

EXCLUSION CLAUSES IN CONTRACT

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I. Introduction

Exclusion of liability by agreement is familiar in common law. In tort law, there is the application of the maxim *volenti non fit injuria*. In contract law, exclusion clauses are used for this purpose. Also known as exemption, disclaimer, or limitation clauses, they are, as a general guide, any term which purports to restrict, modify or exclude a remedy or liability arising out of a breach; or which appears to exclude or restrict a liability or duty that would otherwise arise.

II. Types of Exclusion Clauses

A number of different terms can be classified as exclusion clauses. They have been fully discussed and analyzed elsewhere, so I shall just list them briefly.¹

A. Clauses purporting to completely exempt liability for breach or to prevent the action from ever becoming a breach

A good example of this type of clause is the clause litigated in *Photo Production v. Securicor*.² In that case, Securicor had contracted to provide security services to Photo Productions. Musgrove, an employee of Securicor, started a fire, and the entire factory was burned down. An exclusion clause in the contract said:

Under no circumstances shall the Company [Securicor] be responsible for any injurious act or default by any employee of the Company unless such act or default could have been foreseen and avoided by the exercise of due diligence on the part of the Company as his employer; nor, in any event, shall the Company be held responsible for: (a) Any loss suffered by the customer through burglary, theft, fire or any other cause, except insofar as such loss is solely attributable to the negligence of the Company's employees acting within the course of their employment . . .^{2a}

The House of Lords found that liability for deliberate acts, as well as for negligence, was excluded, and that Securicor was not to be held liable for the damage.

Included in this class, as well, are clauses excluding express or implied terms, such as warranties of fitness and merchantability, which would otherwise be implied by the *Sale of Goods Act*.³ For an example, see *Chabot v. Ford Motor Co.*^{3a}. In that case, the manufacturer's 'warranty' purported to exclude all other warranties, express or implied. This type of clause is often rendered ineffective by provincial consumer protection legislation (see below — legislation).

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1. See D. Yates, *Exclusion Clauses in Contracts* (2nd ed. 1982) 33-41; B. Coote, *Exception Clauses* (1964) 1-18, 144-156.
2. [1980] 1 All. E.R. 556, [1980] 2 W.L.R. 283 (H.L.).
2a. *Ibid.*, at 559.
3. R.S.M. 1970, c. S10, s.16.
3a. (1982), 138 D.L.R. (3d) 417 (Ont. H.C.).

B. Limitations on the promisor's liability for breach, or on the promisee's available remedies

A limitation of liability is not the same as a liquidated damages clause, which is not normally considered an exclusion clause. A limited liability clause does allow for some damages on breach, but it is not a genuine pre-estimate of damages, and is inserted for the benefit of only one party, while a liquidated damages clause is included for the benefit of both parties to the contract, and is construed less harshly. Where the term is a liquidated damages clause, the party establishing the breach does not have to prove any damage in fact. If it is a limitation of liability, the party claiming damages must prove damages at least to the limit set by the clause.⁴ Thus, the distinction can be important from a purely procedural point of view.

Distinguishing between clauses which limit liability, and liquidated damages clauses may be difficult, for the latter does not have to be a true estimate of damages. As well, limitations clauses are often labelled liquidated damages clauses. The important factor is the intent of both parties.

C. Excepted perils and promissory warranties found in insurance contracts

Excepted perils clauses are the type that exclude the insurer's liability for damage or destruction of the insured property by war, nuclear explosion and the like — which perils are insured against is often regulated by statute.⁵ These clauses are to define the insurer's obligations under the contract; to outline the losses for which he agrees to be liable.

In insurance contracts, the term 'warranty' corresponds to 'condition' in ordinary contract terms. An example of a promissory warranty is that the insured promises to install a burglar alarm system, failing which, the insurer has the right to repudiate the contract.⁶

D. Time limitations for seeking a remedy or giving notification of a claim

A successful clause of this type was dealt with in *Smeaton Hanscomb & Co. v. Sassoon I. Setty, Son & Co.*,⁷ where the clause stated that any dispute must be referred to arbitration within 14 days.

E. Indemnity clauses

An example is those clauses often used in construction contracts, in which the contractor indemnifies the owner for liability for any injuries on the site.⁸

An illustration is the clause used by a commercial customer of an insurance company in which the security company agrees to indemnify the

4. See *Suisse Atlantique Société d'Armement Maritime S.A. v. N.V. Rotterdamsche Kolen Centrale*, [1966] 2 All E.R. 61, [1967] 1 A.C. 361 at 420 (H.L.) (per Lord Upjohn).

5. See for example, *Insurance Act*, R.S.M. 1970, c.140, s.138(1).

6. See for example, *Tilden Rent-a-Car v. Clendenning* (1978), 18 O.R. (2d) 601 (C.A.).

7. [1953] 1 W.L.R. 1468, [1953] 2 All E.R. 1471 (Q.B.).

8. Arbitration clauses (as well as liquidated damages clauses) are generally not included. See United Kingdom, Parliament, Law Commission, *Report on Exemption Clauses (2d)*, Report No. 69, (London: The Commission, 1975) 63.

cf. *Anglo-Continental Holidays, Ltd. v. Typaldos Lines (London), Ltd.*, [1967] 2 Lloyd's Rep. 61 (C.A.).

customer for any claims for damages or injury to another while the security company has control of the premises, in addition to holding the security company liable to the customer for any damage to the customer.

[Security Company] agrees to indemnify and save harmless [customer], its successors and assigns, from and against any and all loss, costs, charges, damages, actions, claims, demands, awards, suits or other proceedings whatsoever which [customer] may at any time hereafter sustain or be put to, arising out of, from, or by reason of injury of [customer], or that of any other person, occasioned in the provision by [security company], its servants, agents, or employers, of the services contracted for hereunder.

III. Judicial Treatment of Exclusion Clauses

Twentieth-century common law contract principles are based on nineteenth-century notions of freedom and sanctity of contract. These doctrines both evolved from the model of the typical pristine contract — two gentlemen of equal bargaining power, shrewdly negotiating at arms-length until they come to an agreement fair to both. Today, with assembly-line production of goods and services, exclusion clauses are foisted on hapless customers, who have no choice but to 'take it or leave it'. In consumer transactions, the vision of freedom of contract is most often a myth. The consumer may not be able to obtain better terms either because the seller has a monopoly or all competitors use similar, if not identical, terms. The courts are thus confronted with the conflicting tasks of preserving the freedom and sanctity of contract, and of protecting the weaker party. In principle, exclusion of liability of one party, or both, is allowed by consenting parties to a contract. In practice, the courts disfavor such clauses, and allow them the narrowest effect possible. As *proferens* find new methods of drafting exemption clauses to meet requirements of validity set by the courts, the judiciary is equally inventive in devising new methods to disallow them.

A. Strict Interpretation and Contra Proferentem

A number of interpretative devices have been used by the courts to assist or limit the effect of disclaimer clauses they view as unfair or unconscionable. One method is strict interpretation of the clause⁹ and the related rule of *contra proferentem*. The exclusion clause must cover exactly the event which has occurred, and any ambiguity in the wording will be construed against the *proferens*.¹⁰ For example, if the *proferens* wishes to exclude liability for negligence, he must use explicit words to that effect.¹¹ General wording is not enough to exclude liability for negligence, unless negligence is the only possible grounds for liability.¹² *Contra proferentem* does not always successfully oust an exclusion clause; clear words must be upheld.¹³

9. See *Ailso Craig Fishing Co. v. Malvern Fishing Co.*, [1981] S.L.T. 130 (Ct. of Session); aff'd [1983] 1 All E.R. 101 (H.L.), for a detailed discussion of strict interpretation. See *Cathcart Inspection Services v. Purolator Courier* (1981), 128 D.L.R. (3d) 227 (Ont. H.C.); aff'd (1982), 139 D.L.R. (3d) 371 (Ont. C.A.), for a recent Canadian example.

10. See *Graham v. London Guarantee & Accident Co.*, [1925] 2 D.L.R. 1037 (Ont. S.C.).

11. See for example, *Szymonowski & Co. v. Beck & Co.*, [1923] 1 K.B. 457 at 446; aff'd [1924] A.C. 43 (H.L.); *Canada Steamship Lines Ltd. v. Regem*, [1952] 1 All E.R. 305 (P.C.); *Gilleps Bros. & Co. Ltd. v. Roy Bowles Transport Ltd.*, [1973] 1 All E.R. 193 (C.A.); *Gross v. Sweet* 49 N.Y. (2d) 102, (1979).

12. See *Alderslade v. Hendon Laundry*, [1945] K.B. 189 at 192; but cf. *Woolmer v. Delmer Price*, [1955] 1 Q.B. 291. See also *Lampert & Hall Lines Ltd. v. Coubro & Scrutton Ltd. (The "Raphael")*, [1982] 2 Lloyd's Rep. 42 (C.A.).

13. See *Rutter v. Palmer*, [1982] 2 K.B. 87.

In the sale of goods, the courts often make use of the different terms of contract law so that an exclusion of implied warranties is not effective in excluding implied conditions, etc.¹⁴ The situation was soon reached, however, where "a suitably drafted exemption clause could oust all responsibility for the quality of goods or liability for performance of the contract."¹⁵ As will be seen below, legislative controls were developed to deal with unfair contracts, and the courts became even more inventive.

B. Notice

In order to be effective, an exclusion clause must, of course, be incorporated into the contract. The doctrine of notice was developed to prevent *proferens* from slipping harsh disclaimer clauses into their contracts with an unsuspecting third party. *Consensus ad idem* (the meeting of the minds) is necessary to form a binding contract. Therefore, a clause purporting to exclude or limit liability will have no effect unless there has been sufficient notice to the party against whose interests the clause would operate.

Exactly what constitutes sufficient notice has never been set out clearly by the courts. Certain types of contracts have statutory requirements for notice,¹⁶ but it generally depends on the circumstances of the case. An extreme example of insufficient notice is found in the case of *Pickin v. Hesk*.¹⁷ A number of customers had stored their automobiles in the defendant's garage. Years earlier, a large sign had been erected high above the floor, saying something to the effect that the owners refused to be responsible for damages to vehicles stored in the garage. No one was really certain exactly what the sign said, for years' worth of accumulated oil and grime had obliterated the words. Through the defendant's negligence, the garage burned down, and the plaintiff's car was destroyed. The Ontario Court of Appeal held that the sign provided no defence to the garage owners, for there had been no notice to the plaintiff.

In contrast, is *Union Steamships Ltd. v. Barnes*,¹⁸ a decision of the Supreme Court of Canada only two years later. Barnes and his family had been lowered into a ship by lift early one morning, and when he purchased his tickets for his voyage, the ship was already underway out of the harbor. Barnes noticed there was some printing on the ticket, but, as he was in a hurry to settle his family in their quarters, he neither read nor signed the ticket. As he was leaving for his stateroom, he fell into a hatchway and was badly injured. The court, with a strong dissent by Rand J., held that as

14. See for example, *Chabot v. Ford Motor Co. of Canada*, *supra* n. 3a. See generally: G.H. Fridman, *Sale of Goods in Canada* (2nd ed. 1979) 306 *et seq.*

15. Fridman, *ibid.*, at 308. See for example, *Powell Equipment Co. v. Lac Seul Land & Lumber Co.* (1964), 48 D.L.R. (2d) 691 (Ont. H.C.); *Consolidated Plate Glass (Western) Ltd. v. Manitoba Cartage and Storage Ltd.* (1959), 20 D.L.R. (2d) 779 (Man. C.A.); *Peters v. Parkway Mercury Sales Ltd.* (1974), 9 N.B.R. (2d) 288 (N.B.Q.B.); *aff'd* 10 N.B.R. (2d) 703 (N.B.C.A.)

