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**RETURN OF THE UNDEAD:
FUNDAMENTAL BREACH DISINTERRED**

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Despite the efforts of some judges and academics to eliminate fundamental breach from the corpus of Canadian contract law, a number of recent cases suggest that the doctrine continues to attract the imagination of a number of judges. In this paper the author considers three possible futures for fundamental breach: exorcism, substantiation and transubstantiation. He suggests that the third option is the most desirable and that the most coherent development of the law would be to incorporate fundamental breach into the emergent doctrine of good faith performance.

Malgré les efforts déployés par certains juges et universitaires afin d'éliminer la doctrine de l'inexécution fondamentale du droit des contrats canadien, plusieurs décisions récentes indiquent que cette doctrine suscite toujours l'intérêt d'un grand nombre de juges. Dans le présent article, l'auteur se penche sur trois possibilités pour l'avenir de l'inexécution fondamentale : l'élimination, la clarification et l'intégration. Il avance que la troisième option est la plus intéressante et que l'intégration de la doctrine de l'inexécution fondamentale dans une doctrine naissante, soit celle de l'exécution de bonne foi, ferait évoluer le droit de la façon la plus cohérente.

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1. Introduction

In *Hunter Engineering Co. v. Syncrude Canada Ltd.* Chief Justice Dickson famously, but gently, tried to “lay the doctrine of fundamental breach to rest”¹ and replace it with the more generic concept of unconscionability. In a concurring judgment, however, Wilson J. argued in favour of the continued existence of such a doctrine on somewhat elusive public policy grounds.² A number of recent cases indicate that the spectre of fundamental breach still attracts the imagination of a number of Canadian judges. In this essay I consider these developments by a) identifying several recent apparitions; b) briefly reviewing the genesis of the doctrine of fundamental breach in English law; c) revisiting the history of the doctrine in Canada prior to *Hunter*; d) analyzing the reasons for decision offered in *Hunter*; e) outlining the academic response to *Hunter*; f) considering the conflicting case law since *Hunter*; and g) offering by way of conclusion three possible options, one of which will require a complete exorcism of the doctrine, another its substantiation, and a third its transubstantiation.

Before proceeding further it is essential to focus precisely the issue for analysis. The concept of fundamental breach has been encoded with two distinct meanings in the Anglo-Canadian common law tradition, one of which is uncontroversial, the other highly controversial. The first, unproblematic, usage relates to the remedies available to the innocent party if there has been a breach of a contract. If there is a breach of a relatively minor obligation, the innocent party only has a right to sue for damages, but if there is a breach of a relatively major obligation then the innocent party can both sue for damages and elect to suspend further performance of the contract. The question is how to distinguish between these minor and major obligations? There is consensus that if a party is “deprived of substantially the whole benefit of the contract” then that is a “fundamental breach” thereby entitling them to the strong remedy of treating the contract as ended.³ By contrast, in the middle of the twentieth century there emerged a more particular, and controversial, meaning for fundamental breach: if a party commits a radical breach of a contract and then seeks by means of an exculpatory clause to take all the benefits of the contract but none of the burdens, then the courts will prohibit that party from relying on an exculpatory clause irrespective of how clearly

¹ [1989] 1 S.C.R. 426 at 462 [*Hunter*].

² *Ibid.* at 499 ff.

³ See e.g. *Hong Kong Fir Shipping Co. Ltd. v. Kawasaki Kisen Kaisha Ltd.*, [1962] 2 Q.B. 26 (C.A.) [*Hong Kong Fir*]; *Guarantee Company of North America v. Gordon Capital Corporation*, [1999] 3 S.C.R. 423 at 446 [*Guarantee Co.*]. See also John D. McCamus, *The Law of Contracts* (Toronto: Irwin Law Inc., 2005) at 752-54.

it is drafted, because to do so would be unfair to the other contracting party. Fundamental breach in this sense is conceived as a rule of law and not just a rule of construction and therefore serves as a doctrine to police the equities of the relationship. The controversy arises from this judicial police power because, thus construed, fundamental breach challenges conventional commitments to the ideals of freedom and sanctity of contract, and raises profound questions about the function of contract law in a modern society.

2. Recent Apparitions of Fundamental Breach

Several recent cases suggest that a significant number of Canadian trial and appeal judges are sympathetic to the doctrine of fundamental breach as a mechanism for regulating contractual relations. Sometimes their solicitude is explicit; often it is implicit. Consider the following examples.

In 2002, in *General Refractories Co. of Canada Ltd. v. Venturedyne Ltd.*,⁴ the Ontario Superior Court noted academic comments that “there is not much life left in the concept of fundamental breach of contract” but held that “as long as there is some life left in the concept, I believe that it should be applied in the clearest circumstances.”⁵ Himel J. continued, “Within the context of the facts of this case, I find that the ‘standard warranty’ provision should not attach to the negotiated performance guarantees. It is neither fair nor reasonable to give effect to a standard-form warranty provision which was impliedly waived by [the manufacturer].”⁶ In the following paragraph, the Court added: “I also find that it is unconscionable and unreasonable on the facts of this case that an exclusionary clause should continue to operate for the benefit of the party responsible for the breach.”⁷

⁴ [2002] O.J. No. 54 (Sup. C.J.) (QL) [*General Refractories*]. General Refractories (P) was a manufacturer of heat-resistant refractory brick used to line high temperature industrial furnaces. Venturedyne (D) was a manufacturer of presses but until P’s order D had never made a friction press. Because this was the first time, P wanted certain performance guarantees in place. These were included in the contract. From the time of receipt of the press, P encountered problems with it and after two years, P decided to dispose of it. D took the position that this disposal was premature. P brought an action for the purchase price, out of pocket expenses and loss of profits. The Court awarded the former two and decided the latter was inapplicable since it could not be shown that there were any lost contracts.

⁵ *Ibid.* at para. 213.

⁶ *Ibid.* at para. 214.

⁷ *Ibid.* at para. 215.

In 2005, the same court in *Melrose v. Holloway Holdings Ltd.*⁸ noted that the doctrine of fundamental breach has “had an uncertain history, sometimes finding favour with appellate courts, and sometimes not.”⁹ Nevertheless, the Court found that “the respondent cannot be permitted to now rely upon the provision to avoid liability”¹⁰ and went on to find that “the respondent disposed of the goods in a fashion so cavalier and lacking in the care that one might reasonably expect a bailee to exercise in relation to goods over which it holds a lien that, in my view, it can fairly be said that the respondent’s conduct amounted to a fundamental breach of the contract of bailment.”¹¹ Independently, the Court also determined that if it was “wrong in holding that there has been a fundamental breach of the contract...given the inequality of bargaining power between the parties...[the clauses] are unfair and unreasonable. To permit the defendant to now rely upon them would be unconscionable.”¹²

In *Solway v. Davis Moving and Storage Inc.* the Ontario Court of Appeal, by a majority of two to one, did not explicitly invoke the discourse of “fundamental breach.” Instead it held that a storage company could not rely on a limitation of liability clause because their breach — leaving a trailer containing the bailor’s goods on the street overnight without security or monitoring — was “unconscionable.”¹³

⁸ (2005), 30 C.C.L.T. (3d) 245 [*Melrose*]. The applicant had her belongings kept in storage with the respondent. Initially, she had shared the space with her partner and his name and address were on all of the forms. Her name was in the space provided for identifying spouses. They separated, he emptied the locker of his belongings and they both moved to separate addresses. The applicant and her ex-husband agreed that he would pay the rental fees on the locker for a period of time. He allowed these to fall into arrears. In the contract with the storage company, there was a provision stating that if the rent fell into arrears the owner of the lockers could sell off the belongings in order to cover the balance. The respondent sent notices of intention to sell to the old address provided by the husband. These were returned to sender because he had moved. No notices were ever sent to Ms. Melrose. The respondent sold the applicant’s belongings (worth \$60,000) to an auctioneer for \$800.00. R.A. Clark J. reasoned with respect to *Hunter* that, as per *Fraser Jewellers*, *infra* note 60, the exclusion clauses should *prima facie* be enforced unless they are unconscionable or unless it would be unfair to enforce them. Fundamental breach was cited as the main basis for avoiding the clause and unconscionability was used in the alternative given the inequality of bargaining power.

⁹ *Ibid.* at 258.

¹⁰ *Ibid.*

¹¹ *Ibid.*

¹² *Ibid.* at 259.

¹³ (2002), 62 O.R. (3d) 522 (C.A.) [*Solway*], rev’g (2001), 57 O.R. (3d) 205, (Sup. Ct.) [*Solway SC*]. The plaintiffs, Solway (P), hired the defendants, Davis (D), to move their household possessions, and to store the possessions briefly. One night, to facilitate

Western Canadian courts are also apparently still attracted to the idea of fundamental breach. In *Zhu v. Merrill Lynch HSBC*, the British Columbia Provincial Court boldly announced that, *inter alia*, an online stockbroker's "[l]egal [d]isclaimer falls into the category of an agreement which 'virtually eliminates liability for inaccuracy in the performance of services contracted for by the customer' and can be construed as in fact 'exonerating the broker from acts of...gross negligence' and in fact reserving 'the right to be grossly negligent' to the broker. On this basis I find the legal disclaimer of the Defendant unenforceable."¹⁴ In 2001, in *AT&T Capital Canada Inc. v. Globe Printers Ltd.*¹⁵ the British Columbia Supreme Court forthrightly held that a supplier of photocopiers could not invoke an onerous clause because there had been a fundamental breach of the lease, even though that clause explicitly excluded liability "in the event of a fundamental breach." In 2006, the Manitoba Court of Queen's Bench found a breach of a fundamental term of a contract and refused to enforce an exclusion clause because it "would lead to an unfair and unreasonable result in the circumstances of this case."¹⁶ Moreover, in *Plas-Tex Canada Ltd. v. Dow Chemical of Canada Ltd.*,¹⁷ the Alberta Court of Appeal held that, even in the context of a purely commercial relationship, a large multinational company could not rely on its limitation of liability clause because its conduct was so unconscionable.¹⁸ Although the Court did not explicitly

snowploughing of the D's storage yard, the Ps' possessions were stored in a trailer on an unattended public street adjacent to the moving company's property. The trailer and the Ps' possessions were stolen. The Ps brought action for replacement cost of their possessions. D admitted liability for loss of the possessions, but only to the extent limited in terms of bill of lading. The bill of lading limited recovery to \$0.60 per pound, which totaled \$7,089. The Court of Appeal criticized the trial court's equation of unreasonable with unconscionable. However, the Court found that it would be unconscionable or unfair or unreasonable to impose the limitation of liability clause. On either basis, the Court found that relief should be granted. I will return to this case *infra* at 23-28.

¹⁴ 2002 BCPC 535, [2002] B.C.J. (B.C. Prov. Ct.) (QL) at paras. 17-18 [*Zhu*].

¹⁵ 2001 BCSC 1215, [2001] B.C.J. No. 1708 (S.C.) (QL) at para. 15 [*Globe Printers*].

¹⁶ *Prairie Petroleum Products v. Husky Oil Ltd.*, 2006 MBQB 92, [2006] M.J. No. 153 (Q.B.) (QL) at para. 106 [*Prairie Petroleum*].

¹⁷ (2004) 245 D.L.R. (4th) 650, [2005], 42 Alta. L.R. (4th) 118, (C.A.) [*Plas-Tex*], aff'g 2002 CarswellAlta 1923 (Q.B.) (WeC) [*Plas-Tex QB*]. The defendant, Dow Chemical (D) knowingly sold defective polyethylene resin to the plaintiffs Plas-Tex Canada (P) who were in the business of providing pipeline systems to carry natural gas to rural co-ops. The defective resin cracked and caused the escape of natural gas from the P pipelines, embroiling P in litigation with its clients. The Alberta Court of Appeal found at para. 55 that the trial judge did not err in holding that defendant could not rely on clause limiting liability as it committed fundamental breach of contract in delivering resin it knew to be defective.

