

HUNTER ENGINEERING: THE JUDICIAL REGULATION OF EXCULPATORY CLAUSES

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Exculpatory clauses are regulated in a number of ways by the law of contract. Lord Denning's substantive doctrine of fundamental breach, however, is not one of them. The judges of the Supreme Court of Canada recently confirmed this. They differed, however, as to what other test such clauses must satisfy. Two judges preferred an unconscionability test, two preferred a reasonableness test triggered by a fundamental breach and one judge declined to address the issue. There are difficulties with both of the suggested approaches, especially the view that unconscionability is a suitable control. The major difficulty is that the nature of the unconscionability standard is unclear. The Supreme Court has avoided indicating what that notion might involve.

Les clauses exonératoires sont réglementées de diverses façons par le droit des contrats. La doctrine de droit positif de Lord Denning sur l'inexécution d'une obligation fondamentale du contrat n'en fait cependant pas partie et les juges de la Cour suprême du Canada l'ont récemment confirmé. Ils diffèrent cependant sur d'autres exigences auxquelles ces clauses doivent satisfaire. Deux des juges sont d'avis que de telles clauses doivent être annulées quand elles sont abusives. Deux autres décident que, en cas de violation d'une obligation fondamentale du contrat, les clauses doivent être raisonnables pour être valides. Le cinquième refuse de traiter de la question. Ces optiques présentent toutes deux des difficultés, en particulier celle qui fait appel au caractère abusif pour décider de la validité d'une clause. La difficulté majeure vient du fait qu'il est difficile de savoir ce qui est abusif et la Cour suprême s'est gardée d'indiquer de quoi il s'agit.

Introduction

A contract may be breached in different ways. The breach may be ordinary or it may be fundamental. The distinction between these types of breach is important. Judges have attached special consequences to a breach that is fundamental. One consequence is uncontroversial. Where a breach is fundamental, the innocent party becomes entitled to elect to terminate his or her further obligations under the contract. The second special consequence is, or was, highly controversial. The supposed consequence was that a party who committed a "fundamental" breach could not rely on an exculpatory clause in the contract to reduce or eliminate liability. The controversy has now been resolved, in both Britain and Canada, in favour of the party protected by the clause. It has been determined, however, in an unsatisfactory manner, both in terms of the theoretical analysis and the suggested way of dealing with exculpatory clauses in the future.

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We proceed first to describe the theory of contract breach which has been employed by judges in this context. Although the "doctrine of fundamental breach" is only one aspect of this complex theory, it is necessary to describe the whole paradigm before the consequences of a fundamental breach can be intelligibly located within it. Once the theory is understood, it will be shown that its elaboration in relation to exculpatory clauses has been misconceived. The remaining portion of the article will be concerned with an assessment of the content of the unconscionability standard proposed by the Supreme Court of Canada as an appropriate device to regulate harsh exculpatory clauses in the absence of a substantive doctrine of fundamental breach.

I. *The Diplock Contract Paradigm*

In several cases, spanning two decades,¹ Lord Diplock constructed a conceptual framework to organize and describe contractual obligation. He began the process in *Hong Kong Fir Shipping Co. Ltd. v. Kawasaki Kisen Kaisha Ltd.*² The question requiring an answer in that case was a significant one: "in what event will a party to a contract be relieved of his undertaking to do that which he has agreed to do but has not yet done?"³ The answer, according to Lord Diplock, was that further performance is excused if an event occurs which has the effect of depriving an innocent party of substantially the whole benefit it was intended should be obtained from the contract.⁴ This was the test whether the event resulted from a breach of contract by the other party or was an unforeseen event not caused by either party.⁵

Lord Diplock observed that "it is the event and not the fact that the event is a result of a breach of contract which relieves the party not in default of further performance of his obligations . . .".⁶ Recognizing this, in Lord Diplock's view, meant that the traditional bifurcation of contract terms into "conditions" (terms of major importance) and "warranties" (terms

¹ From 1962 (*Hong Kong Fir Shipping Co. Ltd. v. Kawasaki Kisen Kaisha Ltd.*, [1962] 2 Q.B. 26, [1962] 1 All E.R. 474 (C.A.)) to 1980 (*Photo Production Ltd. v. Securicor Transportation Ltd.*, [1980] A.C. 827, [1980] 1 All E.R. 556 (H.L.)). See also *Hardwick Game Farm v. Suffolk Agricultural Poultry Producers Assos.*, [1966] 1 W.L.R. 287, [1966] 1 All E.R. 309 (C.A.), aff'd, [1969] 2 A.C. 31, [1968] 2 All E.R. 444 (H.L.); *United Dominions Trust (Commercial) Ltd. v. Eagle Aircraft Services, Ltd.*, [1968] 1 W.L.R. 74, [1968] 1 All E.R. 104 (C.A.); *Moschi v. Lep Air Services Ltd.*, [1973] A.C. 331, [1972] 2 All E.R. 393 (H.L.).

² *Ibid.*

³ *Ibid.*, at pp. 66 (Q.B.), 485 (All E.R.).

⁴ *Ibid.*

⁵ The subject matter of this article is limited to instances of breach resulting from the default of one of the parties. The doctrine of frustration is not addressed.

⁶ *Supra*, footnote 1, at pp. 69 (Q.B.), 487 (All E.R.).

of minor or collateral importance) was inadequate.⁷ Instead, it was necessary to distinguish between *three* types of contract terms: conditions, warranties and “intermediate” or “innominate” terms. These three classes of terms were identifiable in accordance with the effect of all possible breaches. If *every* conceivable breach of a particular term would deprive the innocent party of substantially the whole benefit intended under the contract, the term is a condition. It is a warranty if *no* breach of the particular term would deprive the innocent party of substantially the whole benefit intended. This leaves a large category of terms in which some breaches will, and other breaches will not, deprive the innocent party of substantially the whole intended benefit. These are intermediate or innominate terms.⁸

The legal consequence of a breach of warranty is that the innocent party is entitled to damages for the breach but not to be released from his or her own performance. The contractual obligations on both sides continue in force. If the term breached is a condition, on the other hand, the innocent party is entitled to damages *and* to elect whether to proceed with his or her own performance. The situation is different again if the term breached is characterized as an intermediate term. The consequence of a breach of such a term cannot be determined merely by classification. It is necessary to go further and assess the nature of the actual effect of the breach. If the effect is to deprive the innocent party of substantially the whole intended benefit, the consequence (as for a breach of condition) is that the innocent party has a right to elect to decline further performance and to receive damages. If the effect is not this serious, the consequence (as for a breach of warranty) is that the innocent party is entitled to damages but must still perform the contract.

Lord Diplock’s “rediscovery and reaffirmation”⁹ of this tripartite classification was a surprise to lawyers. The simpler division of terms into only two categories had been accepted for many years. Nevertheless, the approach has been confirmed by the House of Lords, along with a reminder that the intentions of the parties remain paramount.¹⁰

Lord Diplock’s scheme of classification operates to define the consequences of breach only if the intention of the parties, in that respect, cannot be ascertained. It is, in that sense, a background or default scheme

⁷ The traditional distinction is discussed by D.W. Greig, *Condition—or Warranty?* (1973), 89 Law Q. Rev. 93.

⁸ These labels were explained by Lord Lowry (*Bunge Corporation v. Tradax SA*, [1981] 1 W.L.R. 711, at p. 719, [1981] 2 All E.R. 513, at p. 544 (H.L.), as follows: “It is ‘intermediate’ because it lies in the middle *between* a condition and a warranty (just as the remedy for its breach lies somewhere between the remedies for breach of a condition and breach of a warranty), and it is ‘innominate’ because it is not *called* a condition or a warranty but assumes the character of each in turn.”

