REPORT

ON

AMENDMENT OF THE LAW OF CONTRACT

ONTARIO LAW REFORM COMMISSION

Ministry of the
Attorney
General

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The Ontario Law Reform Commission was established by the *Ontario Law Reform Commission Act* for the purpose of reforming the law, legal procedures, and legal institutions. The Commissioners are:

James R. Breithaupt, CStJ, CD, QC, MA, LLB, *Chairman*

H. Allan Leal, OC, QC, LLM, LLD, DCL, *Vice Chairman*

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*Mr. Earl A. Cherniak, QC, Dean J. Robert S. Prichard, and Mrs. Margaret A. Ross joined the Commission at a time when this Report was very near completion and almost all the recommendations had been made.

The Commission wishes to acknowledge the critical contribution of three former Commissioners: Hon. Richard A. Bell, PC, QC, Mr. William R. Poole, QC, and Mr. Barry A. Percival, QC, whose tenure at the Commission extended through most of this Project.

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Ontario
Law Reform
Commission

The Honourable Ian G. Scott, QC
Attorney General for Ontario

Dear Mr. Attorney:

We have the honour to submit herewith our *Report on Amendment of the Law of Contract.*

CHAPTER 1

INTRODUCTION

The present project arose directly from our project on the Sale of Goods, completed in 1979.[1] It became clear, in the course of that project, that a number of problems affected contract law generally, and insofar as reforms were recommended in the sales area, the question was bound to arise of the extension of them to all contracts. Accordingly, we determined to make a study of selected aspects of the law of contracts.

It was decided at the outset that no attempt would be made to codify the whole law of contracts. This was a task that had been undertaken by the English and Scottish Law Commissions, but subsequently abandoned.[2] No other common law jurisdiction has made the attempt. Codification would raise very great difficulties which we did not think could be overcome. The approach adopted was, therefore, to examine areas of contract law that appeared to be in need of reform.

We appointed Professors S.M. Waddams and J.S. Ziegel, both of the University of Toronto, as joint Project Directors, and they were responsible for the research design and for advising the Commission. A Research Team was also struck, consisting of Professor E. Belobaba of York University, Professor G.H.L. Fridman of the University of Western Ontario, the late Professor R.H. Hahlo of the University of Toronto, Professor J.D. McCamus of York University, Professor D.J. Mullan of Queen's University, Mr. B. Reiter, then professor at the University of Toronto, Professor Saul Schwartz of the University of Ottawa, Professor R.J. Sharpe of the University of Toronto, Professor D.A. Soberman of Queen's University, and Professor J. Swan of the University of Toronto. These individuals prepared a number of comprehensive research papers which were considered at meetings of the Research Team and formed the basis of subsequent recommendations from the joint Project Directors to the Commission. The joint Project Directors also had the benefit of advice on some of the research topics from a small Advisory Group of practising lawyers and judges, including Mr. David A. Brown, Q.C., His Honour Judge G.S.P. Ferguson, Mr. R.K. McDermott, the Hon. Mr. Justice J. Morden, Mr. Donald G. Pierce, Q.C., Mr. Richard B. Potter, Q.C., Mr. James M. Spence, Q.C., and Mr. David Stockwood, Q.C.

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[1] Ontario Law Reform Commission, *Report on Sale of Goods* (1979).

[2] England, The Law Commission, Report No. 58, *Eighth Annual Report 1972-73*, paras. 3-5, and Scottish Law Commission, Report No. 28, *Seventh Annual Report 1971-72*, para. 16.

To the joint Project Directors, the Research Team and the Advisory Group we wish to express our sincere appreciation for their devoted labours, while making it clear that the recommendations appearing in this Report are those of the Commission and do not necessarily reflect the views of all these parties. We also wish to thank Ms. Patricia Richardson, Counsel to the Commission, Mr. Eric Gertner, formerly a Legal Research Officer with the Commission, Ms. Marilyn Leitman, a Legal Research Officer with the Commission, and Mr. John Calcott and Ms. Cheryl Waldrum, former members of the contractual legal staff, for their contribution to the writing and editing of the Report.

The research papers to which we have referred cover the following topics: consideration, third party beneficiaries, the *Statute of Frauds*, the seal, comparative aspects of consideration, unconscionability, mistake and frustration, penalty clauses, illegality, misrepresentation, minors' contracts, good faith, damages, equitable remedies, and waiver of conditions. In the cases of damages and equitable remedies we concluded that legislative reforms would be unlikely to improve the law and, accordingly, these topics are not included in our Report. The questions examined in this Report vary greatly from the very general to the very particular, and from the highly complex to the comparatively simple. In some cases much previous academic work has been done; in others very little. On some questions other law reform bodies have reported; on others, not.

There has been much discussion in recent years among scholars about the basis and goals of modern contract law. We ourselves have not approached our task with any preconceptions about the right solutions to particular contract problems, preferring instead to deal with each issue on its own merits and in the light of its own history. It could hardly have been otherwise, given the wide diversity of the topics and the widely differing backgrounds of the Commissioners considering the questions. Insofar as a common thread runs throughout our recommendations, it is that certainty is not the only important value in contract law and that frequently it must be matched by flexibility in devising appropriate solutions where past doctrines have proved too rigid or, in some cases, have become obsolete, or where public policy militates against enforcement of all the terms of a bargain.

Contract law touches every phase of the economy of a modern state. It embraces every conceivable type of commercial transaction from the smallest to the most significant. Fortunately, the overwhelming majority of contracts are completed successfully and without argument. Nevertheless, it remains of the first importance that those who are called upon to advise in the drafting of contracts, or to advise when difficulties have erupted between the parties, should know what the law is, and that the legal rules have a rational foundation and command general respect.

The principles of contract law, like the principles of many other branches of Ontario law, are largely judge made. We think it right that this should continue to be the case. However, there are important branches of contract law where the rules have ceased to keep pace with changing needs and perceptions and where remedial legislation is a more certain cure than the unpredictable and

uneven path of judicial self-correction. In other cases, where the rules are of statutory origin, the courts are in any event powerless to make the desirable changes.

We venture to express the hope therefore that the legislative changes recommended in this Report will receive the early study and attention that, in our view, they deserve.

CHAPTER 2

CONSIDERATION

1. INTRODUCTION

Every legal system must have a criterion, or a set of criteria, for determining the enforceability of promises. The principal criterion of enforceability in Anglo-Canadian law is the bargain. Promises that are bargained for are *prima facie* enforceable. The name given to the exchange element in a bargain is consideration.

Promises may also be enforceable at common law, notwithstanding lack of consideration, if made under seal. We return to the law of formal contracts in the next chapter, where we recommend that a witnessed and signed promise in writing should be enforceable without the requirement of a seal.[1] We mention this in the present context because a complete view of enforceability must include the law of formal contracts.

It should be noted that the presence of consideration and compliance with any applicable formalities do not of themselves guarantee enforceability; they simply certify that the promise in question is *prima facie* enforceable. Thus, it is always open to the promisor to raise such defences as mistake, illegality, unconscionability, incapacity, and non-performance of conditions. Defences of this kind are necessary qualifications to any criterion of enforceability.

2. THE PRESENT LAW AND THE CASE FOR REFORM

Originally, consideration seems to have meant the promisor's reason or motive for making the promise. This meaning survives in certain legal phrases, such as "in consideration of natural love and affection". In 1671, consideration was defined as "the material cause of a contract without which no contract can bind the party".[2] By the mid-nineteenth century, however, the modern, and narrower, meaning of consideration was established. In *Thomas v. Thomas*[3], a promise had been made by executors to give effect to an orally expressed desire of a recently deceased person to benefit the plaintiff. The promise was said to be

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[1] *Infra*, ch. 3, sec. 4(a).

[2] *Termes de la Ley* (1671), at 171.

[3] (1842), 2 Q.B. 851, 114 E.R. 330 (subsequent reference is to 2 Q.B.).

"in consideration of such desire". Patteson J.'s comment reveals that the narrower meaning of consideration had by this date become established:[4]

> Motive is not the same thing with consideration. Consideration means something which is of some value in the eye of the law, moving from the plaintiff ....

The growth of modern contract law was closely linked with the developing needs of a commercial society. Since the typical commercial transaction is a bargain, there was good reason for adopting the bargain transaction as the principal test of enforceability. Furthermore, the doctrine of consideration is intimately linked with the remedies available for breach of contract. The disappointed promisee is entitled either to enforce the promise specifically (where specific performance is an available remedy), or to recover a sum of money equivalent to the value of the promised performance. It is, at least in part, because the promisee has bargained for and bought the right to performance — in other words because the promisee has given consideration — that he or she is entitled to the remedies that the current law allows. Any radical enlargement of enforceability would require a review of the scope of the promisee's remedies.[5]

Nevertheless, asserting that, formal contracts aside, consideration is an absolute prerequisite to enforceability has given rise to difficulties. The cases that have generated serious difficulties fall into at least four classes: first, one-sided modifications of existing obligations; secondly, promises made in return for benefits previously received by the promisor or by a third party; thirdly, firm offers; and fourthly, cases of subsequent reliance. Each of these classes of case will be discussed below.[6] In all these cases, the promise is not bargained for, that is, there is no consideration. Difficulties arise because these are promises that, in some circumstances and to some extent at least, most persons would say ought to be enforced.

As almost invariably happens when a legal doctrine stands in the way of results generally thought to be just, courts have developed devices to circumvent the doctrine of consideration, and legislatures have intervened to alter it in particular circumstances in Ontario and in the other common law provinces. Thus, legislation provides that acceptance of part performance in satisfaction of a larger obligation extinguishes the obligation.[7] The courts have constructed an

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[4] *Ibid.*, at 859. In the latter part of the eighteenth century (see *Pillans v. Van Mierop* (1765), 3 Burr. 1663, 97 E.R. 1035), Lord Mansfield attempted to revive a broader view of consideration, but this "heresy" was rejected by Lord Denman in *Eastwood v. Kenyon* (1840), 11 A. & E. 438, 113 E.R. 482 (subsequent references are to 113 E.R.).

[5] See *infra*, this ch., sec. 4(d), for discussion of a limited measure of damages where a promise made without consideration is enforced by reason of subsequent reliance.

[6] See *infra*, this ch., sec. 4.

[7] See, for example, *Mercantile Law Amendment Act*, R.S.O. 1980, c. 265, s. 16.

exchange element even where the facts do not readily suggest one.[8] Reliance on promises and representations has been protected by devices such as estoppel,[9] liability in tort for misrepresentation,[10] and liability for the negligent performance of gratuitous undertakings.[11]

The scope of the legislation dealing with part performance of obligations, however, is so narrow as to create its own anomalies.[12] In addition, the various judicial techniques for enforcing promises unsupported by consideration are not applied consistently, so that similar cases may receive dissimilar treatment.[13] Nor are the devices for protecting reliance interests wholly satisfactory. Not every promise that could reasonably have been expected to induce reliance, and that in fact does so, will give rise to a remedy. Moreover, the scope of estoppel in this context is uncertain. Some cases suggest that it can only be used as a defence while others hold that it can operate to give a cause of action to a plaintiff.[14] For these reasons, the Commission favours some legislative enlargement and clarification of the scope of enforceable promises.

3. THE APPROACH TO REFORM

It has sometimes been suggested that the doctrine of consideration should be abolished "root and branch".[15] In support of this proposal, it may be said that civil systems of law have managed satisfactorily without such a doctrine.

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[8] *Bank of Nova Scotia v. MacLellan* (1977), 78 D.L.R. (3d) 1, 25 N.S.R. (2d) 181 (S.C., App. Div.). The defendant's cooperation in locating her spouse was sufficient consideration for an agreement to accept one-quarter of her indebtedness to the plaintiff in satisfaction of the whole amount.

[9] *Crabb v. Arun District Council*, [1976] Ch. 179, [1975] 3 W.L.R. 847 (C.A.) (subsequent reference is to [1976] Ch.), and *Owen Sound Public Library Board v. Mial Developments Ltd.* (1979), 26 O.R. (2d) 459, 102 D.L.R. (3d) 685 (C.A.).

[10] *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*, [1964] A.C. 465, [1963] 3 W.L.R. 101 (H.L.), and *Haig v. Bamford*, [1977] 1 S.C.R. 466, 72 D.L.R. (3d) 68.

[11] *Baxter & Co. v. Jones* (1903), 6 O.L.R. 360 (C.A.).

[12] See *infra*, this ch., sec. 4(a)(i).

[13] See Reiter, "Courts, Consideration, and Common Sense" (1977), 27 U. Toronto L.J. 439, and Swan, "Consideration and the Reasons for Enforcing Contracts", in Reiter and Swan (eds.), *Studies in Contract Law* (1980) 23, at 39-40.

[14] Compare *Gilbert Steel Ltd. v. University Construction Ltd.* (1976), 12 O.R. (2d) 19, at 23, 67 D.L.R. (3d) 606, at 610 (C.A.) (subsequent references are to 12 O.R.), with *Owen Sound Public Library Board v. Mial Developements Ltd.*, *supra*, note 9. See, also, the comments of Lord Denning M.R. in *Crabb v. Arun District Council*, *supra*, note 9, at 187.

[15] See England, Law Revision Committee, *Sixth Interim Report (Statute of Frauds and the Doctrine of Consideration)* (Cmd. 5449, 1937) (hereinafter referred to as *"Sixth Interim Report"*). The Committee, however, rejected abolition on the ground that the doctrine was too deeply embedded in English law.

Our ability to examine civil systems is obviously limited, and we recognize the difficulties and dangers of drawing superficial conclusions from apparent rules in other legal systems. Without an intimate knowledge of the system in question, it is easy to be led astray. The information available to the Commission indicates that many civil systems, though they do not have a doctrine of consideration as such, do have a rule that requires gift promises to comply with special formalities, such as notarization. They also admit of special defences, such as ingratitude and financial adversity. Some civil systems also have a requirement of "serious intention". So far as we know, there is no legal system that enforces *all* promises.

In our opinion, it would be unwise to import into our law what would amount to a wholly new and unfamiliar framework for determining the enforceability of promises. The consequences would be decades of uncertainty, and, possibly, diminution rather than enlargement of enforceability. For example, it is not obvious that a requirement of "serious intention" would guarantee enforceability of all exchange transactions. A distinction between "gift promises" and other promises, while perhaps not corresponding precisely to the present test of consideration, would likely raise just as many difficulties in practice. Strict formalities for "gift promises" might reduce the scope of protection currently given to reliance on informal gratuitous promises.

The results of reform are likely to be more predictable, in our opinion, if the current framework of the law is maintained. Where we consider that there is a case for enlarging the scope of enforceability, we think it the most prudent course to recommend legislation providing specifically for such an enlargement. Accordingly, in the following sections, we turn to the specific areas where reform appears to be needed.

4. PROPOSALS FOR REFORM

(a) THE PRE-EXISTING DUTY RULE

The pre-existing duty rule, developed at common law, is to the following effect: where B is already bound by contract with A to render a certain performance, neither the promise by B to perform nor actual performance by B can be consideration for a promise from A in return.[16] In connection with this rule, we shall examine the two main areas of difficulty created by the present doctrine of consideration. The first concerns a very specific but very common problem, namely, the enforceability of an agreement whereby, in return for part performance of an existing obligation, the party to whom the performance is owed agrees to extinguish the obligation. The second problem — which in many ways encompasses the first — deals with modification of contracts in general where the agreement to modify is unsupported by consideration.

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[16] *Stilk v. Myrick* (1809), 2 Camp. 317, 170 E.R. 1168; *Foakes v. Beer* (1884), 9 App. Cas. 605, [1881-85] All E.R. Rep. 106 (H.L.); and *Gilbert Steel Ltd. v. University Construction Ltd.*, *supra*, note 14.

(i) Part Performance and Agreements to Extinguish Existing Obligations

a. Amendment of Section 16 of the Mercantile Law Amendment Act

At common law, the most usual example of the operation of the pre-existing duty rule was the unenforceability of an agreement by a creditor to accept from a debtor partial payment of an outstanding debt as full satisfaction of the obligation owed. The reason the common law adopted this position would appear to be that "[a] promise by the debtor to pay only part of the debt provides no consideration for the accord, as it is merely a promise to perform part of an existing duty owed to the creditor".[17] Moreover, actual payment of the lesser sum would make no difference; the creditor would not be bound by the agreement and could seek full payment of the debt owed.[18] In 1884, the House of Lords, in the well known case of *Foakes v. Beer*,[19] approved the propositions of law just stated.

The Ontario Legislature acted swiftly to reverse what was widely perceived as a commercially untenable position. Only a year later it passed *The Administration of Justice Act, 1885*,[20] section 6 of which sought to overcome the rule in *Foakes v. Beer*. Section 6 of that Act is now section 16 of the *Mercantile Law Amendment Act*,[21] which provides as follows:

> 16. Part performance of an obligation either before or after a breach thereof when expressly accepted by the creditor in satisfaction or rendered in pursuance of an agreement for that purpose, though without any new consideration, shall be held to extinguish the obligation.

While this provision has had the effect of negating the worst effects of the rule in *Foakes v. Beer*, it is not without its own problems. For example, section 16 does not cover an outright forgiveness of an obligation. Moreover, because the section is worded in terms of acceptance of part performance rather than agreement to accept part performance, it is doubtful whether it applies to executory promises, that is, promises that are still to be performed. Thus, there is uncertainty whether and when an obligee, who has agreed to accept part performance in satisfaction of the whole obligation, may revoke the agreement.[22] While the Commission supports the general thrust of section 16, we

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17 Guest *et al.* (eds.), *Chitty on Contracts* (25th ed., 1983), para. 209.

18 *Ibid.*

19 *Supra*, note 16.

20 48 Vict., c. 13 (Ont.).

21 *Supra*, note 7.

22 In *Rommerill v. Gardener* (1962), 35 D.L.R. (2d) 717, 40 W.W.R. 265 (B.C.C.A.) the Court left open the question whether an obligee could terminate at will an agreement for part performance before the agreement had been performed. In *Bank of Commerce v. Jenkins* (1888), 16 O.R. 215 (Comm. Pl.), at 225 the Court suggested that once there was an agreement for part performance it could not be revoked. In *Hoolahan v. Hivon*,

believe that reform of the law is warranted in order to clarify these uncertainties or gaps in the law.

