

Exemption Clauses and Fundamental Breach in Contract:
Tercon Contractors Ltd. v. British Columbia

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1. Introduction

If public policy is the unruly horse of the law of contract, fundamental breach is surely its wily beast. Notwithstanding the assertions of two panels of the Supreme Court of Canada, over a two decade period, that it is time to lay the doctrine to rest,¹ a close reading of the latest case, *Tercon Contractors Ltd. v. British Columbia*² suggests that fundamental breach continues to lurk in the underbrush awaiting an appropriate moment to spring forth in the future. Perhaps Binnie J., in his dissenting opinion, was more realistic than he thought when he framed the removal of fundamental breach as an attempt “to shut the coffin on the jargon”³ associated with fundamental breach rather than of expressly overruling the doctrine. Arguably the spirit of fundamental breach continues to survive in the law of contract, doing the work it has always done of defeating exclusion clauses found by a court too offensive to enforce. But once it is appreciated that fundamental breach was always simply a synonym for unfair contract, the failure of the top court to eradicate it root and branch from contract law is understandable, especially in light of the test which the unanimous Court adopted for controlling the abusive use of exclusion clauses in standard form contracts. This test features other contract law synonyms for unfair contracts such as “unconscionable,” “unequal bargaining power,” and “against public policy.” Whether or not the three-step test of construction, unconscionability review at formation and public policy review at enforcement – to which the Court agreed unanimously – is the most efficient resolution is the subject of this comment.

At the outset, it is important to note that the preponderance of scholarly opinion has favoured a resolution broadly along the lines

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¹ *Hunter Engineering Co. v. Syncrude Canada Ltd.*, [1989] 1 S.C.R. 426, 57 D.L.R. (4th) 321 at 342-43 [*Hunter* cited to D.L.R.]; *Tercon Contractors Ltd. v. British Columbia*, 2010 SCC 4, [2010] 1 S.C.R. 69 at 98 [*Tercon*].

² *Tercon*, *ibid.*

³ *Ibid.* at 107.

offered by the Court,⁴ and that a resolution involving concepts like unconscionability, unequal bargaining power and public policy is, like fundamental breach, inevitably subject to accusations of ambiguity in relation to meaning, content and scope of application. It is also important to note that *Tercon* was, like all of the previous leading cases in this area, concerned with a dispute between two sophisticated commercial parties, so that the continuing explicit role of fundamental breach in consumer contracts remains uncertain, although the three-step test proposed in *Tercon* is easily adaptable, *mutatis mutandis*, to consumer contracts. The costs associated with appealing consumer cases to the Supreme Court make consumer appeals highly unlikely. The general conclusion from this analysis is that although the Court left questions unanswered, it has moved closer to an appropriate resolution – though this could have been offered in a two-step rather than a three-step analysis.

2. *The Case*

The chronology of the case was not at issue. The province of British Columbia (BC) issued a request for expression of interest (RFEI) to design and build a road in difficult terrain in northern BC. Six submissions were made including those from Tercon and Brentwood Enterprises Ltd. Several months later BC decided to design the highway itself and issued a request for proposals (RFP) to build the highway. The RFP provided that only the six original proponents would be permitted to submit a proposal and that no other submissions would be considered. Lacking expertise in drilling and blasting, Brentwood entered a pre-bidding agreement with another construction company, which was not an original bidder, to undertake the work as a joint venture. Brentwood submitted the bid in its own name and listed the other company as a major member of its team; teams were

⁴ The clearest exponent of unconscionability as the test for deciding whether to enforce exclusion clauses is Stephen M. Waddams, *The Law of Contracts*, 5th ed. (Toronto: Canada Law Book, 2005) at c. 14. More measured supports for unconscionability as the most likely doctrine to achieve fairness are found in Gerald H.L. Fridman, *The Law of Contract*, 5th ed. (Toronto: Carswell, 2006) at 583-605; John D. McCamus, *The Law of Contracts*, (Toronto: Irwin Law, 2005) at c. 20; and John Swan, *Canadian Contract Law*, 2d ed. (Toronto: Lexis Nexis, 2009) at 739-92. Other scholars have favoured other legal doctrines which also address the core question of the fairness of enforcing an exclusion clause in the circumstances. Richard F. Devlin, "Return of the Undead: Fundamental Breach Disinterred" (2007) 86 Can. Bar. Rev. 1 favours good faith; and M.H. Ogilvie, "Fundamental Breach Excluded But Not Extinguished: *Hunter Engineering v. Syncrude Canada*" (1990-91) 17 Can. Bus. L.J. 75 favoured reasonableness. Robert Flannigan, "*Hunter Engineering*: The Judicial Regulation of Exculpatory Clauses" (1990) 69 Can. Bar. Rev. 515 favoured no particular approach but was critical of unconscionability.