⁹ Per Lord Scarman in *Bunge Corporation v. Tradax SA*, *ibid.*, at pp. 717 (W.L.R.), 542 (All E.R.).

¹⁰ *Bunge Corporation v. Tradax SA*, *ibid.*

of classification.¹¹ The parties are entirely free, in the first instance, to determine whether the breach of a particular term will entitle either party to treat the contract as at an end. They might do so explicitly or implicitly. If they have not done so, however, Lord Diplock's scheme applies and will determine whether the innocent party can choose to terminate further performance upon a breach. This will involve first determining whether *every* or *no* breach of the term will deprive the innocent party of substantially the whole intended benefit. Few terms will fall into either of these categories. All other terms will be intermediate terms, and whether the innocent party can elect will depend on the seriousness of the breach, specifically, whether the breach has deprived the innocent party of substantially the whole intended benefit.

Two observations may be made at this point regarding this scheme for determining the consequences of a given breach. First, there will be less scope for Lord Diplock's analysis to the extent that judges are prepared to find the intentions of the parties by implication or inference from the facts.¹² The second observation has to do with what appears to be the descriptive redundancy of Diplock's terminology.¹³ There seems to be no point in retaining the tripartite classification because, by definition, every consequence is determined by the same test. If a term is a "condition" because every breach of it will deprive the innocent party of substantially the whole benefit, then it would *always* have the consequence that the innocent party could elect. Therefore, it would not matter whether we initially called *all* contract terms intermediate terms or simply "terms" because breaches of so-called conditions and warranties would *always* have the defined consequence. The words "condition" and "warranty", at least in Lord Diplock's scheme, are only proxies for statements of a particular consequence and could be disposed of.

II. Fundamental Breach

The so-called "doctrine of fundamental breach" is a simple idea: any person committing a "fundamental" breach of a contract cannot take the benefit of an exculpatory clause to excuse that breach. The issue in the cases has been whether this happens (if at all) as a matter of construction or interpretation of the contract or if it is a substantive rule of law. If it is the latter, an exculpatory clause is ineffective even if it is worded in such a way as to apply clearly to the circumstances which arose. If it

¹¹ That is, it applies upon the omission of the parties to make provision for their rights in the event of a breach of the particular term.

¹² See *The Mihalis Angelos*, [1971] 1 Q.B. 164 (Q.B., C.A.); *Wickman Machine Tool Sales Ltd. v. L. Schuler A.G.*, [1974] A.C. 235, [1973] 2 All E.R. 39 (H.L.).

¹³ Consider the views of G.H. Treitel, *The Law of Contract* (7th ed., 1987), p. 608; J.W. Carter, *Classification of Contractual Terms: The New Orthodoxy* (1981), 40 Camb. L.J. 219, at pp. 221-222; A.C. Hutchinson and J.N. Wakefield, *Contracts-Innominate Terms: Contractual Encounters of the Third Kind* (1982), 60 Can. Bar Rev. 335.

is only a matter of construction, it amounts at most to a presumption against the operation of the clause. But if sufficiently clear, after receiving a strict construction, the clause will be given effect.

Lord Denning has been the champion of the substantive doctrine. An innocent party, in his view, is unaffected by an exculpatory clause where the breach is fundamental or "goes to the very root of the contract". He initially announced that the common law had progressed to a recognition of this doctrine in the 1956 Court of Appeal decision in *Karsales (Harrow) Ltd. v. Wallis*.¹⁴ In 1970, however, in *Suisse Atlantique Société d'armement Maritime S.A. v. N.V. Rottendamsche Kolen Centrale*,¹⁵ the House of Lords stated that the doctrine was only a matter of construing the contract and that therefore a properly drafted clause would operate even where a breach was fundamental.

The decision in *Suisse Atlantique* did not discourage Lord Denning. In fact, employing statements in the judgments of Lords Reid and Upjohn in that case, he quickly resurrected the substantive doctrine in *Harbutt's Plasticine Ltd. v. Wayne Tank and Pump Co. Ltd.*¹⁶ And this time he was careful to describe the ostensible theoretical basis for the doctrine. That basis was to be found in the one uncontroversial consequence of a fundamental breach, that the innocent party has an election to treat the contract as at an end:¹⁷

Such, then, is established as law when there is "a fundamental breach accepted by the innocent party" that is, when the innocent party has an *election* to treat the contract as at an end and does so. The position must, I think, be the same when the defendant has been guilty of such a fundamental breach that the contract is *automatically* at an end without the innocent party having an election. The innocent party is entitled to sue for damages for the breach, and the guilty party cannot rely on the exclusion or limitation clause: for the simple reason that he, by his own breach, has brought the contract to an end; with the result that he cannot rely on the clause to exempt or limit his liability for that breach.

The defaulting party could not benefit from the clause because, along with the rest of the contract, it had *come to an end* (automatically or by election).¹⁸

Lord Denning again applied the substantive doctrine in his Court of Appeal judgment in *Photo Production Ltd. v. Securicor Transport Ltd.*¹⁹ When the case reached the House of Lords, however, the substantive doctrine was unanimously and emphatically rejected.²⁰ Lord Wilberforce pointed out that Lord Denning's reliance on *Suisse Atlantique* was quite unwar-

¹⁴ [1956] 1 W.L.R. 936, [1956] 2 All E.R. 866 (C.A.).

¹⁵ [1967] 1 A.C. 361, [1966] 2 All E.R. 61 (H.L.).

¹⁶ [1970] 1 Q.B. 447, [1970] 1 All E.R. 225 (C.A.).

¹⁷ *Ibid.*, at pp. 466 (Q.B.), 234 (All E.R.).

¹⁸ An *automatic* ending without the innocent party having an election would be an uncommon event.

¹⁹ [1978] 1 W.L.R. 856, [1978] 3 All E.R. 146 (C.A.).

²⁰ *Supra*, footnote 1.

ranted. With respect to Lord Denning's application of the substantive doctrine in *Harbutt's Plasticine*, Lord Wilberforce stated that it was clear "that so far from following this House's decision in the *Suisse Atlantique* it is directly opposed to it and that the whole purpose and tenor of the *Suisse Atlantique* case was to repudiate [the doctrine]."²¹ The matter was solely one of construction of the contract. Inconsistent terminology had created confusion in the area, but that confusion ought not to be used to cloak a legal innovation.²²

But what can and ought to be avoided is to make use of these confusions in order to produce a concealed and unreasoned legal innovation: to pass, for example, from saying that a party, victim of a breach of contract, is entitled to refuse further performance, to saying that he may treat the contract as at an end, or as rescinded, and to draw from this the proposition, which is not analytical but one of policy, that all or (arbitrarily) some of the clauses of the contract lose, automatically, their force, regardless of intention.

Lord Diplock, with whom Lord Wilberforce agreed, provided the technical exposition of the flaw in the reasoning utilized by Lord Denning to justify the substantive doctrine. Lord Diplock began by describing the consequences of an ordinary breach of a contractual obligation. When persons enter into a contract they create "primary obligations". Whatever each person promises constitutes his or her primary obligations. These obligations may be defined expressly or by implication.²³ A breach of a primary obligation, in the ordinary case, gives rise to a "secondary obligation" implied by law for the defaulting party to pay damages in the amount of the loss occasioned by the breach.

In only two exceptional cases will the innocent party also be entitled to elect to terminate further performance under the contract. First, the parties can agree that a particular breach, whatever the significance of the term breached, will entitle the innocent party to elect. Lord Diplock would describe this as the "breach of condition" exception. Secondly, if the breach has the effect of depriving the innocent party of substantially the whole intended benefit, the innocent party again has the right to elect to terminate future performance. Lord Diplock would confine the use of the phrase "fundamental breach" to this exception.