(1) Executory Promises and Outright Forgiveness of a Debt

The basis for the rule in *Foakes v. Beer* is generally agreed to be a concern to protect a creditor "against a debtor who too ruthlessly exploits the tactical advantage of being a potential defendant in litigation".[23] Once it is conceded that this justification for the rule should not prevent an obligee from accepting partial performance in full satisfaction of the obligation owed by the obligor, we can see no compelling reason to prevent the obligee from entering into an enforceable agreement to so modify the obligation. Such agreements are by no means uncommon, and are generally intended to be relied upon. As a matter of commercial reality, consideration theory notwithstanding, such agreements do generally enure to the obligee's benefit, because they encourage a debtor in financial difficulties to pay at least some of the debt, when otherwise he or she might be tempted to walk away from the agreement altogether. Consequently, it runs counter to reasonable expectations for our courts to refuse to enforce them. In our view, section 16 of the *Mercantile Law Amendment Act* should be amended to make it clear that, subject to actual performance, executory agreements to accept part performance in satisfaction of the whole are binding.

Similarly, we would not prevent an obligee from agreeing to forgive the obligation entirely. It may be argued that such forgiveness is equivalent to an unexecuted gift, and so should meet the formalities required to make a gratuitous promise enforceable. But, unlike a gift, forgiveness of an obligation requires no further action, like delivery, to execute it. Moreover, it would be anomalous for the law to permit enforcement of an agreement to discharge a $1000 debt by the payment of one cent, but to render unenforceable a simple promise to forgive the debt.

What is the law on this point in other jurisdictions? The common law rule in *Foakes v. Beer* is still good law in England. Interestingly, the English Law Revision Committee, in its *Sixth Interim Report*, proposed "[t]hat an agreement to accept a *lesser sum* in discharge of an enforceable obligation to pay a larger sum shall be deemed to have been made for valuable consideration".[24] Arguably, forgiveness of a debt would not be covered by this recommendation,

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[1944] 4 D.L.R. 405, [1944] 3 W.W.R. 120 (Alta. S.C., T.D.), the Court held that an agreement for part performance could not be revoked so long as the agreement was being carried out according to its terms. In instances where the obligor fails to perform the agreement for part performance, the original obligation may be revived. See *Udy v. Doan*, [1940] 2 W.W.R. 440 (Sask. K.B.).

[23] *Chitty on Contracts*, *supra*, note 17, para. 210.

[24] *Sixth Interim Report*, *supra*, note 15, para. 50(3) (emphasis added).

since outright forgiveness calls for no payment. This recommendation, however, must be read together with another general recommendation of the Committee:[25]

> [A]n agreement shall be enforceable if the promise or offer has been made in writing by the promisor or his agent, or if it be supported by valuable consideration past or present.

Under this proposal, an obligee's promise in writing to forgive an obligation would be enforceable. Consequently, it can be seen that implementing the recommendations of the English Law Revision Committee would go a long way towards minimizing the effect of the rule in *Foakes v. Beer*. It should be noted that to date none of the recommendations concerning the doctrine of consideration contained in the *Sixth Interim Report* have found their way into legislation.

In the United States, the law varies from jurisdiction to jurisdiction, with some states providing that a *Foakes v. Beer* type of promise will not be invalid for want of consideration if the promise is reduced to writing and signed by the promisor against whom it is to be enforced.[26]

In our *Report on Sale of Goods*,[27] we recommended that good faith modifications of contracts of sale should be enforceable, whether or not supported by consideration. We return to this issue below.[28] Suffice it to say at this juncture that, in the sales context, we saw no need to retain any vestige of

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[25] *Ibid.*, para. 50(2).

[26] See, for example, *McKinney's Consolidated Laws of New York Annotated*, Vol. 23A, General Obligations Law (1978) (subsequently referred to as "New York General Obligations Law"). Section 5-1103 provides as follows:

> 5-1103. An agreement, promise or undertaking to change or modify, or to discharge in whole or in part, any contract, obligation, or lease, or any mortgage or other security interest in personal or real property, shall not be invalid because of the absence of consideration, provided that the agreement, promise or undertaking changing, modifying, or discharging such contract, obligation, lease, mortgage or security interest, shall be in writing and signed by the party against whom it is sought to enforce the change, modification or discharge, or by his agent.

See, also, American Law Institute, Uniform Commercial Code, Official Text (9th ed., 1978) (hereinafter referred to as "Uniform Commercial Code"), § 1-107, for a provision similar in effect. It states:

> 1-107. Any claim or right arising out of an alleged breach can be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party.

It should be noted that both the provision in the New York General Obligations Law, set out above, and § 1-107 of the Uniform Commercial Code cover a promise to discharge in whole or in part any existing obligation. See, also, American Law Institute, *Restatement of the Law, Second — Contracts, 2d* (1979) (hereinafter referred to as *"Second Restatement"*), § 89, discussed *infra*, this ch., sec. 4(a)(ii).

[27] Ontario Law Reform Commission, *Report on Sale of Goods* (1979) (hereinafter referred to as "Sales Report"), Vol. III, Draft Bill, s. 4.8.

[28] *Infra*, this ch., sec. 4(a)(ii).

the doctrine of consideration for the modification of sales contracts. Nor did we see the need to require a "modification agreement" to be reduced to writing, except where the original agreement itself so provided.[29]

Later in this Report,[30] we shall recommend substantial repeal of the *Statute of Frauds*,[31] as well as the adoption of a general unconscionability doctrine.[32] We see no sufficient reason to require a writing in order to render enforceable a promise to forgive or to accept part performance of an obligation in satisfaction of an existing obligation where the original agreement itself imposed no such requirement. Accordingly, the Commission recommends that section 16 of the *Mercantile Law Amendment Act* should be amended to make it clear that an agreement, whether executed or executory, by an obligee to accept part performance of an obligation in place of full performance, as well as an agreement to waive performance of an obligation, need no consideration to be binding.[33]

(2) Revocation of a Promise Covered by the Mercantile Law Amendment Act

A question arises whether an obligee should be able to revoke a promise to accept part performance where the obligor breaches the obligation of part performance. The English Law Revision Committee, in its *Sixth Interim Report*, recommended that, "if the new agreement is not performed then the original obligation shall revive".[34]

We agree. If the obligor has failed to comply with the new arrangement, the obligee should be entitled to enforce the rights under the original agreement. Our reason for this position is as follows: the obligee has agreed to accept less on the ground that "a bird in the hand is worth two in the bush". It would be unfair, in such a case, to limit the rights absolutely to the single bird of the

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29 Sales Report, *supra*, note 27, Vol. I, at 101-02.

30 *Infra*, ch. 5.

31 *Statute of Frauds*, R.S.O. 1980, c. 481.

32 *Infra*, ch. 6.

33 It should be noted that the Manitoba Law Reform Commission has recently considered s. 6 of the Manitoba *Mercantile Law Amendment Act*, R.S.M. 1970, c. M120, which is similar to s. 16 of the Ontario legislation, except that it imposes a requirement that the creditor expressly accept the part performance in writing: see Manitoba, Law Reform Commission, Report No. 62, *Report on Small Projects, Part 1* (1985) (hereinafter referred to as "Manitoba Report"). The Commission recommends repeal of the writing requirement (*ibid.*, para. 1.14, Recommendation 2, at 10) except where the original contract or obligation requires that any modification be in writing (*ibid.*, para. 1.15, Recommendation 3, at 11). The Commission further recommends that an obligation should not be extinguished by part performance where, upon application, the court finds that extinguishment of the obligation would be unconscionable (*ibid.*, para. 1.18, Recommendation 4, at 11-12). The Report does not deal expressly with waiver, but does recommend that purely executory agreements should remain revocable in the absence of consideration (*ibid.*, para. 1.20, at 13).

34 *Sixth Interim Report*, *supra*, note 15, para. 50(3).

subsequent agreement, for we believe that in most cases it would be an implicit understanding between the parties that failure to comply with the terms of the new agreement would revive the old one. At the same time, we are of the view that the obligee's right of revocation should not be available where the breach of the obligation of part performance by the obligor is merely trivial or technical, so as to prevent the obligee from using a technical breach of the new agreement to breathe life into the original agreement.

Accordingly, we recommend that an agreement under the proposed revised section 16 of the *Mercantile Law Amendment Act* should be revocable by the obligee for breach, unless the breach of the obligation of part performance by the obligor is merely trivial or technical.[35]

(ii) Modification of Contracts

The other context in which problems with the pre-existing duty rule should be addressed is that of modification of contracts in general. The application of the rule is perhaps best exemplified by the 1976 decision of the Ontario Court of Appeal in *Gilbert Steel Ltd. v. University Construction Ltd.*[36]

The facts of *Gilbert Steel* were as follows. The plaintiff and defendant had entered into a written contract for the delivery of fabricated steel by the plaintiff to three separate construction sites. The action concerned the delivery of steel to the third site. During construction on this site, the price of unfabricated steel increased, thereby increasing the plaintiff's costs. Discussions took place between the plaintiff and the defendant, and a "new contract" providing for higher prices for fabricated steel was agreed to by the parties. While the plaintiff sent the defendant a contract embodying the agreed changes in price for the fabricated steel, the written contract was never executed by the defendant. The defendant accepted deliveries of the steel, but payments against the invoices (reflecting the new arrangement) were rounded, with the result that there was a balance left owing by the defendant. The plaintiff sued for payment of this balance and the defendant denied liability on the ground that the new contract was not binding, since the plaintiff was already under an obligation to deliver the steel and the latest arrangement was not supported by new consideration.

The Court of Appeal found for the defendant, relying on the "leading case"[37] of *Stilk v. Myrick*[38] as the fount of the pre-existing duty rule. All efforts by plaintiff's counsel to point to consideration for the new agreement failed. Counsel's attempt to rely on the doctrine of promissory estoppel did not succeed because "estoppel can never be used as a sword but only as a shield"[39] and

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35 Compare Manitoba Report, *supra*, note 33, para. 1.21, Recommendation 6, at 14.

36 *Supra*, note 14.

37 See Gilmore, *The Death of Contract* (1974), at 23-28, where the author discusses how *Stilk v. Myrick* became the "leading case" in this area of the law of contracts.

38 *Supra*, note 16.

39 *Gilbert Steel Ltd. v. University Construction Ltd.*, *supra*, note 14, at 23.

because the plaintiff had failed to prove two of the necessary elements of promissory estoppel.[40] The decision of the Ontario Court of Appeal in *Gilbert Steel Ltd. v. University Construction Ltd.* and the pre-existing duty rule have been the subject of considerable critical commentary.[41]

As stated above, it has been suggested that the reason for the pre-existing duty rule is the law's concern to discourage pressure being brought by one party to a contract for an increase in the exchange at a time when the other party is most vulnerable.[42] In the context of the *Gilbert Steel* case, it may be argued that enforcing the new contract would have rewarded the plaintiff for using the leverage of an incomplete building to gain an increase in the price of the steel to be delivered. However, the application of the pre-existing duty rule did not turn on evidence of duress, undue pressure, or unconscionability. It may well be that in many cases the courts have relied on the doctrine of consideration as an indirect means of giving relief against promises unfairly obtained. Unfortunately, the doctrine may also be applied to render an agreement unenforceable where no such unfairness exists and where the agreement is commercially sensible.

Another criticism of the rule in *Stilk v. Myrick* is the broad exceptions to it, which allow courts to enforce promises where there is, in fact, no more consideration than that in *Gilbert Steel Ltd. v. University Construction Ltd.* One commentator has described[43] four major techniques used to avoid the rule in *Stilk v. Myrick*:

1. finding that 'on the facts of this case' the plaintiff promised to do more than he was obliged to do;

2. finding that circumstances have so changed after the original agreement that the plaintiff's later promise to do exactly what he agreed to do before is consideration for a promise of more from the defendant;

3. concluding that, because the plaintiff has seriously relied on the defendant's later promise, considerations of justice and equity require enforcement of the promise despite orthodox rules; and

4. enforcing the modification if the parties have entered into a 'new agreement' and have not 'merely modified' the original agreement.

Given the frequent judicial resort to these techniques, it is doubtful that the pre-existing duty rule actually prevents contracting parties from threatening to break contracts in order to secure further remuneration from the other party.

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[40] *Ibid.*, at 23-24. The Court said that to found an estoppel the plaintiff had to show "that the conduct of the defendant was clearly referable to the defendant's having given up its right to insist on the original prices" as well as "that the plaintiff relied on the defendant's conduct to its detriment".

[41] See, for example, Reiter, *supra*, note 13.

[42] *Chitty on Contracts*, *supra*, note 17, para. 210.

[43] Reiter, *supra*, note 13, at 474.

American law has long recognized the enforceability of contract modifications, even where the variation in the contract is not supported by consideraton. For example, section 5-1103 of the New York General Obligations Law[44] provides as follows:

> 5-1103. An agreement, promise or undertaking to change or modify, or to discharge in whole or in part, any contract, obligation, or lease, or any mortgage or other security interest in personal or real property, shall not be invalid because of the absence of consideration, provided that the agreement, promise or undertaking changing, modifying, or discharging such contract, obligation, lease, mortgage or security interest, shall be in writing and signed by the party against whom it is sought to enforce the change, modification or discharge, or by his agent.

The *Second Restatement of the Law of Contracts*[45] takes a somewhat different approach. Section 89 of the *Restatement* provides:

> 89. A promise modifying a duty under a contract not fully performed on either side is binding
>
> (a) if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made; or
>
> (b) to the extent provided by statute; or
>
> (c) to the extent that justice requires enforcement in view of material change of position in reliance on the promise.

Section 89(b) simply takes into account statutory provisions such as section 5-1103 of the New York General Obligations Law. Section 89(c) would permit enforcement to the extent justice requires where an obligor acts in reliance on a promise to modify a contract. In this respect, section 89(c) is but a specific instance of the principle found in section 90 of the *Restatement*, to which we shall return below.[46]

This Commission has already called for substantial changes to the pre-existing duty rule in the *Report on Sale of Goods*.[47] There, we observed as follows:[48]

> In inflationary times, or in periods of shortages, the pressure for substantial modifications is particularly strong. One might have thought that the common law would have been content to respect a familiar business phenomenon without fettering it with the restrictive requirements of the doctrine of consideration. Such an attitude could reasonably be justified in terms of the difference between requiring consideration to support the enforceability of an original promise, and

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[44] New York General Obligations Law, *supra*, note 26.

[45] *Second Restatement*, *supra*, note 26.

[46] *Infra*, this ch., sec. 4(d).

[47] Sales Report, *supra*, note 27.

[48] *Ibid.*, Vol. I, at 96 (footnote reference omitted).

recognizing a freely and fairly adopted modification once the bargain has been struck.

We accordingly proceeded to recommend adoption of the following provision:[49]

4.8.-(1) An agreement in good faith modifying a contract of sale needs no consideration to be binding.

(2) An agreement that excludes modification or rescission except by a signed writing cannot be otherwise modified or rescinded but, except as between merchants, such a requirement on a form supplied by the merchant must be separately signed by the other party.

(3) An attempt at modification or rescission that does not satisfy the requirements of subsection 2 may operate as a waiver or equitable estoppel.

(4) A party who has waived compliance with an executory portion of a contract may retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless the retraction would be unjust in view of a material change of position in reliance on the waiver.

In our view, it is implicit in the above provision that agreements modifying or rescinding contracts would be binding, subject to a limited exception: revocation would be permissible in the case of an attempted modification that fails to comply with a contractually required formality. That is, section 4.8(4) was not intended to be of general application, so as to impinge on the operation of section 4.8(1). Rather, it was intended that section 4.8(4) be restricted to cases within section 4.8(3). Section 4.8 of our proposed *Sale of Goods Act* was based on section 2-209 of the Uniform Commercial Code. The Official Comment relating to section 2-209 contains a similar interpretation.[50]

The *Uniform Sale of Goods Act*, proposed by the Uniform Law Conference of Canada,[51] contains an amended version of section 4.8. Section 27 of the Uniform Act states:

27. An agreement varying or rescinding a contract of sale needs no consideration to be binding, but a party may withdraw from an executory portion of the agreement made without consideration and revert to the original contract by giving reasonable notice to the other party, unless the withdrawal would be unjust in view of a material change of position in reliance on the agreement.

Unlike the Uniform Law Conference of Canada, however, we do not believe that a party should generally be able to withdraw from a modified or varied contract on the ground that the contract, or some part of it, is executory

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[49] *Ibid.*, Vol. III, Draft Bill.

[50] Uniform Commercial Code, *supra*, note 26, § 2-209, Comment 4.

[51] Uniform Law Conference of Canada, *Proceedings of the Sixty-fourth Annual Meeting* (1982), Appendix HH (hereinafter referred to as *"Uniform Sale of Goods Act"*).

and no injustice would result from a withdrawal.[52] Rather, we recommend the adoption of a provision similar to section 4.8 of the proposed *Sale of Goods Act*. As we have stated, it is our view that a modified contract should be treated as a contract supported by consideration, and a party should not be able to resile from it merely because doing so would not result in an injustice. We believe that this view, while implicit in section 4.8 of our proposed *Sale of Goods Act*, should be made explicit. Accordingly, we recommend that a provision similar to section 4.8 should be enacted to provide as follows:[53]

(1) an agreement in good faith modifying a contract should not require consideration in order to be binding;

(2) an agreement that excludes modification or rescission except by a signed writing should not be otherwise subject to modification or rescission but, except as between parties acting in the course of business, such a requirement on a form supplied by a party acting in the course of a business should be required to be signed separately by the other party;

(3) an attempt at modification or rescission that does not satisfy the requirements of the preceding paragraph or that does not satisfy any statutory requirement of writing or corroboration should be capable of operating as a waiver or equitable estoppel; and

(4) where paragraph (3) applies, a party who has waived compliance with an executory portion of a contract should be able to retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived, unless it would be unjust in view of a material change in position in reliance on the waiver to allow the waiver to be retracted. In the case of an equitable estoppel, a similar principle should apply.

Before leaving the topic of the pre-existing duty rule, we wish to make a final observation. Given the general provision for modification of contracts that we have proposed, the need for an amended version of section 16 of the *Mercantile Law Amendment Act*[54] might be questioned. Any case of waiver or part performance of an obligation within section 16 could conceivably be described as a "modification" falling within paragraph (1) above. Nevertheless, we believe that an amended version of section 16 should continue to exist alongside a general modification provision. Section 16 has been part of the law of Ontario for approximately one hundred years, and isolates a situation that has proven troublesome. Repeal of the provision, and its replacement by the general modification provision that we have proposed, runs the risk of overlooking some nuance of section 16 of which we might be unaware. Furthermore, section

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[52] The reasons for the Uniform Law Conference of Canada's departure from the position taken by the Commission on this point in its *Sales Report* are set out in Uniform Law Conference of Canada, *Proceedings of the Sixty-third Annual Meeting* (1981), at 190.