originally permitted in the RFEI. Brentwood was selected although Tercon was the other one of the two short-listed proponents. Tercon sued BC on the broad ground that BC was in breach of the bidding contract (Contract A) by considering a bid from an ineligible bidder, that is, a joint venture involving Brentwood, but BC relied upon an exclusion clause in that contract as its defence. The clause provided:

Except as expressly and specifically permitted in these Instructions to Proponents, no Proponent shall have any claim for any compensation of any kind whatsoever, as a result of participating in this RFP, and by submitting a proposal each proponent shall be deemed to have agreed that it has no claim.

The trial judge found that the Brentwood bid was a joint venture bid, that the province knew this and breached the contract with Tercon by considering and awarding the project to Brentwood. She found the exclusion clause too ambiguous on construction to protect the province and found the province in fundamental breach of contract so that it was neither fair nor reasonable to enforce it in the province's favour. The BC Court of Appeal found the exclusion clause to be clear and permitted the province to rely on it to escape liability for breach of contract. The Supreme Court found by a 5-4 decision for Tercon, considering the bundle of legal issues relating to exclusion clauses and fundamental breach in the course of both majority and minority decisions. The Court unanimously agreed on the appropriate legal analysis of these types of cases, but disagreed on the construction of the exclusion clause. The majority thought that the clause did not cover the events while the minority thought that it very clearly did. The majority agreed with the general discussion of legal principles set out in the minority decision and that decision will, therefore, be considered first.

Writing for the minority,⁵ Binnie J. declared at the outset that the jargon associated with fundamental breach, such as "immense" or "colossal" is unhelpful⁶ and that exclusion clauses are not inherently unreasonable,⁷ thereby setting the tone for his judgment, which is

⁵ Which included McLachlin C.J.C., Abella and Rothstein JJ.

⁶ These words are not used in the earlier case law to characterize fundamental breach. Rather, typical words used include "a breach which goes to the root of the contract," "a breach which goes to the essence of the contract," "a breach which destroys the purpose of the contract" and "a breach which deprives the innocent party of the benefit of the contract;" see *Canso Chemicals Ltd. v. Canadian Westinghouse (No. 2)* (1974), 10 N.S.R. (2d) 306, 54 D.L.R. (3d) 517 at 523-24 (C.A.) for a collection of terminology. Arguably these phrases better capture the concept of fundamental breach than the contemporary street slang offered by Binnie J.

⁷ *Supra* note 1 at 107.

founded on the enforcement of contracts freely negotiated. Binnie J. also agreed at the outset that the bid did not comply with the terms of the tender, which precluded joint venture bids,⁸ so that the case was then essentially about the enforcement of the exclusion clause. He further accepted the Contract A/Contract B analysis of structured bidding processes advanced by Estey J. in *R. v. Ron Engineering & Construction (Eastern) Ltd.*⁹ and consistently applied by the Supreme Court of Canada in subsequent tender cases.¹⁰ This means that the initial tendering call itself can give rise to a contract (Contract A) quite independent from the contract (Contract B) subsequently entered into with the winning bidder, and that unsuccessful bidders may have a remedy for breach of Contract A against an owner who breaches the bidding rules set out in Contract A.¹¹ Finally, at the outset, Binnie J. dismissed an argument that there was a statutory bar to enforcing the exclusion clause in provincial legislation.¹² This conclusion expressly favoured the integrity of the tendering process, and was based on the ground that the legislation did not expressly prohibit the use of exclusion clauses, especially between sophisticated and experienced parties like those in the present case, who are accustomed to allocating risk through the use of such clauses.¹³

The argument of the province on appeal was that the exclusion clause applied to the breach of contract that had occurred on construction. The arguments of Tercon were that it did not apply on construction or that if it did, the province was in fundamental breach of contract by considering and selecting an ineligible bidder. Binnie J. considered first the law relating to fundamental breach, and concluded that analysis with the new three-step test to be applied to these types of cases. The evolution of the doctrine of fundamental breach since *Karsales (Harrow) Ltd. v. Wallis*,¹⁴ has been so frequently rehearsed¹⁵ that it is unsurprising that Binnie J. proceeded directly to *Hunter*

⁸ *Ibid.* at 107-10.