This scheme of a general rule with two exceptions corresponds with Lord Diplock's paradigm for the classification of terms and the consequences of their breach. If the parties' intentions as to what is to happen upon a breach can be ascertained, those intentions will be given effect. Otherwise, where the term is an intermediate term, the seriousness of the breach will determine whether the innocent party is entitled to elect to end future

²¹ *Ibid.*, at pp. 841 (A.C.), 560 (All E.R.).

²² *Ibid.*, at pp. 844 (A.C.), 562 (All E.R.).

²³ The primary obligation in *Photo Production*, that the security guards would exercise reasonable skill and care for the safety of the factory, was implied.

performance. The breach must be so serious as to deprive the innocent party of substantially the whole intended benefit.

If a breach of contract is an ordinary one, the innocent party has no right to elect; he or she has only a right to damages for the loss occasioned by the breach. Lord Diplock labelled the obligation on the defaulting party a "general secondary obligation" to pay compensation for non-performance of primary obligations. In the two exceptional cases, "breach of condition" and "fundamental breach", the innocent party can elect. If the election is to affirm and proceed with the primary obligations, the defaulting party is subject only to the general secondary obligation. If the election is to terminate future performance, however, the primary obligations of both parties are replaced by an obligation on the defaulting party to pay compensation for the loss sustained as a consequence of the non-performance of future obligations. This obligation, said to be additional to the general secondary obligation, was named the "anticipatory secondary obligation" by Lord Diplock.

After describing and labelling these types of secondary obligations, Lord Diplock went on to indicate the effect of an exculpatory clause. In the event of "a breach of condition" or "fundamental breach", the election to end the contract must be understood as only the ending of the initially agreed upon primary obligations of the parties. It was to be "borne in mind that for the unperformed primary obligations of the party in default there are substituted by operation of law what I [Lord Diplock] have called the secondary obligations".²⁴ These obligations, he pointed out, could also be modified by agreement:²⁵

My Lords, an exclusion clause is one which excludes or modifies an obligation, whether primary, general secondary or anticipatory secondary, that would otherwise arise under the contract by implication of law. Parties are free to agree to whatever exclusion or modification of all three types of obligations as they please within the limits that the agreement must retain the legal characteristics of a contract. . . .

A contractual termination, in other words, has a limited operation. An election to end future performance does not affect a contractual agreement to modify the secondary obligations which otherwise would arise upon a "fundamental breach". This is why exculpatory clauses remain available for the benefit of the defaulting party.

III. Fundamental Breach in the Supreme Court

The Supreme Court of Canada had considered the doctrine of fundamental breach in the past and had approved the House of Lords' decision in

²⁴ *Photo Production Ltd. v. Securicor Transportation Ltd.*, *supra*, footnote 1, at pp. 850 (A.C.), 567 (All E.R.).

²⁵ *Ibid.* It may be noted that the parties are not completely "free to agree to whatever exclusion or modification of all three types of obligations they please". In addition to the consideration requirement, the parties cannot make an enforceable agreement providing for specific performance or for damages that are a "penalty".

*Photo Production.*²⁶ In *Hunter Engineering Company Inc. v. Syncrude Canada Ltd.*,²⁷ however, the court again felt compelled to address the issue. It was thought that "the law in this area seems to be in need of clarification".²⁸

Syncrude contracted with Hunter in 1975 for thirty-two gearboxes to drive the bucket wheel conveyor belts that transported sand to Syncrude's oil extraction plant at Fort McMurray. Later that same year, in a contract with Allis Chalmers, Syncrude ordered four additional gearboxes when purchasing conveyor systems.²⁹ All of the gearboxes were designed by

²⁶ *Beaufort Realties (1964) Inc. v. Belcourt Construction (Ottawa) Ltd.*, [1980] 2 S.C.R. 718, (1980), 116 D.L.R. (3d) 193.

²⁷ [1989] 1 S.C.R. 426, (1989), 57 D.L.R. (4th) 321.

²⁸ *Ibid.*, at pp. 508 (S.C.R.), 374-375 (D.L.R.), per Wilson J.

²⁹ A few years later Syncrude ordered an additional eleven gearboxes. This time it contracted with a corporation (Hunter Canada) fraudulently purporting to be the Canadian subsidiary of Hunter (Hunter U.S.). The misrepresentation was discovered by Hunter U.S., who alerted Syncrude, and then instituted an action against Hunter Canada for "passing off". Once advised of the allegations of fraud, and in order to ensure that the production of its gearboxes was not delayed, Syncrude obtained a waiver from Hunter Canada of its rights under the contract. In exchange, Syncrude set up a trust of the monies it was to have paid Hunter Canada. The arrangement allowed Syncrude to contract directly with Hunter Canada's gearbox supplier and for the supplier to be paid out of the trust fund. The monies remaining in the trust fund were, according to the terms of the trust, to be paid to the successful litigant in the passing off action between Hunter Canada and Hunter U.S., subject however to the condition that the warranty obligations in the original contract be assumed. If the warranty obligations were not undertaken, the trustee was to return the monies to Syncrude. Hunter U.S. succeeded with its passing off action. It then demanded the monies remaining in the trust fund, but refused to assume the warranty obligations. The trustee declined to pay Hunter U.S.

The Court of Appeal decided that Hunter U.S. was entitled to the fund on the basis of unjust enrichment. In the Supreme Court, the minority agreed that Syncrude would be enriched if it were to regain the monies, that Hunter U.S. would suffer a deprivation and that there was no juristic reason for the enrichment. The majority of the Supreme Court, however, took a different view.

Dickson C.J.C. pointed out, correctly, it is submitted, that the only unjust enrichment in this case was that between Hunter Canada and Hunter U.S. Hunter Canada had breached its fiduciary obligation to Hunter U.S. and was liable to account for any profits acquired by reason of that breach. This followed on a standard fiduciary law analysis. The circumstances also concurrently satisfied the *Pettkus v. Becker* three-part test for unjust enrichment. There was no unjust enrichment as between Syncrude and Hunter U.S., on the other hand, because Syncrude, through its actions in establishing the trust arrangement, sought only to assure for itself what it was entitled to under its original contract with Hunter Canada.

Hunter U.S. could only recover the monies remaining in the trust fund on either of two grounds. First, once found in breach of its fiduciary obligations, Hunter Canada was accountable to Hunter U.S. as constructive trustee of any profits it received. However, the entitlement of Hunter Canada to receive any payment from Syncrude was exclusively contractual and Hunter U.S. could stand in no better position *vis-à-vis* Syncrude than did Hunter Canada. As it was, the contract between Syncrude and Hunter Canada was voidable for fraudulent misrepresentation and, according to Dickson C.J.C., it had been avoided. Thus, interestingly, the fraud of Hunter Canada both created the constructive trusteeship in favour of Hunter U.S. and then denied Hunter U.S. any recovery for that fraud.

Hunter. Shortly after they were put into service, however, bull gears inside the gearboxes failed because of a defective weld. Syncrude had the gearboxes rebuilt and instituted an action against Hunter and Allis Chalmers for the cost.

