ABUSIVE OR UNCONSCIONABLE CLAUSES FROM A COMMON LAW PERSPECTIVE

Stephen Waddams*

It is a pleasure to comment on Professor Grammond’s interesting, informative, and suggestive paper. The same tensions that he identifies in Québec law can be discerned also in Anglo-Canadian law: putting the matter in the most general terms, the idea of sanctity of contract has been balanced against the desire of courts to avoid enforcement of contracts that have been perceived as very unfair. Perspectives on this question have varied markedly over time, and different solutions have been devised for different problems, producing, in common law fashion, what may more readily be called a patchwork than a mosaic. Professor Grammond’s paper concentrates on the avoidance of “abusive or unconscionable” clauses. One word in Professor Grammond’s title is associated, in its origins, with French law; the other with English equity.

To put this question into context from the perspective of Anglo-Canadian law it is necessary to examine briefly the jurisdiction, originally exercised by the courts of equity to set aside unconscionable transactions, to examine 19th-century attitudes in relation to the equitable jurisdiction, and then to examine the rather convoluted history in the 20th century of the treatment of clauses limiting or excluding liability, variously known as exemption clauses, exclusion clauses or disclaimer clauses.

Since comparison between different legal systems is relevant, reference will be made to a recent European harmonization document, Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR). This useful document, published in six volumes in 2009 with commentary and notes, supplies an accessible comparison of all the continental European systems with each other and with English and Irish law in respect of each particular proposed rule of contract law, and is therefore of particular interest to a comparison

* University Professor and holder of the Goodman/Schipper Chair, Faculty of Law, University of Toronto.
between civil and common law in the Canadian context. Some concluding remarks will be made on the concept of good faith, also mentioned at several points by Professor Grammond.

Since the 19th century, writers on English contract law have emphasized the enforceability of contracts, and have tended to marginalize the instances in which contracts have been set aside for unfairness. In dealing with consideration it has been common to point out that inadequacy of consideration is not, in itself, a defence to contractual obligation, and from this “elementary principle,” as Pollock called it, it has been inferred that, if there is sufficient consideration to meet the test of contract formation, the contract must be enforceable. Frederick Pollock in the first edition of his treatise (1876) wrote that it was a distinguishing mark of English jurisprudence that the amount of the consideration is not material. “The value of all things contracted for is measured by the appetite of the contractors, and therefore the just value is that which they be contented to give.” It is accordingly treated as an elementary principle that the law will not enter into an inquiry as to the adequacy of the consideration. 1

The power of English courts to set aside contracts on grounds broadly relating to unfairness and inequality of exchange was, however, considerably wider than the extracts from Pollock’s book suggested. The first published treatise on English contract law (by John Joseph Powell, 1790) included a long chapter entitled “Of the Equitable jurisdiction in relieving against unreasonable Contracts or Agreements.” 2 Powell stated that the mere fact of a bargain being unreasonable was not a ground to set it aside in equity,

for contracts are not to be set aside, because not such as the wisest people would make; but there must be fraud to make void acts of this solemn and deliberate nature, if entered into for a consideration. 3

But Powell went on to point out that “fraud” in equity had an unusual and very wide meaning:

And agreements that are not properly fraudulent, in that sense of the term

---

3. Ibid., p. 144.
which imports deceit, will, nevertheless, be relieved against on the ground of
inequality, and imposed burden or hardship on one of the parties to a
contract; which is considered as a distinct head of equity, being looked upon
as an offence against morality, and as unconscientious. Upon this principle,
such courts will, in cases where contracts are unequal, as bearing hard upon
one party... set them aside.4

Powell gave as an example the very common provision in a
mortgage that unpaid interest should be treated as principal and
should itself bear interest until paid. Powell wrote that "this
covenant will be relieved against as fraudulent, because unjust and
oppressive in an extreme degree."5

The very wide meaning thus given to the concepts of "fraud"
and "fraudulent" indicates that the power to set aside contracts
was much wider than at first appears. Pollock, in his chapter on
duress and undue influence, also explained to his readers that
"fraud" could not be taken at face value:

The term fraud is indeed of common occurrence both in the earlier and in the
later authorities: but "fraud does not here mean deceit or circumvention; it
means an unconscientious use of the power arising out of these circum-
stances and conditions": and this does not come within the proper meaning of
fraud, which is a misrepresentation... made with the intent of creating a
particular wrong belief in the mind of the party defrauded. Perhaps the best
word to use would be imposition, as a sort of middle term between fraud, to
which it comes near in popular language, and compulsion, which it suggests
by its etymology.6

It is significant that Pollock, in elucidating the meaning of the
word fraud, should consciously look for an equally ambiguous
word (imposition), suggesting, on the one hand, the taking of
unfair advantage, and, on the other hand, actual compulsion.

The court of equity commonly gave relief against forfeitures of
all kinds. The most clearly established case was that of a mortgage.
Mortgage documents usually provided that, on default in
repayment, the land should be forfeited to the mortgagee. The
courts consistently refused to enforce this simple provision, despite
the fact that it was well known and perfectly clear. Whatever form
of words was used — even if the document evidenced an outright
conveyance of the land — the court, if convinced that the
substance of the transaction was a secured loan, refused to enforce
the document and permitted the borrower to redeem the land:

4. Ibid., pp. 145-146.
5. Ibid., p. 146.
6. Pollock, supra, footnote 1, at p. 527.
So that in every mortgage the agreement of the parties upon the face of the deed, seems to be, that a mortgage shall not be redeemable after forfeiture...