¹⁸ *Plas-Tex*, *ibid.* at 132.

discuss “fundamental breach,”¹⁹ this was, in effect, the substratum of their analysis, as I will argue later.²⁰

Not to be left behind in a culture of jurisprudential defeatism, some eastern courts have also taken a stand on what they perceive to be unenforceable exculpatory clauses. In 1991, in *Atlas Supply Co. of Canada Ltd. v. Yarmouth Equipment Ltd. and Murphy*, the Nova Scotia Court of Appeal, in a split decision, held that a franchisor could not rely on an exemption clause because its conduct in inducing the franchisee into the relationship was unconscionable.²¹ In the same year, the trial division of the same court held that an exclusion clause “does not entitle the vendor to supply something fundamentally different from that which was contracted for. An exempting clause does not prevail to exempt a party who has failed to live up to a fundamental term of the contract.”²² A similar sentiment has been expressed by the New Brunswick Court of Queen’s Bench.²³

One possible response to these cases is to argue that they have been wrongly decided. They could be attacked and dismissed as the aberrations of well-meaning, but willful (even ideological), judges who misunderstand precedent, ignore legislative regimes, disrespect the autonomy and intentions of the parties, fail to understand the importance of certainty in the marketplace, and underemphasize the significance of insurance concerns and efficiency principles.²⁴ While there may be some virtue in all these criticisms, this paper will explore an alternative possibility: 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. The first stage in making such a claim requires a brief historical overview of the doctrinal origins of the concept of fundamental breach.

¹⁹ The trial court did, however, couch its decision in these terms; see *Plas-Tex QB*, *supra* note 17 at para. 166.

²⁰ *Infra* at 39.

²¹ (1991), 103 N.S.R. (2d) 1 (N.S.C.A.) [*Atlas*]. For a critical assessment of both the majority and dissenting opinions see Vern W. DaRe, “Atlas Unchartered: When Unconscionability ‘Says it All’” (1996) 27 Can. Bus. L.J. 426.

²² *Bagnell’s Launderers and Cleaners Ltd. v. Eastern Automobile Co.* (1991), 111 N.S.R. (2d) 51 (S.C. (T.D.)) at 58.

²³ *Infotec Leasing Ltd. v. Lumac Holdings Ltd.* (1994), 145 N.B.R. (2d) 1 (Q.B.) at 6.

²⁴ See e.g. Margaret H. Ogilvie, “Case Comment — Contract — Exemption Clauses — Fundamental Breach: *Solway v. Davis Moving & Storage Inc*” (2004) 83 Can. Bar Rev. 545 [Ogilvie, “*Solway*”].

3. English Revelations

The history of fundamental breach in England has been told numerous times²⁵ and need not be fully rehearsed again. But it is important to have a sense of the impulse that motivated the development of the doctrine. Briefly, in a series of cases from the 1950s to the 1970s, Lord Denning and other members of the English Court of Appeal developed a doctrine which said that if a party committed a fundamental breach of a contract then, as a rule of law, the said party could not invoke any exculpatory clause that they might have in the contract, regardless of how clearly drafted that clause might be.²⁶ However, the House of Lords rejected Lord Denning's substantive approach and, culminating in *Photo Production Ltd. v. Securicor Transport Ltd.*,²⁷ held that the rule of law analysis was misconceived and that the proper methodology was a proceduralist rule of construction analysis in which the court would review the precise terms of the exculpatory clause to determine if it covered the breach which actually occurred. If so, the clause would take effect; if it did not address the breach, it would be inoperable and the party in breach would be liable. At stake in this rule of law/rule of construction debate is the familiar tension between the virtues of freedom and sanctity of contract on the one hand, and a conception of contractual fairness on the other.

4. Early Canadian Visitations

As it is in England, the early history of fundamental breach in Canada is well documented.²⁸ But two points are worth emphasizing. First, prior to

²⁵ See e.g. Margaret H. Ogilvie, "Fundamental Breach Excluded but not Extinguished: *Hunter Engineering v. Syncrude Canada*" (1990-91) 17 Can. Bus. L.J. 75 at 83-98 [Ogilvie, "Fundamentatal Breach"]; Robert Flannigan, "*Hunter Engineering: The Judicial Regulation of Exculpatory Clauses*" (1990) 69 Can. Bar Rev. 514; Stephen M. Waddams, *The Law of Contracts*, 5th ed. (Aurora: Canada Law Book Inc., 2005) at 332-45; John Swan, *Canadian Contract Law* (Markham: LexisNexis Canada Inc., 2006) at 656-62; McCamus, *supra* note 3 at 754-64.

²⁶ The usual star example is Denning's proposition in *Karsales (Harrow) Ltd. v. Wallis*, [1956] 1 W.L.R. 936 (C.A.) at 940: "Exempting clauses...no matter how widely they are expressed, only avail the party when he is carrying out his contract in its essential respects.... They do not avail him when he is guilty of a breach which goes to the root of the contract. The thing to do is 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."

²⁷ [1980] A.C. 827 (H.L.) [*Photo Production*].

²⁸ See e.g. G.H.L. Fridman, *The Law of Contract* 3d ed. (Toronto: Carswell, 1994) at 626-34; McCamus, *supra* note 3 at 765-68; Waddams, *supra* note 25 at 336-38.

Hunter a significant number of trial, appellate and Supreme Court of Canada judges were highly enthusiastic about Lord Denning's rule of law approach.²⁹ Second, the Supreme Court of Canada had the opportunity to clarify the law on fundamental breach on two occasions prior to *Hunter*. On both occasions it displayed significant ambivalence, an ambivalence that echoes in many contemporary cases and reveals the source of the pervasive, and seemingly indefeasible, judicial concern.

In *B.G. Linton Construction Ltd. v. Canadian National Railway*,³⁰ by a majority of 5 to 4, the Court purported to follow the House of Lords' approach to fundamental breach. Ritchie J., for the majority, adopted the rule of construction analysis and found that a wide ranging exemption clause protected the defendant from its failure to properly telegraph the plaintiff's bid on a construction project. There were, however, two separate and significant dissents. Spence J., joined by Dickson J. and Beetz J., would have applied a Denningesque rule of law approach to preclude the operation of the clause.³¹ Laskin C.J.C. also dissented, arguing that "there must be a residue of obligation that is not cancelled out by concurrent exception; otherwise it is illusory to speak of a contract."³² In his opinion, the "comedy of errors...was so far a departure from what the respondent (through its employees) had undertaken to do as to disentitle it to rely on the exemption clause."³³ Moreover, it should be noted that even the majority seemed to equivocate. Although it endorsed the rule of construction approach, it went out of its way to note that in this case there was only negligent performance as opposed to "the kind of situation in which a breach going to the root of the contract may exclude reliance on an exemption clause. Under such circumstances it can be said that the contract has not been performed at all..."³⁴

In *Beaufort Realities*³⁵ a building contract included a provision which waived the builder's right to a mechanics lien. The owner subsequently

²⁹ See Ogilvie, *supra* note 25 at 96-97; Fridman, *ibid.* at 628-34; Waddams, *supra* note 25 at 336-37.

³⁰ [1975] 2 S.C.R. 678 [*Linton*].

³¹ *Ibid.* at 711-13.

³² *Ibid.* at 684. See also Devlin J.'s claim in *Firestone Tyre and Rubber Co. Ltd. v. Vokins & Co. Ltd.*, [1951] 1 Lloyd's Rep. 32 (K.B.) at 39: "That in law is not a contract at all. It is illusory to say: 'We promise to do a thing, but we are not liable if we do not do it.'"

³³ *Linton*, *ibid.* at 680-81.

³⁴ *Ibid.* at 692.

³⁵ *Chomedy Aluminum Co. v. Belcourt Construction (Ottawa) Ltd.* (1979), 97 D.L.R. (3d) 170 (C.A.) [*Beaufort Realities CA*], *aff'd* [1980] 116 D.L.R. (3d) 193 (sub nom. *Beaufort Realities (1964) Inc. v. Belcourt Construction (Ottawa) Limited*) [*Beaufort*

refused to make payments as they fell due. In the Ontario Court of Appeal, Wilson J.A., speaking for a unanimous court, acknowledged the rule of construction approach³⁶ but proceeded to argue that “what we are to ask ourselves is not whether the exclusionary clause is fair and reasonable in its contractual setting (this is, indeed, to be assumed in a contract between sophisticated parties) but whether it is fair and reasonable that it survive the disintegration of its contractual setting.”³⁷ This proposition is strongly reminiscent of a rule of law type approach and seemingly at odds with the majority of the Supreme Court of Canada in *Linton* just five years previously.

On appeal, the Supreme Court of Canada, this time in a unanimous decision (again crafted by Ritchie J.), explicitly rejected Denning’s rule of law strategy and, once again, held that the proper approach was the House of Lords’ rule of construction analysis in *Photo Production*³⁸ as accepted by the majority in *Linton*.³⁹ Despite this, the Court proceeded to find that the respondent’s refusal to pay was a fundamental breach and approved of Wilson J.A.’s statement that “in the context of the contract as a whole the true construction to be placed on...[the clause] is that the waiver therein contained ceased to bind the respondent upon it having communicated to the appellant its election to treat the contract as at an end.”⁴⁰ Despite the explicit endorsement of the rule of construction methodology, the Supreme Court of Canada’s decision obviously manifests strong undertones of a more substantive approach. As Fridman has noted, both the Court of Appeal and the Supreme Court of Canada “negated by their actual decision the very principle of law which they purported to be approving and applying.”⁴¹ The result of the mixed messages was ongoing indeterminacy and confusion. *Hunter* provided the Supreme Court of Canada with an opportunity to set the law straight.⁴²

5. *Hunter Engineering Co. v. Syncrude Canada Ltd.*

Syncrude entered two separate contracts: first, they purchased thirty-two mining gearboxes from Hunter; second, they purchased a conveyor

Realties SCC].

³⁶ *Beaufort Realities CA, ibid.* at 176.

³⁷ *Ibid.* at 178.

³⁸ *Beaufort Realities SCC, supra* note 35 at 196-97.

³⁹ *Supra* note 30.

⁴⁰ *Beaufort Realities SCC, supra* note 35 at 198.

⁴¹ Fridman, *supra* note 28 at 632. See also McCamus, *supra* note 3 at 768; Ogilvie, *supra* note 25 at 96; Nicholas Rafferty, “Developments in Contract and Tort Law: the 1988-89 Term” (1990) 1 Sup. Ct. L. Rev. (2d) 269 at 290-91.

⁴² *Supra* note 1.

system from Allis-Chalmers which included four additional extraction gearboxes (which had also been designed by Hunter). Both types of gearboxes were defective because of a welding flaw and Syncrude had to have them rebuilt. Syncrude then sued both Hunter and Allis-Chalmers for damages. The Supreme Court of Canada determined that Hunter was responsible for the design failure. It found, however, that both Hunter and Allis-Chalmers' express warranties to Syncrude had expired and thus they were not available to Syncrude. By contrast, they held that the statutorily implied fitness for purpose warranty had been breached by both Hunter and Allis-Chalmers. The key difference, however, was that Allis-Chalmers' exemption clause had expressly excluded the statutory warranties but Hunter's did not; thus the latter was liable. Therefore, the only possible way for Syncrude to succeed against Allis-Chalmers was for the Court to invoke the doctrine of fundamental breach and preclude Allis-Chalmers from invoking their exemption clause. The Court refused to do so but on two quite different grounds.

The five-person Court unanimously agreed that there was no fundamental breach in the sense of Syncrude being deprived of substantially the whole benefit of the contract. But, in *obiter*, two different explanations emerged when Dickson C.J.C. (La Forest J. concurring) and Wilson J. (L'Heureux-Dubé J. concurring) both took the opportunity to outline their views of fundamental breach in the context of exemption clauses. McIntyre J. explicitly refused to address the issue. It is important to revisit both sets of reasons for the decision because, as I will argue below,⁴³ many commentators and judges underappreciate the divergent judicial sensibilities at stake. It is most logical to deal with Wilson J.'s decision first because it is the more substantial discussion and Dickson C.J.C. explicitly drafted his opinion on this point as a response to her analysis.

Wilson J. forcefully argued in favour of retaining a substantive conception of fundamental breach and, in so doing, reiterated some of the positions she had taken in her Court of Appeal opinion in *Beaufort Realities*:

- While the Supreme Court of Canada in *Beaufort Realities* adopted the rule of construction approach, it did not reject the concept of fundamental breach.
- Lower courts in Canada have, in some cases, only paid lip service to the rule of construction approach and continued to apply a modified rule of law doctrine.