After discussing the evidence, the Supreme Court concluded that the design of the gearboxes had been the responsibility of Hunter and that the design was inadequate. All members of the court agreed that the express warranties in the contracts had expired and were of no avail to Syncrude. The implied warranty of fitness in the Ontario Sale of Goods Act³⁰ did apply, however, and had been breached by both defendants. Hunter was liable on this basis because the warranty clause in its contract did not exclude liability for statutory warranties. The warranty clause in the Allis Chalmers contract, on the other hand, did deny the application of other warranties, "statutory or otherwise". Accordingly, the only way Allis Chalmers could be found liable was if, by reason of the doctrine of fundamental breach, the exculpatory clause did not affect Syncrude. Although all members of the court eventually concluded that Allis Chalmers was not liable, they took different views of what to do about exculpatory clauses.

Dickson C.J.C. (La Forest J. concurring) reviewed the history of the substantive doctrine of fundamental breach, pointed to its popularity in the lower courts and noted its utility in providing relief where the operation of exculpatory clauses would have seemed "particularly harsh". He nevertheless adopted the construction approach of the House of Lords. A substantive rule raised numerous difficulties, the major one being the determination of whether a given breach was fundamental.³¹ Moreover,

The second ground on which Hunter U.S. might have obtained the profit would have been in accordance with the terms of the trust arrangement. The effect of the trust in this case was to create an option in favour of the successful litigant in the passing off action. The option was gratuitous, but because set up through a trust, it was enforceable by the trust beneficiary (the successful litigant). Like all options, there was a price to pay upon its exercise. Here the option would crystallize into an obligation on the trustee actually to pay the monies only if Hunter U.S. assumed the warranty obligation. This Hunter U.S. had so far refused to do. And Dickson C.J.C., without explaining why, stated that it was now no longer possible for Hunter U.S. to assume the warranty obligation and collect the payment.

The one curious aspect of this part of the case was the strategy adopted by Hunter U.S. to deny that it had to assume the warranty obligation in order to become entitled to payment from the trustee. On any ground, and even if there had been no fraud as between Hunter Canada and Syncrude, Hunter U.S. would effectively have had to assume the warranty obligation. This would be so because any "profit" received by Hunter Canada as constructive trustee would be its revenues less its expenditures, one if its expenditures being the cost of fulfilling its warranty obligations.

³⁰ R.S.O. 1970, c. 421, now R.S.O. 1980, c. 462.

³¹ *Supra*, footnote 27, at pp. 460 (S.C.R.), 340 (D.L.R.). The difficulty remains, if it is one, since the availability of an election to terminate future obligations depends on whether the breach was fundamental.

many exculpatory clauses were reasonable, the product of an explicit bargained risk allocation, and their presence was reflected in the price. Because of the unnecessary complexities, the resulting uncertainty and the imprecision of its operation, Dickson C.J.C. rejected the substantive rule. His solution to the problem of harsh clauses was to test them under the doctrine of unconscionability. He would address directly the protection of the weak: "Explicitly addressing concerns of unconscionability and inequality of bargaining power allows the courts to focus expressly on the real grounds for refusing to give force to a contractual term said to have been agreed to by the parties."³² Dickson C.J.C. concluded that the clause was clear and that, because these were large sophisticated companies who knew what they were doing, it was not unconscionable.

Nowhere in his judgment did Dickson C.J.C. explicitly analyze the doctrine of fundamental breach in Lord Diplock's terms. He merely noted that there was a distinction between the "concept of fundamental breach in the context of refusal to enforce exclusion clauses and of substantial failure of performance . . .".³³ He observed that the two ideas "have often been confused, even though . . . [they] are quite distinct",³⁴ but he did not explain the nature of the distinction.³⁵

Wilson J. (L'Heureux-Dubé J. concurring) initially pointed to several definitions of what constituted a fundamental breach. Her own preference was for the formulation of Lord Diplock; a breach having the effect of depriving the innocent party of substantially the whole benefit it was the intention of the parties should be obtained from the contract. She referred to Lord Diplock's "primary" and "secondary" obligations and located "fundamental breach" as an exception to the rule that a breach only gives rise to a claim for damages. A breach that is fundamental gives to the innocent party an additional remedy, an election to put an end to all unperformed primary obligations of both parties.

Wilson J. went on to discuss the former second consequence of a fundamental breach. She agreed initially that the law in Canada appeared to be settled and that the construction approach had been accepted. She asserted, however, that some uncertainty "does remain primarily with regard

³² *Ibid.*, at pp. 462 (S.C.R.), 342 (D.L.R.).

³³ *Ibid.*, at pp. 463 (S.C.R.), 342 (D.L.R.).

³⁴ *Ibid.*

³⁵ The distinction, it will be recalled, is that there were two distinct consequences of a breach that is fundamental: (1) that the innocent party acquires the right to elect and (2) the innocent party is unaffected by an exculpatory clause sought to be relied on by the defaulting party. The latter consequence, the doctrine of fundamental breach, was rejected in *Photo Production* and at issue in this case. The two consequences, in any event, are related in at least two senses. First, as we have seen, the election consequence was used by Lord Denning in his attempt to justify the second consequence. Secondly, exculpatory clauses can modify the election consequence. Thus, although these consequences are in fact distinct, it is not always confusion which brings them together.

to the application of the construction approach".³⁶ She thought this uncertainty could be resolved in either of two ways. First, the *Photo Production* case could be accepted in its entirety with the result that exculpatory clauses would be construed without regard to the nature of the breach. The second way would be to import a "reasonableness" requirement into the law to regulate exculpatory clauses. This reasonableness standard would not apply at the time the contract was negotiated; the courts were unsuited to second guess the parties at that stage. Rather, the standard would apply after a breach had occurred.

Wilson J. favoured the second alternative and concluded that the "court must still decide, having ascertained the parties' intentions 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".³⁷ Wilson J., in other words, would use a fundamental breach as the trigger and context for the judicial assessment of the reasonableness of an otherwise operative exculpatory clause:³⁸

The policy of the common law is, I believe, that having regard to the conduct (pursuant to the contract) of the party seeking the indulgence of the court to enforce the clause, the court refuses. This conduct is described for convenience as "fundamental breach". It marks off the boundaries of tolerable conduct.

Wilson J. believed this approach had been recognized by the Supreme Court in the *Beaufort Realties*³⁹ decision.

It will be recalled that Dickson C.J.C. would employ the doctrine of unconscionability to deal with the problem of harsh clauses. Wilson J., having apparently already decided what clauses *should* be invalid, thought that this would "require an extension of the principle of unconscionability beyond its traditional bounds of inequality of bargaining power".⁴⁰ She also thought the unconscionability standard was less certain than her fundamental breach/reasonableness approach. She thought there was "virtue in a residual power residing in the court to withhold its assistance on policy grounds in appropriate circumstances".⁴¹

³⁶ *Supra*, footnote 27, at pp. 506 (S.C.R.), 374 (D.L.R.).

³⁷ *Ibid.*, at pp. 511 (S.C.R.), 377 (D.L.R.). Part of Wilson J.'s analysis was to note the absence in Canada of general legislation like the English Unfair Contract Terms Act 1977. She did point to several provincial statutes, many of which directly or indirectly deal with exculpatory clauses, but did not draw any inference from the existence of such legislation. The inference would be that the provincial legislatures have considered the problem and have legislated the degree of intervention they thought appropriate.

³⁸ *Ibid.*, at pp. 516 (S.C.R.), 381 (D.L.R.).

³⁹ *Supra*, footnote 26.

⁴⁰ *Supra*, footnote 27, at pp. 516 (S.C.R.), 380 (D.L.R.).