... [A]nd a mortgage can no more be irredeemable than a distress for rent-charge can be irrepleviable. The law itself will control that express agreement of the party; and by the same reason equity will let a man loose from his agreement, and will against his agreement admit him to redeem a mortgage.  

No restriction, even by express agreement, was permitted on the right to redeem. In *Spurgeon v. Collier* (1758) Lord Northington said that “[t]he policy of this court is not more complete in any part of it than in its protection of mortgages...; and a man will not be suffered in conscience to fetter himself with a limitation or restriction of his time of redemption. It would ruin the distressed and unwary, and give unconscionable advantage to greedy and designing persons.” 8 This last sentence compendiously illustrates the impact of the separate but interlocking concepts that have run through the unconscionability cases: lack of consent, avoidance of unjust enrichment, and deterrence of wrongdoing, all linked with “the policy of this court.” A few years later the same judge again linked the concepts of reason, justice, freedom of consent, and deterrence of trickery:  

The court, as a court of conscience, is very jealous of persons taking securities for a loan, and converting such securities into purchases. And therefore I take it to be an established rule, that a mortgagee can never provide at the time of making the loan for any event or condition on which the equity of redemption shall be discharged, and the conveyance absolute. And there is great reason and justice in this rule, for necessitous men are not, truly speaking, free men, but, to answer a present exigency, will submit to any terms that the crafty may impose upon them. 9 

Forfeiture in its various forms has obvious advantages to the secured party, and it is not surprising that attempts were made by lenders to secure equivalent advantages without the immediate transfer of the property to be forfeited. The growth of the penal bond represented such an attempt. A common form of the bond was a covenant to pay a fixed sum of money unless some other act was performed by a certain date. The effect was to secure the

performance of the other act, which might itself be the payment of a sum of money that had been lent by the obligee to the obligor.

The court of equity gave relief from such bonds on much the same principle as in cases of mortgages. The bond was, in substance, a device to secure repayment of a loan, and the legitimate interest of the lender was in repayment of the principal (together with interest and costs) and no more. In 1880 the law on the point, out of keeping though it was with the spirit of the 19th century, was explained by Bramwell L.J. (who, though not himself sympathetic, accepted that this was the law) as follows:

[T]he Court of Chancery said that a penalty to secure the payment of a sum of money or the performance of an act should not be enforced; the parties were not held to their agreement; equity in truth refused to allow to be enforced what was considered to be an unconscientious bargain.  

Another judge said, in 1900:

The Court of Chancery gave relief against the strictness of the common law in cases of penalty or forfeiture for non-payment of a fixed sum on a day certain, on the principle that the failure to pay principal on a certain day could be compensated sufficiently by payment of principal and interest with costs at a subsequent day.

Important also was the obvious factor that a borrower in urgent need was apt to sign too readily an extravagant penal bond: the need for the funds was always immediate, and the possibility of enforcement of the bond remote.

The English courts of equity relieved against transactions entered into by persons expecting to own property in the future. The typical case was of the “expectant heir,” and this phrase, together with the otherwise obsolete phrase “catching bargain,” is generally used to denote this branch of English law, but the jurisdiction was not restricted to heirs: it extended to every kind of case in which the “borrower” expected to become the owner of property in the future. The substance of the transaction was a loan, but commonly the transaction took the form of a sale of the expectancy, or of the reversion. The court would set aside the transaction unless the purchaser proved that he had given full value. As in the case of mortgages and penalties, the situation is one in which experience shows that a person, pressed with the immediate need for money, is apt to sell a future interest at an undervalue — sometimes at a gross undervalue: again, the need for

money is immediate, and the interest given up seems remote. So ready was the court to set aside such transactions that the rule came to seem too rigid: a statute of 1867 provided that such transactions should not "be opened or set aside merely on the Ground of Undervalue." The statute, however, did not affect the general jurisdiction of the court to set aside unconscionable transactions, and this line of cases supplies an important illustration of that wider jurisdiction, before and after 1867. Pollock said, in his first edition, that "practically the question is whether in the opinion of the Court the transaction was a hard bargain."

Disadvantageous contractual transactions have frequently been set aside for "undue influence." This phrase covers a number of different circumstances. It may apply to an openly hostile relationship where one party threatens the other with adverse consequences if the agreement is not made. Such a case was Williams v. Bayley where a son had forged his father's signature to promissory notes, and the creditor threatened to prosecute the son unless the father agreed to pay the debt. More commonly the phrase has been applied to situations related to fiduciary duties where one party reposes trust in the other. Certain categories of case have been said to give rise to a presumption of undue influence, but it is not necessary for the weaker party to bring his case into a recognized category: any case in which there is a relationship of trust or confidence may qualify for relief. A 20th-century instance of a case that does not readily fall into any pre-existing category is one where an employee guaranteed her employer's debts. The guarantee was set aside by the English Court of Appeal. Millett L.J. used strong language, very reminiscent of the older equity cases:

This transaction cannot possibly stand... It is an extreme case. The transaction was not merely to the manifest disadvantage of Miss Burch; it was one which, in the traditional phrase, "shocks the conscience of the court". Miss Burch committed herself to a personal liability far beyond her slender means, risking the loss of her home and personal bankruptcy, and obtained nothing in return beyond a relatively small and possibly temporary increase in the overdraft facility available to her employer, a company in

---

12. An Act to amend the Law relating to Sales of Reversions, 31 Vict. c. 4 (1867), s. 1.
14. See the passage quoted at footnote 20, below.
15. Pollock, supra, footnote 1, at p. 534-535.
which she had no financial interest. The transaction gives rise to grave suspicion. It cries aloud for an explanation.\textsuperscript{17}

Closely related, and perhaps conceptually indistinguishable,\textsuperscript{18} are cases where the relationship between the parties is categorized as fiduciary.