⁴³ *Infra* at 25-26.

- Normally the courts should enforce a freely negotiated contract according to the natural construction of its terms, including exemption clauses.
- An absolute and exclusive rule of construction approach, while generating simplicity and certainty, should be rejected because it would allow for harsh results in situations where the contract has disintegrated because of a fundamental breach.
- Freedom of contract can be limited for policy reasons.
- The courts should be able to assess whether it is reasonable to enforce an exclusion clause if it would generate unfair or unreasonable consequences.
- The courts should not perform an *ex ante* reasonableness analysis, that is, an examination of whether the clause is fair and reasonable at the time it was negotiated. Because of the complexities of the negotiation process and the realities of hard bargaining the courts are unsuited to such judgments.
- The courts should, however, be able to engage in an *ex post* reasonableness assessment; they should be able to determine whether, in light of the particular breach that occurred, it would be fair and reasonable to enforce the exclusion clause.
- This is justifiable not just for the narrow concern of fairness between the parties but because of the broader institutional policy-based concern for the integrity of the court: a party should not be able to enlist the support of the court to enforce the benefits of a contract while that same party is seeking to escape the burdens of the contract.
- Although the doctrine of unconscionability might also cover many of the situations that would be captured by fundamental breach, it is problematic for two reasons: it is just as indeterminate as fundamental breach and it cannot operate in situations where there is no inequality of bargaining power.
- The doctrine of fundamental breach is a legitimate residual weapon in the judicial armoury for marking off the boundaries of tolerable conduct for those who are seeking the indulgence of the courts.

- On the facts of the case there was no need to invoke this weapon because Syncrude had not been deprived of substantially the whole benefit of the contract and Allis-Chalmers had neither engaged in “any sharp or unfair dealing” nor “abuse[d] ... freedom of contract.”⁴⁴

The decision of Dickson C.J.C. reveals ten key points on this issue, some of which dovetail with that of Wilson J., others of which are at variance:

- Courts should defer to the bargain the parties have struck.
- The proper approach is the rule of construction analysis based on the ordinary rules of contract interpretation.
- Previous renunciations of the rule of law approach by both the House of Lords and the Supreme Court of Canada had little effect on lower courts in both jurisdictions.
- Wilson J.’s approach to fundamental breach, which entails an *ex post* assessment of the reasonableness of the contract, is misconceived and unnecessary.
- As a tool for relieving parties from unfair bargains, fundamental breach is too blunt, idiosyncratic and complex an instrument because it can be both over and under inclusive.
- Courts may, however, intervene on the basis of unconscionability.
- Unconscionability focuses on inequality of bargaining power and directly addresses the protection of the weak from over-reaching by the strong.
- The focus on contract construction and unconscionability will often have the same result as fundamental breach but it addresses the real issues at stake.
- Nothing in the judgment should be read as a rejection of the concept of fundamental breach as a descriptor of breach going to the root of the contract; the only thing rejected is fundamental breach as a method for excluding exemption clauses.

⁴⁴ *Supra* note 1 at 499-518.

- On the facts there was no basis for Syncrude to claim any unconscionability on the part of Allis-Chalmers.⁴⁵

In short, Dickson C.J.C. assimilated fundamental breach into the doctrine of unconscionability, whereas Wilson J. retained fundamental breach/*ex post* reasonableness as a supplementary regulatory mechanism by which the courts could police contracts they found objectionable. Despite the clarity of their disagreement, as the next two sections will demonstrate, not everyone agrees that there is a substantive difference in their opinions.

6. Canonical Responses

The response of the legal academic community to *Hunter* was mixed. Some were harshly critical of the whole decision: Flannigan roundly condemned it as unsatisfactory and misconceived⁴⁶ and, in particular, launched a volley of criticisms against Wilson J.'s conception of fundamental breach.⁴⁷ Others, such as Rafferty, praised Dickson C.J.C. but despaired of Wilson J.⁴⁸ Ogilvie, on the other hand, argued that Dickson C.J.C.'s judgment was "disappointingly superficial"⁴⁹ and celebrated that of Wilson J. because it embraced a reasonableness standard to police contractual relations.⁵⁰ Fridman worried about the decision's potential to generate uncertainty.⁵¹ Waddams argued that the difference between Dickson C.J.C.'s unconscionability and Wilson J.'s *ex post* unreasonableness analyses "is unlikely to be large."⁵² More recently, McCamus has suggested that depending on how one reads Dickson C.J.C.'s conception of unconscionability, "the difference between the two opinions can be made to diminish, if not

⁴⁵ *Ibid.* at 450-64.

⁴⁶ Flannigan, *supra* note 25 at 514-15.

⁴⁷ *Ibid.* at 525-26.

⁴⁸ *Supra* note 41 at 284-99.

⁴⁹ Ogilvie, "Fundamental Breach," *supra* note 25 at 98.

⁵⁰ *Ibid.* at 104.

⁵¹ Fridman, *supra* note 41 at 634-37.

⁵² Waddams, *supra* note 25. This claim is advanced in Stephen M. Waddams, *The Law of Contracts* 3d ed. (Toronto: Canada Law Book, 1993) at para. 476 and is retained in the fourth edition without modification; see Stephen M. Waddams, *The Law of Contracts* 4th ed. (Aurora: Canada Law Book, 1999). In the fifth edition, however, Waddams criticizes a case that appears to go along with Wilson J.'s approach (*Solway*, *supra* note 13) at 341-42. See also Anthony J. Duggan, "Stolen Goods, A Crime Disaster and a Right of Way Gone Wrong: Three Unconscionable Contracts Cases from a Law and Economics Perspective" (2004) 40 Can. Bus. L.J. 3; but see *contra* British Columbia Law Institute, *Unfair Contract Terms: An Interim Report* (Vancouver, 2005) at 23 [B.C.L.I. Report]. I discuss *Solway infra* at 23-28.

disappear...[and] there appears to be very little separating the concepts of ‘unconscionability’ and ‘unfair and unreasonable’.”⁵³ Later in this article,⁵⁴ I will contest the claims advanced by both Waddams and McCamus, but before doing so it is necessary to analyse how subsequent courts have dealt with *Hunter*.

7. *Judicial Invocations*

The cases surveyed in Part 2 are not aberrations; they are just the latest in a series of cases, from both before and after *Hunter*, in which Canadian judges have struggled with fundamental breach. Three broad patterns can be identified in these cases: those who portray *Hunter* as a reconciliation of two different worldviews; those who recognize the reasoning as sharply distinct; and those who are confused about the Court’s reasoning on fundamental breach.

A. *The Reconciliators*

Despite the fact that Dickson C.J.C. and Wilson J. made it respectfully but firmly clear that their views differed on fundamental breach, a number of courts, mostly at the appellate level, have attempted to reconcile the two positions, primarily by ignoring what Wilson J. actually said.

The Supreme Court of Canada has never substantively revisited its decision in *Hunter*. The closest it has come was in *Guarantee Co.*⁵⁵ when the Court in a passing discussion noted that:

both 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

⁵³ McCamus, *supra* note 3 at 772, 777.

⁵⁴ *Infra* at 24-28.

⁵⁵ *Supra* note 3. Plaintiff Gordon Capital Corp, an investment dealer and broker (P), brought an action against Defendant, Guarantee Co. of North America (D), for payment under a fidelity insurance contract. The Court determined that it was the intention of the parties that the limitation clause was to include a process of bringing a claim against an insurer in circumstances of contractual breach. The Court further surmised that it would not be unconscionable, unfair, unreasonable or otherwise contrary to public policy to uphold the intention of the parties. No policy reason exists to limit a construction approach to fundamental breach to exclusion clauses alone. Under the construction approach, the limitation period in the insurance contract survived wrongful rescission of the contract. The insurer brought a successful motion for summary judgment dismissing the action.

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.⁵⁶

While the first proposition is an accurate portrayal of Dickson C.J.C.'s and Wilson J.'s positions, the latter is an exercise in confession and avoidance insofar as it fails to engage in an analysis of what the difference is. Similarly in *Z.I. Pompey Industries v. ECU Line N.V.*⁵⁷ Bastarache J., in an even more cursory discussion, reiterated the foregoing comments and asserted "the parties' bargain was not unconscionable or unreasonable."⁵⁸

By contrast, several courts of appeal have devoted significantly more attention to the debate. In *Plas-Tex* the Alberta Court of Appeal referred to both *Guarantee Co.* and *Waddams* to argue that there was a "reconciliation" of the differing opinions and went on to structure its decision under the rubric of "unconscionability."⁵⁹ More significantly, in a series of cases, the Ontario Court of Appeal has adopted the same approach. In 1997, in *Fraser Jewellers (1982) Ltd. v. Dominion Electric Protection Co.*,⁶⁰ Robbins J.A. followed *Waddams* in holding that "in practice the difference is unlikely to be large"⁶¹ and on the facts held that there was "nothing unfair or unreasonable or unconscionable in enforcing" the limitation of liability clause.⁶² Two years later in *Carleton*

⁵⁶ *Ibid.* at 448.

⁵⁷ [2003] 1 S.C.R. 450.

⁵⁸ *Ibid.* at 471. While on the New Brunswick Court of Appeal, Bastarache J. also appeared somewhat confused in *Nowlan v. Midland Transport* (1996), 174 N.B.R. (2d) 81 at 88-89, merging the two different senses of fundamental breach. Following Dickson C.J.C., he characterized it as "a rule of construction developed at common law to avoid the implementation of unconscionable provisions in a contract." But in the following paragraph he said, "Fundamental or material breach giving right to rescission of the contract is a remedy at common law that is exceptional and requires proof of conduct that is entirely beyond that contemplated by the parties."

⁵⁹ *Plas-Tex*, *supra* note 17 at 131-32.

⁶⁰ (1997), 34 O.R. (3d) 1 (C.A.) [*Fraser Jewellers*]. *Fraser Jewellers* had a contract with *Dominion Electric* for the installation and monitoring of a security system. The contract contained a limitation of liability clause that protected *Dominion Electric* (ADT) beyond \$890.00, the annual cost of the system. *Fraser* was robbed, they pressed the alarm button, but *Dominion* did not respond for 10 minutes. The thieves got away. The Court reasoned that the contract was for installation and monitoring and these were effectively and sufficiently carried out as per the terms of the contract.

⁶¹ *Ibid.* at 10.

⁶² *Ibid.* at 9. This was followed in *Broda v. AXA Insurance (Canada)*, [2002] O.J. No. 1223 (Sup. Ct.) (QL).

*Condominium Corp. No. 32 v. Camdev Corp.*⁶³ the Court reiterated its position in *Fraser Jewellers*, and in *Shelanu Inc. v. Print Three Franchising Corp.*⁶⁴ in 2003, it reconfirmed that it was following *Guarantee Co.*, despite the fact that it recognized that the opinions had different justifications.⁶⁵

The only deviation from this pattern of cohesion in the Ontario Court of Appeal is to be found in 2002 in *Solway*.⁶⁶ Here the majority held that in *Fraser Jewellers* Robbins J.A. had “reconciled these two approaches”⁶⁷ and went on to find that the application of the limitation of liability clause “would, in the words of Dickson C.J.C. be ‘unconscionable,’ or in the words of Wilson J. be ‘unfair or unreasonable.’”⁶⁸ In a trenchant dissent, however, Carthy J.A. carefully emphasized the different rationales underlying the positions of Dickson C.J.C. and Wilson J. and indicated that he preferred Dickson C.J.C.’s approach because there “is no need for an undefined discretion in the enforceability of exclusion clauses.”⁶⁹ He went on to suggest that, in his opinion, despite their differences neither Dickson C.J.C. nor Wilson J. would have excluded the operation of the clause in this particular fact situation.⁷⁰ With respect, as I will argue below, the logic of Wilson J.’s position suggests otherwise.