⁴¹ *Ibid.*, at pp. 517 (S.C.R.), 381 (D.L.R.). Wilson J. seems to suggest that an exculpatory clause alone, and not the whole contract, could be invalidated using the doctrine of unconscionability. This is problematic. If an exculpatory clause defines the obligation

Even on its own terms, there are some significant difficulties with Wilson J.'s analysis. The first relates to the concern apparently motivating Wilson J.'s efforts to regulate exculpatory clauses. Early in her analysis she indicates that enforcing exculpatory clauses "could be harsh if the parties had not adequately anticipated or considered the possibility of the contract's disintegration through fundamental breach".⁴² A first observation is that if the clause is clear and does apply to the specific circumstances which arose, then the parties *did* "anticipate and consider" the possibility of a fundamental breach. The second observation is that a failure to "anticipate or consider" is a matter that could be addressed directly. The reasonableness of the clause, in any event, is not in any necessary sense connected to this concern.

The second difficulty is found in the several references to "policy" in Wilson J.'s judgment.⁴³ It is not clear, first, whether or not resort to "policy" is simply for the purpose of initially legitimating her approach or if it is to occur in each individual case. If it is the former, then the operative policy seems to be that "having regard to the conduct (pursuant to the contract) of the party seeking the indulgence of the court to enforce the clause, the court refuses".⁴⁴ But in this context, a fundamental breach will not necessarily involve any odious or reprehensible conduct on the part of the breaching party. He or she, for completely benign reasons, may not be able to avoid the innocent party being deprived of substantially the whole intended benefit. It seems unlikely that it is the policy of the law to punish such conduct.

A third difficulty is found in the proposed application of Wilson J.'s approach after breach "in light of subsequent events".⁴⁵ It is in fact the manifest purpose of exculpatory clauses to allocate the risk of *subsequent events*. This is why, at least ostensibly, they are included in contracts. Given that, it seems that a positive justification for this feature of Wilson J.'s approach is in order. It is not enough to say that the approach is inappropriate to the initial bargain of the parties. That does not tell us why it is appropriate *after the breach*. This seems to be an unpromising attempt to incorporate some relational content into a solution to the problem of harsh clauses.

A fourth difficulty is the trigger or threshold role for the fundamental breach of the contract. This would appear to be an entirely arbitrary limitation on a reasonableness standard. Clauses may be totally unreasonable

undertaken, as will be shown, maintaining the contract without the exclusion clause represents a major alteration of the performance promised by one of the parties. Consider also that unconscionable conduct occurs in the making of the *contract* and not, specifically, in the extraction of one or two exculpatory clauses in the course of making the contract.

⁴² *Ibid.*, at pp. 508 (S.C.R.), 375 (D.L.R.).

⁴³ *Ibid.*, at pp. 515-517 (S.C.R.), 380-381 (D.L.R.).

⁴⁴ *Ibid.*, at pp. 516 (S.C.R.), 381 (D.L.R.).

⁴⁵ *Ibid.*

and yet will be given effect under this approach if the breach is only an "ordinary" one. If one is concerned about the reasonableness of exculpatory clauses, the standard ought to be generally applicable. A fundamental breach is irrelevant to that concern.

The foregoing difficulties suggest that Wilson J.'s approach requires further thought. It may be that a straightforward reasonableness standard, divorced from unconscionability, would be a satisfactory test in practice.⁴⁶ It seems unsatisfactory, however, to link such a test with the fortuitous occurrence of a breach that is fundamental.

IV. *Unitary Contract Interpretation*

Both Dickson C.J.C. and Wilson J., we have seen, accepted the decision of the House of Lords in *Photo Production*. And that decision proceeds on the basis of the technical exposition of the effect of exculpatory clauses put forward by Lord Diplock. Unfortunately, just as was the charge against Lord Denning, this theoretical analysis is flawed. Whatever the other utility of Lord Diplock's paradigm,⁴⁷ it suffers in the exclusion clause context from a blinkered approach to the interpretation of contracts. The fact of the matter is that a substantive doctrine of fundamental breach is logically impossible, but not for any reason offered by Lord Diplock.

It is a standard admonition of judges that contracts must be read as a whole if they are to be correctly interpreted. Support for this admonition is found in the view that every term in a contract affects the price. Even minor or incidental terms are "purchased" by the party insisting on them. On this view, there is no such thing as "boiler-plate" or "miscellaneous" terms in the sense that such terms are simply thrown in. Every clause in a contract results from the negotiated allocation of cost or risk.

To avoid a unitary interpretation of a contract, it is necessary to compartmentalize or segment different aspects of the agreement and treat those compartmentalized aspects independently or serially. This is what has happened in the common law as it applies to exclusion clauses. The judges have considered the "obligation" provisions in the contract and then independently looked at the "exculpatory" provisions. Lord Denning explicitly took this approach in *Karsales (Harrow) Ltd. v. Wallis*⁴⁸ when

⁴⁶ As to a statutory reasonableness standard, see M.H. Ogilvie (1984), 62 Can. Bar Rev. 388, at pp. 402 *et seq.*

⁴⁷ The model seems to be solely a descriptive one. It appears to be devoid of normative implications.

⁴⁸ *Supra*, footnote 14, at pp. 940 (W.L.R.), 869 (All E.R.). (Emphasis added). The compartmental approach is also clearly evident in the judgment of Wilson J. She states, *supra*, footnote 27, at pp. 510 (S.C.R.), 376 (D.L.R.), that the defaulting party "is seeking to escape almost entirely the burdens of the transaction but enlist the support of the courts to enforce its benefits". As will become apparent, there is no "burden" in connection with the event which occurred if the obligation is *defined* by the exculpatory clause.

he stated that 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". This is also the approach of Lord Diplock in *Photo Production*. It is an incorrect approach.

A valid exculpatory clause, as a matter of economic reality, constitutes part of the "obligation" undertaken. This was pointed out many years ago.⁴⁹ The real obligation a party agrees to is defined by the *combination* of the "obligation" and "exculpatory" clauses; they must be read together. The real obligation is whatever is initially promised less whatever is excluded. For example, a promise to provide a gearbox to drive a conveyor system along with an exclusion of the statutory warranty of fitness for purpose, as in *Hunter Engineering*, is merely an obligation to provide a piece of machinery which meets the technical definition of a gearbox, whether or not it is fit for the particular purpose. Similarly, an exclusion of liability for injuries caused by a negligently manufactured gearbox is only an obligation to provide a gearbox, which gearbox can be dangerous. The obligation on the seller of the gearbox, in these respects, is limited. The risk is allocated to the buyer, presumably for a lower price. No actual obligation is created or ever exists to the extent that liability for a failure to perform is excluded. Accordingly, where there is no obligation, there can be no breach. *A fortiori*, there can be no "fundamental" breach; it is impossible.⁵⁰

Lord Diplock's use of the compartmental approach in *Photo Production* is surprising for he has always described a fundamental breach as one that deprives the innocent party of substantially the whole benefit *it was intended* should be obtained *under the contract*.⁵¹ The whole benefit *intended* is necessarily determined by what is excluded in the first instance by the parties. The exculpatory clauses, in other words, must be examined at the earliest stage of analysis, when the real obligation *under the contract* is being ascertained. The extent of exculpation will determine what obligation existed and, therefore, whether any breach, fundamental or otherwise, was even possible.

Lord Diplock's judgment in *Photo Production* is especially surprising when it is realized that he employed the correct approach in *Hong Kong*

⁴⁹ B. Coote, *Exception Clauses* (1964), pp. 1-18, 111-116.

⁵⁰ There is a difference here between "exculpatory" clauses and "limitation" clauses. In the case of a limitation clause, the original promise is not excluded and can therefore technically be breached. The clause then operates to limit the *quantum* of the liability for breach. However, although this distinction exists, it provides no basis for treating exculpatory and limitation clauses differently. Nor are there any other apparent justifications for a disparate treatment. Wilson J., *supra*, footnote 27, at pp. 518 (S.C.R.), 382 (D.L.R.), doubts the significance of such a distinction as does the Australian High Court (see *Darlington Futures Ltd. v. Delco Australia Pty Ltd.* (1986), 161 C.L.R. 500).