[53] It should be noted that although probably not affected by the recommendations set out in paragraphs (3) and (4), attempted modifications relating to increased payment or performance may be enforceable under our recommendations in sec. 4(d) of this chapter relating to reliance as a basis of enforcement.

[54] *Supra*, note 7.

16 of the *Mercantile Law Amendment Act* deals not only with contractual obligations, but also applies, for example, to tort claims reduced to judgment, so that it would not be wholly replaced by a provision dealing with modification of contracts.

(b) THE PAST CONSIDERATION RULE

The doctrine of consideration requires that there be a present consideration for a promise to be binding. As the editors of *Chitty on Contracts* have said, "[i]f the act or forbearance alleged to constitute the consideration has already been done before, and independently of, the giving of the promise, it does in law not amount to consideration".[55]

The leading case in this area of the law is *Eastwood v. Kenyon*.[56] The plaintiff, who was the guardian of a young woman, borrowed money to pay for the woman's education and maintenance and to manage her inherited property. After the young woman came of age and married, her husband promised to repay the guardian's loan. When that promise was not honoured, the plaintiff sued the husband. Lord Denman dismissed the plaintiff's claim on the ground that the promise was not supported by consideration except as a past benefit not conferred at the request of the defendant.[57] His Lordship justified the non-enforcement of such promises on the following basis:[58]

> The enforcement of such promises by law, however plausibly reconciled by the desire to effect all conscientious engagements, might be attended with mischievous consequences to society; one of which would be the frequent preference of voluntary undertakings to claims for just debts. Suits would thereby be multiplied, and voluntary undertakings would also be multiplied, to the prejudice of real creditors.

We believe that a case can be made for enforcing, at least to some extent, a promise such as that in issue in *Eastwood v. Kenyon*. The basis for enforcing a gratuitous promise made against a background of past consideration would be the desire to avoid unjust enrichment. Insofar as the value promised is approximately equivalent to the value of the benefit conferred on the promisor, enforcing the promise would seem justifiable. The law of restitution may or may not compel the recipient of an unrequested benefit to pay for it, but if the recipient recognizes an obligation to pay, puts a value on the benefit, and promises to pay, the making of the promise seems to be sufficient reason for enforcing payment. However, we do not mean to suggest by this that a promise supported by past consideration should be fully enforceable. Rather, we are of the view that such promises should be enforced only to the extent necessary to prevent unjust enrichment.

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55 *Chitty on Contracts*, *supra*, note 17, para. 162. For a recent examination of this question, see *Pao On v. Lau Yiu Long*, [1980] A.C. 614, [1979] 3 All E.R. 65 (P.C. (Hong Kong)).

56 *Supra*, note 4.

57 *Ibid.*, at 487.

58 *Ibid.*

This is the position taken in the *Second Restatement of the Law of Contracts*.[59] Section 86 of the *Restatement* reads:

> 86.-(1) A promise made in recognition of a benefit previously received by the promisor from the promisee is binding to the extent necessary to prevent injustice.
>
> (2) A promise is not binding under Subsection (1)
>
> (a) if the promisee conferred the benefit as a gift or for other reasons the promisor has not been unjustly enriched; or
>
> (b) to the extent that its value is disproportionate to the benefit.

It also may be useful to set out the rationale given in the *Restatement* for enforcing promises supported by past consideration:[60]

> Although in general a person who has been unjustly enriched at the expense of another is required to make restitution, restitution is denied in many cases in order to protect persons who have had benefits thrust upon them. See Restatement of Restitution §§ 1, 2, 112. In other cases restitution is denied by virtue of rules designed to guard against false claims, stale claims, claims already litigated, and the like. In many such cases a subsequent promise to make restitution removes the reason for the denial of relief, and the policy against unjust enrichment then prevails.

The present law, through a number of exceptions, permits the enforcement of some promises supported only by past consideration. For example, the courts, on occasion, have characterized a subsequent promise as evidence of an earlier enforceable agreement for remuneration or as a new agreement fixing the amount of remuneration.[61] A subsequent promise by a discharged bankrupt to pay his or her debts notwithstanding the discharge may be enforced.[62] Legislation provides for enforcement of a promise to pay a debt that is statute-barred,[63] and for enforcement of a promise made after a minor reaches majority affirming an unenforceable promise made for consideration during minority.[64] It has been observed, and we would agree, that these statutory exceptions developed because justice required the results that were reached.[65]

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59 *Second Restatement*, *supra*, note 26.

60 *Ibid.*, § 86, Comment b.

61 *Re Casey's Patents; Stewart v. Casey*, [1892] 1 Ch. 104 (C.A.), and *Kennedy v. Brown* (1863), 13 C.B. (N.S.) 677, 143 E.R. 268.

62 *Austin v. Gordon* (1872), 32 U.C.Q.B. 621 (Q.B.), and *Adams v. Woodland* (1878), 3 O.A.R. 213 (C.A.).

63 *Limitations Act*, R.S.O. 1980, c. 240, s. 51(1).

64 *Statute of Frauds*, *supra*, note 31, s. 7.

65 Waddams, *The Law of Contracts* (2d ed., 1984), at 137.

Accordingly, we recommend that any promise made in recognition of a benefit previously received by the promisor or any third party from the promisee, should be binding to the extent necessary to prevent unjust enrichment. Implicit in this recommendation is our view that such promises should not be enforceable where the promisee conferred the benefit as a gift or where for other reasons the promisor has not been unjustly enriched. Finally, the Commission recommends that promises supported by past consideration, where enforceable, should be enforceable only to the extent that the value of the promise is not disproportionate to the benefit.

We would point out that, although our recommendations would allow a court to enforce a promise made in recognition of a benefit conferred on a third person in a case of unjust enrichment, it will only be in comparatively rare cases, like *Eastwood v. Kenyon*,[66] that the promisor can be said to be unjustly enriched by a benefit conferred upon a third party.

The limitations on enforceability that we have proposed are intended to ensure that Ontario courts are given some guidance concerning the extent of enforceability of the kinds of promises in issue, and to guard against the over-enforcement of such promises. We believe that these recommendations, which correspond generally to the provisions of section 86 of the *Restatement*, will provide the courts with the flexibility necessary to do justice.

(c) FIRM OFFERS

At common law, a firm offer — that is, an offer that is said to be irrevocable for a certain period of time or indefinitely — is nevertheless revocable by the promisor unless the offer is bargained for or is made under seal.[67] Such an offer will usually be a gratuitous promise, unsupported by consideration, and therefore subject to the same rules as all gratuitous promises. One object of the law is to protect the offeror from liability for hastily-made or ill-considered firm offers. The presence of consideration or a seal, it may be argued, helps to ensure that a promise to keep an offer open for a definite period of time or until the occurrence of a certain event will be made with due deliberation. Nevertheless, the existing rule gives rise to many difficulties and does not reflect the business community's understanding of the significance of firm offers.

It is these perceptions that underlie past and recent reform efforts. The subject of firm offers was canvassed, for example, in the English Law Revision Committee's *Sixth Interim Report*.[68] It was there recommended "[t]hat an agreement to keep an offer open for a definite period of time or until the occurrence of some specified event shall not be unenforceable by reason of the

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[66] *Supra*, note 4.

[67] *Dickinson v. Dodds*, [1875-76] 2 Ch. D. 463 (C.A.). See, also, *McMaster University v. Wilchar Construction Ltd.*, [1971] 3 O.R. 801, 22 D.L.R. (3d) 9 (H.C.J.), aff'd (1973), 12 O.R. (2d) 512*n* (C.A.).

[68] *Sixth Interim Report*, *supra*, note 15.

absence of consideration''.[69] It was the Committee's opinion that the common law rule was ''undesirable and contrary to business practice''.[70] The Committee explained that an offeror who desired consideration for keeping open an offer could demand it, but the absence of consideration did not justify allowing the offeror to revoke the offer with impunity.[71] The Committee argued that ''the fixing of a definite period should be regarded as evidence of [the offeror's] intention to make a binding promise''.[72] The converse of this argument was, of course, that the failure to fix a period for acceptance of an offer indicated that no contractual obligation was intended.[73]

As with all the subsidiary recommendations in the *Sixth Interim Report*, the recommendation concerning firm offers must be read subject to the Committee's main recommendation. It will be recalled that the Committee favoured the enforceability of any promise or offer made in writing by the promisor or an agent, whether or not the promise or offer was supported by consideration.[74] Accordingly, even an offer that stipulated no date for acceptance would be enforceable if made in writing by the promisor or an agent.

In 1975, the English Law Commission issued a *Working Paper on Firm Offers*.[75] This Working Paper examined the criticisms levelled at the firm offer rule in the *Sixth Interim Report*. Noting that ''it may be a fair criticism of this part of the law that it allows a lower standard of commercial behaviour than that to which reputable businessmen generally conform'', the Law Commission called for an investigation of modern business practices in relation to firm offers.[76] The Law Commission observed, in summary, that ''[t]he trend since 1937, both nationally and internationally, seems ... to favour a modification of the [firm offer] rule ...''.[77]

The Working Paper canvassed a number of options for reform. For example, it provisionally recommended altering the law to make firm offers binding only when made in the course of business.[78] Another matter discussed by the Law Commission was the length of time that a firm offer should be binding.[79] The Commission's provisional view was ''that a promise of non-revocation that was expressed to run for a longer period should cease to be

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69 *Ibid.*, para. 50(6).

70 *Ibid.*, para. 38.

71 *Ibid.*

72 *Ibid.*

73 *Ibid.*

74 *Ibid.*, para. 29.

75 England, The Law Commission, Working Paper No. 60, *Firm Offers* (1975).

76 *Ibid.*, para. 20.

77 *Ibid.*, para. 28.

78 *Ibid.*, para. 31.

79 *Ibid.*, para. 32.

binding after six years''.[80] In the case of an offer that is not made irrevocable for a definite period of time, the Law Commission provisionally rejected a rule that would leave such firm offers open for a reasonable time, in favour of the approach suggested by the Law Revision Committee — that is, that this type of firm offer should be revocable at any time by the offeror.[81] Another possible requirement considered, but tentatively rejected, by the Law Commission was the need for the offer to be in writing.[82] The Law Commission also examined the question of remedies in some detail and provisionally proposed that an attempted revocation of an irrevocable offer should not prevent the offeree from accepting the offer, and that damages should be available to the offeree where the offeror is in breach of a firm offer.[83]

As the Law Commission's Working Paper noted,[84] there has been substantial reform of the common law firm offer rule in the United States. Section 2-205 of the Uniform Commercial Code[85] provides that a signed offer by a merchant to buy or sell goods, which by its terms assures that the offer will be held open for a specified period, is binding for the period specified. If no period is specified, the offer will be held open for a reasonable time, up to a maximum period of three months. Furthermore, if the term assuring that the offer will be held open is contained in a form supplied by the offeree, the form must be separately signed by the offeror.

Under New York legislation, firm offers in writing signed by the offeror are binding whether or not made by a merchant, and no restriction is placed on the length of time for which a firm offer may be binding. The New York provision is made subject to provisions to the contrary in section 2-205 of the Uniform Commercial Code with respect to an offer by a merchant to buy or sell goods.[86]

In addition to these legislative reforms of the firm offer rule, there is a growing body of American case law calling for the enforcement of offers where enforcement is necessary to protect the offeree's reasonable reliance interest. This case law development is reflected in the *Second Restatement of the Law of Contracts*, section 87(2) of which provides:

> 87.-(2) An offer which the offeror should reasonably expect to induce action or forbearance of a substantial character on the part of the offeree before acceptance and which does induce such action or forbearance is binding as an option contract to the extent necessary to avoid injustice.

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80 *Ibid.*

81 *Ibid.*, paras. 33-34.

82 *Ibid.*, para. 35.

83 *Ibid.*, paras. 41-50.

84 *Ibid.*, paras. 24-26.

85 Uniform Commercial Code, *supra*, note 26.

86 New York General Obligations Law, *supra*, note 26, § 5-1109.

This is, essentially, a specific application of section 90(1) of the *Restatement*, which seeks to protect reliance interests generally.[87]

In our own *Report on Sale of Goods*,[88] we canvassed most of these Anglo-American developments in respect of the present firm offer rule, and examined the issues considered by the Law Commission in its 1975 Working Paper. The following provision in our proposed *Sale of Goods Act*[89] would give effect to our recommendation in the *Report on Sale of Goods*:

> 4.3. An offer by a merchant to buy or sell goods which expressly provides that it will be held open is not revocable for lack of consideration during the time stated or, if no time is stated, for a reasonable time not to exceed three months.

As will be apparent from this proposed provision, we agreed with some of the provisional recommendations of the Law Commission and rejected others. For example, we too did not favour a writing requirement in order for firm offers to be binding, on the ground that an "offeror usually has a sound business reason for his willingness to make [a] firm offer, or may be following an established business practice".[90] It should also be noted that our recommendation was restricted to offers by merchants.[91]

With respect to the period of time during which a firm offer should be irrevocable, we differed from the tentative position adopted by the Law Commission. We saw no reason to restrict the period for which an offer may be made irrevocable; nor did we wish to limit the enforceability of firm offers to those that are time limited. We stated in our *Report on Sale of Goods*:[92]

> It appears to us that a merchant is quite capable of determining his own best interest, and that he should be free to set his own period of time, whether it is for more or less than six years. A firm offer that was expressed to remain open for more than six years would no doubt be a very unusual occurrence, but we see no overriding public policy that militates against its effectiveness. If it has been procured by improper means, the problem can be dealt with under other heads. Again, we see no justification, in terms of its effective duration, in drawing a distinction between a firm offer supported by consideration and an offer made without consideration. In the light of these factors, we have concluded that the revised Act should not impose a limit on the effectiveness of an offer expressed to remain open for a specified period, and so recommend.
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> With respect to firm offers for an unspecified period, the Law Commission's Working Paper takes yet another approach. The Law Revision Committee was of the view that a firm offer for an unspecified period should not fall within the rule

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87 See discussion *infra*, this ch., sec. 4(d).

88 Sales Report, *supra*, note 27, Vol. I, at 91-96.

89 *Ibid.*, Vol. III, Draft Bill.

90 *Ibid.*, Vol. I, at 94.

91 *Ibid.*, at 93.

92 *Ibid.*, at 93-94 (footnote references omitted).

> making firm offers enforceable even though not supported by consideration. The Working Paper reaches the same conclusion on the ground that 'the need for certainty outweighs the other considerations'. We are not persuaded by this reasoning. It is well settled law that a simple offer is open for acceptance for a reasonable period, unless the offer provides otherwise. It is difficult to see why a different rule of construction should be applied to firm offers, or why it should create greater uncertainty than in the case of ordinary offers. As will have been noted, neither the Code nor, it would seem, the Uniform Law on Formation [of Contracts for the International Sale of Goods] distinguishes, in this context, between firm offers for a stated duration and firm offers for an unspecified period. Nevertheless, in order to accommodate, to some extent, the Law Commission's apprehensions, we recommend that, where the offer states no time for its duration, it shall remain irrevocable for a reasonable time not to exceed three months.

Finally, we would note that we made no recommendations in our *Report on Sale of Goods* concerning the question of injurious reliance on firm offers outside the scope of our proposed section 4.3. While we recognized the merit of what is now section 87(2) of the *Second Restatement of the Law of Contracts*, we took the position that the doctrine of injurious reliance "raises much broader issues that are more appropriately discussed in the context of a Law of Contract Amendment Project".[93]

Before turning to our recommendations regarding the firm offer rule in the general law of contracts, we should point out that the *Uniform Sale of Goods Act*,[94] adopted in 1982 by the Uniform Law Conference of Canada, incorporates section 4.3 of our proposed *Sale of Goods Act*.[95] This provision is, however, qualified in the *Uniform Sale of Goods Act* by the requirement that an assurance of irrevocability of an offer in a form supplied by the offeree is not binding unless the assurance is separately signed by the offeror.[96] The qualification was borrowed from the Uniform Commercial Code and was adopted "to ensure that an offeror was not surprised by the presence of such a provision secreted in the midst of a boilerplate form".[97]

The *Uniform Sale of Goods Act* also includes a provision that gives effect to the doctrine of injurious reliance mentioned above. Section 23 of the Uniform Act states:

> 23. Where an offer to buy or sell goods that the offeror should reasonably expect to induce substantial action or forbearance by the offeree before acceptance induces such action or forbearance and is revoked, the offeror is bound to compensate the offeree, and in any such case, the court may

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93 *Ibid.*, at 96.

94 *Uniform Sale of Goods Act*, *supra*, note 51.

95 *Ibid.*, s. 22(1).

96 *Ibid.*, s. 22(2).

97 Uniform Law Conference of Canada, *Proceedings of the Sixty-third Annual Meeting* (1981), at 224.

(a) award damages on the same basis as if a contract had been completed between the parties, or

(b) grant compensation limited to the restoration of any benefit conferred upon the offeror, to the recovery of any losses incurred as a result of reliance on the offer or generally, to the extent necessary to avoid injustice.

In our view, insofar as firm offers made by a merchant or trader — in other words, in the course of business — are concerned, the same considerations would appear to be applicable outside the sales context and, therefore, the same conclusion seems appropriate. Accordingly, we recommend that an offer, made by a person in the course of a business, which expressly provides that it will be held open should not be revocable for lack of consideration during the time stated or, if no time is stated, for a reasonable time not to exceed three months.

We have more difficulty with firm offers not made in the course of a business. Because of the potential financial significance of an option (another term for an irrevocable firm offer) and the possible lack of appreciation of this by a non-business person, we are reluctant to render enforceable any gratuitous firm offer made in a non-business context. Accordingly, we recommend that there should be no change in the law relating to firm offers not made in the course of business. In other words, in order to be enforceable, a firm offer, when made by a non-merchant, must be supported by consideration or comply with the formalities that, later in this Report, we recommend to replace the seal — a witnessed signed writing.[98]

Insofar as the doctrine of injurious reliance in the context of firm offers is concerned, we see no need to make a specific recommendation similar to section 87(2) of the *Second Restatement of the Law of Contracts* or to section 23 of the *Uniform Sale of Goods Act*, set out above. The reason for this is that in the next section we shall propose the enactment of a provision similar to section 90 of the *Restatement*, dealing with the enforceability of promises that may reasonably be expected to induce reliance.