B. The Differentiators

Carthy J.A. has not been alone in his sensitivity to the differences between Dickson C.J.C. and Wilson J. Several other courts, mostly at the

⁶³ (1999), 47 C.L.R. (2d) 224 (Ont.C.A.) at 226. The Plaintiff, Carleton Condominium Corp. (P), brought an action alleging defects in the construction of the exterior walls. Camdev Corp., the Defendant, pleaded that its contract with unit holders expressly excluded implied warranties relied on by P. The Court of Appeal determined that a common law implied warranty was excluded by the exclusionary clauses in the contract. The Court further found that the parties clearly agreed by terms of the agreement of purchase and sale that the only warranty was a written one-year guarantee issued by vendor.

⁶⁴ (2003), 64 O.R. (3d) 533 at 546-47 (C.A.) [*Shelanu*]. The dispute arose over a franchise agreement. The franchisee committed four specific breaches of its duty of good faith towards the franchisee. In concluding that there was no fundamental breach, the Court went with Wilson J.’s approach citing that this is a necessarily restrictive doctrine and ought not provide assistance to the party seeking to avoid the contract here.

⁶⁵ *Ibid.* at 547.

⁶⁶ *Solway*, *supra* note 13.

⁶⁷ *Ibid.* at 527.

⁶⁸ *Ibid.* at 528.

⁶⁹ *Ibid.* at 532.

⁷⁰ *Ibid.*

trial level, have demonstrated a similar awareness. In 1995, in *MacKay v. Scott Packing and Warehousing Co. (Canada) Ltd.*,⁷¹ the Federal Court of Appeal carefully delineated the different approaches of Dickson C.J.C. and Wilson J. Significantly, it emphasized that “unconscionability is to be assessed as of the time the parties entered into the contract, and not at the date of the breach;” consequently, the Court held that “the nature and degree of the breach are of no concern.”⁷² By contrast, the court read Wilson J.’s policy-based, unfairness/unreasonableness approach as having a different focus: “First, the fairness and reasonableness of enforcing the clause is to be assessed as of the time of the breach. Second, it follows that the nature and degree of the breach may well be of fundamental significance.”⁷³ Despite this distinction, the court found that on the facts of the case at hand the difference was of “no legal significance” because there was no inequality of bargaining power between the parties nor was the appellant deprived of substantially the whole benefit of the contract.⁷⁴

British Columbia courts appear to be particularly sensitive to the unsettled state of the law. Within a few months of the release of the decision in *Hunter*, Gibbs J. (who had been the trial judge in *Hunter*) explicitly acknowledged the differences in the opinions.⁷⁵ In two cases, *577519 B.C. Ltd. v. Weyerhaeuser Co.*⁷⁶ and *Tembec Industries Inc. v. Lucidyne Technologies, Inc.*,⁷⁷ the British Columbia Supreme Court denied applications for summary judgment in part after identifying the contrasting approaches of Dickson C.J.C. and Wilson J. More substantively, in *Knowles v. Whistler Mountain Ski Corp.*,⁷⁸ Huddart J.

⁷¹ (1995), 192 N.R. 118 (F.C.A.) [*MacKay*].

⁷² *Ibid.* at 123.

⁷³ *Ibid.*

⁷⁴ *Ibid.* at 124.

⁷⁵ *Summitville Consolidated Mining Co. v. Klohn Leonoff Ltd.* (1989), 21 C.L.R. (2d) 128 (B.C.S.C.) at 134-35.

⁷⁶ 2002 BCSC 1689, [2002] B.C.J. No. 2727 (S.C.) (QL). The plaintiffs purchased property from the defendants for recreational development. The plaintiffs relied on representations as to quantity of harvestable timber on property. These representations included reference to assessment of capacity prepared by vendor. The plaintiffs claimed breach of contract and negligent misrepresentation against vendor and its employee who prepared the assessment. Cullen J. dismissed the applications for summary judgment.

⁷⁷ 2003 BCSC 802, [2003] B.C.J. No. 1191 (S.C.) (QL). P sought \$12M in damages for allegedly damaged equipment that they had received from D. The Court decided that it could not settle an important and unsettled point of law on an application for summary judgment.

⁷⁸ [1991] B.C.J. No. 61 (S.C.) (QL). The plaintiff, Knowles (P), rented skis and signed a waiver excluding liability for injuries that might arise from the faulty assembly of skis. The plaintiff was injured due to the faulty assembly of the equipment. Huddart J.

characterized Wilson J.'s decision as endorsing a wider review power whereas Dickson C.J.C.'s decision favoured something "narrower."⁷⁹ She then chose the unconscionability approach. In doing so, she applied the "community standards of commercial morality test" used by Lambert J.A. in an earlier case,⁸⁰ and found the exemption clause valid.⁸¹ In *Waldron v. Royal Bank* Lambert J.A. rejected what he characterized as the "roundabout route" of fundamental breach and called for the direct application of the "legal principle of unconscionability."⁸²

Two Ontario cases, both of which predate *Fraser Jewellers*,⁸³ also note the differences between Dickson C.J.C. and Wilson J. In *Ticketnet Corp. v. Air Canada*, the Ontario Court General Division again drew the distinction and relied heavily on Wilson J. by emphasizing that the "breach ... being of the most serious kind...[Air Canada] ought not to be able to take advantage of any limitation of liability clause unless such clause specifically spelled out the type of conduct [Air Canada] engaged in."⁸⁴ But it also noted that "on either basis...[Air Canada] would be in trouble."⁸⁵ In *Bryandrew Holdings Ltd. v. Sifton Properties Ltd.*⁸⁶ the same court again noted the broader ambit of Wilson J.'s residual power, but also found that on either approach the exclusions from liability were unenforceable.

found that the clause was not unconscionable and that P was aware of and understood the clause. Huddart J. applied the test of unconscionability to the Release Agreement and found nothing contrary to "community standards of commercial morality."

⁷⁹ *Ibid.* at para. 19.

⁸⁰ *Harry v. Kreutziger* (1979), 95 D.L.R. (3d) 231 at 241.

⁸¹ *Supra* note 79 at para. 19.

⁸² (1991), 53 B.C.L.R. (2d) 294 at 302 (C.A.) [*Waldron*]. The female plaintiff owned and operated a ceramics business. She obtained financing for this business from Royal Bank. The plaintiffs signed a demand note for the amount owing and gave security under s. 178 of the Bank Act, including an assignment of "all stock in trade and other inventory." The female plaintiff was hospitalized and the rent for the business premises fell into arrears. Without giving notice to the plaintiffs, the defendant made formal demand for immediate payment of the entire amount due and owing and seized all of the assets of the business by having the locks on the premises changed. The Court awarded relief to the plaintiffs on the basis of unconscionability.

⁸³ *Fraser Jewellers*, *supra* note 60.

⁸⁴ [1993] O.J. No. 289 (Ont. Ct. J. (Gen. Div.)) (QL) at para. 168.

⁸⁵ *Ibid.* at para. 164.

⁸⁶ (1994), 38 R.P.R. (2d) 95 (Ont. Ct. J. (Gen. Div.)). P negotiated the proposed purchase of Pro Hardware, a business located in D's mall. The purchase was subject to approval by D lessor for the transfer of the lease. Cusinato J. related that the two parties were in different positions of bargaining power because D knew about the upcoming expansion of the mall and required that certain language be included in the agreement such that would facilitate this. P was not made aware of the purpose of that language.

Finally, at least one recent Manitoba court devotes significant attention to the differences in opinion, and appears to follow the approach of Wilson J. rather than that of Dickson C.J.C.⁸⁷

C. The Confused

Beyond the previous two categories there is a third: courts that are confused as to the significance of the two sets of reasons for decision in *Hunter*. For example, in *Waldron*,⁸⁸ Lambert J.A. conflated the two decisions and seemed to attribute an unconscionability analysis to Wilson J.⁸⁹ The Supreme Court of British Columbia in *British Columbia v. Guarantee Co. of North America*⁹⁰ engaged in a similar conflation, and in *Carrier Lumber Ltd. v. British Columbia*⁹¹ it went back to two of Lord Denning's decisions to invoke a rule of law style analysis. In *C.I.T. Financial Ltd. v. Weber Construction Ltd.* the Saskatchewan Court of Appeal simply ignored Wilson J.'s judgment.⁹² One decision from the Ontario General Division also seems to have misunderstood both Dickson C.J.C.'s and Wilson J.'s discussions of fundamental breach⁹³ while another fused the two to suggest that there is a "substantive test of reasonableness bestowing on the court a judicial discretion, in an instance of an alleged fundamental breach, not to enforce an

⁸⁷ *Prairie Petroleum*, *supra* note 16 at paras. 83-107.

⁸⁸ *Waldron*, *supra* note 82.

⁸⁹ *Ibid.* at 302.

⁹⁰ [1990] B.C.J. No. 653 (S.C.) (QL) at para. 85. P entered into contract with D for the reconstruction of a portion of highway. A dispute arose over the fact that information regarding the state of the quarry was not conveyed. P claims that if they had known this they would have placed a higher bid. The Court found that D's non-disclosure of the issues, especially those concerning safety, constituted both fundamental breach *and* unconscionability and nullified the exclusionary clauses.

⁹¹ [1999] 47 B.L.R. (2d) 50 (B.C.S.C.) at 102. Carrier Lumber (P) brought action against Crown (D) over a breach of contract for a 10-year forest license that was awarded in order to harvest beetle infested timber. Two intervening events occurred: First Nations blockades on ancestral trap lines and cold snaps which killed much of the beetle population. Legislation changed silviculture requirements which would have cost P another \$31 M in order to comply. P claimed bad faith on the part of the Crown for having made an agreement with First Nations groups in complete disregard of the contract, while attempting to place blame on P for not meeting the requirements. The Court awarded relief to P.

⁹² (2002), 1 W.W.R. 357 at 363 (Sask. C.A.). Weber (P) got financing from CIT (D) for the purchase of some floor scrubbers. The floor scrubbers were found to be defective and P defaulted on payments to D on the basis that the agreement was illegal. Gerwing J.A. did not offer Wilson J.'s approach as an option but concluded that there was no inequality so there was no unconscionability.

⁹³ See e.g. *Idriss Family Enterprises Ltd. v. Hasty Market Inc.*, [1991] O.J. No. 2204 (Gen. Div.) (QL) at paras. 63-68.

exclusionary clause where to do so would be unfair and unreasonable.”⁹⁴ Similarly, in at least two decisions, *Davis v. Robertson*⁹⁵ and *Elite Specialty Nursing Services Inc. v. Ontario*,⁹⁶ the Ontario Superior Court of Justice engaged in some overhasty discussions that missed the different meanings of fundamental breach. Finally, two cases from the Nova Scotia Supreme Court, *A.C.A. Co-operative Association. Ltd. v. Associated Freezers of Canada Inc. et al.*⁹⁷ and *Carter v. Deloupe Inc. Remorques*,⁹⁸ also seemed to collapse Wilson J.’s position into that of Dickson C.J.C. without any recognition of the differences, while a third ignored Wilson J.’s discussion of fundamental breach and focused exclusively on the discussions of unconscionability.⁹⁹

⁹⁴ *Israel v. Townsgate 1 Ltd.*, [1994] O.J. No. 3187 (Gen. Div.) (QL) [*Israel*] at para. 5. The litigation between the parties centered on a dispute regarding the dimensions of a solarium in a luxury condominium. The plaintiff repudiated the contract of purchase without taking possession of the condominium unit and without paying the remaining purchase price installment.

⁹⁵ (2000), 6 B.L.R. (3d) 246 (Ont. Sup. Ct.) at 250-51. Boats owned by the plaintiff, Davis (P), were damaged by a fire that occurred at the marina where they had a storage contract. The defendant, Burlington Sailing and Boating Club (D), claimed exclusion of liability, pointing to the waiver that the boat owners had signed. D was a not for profit club operated by the members. Lederman J. found neither unconscionability based on inequality of bargaining power, nor fundamental breach based on substantial deprivation of the whole benefit.

⁹⁶ [2002] O.J. No. 3009 at paras. 96-103 (Sup. Ct.) (QL). The plaintiff, Elite (P), was responsible for providing health care services including nursing services. A contract was entered into between P and the board of the defendant Healthcare Unit, which allowed for referrals for Complex Care. P argued that there was an implied term that P would receive a fair number of referrals every month, but it only received 10. The Court reasoned that substantially the whole benefit of the contract was not provided and that Wilson J.’s definition had already been accepted by this court in Ontario.