⁵¹ *Hong Kong Fir Shipping Co. Ltd. v. Kawasaki Kisen Kaisha Ltd.*, *supra*, footnote 1, at pp. 66 (Q.B.), 485 (All E.R.).

Fir,⁵² the case in which he first described his contractual model. In that case, in order to decide whether or not a fundamental breach had occurred, he analyzed an exculpatory clause to see what benefit the parties *intended*:⁵³

What the judge had to do in the present case as in any other case, where one party to a contract relies on a breach by the other party as giving him a right to elect to rescind the contract, and the contract itself makes no express provision as to this was to look at the events which had occurred as a result of the breach at the time at which the charterers purported to rescind the charterparty and to decide whether the occurrence of those events deprived the charterers of substantially the whole benefit which it was the intention of the parties as expressed in the charterparty that the charterers should obtain from the further performance of their own contractual undertakings.

One turns, therefore, to the contract, the Baltime 1939 Charter. Clause 13, the "due diligence" clause, which exempts the shipowners from responsibility for delay or loss or damage to goods on board due to unseaworthiness unless such delay or loss or damage has been caused by want of due diligence of the owners in making the vessel seaworthy and fitted for the voyage, is in itself sufficient to show that the mere occurrence of the events that the vessel was in some respect unseaworthy when tendered or that such unseaworthiness had caused some delay in performance of the charterparty would not deprive the charterer of the whole benefit which it was the intention of the parties he should obtain from the performance of his obligations under the contract—for he undertakes to continue to perform his obligations notwithstanding the occurrence of such events if they fall short of frustration of the contract and even deprives himself of any remedy in damages unless such events are the consequence of want of due diligence on the part of the shipowner.

This is the approach Lord Diplock should have employed in *Photo Production*. It is also the approach the Supreme Court of Canada ought to have used. Assessing the exculpatory clause immediately would lead to the conclusion that there was no primary obligation of the sort alleged. There would therefore be no breach of contract, no fundamental breach and no right to elect. The analysis would be straightforward, a matter of ascertaining the real obligation undertaken, and there would be no talk of a substantive doctrine of fundamental breach.

The unitary approach to the interpretation of a contract identifies what is actually being (or not being) promised. A problem, in this regard, is that contracts tend to be structured with "obligation" clauses up front and "exculpatory" clauses buried in the "fine print" or miscellaneous section. The exculpatory clauses are therefore often not read. That particular problem, however, has been addressed in a different way by the common law. The reasonable notice doctrine requires that onerous clauses not be given effect unless a reasonable attempt is made to bring them to the attention of the other party.⁵⁴ But if that doctrine does not apply, and if the clause

⁵² *Ibid.*

⁵³ *Ibid.*, at pp. 72 (Q.B.), 488-489 (All E.R.).

⁵⁴ The doctrine is most commonly applied in "ticket" cases, but even a signature on a contract may not conclusively establish that the signor had notice or reasonable notice

is sufficiently clear and so applies, the issue reduces to whether or in what circumstances we want to give relief to contracting parties who had reasonable notice of the entire and unambiguous obligation of the other party.

V. Unconscionability in the Supreme Court

After rejecting the substantive notion of fundamental breach, Dickson C.J.C. proposed the doctrine of unconscionability as an appropriate regulator of the harshness of exculpatory clauses.⁵⁵ This he does in an almost cavalier fashion. He does not explain what "unconscionability" means, how it would apply in this context or its general significance in the law of contract. This is regrettable, for these are deep waters. This failure to explore the doctrine of unconscionability in detail, or at all, makes the judgment an entirely unsatisfactory foundation for the subsequent application of the standard.

The doctrine of unconscionability in Canada today may be a very narrow or a very wide legal concept. An unconscionability excuse, of narrow scope, has long been a part of our law.⁵⁶ Canadian courts determined that this excuse was available where two elements were present. There had to be (1) an improvident bargain and (2) an inequality in the positions of the parties. The law was summarized in a 1966 case comment:⁵⁷

In the cases now under discussion the courts intervene to rescind the contract whenever it appears that one of the parties was incapable of adequately protecting his interests and the other has made some immoderate gain at his expense. If the bargain is fair the fact that the parties were not equally vigilant of their interest is immaterial. Likewise if one was not preyed upon by the other, an improvident or even grossly inadequate consideration is no ground upon which to set aside a contract freely entered into. It is the combination of inequality and improvidence which alone may invoke this jurisdiction. Then the onus is placed upon the party seeking to uphold the contract to show that his conduct throughout was scrupulously considerate of the other's interests.

In 1974, the English Court of Appeal decided *Lloyd's Bank Ltd. v. Bundy*.⁵⁸ Two of the judges dealt with the case on the basis of undue influence. Lord Denning, however, gave relief to old Herbert Bundy on the basis of a doctrine of "inequality of bargaining power". He said that there were cases in which "the courts will set aside a contract, or a transfer of property, when the parties have not met on equal terms—when the one is so strong in bargaining power and the other so weak—that, as

of onerous terms. See R. Hasson, Tilden Rides Again: A Comment on *Reaume v. Caisse Populaire Ltée* (1988), 14 C.B.L.J. 110.

⁵⁵ *Supra*, footnote 27, at pp. 462 (S.C.R.), 341-342 (D.L.R.).

⁵⁶ See *Berney v. Pitt* (1686), 2 Vern. 14, 23 E.R. 620 (Ch.); *Proof v. Hines* (1735), Cases T. Talbot 111, 25 E.R. 690 (Ch.).

⁵⁷ B. Crawford (1966), 44 Can. Bar Rev. 142, at p. 143.

⁵⁸ [1975] Q.B. 326, [1974] 3 All E.R. 757 (C.A.).

a matter of common fairness, it is not right that the strong should be allowed to push the weak to the wall".⁵⁹ After then reviewing several categories of these cases, Lord Denning framed the principle in this fashion:⁶⁰

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.

Lord Denning's principle soon found favour in Canada. The Ontario Court of Appeal immediately and uncritically applied the principle in *McKenzie v. Bank of Montreal*.⁶¹

In the next significant case, the British Columbia Court of Appeal decision in *Harry v. Kreutziger*,⁶² the judges dealt with the potential of this principle in different ways. McIntyre J.A. referred to *Lloyd's Bank Ltd. v. Bundy* but essentially ignored Lord Denning's principle. He chose instead to apply the traditional doctrine of unconscionability delineated in earlier cases such as, for example, *Morrison v. Coast Finance Ltd.*⁶³ He said:⁶⁴

From these authorities this rule emerges. 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.

Lambert J.A. took a different approach. He sought to combine the traditional Canadian principle and Lord Denning's new principle.⁶⁵

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, to select words from both statements of principle, the *Morrison* case and the *Bundy* case, 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; as, for example, a consideration of whether the consideration was grossly inadequate, rather than merely inadequate, separate from the consideration of whether

⁵⁹ *Ibid.*, at pp. 336-337 (Q.B.), 763 (All E.R.).

⁶⁰ *Ibid.*, at pp. 339 (Q.B.), 765 (All E.R.).

⁶¹ (1976), 76 D.L.R. (3d) 113, 12 O.R. (2d) 719 (Ont. C.A.).

⁶² (1978), 95 D.L.R. (3d) 231, 9 B.C.L.R. 166 (B.C.C.A.).