⁹ [1981] 1 S.C.R. 111, 119 D.L.R. (3d) 267.

¹⁰ *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.*, [1999] 1 S.C.R. 619, 170 D.L.R. (4th) 577 [M.J.B.]; *Martel Building Ltd. v. Canada*, 2000 SCC 60, [2000] 2 S.C.R., 193 D.L.R. (4th) 1; *Naylor Group Inc. v. Ellis-Don Construction Ltd.*, 2001 SCC 58, [2001] 2 S.C.R. 943, 204 D.L.R. (4th) 513; *Double N Earthmovers Ltd. v. Edmonton (City)*, 2007 SCC 3, [2007] 1 S.C.R. 116, 275 D.L.R. (4th) 577.

¹¹ *Supra* note 1 at 109-12.

¹² *Ministry of Transportation and Highways Act*, R.S.B.C. 1996, c. 311, s. 4.

¹³ *Supra* note 1 at 112-15.

¹⁴ [1956] 2 All E.R. 866 (C.A.) [*Karsales*].

¹⁵ Ogilvie, *supra* note 4 at 83-98; Flannigan, *supra* note 4 at 517-26; Waddams, *supra* note 4 at 334-45; Fridman, *supra* note 4 at 594-605; McCamus, *supra* note 4 at 754-79; and Swan, *supra* note 4 at 768-81.

*Engineering Co. v. Syncrude Canada Ltd.*¹⁶ in which the Supreme Court of Canada appears to have offered two distinctive approaches.

Dickson C.J.C. thought that the doctrine of fundamental breach should be laid to rest. He proposed that an exclusion clause first be interpreted, and if it is found applicable to the facts, then a court should assess whether it is unconscionable as of the time of formation as an abuse of superior bargaining power. If the clause is found to be unconscionable, the court should decline to enforce it. Conversely, Wilson J. thought that after construction, a court should have residual power to determine whether or not to enforce an exclusion clause in light of all the circumstances where a fundamental breach had occurred, and may decline to do so on policy grounds in appropriate cases. She further thought that such analysis might also yield a decision to give effect to an exclusion clause, even in the event of a fundamental breach.¹⁷

In two subsequent cases, the Supreme Court continued to speak of fundamental breach, but failed to resolve the differences of approach of Dickson C.J.C. and Wilson J. In *Guarantee Co. of North America v. Gordon Capital Corp.*,¹⁸ Iacobucci J., speaking for the Court, confirmed the starting point as construction of the clause but maintained the possibility of non-application in the event of fundamental breach on the grounds of either unconscionability as *per* Dickson C.J.C., or unfairness, unreasonableness or as contrary to public policy as *per* Wilson J.¹⁹ On the facts of *Guarantee*, involving two sophisticated commercial parties, the Court concluded, as in *Hunter*, that it would not be unconscionable, unfair, unreasonable or contrary to public policy to uphold the application of the exclusion clause.²⁰ Again, in *Domtar Inc. v. ABB Inc.*,²¹ an appeal from Quebec, the Court once more acknowledged the existence of fundamental breach in the law and the possibility that an exclusion clause could protect a party from liability for such a breach, regardless of how inequitable or unreasonable a court thought this outcome to be.²²

From this overview of recent Supreme Court decisions on fundamental breach, Binnie J. concluded that the real question is under

¹⁶ *Supra* note 1.

¹⁷ *Tercon*, *supra* note 1 at 116-19, with references to *Hunter* contained therein.

¹⁸ [1999] 3 S.C.R. 423, 178 D.L.R. (4th) 1 [*Guarantee*].

¹⁹ *Ibid.* at 447-51.

²⁰ *Ibid.* at 453.

²¹ 2007 SCC 50, [2007] 3 S.C.R. 461, 287 D.L.R. (4th) 385 [*Domtar*].