(d) Reliance as the Basis for the Enforcement of Promises

Strict adherence to the doctrine of consideration would result in the unenforceability of a gratuitous promise even where the promisee has detrimentally relied on the promise. Because faithfulness to the doctrine of consideration in such cases would frequently lead to injustice, courts have developed a number of devices to enable them to protect the promisee's reliance interest. For example, courts have resorted to the doctrine of promissory estoppel to

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[98] *Infra*, ch. 3, sec. 4(a).

prevent a promisor from taking advantage of a gratuitous promise that has reasonably induced reliance by the promisee.[99]

It was with the decision of Denning J., as he then was, in *Central London Property Trust, Ltd. v. High Trees House, Ltd.*[100] that the doctrine of promissory estoppel assumed a prominent place in the modern law of contracts. In that case, a landlord, having promised to reduce the rent payable under a lease and having accepted reduced payments in satisfaction of the lessee's rent obligation, was held to be bound by his gratuitous promise and unable to demand the original rent agreed to by the parties. The judgment was rendered in very broad terms, suggesting that reliance could be a nearly complete substitute for consideration.

Limits on the *High Trees* doctrine, however, began to be drawn fairly quickly. In 1951, four years after *High Trees*, the English Court of Appeal decided the case of *Combe v. Combe*,[101] where a wife sought to enforce a promise of maintenance, unsupported by consideration, by resort to the doctrine of promissory estoppel. The Court ruled against the wife and, in so doing, stressed the continuing importance of consideration. Denning L.J., as he then was, commented as follows:[102]

> Much as I am inclined to favour the principle of the *High Trees* case, it is important that it should not be stretched too far, lest it should be endangered. That principle does not create new causes of action where none existed before. It only prevents a party from insisting on his strict legal rights, when it would be unjust to allow him to enforce them, having regard to the dealings which have taken place between the parties.
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> ....
>
> Seeing that the principle never stands alone as giving a cause of action in itself, it can never do away with the necessity of consideration when that is an essential part of the cause of action. The doctrine of consideration is too firmly fixed to be overthrown by a side-wind. Its ill-effects have been largely mitigated of late, but it still remains a cardinal necessity of the formation of a contract, though not of its modification or discharge.

In the same vein, Birkett L.J. considered that the *High Trees* doctrine could be used "as a shield and not as a sword".[103]

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[99] See, for example, *Owen Sound Public Library Board v. Mial Developments Ltd.*, *supra*, note 9.

[100] [1947] 1 K.B. 130, [1956] 1 All E.R. 256*n*.

[101] [1951] 2 K.B. 215, [1951] 1 All E.R. 767 (C.A.) (subsequent reference is to [1951] 2 K.B.).

[102] *Ibid.*, at 219 and 220-21 (footnote references omitted).

[103] *Ibid.*, at 224.

The Supreme Court of Canada, in a number of decisions, has considered and approved the doctrine of promissory estoppel. In *Conwest Exploration Co. Ltd. v. Letain*,[104] Mr. Justice Judson, speaking for the majority of the Court, relied on the case of *Hughes v. Metropolitan Railway Co.*,[105] in which Lord Cairns stated:

> It is the first principle upon which all courts of equity proceed, that if parties, who have entered into definite and distinct terms, involving certain legal results — certain penalties or legal forfeiture — afterwards by their own act or with their own consent, enter upon a course of negotiation which has the effect of leading one of the parties to suppose that the strict rights arising under the contract will not be enforced, or will be kept in suspense, or held in abeyance, the person who otherwise might have enforced those rights will not be allowed to enforce them where it would be inequitable, having regard to the dealings which have thus taken place between the parties.

The Supreme Court of Canada was called upon again to examine the doctrine of promissory estoppel in *John Burrows Ltd. v. Subsurface Surveys Ltd.*[106] Mr. Justice Ritchie, speaking for the Court, rejected the defence of promissory estoppel on the facts of the case, commenting:[107]

> It seems clear to me that this type of equitable defence cannot be invoked unless there is some evidence that one of the parties entered into a course of negotiation which had the effect of leading the other to suppose that the strict rights under the contract would not be enforced, and I think that this implies that there must be evidence from which it can be inferred that the first party intended that the legal relations created by the contract would be altered as a result of the negotiations.
>
> It is not enough to show that one party has taken advantage of indulgences granted to him by the other for if this were so in relation to commercial transactions, such as promissory notes, it would mean that the holders of such notes would be required to insist on the very letter being enforced in all cases for fear that any indulgences granted and acted upon could be translated into a waiver of their rights to enforce the contract according to its terms.

The actions of the plaintiff, Mr. Justice Ritchie concluded, were more in the nature of friendly indulgences.[108]

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104 [1964] S.C.R. 20, at 28, 41 D.L.R. (2d) 198, at 206.

105 (1877), 2 App. Cas. 439 (H.L.), at 448.

106 [1968] S.C.R. 607, 68 D.L.R. (2d) 354 (subsequent references are to [1968] S.C.R.).

107 *Ibid.*, at 615.

108 *Ibid.*, at 617. See, also, *Gillis v. Bourgard* (1983), 41 O.R. (2d) 107, at 109, 145 D.L.R. (3d) 570, at 572 (C.A.), leave to appeal denied (1984), 51 N.R. 320*n*. The Court cautioned against transforming "normal dealings between parties attempting to resolve an insurance claim" into a promissory estoppel.

The Ontario courts in the last decade have also had an opportunity to discuss the nature and scope of the doctrine of promissory estoppel. In *Gilbert Steel Ltd. v. University Construction Ltd.*,[109] for example, the Ontario Court of Appeal decided that to apply the doctrine there had to be proof of detrimental reliance by the promisee on the representations of the promisor.[110] The Court in that case also seemed to accept the sword/shield dichotomy that has grown up around the doctrine of promissory estoppel.[111] However, in *Owen Sound Public Library Board v. Mial Developments Ltd.*,[112] the same Court made no mention of the sword/shield distinction when it allowed the plaintiff to rely on promissory estoppel to recover damages from the defendant.

Judges of the Ontario High Court of Justice have also grappled with the doctrine of promissory estoppel. In *Re Tudale Exploration Ltd. and Bruce*,[113] Grange J., as he then was, noted that the sword/shield distinction had been heavily criticized by academics and stated that he himself had "difficulty in seeing the logic of the distinction". Similar concerns were expressed in *M.L. Baxter Equipment Ltd. v. Geac Canada Ltd.*[114] and *Edwards v. Harris Intertype (Canada) Ltd.*[115]

It is interesting to note that, even before the recent judicial development of the promissory estoppel doctrine, there had been calls for reform. For example, the *Sixth Interim Report* of the English Law Revision Committee, published a decade before *High Trees*, proposed that "a promise which the promisor knows, or reasonably should know, will be relied on by the promisee shall be enforceable if the promisee has altered his position to his detriment in reliance on the promise".[116]

Another judicial device that may be said to give protection to a promisee who relies on a gratuitous promise is the tort of negligent misrepresentation, which came to the fore with the decision of the House of Lords in *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*[117] and was accepted by the Supreme Court of Canada in *Haig v. Bamford*.[118] Until *Hedley Byrne*, the law of torts permitted the recovery of damages only for fraudulent misrepresentations. We need not digress to examine in detail the new tort of negligent misrepresentation. What we do wish to point out is the relationship of this tort and the topic under

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109 *Supra*, note 14.

110 *Ibid.*, at 23-24.

111 *Ibid.*, at 23.

112 *Supra*, note 9.

113 (1978), 20 O.R. (2d) 593, at 597, 88 D.L.R. (3d) 584, at 588 (Div. Ct.).

114 (1982), 36 O.R. (2d) 150, 133 D.L.R. (3d) 372 (H.C.J.).

115 (1983), 40 O.R. (2d) 558 (H.C.J.), aff'd (1984), 46 O.R. (2d) 286 (C.A.).

116 *Sixth Interim Report*, *supra*, note 15, para. 50(8).

117 *Supra*, note 10.

118 *Supra*, note 10.

discussion. Professor Waddams, in his text on *The Law of Contracts*, outlines this relationship:[119]

> The relationship between the cases in tort that permit recovery for loss caused by reliance on negligent misstatements, and the law of contracts, is yet to be fully explored. It was suggested in the leading tort case that a 'special relationship' must exist between the parties in order to give rise to the duty of care and that such a special relationship would exist in circumstances 'analogous to contract' but where, for some reason, no contract happened to exist between plaintiff and defendant. The relevance to the matter at hand is clear. In the various cases of gratuitous promises, we are dealing with circumstances often very close to contract but where, according to the general rules of contract formation, no enforceable contract has been formed. There would seem to be no reason why the reasoning of the tort cases should not be extended to the case of a gratuitous promise inducing reliance. Just as in the case of negligent misstatement, the maker of the promise has acted in a way that he knows, or ought to know, may cause damage to the plaintiff. But the measure of damages in tort is generally agreed to be the plaintiff's loss, not his expectation. It is not to be deduced from this analogy that there is anything to be gained by labelling actions on gratuitous promises as tortious rather than contractual. But it is suggested that it would be wise to preserve to the court the option of applying other measures of damages than the 'normal' contract measure.

The use of promissory estoppel and the tort of negligent misrepresentation are examples of the inventiveness of our courts in creating devices to circumvent the doctrine of consideration where justice appears to require it. It may also be contended that awards in restitution[120] and characterization of promises as unilateral contracts[121] — consideration being the performance of a requested act by the promisee — are other means available to avoid the rigours of the doctrine of consideration, thus ensuring that justice is done where there has been reliance or possible reliance on an otherwise unenforceable promise.

It is in the United States, however, that the most dramatic developments have taken place in respect of the enforcement of promises such as those just described. The culmination of these developments is the adoption in the *Second Restatement of the Law of Contracts*[122] of the following provision:

> 90.-(1) A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. The remedy granted for breach may be limited as justice requires.

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119 Waddams, *supra*, note 65, at 153-54 (footnote references omitted).

120 *Brewer v. Chrysler Canada Ltd.*, [1977] 3 W.W.R. 69, 4 A.R. 497 (S.C., T.D.).

121 See, for example, *Frankel Structural Steel Ltd. v. Goden Holdings Ltd.*, [1969] 2 O.R. 221, 5 D.L.R. (3d) 14 (C.A.), var'd on other grounds, [1971] S.C.R. 250, and *Grant v. Province of New Brunswick* (1973), 35 D.L.R. (3d) 141 (N.B.C.A.).

122 *Second Restatement*, *supra*, note 26.

A number of features of section 90(1) are noteworthy. First, in order to be enforceable under this section, a promise must be one which "the promisor should reasonably expect to induce action or forbearance". A second requirement for enforceability is evidence of action or forbearance induced by the promise. Thirdly, while a promise under section 90(1) may be binding if injustice can be avoided only by its enforcement, the relief ordered by a court "may be limited as justice requires". Accordingly, in some cases, the promisee will be able to recover expectation damages; in others, relief may be "limited to restitution or to damages or specific relief measured by the extent of the promisee's reliance rather than by the terms of the promise".[123] In addition to the general provision on detrimental reliance, the *Restatement* also contains a number of specific applications of the same principle. Reference has already been made, for example, to section 89 concerning modification of contracts[124] and to section 87(2) concerning firm offers.[125]

Section 90 is a frequently cited section of the *Restatement*.[126] Moreover, the variety of cases adopting this section indicate that the formulation is a useful one, allowing the courts sufficient flexibility to do justice.

We come, then, to the question whether the law in Ontario should be amended to recognize expressly the importance of protecting a promisee's reliance on a promise that might otherwise not be enforceable because of lack of consideration. This question is central to any reform of the doctrine of consideration.

What are the arguments in favour of adopting a statutory provision along the lines of section 90(1) of the *Restatement*? It seems clear that, in practice, courts frequently protect reliance on a promise and it may be desirable for the sake of completeness, simplicity and clarity to empower courts to do directly what they have sought to achieve by other means. Secondly, it may be contended that consideration, while sufficient to justify the enforcement of promises, should not be the exclusive criterion of enforceability.

A third reason to recognize reliance as a basis for the enforcement of promises is the desire to prevent unfairness. Assume that A promises B to convey to him a parcel of land, and that, on the basis of this promise, B builds a cabin on the land. To allow A to renege on the promise would result in A's being unjustly enriched by the value of the cabin. Avoidance of unfairness will not, however, necessarily require that A's promise be enforced to the full extent. If, in the above example, the land promised to be conveyed by A is worth $100,000 and the cabin built by B is worth $10,000, by requiring A to pay to B the value of the cabin, the law will not only prevent A from being

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123 *Ibid.*, § 90, Comment d.

124 *Supra*, this ch., sec. 4(a)(ii).

125 *Supra*, this ch., sec. 4(c). See, also, *Second Restatement*, *supra*, note 26, § 88(c).

126 *Second Restatement*, *supra*, note 26, Appendix to the *Second Restatement*. See, also, Cumulative Annual Supplement (1984-85).

unjustly enriched but will also protect B's reliance interest. These two bases for relief — unjust enrichment and reliance — will not always be identical or coincide, but resort to either measure of damages, rather than the expectation measure of damages, will usually be sufficient to ensure fairness.

In some cases, on the other hand, the reliance measure and the expectation measure will lead to the same result. For example, where an insurance policy holder is advised by the insurer that the policy will be changed to insure against a certain event, and where the insurer fails to make the change and the event occurs, the same damages will be appropriate whether one seeks to protect the reliance or the expectation interest of the insured.

These examples are intended simply to show that the enforceability of reliance-based promises need not require full enforcement in all cases, but can be limited as justice requires.

What are the arguments against the adoption of an equivalent to section 90(1) of the *Restatement*? One possible argument is that such a provision, when considered in conjunction with the other recommendations in this chapter, would all but abolish the doctrine of consideration. Secondly, it may be contended that a provision like section 90(1) would result not only in flexibility, but also in uncertainty in an area of law that requires certainty.

The Commission does not find these arguments convincing. The doctrine of consideration is already subject to a great many exceptions. These exceptions have had the effect of minimizing the rigours of the doctrine and introducing flexibility into the law. We venture to surmise that few supporters could be found for giving effect to the pure doctrine of consideration: it is simply too late in the day for this to be a reasonable alternative. Moreover, we do not share the view that a provision similar to section 90(1) will introduce undue uncertainty. As we sought to point out above, the present law includes various devices to circumvent the strict doctrine of consideration, and does so without openly recognizing the basis for enforcing promises where there has been reliance by promisees. This we find to be an unsatisfactory state of the law of contracts.

Accordingly, we recommend that a promise that the promisor would reasonably expect to induce action or forbearance on the part of the promisee or a third person and that does induce such action or forbearance should be binding if injustice can be avoided only by enforcing the promise. To ensure that justice is done, not only for promisees but also for promisors, we further recommend that the remedy granted for breach of a promise inducing reliance should be limited as justice requires.

We recognize that such a provision would overlap with a number of existing principles and proposed statutory reforms. The former would include the principles of waiver and estoppel. Some of the statutory reforms proposed earlier in this chapter would give full enforceability to promises formerly held unenforceable, as in the case of modifications of contracts. Where such provisions would be applicable, a general provision protecting reliance would, of course, not be needed. Where existing concepts of estoppel apply, again a

general reliance provision would be unnecessary. But there are gaps in the present law. It is doubtful, for example, to what extent estoppel can be used by a promisee seeking positive enforcement, rather than seeking to raise the promise as a defence. Consequently, the general provision for the protection of reliance proposed here is to be regarded as an independent, as well as a residuary provision, empowering the court to protect reliance whether or not other legal doctrines prove incapable of doing so.

The preceding discussion of the reliance provision of the *Restatement* has made no reference to section 90(2), which states as follows:

> 90.-(2) A charitable subscription or a marriage settlement is binding under Subsection (1) without proof that the promise induced action or forbearance.

Some American cases, going back to the nineteenth century, have enforced charitable subscriptions even without proof of reliance by the promisee.[127] In Canada, it has been clearly established since 1934[128] that no special rule applies to charitable subscriptions. They are unenforceable unless they are under seal or meet the test of consideration. In the Commission's view, there is no need for a change in the law on this point. The early cases enforcing such subscriptions go back to a period when institutions providing needed social services were wholly dependent on private subscriptions. Moreover, the effect of treating subscriptions as fully enforceable promises will be, where the promisor becomes insolvent, to rank the charity equally with creditors who have given full value, and ahead of the promisor's dependants, who may be in need. If it is generally sound to permit a promisor to withdraw a gratuitous promise, we see no reason to depart from this rule when the promisee is a charity. Further, in accordance with our proposal below,[129] a signed and witnessed writing will replace the seal as the test of enforceability of formal contracts. This, in our opinion, gives ample opportunity to charities to secure binding promises.

Insofar as marriage settlements are concerned, again, we see no need for a special rule, especially in light of the fact that marriage settlements are rare in modern times.

Recommendations

The Commission makes the following recommendations:

1. Section 16 of the *Mercantile Law Amendment Act* should be amended to make it clear that an agreement, whether executed or executory, by an obligee to accept part performance of an obligation in place of full performance, as well as an agreement to waive performance of an obligation, need no consideration to be binding.

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[127] Farnsworth, *Contracts* (1982), § 2.19, at 90-91.

[128] *Dalhousie College v. Boutilier Estate*, [1934] S.C.R. 642, [1934] 3 D.L.R. 593.

[129] *Infra*, ch. 3, sec. 4(a).

2. An agreement under the proposed revised section 16 of the *Mercantile Law Amendment Act* should be revocable by the obligee for breach, unless the breach of the obligation of part performance by the obligor is merely trivial or technical.