⁶³ (1965), 55 D.L.R. (2d) 710, 54 W.W.R. 257 (B.C.C.A.).

⁶⁴ *Supra*, footnote 62, at pp. 237 (D.L.R.), 173 (B.C.L.R.).

⁶⁵ *Ibid.*, at pp. 240-241 (D.L.R.), 177 (B.C.L.R.).

bargaining power was grievously impaired, or merely badly impaired. Such separate consideration of separate questions produced by the application of a synthetic rule tends to obscure rather than aid the process of decision.

The single question of whether the transaction, seen as a whole, is sufficiently divergent from community standards of commercial morality that it should be rescinded must be answered by an examination of the decided cases and a consideration, from those cases, of the fact patterns that require that the bargain be rescinded and those that do not. In that examination, Canadian cases are more relevant than those from other lands where different standards of commercial morality may apply, and recent cases are more germane than those from earlier times when standards were, in some respects, rougher and, in other respects, more fastidious. In my opinion, it is also appropriate to seek guidance as to community standards of commercial morality from legislation that embodies those standards in law.

Several decisions on unconscionability have been rendered since *Harry c. Kreutziger* was decided. A number of the judges have utilized Lambert J.A.'s approach.⁶⁶

In declaring that transactions are to be evaluated against "community standards of commercial morality" Lambert J.A. has arguably merely expressed the original motivation for both the traditional Canadian doctrine of unconscionability and Lord Denning's general principle. At the same time, however, the "community standards" test would appear to allow for relief in cases where relief would have been difficult to justify under the traditional approach. It is, potentially, a very wide doctrine.⁶⁷ A number of subsequent cases illustrate this potential.⁶⁸ In particular, contracts between businesspersons have been set aside because of commercial pressure. These decisions are hard to reconcile with the recent Privy Council reasoning in relation to the doctrine of duress to the effect that commercial pressure must involve a coercion of the will before a contracting party may complain.⁶⁹

The apparent acceptance by some lower courts of a wider notion of unconscionability, it should be noted, has not proceeded unchallenged. In 1985, in *National Westminster Bank Plc v. Morgan*,⁷⁰ the House of Lords flatly rejected Lord Denning's inequality of bargaining power principle. In doing so, it removed one of the pillars on which Lambert J.A. constructed his "community standards" approach.

⁶⁶ *A & K Lick-A-Chick Franchises Ltd. v. Cordiv Enterprises Ltd.* (1981), 119 D.L.R. (3d) 440 (N.S.T.D.); *Vencer Mortgage Investments Ltd. v. Bailey* (1984), 27 B.L.R. 255 (B.C.S.C.); *Osorio v. Cardona* (1984), 15 D.L.R. (4th) 619 (B.C.S.C.); *Haymour Holdings Ltd. v. R.* (1986), 5 B.C.L.R. (2d) 145 (B.C.S.C.).

⁶⁷ The traditional doctrine of unconscionability was arguably only narrower because it was used sparingly and in very compelling circumstances. Nevertheless, Lambert J.A.'s reformulation of the test raises directly the question whether the law of contract should adopt a general standard of "fairness" with which all contracts must comply.

⁶⁸ See the cases in footnote 66, *supra*.

⁶⁹ *Pao On v. Lau Yiu*, [1980] A.C. 614, at pp. 635-636, [1979] 3 All E.R. 64, at pp. 78-79 (P.C.).

⁷⁰ [1985] A.C. 686, at pp. 707-708, [1985] 1 All E.R. 821, at p. 830.

This is the recent history of unconscionability. There are, accordingly, two, or possibly three, conceptions of the doctrine: the narrow traditional idea, the wider "community standards" approach or some other general notion of "fairness". This third possibility is proposed by Professor Waddams,⁷¹ who takes several instances of judicial relief as establishing the recognition by the courts of "a general principle based on fairness".⁷²

Unfortunately, no review of the history of unconscionability is found in *Hunter Engineering*. Nor is there any apparent appreciation that there are different views of what unconscionability might mean. Dickson C.J.C., for his part, states that the doctrine is concerned with "the protection of the weak from over-reaching by the strong",⁷³ and that unconscionable contracts "might arise from situations of unequal bargaining power between the parties".⁷⁴ These are vague statements, and there is little else in his judgment. The judgment of Wilson J. is more revealing, but only in the sense that it is possible to discern what her view of unconscionability is. She appears to believe that unconscionability is a narrow doctrine, and that it is traditionally associated with inequality of bargaining power. As indicated earlier, to be suitable for the regulation of exculpatory clauses, in her view, would "require an extension of the principle of unconscionability beyond its traditional bounds of inequality of bargaining power".⁷⁵ She cites a number of authorities but, again, does not distinguish between the various possible views of the content of the doctrine.⁷⁶

The traditional (and narrow) doctrine of unconscionability is relatively uncontroversial. Most people applaud judicial intervention to avoid one person taking advantage of the severe situational disabilities of another. The expansion of the unconscionability notion to a general "fairness" standard, on the other hand, has been the subject of much recent academic discourse. Professor Waddams, the only commentator cited in *Hunter Engineering* on this point, clearly favours a generalized doctrine.⁷⁷ Others, however, doubt the utility of such a principle and advance a range of arguments against its acceptance.⁷⁸ No effort is made here to assess those various arguments. Only one observation will be made.

⁷¹ S.M. Waddams, *The Law of Contracts* (2nd ed., 1984), c. 14.

⁷² *Ibid.*, p. 389.

⁷³ *Supra*, footnote 27, at pp. 462 (S.C.R.), 341 (D.L.R.).

⁷⁴ *Ibid.*, at pp. 462 (S.C.R.), 342 (D.L.R.).

⁷⁵ *Ibid.*, at pp. 516 (S.C.R.), 380 (D.L.R.).

⁷⁶ *Ibid.*, at pp. 513 (S.C.R.), 378 (D.L.R.).

⁷⁷ *Op. cit.*, footnote 71.

⁷⁸ See D. Tiplady, *The Judicial Control of Contractual Unfairness* (1983), 46 Mod. L. Rev. 601; A.A. Leff, *Thomist Unconscionability* (1979-80), 4 C.B.L.J. 424; D. Vaver, *Unconscionability: Panacea, Analgesic or Loose Can(n)on?* (1988), 14 C.B.L.J. 40; M.J. Trebilcock, *The Doctrine of Inequality of Bargaining Power: Post-Benthamite Economics in the House of Lords* (1976), 26 U.T.L.J. 359.

Proponents of a general doctrine might have argued that contract law is not, but should be, concerned with or based on fairness. They do not, however, make this claim. Nor could they, for fairness is precisely the reason the intentions of the parties, subject to defined limitations, are enforced. They assert, instead, that judges actually employ the "fairness" standard every day and that it would conduce to certainty if this principle were openly recognized. It would then be possible to begin to fashion suitable guidelines for its application. According to Professor Waddams:⁷⁹

Only with open recognition of the true principle can the courts begin to develop relevant criteria and guidelines that will satisfactorily explain their decisions and offer a useful guide for the future. This is not to underestimate the difficulty of developing such guidelines, but to maintain that to make a start on that task would be an advance in certainty as well as in justice.

These remarks may be assessed, in part, by examining the suggestions that have been made as to what would be "rational criteria and guidelines".