16. See for example, *Insurance Act*, R.S.M. 1970, c. 140, s.143, which states that any contract containing (a) a deductible clause; or (b) a co-insurance, coverage or similar clause; or (c) a clause limiting recovery by the insured to a specified percentage of the value of any property insured . . . shall have printed or stamped upon its face in red ink the words "This policy contains a clause that may limit the amount payable" and unless those words are so printed or stamped the clause shall not be binding upon the insured. (Similar provisions are in force in the other provinces and territories).

17. [1954] 4 D.L.R. (2d) 90 (Ont. C.A.).

18. [1956] S.C.R. 842.

there was an endorsement on the ticket in red which referred to conditions on the back, there had been a reasonable effort to bring a clause limiting liability for injury to the notice of the plaintiff. A rather surprising decision, in view of the fact the plaintiff had no real opportunity to examine the ticket and assent to its terms, and that the defendant had no reasonable grounds to believe he had done so. In light of recent decisions such as *Tilden Rent-a-Car v. Clendenning*,¹⁹ it is submitted that if the case were decided today, the outcome would be different.

The courts are reluctant to set stringent rules for the notice requirement. It is clear that the exclusionary clause must be obvious; the more sweeping the clause, the more obvious it must be.²⁰ The degree of knowledge required by the party against whom the clause operates is unclear. In *Parker v. South Eastern Railway Co.*,²¹ Midlish L.J. said that it would be sufficient if the party was aware, or ought to have been aware, that the document contained terms and conditions. Denning L.J., in *Spurling v. Bradshaw*,²² also said constructive knowledge is sufficient. However, in *McCutcheon v. David MacBrayne Ltd.*,²³ Devlin L.J. seems to say that actual knowledge must be proven. That judgment, however, has been criticized for being too subjective.²⁴ Today, it is generally accepted that the test is an objective one.

Proferens may satisfy the notice requirement by having the other party sign the contract. Traditionally, a signature was thought to be conclusive proof of assent to the contract's terms, according to the Rule in *L'Estrange v. Graucob*.²⁵ Scrutton L.J., following *dicta* in *Parker v. South Eastern Railway Co.*, held that:

When a document containing contractual terms is signed, then, in the absence of fraud, or, I will add, misrepresentation, the party signing it is bound, and it is wholly immaterial whether he has read the document or not.²⁶

To avoid the consequences of this harsh doctrine, the signing party had to prove a misrepresentation. Fraud was, of course, sufficient,²⁷ and in *Curtis v. Chemical Cleaning and Dyeing Co.*,²⁸ Denning L.J. held that an innocent misrepresentation would oust an exemption clause as well.²⁹

In *Curtis*, the plaintiff took a satin, sequin-covered dress to be dry-cleaned, and was asked to sign a receipt. When Mrs. Curtis asked why she was to sign, a clerk told her that the defendant dry cleaner would not take responsibility for certain risks, such as the risk of damage to the sequins. The receipt actually contained a clause purporting to exempt the cleaner

19. *Supra* n. 6 (see also *infra*).

20. See *J. Spurling Ltd. v. Bradshaw*, [1956] 1 W.L.R. 461 (C.A.); *Thornton v. Shoe Lane Parking*, [1971] 2 Q.B. 163 (C.A.). (1877), 2 C.P.D. 416 (C.A.).

21. *Supra* n. 20, at 468.

22. [1964] 1 W.L.R. 125 (H.L.).

23. See *Hardwick Game Farm v. S.A.P.P.A.*, [1969] 2 A.C. 31 (H.L.).

24. [1934] 2 K.B. 394.

25. *Ibid.*, at 403.

26. See for example, *Ward v. Hobbs* (1878), 4 A.C. 13 (H.L.).

27. [1951] 1 K.B. 805.

28. See *Mendelssohn v. Normand Ltd.*, [1969] 2 All. E.R. 1215 (C.A.); followed in Canada by, *Canadian Acceptance Corp. v. Mid-town Motors Ltd.* (1970), 72 W.W.R. 365 (Sask. D.C.).

from liability for any damage, however caused. It was held that the defendant could not rely on the exclusion clause because the innocent misrepresentation by the clerk had given Mrs. Curtis a false impression of the effect of the clause and had induced her to sign.

The Ontario Court of Appeal, with their decision in *Tilden Rent-a-Car v. Clendenning*,³⁰ have gone a step further, by holding that the signing party may not necessarily have to prove misrepresentation by the *proferens*. This case dealt with a promissory warranty in an insurance contract. The plaintiff, Clendenning, had rented a car from the defendant company, and purchased additional insurance coverage at the same time. Although he had rented cars from Tilden on a number of occasions, he had never actually read a copy of the standard contract of insurance. On the back of the form, in small type, was a clause saying that the customer agreed not to allow the car to be operated by anyone who had consumed any intoxicating liquor, *whatever the amount*. Clendenning was involved in an accident, and, although he had been drinking, evidence was accepted that he had not been intoxicated, and the accident was not his fault. Tilden, however, refused to pay on the insurance, relying on the Rule in *L'Etrange v. Graucob*³¹ to allege that Mr. Clendenning's signature on the contract was proof of his consent to the harsh disclaimer clause. Mr. Clendenning had realized that he would be responsible for any accident he had while intoxicated, but assumed, quite naturally, that he would be responsible only if incapable of proper control of the vehicle. Dubin J.A., holding that the clause did not exclude Tilden's liability, said:

Consensus ad idem is as much a part of the law of written contracts as it is of oral contracts. The signature to a contract is only one way of manifesting assent to contractual terms.³²

He later went on to say:

In modern commercial practice, many standard form printed documents are signed without being read or understood. In many cases the parties seeking to rely on the terms of the contract, knows or ought to know that the signature of a party to the contract does not represent the true intention of the signer, and that the party signing is unaware of the stringent and onerous provisions which the standard form contains. Under such circumstances, I am of the opinion that the party seeking to rely on such terms should not be able to do so in the absence of first having taken reasonable measures to draw such terms to the attention of the other party, and, in the absence of such reasonable measures, *it is not necessary for the party denying knowledge of such terms to prove either fraud, misrepresentation or non est factum*.^{32a}

The burden of proof of a misrepresentation has thus been shifted away from the party who signed, to the *proferens*, who must now prove an effort was made to draw the exclusion clause to the signer's attention. "[T]he signer is bound by the terms of the document if, and only if, the other party believes on reasonable grounds that those terms truly express the signer's intention."³³

30. *Supra* n. 6.

31. *Supra* n. 25.

32. *Supra* n. 6, at 604.

32a. *Ibid.*, at 609 (emphasis added). See also *Nikkel v. Standard Group Ltd.* (1982), 16 Man. R. (2d) 71 (Q.B.); *Crocker v. Sundance Northwest Resorts Ltd.* (1983), 25 C.C.L.T. 201 (Ont. S.C.).

33. S.M. Waddams, *Products Liability* (2nd ed. 1980) 170.

C. Sequence of Operation

The sequence of operation argument has also been used to find that an exemption clause was never incorporated into the contract. In *Chapleton v. Barry U.D.C.*,³⁴ the plaintiff, a passenger in a cruise ship, rented one of a pile of deck chairs, paid, and was then given a ticket containing a clause disclaiming liability for personal injury. Mrs. Chapleton sat on the chair, fell through, and was injured. The Court of Appeal held that the clause was ineffective, as it had not formed part of the bargain. The offer of the chair had been accepted by the payment, and the terms on the ticket were just a futile attempt to modify an already existing contract.³⁵

This argument was also used by Denning L.J., in *Thornton v. Shoe Lane Parking*,³⁶ which involved a parking ticket dispensed by a machine. In that case, the argument may not have been applicable, for Thornton was to pay when he left the parking lot. Evidently, his Lordship recognized the possible difficulty, and held, alternately, that the clause exempting liability for injury was ineffective because of insufficient notice.

The sequence of operation argument will fail also, if the court finds that the existence of the exemption clause was in the contemplation of the parties,³⁷ or if it can be incorporated by a course of dealing; in other words, if it would not be unfair to include it in the contract.

D. Collateral Terms

There may be some collateral undertaking, separate and distinct from the main contract, which binds the *proferens* even though he has purported to exclude his liability. An example is in *Couchman v. Hill*,³⁸ which involved the sale of a heifer "with all faults". The seller made an oral representation that the heifer was unserved, but it was actually in calf, and soon died. It was held that there had been a collateral warranty to which the exclusion clause in the written contract did not apply.

There have been several Canadian cases in which collateral undertakings have been found,³⁹ but the Supreme Court of Canada decision in *Hawrish v. Bank of Montreal*⁴⁰ casts some doubt on the doctrine. In its decision, the Supreme Court held that no collateral agreement is established when it is inconsistent with or contradicts the written agreement.

In addition to the above, the English case of *J. Evans & Son (Portsmouth) Ltd. v. Andrea Merzario Ltd.*⁴¹ causes further confusion in this area of the law, for it contains conflicting decisions on how to characterize oral representations.⁴²

34. [1940] 1 K.B. 532 (C.A.).

35. It would be more in keeping with principles of offer and acceptance to hold that the display of chairs was merely an invitation to treat, and Mrs. Chapleton made the offer of payment. See *Pharmaceutical Society of Great Britain v. Boots Cash Chemists (Southern) Ltd.*, [1953] 1 Q.B. 401 (C.A.).

36. *Supra* n. 20.

37. See for example, *Evans Products Ltd. v. Crest Warehousing Ltd.*, [1979] 5 W.W.R. 385 (S.C.C.).

38. [1947] K.B. 554 (C.A.).

39. See for example, *Rose v. Barisko Bros. Ltd.* (1981), 33 O.R. (2d) 685 (H.C.); *Zien v. Field* (1963), 43 W.W.R. 577 (B.C.C.A.).

40. [1969] S.C.R. 515.

41. [1976] 2 All. E.R. 930 (C.A.).

42. See generally: G.H.L. Fridman, "Written Contracts with an Oral Element" (1977), 8 Man. L.J. 383.

IV. Fundamental Breach and Breach of a Fundamental Term

The related principles of fundamental breach and breach of a fundamental term,⁴³ although often treated by judges as fundamental principles of contract law, have existed as an independent concept for only 30 years, since Devlin J. formulated them in *Smeaton Hanscomb & Co. v. Sassoon I. Setty, Son & Co.*⁴⁴ That case involved a contract for the sale of mahogany logs which included a clause stating that any dispute or claim on the contract had to be referred to arbitration within 14 days of final discharge of the goods. More than 14 days after discharge the buyers claimed compensation from the sellers for a shortage in measured grade. The question was raised whether the buyers could make any claim under the contract; the buyers asserted they could, as the sellers had not delivered what was promised and could not rely on their limitation clause. In his judgment, Devlin J. said that the clause limiting time in which a dispute could be brought to arbitration was an exception clause, and, as a principle of construction, "exceptions are to be construed as not being applicable for the protection of those for whose benefit they are inserted if the beneficiary has committed a breach of a fundamental term of the contract"⁴⁵ A fundamental term was defined as "something which underlies the whole contract so that, if it is not complied with, the performance becomes something totally different from that which the contract contemplates."⁴⁶ In this case, the clause was effective as there had been no breach of a fundamental term.