²² *Ibid.* at 413. For Binnie J.'s overview of these cases, see *Tercon*, *supra* note 1 at 119-20.

what circumstances a court will uphold the freedom of the parties to contract at the outset by construction of an exclusion clause, and when on the other hand a court will employ its residual power to refuse to do so even in commercial contracts; he referred to this power under the rubric of public policy.²³ He then proposed that contracts should not be upheld where there is “criminality” or fraud,²⁴ and used the case of *Plas-Tex Canada Ltd. v. Dow Chemical of Canada Ltd.*²⁵ as a less extreme commercial example of when the power to overturn contracts should be used. In that case, a company knowingly supplied a defective product and sought to protect itself with limitation of liability clauses which a court declined to honour on the ground of unconscionability.

Binnie J. concluded his doctrinal analysis by setting out his three-part test. First, the court should interpret the contract to determine whether the exclusion clause applies to the circumstances in the case. Secondly, where the clause applies, the court should decide whether the clause was unconscionable at the time of contract formation, and this decision will take account of unequal bargaining power between the parties. Thirdly, where the contract is not unconscionable at formation, the court may still refuse to uphold the exclusion clause because of an overriding public policy that outweighs the “very strong” public interest in the enforcement of contracts.²⁶

On the facts in *Tercon*, Binnie J. agreed that Contract A had been breached by the province and that the exclusion clause on construction applied to the breach. Much of the difference of opinion between the majority and dissenting judgments on the interpretation of the clause was concerned with the meaning of “participating in this RFP,” and Binnie J. thought that phrase to encompass both submission of a proposal as well as selection of the winning bid. He stressed that a construction of that clause to mean that the process halted when an ineligible bidder participated was strained and artificial, and agreed with the views of Wilson J. in *Hunter* that strained and artificial constructions should be avoided, notwithstanding an *ex post facto* distaste for an unfair contract.²⁷ Turning to the second step of the test, unconscionability at formation, Binnie J. found no unequal bargaining power in *Tercon* in relation to the province. Not only was *Tercon* a sophisticated commercial party which had the option to bid or not bid on this project; it had a few

²³ *Tercon*, *ibid.* at 120-21.

²⁴ *Ibid.* at 121-22.

²⁵ 2004 ABCA 309, 245 D.L.R. (4th) 650 [*Plas-Tex*].

²⁶ *Tercon*, *supra* note 1 at 123.

²⁷ *Ibid.* at 124-25.

years earlier won a case against the province on a bidding default, and so was likely very sensitive to the risks associated with exclusion clauses.²⁸ Binnie J. also rejected Tercon's argument that an absence of transparency and integrity as statutorily required constituted unconscionability. He did this on two grounds: that those policies are no bar to the ability of parties to agree on commonplace commercial terms; and that other remedies besides damages were available for breach of Contract A, including injunctive relief at the time Tercon learned that Brentwood would bid on the contract as a joint venture. A court should be slow to require the taxpayers to pay for both the winning bid and a losing bid.²⁹ Finally, Binnie J. found there to be no overriding public policy operating here; the ministry's conduct was not so aberrant as to override the exclusion clause on public policy grounds. Ineligible bidders and bids were described as the "bread and butter" of construction disputes; all parties would know this and know this was a reason for the use of exclusion clauses. Contractors are free to bid or not. If they do not like the way the province handles bids, the refusal of enough contractors to participate would force the province to change its approach. A judicial appeal to public policy should not operate here instead.³⁰

Writing for the majority, Cromwell J. concluded that the exclusion clause did not operate to protect the province, and awarded damages of about \$3.5 million to Tercon. In relation to the first step of construction, which is the only step considered by the majority, Cromwell J. emphasized that construction must take place within the entire contractual circumstances, including in this case the need for transparency in public procurement both for the parties and the public at large.³¹ He further noted that, even where the tendering process did not expressly provide that only compliant bids be considered, the Court in *M.J.B.* thought such a term could be implied, and that a duty of fairness to all bidders could also be implied.³² However, he also interpreted the phrase "participating in this RFP" to be restricted to a process involving only the six eligible bidders; the presence of an ineligible bidder turned the process into a different process, to which the clause did not apply.³³ He further interpreted the phrase "submitting a proposal" not to mean the same thing as "participating in this RFP," with the result that compensation was not excluded where the province departed from the

²⁸ *Ibid.* at 112 and 126.