The courts of equity exercised a more general jurisdiction to set aside transactions that they regarded as very unfair. In \textit{Evans v. Llewellyn} where a disadvantageous transaction was set aside despite the absence of any kind of misrepresentation, concealment or non-disclosure, Kenyon M.R., relying on a cumulation of considerations, had evidently been challenged to explain and formulate an appropriate principle:

I am called upon for principles upon which I decide this case; but where there are many members of a case, it is not always easy to lay down a principle upon which to rely. However, here, I say, the party was taken by surprise; he had not sufficient time to act with caution; and therefore though there was no actual fraud, it is something like fraud, for an undue advantage was taken of his situation. The cases of infants dealing with guardians, of sons with fathers, all proceed on the same general principle, and establish this, that if the party is in a situation, in which he is not a free agent, and is not equal to protecting himself this Court will protect him.\textsuperscript{19}

In 1888, summarizing the cases, Kay J. said:

The result of the decisions is that where a purchase is made from a poor and ignorant man at a considerable undervalue, the vendor having no independent advice, a Court of Equity will set aside the transaction.

This will be done even in the case of property in possession, and \textit{à fortiori} if the interest be reversionary.

The circumstances of poverty and ignorance of the vendor, and absence of independent advice, throw upon the purchaser, when the transaction is impeached, the onus of proving, in Lord Selborne's words, that the purchase was "fair, just, and reasonable."\textsuperscript{20}

Was undervalue alone a sufficient ground for relief at the beginning of the 19th century? This question is not easy to answer because of the elusive meaning of "fraud." There are, indeed, many statements by courts and commentators to the effect that undervalue alone was insufficient, but these cannot be taken at


\textsuperscript{19} (1787), 1 Cox 334, p. 340 29 E.R. 1191 (emphasis in original).

\textsuperscript{20} Fry v. Lane (1888), 40 Ch. D. 312, p. 322. Lord Selborne's words were from \textit{Morris v. Earl of Aylesford}, supra, footnote 13 above, p. 491.
face value because of frequent indications that a gross undervalue created a "presumption of fraud": where there was a large inequality of exchange the court could presume, without any separate proof, that the disadvantaged party must have been labouring under some sort of mistake or disability, or else must have been influenced by necessity, or by some sort of pressure, or by a relationship with the stronger party. Some cases and contemporary comments suggest that the presumption was practically irrebuttable.

Inequality of exchange was not, in itself, conclusive, but it does not follow that it was irrelevant: a large inequality of exchange may be said to have called for some sort of explanation (which might be that a part-gift was intended, or that the inequality was caused by risks fairly allocated by the transaction).

An attempt in the 20th century by Lord Denning to restate a general principle in terms of unfairness and inequality of bargaining power was rejected by the House of Lords, but the older cases were not overruled, and Lord Denning's statement has been cited with approval in Canadian cases. In Anglo-Canadian law, as in Québec law, the fear has been that an unfettered power to set aside contracts for reasons of unfairness would be too broad, and various attempts have been made to restrain the practical operation of the doctrine. As Professor Grammond mentions, it has been said in a number of cases that two elements are needed: inequality of bargaining power, and undue advantage taken of it.

This distinction corresponds in some degree, though not precisely, with the distinction, also discussed by Professor Grammond, between procedure and substance. Also relevant, as Professor Grammond points out, is the distinction between the concept of mistake in contract formation, and a test of unfairness. None of these distinctions can explain all the past cases, and none, standing alone seems to offer a satisfactory guide for the future. It would be true to say of the common law, as Professor Grammond says, in two very suggestive phrases, of the civil law, that the law has not been “boxed into rigid categories of procedure and substance” and that “there appears to be some sort of osmosis, or synergy, between the two categories.”

The Draft Common Frame of Reference includes the following:

II - 7:207 Unfair exploitation
(1) A party may avoid a contract if, at the time of the conclusion of the contract:
   (a) the party was dependent on or had a relationship of trust with the other party, was in economic distress or had urgent needs, was improvident, ignorant, inexperienced or lacking in bargaining skill; and
   (b) the other party knew or could reasonably have been expected to have known this and, given the circumstances and purpose of the contract, exploited the first party’s situation by taking an excessive benefit or grossly unfair advantage.

(2) Upon the request of the party entitled to avoidance, a court may if it is appropriate, adapt the contract in order to bring it into accordance with what might have been agreed had the requirements of good faith and fair dealing been observed.

II - 7:208 Third persons
(1) Where a person for whose acts a party is responsible or who with a party’s assent is involved in the making of a contract:
   (a) causes a mistake, or knows of or could reasonably be expected to know of a mistake; or
   (b) is guilty of fraud, coercion, threats or unfair exploitation, remedies under this Section are available as if the behaviour or knowledge had been that of the party.

(2) Where a third person for whose acts a party is not responsible and who does not have the party’s assent to be involved in the making of a contract is guilty of fraud, coercion, threats or unfair exploitation, remedies under this Section are available if the party knew or could reasonably be expected to have known of the relevant facts, or at the time of avoidance has not acted on the contract.27

The comment states that “the Article adopts the principle that a contract which gives one party excessive advantage and which involved unfair exploitation may be avoided at the request of the disadvantaged party.”