The concept of fundamental breach sprang from the shipping deviation cases, which were referred to as "long-established" as long ago as 1779, by Mansfield L.J. in *Lavabre v. Wilson*.⁴⁷ If a ship deviated from the route it was contracted to take, that was considered a breach serious enough for marine insurance to cease to operate. The effect of deviation was clear. The shipowner could not take the benefit of any exclusion clause for any loss or damage which occurred during the deviation, unless he could prove such loss or damage would have occurred regardless of the deviation, a practically impossible task.⁴⁸

The deviation principle was extended to the quasi-deviation cases in the 1800's and early 1900's; to carriage of goods by land,⁴⁹ and to general bailment situations.⁵⁰ The terms "fundamental breach" and "breach of a fundamental term" were first used by the House of Lords in *Hain Steamship Ltd. v. Tate and Lyle Ltd.*⁵¹ Devlin L.J. picked the terms up and used

43. Some authors feel these are two separate doctrines. See for example, D. Yates, *supra* n. 1. Prof. Coote, however, argues that they are merely parts of a single doctrine, and separating them does not help to solve the logical difficulties the doctrine presents. See B. Coote, "The Rise and Fall of Fundamental Breach" (1967), 40 A.L.J. 336.

44. [1953] 1 W.L.R. 1468 (Q.B.). See generally: B. Coote, *ibid.*

45. *Ibid.*, at 1470.

46. *Ibid.*

47. (1779), 1 Doug. 284.

48. See for example, *Joseph Thorley Ltd. v. Orchis Steamship Co.*, [1907] 1 K.B. 660 (C.A.). See generally: B. Coote, *supra* n. 1, at 80-84.

49. See for example, *L.N.W. Railway v. Neilson*, [1922] 2 A.C. 263 (H.L.); *Gibaud v. Great Eastern Railway*, [1921] 2 K.B. 426 (C.A.).

50. See for example, *Lilley v. Doubleday* (1881), 7 Q.B.D. 510 (note: no exception clauses actually used in contract).

51. [1936] 2 All. E.R. 597 at 607-8.

them in two 1951 decisions, *Chandris v. Istrandtsen-Moller Co.*⁵² and *Alexander v. Railway Executive*.⁵³ However, as late as 1953 in *The Albion*,⁵⁴ the Court of Appeal asserted that fundamental breach had no special use or significance outside of carriage or bailment. In spite of this *dictum*, Devlin J., in *Smeaton Hanscomb*⁵⁵ applied to sale of goods the same results as were caused by deviation from contracts of bailment.

V. Rule of Construction or Substantive Rule of Law?

Almost immediately, a debate arose over whether the new doctrine was a rule of construction — a *prima facie* but rebuttable presumption — or a substantive rule of law, to be applied regardless of the contracting parties' intentions. Deviation, the forerunner of fundamental breach, is a substantive rule of law — no matter how an exclusion clause is worded, once the ship deviates from route, the owner is liable for any loss or damage to its cargo.⁵⁶ In *Smeaton Hanscomb*,⁵⁷ although Lord Devlin used the terminology of construction, it is obvious he was applying fundamental breach as a rule of law. Any doubt was resolved by Denning L.J., three years later, in *Spurling (J) Ltd. v. Bradshaw*⁵⁸ and *Karsales (Harrow) Ltd. v. Wallis*.⁵⁹ In *Karsales*, Mr. Wallis had agreed to purchase a car from S., who was to arrange financing through a hire-purchase company. Karsales bought the car from S. and sold it to M., who let it out to Wallis on hire-purchase terms. Wallis had not seen the car since his initial inspection, when it had been in excellent condition. About a week later, it was left by Wallis' garage late at night, so badly damaged it had to be towed. Wallis refused to take the car and to make payments, so Karsales, who had been assigned M.'s rights under the hire purchase agreement, sued for payment, relying on a clause which said that no condition or warranty that the vehicle was road-worthy was given by the owner.

Denning L.J. held that in hire-purchase agreements of this kind, there was an obligation on the lender to deliver the car in substantially the same condition as when it was inspected. Karsales's failure to deliver the car in good condition was a fundamental breach, or a breach going to the root of the contract, and, as such, disentitled the plaintiff from relying on his exemption clause:

The principle is sometimes said to be that the party cannot rely on an exempting clause when he delivers something 'different in kind' from that contracted for, or has broken a 'fundamental term' or a 'fundamental contractual obligation,' but these are, I think, all comprehended by the general principle that a breach which goes to the root of the contract disentitles the party from relying on the exempting clause.⁶⁰

52. [1951] 1 K.B. 240.

53. [1951] 2 K.B. 882.

54. [1953] 1 W.L.R. 1026 at 1031 (C.A.).

55. *Supra* n. 44.

56. See *Glynn v. Margetson & Co.*, [1893] A.C. 351 (H.L.).

57. *Supra* n. 44.

58. *Supra* n. 20.

59. [1956] 1 W.L.R. 936 (C.A.).

60. *Ibid.*, at 941.

The doctrine of fundamental breach became generally accepted as rule of law in Canada as well as in England.⁶¹

There were some problems with the doctrine of fundamental breach, such as the question of what exactly constituted a fundamental breach. In *Karsales*,⁶² what was delivered to Wallis was completely useless as a car; it is easy to accept that as a fundamental breach. But in *Charterhouse Credit v. Tolly*,⁶³ a merely defective back axle was also held to be a fundamental breach. Canadian courts seemed to consider whether the innocent party had got what he bargained for in the contract,⁶⁴ and whether the breach was flagrant.⁶⁵ The innocent party, however, could never be really certain what the courts would interpret as a fundamental breach, and whether he had a right to repudiate the contract.

It was also unclear how a fundamental breach would affect the contract. In *Alexander v. Railway Executive*⁶⁶ Devlin L.J., said that a fundamental breach terminated the entire contract unless it were waived, as there could not be selective rescission of only part of the contract.⁶⁷ If the contract was re-affirmed, so was the exemption clause. This analysis was in direct conflict with Lord Denning's later judgment in *Karsales*,⁶⁸ where he said that the party in fundamental breach was disentitled to rely on his exemption clause, while the remainder of the contract remained in effect.

VI. Away from Fundamental Breach

The swing away from fundamental breach began with Pearson L.J.'s decision in *U.G.S. Finance v. National Mortgage Bank of Greece*,⁶⁹ which was adopted by the House of Lords in their landmark decision in *Suisse Atlantique*.⁷⁰ Briefly, the facts of *Suisse Atlantique* are as follows: the respondents (charterers) had chartered a ship from the appellants for two years of consecutive voyages, to carry coal from the U.S.A. to Europe. In the contract was a clause providing for demurrage at \$100 per day if the ship were delayed loading, or unloading, beyond a stipulated rate. The charterers apparently found it cheaper to pay demurrage than freight at the contract price (probably because of the fall in market freight rates after the re-opening of the Suez Canal in 1957) and the shipowners alleged that

61. See A.G. Guest, "Fundamental Breach of Contract" (1961), 77 L.Q.R. 98 at 98: "A party who has been guilty of a fundamental breach of contract cannot rely on an exemption clause inserted in the contract to protect him."; *Yeoman Credit v. Apps*, [1962] 2 Q.B. 508 (C.A.); *Charterhouse Credit Co. Ltd. v. Tolly*, [1963] 2 Q.B. 683 (C.A.); *Knowles v. Anchorage Holdings Co.* (1964), 43 D.L.R. (2d) 300 (B.C.S.C.); *Western Processing and Cold Storage v. Hamilton Construction Co.* (1965), 51 W.W.R. 354 (Man. C.A.); *Canadian-Dominion Leasing Corp. v. Suburban Superdrug Ltd.* (1966), 56 D.L.R. (2d) 43 (Alta. C.A.).

62. *Supra* n. 59.

63. *Supra* n. 61.

64. See for example, *Western Processing v. Hamilton Construction*, *supra* n. 61; *Green v. Holiday Chevrolet-Oldsmobile Ltd.*, [1975] 4 W.W.R. 445 (Man. C.A.).

65. See for example, *Canadian-Dominion Leasing v. Suburban Superdrug*, *supra* n. 61.

66. *Supra* n. 53.

67. See *Tate and Lyle*, *supra* n. 51.

68. *Supra* n. 59.

69. [1964] 1 Lloyd's Rep. 446 (C.A.) at 453.

70. *Supra* n. 4. See generally: G.H.L. Fridman, "The Effect of Exclusion Clauses" (1969), 7 Alta. L.R. 281. Note: the Australian courts never really embraced the doctrine of fundamental breach as a rule of law. See *Council of the City of Sydney v. West* (1965), 114 C.L.R. 481 (Aust. H.C.) and the cases cited therein.

six to nine more voyages could have been made if the respondents had not delayed loading and discharging the ship. They claimed damages for the extra freight they would have made, minus credit for demurrage payments received.

In the House of Lords, the appellants alleged that the deliberate delays by the charterers constituted a fundamental breach, and disentitled them from relying on the demurrage provision. The appeal was dismissed, primarily because the contract gave the shipowners no right to any certain number of voyages, and any damage recoverable was limited by the demurrage provision, which was an agreed damages clause, inserted for the protection of both parties, rather than an exclusion clause.

Their Lordships went on to consider fundamental breach, even though the doctrine applied only to exclusion clauses, and not demurrage clauses. They were unanimous in holding that there was no substantive doctrine of fundamental breach; whether or not an exclusion clause covered a breach depends on its true construction. The decisions, unfortunately, are complex and hard to understand, and contain some ambiguities which were later used to reintroduce the doctrine of fundamental breach.

Ambiguities in Lord Reid's speech seem to suggest that if an innocent party elects to affirm a contract upon a fundamental breach, whether an exemption clause covers the breach depends on construction. But, if the innocent party does not affirm, the entire contract is terminated, including the exemption clause. Denning L.J. immediately seized on the opportunity, and, in *Harbutts "Plasticine" Ltd. v. Wayne Tank and Pump Co.*,⁷¹ he reinstated fundamental breach as a rule of law. In that case, the defendants had installed new equipment in the plaintiff's factory to carry hot 'plasticine'. The pipes used were made of 'durapipe', which could not withstand the high temperatures of the liquid 'plasticine'. The heat was left on all night to keep the 'plasticine' flowing through the pipes, a fire broke out, and the plaintiff's factory was burned to the ground. It was found that the defendants were in fundamental breach of contract in supplying a material so unsuited for the purpose for which it was intended. The issue arose as to whether they could rely on the limitation of damages clause in their contract. Lord Denning held that they could not, interpreting *Suisse Atlantique*⁷² as saying:

It affirms the long line of cases in this court that when one party has been guilty of a fundamental breach of the contract, that is, a breach which goes to the very root of it, and the other side accepts it, so that the contract comes to an end — or if it comes to an end anyway by reason of the breach — then the guilty party cannot rely on an exception or limitation clause to escape from his liability for the breach.⁷³

The result in *Harbutt's* clearly demonstrates the dangers of using the doctrine of fundamental breach to oust exemption clauses which the courts feel are unfair. In that case, there was no evidence the clause was harsh or

71. [1970] 1 Q.B. 447, [1970] 1 All E.R. 225 (C.A.).