In *Hunter Engineering* only Wilson J. offered any guidelines for the task of assessing the fairness of a contractual provision.⁸⁰ She referred to the judgment of Anderson J. in *Davidson v. Three Spruces Realty*⁸¹ and his proposed criteria for testing an exculpatory clause. They were as follows:⁸²

- (1) Was the contract a standard form contract drawn up by the bailee?
- (2) Were there any negotiations as to the terms of the contract or was it a commercial form which may be described as a "sign here" contract?
- (3) Was the attention of the plaintiffs drawn to the limitation clause?
- (4) Was the exemption clause unusual in character?
- (5) Were representations made which would lead an ordinary person to believe that the limitation clause did not apply?
- (6) Was the language of the contract when read in conjunction with the limitation clause such as to render the implied covenant made by the bailee to use reasonable care to protect the plaintiffs' property meaningless?
- (7) Having regard to all the facts including the representations made by the bailee and the circumstances leading up to the execution of the contract, would not the enforcement of the limitation clause be a tacit approval by the Courts of unacceptable commercial practices?

Most of these criteria replicate existing contract law. The first, third and fourth criteria raise the "reasonable notice" doctrine. The first also raises the *contra proferentem* rule. The second criterion asks whether there was economic duress. The fifth deals with the law of representations and collateral contract. The sixth criterion suffers from the same flawed approach used in the fundamental breach context. The "language of the contract" must be read "in conjunction with the limitation clause". Only then can the real obligation be identified. The effect of the limitation may indeed

⁷⁹ *Op. cit.*, footnote 71, pp. 399-400.

⁸⁰ *Supra*, footnote 27, at pp. 514-515 (S.C.R.), 379-380 (D.L.R.).

⁸¹ (1977), 79 D.L.R. (3d) 481, [1977] 6 W.W.R. 460 (B.C.S.C.).

⁸² *Ibid.*, at pp. 493 (D.L.R.), 476-477 (W.W.R.), cited by Wilson J., *supra*, footnote 27, at pp. 514-515 (S.C.R.), 379-380 (D.L.R.).

be that there is no covenant to use reasonable care. The seventh criterion requires clarification but it is suspect if it means a judge could invalidate a provision which does *not* offend any contract rule but is, in the view of the particular judge, an "unacceptable commercial practice". Most of these factors, in the end, reproduce existing judicial considerations. In that respect, the analysis amounts only to a reinvention of contract law.

The same may be said of a second suggested list of factors. This is the list proposed by the Ontario Law Reform Commission in its 1987 Report on Amendment of the Law of Contract.⁸³ The Commission recommended legislation which would give the courts power to grant relief from contracts and contractual provisions that are unconscionable using the following non-exclusive list of decisional criteria for guidance:⁸⁴

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 the 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 or demand;
- (i) whether the party seeking relief knew or ought reasonably to have known of the existence and extent of the term or terms alleged to be unconscionable;

⁸³ Ministry of the Attorney General (Ontario), Toronto, 1987. The joint directors of this law reform project were Professors Waddams and Ziegel of the University of Toronto.

⁸⁴ *Ibid.*, pp. 136-137. These clauses are to be construed according to the plain meaning of the words and without recourse to the laconic or non-existent explanations in the Commission's report.

- (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.

Clause (a) raises the doctrines of traditional unconscionability, capacity, economic duress, undue influence, *non est factum* and fiduciary obligation.⁸⁵ Clause (b) is a curious one. If the terms being tested for their necessity are terms that were included by one party for his or her protection, they presumably were thought to be "reasonably necessary" for the protection of that party. Moreover, the fact that the terms are now being invoked indicates that the benefitting party properly assessed the degree of protection he or she required and was only prudent in bargaining for the risk to be borne by the informed other party. If the terms are instead just other terms found in the contract, it is difficult to see why (even if it could be determined that they were not reasonably necessary) they should result in the whole contract or *other* provisions being found to be unconscionable. Clause (c) appears to outlaw or disallow exculpatory clauses altogether since they clearly require "a party to waive rights to which he or she would otherwise be entitled". This is a startling, and doubtful, consideration. Clause (d) merely raises the improvidence of a transaction. This factor is already an element in, for example, the doctrines of undue influence and traditional unconscionability. Clause (e) appears to relate either to a unilateral mistake as to the terms of a contract or is an attempt to rewrite significantly the law of mistake. Alternatively, it may involve a question of reasonable notice. Clause (f) appears to deal with misrepresentation and undue influence; clause (g) with traditional unconscionability, duress and undue influence; clause (h) with duress and traditional unconscionability; and clause (i) with reasonable notice. Clause (j) is another doubtful consideration because, notwithstanding that one party is better able to guard against a loss, the parties might, by their express exculpatory clause, intentionally allocate the risk of loss to the other party. It may be inefficient to do this, but they are clearly entitled to do it. In clause (k) one can only wonder what "written standard terms of business" means. Clause (k) also raises, as does clause (l) the possibility of deriving implications or implied terms from the circumstances of individual cases. Accordingly, in this collection of factors, there is again a substantial replication of contract law.

⁸⁵ Fiduciary obligation is not normally considered a part of contract law although undue influence (which can occur in a fiduciary relationship) tends to be included in contract treatises. See generally, R. Flannigan, *The Fiduciary Obligation* (1989), 9 Oxford J. Leg. Stud. 285, and *Fiduciary Obligation in the Supreme Court* (1990), 54 Sask. L. Rev. 45.

If the formulation of guidelines for the application of the unconscionability standard leads only to the reinvention of contract law, we will have wasted considerable effort in achieving recognition of what must be the obvious "fairness" of contract law. There would be no evident increase in certainty, nor any particular change in approach. We would still enforce the intentions of the parties subject to defined limitations.

Moving to a general doctrine of unconscionability could have an effect other than the reproduction of much of the law of contract. The effect might be the discounting of the current individual bases for relief. A misrepresentation, for example, today allows for the rescission of a contract. But if a misrepresentation is only one factor to consider in a "fairness" analysis, and will therefore not necessarily attract relief by itself, its significance is much reduced. The same effect would occur with all the various factors. They would lose their distinct status as singular bases of relief. This would amount to rather a substantial alteration in the law of contract.

The utility of a general doctrine of unconscionability remains to be demonstrated. The claim of greater "certainty" and "justice" is not yet proven. The debate, presumably, will continue. Unfortunately, there is little in *Hunter Engineering* which will assist in the determination of the issue. The court avoided any serious investigation into the nature of the doctrine. The decision amounts only to a confirmation that the Supreme Court will apply the narrow doctrine of unconscionability in the exculpatory clause context.

Conclusion

The particular problem addressed in *Hunter Engineering* was how to regulate harsh exculpatory clauses.⁸⁶ The Supreme Court's solution to the problem was to reject a substantive doctrine of fundamental breach and to offer other means to deal with such clauses. Wilson J. proposed a limited reasonableness test. Dickson C.J.C. disagreed with Wilson J. on this, preferring to rely on the doctrine of unconscionability. Only the latter approach is justified at present.⁸⁷ Accordingly, at a minimum, exculpatory clauses will be regulated by (1) a strict construction of the wording of the provision and (2) an assessment of whether one party took advantage of the severe situational disability of the other party.

The nature of the unconscionability standard, as a general matter, remains to be specifically defined. This is perhaps unsurprising. Although

⁸⁶ It must be borne in mind that, because they define the obligation undertaken, harsh exculpatory clauses are in fact harsh obligation clauses.

⁸⁷ The divergence in views on the issues of reasonableness and unconscionability means, in effect, that the law remains as it was—all contracts being regulated by some (unclear) standard of unconscionability.

a pleasing incantation, it is a complex and contestable notion. Much will turn on the way in which the principle is constructed. All of this becomes evident upon even a cursory exploration of the basis of the intervention. This may account for the continuing hesitation of judges to go beyond the unhelpful platitudes that litter this area of the law. But the principle will not define itself. It does not exist independently of our social condition. Its content is for us to choose.