Here are several concepts very familiar to Anglo-Canadian lawyers. The factors mentioned in 7:207(1)(a) (dependence, trust, economic distress, urgent needs, improvidence, ignorance, inexperience, lack of bargaining skill) largely echo expressions used in Anglo-Canadian courts and tend to suggest lack of consent. The concept in paragraph (b) of “knew or could reasonably be expected to have known” echoes the equitable concept of constructive notice. The requirement of the means of knowledge on the part of the stronger party tends to suggest an element of wrongdoing, but the open-ended indication of what it is that might reasonably have been known (“this” referring to the list in 7:207(1)(a), and “the relevant facts” in 2:708(2)) leaves much flexibility. The phrases “excessive benefit” and “grossly unfair advantage” echo phrases like “immoderate gain” and “undue advantage,” and suggest unjust enrichment. But lack of consent, wrongdoing, and unjust enrichment are not expressly required to be proved. The provision in 7:208 on third persons echoes the concerns of Anglo-Canadian courts in attempting to deal with the responsibility of lenders to guarantors influenced by family members and others. The inclusion of these various elements in a carefully considered international document suggests that it has not been possible to reduce the issue to a single governing concept: several concepts, not wholly commensurable, appear to be simultaneously in play.

One interesting phrase in 7:207(1)(b) is “given the circumstances and purpose of the contract.” This invites the court to look at the real substance of the transaction and ask whether the enrichment can be justified by the allocation of risks properly inherent in the particular kind of transaction. The sale of a reversionary interest in land was, on the face of it, a sale of an interest in land. If that were the real substance of the transaction, that is; if the seller were

---

29. The English law on undue influence and unconscionability is referred to in Note 4, as is the Consumer Credit Act, vol. I, pp. 511-512.
dealing in a fair market for the purchase and sale of future property interests, a very large enrichment to either party would be wholly defensible if it arose from risks inherent in the purchase and sale of property, for example an unexpected rise in land values after the date of the contract. The allocation of that risk is the very nature of the contract, and the buyer takes a corresponding risk of a fall in values: general contractual principles give strong support for enforcement even if there is a substantial enrichment to the buyer. The buyer, in that case, would simply have made a profitable and legitimate bargain. But, if the real substance of the transaction is a loan, the court will compare the net effect of the transaction with the terms on which money could be borrowed in a fair market for the lending of money, and will not allow the lender to extract what is, in effect, an extravagant rate of interest. The point was made in an 18th-century case:

An annuity may be purchased at as low a rate as you can, provided it was the original negotiation to purchase and sell an annuity: but if the treaty began about borrowing and lending, and ends in the purchase of an annuity, it is evident, that it was only a method or contrivance to split the payment of the principal and usurious interest into several instalments, and consequently that it was a shift... So, in the sale of goods or merchandise it is lawful to sell as dear as you can, on a clear bargain by the way of sale: but if it is first proposed to borrow, and afterwards to sell goods beyond the market price, this is usurious.31

Another interesting phrase is in the closing words of 7:208, allowing avoidance of a contract induced by a third party “if the [other contracting] party... at the time of avoidance has not acted on the contract,” even if that party had no means of knowledge of the relevant facts. This phrase recognizes a distinction between what Anglo-Canadian lawyers might call the “expectation interest” and the “reliance interest.” The party seeking enforcement may be deprived of the right of full enforcement unless there has been reliance. It must follow that if there has been limited reliance the disadvantaged party may escape the consequences of full enforcement on compensation of the other party’s reliance, for it can scarcely be a working legal rule that a million-dollar transaction becomes fully enforceable because the party seeking enforcement has incurred the cost of a postage stamp. Where the weaker party has, by his or her own foolishness, caused actual out of pocket loss, there is a strong argument for requiring the weaker party, as a condition of relief, to reimburse the other party’s actual

loss. But this concept does not support full enforcement of the stronger party's expectation interest. The distinction corresponds to that made in some old cases, where the weaker party was successful in setting aside the impugned transaction, but was required to pay the other party's costs, and suggests that a choice of "all or nothing" is not always necessary or desirable. The fact that these provisions have been included in a draft to which European civil and common lawyers have both contributed strongly suggests that it is no less important now than it was 250 years ago to avoid transactions that would "ruin the distressed and unwary, and give unconscionable advantage to greedy and designing persons." 32

One method of denying validity to burdensome clauses has been by concluding that there has been insufficient assent to the clause. Formerly it was taken to be the law that signature was conclusive evidence of assent, but in *Tilden Rent-a-Car Co. v. Clendenning*, 33 a burdensome clause was invalidated by the Ontario Court of Appeal even though the clause was contained in a signed document. Professor Grammond discusses this case in his paper. As he rightly says, the case depends primarily on the concept of lack of assent, but, as he also points out, the burdensome nature of the clause was plainly also influential. The Draft Common Frame of Reference lays down a very similar rule:

II. – 9:103: Terms not individually negotiated

(1) Terms supplied by one party and not individually negotiated may be invoked against the other party only if the other party was aware of them, or if the party supplying the terms took reasonable steps to draw the other party's attention to them, before or when the contract was concluded.

(3) . . .

(b) terms are not sufficiently brought to the other party's attention by a mere reference to them in a contract document, even if that party signs the document.