3. A provision similar to section 4.8 of the proposed *Sale of Goods Act* should be enacted to provide as follows:

   (a) an agreement in good faith modifying a contract should not require consideration in order to be binding;

   (b) an agreement that excludes modification or rescission except by a signed writing should not be otherwise subject to modification or rescission but, except as between parties acting in the course of business, such a requirement on a form supplied by a party acting in the course of a business should be required to be signed separately by the other party;

   (c) an attempt at modification or rescission that does not satisfy the requirements of the preceding paragraph or that does not satisfy any statutory requirement of writing or corroboration should be capable of operating as a waiver or equitable estoppel; and

   (d) where paragraph (c) applies, a party who has waived compliance with an executory portion of a contract should be able to retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived unless it would be unjust in view of a material change in position in reliance on the waiver to allow the waiver to be retracted. In the case of an equitable estoppel, a similar principle should apply.

4. A promise made in recognition of a benefit previously received by the promisor or by any third party from the promisee, should be enforceable to the extent necessary to prevent unjust enrichment.

5. A promise made in recognition of a benefit previously received by the promisor or by any third party from the promisee, should not be enforceable where the promisee conferred the benefit as a gift or where for other reasons the promisor has not been unjustly enriched.

6. Promises supported by past consideration, where enforceable, should be enforceable only to the extent that the value of the promise is not disproportionate to the benefit.

7. An offer, made by a person in the course of a business, which expressly provides that it will be held open should not be revocable for lack of consideration during the time stated or, if no time is stated, for a reasonable time not to exceed three months.

8. There should be no change in the law relating to firm offers not made in the course of business; that is, in order to be enforceable, a firm offer, when made by a non-merchant, should be supported by consideration or comply with the requisite formalities (See *infra*, ch. 3, Recommendation 2).

9. A promise that the promisor would reasonably expect to induce action or forbearance on the part of a promisee or a third person and that does induce such action or forbearance should be binding if injustice can be avoided only by enforcing the promise.

10. The remedy granted for breach of a promise inducing reliance should be limited as justice requires.

11. No special rule should be adopted for the enforceability of charitable subscriptions or promises to make a marriage settlement.

CHAPTER 3

FORMAL CONTRACTS

1. INTRODUCTION

An agreement that is not supported by consideration is enforceable if made under seal. The issue to be considered in this chapter is whether the use of seals to make a binding agreement should be discontinued and, perhaps, replaced by some other formality to give force to gratuitous promises.

2. THE PRESENT LAW

Holdsworth's *A History of English Law*[1] contains the following passage on the origins and use of a sealed writing in the context of the law of contracts:

> The action of covenant was the action which was brought upon instruments which were enforceable by virtue of their form. After a period of hesitation it was settled in Edward I.'s reign that that form must be a writing which is sealed.
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> ....
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> In later days, when the doctrine of consideration had come to be the most distinctive feature of the English law of contract, these contracts under seal were thought to be brought into line with the general rule requiring consideration, by saying that the seal imports a consideration, and that the parties were therefore bound. This view that the seal imports a consideration was put forward as early as 1566; but at that date the theory of consideration was not completely developed; and the expression was there used somewhat metaphorically to express the undoubted truth that the operation of the seal upon the agreement was similar to the operation of a consideration, in that it made it enforceable at law. But if the expression is used to mean that consideration is presumed, it obviously gives a wholly false view of the reason why the stipulations in an instrument under seal are enforceable. They are enforceable by reason, not of the presumption of consideration, but of the form of the instrument ....

Most of the case law concerning promises under seal in the last one hundred years is concerned with determining the prerequisites of a promise under seal.[2] It is a question of fact in each case whether a document is

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[1] Holdsworth, *A History of English Law* (rep. 1966), Vol. III, at 417 and 419 (footnote references omitted).

[2] *Zwicker v. Zwicker* (1899), 29 S.C.R. 527; *Ross v. Ross* (1977), 80 D.L.R. (3d) 377 (N.S.S.C., T.D.); and *Helm v. Simcoe Erie General Ins. Co.* (1980), 108 D.L.R. (3d) 8 (Alta. C.A.).

effectively sealed. Particularly in recent years, the intentions of the party purported to have executed a sealed document appear to be more significant than the traditional or ceremonial aspects of sealing. This is illustrated by three recent Ontario cases, including a decision of the Court of Appeal, in which the elements necessary for sealing were considered.

In *Linton v. Royal Bank of Canada*,[3] the validity of a guarantee was at issue. Although the guarantee document contained the phrase "signed, sealed and delivered", and the word "seal" appeared in parentheses opposite the space provided for signatures, no seal was affixed to the document at the time of execution. Subsequently, a seal was affixed in the appropriate place, without the knowledge or consent of the plaintiff. The plaintiff argued that the affixing of the seal by one of the bank's employees constituted an unauthorized material alteration to the contract, enabling the plaintiff to avoid the contract. Since he concluded that the document was a sealed document without the subsequently attached seal, Mr. Justice Hartt held that the addition of the seal did not constitute a material alteration.[4] In coming to this conclusion, Hartt J. relied on two earlier English decisions: *Re Sandilands*[5] and *Stromdale & Ball, Ltd. v. Burden*.[6] These cases support the proposition that no particular formality is necessary to constitute a sealing.[7] If a document contains some indication of a seal, the fact that a person intended to execute the document as a deed is sufficient adoption or recognition of the "seal" to amount to proper execution as a deed.[8]

Six months after the decision in *Linton v. Royal Bank of Canada*, the Ontario Court of Appeal gave judgment in *Royal Bank of Canada v. Kiska*,[9] another case involving a guarantee. As in the case of *Linton v. Royal Bank of Canada*, at the time the guarantee was signed, "no wafer seal was affixed to it, the word 'seal' in brackets was printed upon the document immediately to the right of the space in which [the] signature was written and an attesting witness signed his name".[10] The majority of the Court decided that the guarantee was binding because it was supported by consideration, so that it was not necessary to decide whether the guarantee was made under seal.

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[3] [1967] 1 O.R. 315, 60 D.L.R. (2d) 398 (H.C.J.) (subsequent reference is to [1967] 1 O.R.).

[4] *Ibid.*, at 318-19.

[5] *Re Sandilands* (1871), L.R. 6 C.P. 411.

[6] *Stromdale & Ball, Ltd. v. Burden*, [1952] Ch. 223, [1952] 1 All E.R. 59 (subsequent reference is to [1952] Ch.).

[7] *Supra*, note 5, at 413.

[8] *Supra*, note 6, at 230.

[9] *Royal Bank of Canada v. Kiska*, [1967] 2 O.R. 379, 63 D.L.R. (2d) 582 (C.A.) (subsequent references are to [1967] 2 O.R.).

[10] *Ibid.*, at 381.

Laskin J.A. (as he then was) disagreed, however, with the majority's conclusion on the issue of consideration. As a result, he was obliged to determine whether or not the guarantee was valid as a contract under seal. Mr. Justice Laskin began by outlining the present day purpose of sealing:[11]

> We are in the field of formality; and so long as the doctrine of consideration subsists with its present constituents, it is commercially useful to have an alternative method of concluding a binding transaction. The formal contract under seal is not as formal today as it was in the time of Coke; apart from statute (and there is none on the subject in Ontario relevant to the present case), there has been a recognized relaxation of the ancient common law requirement of a waxed impression .... A gummed wafer is enough when affixed by or acknowledged by the party executing the document on which it is placed. I would hold also that any representation of a seal made by a signatory will do. The present case is an invitation to be satisfied with less than the foregoing. We confront the question of how far we should, as a common law development, relax formality and still affirm that we are not enforcing a gratuitous promise merely because it is in writing.

Turning, then, to the facts of the case before him, Laskin J.A. rejected the argument that the mere presence of the words "Given under seal at ..." and "Signed, Sealed and Delivered in the presence of" or the bracketed word "seal", either individually or when considered together, were sufficient to enable a court to conclude that the guarantee had been executed under seal. He rested his finding on the following reasoning:[12]

> The respective words are merely anticipatory of a formality which must be observed and are not a substitute for it. I am not tempted by any suggestion that it would be a modern and liberal view to hold that a person who signs a document that states it is under seal should be bound accordingly although there is no seal on it. I have no regret in declining to follow this path in a case where a bank thrusts a printed form under the nose of a young man for his signature.

Another Ontario decision respecting the prerequisites for sealing is *Procopia v. D'Abbondanzo*.[13] This case involved a lease that was signed by the parties thereto, but to which no seal was affixed. The plaintiff was the assignee of the lessee; the defendants had purchased the leased premises from the original lessor. The defendants consented to the assignment of the lease and this assignment was made under seal. The defendants attempted to question the validity of the original lease since no seal had been affixed to it when executed. Mr. Justice Donnelly rejected the defendants' argument. While remarking that "[c]onsideration must be given to the lack of seals on the original lease",[14] he concluded, relying on the judgment of Hartt J. in *Linton v. Royal Bank of*

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[11] *Ibid.*, at 390-91.

[12] *Ibid.*, at 391-92.

[13] [1973] 3 O.R. 8, 35 D.L.R. (3d) 641 (H.C.J.) (subsequent references are to [1973] 3 O.R.).

[14] *Ibid.*, at 12.

Canada, that "[t]he parties executed the document with the intention that it be a lease under seal ... and cannot now deny that it is so".[15]

The three cases discussed above illustrate the tension in the existing law of contracts, which permits gratuitous promises to be enforced only if made under seal, yet strains to enforce such promises even though the parties to the agreement in question have not applied their minds to the elements of sealing. In other words, these cases raise the question whether the seal is the appropriate modern formality to make gratuitous promises binding.

3. THE CASE FOR REFORM

(a) GENERAL: THE NEED FOR FORMAL CONTRACTS

Before turning to consider the arguments for and against retaining the seal as a means of rendering enforceable otherwise unenforceable gratuitous promises, a brief review of the Commission's recommendations respecting the doctrine of consideration is appropriate. The Commission has proposed that the doctrine of consideration in the law of contracts should be retained, but that the most troublesome consequences of the doctrine should be addressed.[16] In particular, the Commission has proposed that the pre-existing duty rule should be substantially abrogated and has proposed changes to the rule that modification of a contract is binding only if supported by consideration.[17] Similarly, the past consideration rule would be attenuated by our recommendations relating to this matter.[18] Extension of the proposals concerning firm offers made in our *Report on Sale of Goods*[19] to the law of contracts generally addresses another much criticized result of strict adherence to the doctrine of consideration.[20] Finally, the adoption of a provision similar to section 90(1) of the *Second Restatement of the Law of Contracts*[21] would do much to soften the rigours of the doctrine of consideration.[22]

Given these proposed reforms, the question arises whether the seal or any other formality would continue to be necessary as a means of guaranteeing the enforceability of gratuitous promises. It is clear that the Commission's recommendations on consideration, if implemented, would do much to make enforceable otherwise unenforceable gratuitous promises. However, these recommendations certainly would not render all gratuitous promises enforceable; nor would they provide a method of ensuring the enforceability of even those

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15 *Ibid.*, at 13.

16 See *supra*, ch. 2, sec. 3.

17 *Ibid.*, sec. 4(a).

18 *Ibid.*, sec. 4(b).

19 Ontario Law Reform Commission, *Report on Sale of Goods* (1979), Vol. I, at 91-96.

20 See *supra*, ch. 2, sec. 4(c).

21 American Law Institute, *Restatement of the Law, Second — Contracts, 2d* (1979).

22 See *supra*, ch. 2, sec. 4(d).

kinds of promises mentioned in the preceding paragraph. Ontario courts would have considerable flexibility in determining which promises should be enforced and which should not. Moreover, under our recommendations on consideration, enforceability would not always permit full enforcement and enable the promisee to recover expectation damages. The seal, on the other hand, does guarantee full enforceability of the promise thereunder as if the promise were supported by consideration. As a result of our recommendations concerning the doctrine of consideration, then, the scope for formal contracts would be reduced substantially, but not eliminated.

Many legal systems permit or require some kind of formal contract to give effect to certain kinds of promises, gratuitous promises for the most part. There is no public policy against gifts, and a promise to make a gift can be made enforceable by the use of nominal consideration. There seems to be no objection to the use of a formality to achieve the same end. We believe that formal contracts should continue to have a place under an amended law of contracts. Promises unsupported by consideration but made with care and serious intent are generally expected to be binding, and the law should accord with such common and reasonable expectations. Formality in the making of such a promise is one way to evidence intent to bind and, at the same time, serves to caution the maker of the promise.

The discussion that follows concerns the kind of formal contract our law of contracts should countenance and, more specifically, whether the seal should be retained as a means of creating a fully enforceable contract.

(b) Retention or Abolition of the Seal: Reform Proposals from Other Jurisdictions

The traditional method of making a sealed instrument at the time of Sir Edward Coke — the formal sealing of the document with hot wax and the making of an impression thereon — may have been a solemn performance calculated to impress persons with the significance of the step they were taking. The trend since then has been one of increasing informality, so that today there exist a great many judicially approved methods of sealing. We must decide whether the requirements of sealing that are acceptable under the present law are sufficient to impress upon the maker of a sealed instrument the nature of his or her act, whether the law of sealing should be made more rigorous, or whether some other formality might not more effectively fulfil the function of the seal.

We are not the first law reform body to confront these issues. The seal and its place in the law of contracts have received substantial attention from law reformers and others. While, in all cases, alternatives to the seal as means of enforcing gratuitous promises have been considered, some would go further and deprive the seal entirely of its legal effect.

(i) The New York Law Revision Commission

In the 1930's, as a result of legislation based on recommendations made by the New York Law Revision Commission, the common law effect of the seal was thought to be abolished in New York State.[23] The relevant legislation provided that "[a] seal upon a written instrument hereafter executed shall not be received as conclusive or presumptive evidence of a sufficient consideration",[24] and that "[t]he common law effect heretofore given to a seal upon a written instrument is hereby abolished".[25] The New York courts, however, were reluctant to give full effect to these provisions and, instead, continued to give effect to the seal.[26] The New York Court of Appeals explained this judicial response in the following terms:[27]

> Throughout the centuries, the rule as to the binding effect of the seal has been founded in reason and based on necessity. Today, in the face of the tremendous number of business transactions open to investigation of the courts, reason continues to dictate and necessity to require more forcefully than before that a party to a sealed instrument should be estopped to assert want of consideration.

As a result of judicial resistance to the legislation, the New York Law Revision Commission reexamined the place of the seal in the law of contracts. The Commission opposed continued use of the seal on the ground of its inappropriateness as a method of guaranteeing solemnity and deliberateness on the part of the promisor, stating:[28]

> The seal has degenerated into an L.S. or other scrawl which, in modern practice, is frequently a printed L.S. upon a printed form. To the average man it conveys no meaning, and frequently the parties to instruments upon which it appears have no idea of its legal effects. Moreover, under the present law, the character of an instrument which bears the magic letters, but which contains no recital of sealing, is left uncertain as to whether it is sealed ....

In the background paper to the New York Law Revision Commission's Report, alternatives to the seal, such as notarization, a simple writing, or a writing that makes clear an intention to be legally bound by a promise contained in it, were considered.[29] However, the New York Commission rejected all three alternatives, doubting "the wisdom of any device that is applicable to all kinds

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[23] New York, Law Revision Commission, Legislative Document No. 65, "Acts, Recommendation and Study Relating to the Seal and to the Enforcement of Certain Written Contracts", in *Report of the Law Revision Commission* (1941) (hereinafter referred to as "New York Report"), at 357.

[24] 1935 N.Y. Laws, ch. 708.

[25] 1936 N.Y. Laws, ch. 353.

[26] New York Report, *supra*, note 23, at 368-73.

[27] *Cochran v. Taylor*, 273 N.Y. 172, at 180, 7 N.E. (2d) 89, at 91 (1937).

[28] New York Report, *supra*, note 23, at 359 (footnote references omitted). The initials L.S., or *locus sigilli*, refer to "the place of the seal".

[29] New York Report, *supra*, note 23, at 376.

of promises under all circumstances''.[30] Rather, the Commission favoured a regime that would provide specific solutions to problems related to the enforceability of specific kinds of promises, such as commercial promises unsupported by consideration, promises supported by past consideration, and firm offers.[31]

(ii) The English Law Revision Committee

In contrast to the position taken by the New York Law Revision Commission with respect to gratuitous promises, the English Law Revision Committee, in its *Sixth Interim Report*, proposed that ''an agreement shall be enforceable if the promise or offer has been made in writing by the promisor or his agent''.[32] Although the Report does not deal with the seal as such, it should be apparent that the above recommendation, if it had been adopted, would have effectively obviated the need for such a formality. Indeed, one of the Commissioners, Mr. Justice Goddard, went further and appended a Memorandum to the Report in which he recommended the abolition of the seal.

(iii) The Model Written Obligations Act

The Model Written Obligations Act, promulgated by the National Conference of Commissioners on Uniform State Laws in 1925,[33] has one substantive provision:

> 1. A written release or promise hereafter made and signed by the person releasing or promising shall not be invalid or unenforceable for lack of consideration, if the writing also contains an additional express statement, in any form of language, that the signer intends to be legally bound.

The Act is in force in only one state[34] and has been criticized by commentators. For example, the New York Law Revision Commission, in its study respecting the seal and contracts, commented that the question arising under the Act, — that is, what is an expression of intent to be legally bound — would be extremely difficult to decide.[35] As well, the New York Commission contended that the formality provided under the Act might well work against the intentions of the parties, stating as follows:[36]

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30 *Ibid.*, at 360.

31 *Ibid.*

32 England, Law Revision Committee, *Sixth Interim Report (Statute of Frauds and the Doctrine of Consideration)* (Cmd. 5449, 1937) (hereinafter referred to as ''*Sixth Interim Report*''), para. 50(2).

33 Model Written Obligations Act, National Conference of Commissioners on Uniform State Laws, Uniform Laws Annotated (1925), Vol. 9C.

34 Pennsylvania (1927 Pa. Laws 33) has adopted the provision. Utah adopted the provision but subsequently repealed it. See, Williston (ed. Jaeger), *Williston on Contracts* (3d ed., 1957), § 219, *n.* 20.

35 New York Report, *supra*, note 23, at 381.

36 *Ibid.*, at 381-82.

> The Act, like the doctrine of the seal, provides no reliable basis for distinguishing between promises which are made with added deliberation and thoughtfulness and those in which there is no such additional factor. On the one hand, promises which are in fact made with such deliberation and care will fail of enforcement where the promisor, not knowing of the requirement, omits the words of legal intent, and on the other hand, the fortuitous inclusion of words which may be interpreted by the court as expressing intent to be legally bound will make the promise enforceable though in fact the promise was made with no more deliberation and care than would characterize the making of any other promise.