72. *Supra* n. 4.

73. *Supra* n. 71, at 235.

unconscionable. It was included so that the contracting parties knew exactly which risks were allocated to them, and each could obtain adequate insurance coverage. The plaintiff's insurer had been paid to assume the risk of loss by fire. Rather than control an unfair agreement, the result in *Harbutt's* was to shift the loss to the defendant or his insurer. Even though the proper terminology for exclusion of loss had been employed, as Reid L.J. in *Suisse* said was possible,⁷⁴ the exclusion clause failed. Despite the apparent irreconcilability of the decision with that of *Suisse Atlantique*, *Harbutt's* was followed in a number of decisions.⁷⁵ At least one Canadian court, however, refused to follow the decision blindly, preferring instead to uphold an apparently fair allocation of risk.⁷⁶

A second ambiguity leaving the door open to the re-establishment of fundamental breach is also in Lord Reid's speech, where he distinguished between two different kinds of fundamental breach. Fundamental breach, he said, is either:

(i) a performance totally different from that which the contract contemplates, (ii) a breach of contract more serious than one which would entitle [the innocent party] . . . to refuse performance or further performance under the contract.

There is in fact no necessary coincidence between the two kinds of (so-called fundamental) breach. For, though it may be true generally, if the contract contains a wide exceptions clause, that a breach sufficiently serious to take the case outside that clause, will also give the other party the right to refuse further performance, it is not the case, necessarily, that a breach of the latter character has the former consequence. An act which, apart from the exceptions clause, might be a breach sufficiently serious to justify refusal of further performance, may be reduced in effect, or made not a breach at all, by the terms of the clause.⁷⁷

Donaldson J., attempting to reconcile *Suisse Atlantique* and *Harbutt's* in *Kenyon, Son & Craven Ltd. v. Baxter Hoare & Co. Ltd.*, interpreted Lord Wilberforce's speech as meaning that if:

. . . [P]erformance is non-contractual in the sense that it is totally different from that which the contract contemplated . . . one can ignore the construction of the exception clause or treat it as inapplicable notwithstanding that, as a matter of construction, it covers the loss which has occurred.⁷⁸

According to Donaldson J., Wilberforce L.J. had meant that whether an exclusion clause covers a breach is normally a rule of construction, but becomes a rule of law in the case of a serious breach.⁷⁹

The most common method of abrogating the principle enunciated in *Suisse Atlantique* was to pay lip service to the decision, and then strike

74. *Supra* n. 4, at 399.

75. See for example, *Wathes (Western) Ltd. v. Austins (Menswear) Ltd.*, [1976] 1 Lloyd's Rep. 14 (C.A.); *Farnworth Finance Facilities Ltd. v. Attridge*, [1970] 2 All. E.R. 774 (C.A.); *Burlington Leasing v. De Moura* (1975), 60 D.L.R. (3d) 71 (Ont. Co. Ct.).

76. *Inelco Industires Ltd. v. Venture Well Services Ltd.* (1975), 59 D.L.R. (3d) 458 (Alta. S.C. App. Div.).

77. *Supra* n. 4, at 431.

78. [1971] 1 W.L.R. 519 at 531 (Q.B.).

79. See *Cain v. Bird Chevrolet-Oldsmobile Ltd.* (1976), 12 O.R. (2d) 532 at 534 (H.C.) for a similar view expressed in a Canadian court. Lord Wilberforce, in *Photo Productions*, *supra* n. 2 at 561, described Donaldson J.'s reasoning in *Kenyon* as a "contortion".

down a clause as a 'matter of construction' whenever there had been a fundamental breach.⁸⁰ In Canada, the House of Lord's decision in *Suisse* made little practical difference to the results of subsequent decisions. The Supreme Court of Canada adopted *Suisse* in *B.G. Linton Construction Ltd. v. C.N.R. Co.*,⁸¹ but, in the words of the Ontario Law Reform Commission, "while our courts pay lip service to the intention test . . . they have been strikingly consistent in reaching the same conclusions they would have reached if *Suisse Atlantique* had never been decided."⁸² By this point, the rule of construction/rule of law debate on fundamental breach was quite stale, for no clause could withstand the rigorous interpretation of the courts.⁸³ As a matter of law, however, the difference remained important, and the British Law Commission pleaded with the courts to clarify the issue.⁸⁴

In 1980, in their decision in *Photo Production Ltd. v. Securicor Transport Ltd.*,⁸⁵ the House of Lords heeded that request, and unequivocally stated that whether an exclusion clause is ineffective in the event of a fundamental breach is always a matter of construction. The deviation cases were explained as being *sui generis*.⁸⁶ Although it was acknowledged that the speeches in *Suisse Atlantique* were, at times, "lengthy and . . . somewhat indigestible",⁸⁷ the main principle of that case was affirmed.

In the *Photo Production* case, the estimated damage to the factory was £600,000. The security guard's state of mind at that time was never established, nor was it ever shown that Securicor had been negligent in employing him.⁸⁸ Photo Production was insured against fire with a £25,000 deductible, and Securicor was insured against liability over £10,000 for the acts of their servants.⁸⁹ Thus, the real issue in this case was whose insurance company would be help responsible for the loss. Securicor asserted that a clause in their contract exempted them from liability:

'Under no circumstances shall the Company [Securicor] be responsible for any injurious act or default by any employee of the Company unless such act or default could have been foreseen and avoided by the exercise of due diligence on the part of the Company as his employer; nor, in any event, shall the Company be held responsible for: (a) Any loss suffered

80. See for example, *Mendelssohn v. Normand Ltd.*, *supra* n. 29; *Levison v. Patent Steam Cleaning Carpet Co. Ltd.*, [1978] Q.B. 69 at 83-84 (C.A.) (*per* Orr L.J. and Cairns L.J.).

81. (1974), 49 D.L.R. (3d) 548 (S.C.C.).

82. Ontario Law Reform Commission, *Report on Consumer Warranties and Guarantee in the Sale of Goods* (Toronto: Dept. of Justice, 1972) 52. See for example, *Keelan v. Norray Distributing Ltd.* (1967), 62 D.L.R. (2d) 466 (Man. Q.B.); *Lighburn v. Belmont Sales* (1969), 6 D.L.R. (3d) 692 (B.C.S.C.); *R.G. MacLean v. Canadian Vickers* (1970), 15 D.L.R. (3d) 15 (Ont. C.A.); *Canso Chemicals Ltd. v. Canadian Westinghouse Co.* (1974), 54 D.L.R. (3d) 517 (N.S.S.C. App. Div.); *Heffron v. Imperial Parking* (1974), 46 D.L.R. (3d) 642 (Ont. C.A.); *Beldessi v. Island Equipment Ltd.* (1974), 41 D.L.R. (3d) 147 (B.C.C.A.); *Cain v. Bird Chevrolet-Oldsmobile Ltd.*, *supra* n. 79.

83. See G.H. Trietel, *The Law of Contract* (5th ed. 1979) 168-169.

84. *Supra* n. 8.

85. *Supra* n. 2.

86. *Ibid.*, at 563.

87. *Ibid.*, at 560.

88. Singular as this incident seems, it is apparently not the only time such an incident has happened. One security company surveyed for this article had a similar story to relate about one of their employees. In that case, the guard was apparently bored, and, thinking he would become a hero, began a fire purposely so he could 'discover' it, and put it out. Unfortunately, the fire got out of control and caused extensive damage. The case was settled out of court.

89. See C.A. decision, [1978] 1 W.L.R. 856 at 866 (*per* Denning L.J.).

by the customer through burglary, theft, fire or any other cause, except insofar as such loss is solely attributable to the negligence of the Company's employees acting within the course of their employment"⁹⁰

The House of Lords unanimously overruled the Court of Appeal, and held that Securicor was not liable. The Court upheld the main proposition of *Suisse Atlantique* "that the question whether, and to what extent, an exclusion clause is to be applied to a fundamental breach, or a breach of fundamental term, or indeed to any breach of contract, is a matter of construction of the contract."^{90a} Conflicting decisions of the Court of Appeal were commented on and overruled.⁹¹ Wilberforce L.J. particularly criticized Denning L.J.'s decision in *Harbutt's* for his "unsatisfactory reasoning as to 'termination' of the contract and the effect of 'termination' on the plaintiffs' claim for damage."⁹² No breach of contract, however radical, automatically puts an end to the contract. What it may do is give the innocent party the election to repudiate the contract; to put an end to all unperformed obligations under the contract. This election does not obliterate the contract *ab initio*. The contract is still referred to in determining damages, and what is said about the limitation or exclusion of damages cannot be disregarded.

Lord Diplock explains the effect of a breach in terms of primary and secondary obligation. Primary obligations are the promised performance under the contract; secondary obligations are the payment of damages, or other remedies, provided either under the contract, or implied by common law or statute. Upon breach of a primary obligation, the innocent party may elect to put an end to unperformed primary obligations, and remaining primary obligations of the party in breach are transformed into a secondary obligation to pay damages. As the contract may be a source of secondary obligation, the parties may choose to limit, liquidate, or exclude them as they wish. By this analysis, it is clear that on termination by breach, the clause determining the measure of damages should not be disregarded, but at this point it becomes most relevant.⁹³

The resolution of the rule of construction versus rule of law debate was necessary and welcome. But, more important and far reaching in its implications, is the more lenient approach of their Lordships towards construction of disclaimer clauses. The argument that where an exclusion clause could cover both deliberate acts and negligence it should be construed as applying only to negligence was rejected by Lord Wilberforce as a "perversion of the rule that if a clause can cover something other than negligence it will not

90. *Supra* n. 2, at 559.

90a. *Ibid.*, at 561 (*per* Wilberforce L.J.).

91. *Harbutt's "Plasticine"*, *supra* n. 71 (*per* Wilberforce L.J. and Diplock L.J.); *Charterhouse Credit Co. v. Tolly*, *supra* n. 61; and *Wathes (Western) Ltd. v. Austins Menswear Ltd.*, *supra* n. 75 (*per* Wilberforce L.J.).

92. *Supra* n. 2, at 562.

93. Although not mentioned in *Photo Production*, it should be noted that this view of the effect of breach on exclusion clauses is affirmed statutorily by the *Unfair Contract Terms Act 1977*, c.50, s.9(1) (U.K.):

Where for reliance upon it a contract term has to satisfy the requirement of reasonableness, it may be found to do so and be given effect accordingly notwithstanding that the contract has been terminated either by breach or by a party electing to treat it as repudiated.

be applied to negligence.⁹⁴ Unfortunately, little notice was taken of the provision that Securicor assumed responsibility for the negligence of their employees acting within the course of their employment. This was so, even though their Lordships, with the notable exception of Lord Diplock, assumed that had it not been for the exemption clause, Securicor would have been answerable for their employee's conduct. Why it was not felt that the fire had been started in the course of his employment was never discussed. Nor was any comment made on the extent to which the old rules of construction would remain applicable in the future.