In the mid-20th century a technique developed for the control of clauses limiting liability (disclaimer, exemption, or exclusion

32. See *Spurgeon v. Collier*, supra, footnote 8, above.

The concept, largely developed by Lord Denning,\(^{34}\), was that a disclaimer clause could not be enforced if there had been a fundamental breach (or breach of a fundamental term). The concept suffered from lack of clarity as to whether it rested on interpretation, or on an overriding rule of law, and it failed to distinguish between consumer and non-consumer contracts, or between fair and unfair clauses. Largely for these reasons it was rejected by the House of Lords, first in 1966,\(^{35}\), and then, definitively, in 1979.\(^{36}\) These House of Lords cases were approved in Canada,\(^{37}\), but uncertainty remained after Hunter Engineering Co. v. Syncrude Canada Ltd.\(^{38}\), in which two judges of the Supreme Court of Canada held that the test of validity was unconscionability, and two others held that the test was whether it would be unfair or unreasonable to give effect to a disclaimer clause. The doctrine of fundamental breach was finally, it would seem, laid to rest in Tercon Contractors Ltd. v. British Columbia (Ministry of Transportation and Highways),\(^{39}\), where Cromwell J. said, for the majority:

On the issue of fundamental breach in relation to exclusion clauses, my view is that the time has come to lay this doctrine to rest, as Dickson C.J. was inclined to do more than 20 years ago: Hunter Engineering Co. v. Syncrude Canada Ltd. . . . I agree with the analytical approach that should be followed when tackling an issue relating to the applicability of an exclusion clause set out by my colleague Binnie J.\(^{40}\)

Binnie J., stating the view of the whole court on this point, said that

On this occasion we should again attempt to shut the coffin on the jargon associated with “fundamental breach”. Categorizing a contract breach as “fundamental” or “immense” or “colossal” is not particularly helpful. Rather, the principle is that a court has no discretion to refuse to enforce a valid and applicable contractual exclusion clause unless the plaintiff . . . can point to some paramount consideration of public policy sufficient to override the


\(^{40}\) Id., at para. 62.
public interest in freedom of contract and defeat what would otherwise be the contractual rights of the parties. . . . There is nothing inherently unreasonable about exclusion clauses. 41

The approach now approved by the Supreme Court of Canada is first to interpret the clause (the question on which the court divided in the Tercon case). Then, "[i]f the exclusion clause applies, the second issue is whether the exclusion clause was unconscionable at the time the contract was made, 'as might arise from situations of unequal bargaining power between the parties'. . . ." 42 If the clause is applicable and valid on these tests, it should be enforced unless contrary to an overriding public policy. 43 This decision marks a definitive preference for Dickson C.J.C.'s view in Hunter: the nature of a breach may be relevant to the interpretation of an exclusion clause, but, no matter how grave the breach, there is no rule of law that clauses limiting or excluding liability are invalid, provided that they are not grossly unfair (unconscionable) at the time of the agreement, and that they do not contravene an overriding public policy. The decision is also significant in its recognition of unconscionability as an independent ground for setting aside very unfair contracts, and the implication of this is not only that exemption clauses may be enforceable if not unconscionable, but that other kinds of unfair clauses may be disallowed if they are unconscionable. 44

The Draft Common Frame of Reference includes, in addition to the general provision already mentioned on "unfair exploitation," quite detailed provisions on "unfair terms," distinguishing three classes of contract, namely, those between a business and a consumer, those between non-business parties, and those between businesses. In a business/consumer contract a term is unfair "if it has been supplied by the business and if it significantly disadvantages the consumer contrary to good faith and fair dealing." In a later section there is a long list of terms presumed to be unfair in business/consumer contracts. In a contract where neither party is a business, a term is unfair "only if it is a term

41. Id., at para. 82.
42. Id., para. 122, quoting from Hunter, at p. 462.
43. Id., para. 123. See para. 119, referring to Plas-Tex Canada Ltd. v. Dow Chemical of Canada Ltd. (2004), 245 D.L.R. (4th) 650, 2004 ABCA 309, leave to appeal to S.C.C. refused 250 D.L.R. (4th) vii, [2005] I S.C.R. ix, where the defendant was found to have engaged in deceptive conduct. Another example given of overriding public policy was selling products known to be dangerous to life.
forming part of standard terms supplied by one party and significantly disadvantages the other party contrary to good faith and fair dealing.” In case of contracts between businesses a term is unfair “only if it is a term forming part of standard terms supplied by one party and of such a nature that its use grossly deviates from good commercial practice, contrary to good faith and fair dealing.”

Unconscionability, as a general concept for dealing with unfair contract terms, has certain merits, but also certain drawbacks. It has the advantages of being a concept applicable to all kinds of contract, while indicating, by implication, that its application must be highly exceptional. On the other hand, the word has certain disadvantages. It has sometimes been taken to suggest wrongdoing, but many cases, old and modern, have held that proof of wrongdoing is not a requirement for relief, and it is implied by Tercon that the clause might have been found to be unconscionable without any proof of independent wrongdoing on the part of the government. The cases on penalty clauses and exemption clauses have never involved any wrongdoing on the part of the party seeking enforcement. Another difficulty is that unconscionability suggests the need to prove inequality of bargaining power, but in some kinds of case, including relief against penalty clauses, inequality of bargaining power, in the ordinary sense of the words, has not always been required. A simpler general concept, therefore, and a useful synonym for unconscionability may be unfairness: a contract may be set aside if it produces consequences that are very unfair. Such a general concept is capable of recognizing distinctions, such as those made in the Draft Common Frame of Reference, between business and consumer contracts, and between standard forms and terms individually negotiated.