The New York Commission also suggested that the Model Written Obligations Act was too broad in its sweep, covering all gratuitous promises.[37]

(iv) Other Jurisdictions

Before proceeding to outline our conclusion concerning retention of the seal, the recommendations of two other law reform agencies should be outlined briefly. The Law Reform Committee of South Australia, in a Report issued in 1971,[38] considered whether the South Australia *Law of Property Act, 1936*[39] should be amended to include a provision like section 38 of the New South Wales *Conveyancing Act*.[40] Section 38, while not abolishing the seal, provides that "[e]very instrument expressed to be an indenture or a deed, or to be sealed, which is signed and attested [by at least one witness not being a party to the deed], shall be deemed to be sealed".[41] Subject to certain amendments, the Law Reform Committee of South Australia favoured the New South Wales approach. Indeed, the Committee was prepared to go further, and recommended that, even where execution was defective, but the person to be charged therewith had intended to execute the deed and had in fact taken a benefit or benefits under it, "execution shall be deemed to be valid and binding in all respects on him".[42]

A 1975 Report issued by the Victoria Chief Justice's Law Reform Committee[43] proposed a regime in which there would be no need for the seal. While sealing was not to be deprived of its legal effect, the Committee's proposal would, if implemented, make "every instrument, executed by an individual and which is signed in the presence of an attesting witness and expressed to be delivered as a deed ... a deed, notwithstanding that it has not been sealed".[44]

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37 *Ibid.*, at 382.

38 Law Reform Committee of South Australia, *Sixteenth Report Relating to the Law on Sealing of Documents* (1971).

39 S. Austl. Stat. 1837-1936, No. 2328.

40 *Conveyancing Act, 1919*, Stat. N.S.W. 1824-1957, No. 6.

41 *Ibid.*, s. 38(3).

42 *Supra*, note 38, para. 6.

43 Victoria, Chief Justice's Law Reform Committee, *Sealing of Documents* (1975).

44 *Ibid.*, para. 4.

(c) CONCLUSION

While the law reform bodies that have examined the question of the seal and its place in the modern law of contracts have not all arrived at the same substitute for the seal, there would seem to be agreement that the seal has outlived its usefulness as the sole formality available to ensure the enforcement of gratuitous promises in the law of contracts. Because the magic or solemnity of the seal has diminished over the years, other formalities more relevant to current needs have been suggested. Perhaps no more succinct criticism of the seal is to be found than the following comments of Mr. Justice Cardozo, then Chief Justice of the New York Court of Appeals:[45]

> In days when seals counted for a good deal, there may have been some reason in this recognition of a mystical solemnity. In our day, when the perfunctory initials 'L.S.' have replaced the heraldic devices, the law is conscious of its own absurdity when it preserves the rubrics of a vanished era. Judges have made worthy, if shamefaced, efforts, while giving lip service to the rule to riddle it with exceptions and by distinctions reduce it to a shadow. A recent case suggests that timidity, and not reverence, has postponed the hour of dissolution. The law will have cause for gratitude to the deliverer who will strike the fatal blow.

We believe that the seal no longer plays a useful role in the law of contracts, and should be abolished. It may be argued that this is too radical a step, and that, while an alternative to the seal should be authorized by law, the seal should be retained because of its familiarity. Some would contend that lawyers, if not laypersons, do appreciate the significance of the seal and, therefore, the seal should be retained as a formality, although not the exclusive formality, to give full force and effect to gratuitous promises.

We are not convinced by this argument. If all persons making gratuitous promises were knowledgeable about the legal ramifications of the seal, retaining the seal might be sensible. But it is precisely because there are many individuals who do not appreciate the significance of a seal being affixed to a document, or of the words "signed, sealed and delivered" appearing on an agreement, that we believe the seal should be abolished. In our view, it would make little sense to retain the seal because of the legal community's attachment to what is generally agreed to be an anachronism. Accordingly, we recommend that the seal should be denied all legal effect in the law of contracts.

4. A REPLACEMENT FOR THE SEAL

(a) GENERAL

Given the Commission's reasons for recommending the abolition of the use of the seal as a means of creating a fully enforceable contract, we are somewhat constrained in our selection of a substitute for the seal. It is our belief that the cautionary function once served by the seal would be better served by some other formality more generally understood by Ontario's citizens.

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[45] Cardozo, *The Nature of the Judicial Process* (1921), at 155-56 (footnote references omitted).

In our view, the proposal of the English Law Revision Committee[46] that a promise or offer made in writing by the promisor or an agent should be binding would not be an adequate replacement for the seal. As a number of critics of this recommendation in the *Sixth Interim Report* have pointed out,[47] this type of formality would not serve the cautionary function generally ascribed to formalities, although it would serve the evidentiary function.

We consider that a signed writing would not be much better than a writing requirement, since it too would not be sufficient to caution against the making of rash promises that are not intended to have legal consequences. For example, a signed writing requirement would be satisfied by a letter or a note from the promisor. This substitute for the seal, in our view, would cast too wide a net, catching many promises not intended to be legally binding.

A further alternative is notarization, a method of creating legal obligations that is widely used in civil law systems. We reject this approach because it imposes too great a burden on those persons wishing to bind themselves legally. In many cases, it would require one to travel to the office of a notary and incur the expense associated with notarization.

The formality that we favour as a substitute for the seal is a "witnessed signed writing". We would define a "witnessed signed writing" as a writing executed by the party to be bound in the presence of a witness and signed by the witness in the presence of the executing party. Unlike notarization, this alternative would be unlikely to result in any inconvenience to the public. At the same time, it would serve some cautionary purpose. Accordingly, we recommend that a witnessed signed writing should take the place of the seal for the purposes of contract law.

We would emphasize that it is not our intention to give any countenance to gratuitous promises secured by unconscionable behaviour. In this respect, we draw attention to the fact that our recommendations respecting the doctrine of unconscionability[48] would apply to promises that would otherwise be enforceable under the above recommendation.

(b) SUBSIDIARY ISSUES

Before we leave the topic of the seal, there are two subsidiary issues that should be addressed. The first concerns the limitation period applicable to witnessed signed writings. The second concerns the remedies available in respect of witnessed signed writings.

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[46] *Sixth Interim Report*, *supra*, note 32, para. 50(2).

[47] The comments of many of the critics are summarized in Sutton, *Consideration Reconsidered* (1974), at 225-28.

[48] See *infra*, ch. 6.

(i) Limitation Period

Under the present law, a promise under seal, also known as a specialty, attracts a twenty year limitation period. Section 45(1)(b) of the *Limitations Act*[49] provides as follows:

> 45.-(1) The following actions shall be commenced within and not after the times respectively hereinafter mentioned,
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> ....
>
> (b) an action upon a bond, or other specialty, except upon a covenant contained in an indenture of mortgage made on or after the 1st day of July, 1894;
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> ....
>
> within twenty years after the cause of action arose ....

In our *Report on Limitation of Actions*,[50] we proposed that this period be reduced to ten years.[51] It should be noted that, under the scheme envisaged by us, only judgments would attract a twenty year limitation period;[52] the next longest period would be ten years.

In 1977, the Ontario Ministry of the Attorney General released a *Discussion Paper on Proposed Limitations Act*.[53] The Ministry's *Discussion Paper* favoured a six year limitation period for contracts under seal as opposed to the ten year period suggested by the Commission. The *Discussion Paper* contained the following rationale for the six year limitation period for such contracts:[54]

> Actions on deeds may either be treated as an ordinary contract action or may be given a longer limitation period. After full discussion, the Ontario Law Reform Commission concluded that there were good but not compelling reasons for either choice, and on balance the limitation period applicable to actions on deeds should be ten years rather than the six-year period for contracts not under seal.
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> The Law Reform Commission of British Columbia recommended that deeds be treated for limitation purposes the same as contracts not under seal and the 1975 British Columbia *Limitations Act* implements that recommendation. *The Uniform*

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[49] R.S.O. 1980, c. 240.

[50] Ontario Law Reform Commission, *Report on Limitation of Actions* (1969).

[51] *Ibid.*, at 42-47.

[52] *Ibid.*, at 47-51.

[53] Ontario, Ministry of the Attorney General, *Discussion Paper on Proposed Limitations Act* (1977).

[54] *Ibid.*, at 38-39. See, also, *Limitations Act, 1983*, Bill 160, 1983 (32d Leg. 3d Sess.). The Bill, which received only first reading in 1983, has not been reintroduced. It provided five general limitation periods. Consistent with the Draft Bill proposed in the *Discussion Paper*, contracts under seal would have been governed by a six year limitation period (see s. 3(6)).

Limitations of Actions Act, adopted by four provinces and the two territories provides for a six-year period for both deeds (specialties) and contract. Once again, we believe that in the absence of strong reasons to the contrary, the arguments in favour of uniformity of limitations legislation should prevail and that the six-year period should apply to both deeds and contracts not under seal. However, if good reasons are found for retaining a ten-year period for actions with respect to charges on both real and personal property, a ten-year period should be applied to deeds.

Having abolished the seal, the question arises whether the limitation period for its replacement — a witnessed signed writing — should be the same as that applicable to contracts generally, or whether a special limitation period is justified. In our view, a promise in a witnessed signed writing should be treated by the law the same as any other contract. We can see no convincing reason for an extended limitation period for such contracts.

Accordingly, we recommend that an action for breach of a promise contained in a witnessed signed writing should be required to be brought no later than six years from the date that the cause of action arose, in accordance with the Commission's proposals concerning the limitation period for actions in contract in its *Report on Limitation of Actions*. This recommendation is also consistent with the limitation period governing contracts proposed by both the Ontario Ministry of the Attorney General in its *Discussion Paper* and the Ontario Government in its 1983 Bill.[55]

(ii) Remedies

Under present law, equitable remedies may not be available for the enforcement of a gratuitous promise under seal. The position of the courts of equity in regard to sealed instruments was consistent with the general equitable approach to gratuitous promises. That is, the courts of equity required that any gift be completed before equity would intervene.[56] Equitable remedies were, therefore, frequently unavailable to the gratuitous promisee.[57] There would seem to be no basis for such a distinction now. The fusion of law and equity should have resulted in a unified approach to the enforcement of promises and there is nothing that would justify an award of damages for breach of a gratuitous promise that would not justify an award of specific performance.[58]

While we have recommended that the seal be abolished for the purposes of contract law, we are concerned that this restriction on the remedies available for the enforcement of gratuitous promises under seal might be held to apply to our

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[55] *Supra*, notes 53 and 54.

[56] *Milroy v. Lord* (1862), 4 De G.F. & J. 264, 45 E.R. 1185.

[57] See *Jefferys v. Jefferys* (1841), Cr. & Ph. 139, 41 E.R. 443; *Savereux v. Tourangeau* (1908), 16 O.L.R. 600 (Div. Ct.); and *Riches v. Burns* (1924), 27 O.W.N. 203 (H.C.J.). But see *Mountford v. Scott*, [1975] 1 All E.R. 248 (C.A.), and Waddams, *The Law of Contracts* (2d ed., 1984), at 132.

[58] Sharpe, "Specific Relief for Contract Breach", in Reiter and Swan (eds.), *Studies in Contract Law* (1980) 123, and Swan, "Damages, Specific Performance, Inflation and Interest" (1980), 10 R.P.R. 267.

proposed substitute for the seal. Accordingly, the Commission recommends that the *Courts of Justice Act, 1984*[59] should be amended to empower a court, in any action upon a gratuitous promise where it is determined that damages could be given for breach of such promise, to grant an injunction or order specific performance thereof if it considers it proper to do so, notwithstanding that the promise was gratuitous.

Recommendations

The Commission makes the following recommendations:

1. The seal should be denied all legal effect in the law of contracts.

2. (1) A witnessed signed writing should take the place of the seal for the purposes of contract law.

   (2) A witnessed signed writing should be defined as a writing executed by the party to be bound in the presence of a witness and signed by the witness in the presence of the executing party.

3. An action for breach of a promise contained in a witnessed signed writing should be governed by the same limitation period as that applicable to contracts generally, that is, six years from the date the cause of action arose.

4. The *Courts of Justice Act, 1984* should be amended to empower a court, in any action upon a gratuitous promise where it is determined that damages could be given for breach of such promise, to grant an injunction or order specific performance thereof if it considers it proper to do so, notwithstanding that the promise was gratuitous.

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[59] S.O. 1984, c. 11.

CHAPTER 4

THIRD PARTY BENEFICIARIES AND PRIVITY OF CONTRACT

1. INTRODUCTION

The doctrine of privity is to the effect that only a party to a contract may enforce it. A person not a party to a contract cannot claim any benefit under it or rely on it by way of defence to a claim.[1] The doctrine has been justified on the ground that contracts are very personal things and that only those who actually make them should be allowed to enforce them.[2] A related concern is that only those who give consideration should be permitted to sue to enforce contractual undertakings.[3]

The persuasiveness of these reasons may be questioned, particularly in view of the serious practical difficulties engendered by the doctrine of privity. The doctrine impairs the enforceability of sensible commercial and personal arrangements made on a daily basis. Not surprisingly, therefore, the courts have sought to by-pass the doctrine by resorting to trust law, agency notions, and the concept of collateral contracts to enable intended beneficiaries of contracts to enforce stipulations made for their benefit. As a result, this area of the law of contracts is in a very unsatisfactory state.

The sanctity of the privity of contract rule has been further diminished by substantial statutory inroads.[4] This Commission, in at least two Reports, has recommended changes in the law that, if implemented, would result in

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[1] See, for example, *Canadian General Electric Co. Ltd. v. Pickford & Black Ltd.*, [1971] S.C.R. 41, 14 D.L.R. (3d) 372, and *Greenwood Shopping Plaza Ltd. v. Beattie*, [1980] 2 S.C.R. 228, 111 D.L.R. (3d) 257; and compare *International Terminal Operators Ltd. v. Miida Electronics Inc.*, [1986] 1 S.C.R. 752, 68 N.R. 241.

[2] See, for example, Treitel, *The Law of Contract* (6th ed., 1983), at 458.

[3] See, for example, *Dunlop Pneumatic Tyre Co., Ltd. v. Selfridge & Co., Ltd.*, [1915] A.C. 847, [1914-15] All E.R. Rep. 333 (H.L.) (subsequent references are to [1915] A.C.).

[4] See discussion *infra*, this ch., sec. 2(b)(v).

additional erosion of the rule.[5] Consequently, the Commission believes that this is the proper time to reevaluate the principle of privity of contract. We begin with a review of the present law.

2. THE PRESENT LAW

(a) THE DOCTRINE OF PRIVITY

The present law relating to contracts for the benefit of third parties is complex and difficult to state, owing to the considerable divergence between theory and practice. The exceptions to the doctrine of privity and glosses on it which the courts have developed have no rational basis except to avoid the application of the doctrine, so that it is easy to understand why the courts' attempts to reconcile the exceptions with the doctrine have resulted in confusion and complexity. It is these tendencies that appear to offer the best explanation of the current state of the law relating to third party beneficiaries.

It was held in the 1861 English case of *Tweddle v. Atkinson*[6] that only a party to a contract could sue on it, and that only one who had paid for a promise could enforce it. This rule, although apparently contrary to some earlier common law authority,[7] has since been forcefully affirmed by the House of Lords[8] and the Supreme Court of Canada.[9] Such affirmations notwithstanding, judicial misgivings regarding the doctrine have been expressed with some frequency, particularly in England. Some of the law lords have called for

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[5] See Ontario Law Reform Commission, *Report on Consumer Warranties and Guarantees in the Sale of Goods* (1972) (hereinafter referred to as "Consumer Warranties and Guarantees Report"), at 65-77, and Ontario Law Reform Commission, *Report on Sale of Goods* (1979) (hereinafter referred to as "Sales Report"), Vol. I, at 128, 132, and 243-55.

[6] (1861), 1 B. & S. 393, 121 E.R. 762.

[7] See, for example, *Dutton v. Poole* (1678), 2 Lev. 210, 83 E.R. 523, and *Ferguson v. Kerr* (1850), 5 U.C.Q.B. 261. See, also, Corbin, *Corbin on Contracts* (1951), Vol. 4, § 839, *n.* 11.

[8] See *Dunlop Pneumatic Tyre Co., Ltd. v. Selfridge & Co., Ltd.*, *supra*, note 3; *Midland Silicones Ltd. v. Scruttons Ltd.*, [1962] A.C. 446, [1962] 1 All E.R. 1 (H.L.); *Beswick v. Beswick*, [1968] A.C. 58, [1967] 2 All E.R. 1197 (H.L.) (subsequent reference is to [1968] A.C.); and *Woodar Investment Development Ltd. v. Wimpey Construction (U.K.) Ltd.*, [1980] 1 W.L.R. 277, [1980] 1 All E.R. 571 (H.L.) (subsequent reference is to [1980] 1 W.L.R.).

[9] *Greenwood Shopping Plaza Ltd. v. Beattie*, *supra*, note 1; *Canadian General Electric Co. Ltd. v. Pickford & Black Ltd.*, *supra*, note 1; and *Vandepitte v. Preferred Accident Insurance Co.*, [1932] S.C.R. 22, [1932] 1 D.L.R. 107, aff'd [1933] A.C. 70 (P.C. (Can.)).

reform of the law in this area.[10] The doctrine has also attracted severe academic criticism.[11]

(b) EXCEPTIONS TO THE DOCTRINE OF PRIVITY

Although Anglo-Canadian courts have repeatedly affirmed the doctrine of privity of contract, the same courts have created and employed a number of exceptions to it. In this section, we describe briefly the legal devices used to circumvent the privity of contract rule, and the limitations that have been imposed on their use.

(i) Trust Law

Up until the late nineteenth century, the common law courts were still in the process of settling the law.[12] The courts of equity had recognized rights of third party beneficiaries of contracts by the middle of the eighteenth century. In *Tomlinson v. Gill*,[13] the defendant had promised a widow that, if she would consent to his appointment as administrator of her deceased husband's estate, he would pay the debts of the deceased to the extent of any deficiency of the assets of the estate. The plaintiff, a creditor of the deceased, brought a bill in equity to enforce the promise. He obtained his decree on the ground that the widow was a trustee for the plaintiff since the promise was made for his benefit. Lord Hardwicke said:[14]

> The plaintiff is proper for relief here .... He could not maintain an action at law, for the promise was made to the widow; but he is proper here, for the promise was for the benefit of the creditors, and the widow is a trustee for them.

