, it is possible to describe them briefly in general terms.

Unconscionability

An unconscionable contract is a contract that offends the court's conscience. In these cases, the court retains the discretion to refuse to enforce the contract. In practice, the courts have focussed this discretion on abuses of bargaining power and extremely one-sided transactions. The leading British Columbia case on unconscionability has formulated a two-step test. To make out a claim of unconscionability, a plaintiff must show (1) an inequality in the bargaining position of the parties due to a factor such as ignorance, disability, or poverty, which left the weaker party at the mercy of the stronger and (2) a substantial unfairness in a term or the terms of the resulting contract.¹ An alternative formulation, which is applied from time to time, holds that an unconscionable contract is one that "seen as a whole, is sufficiently divergent from community standards of commercial morality that it should be rescinded."² Although unconscionability is often associated with consumer contracts (it has been enshrined in consumer-protection legislation),³ it has been applied to a wide range of contracts, even purely commercial agreements.

Duress

Duress occurs when a party has been compelled to enter into a contract, against that party's wishes. The common law has long allowed courts to refuse to enforce a contract that was obtained by one party physically threatening the other. Another situation traditionally covered by duress involves cases where a person's property is effectively held to

1. See *Morrison v. Coast Finance Ltd.* (1965), 55 D.L.R. (2d) 710 at 713, 54 W.W.R. 257 (B.C.C.A.), Davie J.A.

2. *Harry v. Kreutziger* (1978), 95 D.L.R. (3d) 231 at 241, 9 B.C.L.R. 166 (C.A.), Lambert J.A.

3. See *Business Practices and Consumer Protection Act*, S.B.C. 2004, c. 2, ss. 7–10.

ransom to compel the person to enter into a contract. These types of cases are relatively straightforward. A more recent development has proved to be more controversial. Since the late 1970s, the courts have shown a willingness to apply duress in cases of business compulsion. These cases of economic duress hold out the prospect that the courts could strike down an agreement that was obtained by the inappropriate use of commercial pressure. At its core, duress is intended to protect the ability of contracting parties to form their agreements voluntarily. There is, as of today, no hard and fast test in this area; instead, the courts apply various factors, such as whether the party protested at the time, took steps to disavow the contract, and whether the contract was supported by consideration.⁴ Duress has been applied to all types of contracts, but the vast majority of economic-duress cases have involved contracts between businesses.

Undue Influence

Closely related to duress is undue influence. Undue influence also protects the ability of contracting parties to enter into agreements only through their voluntary consent. Undue influence typically appears in cases where someone has taken advantage of their relationship to another person to coerce that person into entering into a contract. The leading Canadian judgment on undue influence notes that the jurisprudence has recognized two distinct categories of cases. First, there are cases where one party has unfairly used some advantage to victimize the other. In these cases, the plaintiff must prove undue influence. Second, there are cases where the contracting parties are in a special relationship, such as parent and child, trustee and beneficiary, doctor and patient, or lawyer and client. (It is important to note that these categories of relationships are not closed—that is, the courts could recognize other relationships as belonging to this group.) In these cases, undue influence is presumed from an unfair agreement, though it may be rebutted.⁵ Undue influence has been applied to a wide range of contracts, though it is primarily at play in family agreements and consumer loans.

Good Faith

The three previously discussed concepts tend to focus on misconduct during the events leading up to the creation of a contract. Good faith, on the other hand, has cropped up as an issue in three phases of a contract's life cycle: (1) during negotiations; (2) during performance of a party's rights and obligations under the contract; and (3) during enforcement of rights and remedies. (The emphasis in the cases has tended to be on the second and third items.) As such, good faith is an important concept for all types of contracts, especially those that create an ongoing relationship between the parties. Unlike the law of other jurisdictions, Canadian law (apart from the civil law of Québec) has not recognized a general obligation to act in good faith. Instead, the obligation has been recognized by the courts in an ad hoc way, as attaching to certain types of contracts. The leading examples are contracts of employment, franchise agreements, and insurance contracts. The meaning of good

4. See *Gordon v. Roebuck* (1992), 9 O.R. (3d) 1, 92 D.L.R. (4th) 670 (C.A.); *Greater Fredericton Airport Authority Inc. v. NAV Canada*, 2008 NBCA 28, 290 D.L.R. (4th) 405.