45. DCFR, II-9: 401-410.
48. Independent, that is, of the insertion of a clause enforcement of which is subsequently determined to be unconscionable.
The Québec concept of "abusive clauses" discussed by Professor Grammond offers an interesting alternative approach. There has been occasional support in Anglo-Canadian law for the concept of "abuse" as a limit on contractual rights. Denning L.J. said, in 1949, that "there is the vigilance of the common law which, while allowing freedom of contract, watches to see that it is not abused."\footnote{John Lee & Son (Grantham) Ltd. v. Railway Executive, [1949] 2 All E.R. 581 at p. 584, 65 T.L.R. 604 (C.A.).} Professor Ernest Weinrib has favoured the concept of "abuse of rights" as a limit on the exercise of contractual remedies.\footnote{Ernest Weinrib, "Two Conceptions of Remedies," in Charles E.F. Rickett, ed., Justifying Private Law Remedies (Oxford, Hart Publishing, 2008), p. 3.} On the other hand, there would be some conceptual difficulty in importing the concept of abuse of rights into Anglo-Canadian contract law, in that it might seem that a right that cannot be exercised in certain circumstances is something less than a right in the usual sense. A search for precision would seem to require a redefinition of the right itself, rather than a general judicial power which might seem to make the enforcement of all rights discretionary. Lord Reid made substantially this point in 1961 in a Scottish case, recognizing no distinction between Scottish and English law on this point:

> It might be, but it never has been, the law that a person is only entitled to enforce his contractual rights in a reasonable way, and that a court will not support an attempt to enforce them in an unreasonable way. One reason why that is not the law is, no doubt, because it was thought that it would create too much uncertainty to require the court to decide whether it is reasonable or equitable to allow a party to enforce his full rights under a contract.\footnote{White and Carter (Councils) Ltd. v. McGregor, [1962] 1 A.C. 413 at p. 430, [1961] 3 All E.R. 1178 (H.L., Sc.).}

On the other hand, there would be certain attractions in recognizing something like a discretionary power in a judge of first instance, perhaps restricted to consumer transactions and standard form contracts, to set aside unfair clauses, without the necessity for elaborate reasons likely to set precedents for future cases, thereby causing alarm in the corridors of businesses and of their legal advisers, inviting inconclusive and repetitive appeals to the appellate courts.

A concept sometimes associated with abuse of rights is good faith, to which reference has been made by Professor Grammond. The phrase occurs frequently in the Draft Common Frame of Reference, as appears from some of the earlier quotations. The
concept of good faith, though not itself described as an underlying principle, is discussed in the Draft Common Frame of Reference as part of the underlying principle of “justice,” with the sub-headings “Not allowing people to rely on their own unlawful, dishonest or unreasonable conduct,” “No taking of undue advantage,” and “No grossly excessive demands.” These sub-headings indicate that considerations of policy, in the sense of what were thought to be desirable standards of behaviour, were not absent from the minds of the drafters. The Draft Common Frame of Reference includes a duty of good faith, and in a note to the relevant article the drafters comment that, although England and Ireland do not recognize a general obligation to conform to good faith and fair dealing.

many of the results which in other legal systems are achieved by requiring good faith have been reached in England and Ireland by more specific rules . . . Thus to some extent [the present Article] merely articulates trends already present in English law. But the English approach based on construction of the agreement is a weak one as it cannot prevail against clear contrary provisions in the agreement . . . Thus [the Article] represents an advance on English and Irish law.

This passage, it may be observed, shows some indications of committee drafting, and some indications of wishful thinking. Inconsistent lines of thought can be discerned: this Article will make no substantial difference to English law; or not very much; in any event the trends are in this direction; at least they should be in this direction if English law is to advance.

The object of this observation is not to criticize the drafters. From their point of view harmonization was, understandably, an overriding objective, and this could not have been achieved without including some provision on good faith because all European countries except England and Ireland recognized some version of it. But the Notes point out that there is a considerable variation among the civil law jurisdictions as to the meaning and significance of good faith, and to the prominence of its role. It is likely, therefore, that, if the Draft Common Frame of Reference were adopted in Anglo-Canadian law, different meanings of “good faith” would emerge in different contexts.

55. Ibid.
Good faith is a concept that has been used in different senses to address several distinct questions in contract law. These questions include, among others: whether pre-contractual negotiations can be broken off; whether material facts known to one party must be disclosed to the other in pre-contractual negotiations; whether contracts are enforceable if induced by misrepresentation or mistake; whether and to what extent the courts should imply terms into contracts; whether terms that are very unfair can be enforced; whether non-performance by one party excuses the other; whether deliberate breaches of contract justify punitive damages; and whether the exercise of contractual rights may in some circumstances be restrained or precluded. The concept of good faith, as applied to these various problems, necessarily varies substantially in meaning and significance, and for that reason it is not possible to assign a single meaning to the concept, nor is it plausible to call “good faith,” when applied to such disparate questions, a single principle. The phrase suggests disapproval of selfish motives, but selfish motives could not, in all contractual disputes, be conclusive against a party entertaining them; nor could pure unselfish motives in themselves enlarge contractual rights, or excuse a party who was actually in breach of a contractual obligation. Neither could the motives of either party be conclusive on the question of whether contractual terms were unfair. It may seem attractive, or innocuous, to embrace an overriding principle of good faith, but the effect of doing so on the scope of contractual rights and obligations would be far from clear: a contractual right that could only be exercised for unselfish reasons would, to the extent that it could not be exercised, lack the usual characteristics of a “right.”