²⁹ *Ibid.* at 126-27.

³⁰ *Ibid.*, at 127-30.

³¹ *Ibid.*, 100-01.

³² *Ibid.* at 101.

³³ *Ibid.* at 103.

eligibility requirements.³⁴ The exclusion clause was not intended to apply where the ministry's conduct of the bidding process was entirely outside the RFP process governed by Contract A.³⁵ Limiting the eligibility to bid to the six proponents was the entire basis for the operation of the contract;³⁶ to conclude that the province could consider other proponents effectively gutted the contract of meaning.³⁷ Cromwell J. further opined that even if this interpretation of the clause was incorrect, the language could also be ambiguous so that by operation of the *contra proferentem* rule, the ambiguity would defeat the province's attempt to avoid liability under the clause.³⁸ In light of the conclusion that the clause was not operative, the majority did not consider the second and third steps of the test propounded by Binnie J.

3. Discussion

In *Tercon*, the Supreme Court of Canada self-consciously addressed the legal issues relating to exclusion clauses and fundamental breach with a view to their resolution, which previously courts had attempted with results not widely accepted as satisfactory. The earlier attempts had produced clearish tests,³⁹ ambiguously-worded compromises⁴⁰ and bifurcated judgments.⁴¹ In *Tercon*, notwithstanding the division on the application of the first step of construction in the test, the Court unanimously affirmed a three-step test to deal comprehensively, in its view, with the various issues relating to exclusion clauses and fundamental breach. The replacement of the two approaches proposed in *Hunter* is, at first glance, a positive outcome. Earlier Supreme Court decisions⁴² and provincial appellate court decisions⁴³ had assumed that

³⁴ *Ibid.* at 104.

³⁵ *Ibid.* at 105.

³⁶ *Ibid.* at 104.

³⁷ *Ibid.* at 105.

³⁸ *Ibid.* at 106.

³⁹ *B.G. Linton Construction Ltd. v. C.N.R. Co.*, [1975] 2 S.C.R. 678, 49 D.L.R. (3d) 548.

⁴⁰ *Chomey Aluminum Co. Ltd. v. Belcourt Construction (Ottawa) Ltd. et al.* (1979), 24 O.R. (2d) 1, 97 D.L.R. (3d) 170 (C.A.), aff'd [1980] 2 S.C.R. 718. See also M.H. Ogilvie, "Photo Production Ltd. v. Securicor Transport Ltd.: An Inconclusive, Unscientific (Canadian) Postscript" (1980-81) 5 Can. Bus. L.J. 368.

⁴¹ *Hunter*, *supra* note 1, and the articles by Devlin, Flannigan and Ogilvie, *supra* note 4. As applied in *Guarantee*, *supra* note 18 and *Domtar*, *supra* note 21.

⁴² *Guarantee*, *ibid.* and *Domtar*, *ibid.*

⁴³ *Kordas v. Stokes Seeds Ltd.* (1992), 11 O.R. (3d) 129, 96 D.L.R. (4th) 129 (C.A.); *Fraser Jewellers (1982) Ltd. v. Dominion Electric Protection Co.* (1997), 34 O.R. (3d) 1, 148 D.L.R. (4th) 496 (C.A.); *Solway v. Davis Moving and Storage Inc.* (2002), 62

the two approaches amounted to one unified test, but *Tercon* formulated that unified test formally and clearly. Comparison of the Court's formulation with the approaches of Dickson C.J.C. and Wilson J. in *Hunter* suggests that the Court simply dropped Wilson J.'s preference for continued use of the concept of fundamental breach, and also welded the two approaches together; this was accomplished by limiting Dickson C.J.C.'s preference for unconscionability to the time of contractual formation in the second step, and reiterating Wilson J.'s preference for a residual judicial discretion to decline to uphold unfair clauses on policy grounds (further limited to public policy) as the third step at enforcement. Whether the language change from policy to public policy is significant cannot be determined from Binnie J.'s judgment. The former covers a broad range of reasons to decline to enforce contracts, whereas if the latter is a synonym for illegality, a narrower range of reasons to decline to enforce contracts would be available.