5. See *Geffen v. Goodman Estate*, [1991] 2 S.C.R. 353 at 368–70, 81 D.L.R. (4th) 211, Wilson J.

faith is also highly contextual, ranging from acting honestly and fairly to avoiding bad-faith conduct.⁶

Exclusion Clauses

Clauses that exclude or limit liability for a contracting party continue to pose a special problem. In the mid-twentieth century, the English courts developed a relatively simple solution to abuses of these types of contract terms by applying what they characterized as a rule of law that allowed the courts to refuse to enforce exclusion clauses in the face of a fundamental breach of the contract. This rule of law was picked up by Canadian courts, even though it had attracted a good deal of criticism. The critics appeared to win the day when the Supreme Court of Canada decided that the rule of law approach should no longer be applied.⁷ Unfortunately, the court divided on the approach to be applied in its place, with two judges concluding that this area should be assimilated to unconscionability⁸ and two other judges calling for new approach that focussed on whether the clause was fair and reasonable in all the circumstances, including in the light of events that have taken place after the contract was signed.⁹ This has caused some confusion in how to approach exclusion clauses, with some courts even appearing to revert to the overruled rule-of-law approach.

Misrepresentation

Finally, there is misrepresentation. This concept can be grasped in relatively straightforward terms as being an incorrect statement or an assertion that does not, in fact, correspond to reality. The law on misrepresentation, in contrast, is invariably characterized as difficult or complex.¹⁰ Misrepresentation poses a number of vexing problems for the law of contract, which cannot be briefly summarized in this backgrounder. Suffice it to say that this problems turn, in part, on appreciating a number of subtle distinctions that make up this body of law. These distinctions go the intention of the person making the misrepresentation, specifically whether it can be classed as fraudulent or innocent. The remedies available flow from the outcome of this classification. Notably, some jurisdictions have enacted legislation in this area.¹¹ British Columbia has also has legislation, but its coverage only extends to consumer contracts.¹²

6. See *Gateway Realty Ltd. v. Arton Holdings Ltd.* (1991), 106 N.S.R. (2d) 180 at para. 38, 29 A.C.W.S. (3d) 262 (S.C.), Kelly J., *aff'd on other grounds* (1992), 112 N.S.R. (2d) 180, 32 A.C.W.S. (3d) 1161 (C.A.).

7. See *Hunter Engineering Co. v. Syncrude Canada Ltd.*, [1989] 1 S.C.R. 426, 57 D.L.R. (4th) 321 [*Hunter Engineering* cited to S.C.R.].

8. See *Hunter Engineering*, *ibid.* at 462, Dickson C.J.

9. See *ibid.* at 510–11, Wilson J.

10. See, e.g., Stephen M. Waddams, *The Law of Contracts*, 5th ed. (Toronto: Canada Law Book, 2005) at para. 425; Angela Swan, *Canadian Contract Law*, 2d ed. (Markham, ON: LexisNexis Canada, 2009) at § 8.163.

11. See *Misrepresentation Act 1967*, (U.K.), 1967, c. 7.

12. See *Business Practices and Consumer Protection Act*, *supra* note 3, ss. 4–6.

RATIONALE FOR REFORM

Contractual unfairness has been a fertile area for both learned commentary and law-reform proposals. At some level, it is not surprising that this subject has generated so much discussion. It cuts to the heart of contract law, which is that promises voluntarily entered into and supported by consideration should be binding on the parties to the agreement. A strong public-policy rationale is needed to displace this general rule. For many years—hundreds of years, if this line of thought is pursued back to its origins in the English courts—the courts have found this rationale in the need to protect contracting parties from victimization. But this rationale has often been framed in moralistic terms, which leads critics to have genuine concerns about its coherence and its potential to undermine the certainty of consumer and commercial transactions. Law reform agencies, which can approach these questions from a broadly based and independent point of view, have often made a contribution in rationalizing concepts that address contractual unfairness.

Defining the scope of these concepts has proved to be a particular challenge. Words like “unconscionable,” “duress,” and “good faith” have everyday meanings, but they can be extremely difficult to define in precise juridical terms. Principles can be found in the jurisprudence, but these principles often need to be supplemented with other public-policy considerations. And the relation of one concept to the others needs to be considered, if the law is to provide a coherent and integrated framework. There appears to be gaps in the coverage of these concepts, which require further study and may require reforms to remedy. For institutional reasons, it is often difficult for the courts to provide the type of analysis that is now needed in this area of the law.