⁹⁷ (1990), 97 N.S.R. (2d) 91 at 171-72 (S.C.(T.D.)). The plaintiff, A.C.A. Co-operative (P), stored their product in a freezer warehouse owned by Polar Freez Ltd. and managed by defendant Associated Freezers of Canada Inc. (D). The warehouse roof collapsed causing the area to heat, thus thawing \$3M worth of merchandise. The Court found that even with a fundamental breach, liability was limited to \$40.00/pkg because the clause was not tainted by any sharp or unfair dealing.

⁹⁸ 2002 NSSC 202, [2002] N.S.J. No. 481 (S.C. (T.D.)) (QL). Plaintiff, Carter (P), purchased a semi-trailer from a subsidiary of the defendant, Deloupe Inc. Remorques (D), which turned out to be defective. D was a party to the contract, which contained a warranty covering defects, through the subsidiary. D attempted for 12 days to repair the trailer but was unsuccessful and exchanged it with P for a new one. P brought action against D for non-use of the trailer for 12 days. The appeal was dismissed on the basis that P was deprived substantially of the whole benefit of the contract.

⁹⁹ *Key Equipment Finance Ltd. v. Jacques Whitford Ltd.*, 2006 NSSC 68, [2006] N.S.J. No. 76 (S.C. (T.D.)) (QL) at paras. 66-67, 83-86.

In sum, this review of the reconciliators, differentiators and confused suggests that there is little judicial consensus on the status of fundamental breach in Canadian law. While some judges are sensitive to the differences in the analyses of Dickson C.J.C. and Wilson J., many are content to either ignore the differences, or subsume one into the other. The next, and penultimate, section considers where we might go from here in pursuit of a more coherent doctrinal regime.

8. *Future Options*

In this section I argue that Canadian courts have at least three options when dealing with fundamental breach in future: exorcism, substantiation and transubstantiation.¹⁰⁰

A. *Exorcism*

Canadian judges could be more harsh about fundamental breach than Dickson C.J.C. who delicately tried to “lay it to rest.” Instead, they could put the doctrine out of its misery by exorcising it from the temple of the common law of contracts. If this path were followed, the governing principle would be the rule of construction and, following Dickson C.J.C., the only additional ground for non-enforcement would be “unconscionability.” Such a move would have several benefits. The first is simplicity.¹⁰¹ All a judge would have to do is to analyse the text of the contract, apply the standard canons of interpretation and determine whether the words of the contract cover the breach. If they do, that is the end of the judicial task, unless the plaintiff can prove unconscionability. Second, it is often claimed that the curtailing of judicial review powers will generate certainty in the marketplace because parties do not have to be looking over their shoulders for the contract police. Third, adopting the doctrine of unconscionability would dovetail with legislative interventions in several jurisdictions, thereby enhancing the coherence of the larger regulatory regime.¹⁰²

Exorcism, however, does have some significant limitations. First, while simplicity and certainty are vital virtues both for the parties who draft contracts and the judges who must interpret them, they are not

¹⁰⁰ A fourth possibility is to follow Ogilvie’s suggestion to adopt a freestanding unreasonableness doctrine; see Ogilvie, “Fundamental Breach,” *supra* note 25 at 106-13. While interesting, such a suggestion does not seem to have grabbed the imagination of most Canadian judges. But see *contra Israel*, *supra* note 91.

¹⁰¹ Rafferty, *supra* note 41 at 284.

¹⁰² See e.g. *Business Practices and Consumer Protection Act*, S.B.C. 2004, c. 2; *Consumer Protection Act, 2002*, S.O. 2002, c. 30, Sch. A.

absolute virtues. Indeed, in the context of contracts, simplicity and certainty are probably best conceived as second-order virtues, instrumental to the achievement of the general principle of fulfilling the reasonable expectations of the parties.¹⁰³

Second, as Wilson J. pointed out, the concept of unconscionability is also decidedly indeterminate.¹⁰⁴ In *Hunter*, Dickson C.J.C. himself tells us very little about what he means by unconscionability beyond a vague reference to inequality of bargaining power, while McCamus, in a recent and particularly close reading of Dickson C.J.C.'s decision, suggests that there may be two different meanings at play.¹⁰⁵ Others have raised concerns not only about unconscionability's conceptual incoherence, but about its potential to generate uncertainty, unfairness and obfuscation as well as the inevitable slippery slopes.¹⁰⁶

Third, unconscionability is also open to criticism because of its excessive narrowness — it only applies to situations of inequality of

¹⁰³ For a recent application of this “general principle” see *Fidler v. Sun Life Assurance Co. of Canada*, [2006] 8 W.W.R. 1. See also J. Steyn, “Contract Law: Fulfilling the Reasonable Expectations of Honest Men” (1997) 113 Law Q. Rev. 433. While on the bench Steyn L.J. has opined in *First Energy (U.K.) v. Hungarian International Bank Ltd.* [1993] 2 Lloyd’s Rep. 194 at 196:

A theme that runs through our law of contract is that the reasonable expectations of honest men must be protected. It is not a rule or principle of law. It is the objective which has been and still is the principal moulding force of our law of contract. It affords no licence to a Judge to depart from binding precedent. On the other hand, if the prima facie solution to a problem runs counter to the reasonable expectations of honest men, this criterion sometimes requires a rigorous re-examination of the problem to ascertain whether the law does indeed compel demonstrable unfairness.

See also Swan, *supra* note 25, c. 1. For a critique see Catherine Mitchell, “Leading a Life of its Own? The Roles of Reasonable Expectation in Contract Law” (2003) 24 Oxford J. Legal Stud. 639.

¹⁰⁴ *Supra* note 1 at 516-17; see also Ogilvie, “Fundamental Breach,” *supra* note 25 at 101; Flannigan, *supra* note 25 at 529-36; Duggan, *supra* note 51 at 6; P. Bogden, “On the ‘Agreement Most Foul’: A Reconsideration of the Doctrine of Unconscionability” (1997) 25 Man. L.J. 187.

¹⁰⁵ McCamus, *supra* note 3 at 771 suggests that the traditional approach to unconscionability allows for “rescission of the entire agreement in the context of inequality of bargaining power” whereas the “new and innovative doctrine...restrict[s] the application of an exculpatory clause in circumstances of unconscionability.”

¹⁰⁶ Bogden, *supra* note 104; DaRe, *supra* note 21; Flannigan, *supra* note 25 at 529-36. See also David Vaver, “Unconscionability: Panacea, Analgesic, or Loose Can(n)on? A Critique of the Ontario Law Reform Commission’s Report on the Amendment of the Law of Contract” (1988) 14 Can. Bus. L.J. 40; Rick Bigwood, “Antipodean Reflections on the Canadian Unconscionability Doctrine” (2005) 84 Can. Bar Rev. 171.

bargaining power. But there is a significant difference between unconscionability and fundamental breach/*ex post* reasonableness in this regard. Unconscionability has a two part focus: inequality of bargaining power and improvident bargain,¹⁰⁷ both of which are capable of being determined at the time of making the contract.¹⁰⁸ In that sense it is similar to Wilson J.'s category of *ex ante* reasonableness, which she rejected. But fundamental breach/*ex post* unreasonableness is a wait-and-see methodology: a decision whether to enforce the exculpatory clause or not is dependent upon the impact of the breach on the aggrieved party.

*Zhu*¹⁰⁹ is a nice example of where, though inequality of bargaining power was not really an issue, the court still refused to enforce the disclaimer clause. The court specifically acknowledged that the plaintiff was knowledgeable in the investment market and a sophisticated computer software engineer. It relied on these strengths of the plaintiff, rather than his unequal status, to demonstrate the unacceptable nature of the defendant's online brokerage system and procedures given the impact of the breach on Mr. Zhu.¹¹⁰

Solway is particularly enlightening as to the limitations of relying exclusively on unconscionability as a judicial oversight power.¹¹¹ Consider Waddams' recent condemnation of the case in the fifth edition of his leading treatise:

The majority considered the clause limiting liability to be unreasonable, unfair, and unconscionable. On the facts of the case this conclusion may be doubted. The terms were prescribed by the legislature and the parties were well aware of them as demonstrated by additional insurance taken out by the plaintiffs. Nor do the facts suggest that the defendant's conduct radically increased the risk of loss. Declining to enforce a limitation clause in such circumstances tends to defeat insurance arrangements, and implies a wider power to strike down contractual clauses than was contemplated in *Hunter Engineering*. That case implies that limitation of liability clauses ought to be enforced unless shown to be unfair, unreasonable, unconscionable, or otherwise contrary to public policy. Some element of uncertainty is, of course, inherent in such tests, but the whole tenor of the *Hunter* case is that they should be narrowly defined and applied for the sake of certainty and predictability, and, therefore, in the long run, for the sake of justice to contracting parties. There is a danger of

¹⁰⁷ See e.g. *Morrison v. Coast Finance Ltd. et. al.* (1965), 55 D.L.R. (2d) 710 at 713 (B.C.C.A.); *Norberg v. Wynrib*, [1992] 2 S.C.R. 226 at 256; *Atlas*, *supra* note 21.

¹⁰⁸ See *MacKay*, *supra* note 71 at paras. 12-13; Waddams, *supra* note 3 at 338.

¹⁰⁹ *Zhu*, *supra* note 14.

¹¹⁰ *Ibid.* at paras. 1, 26.

¹¹¹ *Supra* note 13.

reintroducing the radical uncertainty of the doctrine of fundamental breach which it was the object of the *Hunter Engineering* case to eliminate.¹¹²

This is a provocative critique that deserves careful consideration. First, Waddams is right that *Solway* is not really a case of unconscionability, because the bailors were relatively sophisticated parties and there was no improvident bargain at the time the contract was made. Second, however, and contrary to Waddams, it is simply inaccurate to claim that *Hunter* sought to eliminate the “radical uncertainty of fundamental breach.” As pointed out earlier in this article, Wilson J. undoubtedly wanted to keep the doctrine as a residual category. Third, Waddams’ claim that the defendant’s conduct did not radically increase the risk of loss is, quite frankly, an unsupported assertion. Leaving the trailer unmonitored on the street overnight arguably added dramatically to the risk. Consider the scenario: it is Canada, it usually snows in February — therefore, it is reasonably foreseeable that plans will have to be made for the secure storage of containers when snow removal is in process. Fourth, Dickson C.J.C. may have had a relatively narrow conception of the power of the court to review, but once again it is simply inaccurate to say that Wilson J. did not embrace a “wider power to strike down contractual clauses” — that was the whole point of her analysis! Fifth, the conflation of “justice to the contracting parties” with “certainty and predictability” is curious because elsewhere in the same treatise Waddams argued that certainty, while important, is insufficient for contractual justice.¹¹³ Insurance arrangements are an absolutely vital consideration that judges should not ignore, but they should not be determinative.¹¹⁴ In exceptional cases when a party is acting in flagrant disregard of their contractual obligations, nuanced judicial discretion is appropriate.¹¹⁵

¹¹² Waddams, *supra* note 25 at 318-20. See also Ogilvie, “*Solway*,” *supra* note 24.

¹¹³ See discussions by Waddams in *ibid.* at 313-14, 360, 384-85. See also *Shelanu*, *supra* note 64 at 552-53, where the Ontario Court of Appeal stated that “legal values such as fairness, equity and justice underlie contractual interpretation and enforcement. Before the court allows the coercive power of the state to be used to serve the private interests of a party to a contract, the court will want to ensure that the contract does not offend these legal values.” For an excellent overview of the complexity of pursuing contractual justice see John Manwaring, “Unconscionability: Contested Values, Competing Theories and Choice of Rule in Contract Law” (1993) 25 *Ottawa L. Rev.* 235.

¹¹⁴ For example, *The Unfair Contract Terms Act, 1977* (U.K.), 1977, c. 50, s. 11(4)(b) acknowledges the significance of insurance in determining what is reasonable, but this does not preclude consideration of other variables. For a more general critique of an excessive focus on insurance and the “ideology of actuarialism” see N. Huls, “Critical Insurance Law” in Thomas Wilhelmsson, ed. *Perspectives of Critical Contract Law* (Aldershot: Dartmouth, 1991) [*Perspectives*] at 149.