The extent to which *Photo Productions* is applicable in Canada is uncertain. One of the main reasons for the lenient approach to construction in that case was the passage of the *Unfair Contract Terms Act*,⁹⁵ an act for which there is no equivalent in Canada. The *U.C.T.A.* prohibits certain types of exemption clauses, and others are subject to an overriding test of reasonableness. Their Lordships found it significant that the entire field of contract law had not been legislated. They inferred that it was Parliament's intention to leave parties of equal bargaining power in commercial matters free to apportion risks as they see fit.⁹⁶ It is clear, however, that their Lordships were also impressed by the commercial nature of the contract, the equality of bargaining power, the amount of risks against the remuneration, and the likelihood of insurance in these types of transactions.⁹⁷

The Supreme Court of Canada, in *Beaufort Realities (1964) Inc. v. Chomedy Aluminum Co. Ltd.*,⁹⁸ ostensibly adopted the reasoning of the House of Lords in *Photo Production*.⁹⁹ Unfortunately, it failed to take advantage of an excellent opportunity to clarify the law as it stands in Canada, and state the extent to which *Photo Production* is to be applied in this country. The facts of *Beaufort* are briefly that Beaufort Realities had retained Belcourt Construction to construct an apartment complex. Belcourt, in turn, subcontracted the aluminum windows, glass and glazing to Chomedy Aluminum. Belcourt was critical of Chomedy's work and withheld payment. After Chomedy made a number of requests for payment, which were denied, it withdrew from the job before completion. Belcourt hired another subcontractor to finish the work. By a clause in the contract between Belcourt and Chomedy, the latter had waived its rights to a lien on the property. Chomedy, notwithstanding that provision, filed a mechanic's lien against the property and issued a writ against Beaufort and Belcourt to recover for work done, and for a declaration that the lien was valid. At County Court, Fogarty J. held that Belcourt was in fundamental breach of contract by withholding payment, and, as Chomedy could consider the contract terminated, Belcourt could not take advantage of the waiver of

94. *Supra* n. 2, at 564. What effect this has on *Levison v. Patent Steam Cleaning*, *supra* n. 80 as authority is unclear, for in that case a similar argument was accepted as sound. Wilberforce L.J., however, commented on *Levison* as being sound "in light of well known principle" [*supra* n. 2, at 564].

95. *Supra* n. 93. Hereinafter referred to as the *U.C.T.A.*. See *infra*.

96. *Supra* n. 2, at 289 (W.L.R.).

97. *Supra* n.2, at 564 (*per* Wilberforce L.J.); at 568 (*per* Diplock L.J.); at 568 (*per* Salmon L.J.); at 570 (*per* Scarman L.J.).

98. [1980] 2 S.C.R. 718.

99. *Supra* n. 2.

lien, which was an exclusion clause. At Divisional Court, the majority (O'Leary J and Linden J.), following their earlier decision in *Shill-Brand Inc. v. Belcourt Construction (Ottawa) Ltd.*¹⁰⁰ found that, although there was a fundamental breach, the waiver of lien was effective, and Chomedy was entitled only to a personal judgment. Chomedy appealed that decision to the Court of Appeal.

Wilson J.A., in a judgment handed down before the House of Lords decision in *Photo Production*, affirmed that there had been a fundamental breach of contract by Belcourt. Following *Suisse Atlantique*¹⁰¹ and *B.G. Linton Const. Ltd. v. C.N.R.*,¹⁰² she held that whether the exclusion clause covered the breach was a question of construction of the contract. She continued on to ask "whether it is fair and reasonable that [the exclusion clause] survive the disintegration of its contractual setting."¹⁰³ Wilson J.A. concluded that it was not fair and reasonable to attribute to the parties the intention that the waiver of lien would be binding even if Belcourt refused to pay, and overruled the clause as a 'matter of construction', even though she never really referred to its actual wording. This construction of the clause is certainly a very harsh one. If it is to be assumed that the clause was not intended to operate when there was a genuine disagreement over the quality of work, it is difficult to imagine under what circumstances one could assume the parties did intend the clause to operate.

The Supreme Court of Canada handed down their decision in 1980, having had the benefit of the House of Lords' decision in *Photo Production*.¹⁰⁴ Ritchie J., in a judgment of the court, adopted the rule of construction approach to exclusion clauses enunciated in *Photo Production*. He quoted extensively from that case, and then, virtually without comment, adopted Madame Justice Wilson's decision that the waiver of lien clause, on its true construction, did not bind Chomedy. The main point of *Photo Production*, that the clear language of a contract between freely contracting parties should be respected, seems to have been ignored. Ritchie J. appears to adopt Wilson J.A.'s 'fair and reasonable' test, even though the Lords in *Photo Production*, especially Lord Diplock,¹⁰⁵ clearly expressed their disfavor of such an approach. There is no comment on the extent to which the fair and reasonable test should be employed, if at all, or how the apparent conflict of the test with the decisions in *Photo Production* is to be resolved. Once again, lip service is paid to the principle that the intention of the contracting parties, as expressed by the clear words of the contract, is to be upheld. No actual construction of the actual terms is discussed, nor are any clear guidelines for construction established.

100. (1978), 19 O.R. (2d) 606.

101. *Supra* n. 4.

102. *Supra* n. 81.

103. *Chomedy Aluminum Co. Ltd. v. Belcourt Construction (Ottawa) Ltd.* (1979), 24 O.R. (2d) 1 at 8. Note: The distinction drawn by Wilson J.A. between what is fair and reasonable within the contractual setting and after the disintegration of the contractual setting is really unjustified, for it ignores that the exclusion clause, as determinant of the secondary obligations, does not disintegrate upon a breach. See M.H. Ogilvie, "The Reception of *Photo Production Ltd. v. Securicor Transport Ltd.* in Canada: *Nec Tamen Consumebatur*" (1982), 27 McGill L.J. 424 at 437.

104. *Supra* n. 2.

105. *Infra* n. 162.

While the old hostility towards exclusion clauses continues to surface in Canada under the guise of rules of construction, the British courts have gone even further than ever to allow parties of equal bargaining power to allocate risks as they see fit. *Ailso Craig Fishing Co. v. Malvern Fishing Co.*,¹⁰⁶ like its predecessor, *Photo Production*, involved a security service contract with Securicor, this time in a Scottish harbor. Through Securicor's admitted negligence, a proper security patrol was not provided, and two vessels sank in the harbor, after the bow of one of the ships was 'swabbed' under the pier. The issue before the House of Lords was whether a clause in Securicor's contract was effective in limiting the amount of damages for which Securicor was liable. The clause read:

'If, pursuant to the provisions set out herein, any liability on the part of the Company shall arise (whether under the express or implied terms of this Contract, or at Common Law, or in any other way) to the customer for any loss or damage of whatever nature arising out of or connected with the provision of, or purported provision of, or failure in provision of, the services covered by this Contract, such liability shall be limited to the payment by the Company by way of damages of a sum . . .'¹⁰⁷

of £1,000 for any one claim, and £10,000 for any aggregate of claims which are the consequence of any one incident, or within a twelve month period.¹⁰⁸

Their Lordships felt that whether or not there had been a fundamental breach of contract by Securicor was unimportant,¹⁰⁹ as it made no difference to the construction of the limitation clause. The effect of a limitation clause is to be determined by construing it in the context of the contract as a whole. While the clause is to be construed *contra proferentum*, the court must not strive to create ambiguity, but must accord the words their plain, natural meaning.¹¹⁰ Thus, the House of Lords has laid to rest for good (in England, at least) the 'rule of construction' that a disclaimer clause is to be construed as not applying to a fundamental breach.

Next, their Lordships went on to add a principle, or guideline of construction, that a limitation of liability clause is not to be treated "with the same hostility as clauses of exclusion,"¹¹¹ for it is more likely that a limitation clause reflects the true intention of the parties. While it is "inherently improbable" that the other party to a contract should intend that the *proferens* completely escape liability that would otherwise fall to him, it is not so improbable that he would intend the liability of the *proferens* to be limited. This is especially so when the potential losses are so great in proportion to the remuneration he receives, and the other party has better opportunity to insure.¹¹²

This attempt to establish guidelines for future construction of disclaimer clauses, rather than clarifying the principles enunciated in *Photo*

106. *Supra* n. 9 (H.L.).

107. *Ibid.*, at 103.

108. *Ibid.*, at 103-104.

109. *Ibid.*, at 103 (*per* Wilberforce L.J.); at 106 (*per* Fraser L.J.).

110. *Ibid.*, at 102.

111. *Ibid.*, at 102-3.

112. *Ibid.*, at 102-3, 105-6.

Production,¹¹³ is likely to cause much confusion and discussion in subsequent cases. As Denning L.J. has already pointed out, there is very little difference in principle between a clause which saves the *proferens* from paying anything, and one which saves him from paying as much as he would have otherwise.¹¹⁴ The courts will be put in a position of having to decide the amount by which damages can be limited in a clause before it can be accepted as a true reflection of the contracting parties' intentions. Obviously, the clause need not be a genuine pre-estimate of damages, for it would then be a true liquidated damages clause. But, it would be ludicrous for the courts to hold that a limitation of one dollar on a million dollar claim is more likely to accord with the true intention of the parties than is a total exclusion of liability. The distinction is, by its very nature, an arbitrary one.

Oliver L.J., in *George Mitchell v. Finney Lock Seeds*,¹¹⁵ explains the distinction made by the House of Lords in terms of the analysis of the exclusion clause as being substantive rather than procedural in its effect. He states that since an exclusion clause:

... [M]ay not only modify or limit the secondary obligation to pay damages for breach but may also show the extent of the primary obligation, a clause totally excluding liability tends to be construed more restrictively than a clause merely limiting damages payable for breach, for a total exclusion of liability, if widely construed, might lead to the conclusion that there was no primary obligation at all ...¹¹⁶

The substantive and procedural approaches to exclusion clauses are discussed below. When dealing with parties of generally equal bargaining power, it is submitted a substantive approach is more realistic, and Oliver L.J. appears to have recognized that. However, it is wrong to assume that a substantive analysis is appropriate merely because a clause limits damages rather than excludes them totally, and to automatically construe the former clause less strictly.

VII. A Substantive versus a Procedural Approach

Traditionally, the courts have viewed exclusion clauses with disfavor, seeing them as a defence set up by a promisor so that he can break his contractual obligations without fear of penalty. The contract, apart from the exclusion clause, is examined to determine the promisor's obligations. If he is in a breach of his obligations, the exempting clause is then construed to determine whether it provides an effective defence against liability for breach.¹¹⁷

The procedural approach to exclusion clauses still prevails, despite the urging of academics to regard these clauses as more substantive in their effect;¹¹⁸ *i.e.* as defining the promisor's obligations under the contract, rather

113. *Supra* n. 83.

114. *George Mitchell (Chesterhall) Ltd. v. Finney Lock Seeds Ltd.*, [1983] 1 All E.R. 108 at 116 (C.A.) (*per* Denning L.J., citing: *Atlantic Shipping and Trading Co. v. Lanis Dreyfuss & Co.*, [1922] 2 A.C. 250 at 260. Lord Denning felt the real underlying principle was what was fair and reasonable, a charge which is borne out by the case of *Rose v. Boristo Bros. Ltd.*, *supra*, n. 39.).

115. *Ibid.*

116. *Ibid.*, at 118-9.