Modernization of the legal landscape is also a matter to consider. Looking beyond the substantive content of these concepts to matters such as procedure and remedies, it is noteworthy that the law can often be rather restrictive. The legislation has, in places, put the law on a more expansive footing, but the legislation that has been passed has only extended to individual consumers.¹³ It is worthwhile considering whether other groups should also receive the benefit of these innovations.

ISSUES

At the starting point in this project, the committee is interested in examining a number of issues.

- (1) What elements should make up the legal tests for each concept?
- (2) How should key terms such as “unconscionability” and “good faith” be defined?
- (3) To what types of contracts should these concepts be applied?
- (4) What types of contracting parties should these concepts benefit?

13. See *Business Practices and Consumer Protection Act*, *ibid.*

- (5) How should factors such as independent legal advice and insurance be treated in cases involving contractual unfairness?
- (6) Do certain types of contracts or contract terms require special rules?
- (7) Are procedural innovations needed in certain areas need to improve the functioning of substantive rules relating to contractual unfairness?
- (8) Can the various contract-law concepts be integrated into a more harmonious legal framework?

EARLIER LAW REFORM WORK

There is a wide range of work by law reform agencies on this topic. The publications can be divided into two groups—those addressing contractual unfairness generally and those that focus on a specific instance of unfairness, or how unfairness affects a specific type of contract, contract term, or contracting party.

The first group includes the following publications:

- British Columbia Law Institute, *Unfair Contract Terms: An Interim Report* (BCLI Rep. No. 35) (Vancouver: The Institute, 2005)
- Ontario Law Reform Commission, *Report on Amendment of the Law of Contract* (Toronto: The Commission, 1987)
- New Zealand Law Commission, *“Unfair Contracts”: A Discussion Paper* (NZLC PP11) (Wellington: The Commission, 1990)¹⁴

And the second group includes these publications:

- 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)
- Ontario Law Reform Commission, *Report on Sale of Goods* (Toronto: The Commission, 1979)
- Law Commission for England and Wales & Scottish Law Commission, *Report on Unfair Terms in Contracts* (Law Com No. 292; Scot Law Com No. 199) (London: HM Stationary Office, 2005)

It is also worthwhile to note here that some of Canada’s leading trading partners and fellow common-law jurisdictions have been active legislatively in this area. The following statutes are particularly useful for study as potential models for reform:

- New South Wales, *Contracts Review Act 1980*

14. The final report for this project contains much less analysis and detail regarding contractual unfairness, and so is less helpful for the purposes of the BCLI’s project than the discussion paper. See New Zealand Law Commission, *Report on Contract Statutes Review* (NZLC R25) (Wellington: The Commission, 1993).

- United States, UCC §§ 1-201 (20) (definition of “good faith”), 1-304 (obligation of good faith), and 2-302 (unconscionable contract or term)
- United Kingdom, *Unfair Contract Terms Act 1977*

GOALS OF THE PROJECT

The project’s primary goal is the publication of a final report, which will include recommendations in the form of draft legislation and commentary on that draft legislation. Secondary goals include conducting legal research into the unfair contracts and promoting understanding of the current state of the law.

NEXT STEPS IN THE PROJECT

Committee Meetings

During the initial phase of the project, which will run through the winter of 2009 and the spring of 2010, the committee will meet regularly to consider the legal issues posed by unfairness in contracting and the options for reform.

Consultation Paper and Public Consultation

The committee intends to publish a consultation paper in fall 2010. The consultation paper will survey the current law, discuss options for reform, and present the committee’s tentative recommendations. The public will have the opportunity to comment on the committee’s tentative recommendations during a public consultation period that is expected to run from fall 2010 to winter 2011.

Final Report

The committee’s final report will be published in September 2011.

ABOUT THE BRITISH COLUMBIA LAW INSTITUTE

The British Columbia Law Institute was incorporated in 1997 under the British Columbia *Society Act*. Its 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.

CONTACT

Kevin Zakreski
Staff Lawyer
British Columbia Law Institute
1822 East Mall, University of British Columbia
Vancouver, BC V6T 1Z1
Tel.: (604) 827-5336
E-mail: kzakreski@bcli.org