Once it is seen that the second step of unconscionability is limited to formation, that is, it is limited to procedural unconscionability at the time of formation and does not encompass substantive unconscionability operating at the time of enforcement as well,⁴⁴ it may be asked if there is a role for substantive unconscionability in Binnie J.'s analysis and whether it might fit into the third step. By limiting that step to public policy, meaning illegality as understood in contract law, of which fraud and crime are given as the only examples, the status of the other overriding reasons for declining to enforce exclusion clauses becomes uncertain. These include negligent and innocent misrepresentation, unreasonableness, substantive unconscionability, duress and breach of fiduciary obligation.⁴⁵ Indeed, had the Court reminded itself of the numerous other legal principles used to override exclusion clauses, it might have been able to simplify its three-part test into a two-part test: (i) Does the clause on construction exclude liability for breach of contract? and (ii) Are there any overriding legal principles as a result of which a court should refuse to enforce the clause in favour of the party in breach of contract? Both approaches assume a prior finding that the

O.R. (3d) 522, 222 D.L.R. (4th) 251 (C.A.), leave to appeal refused, [2003] S.C.C.A. No. 57; and *Plas-Tex*, *supra* note 25. See also Anthony J. Duggan, "Stolen Goods, A Cruise 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; and M.H. Ogilvie, "Contract, Exemption Clauses – Fundamental Breach: *Solway v. Davis Moving & Storage Inc.*" (2004) 83 Can. Bar Rev. 545.

⁴⁴ Arthur Leff, "Unconscionability and the Code – The Emperor's New Clause" (1967) 115 U. Pa. L. Rev. 485; and Swan, *supra* note 4 at 785-92.

⁴⁵ See the chapter on illegality in any standard contract text for the lists of principles and their supporting cases.

clause has been incorporated into the contract by signature, reasonable notice or a previous course of dealing.⁴⁶

A two-step test more easily accommodates all the overriding factors at both formation and enforcement, including procedural and substantive unconscionability, since these factors typically operate at both formation and enforcement when a court is deciding whether or not to uphold an exclusion clause. In short, other than a lingering attempt to honour both Dickson C.J.C. and Wilson J., there is no reason for a three-step test when essentially all the Court is proposing to do is to determine the meaning of the clause and then to decide whether there is a better reason in law not to enforce it than that the parties have agreed to it.

A second observation about the three-part test is that it reflects a general approach to contract which favours and enhances the contract law *grundnorm* of freedom of contract and the role of contract in regulating the marketplace. The principle of freedom of contract is especially evident in the judgment of Binnie J. who repeatedly emphasized the importance of permitting commercial parties to make their own agreements; the importance of exclusion clauses as risk allocation devices within those agreements; the fact that such clauses are not inherently unreasonable; and the role of the parties in choosing whether or not to bargain on such terms, this choice servicing as a means of forcing parties with superior bargaining power to change unfair terms in response to unwillingness in the market to contract on such terms. Binnie J. regards the market as a better place to control unfair terms than the courts. For contracts between commercial parties, this test signals the likelihood that judicial intervention would likely only occur when the clause on construction does not expressly protect from liability or where there is actual criminal or tortious conduct which would override the contract anyway. For consumer contracts, there is the additional likelihood of intervention on grounds of procedural unconscionability resulting from the bargaining inequality of consumers. The net outcome is that exclusion clauses are to be treated no differently than any other contractual clauses; they should be interpreted in accordance with the usual construction rules for all contract clauses and enforced except where there is illegality or unconscionable conduct respectively, or other reasons for refusing to enforce agreements not considered by the court such as duress or mistake. The absence of reference by Binnie J. to the *contra proferentem* rule in formulating the first step is difficult to construe, but whether that is simply an example of Homer nodding or

⁴⁶ This, of course, could be the first question in a new three-part test, to be followed by the other two relating to meaning and overriding factors.

was deliberate is irrelevant once strict and natural construction is assigned the primary role in controlling unfair clauses: an ambiguous clause has no meaning and therefore cannot, *ipso facto* be enforced. Thus, the Court in *Tercon* has returned to the parties the freedom to contract as they wish, subject only to clear draftsmanship and the stricture against illegal contracts.