¹¹⁵ Duggan, *supra* note 51 at 11, is also critical of the decision characterizing it as “reliev[ing] the plaintiff from what in hindsight is a bad deal.” In doing so he, like Waddams, fails to discuss the precise circumstances leading up to the theft of the goods.

Sixth, and finally, Waddams and others¹¹⁶ have protested that the majority decision in *Solway* fails to respect the statutory regime that prescribed a limitation of liability clause. At first blush this would appear to be a knockdown policy argument — legislative wisdom should trump judicial willfulness. Caution is warranted, however. The traditional common law rule was that carriers had absolute liability. As Carthy J.A. acknowledged in his dissent, quoting John McNeil, there were good policy reasons for this:

[T]he cargo owner's separation from his cargo involves relinquishment of any opportunity to protect it; the carrier's exclusive possession gives the carrier exclusive access to all evidentiary considerations in the event of a loss; the ability of the owner to prove a cause of action based on fault would be completely illusory; and imposing liability without fault on the carrier would encourage his diligence and care in the safeguard of the cargo.¹¹⁷

Then he continued:

Eventually it was found that commercial realities required a limit to that liability. The carrier has no means of knowing the value of the goods and, even if it did, the cost of insurance for the most valuable of goods in a cargo would impose prohibitive charges on the consignor of lesser valued goods. Thus statutes or regulations emerged maintaining the concept of absolute liability but limiting that liability to a declared value or, more often, to a value measured by weight. In this fashion the consignor can either insure the goods or bear the risk of their loss or damage, knowing the value of such goods. The carrier also bears some risk, which will act as an incentive to act prudently, while knowing that the extent of liability is tied to the weight of the goods being transported.

Provisions similar to those under our *Truck Transportation Act* are found in each of the provinces and extend internationally in treaties such as the *Warsaw Convention, 1929*, applying in Canada to international carriage by air, and the *Hague-Visby Rules* in respect of international carriage by water.

Thus we have a legislative policy that has developed over many years, permeates all facets of the transportation of goods industry and is based upon a sensible business and commercial rationale. I see no policy basis for not applying the limitation provision against the respondents in the present case. To the contrary, allowing the

¹¹⁶ Duggan, *ibid.* at 10-11; Swan, *supra* note 25 at 661, fn 127; Ogilvie, *supra* note 24 at 549.

¹¹⁷ *Solway*, *supra* note 13 at 533.

respondents' claim opens the door to every imaginable complaint of misfeasance and would undermine the entire structure built up under this longstanding policy.¹¹⁸

Several points can be made in response to this line of argument. For example, whose "commercial realities" are we discussing here? Note how Carthy J.A. slips into the passive voice with "[e]ventually it was found that ..." or "[t]hus statutes or regulations emerged ..." A thorough policy analysis would require going beyond such reified reasoning¹¹⁹ to inquire, for example, if these changes came about because of the lobbying efforts of carriers at the expense of consignors.¹²⁰ Indeed, it would seem as if the maximum liability provision was only introduced between 1950 and 1960.¹²¹ Moreover, the limitation of liability

¹¹⁸ *Ibid.* at 533-34.

¹¹⁹ Peter Gabel, "Reification in Legal Reasoning" in Piers Beirne and Richard Quinney, eds., *Marxism and Law* (New York: John Wiley, 1982) 262.

¹²⁰ For example, Carthy J.A.'s reference to the Hague-Visby Rules in respect of international carriage by water ignores the fact that these rules were the product of very concerted lobbying efforts by highly mobilized interest groups, shipowners and cargo owners. See Michael Sturley, ed., *The Legislative History of the Carriage of Goods by Sea Act and the Travaux Préparatoires of the Hague Rules* (Littleton: F.B. Rothman, 1990) Vol. 1, c. 1. Thanks to my colleague Hugh Kindred for his assistance on this point. See also *Alcoa Inc. v. C.P. Ships (U.K.) Ltd.*, [2006] O.J. No. 4037 (Sup.Ct.) (QL) at paras. 45-47.

¹²¹ The predecessor to the *Truck Transportation Act* was the *Public Commercial Vehicles Act*, which had been in existence since 1927 (S.O. 1927, c. 68). The *Act* itself is not relevant to the issue of liability, instead the Regulations pursuant to the *Act* set out limits for liability of the carrier. The early Regulations did not contain monetary liability limits. In 1960, the Regulations were amended to include liability limits for carriers and the limit has not changed much since 1960. In 1960 and 1970, regulations set the limit at \$1.50 per pound (or \$3.31 per kilogram). Since 1980 the limit has been \$4.41 per kilogram.

There is no indication from the legislative debates of the period to indicate conclusively why the Regulations were amended to include the limitation of liability provisions, but larger historical events may provide some insight into the increased lobbying power of the trucking industry. In late 1960, the country was preparing itself for a rail strike, which was to take place on December 3, 1960. However the federal government passed legislation to postpone the labour dispute until May 1961; see Jack McArthur, "The Truckers Will be Ready" *Toronto Daily Star* (3 December 1960). It appears that the trucking industry was taking advantage of the uncertainty in rail transportation by challenging the "special privileges" received by railways; see *ibid.* It also appears that the trucking industry had been lobbying the Government of Ontario for greater protection against instability. According to an article published in the *Globe and Mail* in November 1960, the Automotive Transport Association of Ontario (currently the Ontario Trucking Association — at <<http://www.ontruck.org/info/history.php>>) provided a brief to the Government of Ontario asking for greater protection "from the instability by enlargement of Government controls;" see "Stability or Stagnation" *The Globe and Mail* (21 November 1960). The instability, they suggested, was due to the excess capacity

provisions are not to be found in the legislation, but in the regulations made pursuant to it.¹²² This of course does not invalidate them, but it does contextualize the concerns of Waddams and Carthy J.A. that judges are flouting legislative intent, when the intent is more realistically that of government bureaucrats.

Finally, when read in light of precedent, the majority decision in *Solway* might not be as outrageous an affront to our democratic sensibility as Waddams suggests. *Solway* might be helpfully compared with the judgment of Wilson J.A. in *Beaufort Realities*,¹²³ a decision which, as we have seen, was affirmed by the Supreme Court of Canada,¹²⁴ as well as with the Supreme Court's decision in *Linton*.¹²⁵ In *Beaufort Realities* the legislation allowed for the waiver of liens by an express contract, but Wilson J.A. held that it could not have been the intention of the legislature to allow reliance on such a waiver where the owner committed fundamental breach.¹²⁶ Analogously, in *Solway* it could be argued that it could not have been the intention of the legislature to allow for reliance on a limitation of liability clause in the face of such flagrant disregard of the bailee's contractual obligations. Similarly, in *Linton* an exclusion of liability clause had been promulgated by a regulatory agency, the Board of Railway Commissioners, under the authority of the *Railway Act*. While the majority of the Supreme Court deferred to this formal legislative authorization, Laskin C.J.C., in dissent, contested it arguing:

It is to me a rather monstrous proposition...that Parliament in its legislation authorized total immunity from liability to be conferred upon a carrier which, under its cover, could decide when and if it would send a requested telegram.... I do not regard any orders of the regulatory agency as giving *carte blanche* to a carrier to take or refuse or to ignore messages tendered for transmission.¹²⁷

of the industry and firms which sought to develop services in anticipation of, rather than in response to, demand. The trucking industry's brief documented the expansion of the trucking industry, which stemmed in part from the "public preference for highway transport, as against rail transport;" see *ibid*. The roadways and highways had improved to a state where the trucking industry had access to most communities year-round and was becoming a more viable transportation option and thus gaining more lobbying power as an industry.

¹²² O. Reg. 643/05, Sch. 1, s. 9.

¹²³ *Supra* note 35.

¹²⁴ *Ibid*.

¹²⁵ *Supra* note 30.

¹²⁶ *Beaufort Realities CA*, *supra* note 35 at 179; *Beaufort Realities SCC*, *supra* note 35 at 725-26.

¹²⁷ *Supra* note 30 at 683, commenting on the *Railway Act*, R.S.C. 1952, c. 234, s. 381A.

Is it not equally monstrous to provide bailees with a *carte blanche* to leave the bailor's goods on the street unmonitored and unsupervised? While we certainly do not want judges to have roving unfettered discretion to eviscerate sensible regulative regimes, neither do we want our judges to be pressganged into the service of a regimented formalism.

McCamus also seems to favour exorcism of the doctrine of fundamental breach by subsuming it within unconscionability.¹²⁸ He argues that it is possible to divine in Dickson C.J.C.'s decision an enlarged conception of unconscionability that goes beyond situations of inequality of bargaining power by focusing on the Chief Justice's comment "unconscionable, *as might arise* from situations of unequal bargaining power."¹²⁹ While it is excessive to argue that McCamus is grasping at straws in an attempt to incorporate fundamental breach into unconscionability, such a reading seems unlikely for at least two reasons. First, Dickson C.J.C. himself clearly thought his decision was at odds with, and significantly narrower in ambit than, that of Wilson J. Second, it is hard to imagine that a judge as sophisticated as Dickson C.J.C. would want to generate such a radical reconception of unconscionability in such a subtle manner. Indeed, he suggests that by addressing inequality of bargaining power, courts are able to "focus expressly on the real grounds for refusing to give force to a contractual term."¹³⁰

In sum, policy arguments based upon an allocation of risk analysis, insurance, legislative intent and unconscionability are vitally important and militate against a doctrine such as fundamental breach. However, there remain other policy arguments that also need to be considered before consigning fundamental breach to the dustbin of history. Exorcism, while an apparently simple solution, is premised upon some unpersuasive argumentation and leaves the law of contract in an impoverished state.

B. Substantiation

A second option is for Canadian judges to keep the doctrine of fundamental breach and give it more body by spelling out, more clearly than Wilson J., the public policy justifications.

¹²⁸ McCamus, *supra* note 3 at 427, 772-73, 777.

¹²⁹ *Ibid.* at 772-73, note 84, citing Dickson C.J.C. in *Hunter*, *supra* note 1 at 462 [emphasis in original].

¹³⁰ *Hunter*, *ibid.* at 462. I am, however, persuaded by McCamus' argument that there is a way to reconcile both Dickson C.J.C.'s and Wilson J.'s understandings of the remedial impact of unconscionability, i.e., that it allows for the restriction of the application of the exculpatory clause but not rescission of the whole agreement; see McCamus, *supra* note 3 at 772, 776. My concern relates to what can trigger an

*Fraser Jewellers*¹³¹ might be worthy of reconsideration if we were to retain Wilson J.'s fundamental breach/*ex post* reasonableness approach. McCamus invokes this case as a nice example of where the differences between Dickson C.J.C. and Wilson J. can be elided.¹³² While the contract in this case could not be realistically conceived of as unconscionable because there was no improvident bargain at the time of its creation, it may be appropriate in the context of the particular facts to leave a residual power with the court to refuse to enforce the limitation of liability clause. If one were to ask any reasonable parties if they expected an employee to abandon his post with the consequence that \$50,000 of goods would be stolen, but the liability limited to \$890, they would be unlikely to agree that this was a possibility they could be expected to contemplate.¹³³ By contrast, consider how McCamus plays down the facts of the case, noting that "losses occasioned by theft may have been exacerbated by ADT's failure to respond promptly to the alarm..."¹³⁴ While it is entirely appropriate for the Court and McCamus to highlight the importance of insurance and the efficient allocation of risk, it is not clear that these should be the exclusive determinants for a comprehensive theory of contracts. As Freeman J.A. pointed out in *Atlas*, the courts have the responsibility to ask who has "the clout to shift the risk?"¹³⁵ Exculpatory clauses are important for allocating risk and achieving certainty in the marketplace, but they should not be conceived of as a blank cheque or some sort of "Get Out of Jail Free" card that provides absolute immunity or licence for the avoidance of reciprocity.

Moreover, there is also a tendency when thinking about cases such as *Fraser Jewellers*¹³⁶ to have recourse to the distinction between consumer and commercial agreements.¹³⁷ While unconscionability might have some purchase in the former context, it rarely applies in the latter.¹³⁸ But this distinction may be porous: the respondent in this case was in reality ADT a multinational corporation operating worldwide; *Fraser Jewellers* was pretty much a mom-and-pop operation, in small

unconscionability intervention by a court, not the remedy.