117. See for example, *Karsales (Harrow) Ltd. v. Wallis*, *supra* n. 59, at 940 (C.A.) (*per* Lord Denning).

118. See for example, B. Coote, *supra* n. 1; D. Yates, *supra* n. 1.

than merely providing a defence to a breach. It is certainly more consistent with principles of contract law to construe the contract, including the exemption clauses, in its entirety, rather than to selectively remove the clauses from their contractual context. The judiciary is to some extent beginning to accept the substantive approach. In the words of Oliver L.J.:

The contract has to be construed as a whole, for the exclusion clause is part of an entire contract and may, as a matter of construction, be an essential factor in determining the extent of the primary obligation.¹¹⁹

A procedural approach is still appropriate for certain types of exclusion clauses, such as those limiting remedies. Those clauses do not define obligations under the contract, but limit remedies upon a breach.¹²⁰

VIII. Function of Exclusion Clauses

Many exclusion clauses are foisted upon consumers who have no choice but to accept the harsh terms, or not obtain the goods or services they desire. Under such circumstances, there is no true 'meeting of the minds' and the exclusion clauses should be policed rigorously or altogether prohibited.

In commercial matters, however, exclusion clauses can serve another, primarily economic function. Between the commercially contracting parties they are a convenient and effective tool for the allocation of risk in a way the contracting parties find most convenient and economically appropriate.¹²¹ Businessmen use exclusion clauses to outline exactly what contingent losses they are willing to assume for the price they are being paid for their product. The businessman contracting to purchase the product realizes that he will have to pay more for more inclusive warranties: he does a cost-benefit analysis, and, at some point, decides to take on the risks himself. Under these circumstances, exclusion clauses are a legitimate device for determining which party to a contract shall assume any of the inherent risks, or the costs of insuring those risks. Viewed in this manner, exclusion clauses no longer appear to be inherently evil, but are merely an effective method by which parties may delineate their respective risks and obligations under the contract.

The economic function of exclusion clauses has not generally been judicially considered primarily because of the prevalent view that such clauses are mainly used to deprive innocent parties of their remedies for breach. It is submitted that always treating exclusion clauses as mere defences is wrong in principle, for the clauses form part of the contract, and must be referred to when construing the contract to determine the extent of the promisor's obligations. Thus, a clause contained in a contract for the sale

119. *George Mitchell (Chesterhall) Ltd. v. Finney Lock Seeds Ltd.*, *supra* n. 114, at 118.

120. See *Chomedy Aluminum Co. Ltd. v. Belcourt Construction (Ottawa) Ltd.*, *supra* n.103, at 8-9; aff'd [1980] 2 S.C.R. 718; *per Wilson J.A.*:

While I agree that the waiver of lien clause is an exclusionary clause . . . It is not . . . one of those exclusionary clauses which must be resorted to in order to determine whether there has been a breach at all or the extent to which there has been a breach. It does not modify the obligation or restrict the liability of the party in default: it deprives the party not in default of an additional remedy.

121. See generally: G. Garrett, "At Whose Risk" (1966), 116 New L.J. 1192.

of a car which states, "The vendor does not guarantee the car will be blue," does not operate to provide a defence to the vendor for failure to deliver a blue car. Rather, it means that the vendor has not assumed an obligation to deliver a blue car. The exclusion clause has a substantive function; it defines and modifies the primary obligation of the contract.

Some may argue that the exclusion clause is, by its very nature, deceptive; a consumer reading the contract would see a promise for the delivery of a blue car, and believe that promise is a contractual obligation. However, a consumer understands a contractual obligation to be a promise that is enforceable. If he read the clause he would understand that the promise for a blue car is unenforceable, and therefore non-contractual.¹²² The common law doctrines, such as the notice requirement and *contra proferentum*, answer the objections that exclusion clauses may not be read, or are difficult to understand. The adoption of the view that exclusion clauses have a substantive function in defining contractual obligation would not, it is submitted, have a deleterious effect on the effectiveness of these doctrines. As well, statute prohibits the exclusion of certain warranties and conditions in consumer sales, and further controls over unfair clauses, would be possible through the adoption of the Ontario Law Reform Commission's and U.L.C.'s recommendations that a general unconscionability provision be adopted.

As noted earlier,¹²³ certain members of the judiciary have begun to endorse a substantive view of the function of exclusion clauses.¹²⁴ At the same time, however, the spectre of fundamental breach has once again risen. If exclusion clauses do not operate so as to define the extent of contractual obligations, the argument goes, a clause could be worded so as to prevent any obligation from ever arising, and the contract would fail for lack of consideration. Thus, a total exclusion may not be possible. Lord Wilberforce, in *Suisse Atlantique*,¹²⁵ states that an act which, without the presence of the exclusion clause might constitute a breach, "may be reduced in effect, or made not a breach at all, by the terms of the [exclusion] clause".¹²⁶ He goes on to warn that the contractual promises must not be reduced to a "mere declaration of intent."¹²⁷ Similarly, in his analysis of contractual obligations in *Photo Productions*, Lord Diplock points out that while promisors may use exclusion clauses to modify their primary obligations under the contract, they must do so "within the limits that the agreement must retain the legal characteristics of a contract";¹²⁸ *i.e.* there must be *some* consideration.¹²⁹

122. See B. Cooté, *supra* n. 1, at 140-144.

123. *Supra* n. 114; n. 103.

124. See *Photo Production Ltd. v. Securicor Transport Ltd.*, *supra* n. 2 (per Diplock L.J.); *Suisse Atlantique*, *supra* n. 4, at 433 (per Wilberforce L.J.); *Wathes (Western) Ltd. v. Austin Menswear Ltd.*, *supra* n. 75; *Levison v. Patent Steam Carpet Cleaning Co.*, *supra* n. 80; *The Angelia*, [1973] 2 All E.R. 144 at 162-3 (Q.B.); *Thomas National Transport (Melbourne) Pty. Ltd. v. May and Baker (Aust.) Pty. Ltd.* (1966), 115 C.L.R. 353 at 385-6 (H.C. Aust.); *Council of the City of Sydney v. West*, *supra* n. 70 at 493-6 (per Kitta J.).

125. *Supra* n. 4.

126. *Ibid.*, at 431.

127. *Ibid.*, at 432.

128. *Supra* n. 2, at 567.

129. See *Firestone Tyre & Rubber Co. v. Yokins & Co.*, [1951] 1 Lloyd's Rep. 32 at 38-9 (K.B.) (per Devlin J.); Fridman, "The Effect of Exclusion Clauses", *supra* n. 70.

It is indeed possible that an exclusion clause which purports to completely exclude the promisor's liability for non-performance might be declared void as repugnant to the main purpose of the contract.¹³⁰ However, it has been suggested that if the clause were phrased so that it relieved the promisor from any duty to perform, the effect, rather than to render the contract void for uncertainty, would be to simply transform what would otherwise be a bilateral contract into a unilateral contract. The promisor has no obligation to do anything under such a contract, but if he does render the specified performance, the promisee has an obligation to pay, or to perform his part of the bargain.¹³¹

IX. Practical Considerations

Throughout the summer of 1983, a number of lawyers and businesspersons were surveyed in order to determine how often, and for what reason, exclusion clauses are used in the business community. In all, the study included 30 businesspersons and lawyers (including some in-house legal counsel) in the Winnipeg area. Twelve of the businesses whose representatives were interviewed could be classified as commercial enterprises, dealing generally with other businesses, as opposed to the general public. This group included security companies, engineering firms and consultants, and wholesalers/manufacturers. Seven of the businesses were consumer operations, dealing mainly with the public — mostly dry cleaners and gymnasiums or health studios. The remaining businesses deal with both commercial and consumer clients. They include retail sales and service outlets, and courier services.

A. Commercial Operations

All of the businesses surveyed agree that when one company is dealing with another, any exclusion clauses in their contract are part of the bargain. They are generally viewed as a method of allocation of risk. Whether exclusion clauses are used at all in a commercial context depends on a number of factors. One major determinant is the standards in the industry. Engineering firms generally make no attempt to exclude liability for negligence; as professionals, their reputations are at stake. Security companies all use some form of exclusion clause to protect against liability for the negligence of their employees. The rationale given is that if security companies were forced to become insurers, their prices would skyrocket. It is less expensive for the customer to insure his property himself.

Equally important is the relative bargaining positions of the parties to the contract. Firms submitting bids are generally in no position to use the clauses. The bid risks being rejected, as no one else is likely to have included such a term. Especially in tough economic times, it is a buyer's market. As one manufacturer said, "They're in the driver's seat." The customer can demand larger warranties on his purchase, for he knows that a number of

130. See *Sze Hai Tong Bank Ltd. v. Rambler Cycle Co. Ltd.*, [1959] A.C. 576 (P.C.).

131. See *United Dominion Trust (Commercial) Ltd. v. Eagle Aircraft Services Ltd.*, [1968] 1 W.L.R. 74, [1968] 1 All E.R. 104 (C.A.). See also N.E. Palmer and A. Evans, "Commentary" (1980), 58 C.B.R. 773 at 777; D. Yates, *supra* n. 1.

firms are anxious to have his business. However, when there are more guarantees and fewer exclusion clauses, the price to the customer will increase.

Almost all businesses surveyed use *force majeure* clauses, exempting them from liability for events beyond their control. The next most common type of clause is clauses limiting time in which a remedy could be sought, or limitations of damages clauses. Most businesses are reluctant to attempt a total exclusion of liability, or to exclude liability for negligence or fundamental breach, for fear that customers would be scared off. Such clauses are not considered commercially credible. However, many of the limitation of damages clauses, often referred to in the contract as 'liquidated damages clauses', purport to limit liability to an amount so negligible that they are essentially no different than total exclusions. This is most common with security contracts, where liability may be limited to as little as \$50.00 or even less.

There are three major reasons commercial businesses give for using exclusion clauses: (1) They should not be liable for consequential damages; the cost of their service is low, and they cannot afford to be insurers of their clients' property. A common statement is that if the consumer wants a better guarantee, he has to pay higher prices. [At least one security company offers different 'grades' of guards, at varying prices. The limitation of liability, however, does not vary!] Most security services feel it is up to the customer to obtain insurance. One company representative made the point that the amount a client saves on their insurance premiums by having security often covers the charge of the security service. The security companies cannot themselves insure their clients, all they can do is provide a 'reasonable deterrrent', he declared. (2) The clauses are standard in the industry; the fact that 'everyone else uses them' is a very common reason businesses give for using exclusion clauses. Companies will often pick up a competitor's contract and use it as their own, without really knowing what it means. In the businesses surveyed, three unrelated courier services had almost identical exclusion clauses. As well, lawyers keep precedents, and may use the same kinds of clauses, including exclusions, for a number of clients. (3) A final reason is to avoid litigation. All of the businesses surveyed were anxious to avoid having to go to court, which is a costly process, and terrible for public relations. A lot of time, money and effort is spent drafting clauses to make very clear the exact extent of the obligations they are willing to assume under the contract, and the limits of liability. Everything that could possibly go wrong is considered, and a carefully drafted clause is inserted in the contract. Considering this enormous effort, it is surprising that a large number of businesses, especially couriers, are willing to accept their client's bills of lading, or purchase orders, thereby risking losing the protection afforded by their own contract.

When this risk was pointed out, the reaction was invariably one of surprise — the problem had not been considered by the companies. Generally, they thought that as the customer knew the terms on which the company was willing to contract, there should be no problem. That argu-

ment might be accepted in court if there has been a regular course of dealing, but it is much wiser to avoid the problem in the first place by ensuring that the exclusion clause forms part of the written contract. The courts are reluctant to read such a provision into a written contract.