A third observation follows. *Tercon* was, like all the other recent cases, a dispute between two sophisticated commercial parties, so its application to consumer contracts may be queried. Although neither judgment considered the matter, the decision is arguably equally applicable to consumer contracts since these too have always had to be first interpreted and then assessed for vitiating factors. In relation to consumer contracts, there are typically more of these factors and the courts have been more willing to use them. An example is reference to consumer protection legislation, which usually includes unfair contract provisions of various sorts based on unconscionability, unreasonableness and unfairness.⁴⁷ These statutory provisions simply constitute an additional example of illegality, that is, statutory illegality, on the basis of which a clause should not be enforced. In this light, *Tercon* is not only applicable to commercial contracts but also to consumer contracts as well.

Fourthly, as the divided court in *Tercon* suggests, the workhorse of the three-part test is likely to be the first step of construction of the contract, notwithstanding the substantive ambiguities in the second and third steps. In commercial contracts, the last two steps are unlikely to be much invoked given the conceptual underpinning of freedom of contract, and in consumer contracts, courts are likely to look to consumer protection legislation for hints as to how to apply both unconscionability and public policy. The dangers of construction of exclusion clauses are, of course, well known. In particular, courts are tempted to engage in strained constructions when they do not wish to uphold those clauses. In an earlier day, the cases excluding liability for negligence when negligence was not expressly mentioned in the clause are a case in point.⁴⁸ Interestingly, of the total of thirteen judges who heard *Tercon* from trial to final appeal, seven agreed with Binnie J.'s view that the clause clearly covered the breach and six agreed with Cromwell J.'s view that it did not. While I consider Binnie J.'s interpretation to be correct

⁴⁷ See the various provincial consumer protection statutes for examples of legislative techniques to control exclusion clauses in consumer contracts.

⁴⁸ See e.g. *R. v. Canada S.S. Lines Ltd.*, [1952] A.C. 192 (H.L.); *Smith v. South Wales Switchgear Co. Ltd.*, [1978] 1 W.L.R. 165 (H.L.). For a longer discussion, see *Chitty on Contracts*, 30th ed. (London: Sweet & Maxwell, 2008), vol. 1 at 916-20.

and Cromwell J.'s interpretation to be one of the most strained interpretations of exclusion clauses I have ever seen, the most interesting feature of this divergence is that in order to remove the exclusion clause from further application in the case, Cromwell J. effectively resorted to an implicit recognition that a fundamental breach of contract had occurred!

By concluding that the clause did not apply to the bidding contest at hand but rather to some other bidding contest whose rules are otherwise unknown, Cromwell J. implied that the province simply did not perform the contract it originally committed itself to perform, that is, was in fundamental breach of contract. Thus, fundamental breach continues to hover in the background. In *George Mitchell (Chesterhall) Ltd. v. Finney Lock Seeds Ltd.*,⁴⁹ a seed merchant supplied a different kind of seed from that ordered, with the result that the crop had to be ploughed in. The English Court of Appeal found that the seller could not rely on the limitation of liability clause because it did not apply to the breach which had occurred, without characterizing that breach as fundamental. The House of Lords reversed the decision and permitted the seller to rely on the clause; Lord Bridge criticized the approach of Oliver L.J. as “dangerously near to reintroducing by the back door the doctrine of fundamental breach which this House in [*Photo Production Ltd. v. Securicor Transport Ltd.*]⁵⁰ ... had so forcibly evicted from the front.”⁵¹ In *Tercon*, Cromwell J. made the same error as Oliver J.A. did in *George Mitchell*, thereby raising the possibility that the Supreme Court has still not extirpated fundamental breach from the law of contract in Canada.

A proper understanding of the first step of construction assumes that any attempt to perform is sufficient to engage the contract, absent a total failure of consideration, and the remaining issue is whether the exclusion clause excuses the type of engagement which has occurred without the need to characterize it either expressly or implicitly as performance in fundamental breach. Given the sophistication of drafters of both commercial and consumer contracts today, only rarely will a clause not protect from liability for defective or non-performance. Commercial

⁴⁹ [1983] 2 All E.R. 737 (H.L.) [*George Mitchell*].

⁵⁰ [1980] 1 All E.R. 556 (H.L.). See also M.H. Ogilvie, “*Suisse Atlantique* Revisited: How Long, O Lords, How Long” (1980-81) 5 C.B.L.J. 100; and “The Reception of *Photo Production Ltd. v. Securicor Transport Ltd.* in Canada: *Nec Tamen Consumebatur*” (1982) 27 McGill L.J. 422.