¹³¹ *Fraser Jewellers*, *supra* note 60.

¹³² McCamus, *supra* note 3 at 773.

¹³³ Similarly in *Solway SC*, *supra* note 13 at 214-15, the value of the goods was estimated at \$750,000. The plaintiffs never received any reimbursement from the storage company, despite the statutory provision that they be paid 60 cents per pound. All they received was \$170,200 from their own insurer.

¹³⁴ McCamus, *supra* note 3 at 774.

¹³⁵ *Atlas*, *supra* note 21 at 28.

¹³⁶ *Fraser Jewellers*, *supra* note 60.

¹³⁷ McCamus, *supra* note 3 at 775.

¹³⁸ *Ibid.* at 404-25, 774-78.

town eastern Ontario. Its commercial identity may occlude its true socio-economic status.

However, despite these arguments in favour of substantiation, it must be acknowledged that there are real problems with a discrete fundamental breach/*ex post* reasonableness category of judicial supervision. Wilson J.'s decision never quite deals with the common objection that it is inappropriate to single out exculpatory clauses, because there may be other provisions that are equally onerous to one of the contracting parties.¹³⁹ Moreover, as is often argued, exculpatory clauses can serve very positive functions in terms of the efficient allocation of responsibility, risk and insurance between the parties.¹⁴⁰ It is therefore inappropriate to single them out for such discrete clausal profiling.

C. Transubstantiation

Third, fundamental breach could be transubstantiated into the increasingly emergent doctrine of good faith performance. It is beyond the scope of this paper to address the passionate debate about the wisdom of adopting such a doctrine in Canada,¹⁴¹ but there can be little doubt that good faith now forms a part of our contractual landscape.¹⁴² McCamus, for example, in his recent treatise, has (somewhat reluctantly) begun to “identify recurring themes in the factual patterns of these cases, with a view to demystifying the doctrine and giving the doctrine more concrete

¹³⁹ Waddams *supra* note 25 at 332. See also B.C.L.I. Report, *supra* note 50, c. 2 for a helpful overview of such terms. This criticism is reinforced by some recent research which argues that not only “harsh boilerplate terms” but also “beneficial boilerplate terms” can have negative consequences for consumers. See D. Gilo and A. Porat, “The Hidden Roles of Boilerplate and Standard Form Contracts: Strategic Imposition of Transaction Costs, Segmentation of Consumers and Anti-Competitive Effects” (2006) 104 Mich. L. Rev. 983.

¹⁴⁰ McCamus, *supra* note 3 at 749, 758; Flannigan, *supra* note 25.

¹⁴¹ Classic discussions include: Philip Girard, “‘Good Faith’ in Contract Performance: Principle or Placebo?” (1983) 5 Sup. Ct. L. Rev. 309; Michael Bridge, “Does Anglo-Canadian Contract Law Need a Doctrine of Good Faith?” (1984) 9 Can. Bus. L.J. 385; Edward Belobaba, “Good Faith and Canadian Contract Law” in Law Society of Upper Canada, *Special Lectures 1985, Commercial Law: Recent Developments and Emerging Trends* (Toronto: R. De Boo, 1985) at 73; Ontario Law Reform Commission, *Report on the Amendment of the Law of Contract* (Toronto: Ministry of the Attorney General, 1989) at c. 9; Stephen M. Waddams, “Good Faith, Unconscionability and Reasonable Expectations” (1995) 9 J. Contract L. 55.

¹⁴² See e.g. McCamus, *supra* note 3 at c. 21; Swan, *supra* note 25 at 243-59, 538-48, 694-707; Shannon O’Byrne, “Good Faith in Contractual Performance: Recent Developments” (1995) 74 Can. Bar Rev. 70; David Stack, “The Two Standards of Good Faith in Canadian Contract Law” (1999) 62 Sask. L. Rev. 201.

content.”¹⁴³ As a result, he has carefully mapped out the possible parameters of such a doctrine but has limited them to three contexts: “those imposing duties to cooperate in achieving fulfillment of the objectives of the agreement; those imposing limits on the exercise of contractual discretionary powers; and those precluding parties from evading contractual obligations.”¹⁴⁴ McCamus does not include a discussion of any of the fundamental breach cases in any of his three categories, although the first and third might seem especially pertinent. It might be worth considering the addition of another subfield of good faith, fundamental breach/*ex post* unreasonableness.¹⁴⁵

Commentators have identified a tension between two different conceptions of good faith performance in Canadian case law.¹⁴⁶ In its narrow incarnation, good faith performance is simply an attempt to enforce the parties’ reasonable expectations of each other.¹⁴⁷ In its broad incarnation it provides courts with an independent authority to review the reasonableness or fairness of the contract *per se*. Those who favour the narrow version of good faith tend to argue that the parties’ expectations, or the objectives of the contract, can only be found within the four corners of the written contract. Those who favour the wider view, tend to look at larger social and economic norms.¹⁴⁸

I would suggest that a happy meeting place for these two competing perspectives is the parties’ reasonable expectations in light of the relationship they have forged.¹⁴⁹ A number of commentators have argued that the essence of a contemporary contract is that there be a relationship

¹⁴³ McCamus, *ibid.* at 782. See also John D. McCamus, “Abuse of Discretion, Failure to Co-operate and Evasion of Duty: Unpacking the Common Law Duty of Good Faith Contractual Performance” (2004) 29 *Advocates Q.* 72.

¹⁴⁴ McCamus, *ibid.* at 784.

¹⁴⁵ See also O’Byrne, *supra* note 142 at 90-91.

¹⁴⁶ O’Byrne, *ibid.*; Stack, *supra* note 142; McCamus, *supra* note 3 at 805-06; Waddams, *supra* note 25 at 389.

¹⁴⁷ McCamus, *ibid.* at 783; Stack, *ibid.*; Swan *supra* note 25 at 539, 543.

¹⁴⁸ Stack, *ibid.* at 203, 208, 217.

¹⁴⁹ See also Steven J. Burton and Eric G. Andersen, *Contractual Good Faith: Formation, Performance, Breach, Enforcement* (Toronto: Little Brown, 1995) at 3, 13, 21, 57; Swan, *supra* note 25 at 539, 697. For an example of the Supreme Court of Canada considering the overall relationship between the parties in the context of terms implied by law see *Machtiger v. HOJ Industries*, [1992] 1 S.C.R. 986. This also points to another significant difference between fundamental breach and unconscionability. Unconscionability is a doctrine imposed by law, despite the agreement of the parties, whereas good faith arises from the proper understanding of the agreement (or more accurately the relationship) between the parties, and their mutual expectations; see also McCamus, *supra* note 3 at 806; O’Byrne, *supra* note 142 at 82-85, 94. I am advancing this modest conception of good faith for the limited purposes of this paper, which has its

of give and take, of reciprocity and mutuality, of interdependence and cooperation.¹⁵⁰ All the parties have some expectation that they will get some fruit from the contract.¹⁵¹ Several of the cases that support a good faith performance principle reinforce this proposition. For example, in *Gateway Realty Ltd. v. Arton Holdings Ltd.*, Kelly J. proposed that

bad faith can be said to occur when one party, without reasonable justification, acts in relation to a contract 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.¹⁵²

Similarly, Shannon J. in the trial level decision in *Mesa Operating Ltd. Partnership v. Amoco Canada Resources Ltd.* proclaimed, “The common law duty to perform in good faith is breached when a party acts in bad faith, that is, when a party acts in a manner that substantially nullifies the contractual objectives or causes significant harm to the other, contrary to the original purposes or expectations of the parties.”¹⁵³ In another case Blair J. has held that good faith performance means that a party “must not act in a fashion designed to eviscerate the very right that has been given.”¹⁵⁴ Other cases have talked about ensuring “that parties do not act in a way that eviscerates or defeats the objectives of the agreement they have entered into.”¹⁵⁵ Gonthier J. has phrased the good faith duty more positively: “[I]t imposes upon the parties the obligation to act with loyalty and sincerity, with a minimal level of concern for the well-being of others and in the spirit of cooperation.”¹⁵⁶

focus on fundamental breach. I am not precluding the possibility of a more autonomous doctrine in other contexts.

¹⁵⁰ See generally, Ian MacNeil, *The New Social Contract: An Inquiry into Modern Contractual Relations* (New Haven: Yale University Press, 1980); Hugh Collins, “Good Faith in European Contract Law” (1994) 14 *Oxford J. Legal Stud.* 229 at 253-54; Roger Brownsword, “‘Good Faith in Contracts’ Revisited” (1996) 49 *Curr. Legal Probs.* 112; A. Mason, “Contract, Good Faith and Equitable Standards in Fair Dealing” (2000) 116 *Law Q. Rev.* 66; Thomas Wilhelmsson, “Questions for a Critical Contract Law — and a Contradictory Answer: Contract as Social Cooperation” in Wilhelmsson, *Perspectives*, *supra* note 114 at 9.

¹⁵¹ See also Burton and Anderson, *supra* note 149 at 20, 32.

¹⁵² (1991), 106 N.S.R. (2d) 180 at 197 (S.C. (T.D.)) [*Gateway*], *aff’d* (1992), 112 N.S.R. (2d) 180 (N.S.C.A.).

¹⁵³ (1992), 129 A.R. 177 at 218 (Q.B.), *aff’d* (1994), 19 *Alta. L.R.* (3d) 38 (C.A.) at 45. See also *CivicLife.com Inc. v. Canada (Attorney-General)*, [2005] O.J. No. 3485 (Ont. Sup. Ct.) (QL) at paras. 50-52.

¹⁵⁴ *GATX Corp. v. Hawker Siddeley Canada Inc.* (1996), 27 B.L.R. (2d) 251 at 276 (Ont. Gen. Div.).

¹⁵⁵ *TransAmerica Life Canada v. ING Canada* (2003), 234 D.L.R. (4th) 367 (Ont. C.A.) at 378.

¹⁵⁶ Charles Gonthier, “Liberty, Equality, Fraternity: The Forgotten Leg of the

In seeking these obligations, objectives or expectations the text of the contract is of course of foundational importance, but it is not necessarily determinative of the whole relationship.¹⁵⁷ Thus if the conduct of one party leaves the other party without any benefits, “substantially nullifying” or “eviscerating” them, then this would suggest that the text does not capture their genuine and reasonable expectations. As Laskin C.J.C. argued in 1975, there must be a “residue of obligation”¹⁵⁸ and if the text suggests that this is not the case, then it can be questioned whether the text fully captures the parties’ reasonable expectations or, as Brownsword puts it, “their implicit understanding of the deal.”¹⁵⁹ Moreover, contractual texts, like all texts, are unable to anticipate all contingencies. An excessive prioritization of the details may obscure the inner logic and general purpose of the relationship. What good faith can do is provide a mechanism which seeks the essence of the relationship. Such an approach does not ignore the express terms; it seeks to contextualize them in the overall relationship between the parties so as to ensure that the fruits of the contract are not completely destroyed for one of the parties.¹⁶⁰

Support for such a contextualized approach to the interpretation of contracts can be found in a variety of *dicta* from the House of Lords. Lord Wilberforce, for example, has argued:

No contracts are made in a vacuum: there is always a setting in which they have to be placed. The nature of what is legitimate to have regard to is usually described as “surrounding circumstances” but this phrase is imprecise: it can be illustrated but hardly defined. In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating....[W]hat the court must do must be to place itself in thought in the same factual matrix as that in which the parties were. All of these opinions seem to me implicitly to recognize that, in the search for the relevant background, there may be facts which form part of the circumstances in which the parties contract in which one, or both, may take no particular interest, their minds being addressed to or concentrated on other facts so that if asked they would assert that they did not have

Trilogy, or Fraternity: The Unspoken Third Pillar of Democracy” (2000) 45 McGill L.J. 567 at 583-584.

¹⁵⁷ See also Steyn, *supra* note 103 at 441. For a helpful example of a case that adopts this relational understanding of contract in the context of negligent misrepresentation see *Robet v. Versus Brokerage Services, Inc.*, [2001] O.J. No. 1341 (QL).