Tomlinson v. Gill was an early application of the trust concept for the advantage of a contract beneficiary. Later English judicial decisions continued to draw on trust notions to allow third party beneficiaries to recover.[15] Ontario courts availed themselves of the same technique to afford relief.[16]

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[10] See, for example, Lord Reid's comments in *Beswick v. Beswick*, *supra*, note 8, at 72, and Lord Scarman's comments in *Woodar Investment Development Ltd. v. Wimpey Construction (U.K.) Ltd.*, *supra*, note 8, at 300-01.

[11] See, for example, Corbin, "Contracts for the Benefit of Third Persons" (1930), 46 L.Q. Rev. 12; Swan and Reiter, "Developments in Contract Law: The 1979-80 Term" (1981), 2 Sup. Ct. L.R. 125; and Waddams, "Third Party Beneficiaries in the Supreme Court of Canada" (1981), 59 Can. B. Rev. 549.

[12] See *supra*, this ch., sec. 2(a).

[13] (1756), Amb. 330, 27 E.R. 221 (subsequent reference is to 27 E.R.).

[14] *Ibid.*, at 222.

[15] See, for example, *Gregory v. Williams* (1817), 3 Mer. 582, 36 E.R. 224; *Fletcher v. Fletcher* (1844), 4 Hare 67, 67 E.R. 564; *Lloyd's v. Harper* (1880), 16 Ch. D. 290, 50 L.J. Ch. 140 (C.A.); and *Les Affréteurs Réunis Société Anonyme v. Leopold Walford (London), Ltd.*, [1919] A.C. 801, 88 L.J.K.B. 861 (H.L.).

[16] See, for example, *Mulholland v. Merriam* (1872), 19 Gr. 288, aff'd (1873), 20 Gr. 152, and *Kendrick v. Barkey* (1907), 9 O.W.R. 356 (H.C.J.).

In this century, however, English and Canadian courts have been more reluctant to discover a trust in order to allow third parties to sue directly. The English Court of Appeal sounded the death knell for wide use of trust law in this context in *Re Schebsman*.[17] Schebsman had made a contract of settlement with his employer whereby the employer promised to make payments to Schebsman's wife and daughter after his death. Schebsman died and the Court held that, with respect to the payments due to the widow and daughter, Schebsman was neither an agent nor a trustee. In his decision, du Parcq L.J. said:[18]

> [U]nless an intention to create a trust is clearly to be collected from the language used and the circumstances of the case, I think that the court ought not to be astute to discover indications of such an intention.

A number of more recent authorities have also refused to find trusts enabling third parties to sue directly, in the absence of evidence of a clear intention to create a trust.[19]

It will be seen therefore that the technique of finding a trust appears to have fallen into disfavour of late. While it is still theoretically available, since the existence of an intention to create a trust is always a question to be decided on the facts of the individual case, trust notions cannot be relied on as a means of recognizing third party rights.

(ii) The Law of Agency

A second method that courts have employed to avoid results dictated by strict adherence to the doctrine of privity is to conclude that the promisee has contracted with the promisor as an agent of the third party beneficiary. So long as the promisee is found to be an agent for the third party, it is clear that the third party can sue the promisor directly and the privity requirement is circumvented.[20] However, it is difficult to predict when the courts will make use of the agency concept to enforce the rights of a third party beneficiary of a contract, since the question whether some sort of agency relationship exists must be determined on the facts of each case.[21] The situation in respect of the agency device thus resembles that in respect of the trust device described above.

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[17] [1944] Ch. 83, [1943] 2 All E.R. 768 (C.A.) (subsequent reference is to [1944] Ch.).

[18] *Ibid.*, at 104.

[19] See, for example, *Fournier Van & Storage Ltd. v. Fournier*, [1973] 3 O.R. 741, 38 D.L.R. (3d) 161 (H.C.J.), and *Green v. Russell*, [1959] 2 Q.B. 226, [1959] 2 All E.R. 525 (C.A.).

[20] See, for example, *International Terminal Operators Ltd. v. Miide Electronics Inc.*, *supra*, note 1; *New Zealand Shipping Co. Ltd. v. A.M. Satterthwaite & Co. Ltd.*, [1975] A.C. 154, [1974] 1 All E.R. 1015 (P.C.(N.Z.)); and *Ceres Stevedoring Co. Ltd. v. Eison und Metall A.G.* (1976), 72 D.L.R. (3d) 660 (Que. C.A.).

[21] Compare *Ceres Stevedoring Co. Ltd. v. Eison und Metall A.G.*, *supra*, note 20, and *Calkins & Burke Ltd. v. Far Eastern Steamship Co.* (1976), 72 D.L.R. (3d) 625, [1976] 4 W.W.R. 337 (B.C.S.C.).

(iii) Assignment of Contractual Rights to Third Party Beneficiaries

An assignment creates a contractual right in one who is not a party to the original agreement and, as such, provides another way to avoid third party privity problems. If a court determines that a contractual right was validly assigned to a third party, that third party's rights become enforceable.[22] Equity has long recognized the validity of assignments of choses in action,[23] and legislation specifically recognizes a legal right arising from an assignment.[24] However, the usefulness of this device is limited because not all contracts are assignable. For example, some contracts cannot be assigned as a matter of public policy.[25] In addition, with contracts that can be assigned, there must be sufficient evidence of the assignment in fact of the promisee's rights to the third party before the third party will be allowed to sue.[26]

(iv) Other Legal Techniques to Avoid the Privity of Contract Rule

Other legal techniques that have been used by the courts to enable third parties to enforce contractual claims against promisors include recent developments in tort law such as actions in negligent misstatement and the construction of collateral contracts.

The creation of a right of action for negligent misstatement, and extensions of the neighbour principle enunciated in *Donoghue v. Stevenson*,[27] have at times served to circumvent the doctrine of privity of contract by making persons who assume a duty of care under a contract liable to persons other than the promisee. The principle enunciated by the House of Lords in *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*[28] and adopted by the Supreme Court of Canada in *Haig v. Bamford*,[29] has resulted, for example, in liability on the part of an auditor to a third party where it was reasonable to expect that the third party would rely on the financial statements prepared by the auditor. The case law includes examples of liability on the part of other professionals as well.[30]

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22 See, for example, *Andrews v. Moodie* (1907), 6 W.L.R. 185, 17 Man. R. 1 (C.A.), and *Maloney v. Campbell* (1897), 28 S.C.R. 228.

23 *Row v. Dawson* (1749), 1 Ves. Sen. 331, 27 E.R. 1064, and *Fitzroy v. Cave*, [1905] 2 K.B. 364 (C.A.), at 372.

24 *Conveyancing and Law of Property Act*, R.S.O. 1980, c. 90, s. 53.

25 *Re Robinson* (1884), 27 Ch. 160 (C.A.). In that case an assignment of a right to alimony was invalid as being against public policy.

26 *Frontenac Loan & Investment Society v. Hysop* (1892), 21 O.R. 577 (Ch. D.).

27 [1932] A.C. 562, [1932] All E.R. Rep. 1 (H.L.). Atkin L.J. defined a neighbour at law to be a person who is so closely and directly affected by one's act or omission that one ought to contemplate that that person would be affected by the act or omission.

28 [1964] A.C. 465, [1963] 2 All E.R. 575 (H.L.).

29 [1977] 1 S.C.R. 466, 72 D.L.R. (3d) 68.

30 See Linden, *Canadian Tort Law* (3d ed., 1982), at 436.

Beswick v. Beswick[31] provides an example of judicial enforcement of third party rights at the suit of the promisee. In that case, a nephew promised his uncle that, in consideration of the transfer of the uncle's business to the nephew, the nephew would pay his aunt an annuity after his uncle's death. The annuity was not paid, and the aunt sued the nephew in her capacity as administratrix of her husband's estate and personally. While it was assumed that the aunt could not succeed in her personal capacity, and while some judges conceded that, in a suit for damages, the aunt as administratrix would recover only nominal damages, nevertheless the House of Lords awarded specific performance to the widow in her capacity as administratrix. Some Canadian decisions have applied the approach used in the *Beswick* case in order to protect third party interests.[32]

Courts have also construed collateral contracts between the promisor and the third party in order to enforce third party rights.[33] However, the construction of collateral contracts tends to require complex and artificial reasoning and is only feasible in limited fact situations.

(v) Statutory Exceptions to the Doctrine of Privity

In addition to judicial inroads on the doctrine of privity of contract, there are numerous legislative provisions in Ontario that enable someone other than a party to a contract to claim the benefit thereunder. Many of the statutory exceptions to the doctrine of privity may be found in the *Insurance Act*.[34]

For example, in *Vandepitte v. Preferred Accident Insurance Co.*,[35] the Supreme Court of Canada dismissed an action against an insurer by a passenger injured in a motor vehicle accident on the ground that there was no privity of contract between the insured's daughter, who was driving the car, and the insurer. In response to this decision, the *Insurance Act* was amended to permit an action in circumstances similar to those in *Vandepitte*.[36] In a similar vein, section 172 of Ontario's *Insurance Act* permits a beneficiary under a life insurance policy to enforce the policy.[37]

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31 *Supra*, note 8.

32 See, for example, *Gasparini v. Gasparini* (1978), 20 O.R. (2d) 113, 87 D.L.R. (3d) 202 (C.A.), and *Waugh v. Slavik* (1975), 62 D.L.R. (3d) 577, [1976] 1 W.W.R. 273 (B.C.S.C.).

33 See, for example, *The Satanita*, [1895] P. 248 (C.A.), aff'd [1899] A.C. 59, and *McConnell v. Mabee-McLaren Motors Ltd.*, [1926] 1 D.L.R. 282 (B.C.C.A.).

34 *Insurance Act*, R.S.O. 1980, c. 218.

35 *Supra*, note 9.

36 Brown and Menezes, *Insurance Law in Canada* (1982), at 403, *n.* 208. And see the *Insurance Act*, *supra*, note 34, ss. 209(1), 210, and 213.

37 *Insurance Act*, *supra*, note 34, s. 172.

Other examples of legislated deviations from the doctrine of privity of contract include legislation to enable a mortgagee to sue the assignee of a mortgagor who promises to assume the mortgage obligation,[38] and the right of a consignee to sue on a bill of lading pursuant to section 7(1) of the *Mercantile Law Amendment Act*.[39]

(vi) Conclusion

The preceding discussion shows that it is difficult to state with confidence what the law is. The rule denying contractual rights to third party beneficiaries has been widely avoided by judicial devices and statutory provisions. While the courts have continued to pay lip service to the doctrine of privity of contract, they have often circumvented it through the use of the legal techniques described above. On the other hand, and particularly in light of the Supreme Court of Canada's recent uncritical affirmation of the doctrine of privity of contract in *Greenwood Shopping Plaza Ltd. v. Beattie*,[40] the possibility remains that meritorious claims will be defeated by the application of the doctrine. The uncertainty that pervades this area of the law of contracts is likely to continue unless legislative reform of the doctrine of privity is undertaken.

3. AMERICAN DEVELOPMENTS

In the United States, state legislation in several jurisdictions provides expressly that a third party beneficiary may enforce contractual rights made for his or her benefit. For example, California has legislation[41] simply overruling the common law privity of contract rule. California's Civil Code provides that "[a] contract, made expressly for the benefit of a third person, may be enforced by him at any time before the parties thereto rescind it".[42] This provision has been in force since 1872.

There is some uniform legislation containing similar provisions. The Uniform Commercial Code[43] and the Uniform Land Transactions Act[44] both provide for enforcement by third parties of rights arising out of the contracts of others. In the case of the latter, section 2-312 ensures that warranties of title "run with the land", unless the parties have made an agreement to the contrary. The Uniform Commercial Code provides that the warranty of a seller of goods

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38 *Mortgages Act*, R.S.O. 1980, c. 296, s. 19.

39 R.S.O. 1980, c. 265.

40 *Supra*, note 1.

41 *West's California Codes*, The Civil Code of the State of California (1985), § 1559.

42 *Ibid.*

43 American Law Institute, Uniform Commercial Code, Official Text (9th ed., 1978) (hereinafter referred to as "Uniform Commercial Code"), § 2-318.

44 Uniform Land Transactions Act, National Conference of Commissioners on Uniform State Laws, Uniform Laws Annotated: Civil Procedural and Remedial Laws (1975), Vol. 13 (hereinafter referred to as the "Uniform Land Transactions Act"), § 2-312.

extends to persons other than the person with whom the seller was in privity if the goods are defective and cause injury to the person or damage to property.[45]

A significant development in this area of the law of contracts was the publication of the *Second Restatement of the Law of Contracts*.[46] Section 304 of the *Second Restatement* sets out the substantive right of enforcement available to third party beneficiaries. It provides:

> 304. A promise in a contract creates a duty in the promisor to any intended beneficiary to perform the promise, and the intended beneficiary may enforce the duty.

Section 303 describes the kinds of promise covered by section 304. Both conditional and unconditional promises, as well as sealed and unsealed promises, are subject to the section. The scope of section 304 is also affected by section 302, which in essence defines the term ''intended beneficiary''. Section 302(1) reads:

> 302.-(1) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either
>
> (a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or
>
> (b) the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.

Paragraphs (a) and (b) deal with the ''creditor beneficiary'' and the ''donee beneficiary'', respectively, terms that were used in the initial *Restatement*.[47]

Finally, in defining the scope of section 304 reference should be made to section 308, which provides that ''[i]t is not essential ... that [the intended beneficiary] be identified when a contract containing the promise is made''. However, as the Comment to section 308 indicates, the fact that a beneficiary cannot be identified at the time the contract is entered into may be a factor in determining whether the beneficiary is an intended beneficiary.[48]

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[45] Uniform Commercial Code, *supra*, note 43, § 2-318.

[46] American Law Institute, *Restatement of the Law, Second — Contracts, 2d* (1981) (hereinafter referred to as ''*Second Restatement*'').

[47] See American Law Institute, *Restatement of the Law, Contracts* (1932) (hereinafter referred to as the ''*First Restatement*''), §§ 133 and 141. The *First Restatement* expressly recognized contracts for the benefit of third parties and contained a substantial number of consequential provisions. The *Second Restatement*, while reaffirming the *First Restatement* on the issue of principle, has substantially changed some of the consequential rules.

[48] *Second Restatement*, *supra*, note 46, § 308, Comment a.

Insofar as the rights of the promisor, promisee, and third party *inter se* are concerned, section 305(1) prevents double recovery against the promisor, since "[w]hole or partial satisfaction of the promisor's duty to the beneficiary satisfies to that extent the promisor's duty to the promisee". This provision should be read in conjunction with section 310, which is concerned with the category of beneficiaries formerly known as "creditor beneficiaries", those now covered by section 302(1)(a) of the *Second Restatement*. Section 310 states:

> 310.-(1) Where an intended beneficiary has an enforceable claim against the promisee, he can obtain a judgment or judgments against either the promisee or the promisor or both based on their respective duties to him. Satisfaction in whole or in part of either of these duties, or of a judgment thereon, satisfies to that extent the other duty or judgment, subject to the promisee's right of subrogation.
>
> (2) To the extent that the claim of an intended beneficiary is satisfied from assets of the promisee, the promisee has a right of reimbursement from the promisor, which may be enforced directly and also, if the beneficiary's claim is fully satisfied, by subrogation to the claim of the beneficiary against the promisor, and to any judgment thereon and to any security therefor.

Turning to the defences that the promisor may raise in an action by the beneficiary, the *Second Restatement* proceeds from the concept that the third party's rights are derivative in character and, therefore, in general are no greater than the promisee's rights. The promisor may raise certain defences against the beneficiary involving the existence of an enforceable contract, including the defence that the contract was "voidable or unenforceable at the time of its formation",[49] or has ceased to be binding "because of impracticability, public policy, non-occurrence of a condition, or present or prospective failure of performance".[50] Moreover, the beneficiary's right against the promisor "is subject to any claim or defence arising from [the beneficiary's] own conduct or agreement".[51] However, except as provided in section 311 or by contract, the beneficiary's right against the promisor is not subject to claims or defences of the promisor that are personal against the promisee.

Section 311(1) provides that, if the contract prohibits discharge or modification, any such attempt is ineffective. Sections 311(2) and (3) then stipulate that, in the absence of such a contractual term, the parties to the contract are free to discharge or modify it up until the time the beneficiary "materially changes his position in justifiable reliance on the promise or brings suit on it or manifests assent to it at the request of the promisor or promisee". It should also be noted that section 306 enables the beneficiary to disclaim any promise for his or her benefit within a reasonable time after learning of its existence. However, disclaimer is possible, it would seem, only before the beneficiary has assented to the promise.

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[49] *Ibid.*, § 309(1).

[50] *Ibid.*, § 309(2).

[51] *Ibid.*, § 309(4).

As will be apparent from the foregoing discussion, the privity of contract rule has been substantially eroded by legislative and judicial developments in the United States.

4. PROPOSALS FOR REFORM AND STATUTORY RECOGNITION OF THIRD PARTY RIGHTS IN OTHER JURISDICTIONS

(a) NEW ZEALAND

The only other law reform body in the Commonwealth[52] to have examined the doctrine of privity of contract to date is the Contracts and Commercial Law Reform Committee in New Zealand. The Committee's *Report on Privity of Contract*[53] was published in 1981, and the recommendations contained in it have been given legislative effect by the *Contracts (Privity) Act 1982*.[54]

The New Zealand Report contains a description of the problems that arise from strict adherence to the doctrine of privity of contract. It then proceeds to outline the various legal techniques used by the courts to avoid the harsh or unjust consequences flowing from the doctrine. The New Zealand Committee rejected the approach of situation-specific statutory reform.[55] It did not agree with the suggestion that the courts are able to avoid the rigours of the privity doctrine and always give effect to the intentions of the contracting parties.[56] Instead, unable to find any policy "justifying the frustration of contractual intentions",[57] the Committee recommended "changes in the law to enable the third party beneficiary to sue the promisor directly".[58] The objectives of the reforms proposed by the New Zealand Committee were stated to be as follows:[59]

> The reform we propose is the enactment of legislation to enable a third party to enforce a term of a contract intended by the contracting parties to benefit him, or to give to him the benefit of any immunity or limitation of liability which the contracting parties intended to apply to him, in cases where it appears, as a matter of construction of the contract, that the contracting parties also intended that the beneficiary would have rights of enforcement of that term. We propose to leave unchanged the principle that no burden can be cast upon a third party by a contract

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52 This Commission has made recommendations in two separate Reports which would involve modification or repeal of the doctrine of privity. See Consumer Warranties and Guarantees Report, *supra*, note 5, at 65-77, and Sales Report, *supra*, note 5, at 128, 132, and 243-55.