B. Consumer Operations

Businesses dealing with the general public tend to use exclusion clauses more often than do commercial businesses, and the clauses used are wider in their scope. Of all the companies surveyed, only one dealing with the public said they do not use some kind of exclusion or waiver in their contract. They felt a waiver of personal injury would be ineffective and that their own insurance coverage was sufficient. They commented that at least 10% of their customers inquire about insurance and liability. All five gymnasiums or health clubs spoken to had some sort of waiver or notice disclaiming responsibility for personal injuries. They all admitted, however, to having doubts about the effectiveness of the disclaimers, and carried heavy liability insurance coverage.¹³² In at least two cases, the concern was well justified, for the only disclaimers were in signs posted in the exercise and locker rooms.

Businesses in retail sales often include a number of exclusion clauses in the 'warranty' documents they give the consumer along with their products. These 'warranties' normally guarantee free parts and/or labour for a certain period of time, and then purport to exclude all other conditions and warranties express, or implied, by statute or otherwise. Used goods are sold on an 'as is' basis, with no guarantee or warranties that they will work. Many of these exclusion clauses would be rendered void by virtue of the *Consumer Protection Act*¹³³ or other relevant legislation. Section 58(5) of the Manitoba Act does say the fact that the goods are used may be taken into account in assessing the implied warranties of merchantability.

C. Conclusions Drawn

Consumer businesses were generally less candid about their motives for using exclusion clauses than were their commercial counterparts. The most common reason given was a desire to avoid litigation and the attendant expense and bad publicity. However, the main effectiveness of the clauses seems to lie in their power of intimidation. Many consumers are, regrettably, unaware of their rights under a contract, or of the ineffectiveness of any exclusion clause it may contain.

One important factor a court should examine when dealing with an exclusion clause is the relative positions of the parties to the contract. Where the parties are dealing from equal positions, the exclusion clause is part of

132. These are well justified, for the courts are reluctant to enforce exclusions of liability for personal injury, even in cases where a waiver was signed. See for example, *Smith v. Horizon Aero Sports* (1981), 19 C.C.L.T. 89 (B.C.S.C.); *Crocker v. Sundance Northwest Resorts Ltd.*, *supra* n. 32a; American Law Institute and National Conference of Commissioners on Uniform State Laws, *Uniform Commercial Code* (Philadelphia: The Institute, 1971) s.2-719 (hereinafter referred to as the U.C.C.); and the Ontario Law Reform Commission (hereinafter referred to as the O.L.R.C.) and Uniform Law Conference (hereinafter referred to as the U.L.C.) recommendations for the adoption of a similar provision in Canada, *infra*.

133. R.S.M. 1970, c. C200.

the contract, and has been negotiated fairly. Thus, it should be construed by the substantive approach discussed above. If, however, the parties are unequal, the clause is properly subjected to more rigorous tests of interpretation.

X. Legislative Treatment of Exclusion Clauses

A. United Kingdom

In an attempt to resolve the problem of unfair disclaimer clauses, the United Kingdom has enacted the *Unfair Contract Terms Act 1977*,¹³⁴ which supersedes the *Sale of Goods (1973) Act*.¹³⁵ Under the *U.C.T.A.*, certain types of exclusion clauses are prohibited; for example, under s.2(1), one cannot exclude liability for personal injury or death as a result of one's negligence; and under s.7(2) a seller cannot exclude liability for breach of warranty in consumer sales. In certain transactions,¹³⁶ both consumer and commercial, the court is given the discretion to strike down any exclusion clauses, or part thereof, which it feels are not 'fair and reasonable'.

The *U.C.T.A.* has not completely solved the problem of unfair exclusion clauses. Section 4(1) provides that no person dealing *as a consumer* can be made to indemnify another person, except so far as the contract term satisfies the general requirement of reasonableness. This seems to put a loophole in the statutory control of purely commercial transactions; an indemnity clause appears to escape any statutory control, whereas if it had been phrased as an exclusion clause it would be subject to the test of reasonableness. Under s.3, where one of the contracting parties deals "as a consumer or on the other's written standard terms of business", and the contract in question contains an exclusion clause, that clause is subject to the test of reasonableness. For this section, an exclusion clause is one that (a) permits the party in breach to "exclude or restrict any liability of his in respect of the breach",¹³⁷ (b) permits the promisor to render performance substantially different from that promised, or (c) to render no performance which was promised at all. As Professor Yates has pointed out, the words "in respect of the breach" may allow some clauses to escape the ambit of the Act.¹³⁸ If the effect of an exclusion clause was clearly not to limit or exclude liability for breach, but was to actually modify the primary obligation and prevent certain conduct from every constituting a breach, then the clause would not be covered by s.3(2)(a), which operates only in respect of a breach. Nor does (b) cover the clause, for the promisee cannot expect any performance other than that which was actually promised. An ingenious draftsman could easily word an exclusion clause so as to define primary obligations rather than exclude liability, and thus escape the test of reasonableness provided under the Act.

134. c.50 (U.K.)

135. See generally: D. Yates, *supra* n. 1 at 73-122, for an excellent discussion of the *U.C.T.A.* and other relevant U.K. provisions. See also R. Lawson, *Exclusion Clause After the Unfair Contract Terms Act 1977* (1979).

136. Schedule One to the Act lists contracts to which sections of the Act do not apply.

137. *U.C.T.A. 1977*, c.50, s.3(2)(a) (U.K.).

138. See D. Yates, *supra* n. 1, at 90-93.

The general test of reasonableness is set out in s.11(1) of the *U.C.T.A.*:

... [T]he requirement of reasonableness... is that the term shall have been a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made.

The test is rather subjective and uncertain, as there are no guidelines set out for its application by the court. However, ss.6(3) and 7(3), dealing with exclusion or restriction of implied terms in non-consumer sales and hire-purchase of goods, and analogous transactions, along with s.4, dealing with indemnity clauses by consumers, are subject to a special test of reasonableness, in addition to the general test of s.11(1). The criteria of the special test deal with such things as the relative strength of bargaining power, availability of the goods from alternate sources, and whether the goods were specially-made for the purchaser.

B. Canada¹³⁹

Canada has no existing legislation similar in scope to the *U.C.T.A.* 1977, but three provinces, Ontario, British Columbia and Alberta, have enacted some form of fair trade practices legislation.¹⁴⁰ These statutes prohibit unfair practices in consumer transactions, and give non-exhaustive lists of acts which may be considered unfair or unconscionable.¹⁴¹

The general trend in legislating against exemption clauses has been to prohibit the exclusion of terms which would otherwise be implied by the *Sale of Goods Act* of the province, or other relevant legislation. For example, the Ontario *Consumer Protection Act*¹⁴² prohibits exemption from terms implied by the *Sale of Goods Act*¹⁴³ such as implied warranties of fitness and merchantability, as does the Nova Scotia *Consumer Protection Act*,¹⁴⁴ the B.C. *Amendment to the Sale of Goods Act*,¹⁴⁵ the Manitoba *Consumer Protection Act*,¹⁴⁶ the New Brunswick *Consumer Product Warranty and Liability Act*,¹⁴⁷ and similar legislation in other provinces and territories.

The protection against unfair exclusion clauses afforded by these enactments is far from complete, however, and varies considerably from province to province. For example, the Ontario Act does not apply to non-business associations, including charitable organizations, who may need its protection as badly as any consumer. Goods not purchased for the consumer's own consumption or use are not covered, such as goods one may purchase for a friend.¹⁴⁸ Only sales of goods are covered, to the exclusion of leases

139. See S.M. Waddams, *The Law of Contracts* (1977) 291-303 for a general review and criticism of existing legislation.

140. *Trade Practice Act*, R.S.B.C. 1979, c.406, esp. ss. 3, 4; *Business Practices Act*, R.S.O. 1980, c.55, esp. ss. 2, 4; *Unfair Trade Practices Act*, R.S.A. 1980, c.U3, esp. s.4.

141. See generally: E.P. Belobaba, "Unfair Trade Practices Legislation: Symbolism and Substance in Consumer Protection" (1977), 15 *Osgoode Hall L.J.* 327.

142. R.S.O. 1970, c. 82.

143. R.S.O. 1980, c.462.

144. R.S.N.S. 1967, c.53.

145. R.S.B.C. 1960, c.344, as am. by S.B.C. 1971, c.52, s.1.

146. R.S.M. 1970, c. C200, esp. s.58(1).

147. R.S.N.B. 1983, c. C18.1, esp. ss. 2, 24-26.

148. R.S.O. 1970, c. 82, s.1(a).

and analogous transactions, and only written, not oral, exemption clauses are prohibited. The Manitoba Act sets a monetary limit of \$25,000 on transactions covered by the Act so that a consumer making a large purchase, such as a boat or motorhome, may not be covered when he needs the protection the most.

There have been recommendations by the Ontario Law Reform Commission¹⁴⁹ and by the Uniform Law Conference¹⁵⁰ that a general, unexcludable unconscionability provision be introduced in a uniform Canadian Sale of Goods Act, and that such a provision not be restricted to consumer transactions. Certain exclusion clauses, especially in consumer transactions, would be altogether prohibited, and, generally in non-consumer transactions, other exclusion clauses would be subject to the overriding test of unconscionability.

C. United States

The recommended Canadian unconscionability provision is modelled on section 2-302, in Article 2 (Sale of Goods) of the American *Uniform Commercial Code*.¹⁵¹

- (1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

This provision has been adopted in the *U.C.C.* of every state except California, where it has been included in the *Civil Code Amendment* of 1979 (s. 1670.5), and made applicable to contracts generally, rather than just sales contracts. The provision enables the court to police agreements it deems harsh and inequitable directly, without having to resort to awkward common law methods outlined earlier in this essay.

Section 2-719 of the *U.C.C.*¹⁵² allows parties to a contract to modify or exclude remedies for breach, subject to an overriding test of unconscionability. As a guideline, it states that: "Limitation of consequential damages for injury to the person in the case of consumer goods is *prima facie* unconscionable but limitation of damages where the loss is commercial is not."¹⁵³ The choice of words here is perhaps unfortunate, for what exactly constitutes a commercial loss is not clear. The O.L.R.C. recommends that, in a Canadian act, such loss be termed 'economic loss'. The U.L.C. is of the view that it is unnecessary to say economic losses are not *prima facie* unconscionable, as the burden of proof is already on the party averring unconscionability. The *U.C.C.* provision is, on its face, limited to disclaimers

149. Ontario Law Reform Commission, *Report on the Sale of Goods* (Toronto: Ministry of the Attorney General, 1979).

150. Uniform Law Conference, *Uniform Sale of Goods Act and Report* (Canada: The Conference, 1981).

151. *Supra* n. 132.