¹⁵⁸ *Linton*, *supra* note 30 at 684.

¹⁵⁹ *Supra* note 150 at 121.

¹⁶⁰ See more generally, David Campbell et al., eds., *Implicit Dimensions of Contract: Discrete, Relational and Network Contracts* (Oxford: Hart Publishing, 2003).

these facts in the forefront of their mind, but that will not prevent those facts from forming part of an objective setting in which the contract is to be construed.¹⁶¹

Lord Hoffmann has expanded the “factual matrix” approach even further:

Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract... The background was famously referred to by Lord Wilberforce as “the matrix of fact” but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties .. it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.¹⁶²

A good faith approach to fundamental breach scenarios may avoid some of the criticisms, both general and particular, that have bedeviled the rule of law conception of fundamental breach. The Waddams/Dickson C.J.C. general concern about over- or underinclusion is not an issue because good faith can be applied to all clauses that have an excessively onerous consequence for one of the parties.¹⁶³ Good faith can easily recognize that exculpatory clauses are part of the complete package that is a contract, that they are often central to the allocation of risk in a contract, as well as its price, and is therefore sensitive to the importance of insurance issues and incentives.¹⁶⁴ Hence it counsels temerity in refusing to enforce them out of respect for the principles of freedom and sanctity of contract.¹⁶⁵ But at the same time, temerity is not fecklessness and it allows for judicial oversight where enforcement would fail to respect the foundational obligations of reciprocity that a contract imposes on all parties to the contract.

The key particular objection advanced by Dickson C.J.C., following Waddams, was that Wilson J.’s fundamental breach doctrine generates “games of characterization.”¹⁶⁶ While Dickson C.J.C. was not fully clear

¹⁶¹ *Reardon Smith Line Ltd. v. Hansen-Tangen*, [1976] 1 W.L.R. 989 at 995, 997.

¹⁶² *Investors Compensation Scheme Ltd. v. West Bromwich Building Society*, [1998] 1 W.L.R. 896 at 912-13. For an earlier, and particularly eloquent, American invocation of a contextual methodology for contract interpretation see Justice Cardozo’s dicta in *The Utica City National Bank v. Gunn*, [1918] 118 N.E. 607 at 608.

¹⁶³ *Hunter*, *supra* note 1 at 460-61; Waddams, *supra* note 25 at 339.

¹⁶⁴ See e.g. Flannigan, *supra* note 25; Ogilvie, “Fundamental Breach,” *supra* note 25 at 89; Rafferty, *supra* note 41 at 287.

¹⁶⁵ See also *Gateway*, *supra* note 152 at 198.

¹⁶⁶ *Hunter*, *supra* note 1 at 460.

as to what he meant by this, it would appear that he was referring to two different possible issues: whether a particular breach is fundamental or not, and whether a particular clause was an exculpatory clause.¹⁶⁷ While the basic point — that an absolutist either/or rule of law approach can have a dramatic impact — is accurate, there is a danger in overplaying this point. In law, characterization is an inevitable part of the game. Even Dickson C.J.C. acknowledged this when he went out of his way to emphasize that he was not rejecting the idea of breach of a fundamental term of a contract,¹⁶⁸ though it is not clear what alternative option he had in mind. A breach of a warranty, we can assume. But in that context, it is trite law that that distinction is often unclear and that judges inevitably must engage in characterization exercises.¹⁶⁹ The good faith approach is not absolutist in the sense of fundamental breach. It will determine what the impact of the breach is and, in that sense, it is inevitably an exercise in characterization. That, however, will only be part of a more sophisticated analysis that will consider the multiple factors that constitute the contractual relationship and the parties' expectations.

Moreover, adoption of a good faith performance analysis may enhance the certainty of the law. Dicta in some of the fundamental breach cases suggest that good faith performance of one's contractual obligations is, in fact, a central underlying concern for judges. For example, in *Hunter Wilson J.* explicitly noted that Allis-Chalmers was not "guilty of any sharp or unfair dealing" nor was there any abuse of "freedom of contract."¹⁷⁰ In *Linton*, Laskin C.J.C., in dissent, noted that "[no telegram] was sent, nor was there even an attempt to send one which was aborted by difficulties of one sort or another. The situation goes beyond mere negligence on the part of the respondent's employees.... In these circumstances, I find the exemption provision inapplicable."¹⁷¹

Plas-Tex provides another example of how a good faith analysis may kick in. Here the supplier knew that the resin was defective and possibly dangerous, but rather than revealing this information, it "chose to protect itself from liability by inserting liability limiting clauses"¹⁷² in the contract with a devastating impact on the plaintiff. While there was clearly a situation of asymmetrical information, one would be hard pressed to agree with the Alberta Court of Appeal that this can fit within a traditional approach to unconscionability because of the commercial

¹⁶⁷ Rafferty, *supra* note 41 at 282, 286.

¹⁶⁸ *Hunter*, *supra* note 1 at 463.

¹⁶⁹ See e.g. *Hong Kong Fir*, *supra* note 3.

¹⁷⁰ *Hunter*, *supra* note 1 at 517.

¹⁷¹ *Linton*, *supra* note 30 at 684-85.

¹⁷² *Supra* note 17 at 132.

nature of the relationship, and the strict requirements in establishing unconscionability to show inequality of bargaining power and an improvident bargain at the time the contract is made. But in light of the devastating nature of the breach, a Wilsonian fundamental breach/*ex post* unreasonableness standard seems appropriate in *Plas-Tex* because there was clearly no good faith on Dow Chemical's part.

Similar good faith concerns appear to motivate the majority in *Atlas*, which emphasized that the franchisor made excessively favourable projections based on guesswork and unjustifiable assumptions, amounting to "equitable fraud."¹⁷³ According to Matthews J.A., "this appellant should not be permitted to engage in such conduct secure in the knowledge that no liability could be imposed upon it because of the exclusionary clause."¹⁷⁴ Or, in the Nova Scotia vernacular of Freeman J.A., the franchisee "needed a lifeline. He was thrown an anchor."¹⁷⁵ In *Globe Printers* the judge found that there was evidence that the lessor knew there were significant problems with the machines they were selling.¹⁷⁶ Similarly in *Solway*, it might be possible to conceive that leaving the goods insecure on the street on a winter's night falls short of the good faith performance of one's obligations.¹⁷⁷ And even in *Fraser Jewellers*¹⁷⁸ it might be argued that the employee's abandonment of their post is or is not a failure of good faith performance. All of these cases go beyond the common problem of asymmetrical information. They are examples of flagrant disregard of one's contractual obligations, well short of a good faith effort to perform.

Of course, an embrace of good faith will excite the passions of those who are opposed to the idea of unconscionability, and who will likely perceive good faith as even less amenable to clear definition. The reality, however, appears to be that courts will always want to have an element of flexibility to do the right thing in spite of the shibboleths of sanctity and freedom of contract. The move towards a doctrine of good faith might also increase what the British Columbia Law Institute calls the "deterrent effect" of contract doctrine.¹⁷⁹

Finally, incorporating fundamental breach within the domain of good faith performance might help stem fears that a judicial

¹⁷³ *Supra* note 21 at 16, 24.

¹⁷⁴ *Ibid.* at 24.

¹⁷⁵ *Ibid.* at 28.

¹⁷⁶ *Globe*, *supra* note 15 at para. 10.

¹⁷⁷ *Supra* note 13.

¹⁷⁸ *Supra* note 60.

¹⁷⁹ B.C.L.I. Report, *supra* note 50 at 21.

unwillingness to enforce exculpatory clauses would cause chaos in the law and the marketplace.¹⁸⁰ While it inevitably leaves some discretion with the judiciary, it does provide both an objective and subjective focus for the assessment of the relationship. It goes beyond asking whether one party was deprived of substantially the whole benefit of the relationship to inquire into the conduct of the breaching party. As even Wilson J. acknowledged, there is no absolute rule that an exculpatory clause automatically loses its validity just because one party is denied their expectations; when it is understood in its full context a contract may have anticipated this possibility. Something more is required. Thus in cases such as *Atlas*, *Plas-Tex* and *Solway* the courts were concerned not just with the fact of calamitous or catastrophic loss suffered by an innocent party, but the nature of the misperformance by the breaching party: misrepresenting predictions, knowingly supplying hazardous materials, or abandoning goods on the street on a nasty winter's night.¹⁸¹

9. Conclusions

Although it has been almost two decades since the Supreme Court of Canada decision in *Hunter*, the “viability of the doctrine of fundamental breach”¹⁸² appears to remain an unresolved issue for Canadian law. Those who have argued that “there is not much life left in the concept”¹⁸³ either do not understand their colleagues and their contractual vision or

¹⁸⁰ See e.g. *Catre Industries Ltd. v. Alberta* (1989), 63 D.L.R. (4th) 74 (Alta. C.A.) at 94-95.

¹⁸¹ Some support for locating fundamental breach within the rubric of good faith can be drawn from other jurisdictions. The United States, Article 205 of the American Law Institute, *Restatement of the Law — Contracts (2d)* (St. Paul: American Law Institute Publishers, 1981) at 99 provides: “Every contract imposes upon each party a duty of good faith and fair dealing in its performance and enforcement.” The Commentary is more pertinent. It provides at 100-01: “A complete catalogue of types of bad faith is impossible, but the following types are among those which have been recognized in judicial decisions: evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance.” Similarly, Article 3(1) of the European Union's *Directive on Unfair Terms in Consumer Contracts* (93/13/EEC, 5 April 1993, OJL 95/29, 21/4/93) states: “A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.” More particularly, Annex 1, paragraph b, specifies that a term is unfair if it has the effect of “inappropriately excluding or limiting the legal rights of the consumer in the event of total, partial or inadequate performance.” For a fuller discussion of both these provisions see Collins, *supra* note 150 at 249-52.

¹⁸² *Hunter*, *supra* note 1 at 482.

¹⁸³ *Kordas v. Stokes Seeds Ltd.* (1993), 11 O.R. (3d) 129 at 135.

wistfully pine for simpler days. Unlike England, where it is said that fundamental breach has received “the final quietus”¹⁸⁴ the idea still pervades the Canadian judicial imagination resulting in confusion and uncertainty.¹⁸⁵ But in England it is no longer necessary to have a doctrine such as fundamental breach because there has been positive legislative intervention in the form of the *Unfair Contract Terms Act*.¹⁸⁶

It is unfortunate that the Supreme Court of Canada refused leave in *Solway*¹⁸⁷ and gave such superficial attention to the issue in *Guarantee Co.*¹⁸⁸ If there is, in Laskin C.J.C.’s words, “no residue of obligation”¹⁸⁹ because of an exculpatory clause then there must be room for what Wilson J. has described as a “residual power residing in the court to withhold its assistance on policy grounds in appropriate circumstances”¹⁹⁰ to ensure good faith reciprocity in the agreement. Contracts are about mutuality; when one party seeks to take all the benefits and none of the burdens through the use of an exculpatory clause — “where the very thing bargained for has not been provided”¹⁹¹ — the law needs some substantive mechanism to police the equity of the relationship. The problem has not gone away and is not likely to do so. Lamentably, legislatures and the Supreme Court seem uninterested; the result is confusion, incoherence and checkerboard jurisprudence in which everyone loses. The undead continue to roam. The nightmare continues. A solution is required. A modest expansion of the good faith performance principle may be the least worst option.

¹⁸⁴ *George Mitchell (Chesterhall Ltd) v. Finney Lock Seeds Ltd.*, [1983] 2 All E.R. 737 at 741 (H.L.).

¹⁸⁵ See also Fridman, *supra* note 25 at 634-37.

¹⁸⁶ As McCamus, *supra* note 3 at 763-64 notes, the *George Mitchell* case, *supra* note 184, is a perfect example of where the legislative regime eclipses a fundamental breach analysis.

¹⁸⁷ Leave to appeal refused 224 D.L.R. (4th) vii.

¹⁸⁸ *Supra* note 3.

¹⁸⁹ *Linton*, *supra* note 30.

¹⁹⁰ *Hunter*, *supra* note 1 at 517.

¹⁹¹ *Ibid.* at 500.