It would, indeed, be possible to conceive of the whole of contract law as the embodiment of the idea of good faith. Frederick Pollock wrote in the third edition of his treatise in 1881, and repeated in subsequent editions, that

the law of Contract is in truth nothing else than the endeavour of the sovereign power, a more or less imperfect one by the nature of the case, to establish a positive sanction for the expectation of good faith which has grown up in the mutual dealings of men of average right-mindedness.56

Evidently Pollock was thinking of good faith primarily as supplying a reason for enforcement of promises, not as a limit

on enforcement. He meant that the rules of contract law, taken as a whole, themselves reflected the community's sense of what good faith required — an idea that Pollock came to associate with protection of reasonable expectations — not that good faith should be deployed to modify or displace the actual rules of English contract law: a contracting party must defer to the other party's interests insofar, but only insofar, as the contract requires him or her to do so. Whether as a reason for enforcement or as a limit on enforcement, the adoption of good faith as a general principle could not eliminate the need for particular rules in the various contexts in which it has been invoked, and, as suggested, it seems probable that such particular rules would develop in Anglo-Canadian law if the Draft Common Frame of Reference were adopted, or if a general concept of good faith were adopted from another source.  

The phrase "implied term" has been used in contract law with several different meanings. Sometimes it means what the parties actually agreed; sometimes what they would probably have agreed if they had contemplated the issue that has arisen; very often it means what reasonable persons would have agreed if they had contemplated the issue in question. The meanings have overlapped in application because it is easy to presume that contracting parties intend what is reasonable, and this presumption creates a convenient correspondence between the intention of the parties and the justice of the result.

The last meaning (what reasonable persons would have agreed) necessarily imports the court's own sense of justice, for a writer (court or commentator) of course attributes to hypothetical reasonable persons an agreement that leads to a fair, just, and reasonable result. This approach has been used to avoid unfair results, by introducing implied terms to the effect that, despite appearances, the parties cannot truly have intended to agree to anything that would lead to a very unequal exchange. The approach has also been employed in order to relieve against the effects of mistake and of unexpected changes in circumstances. The attraction of this approach is that both kinds of problem (unfairness and mistake) can be resolved without apparently departing from an application of the parties' intention. But the appearance is, in the end, illusory, because the court necessarily

57. See also Waddams, "Good Faith, Unconscionability, and Reasonable Expectations" (1995), 9 J.C.L. 55.
58. Leaving aside, in the present discussion, terms "implied by law."
imports its own view of what is fair and just in the circumstances. Lord Wright wrote, in 1939, that “the judge finds in himself the criteria of what is reasonable. The Court is in this sense making a contract for the parties — though it is almost blasphemy to say so.”59 In a recent case another English judge, recognizing that the court’s power to imply terms goes beyond what is strictly “necessary,” said that “questions of reasonableness, fairness and the balancing of competing policy consideration” are more important than “the elusive standard of necessity.”60

It is true to say that, as the drafters of the Draft Common Frame of Reference suggested, Anglo-Canadian law has, by implying terms and by other techniques of interpretation, often reached the same results as would, in other systems, be reached by application of concepts of good faith, or of “good faith and fair dealing.”61 Implied terms, however, are in one sense wider, and in another sense narrower than what is suggested by the phrase “good faith.” Absence of good faith, in any ordinary sense of the words, is not a requirement for implication of a term, and the presence of good faith is not a defence to an action for breach of an implied term. A party’s belief, no matter how honest and reasonable, that he or she is not bound by a particular obligation is wholly irrelevant if the court finds that the obligation has, as a matter of law, been incurred. The Supreme Court of Canada made this point in a case in which a term had been implied into an invitation for tenders for a construction project, with the result that the defendant was held liable to an unsuccessful tenderer for accepting a non-compliant bid. The defendant claimed that it had acted in perfect good faith, honestly believing that it had no such obligation to unsuccessful tenderers, and there is no need to doubt this claim, since it was quite reasonable as the law had formerly stood. But the claim was rejected:

The respondent’s argument of good faith in considering the . . . bid to be compliant is no defence to a claim for breach of contract: it amounts to an argument that because it thought it had interpreted the contract properly it cannot be in breach. Acting in good faith or thinking that one has interpreted the contract correctly are not valid defences to an action for breach of contract.62

61. The phrase “good faith and fair dealing” appears in the Second Restatement of Contracts (1979), s. 205, referring to the Uniform Commercial Code, 1-201(19) and 2-103(1)(b), and in the Draft Common Frame of Reference, III – 1:103.
It is only by giving a very special meaning to the phrase that the result in this case, or the results in many other cases of implied terms, could be said to depend on "good faith."

Canadian courts have used the phrase "good faith" with approval in various contexts, but the Ontario Court of Appeal, sounding a note of caution, has indicated both the limitations of the concept of good faith, and its proper scope:

... Canadian courts have not recognized a stand-alone duty of good faith that is independent from the terms expressed in a contract or from the objectives that emerge from those provisions. The implication of a duty of good faith has not gone so far as to create new, unbargained-for, rights and obligations. Nor has it been used to alter the express terms of the contract reached by the parties. Rather, courts have implied a duty of good faith with a view to securing the performance and enforcement of the contract made by the parties, or as it is sometimes put, to ensure that parties do not act in a way that eviscerates or defeats the objectives of the agreement that they have entered into...  

Good faith has thus been accepted as a useful tool of interpretation, as a relevant, though not conclusive test in precontractual negotiations, and it has sometimes been used to summarize the power of the court, discussed earlier in this paper, to set aside agreements for unconscionability, or unfairness. But it has not been generally accepted as empowering courts to override the provisions of a fair and reasonable agreement properly interpreted, or to create obligations that cannot be derived from the parties' actual agreement. Good faith has an important role in determining the extent of contractual obligations, but it is not a substitute for the concept of unfairness, and it cannot be accepted as a carte blanche for the creation or dissolution of contractual obligations without further reasoning. Another aspect of the matter is that good faith might be categorized (though

inappropriately, in my view)\(^{65}\) as a question of fact, and so largely immune from appellate review, and a question exclusively for the jury where there is a jury trial.