⁵¹ *Supra* note 49 at 741. See also the comparison case *Ailsa Craig Fishing Co. Ltd. v. Malvern Fishing Co. Ltd.*, [1983] 1 All E.R. 151 (H.L.); M.H. Ogilvie, “Contract-Limitation and Exclusion Clauses – Fundamental Breach – Statutory Reasonableness” (1984) 62 Can. Bar. Rev. 390.

parties will understand that the risks of such performance will be theirs and, as shown in Binnie J.'s judgment, be expected to swallow all risks freely accepted; consumer parties who are thought to have less knowledge and more need for protection in entering contracts may be more likely to be relieved from the risks they may not have knowingly accepted.

A fifth observation about *Tercon* relates only to the view of the majority that the exclusion clause cannot exclude liability for breach of the province's implied duty of fairness to bidders.⁵² Although this assertion was not much developed by Cromwell J., the perception that the province acted unfairly undergirds his judgment and is reflected in his analysis of the meaning of the clause. Fairness is a fine thing in contract and ought not to be scoffed at lightly. But freedom of contract means nothing if it does not mean that the parties are permitted to determine for themselves their bargain and that includes agreeing to contracts which a third party or a court might consider to be unfair. A party might even consider the contract to be unfair but nevertheless enter it for some other reason it considers more important and in its own short- or long-term best interests. Commercial parties accustomed to risk allocation clauses, such as exclusion clauses, frequently do precisely that. As Binnie J. observed, *Tercon* was such a party, with previous experience of contracting with the province on very similar terms to the contract at issue in the case. To imply a duty of fairness is to remake the contract. In *Karsales*,⁵³ Denning L.J. implied a term about fairness into the contract when he asserted that there was an implicit term in the contract that the car would be maintained in good condition until the sale. This implied term directly conflicted with the exclusion clause which expressly precluded any such undertaking; nevertheless, the Court enforced the implied term in preference to the express term by finding the seller to be in fundamental breach of contract. In *Tercon*, Cromwell J. repeated the same error: he rewrote the contract to include an implied duty of fairness and then overturned the real contract negotiated by the parties on the ground that one party did not perform the contract written by the Court, that is, was implicitly in fundamental breach of the Court's contract. It might be wondered whether the majority decision is really an advance or a retreat back into the early 1950's world of *Karsales*?

A final, and related, observation is about the role of risk in the majority decision – or rather the fact that risk plays no role. Nowhere does the majority consider that exclusion clauses are, and are universally

⁵² *Supra* note 1 at 98-99, *per* Cromwell J.

⁵³ *Supra*, note 14.

acknowledged to be, risk allocation devices in the real world of contract-making. Had the majority considered this, it might have come to the construction test in the same way as *Binnie J.* rather than as an exercise of making words mean what a well-meaning majority wanted them to mean, that is, to make fair contracts. This is what the parties did when they exercised their freedom to enter their contract in the first place.

4. Conclusion

In *Tercon*, the Supreme Court of Canada unanimously moved one step closer to a workable test for dealing with exclusion clauses in standard form contracts by assimilating the two approaches of Dickson C.J.C. and Wilson J. in *Hunter*. However, the Court ought to have taken the final step of assimilating its second and third steps into one and creating a two-step test as the House of Lords did in *Photo Production* thirty years ago. This is easy: in deciding whether or not a court should uphold an exclusion clause, it should first decide what the clause means and then decide whether there are any better reasons in law or equity why the clause should not be enforced.

The real test for Canadian courts after *Tercon* will be avoiding the temptation to follow too closely the approach of the majority in applying that test. A court which ignores freedom of contract and the risk allocation function of exclusion clauses, and seeks to enforce its idea of a fair bargain, will prove that it has not understood the test no matter how much lip-service it pays to it, as the majority amply demonstrated in *Tercon* itself. On the other hand, a court which treats the minority decision as the model for how to apply the test will more likely produce an outcome both strengthening the law of contract and workable in commercial and consumer markets. Freedom to enter contracts, even at the expense sometimes of costly mistakes is, after all, a foundation of liberal democracy and courts ought to demonstrate a firm understanding of that principle.