152. Adopted by all states, with slight modifications by Alabama, California, Vermont and Washington.

153. *Supra* n. 132, at s.2-719(3).

of consequential damages, but, by s.2-302, all limits of remedies clauses are subject to a general unconscionability review. Both the O.L.R.C. and U.L.C. recommend *specifically* extending the provision in a Canadian act to limitation or exclusion of warranty and remedies of any sort.¹⁵⁴

XI. A Doctrine of Unconscionability

Various methods have been used by the courts in their attempts to prevent unfair or unconscionable exclusion clauses from having effect. The clauses are strictly construed, and interpreted *contra proferentem*. Sufficient notice is required; a collateral representation may not be covered by the exemption clause; a clause could not cover a fundamental breach. Disguising the real policy reasons behind principles of construction has, in itself, produced unfair results, and the principles have become distorted and unreliable. The doctrine of fundamental breach is far too coarse an instrument to use in dealing with unconscionability in contracts. It is on one hand too wide, striking down clauses which, in their commercial context, are perfectly fair and reasonable;¹⁵⁵ and, on the other hand, too narrow, for it applies only to exclusion clauses, while other equally unconscionable terms go untouched.¹⁵⁶

Certain types of exclusions are prohibited by statute and there are some isolated attacks on unconscionable transactions,¹⁵⁷ but no general legislation provision against unconscionability in contracts has yet been enacted in Canada. Such legislation is both desirable and necessary. The adoption of recommendations of the O.L.R.C. and the U.L.C. regarding a uniform Sale of Goods Act would certainly be a move forward, but an act dealing only with exclusion clauses in sales and analagous transactions is not sufficient. Many terms which are not exclusion clauses are unconscionable, and many unconscionable provisions are used in transactions other than the sale of goods.

It might be argued, that a general legislative principle against unconscionability is unnecessary, for such a principle already exists at common law. As early as 1750, in *Earl of Chesterfield v. Janssen*,¹⁵⁸ the Lord Chancellor declared that the court would not enforce any contract so "contrary to conscience . . . such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other".¹⁵⁹ American courts have held that the doctrine of unconscionability is "sufficiently grounded in the common law to be extended" to non-sale transactions outside the scope of *U.C.C. s. 2-302*.¹⁶⁰ In a number of deci-

154. It is interesting to note that, even though the jury system is used in the States extensively, the question of unconscionability is one of law, and therefore left to the judge. This has been criticized as yielding poor and unrealistic results. See D.R. Price, "The Conscience of Judge and Jury: Statutory Unconscionability as a Mixed Question of Law and Fact" (1981), 54 Temple L.Q. 743.

155. See for example, *Canso Chemicals*, *supra* n. 82; *Harbutt's "Plasticine"*, *supra* n. 71.

156. See for example, *Bata v. City Parking Can. Ltd.* (1973), 2 O.R. (2d) 446, 43 D.L.R. (3d) 190 (C.A.).

157. See for example, *Unconscionable Transactions Relief Act*, R.S.M. 1970, c. U20.

158. (1750), 28 E.R. 82 at 100.

159. See also *Samuel v. Newbold*, [1906] A.C. 461 (H.L.).

160. See *Cronk v. State*, 100 Misc. (2d) 680 (1979), 420 N.Y.S. (2d) 113; *Weidman v. Tomaselli*, 81 Misc. (2d) 328 (1975), 365 N.Y.S. (2d) 681; A.L. Corbin, *Contracts* (1950) 128.

sions, Lord Denning has repeatedly declared that the Court "will not allow a party to exempt himself from his liability at common law when it would be quite unconscionable for him to do so."¹⁶¹ In his judgment in the House of Lords in *Photo Production*, however, Lord Diplock expressly disapproved Lord Denning's 'reasonableness' approach to exclusion clauses, saying that while reasonableness is a relevant factor to be considered while construing the contract, "this does not entitle the court to reject the exclusion clause, however unreasonable the court itself may think it is, if the words are clear and fairly susceptible of one meaning only."¹⁶²

Lord Denning's approach has found approval in Canada, however, in *Davidson v. Three Spruces Realty*.¹⁶³ That case dealt with a limitation of liability clause contained in a contract for the bulk storage of the plaintiff's property. The defendants, later found guilty of a fundamental breach, had stored the goods improperly. Anderson J. held in favour of the plaintiffs and, following Denning's judgment in *Gillipsi Bros.*,¹⁶⁴ said:

I agree that, as a general rule, apart from fraud, it would be a dangerous thing to hold that contracts freely entered into should not be fully enforced. It is not correct, however, to suppose that there are no limitations on freedom of contract. The point has been reached in the development of the common law where, in my opinion, the courts may say, in certain circumstances, that the terms of a contract, although perfectly clear, will not be enforced because they are entirely unreasonable.

I do not think that standard form contracts should be construed in a vacuum. I do not think that mere formal consensus is enough. I am of the opinion that the terms of a contract may be declared to be void as being unreasonable where it can be said that in all the circumstances it is unreasonable and unconscionable to bind the parties to their formal bargain.¹⁶⁵

In *Beaufort Realty*,¹⁶⁶ the facts of which were outlined earlier, Madame Justice Wilson also took a Denning-esque approach, holding that whether an exclusion clause survives a fundamental breach depends on whether such a result is 'fair and reasonable'. This approach has been followed in a number of recent decisions dealing with exclusions clauses, including another Ontario Court of Appeal decision in *Canadian Dominion Leasing Corp. Ltd. v. George A. Welch Ltd.; O'Connor Office Machines Ltd. (Third Party)*.¹⁶⁷ In that case, the respondent leased a photocopying machine, supplied by O'Connor, from the appellant. An exemption clause in the lease stated that the appellant made no warranties as to the effectiveness of the machine. It further stated that the parties agreed if the equipment was defective, the respondent's only remedy was against O'Connor, and the respondent would continue to pay the appellant all amounts due under the lease. The machine was defective, the respondent cancelled the lease, and the appellant sued for the rent due. The Court, reaffirming principles of *Photo Production* and

161. *Gillespie Bros. & Co. v. Ray Bowles Transport Ltd.*, *supra* n. 17 at 200. See also *Levison v. Patent Steam Cleaning Co.*, *supra* n. 80 at 79; *Photo Productions v. Securicor Transport Ltd.*, [1978] 1 W.L.R. 856 at 865 (C.A.); *George Mitchell v. Finney Lock Seeds*, *supra* n. 114; *Lloyd's Bank v. Bundy*, [1974] 3 W.L.R. 501 (C.A.).

162. *Supra* n. 2, at 568.

163. [1977] 6 W.W.R. 460; 79 O.L.R. (3d) 481 (B.C.S.C.). See also *Drake v. Bekins Moving & Storage Co.*, [1982] 6 W.W.R. 640 (B.C.Co.Ct.).

164. *Supra* n. 11. This *dicta* should, perhaps, be restricted to standard form contracts.

165. *Supra* n. 163, at 476.

166. *Supra* n. 103.

167. (1981), 33 O.R. (2d) 826.

Beaufort, held that it is a question of construction whether the exclusion clause survives a fundamental breach, which in turn depends on whether it is fair and reasonable in the circumstances. In this case, the clause was clear, and thus it was fair and reasonable to uphold its terms.

A common law doctrine of unconscionability is far from established in Canada, in spite of such decisions. Most recent cases on exclusion clauses have been decided on the old doctrine of *contra proferentem*.¹⁶⁸ The Supreme Court of Canada, in their decision in *Beaufort Realities*,¹⁶⁹ did not take the opportunity to comment on the doctrine of unconscionability. Apart from Lord Denning's persistent advocacy of a general common law doctrine, the British courts preferred to leave the issue of unconscionability to the legislature, who responded with the *U.C.T.A.* 1977. Most likely, Canadian courts will do the same. It is unlikely that our courts will follow the American lead in developing a general doctrine of unconscionability unless there is similar legislative development in this country. A judicial doctrine of unconscionability would be welcome, but the development of such a doctrine seems highly improbable without some form of statutory encouragement.

Some writers point out that there may be a trade-off between certainty in contracts, and a refusal to enforce contracts which are viewed as unconscionable.¹⁷⁰ They feel that the advantages of a provision against unconscionability are outweighed by the disadvantages of attendant uncertainty and confusion. This argument is not very convincing, for the *ad hoc* application of the rules of construction to strike down unfair clauses has led to far more uncertainty than that which a doctrine of unconscionability is likely to cause. At the present, because the courts have not acknowledged underlying policy reasons for their decisions, it is impossible to predict with certainty which clauses will be accepted. If a general doctrine of unconscionability were introduced, the courts could soon formulate general guidelines and principles on what would be deemed unconscionable.

XII. Conclusion

A. 'Fair and Reasonable' v. 'Unconscionability'

The O.L.R.C. and U.L.C. have modelled their proposed unconscionability provisions after the American *U.C.C.*, provision 2-302, rather than the British model, phrasing it in terms of an 'unconscionability', and not a 'fair and reasonable' test. That decision is well-advised, for intention in contract is subjective, and the more subjective test of unconscionability is preferable to an objective reasonableness test. One party to a contract may not be a reasonable man, because of age or infirmity, illiteracy or poor education, or sheer lack of bargaining power. A subjective test of uncon-

168. See for example, *Cathcart Inspections v. Purolator Courier*, *supra* n. 9; *Chabot v. Ford Motor Co. of Canada*, *supra* n. 14; *Nikkel v. Standard Group Ltd.*, *supra* n.32a.

169. *Supra* n. 98.

170. See M.J. Trebilock, "Economic Approach to the Doctrine of Unconscionability" in *Studies in Contract Law* (Reites and Swan ed., 1980).

scionability is more likely to take such factors into account. As well, an unconscionability test will examine the conduct of both parties, rather than just that of the *proferens*, thus giving a more accurate assessment of the clause's fairness.

B. Should the Legislature set Guidelines?

Recommendations by the O.L.R.C. and the U.L.C. include a set of factors which the court should consider when deciding whether a particular contractual provision is unconscionable. The American *U.C.C.* s.2-302, which includes no guidelines, has been criticized for being too *ad hoc*. As well, there is uncertainty about the situations to which the provision is to apply, and whether it encompasses other provisions of the Code.¹⁷¹

Considering the American experience, it would be wise to give the courts some general guidelines through legislation, while allowing them to retain some autonomy in establishing the general principles of unconscionability, or the legislation would be too restricted and rigid. For example, one factor the legislature may instruct the court to consider in determining unconscionability is the relative bargaining position of the parties. It is important that the court retain discretion to decide how important the presence of equal bargaining power is in the individual case. To hold that the mere presence of unequal bargaining power renders an exclusion clause unconscionable would be absurd, for equal bargaining power occurs only in a purely competitive market; the rare exception rather than the rule in our capitalist system. It is not the mere presence of unequal bargaining power, but the unconscionable exploitation of a weaker party's position with which the court must be concerned.

Another issue is knowledge — must the party seeking to uphold the clause actually have known of the other party's weakness, or is constructive knowledge enough? In *Marshall v. Canada Permanent Trust*,¹⁷² constructive knowledge was enough. That case can be restricted to situations involving mental deficiency of the weaker party; there was no real consensus. It may seem harsh that actual knowledge of the unfair bargain is necessary, for two parties in exactly the same situation may not be allowed the same relief. Commercial certainty, however, demands that actual knowledge be required.

The calculation of damages raises another problem. Once a contractual term is found too harsh to uphold, should it have any effect at all in limiting damages? The courts are reluctant to rewrite a contract, but it may be just as unfair to throw all of the risk back to the party seeking to have the term enforced. In general, it is more in line with the original contractual intent to allocate the liability fairly, rather than shift it all to one party. The parties were aware that the term was in the contract — the question is one of degree and not kind. When using an innovative doctrine like unconscionability in contracts, the court will have to be equally innovative in determining the remedy.

171. A.A. Leff, "Unconscionability and the Code - The Emperor's New Clause" (1967), 115 U. Pa. L. Rev. 485 at 516-28. Contra S. Deutch, *Unfair Contracts* (1977) 61-73.

172. (1968), 69 D.L.R. (2d) 260 (Alta.S.C.).