\(^{65}\) What a person does, says, and thinks are questions of fact, but whether a sequence of actions and thoughts should be categorized as “bad faith” for legal purposes must, if it is conclusive of a legal outcome, be a question of law. It seems doubtful that Anglo-Canadian commercial law would benefit, in respect of ordinary commercial transactions, from an increase in the unreviewable powers of trial judges to add to or subtract from contractual obligations, or from the creation of further incentives to seek jury trials in the resolution of contractual disputes.
# TABLE OF CONTENTS

**EDITORIAL** ............................................................... 185

**ARTICLES AND SYMPOSIA**

On Polyphony and Paradoxes in the Regulation of Securities Within the Canadian Federation  
*Noura Karazivan and Jean-François Gaudreault-DesBiens* ........ 1

The Late, But Welcome, Arrival of a New Federal Not-for-Profit Corporations Law  
*Wayne D. Gray* .......................................................... 40

Subordination Agreements, Bankruptcy and the PPSA  
*Roderick J. Wood* ..................................................... 66

*Tercon Contractors*: The Effect of Exclusion Clauses on the Tendering Process  
*Jassmine Girgis* ......................................................... 187

Small Claims Court Identity Crisis: A Review of Recent Reform Measures  
*Shelley McGill* .......................................................... 213

The Regulation of Abusive or Unconscionable Clauses from a Comparative Law Perspective  
*Sébastien Grammond* ................................................... 345

Abusive or Unconscionable Clauses from a Common Law Perspective  
*Stephen Waddams* ....................................................... 378

*Joost Blom* .............................................................. 400

The Priority Pitfall Problem: The Contest Between Judgment and Secured Creditors in Ontario  
*Brian M. Studniberg* .................................................... 425

**COMMENTARIES**

Solidarity, Unconscionability and Enforcement of Union Fines:  
*Birch v. Union of Taxation Employees, Local 70030*  
*Michael Mac Neil* ....................................................... 99

Restrictions on Unilateral Termination of Franchise Agreements  
*Jonathan C. Lisus and Adam Ship* .................................... 113

*Nareerux Import Co. Ltd. v. Canadian Imperial Bank of Commerce*:  
A New Implied Duty of Good Faith for Banks Issuing Letters of Credit?  
*Bradley Crawford, Q.C.* ................................................. 130

Doctrinal Reform and Post-Contractual Modifications in New Brunswick: *Nav Canada v. Greater Fredericton Airport Authority Inc.*  
*Rick Bigwood* ............................................................ 256
Insurance Salvage Rights and the PPSA
Anthony Duggan ........................................... 278

Part Payment, Promissory Estoppel and Lord Denning's
"Brilliant" Balance
M.H. Ogilvie .................................................. 287

Fundamental Breach is Dead; Or is it? Tercon Contractors Ltd.
v. British Columbia (Transportation and Highways)
Angela Swan and Jakub Adamski. ........................................... 452

Dead Man Walking? Malamas v. Crear Properties Corp. Affirms
a Dissolved Corporation's Right to Defend Itself
Ray Thapar and Ronald Podolny ........................................... 465

REVIEW ESSAYS AND BOOK REVIEWS
Critical Moments and Turning Points in Law, Development
and Corporate Governance
Gil Lan ........................................................ 146

The Little Book of Plagiarism, by Richard A. Posner
(Mark Perry) ................................................ 166

Financial Institutions: The Regulatory Framework, by
Christopher C. Nieholls
(James C. Baillie) ........................................... 175

Agreements on Jurisdiction and Choice of Law, by
Adrian Briggs
(Vaughan Black) ........................................... 300

Antitrust and Global Capitalism 1930-2004, by
Tony A. Freyer
(Peter Carstensen) ........................................... 309

Economic Interests in Canadian Tort Law, by
Peter T. Burns and Joost Blom
(Hazel Carty) ........................................... 323

Democratizing Pension Funds: Corporate Governance and
Accountability, by Ronald B. Davis
(Freya Kodar) ........................................... 327

Corporate Social Responsibility: A Legal Analysis, by Michael
Keir, Richard Janda and Chip Pitts
(Sara L. Seck) ........................................... 335

Cross-Border Litigation: Interjurisdictional Practice and Procedure,
by Kenneth C. MacDonald
(Joost Blom) ........................................... 472

Mistakes in Contract Law, by Catharine MacMillan
(David Capper) ........................................... 476

Proprietary Rights and Insolvency, by Richard Calnan
(Anthony Duggan) ........................................... 483

Canadian Bankruptcy and Insolvency Law: Cases, Text and
Materials, by A. Duggan, S. Ben-Ishai, T.G.W. Telfer, J.S.
Ziegel and R. Wood
(Geoffrey B. Morawetz) ........................................... 492
<table>
<thead>
<tr>
<th>Title</th>
<th>Authors</th>
<th>Pages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eligible Financial Contracts: A Legal Analysis</td>
<td>Martin Marcone (Christopher C. Nicholls)</td>
<td>496</td>
</tr>
<tr>
<td>Conflict of Laws</td>
<td>Stephen G.A. Pitel and Nicholas S. Rafferty (Janet Walker)</td>
<td>502</td>
</tr>
<tr>
<td>LETTER TO THE EDITOR</td>
<td></td>
<td>343</td>
</tr>
</tbody>
</table>