53 New Zealand Contracts and Commercial Law Reform Committee, *Privity of Contract* (1981) (hereinafter referred to as "New Zealand Report").

54 *Contracts (Privity) Act 1982*, Stat. N.Z., No. 132.

55 New Zealand Report, *supra*, note 53, para. 6.

56 *Ibid.*

57 *Ibid.*, para. 6.2.

58 *Ibid.*, para. 6.4.

59 *Ibid.*, para. 8.1.

> in which he is not joined, but it will be necessary to ensure that where the benefit, immunity or limitation is conditional, the third party should not be entitled to enforce it unless the conditions have been satisfied.

The recommendations of the Committee are extensive. They deal not only with the kinds of promise that should be enforceable by a third party beneficiary, but also with the need for a writing requirement, the right of the promisor or promisee to vary or cancel the contract, and the defences that should be available to the promisor in an action by a third party beneficiary.

As mentioned above, the Committee's recommendations were implemented by the *Contracts (Privity) Act 1982*.[60] The key provision of the Act is section 4, which provides as follows:

> 4. Where a promise contained in a deed or contract confers, or purports to confer, a benefit on a person, designated by name, description, or reference to a class, who is not a party to the deed or contract (whether or not the person is in existence at the time when the deed or contract is made), the promisor shall be under an obligation, enforceable at the suit of that person, to perform that promise:
>
> Provided that this section shall not apply to a promise which, on the proper construction of the deed or contract, is not intended to create, in respect of the benefit, an obligation enforceable at the suit of that person.

The noteworthy features of section 4 are the following. First, it applies to both ordinary contracts and contracts under seal. While section 4 is not limited to contracts in writing,[61] it must be read subject to section 14(1)(b), which has the effect of leaving unaffected the New Zealand equivalent of our *Statute of Frauds*.[62] Secondly, while section 4 is not restricted in its application to express promises conferring a benefit on a third person, it may be relied upon only in cases of contracts or deeds intended "to create ... an obligation enforceable at the suit of that [third] person". Thirdly, the right conferred by section 4 is available "whether or not the person [intended to be benefited] is in existence at the time when the deed or contract is made". Accordingly, the rights under the Act are available to those unborn at the time of the making of the agreement.[63] Fourthly, the section permits the intended beneficiary to be identified by name, description or class.

Sections 5, 6, and 7 of the *Contracts (Privity) Act 1982* deal with variation or discharge of promises covered by section 4. Such promises may not be varied without the consent of the beneficiary where the beneficiary has obtained a judgment, or an award of an arbitrator, against the promisor upon the promise, or where the position of a beneficiary has been materially altered by

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60 *Supra*, note 54.

61 Under section 2 of the *Contracts (Privity) Act 1982*, *supra*, note 54, a contract "includes a contract made by deed or in writing, or orally, or partly in writing and partly orally or implied by law".

62 R.S.O. 1980, c. 481, discussed *infra*, ch. 5.

63 New Zealand Report, *supra*, note 53, para. 8.2.3.

reliance on the promise by the beneficiary or any other person.[64] Further, a promise may be varied or discharged if there is an agreement to that effect between the parties to the contract and the beneficiary,[65] or if such variation or discharge is expressly permitted by the contract, the provision is known to the beneficiary, and the beneficiary has not materially altered his or her position in reliance on the promise before the provision becomes known to the beneficiary.[66]

Where a variation or discharge of a promise would be otherwise precluded by the reliance of the beneficiary or any other person on the promise or where there is uncertainty whether a variation or discharge is precluded, the court is empowered to make an order authorizing a variation or discharge of a promise if it is just and practicable to do so.[67] Such an order may be conditioned upon the payment of compensation to the beneficiary if the court is satisfied that the beneficiary has been injuriously affected by reliance of the beneficiary or any other person on the promise.[68]

Section 8 gives a beneficiary a right of action to enforce an obligation imposed by section 4 as if he or she were a party to the deed or contract in question. Such an action may not be refused on the ground that the beneficiary was not a party to the deed or contract, or that the beneficiary is a volunteer as against the promisor. Section 9 sets out the defences that are available to the promisor in an action under the Act. The promisor is entitled to raise any defence, counterclaim, or set-off that would have been available if the beneficiary had been in privity with the promisor or if the action had been brought by the promisee.[69] The right of set-off, however, is restricted by section 9(3) to cases in which "the subject-matter of [the] set-off ... arises out of or in connection with the deed or contract in which the promise is contained". The same is true with respect to counterclaims, and a beneficiary's liability on a counterclaim may not exceed the value of the benefit conferred on him by the promise.[70] The beneficiary will be liable on the counterclaim only if he or she elects to proceed with a claim with full knowledge of the counterclaim.[71]

The last important feature of the New Zealand Act is section 14, which leaves intact "[a]ny right or remedy which exists or is available apart from this Act".[72] It specifically leaves unaffected the law of agency and the law of

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64 *Supra*, note 54, s. 5(1).

65 *Ibid.*, s. 6(a).

66 *Ibid.*, s. 6(b).

67 *Ibid.*, s. 7(1).

68 *Ibid.*, s. 7(2).

69 *Ibid.*, s. 9(2).

70 *Ibid.*, s. 9(4)(b).

71 *Ibid.*, s. 9(4)(a).

72 *Ibid.*, s. 14(1)(a).

trusts,[73] thereby permitting a third party beneficiary to use the remedies that have been developed to date in those areas of the law.[74]

(b) WESTERN AUSTRALIA

Section 11 of the Western Australia *Property Law Act, 1969*[75] provides as follows:

> 11.-(1) A person may take an immediate or other interest in land or other property, or the benefit of any condition, right of entry, covenant or agreement over or respecting land or other property, although he is not named as a party to the conveyance or other instrument that relates to the land or property.
>
> (2) Except in the case of a conveyance or other instrument to which subsection (1) of this section applies, where a contract expressly in its terms purports to confer a benefit directly on a person who is not named as a party to the contract, the contract is, subject to subsection (3) of this section, enforceable by that person in his own name but —
>
> (a) all defences that would have been available to the defendant in an action or proceeding in a court of competent jurisdiction to enforce the contract had the plaintiff in the action or proceeding been named as a party to the contract shall be so available;
>
> (b) each person named as a party to the contract shall be joined as a party to the action or proceeding; and
>
> (c) such defendant in the action or proceeding shall be entitled to enforce as against such plaintiff, all the obligations that in the terms of the contract are imposed on the plaintiff for the benefit of the defendant.
>
> (3) Unless the contract referred to in subsection (2) of this section otherwise provides, the contract may be cancelled or modified by the mutual consent of the persons named as parties thereto at any time before the person referred to in that subsection has adopted it either expressly or by conduct.

The legislation is noteworthy in a number of respects. First, insofar as the scope of the legislation is concerned, a third party beneficiary is only entitled to enforce a contract "where the contract expressly in its terms purports to confer a benefit directly". Accordingly, it would appear that a third party enjoys no statutory right of enforcement where the contract *impliedly* confers a benefit.

Secondly, the section protects the promisor in a number of respects. Section 11(2)(a) stipulates that a promisor may, in an action brought by a third party to enforce a contract, raise any defences against the third party that would have been available to the promisor had the third party been named as a party to the contract. Section 11(2)(c) would seem to permit the promisor, in any such action, to enforce as against the plaintiff any obligations imposed on him or her

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[73] *Ibid.*, s. 14(1)(d) and (e).

[74] See discussion, *supra*, this ch., sec. 2(b).

[75] W. Austl. Acts 1969, No. 32.

under the contract for the promisor's benefit. Section 11(3) authorizes the parties to the contract to cancel or modify the contract "at any time before the [third party] has adopted it either expressly or by conduct".

Thirdly, with respect to the question of the procedure to be followed in an action brought by a third party beneficiary, section 11(2)(b) of the Western Australia *Property Law Act, 1969* requires that each party named in the contract "be joined as a party to the action or proceeding". The New Zealand Report was critical of this requirement "because it could lead to unnecessary expense and possible problems as to service of the proceedings".[76]

(c) QUEENSLAND

Section 55 of the Queensland *Property Law Act 1974*[77] provides another legislative precedent for reform of the doctrine of privity. That section reads as follows:

> 55.-(1) A promisor who, for a valuable consideration moving from the promisee, promises to do or to refrain from doing an act or acts for the benefit of a beneficiary shall, upon acceptance by the beneficiary, be subject to a duty enforceable by the beneficiary to perform that promise.
>
> (2) Prior to acceptance the promisor and promisee may without the consent of the beneficiary vary or discharge the terms of the promise and any duty arising therefrom.
>
> (3) Upon acceptance —
>
> (a) the beneficiary shall be entitled in his own name to such remedies and relief as may be just and convenient for the enforcement of the duty of the promisor; and relief by way of specific performance, injunction or otherwise shall not be refused solely on the ground that, as against the promisor, the beneficiary may be a volunteer;
>
> (b) the beneficiary shall be bound by the promise and subject to a duty enforceable against him in his own name to do or refrain from doing such act or acts (if any) as may by the terms of the promise be required of him;
>
> (c) the promisor shall be entitled to such remedies and relief as may be just and convenient for the enforcement of the duty of the beneficiary;
>
> (d) the terms of the promise and the duty of the promisor or the beneficiary may be varied or discharged with the consent of the promisor, the promisee, and the beneficiary.
>
> (4) Subject to subsection (1), any matter which would in proceedings not brought in reliance on this section render a promise void, voidable or unenforceable, whether wholly or in part, or which in proceedings (not brought in reliance

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[76] New Zealand Report, *supra*, note 53, para. 7.1(d).

[77] Queensl. Stat., No. 76, s. 55.

on this section) to enforce a promissory duty arising from a promise is available by way of defence shall, in like manner and to the like extent, render void, voidable or unenforceable or be available by way of defence in proceedings for the enforcement of a duty to which this section gives effect.

(5) In so far as a duty to which this section gives effect may be capable of creating and creates an interest in land, such interest shall, subject to section 12, be capable of being created and of subsisting in land under the provisions of any Act but subject to the provisions of that Act.

(6) In this section —

(a) 'acceptance' means an assent by words or conduct communicated by or on behalf of the beneficiary to the promisor, or to some person authorized on his behalf, in the manner (if any), and within the time, specified in the promise or, if no time is specified, within a reasonable time of the promise coming to the notice of the beneficiary;

(b) 'beneficiary' means a person other than the promisor or promisee, and includes a person who, at the time of acceptance is identified and in existence, although that person may not have been identified or in existence at the time when the promise was given;

(c) 'promise' means a promise —

(i) which is or appears to be intended to be legally binding; and

(ii) which creates or appears to be intended to create a duty enforceable by a beneficiary,

and includes a promise whether made by deed, or in writing, or, subject to this Act, orally, or partly in writing and partly orally;

(d) 'promisee' means a person to whom a promise is made or given;

(e) 'promisor' means a person by whom a promise is made or given.

(7) Nothing in this section affects any right or remedy which exists or is available apart from this section.

(8) This section applies only to promises made after the commencement of this Act.

Like the Western Australia provision discussed in the preceding section, section 55 of the Queensland statute is not restricted in its application to any particular type or class of contract. Like section 11 of the Western Australia *Property Law Act, 1969*,[78] the Queensland provision enables the promisor to raise against the third party any defence that could have been raised against the promisee. The Queensland provision also permits the parties to the contract to "vary or discharge the terms of the promise and any duty arising therefrom".

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[78] *Supra*, note 75.

The Queensland section differs from its Western Australia counterpart in certain vital respects. First, it appears to be broader in scope than section 11 of the Western Australia *Property Law Act, 1969*. Section 55(6)(b) of the Queensland legislation provides that "beneficiary" means "a person other than the promisor or promisee, and includes a person who, at the time of acceptance is identified and in existence, although that person may not have been identified or in existence at the time when the promise was given". Consequently, the beneficiary need not be in existence or identified at the time of the contract. Section 55 does not raise an obstacle to class identification, as long as at the time of acceptance the person or persons are identified and in existence. Moreover, in contrast to the Western Australia legislation, section 55 does not require that the contract expressly confer a benefit on the third party.

Secondly, the Queensland legislation imposes no obligation on the third party beneficiary to join in an action all those persons who are parties to the contract. This is made clear by section 55(3)(a), which states that "the beneficiary shall be entitled in his own name" to such relief and remedies as may be just and convenient.

(d) QUEBEC

The Quebec *Civil Code* contains a general provision dealing with contracts in favour of third parties. Article 1029 of the *Code* states as follows:

> 1029. A party in like manner may stipulate for the benefit of a third person, when such is the condition of a contract which he makes for himself, or of a gift which he makes to another; and he who makes the stipulation cannot revoke it, if the third person have [sic] signified his consent to it.

While the Article does not expressly provide that the third party may enforce a contract for his or her benefit, the courts have read such a right into the provision. The Article, like legislation in other jurisdictions, deals with the right of revocation and restricts this right to the time prior to the third party having signified consent to the contractual benefit.

The Draft *Civil Code* prepared by the Civil Code Revision Office contains a series of provisions dealing with "stipulations in favour of another". Articles 85 to 93 of the Draft *Civil Code* read as follows:[79]

> 85. A person may stipulate by contract for the benefit of another.
>
> 86. The stipulation gives rise to a direct right against the promisor in favour of the third party beneficiary.
>
> 87. The third party beneficiary must exist at the time of the stipulation, subject to express provision of law.

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[79] See Civil Code Revision Office, *Report on the Quebec Civil Code* (1978), Draft *Civil Code*, Vol. I.

88. A stipulation may be revoked as long as the third party beneficiary has not advised the stipulator or the promisor of his will to accept.

89. The stipulator alone may revoke a stipulation.

However, he may not revoke a stipulation to the detriment of the promisor who justifies his interest in maintaining the stipulation.

90. The stipulator's right of revocation may not be exercised by his heirs or creditors.

Revocation or lapse of the stipulation benefits the stipulator.

This article applies unless the law, the will of the parties or the nature of the contract provides otherwise.

91. Revocation by the stipulator takes effect as soon as it is made known to the promisor.

Revocation made by will, however, takes effect of right at the time of death.

92. A third party beneficiary and his successors may validly accept the stipulation, even after the stipulator or the promisor has died, unless the law, the will of the parties or the nature of the contract provides otherwise.

93. A promisor may set up against a third party beneficiary the exceptions which he could have set up against the stipulator, provided he was unaware that these exceptions existed when the stipulation was made.

The *Report on the Quebec Civil Code* states that "it was thought right to insert in the Draft the rules evolved by judicial decisions based on Article 1029" of the *Civil Code*.[80]

A few comments on the provisions proposed to be included in the new Quebec *Civil Code* are in order. First, it should be noted that Article 87 would require the third party beneficiary to be in existence at the time the agreement is entered into. Secondly, the right of the stipulator (the promisee) to revoke the stipulation would be personal to the stipulator and, by virtue of Article 90, could not be exercised by his or her heirs or creditors, unless the contract provides otherwise. By contrast, Article 92 enables the successors of the third party beneficiary to accept the stipulation, unless the contract provides otherwise. Thirdly, Article 93 would allow the promisor to set up against the third party beneficiary those defences that he or she could set up in an action against the promisee.

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[80] *Ibid.*, Vol. II, at 616.

5. ARGUMENTS FOR AND AGAINST REFORM

A number of arguments have been raised in defence of the rule barring third party beneficiaries from suing directly on their own behalf. Two of these justifications, mentioned above,[81] are closely related. It has been argued, with some circularity as will be discussed shortly, that only those in privity with another contractor should be allowed to sue in contract.[82] A related argument is that it is the providing of consideration that gives rise to the right to enforce a contract.[83] As it is very unlikely that someone who is not a party to a contract will give consideration, these first two arguments go hand-in-hand.

The consideration argument is often associated with an apparent corollary. It has been suggested that the third party, not having bargained with the promisor for the rights in question, should not be entitled to them[84] on the ground that the absence of any bargain between the promisor and third party results in a lack of mutuality. That is to say, assuming that the third party could sue the promisor, the promisor would have no rights against the third party.

Insofar as the first argument is concerned, it is the courts themselves that determine whether someone is a party to an agreement. For example, in one important case the Court concluded that a right of enforcement should accrue to someone who was named in the contract and who had signed the agreement; in other words, that person was found to be a party to the agreement.[85] Yet, there seems to be little difference between such a case and the case of one who is named in a contract as intended to benefit from performance of it, and who may detrimentally rely on receipt of the proposed benefit. Judicial distinctions based on privity tend to be circular, serving only to define the class not permitted to enforce agreements, rather than to give an explanation of why a particular class is to be denied rights of enforcement.[86]

Moreover, as pointed out in an earlier section of this chapter,[87] recent developments in tort law have resulted in a breaking down of the privity barrier in a large number of cases. While it might have been intended at some point to confer contractual benefits only on those who were parties to the agreement,[88] it

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81 *Supra*, this ch., sec. 1.

82 See, for example, *Winnett v. Heard* (1928), 62 O.L.R. 61, [1928] 2 D.L.R. 594 (H.C. Div.).

83 See *Dunlop Pneumatic Tyre Co., Ltd. v. Selfridge & Co., Ltd.*, *supra*, note 3.

84 A classic expression of this view may be found in Holmes, *The Common Law* (Howe ed., 1963), at 227-30. See, also, Gilmore, *The Death of Contract* (1974), at 18-21.

85 See *Coulls v. Bagot's Executor and Trustee Co. Ltd.* (1967), 40 L.J.R. 471 (Aust. H.C.). See, also, *Midlands Silicones Ltd. v. Scruttons Ltd.*, *supra*, note 8, and *New Zealand Shipping Co. Ltd. v. A.M. Satterthwaite & Co. Ltd.*, *supra*, note 20.

86 See Corbin, *supra*, note 11, at 28-31.

87 See discussion *supra*, this ch., sec. 2(b)(iv).

88 *Winterbottom v. Wright* (1842), 10 M. & W. 109, 152 E.R. 402.

is now clear that contracts between two persons may well give rights in tort to a large group of others.

With respect to the consideration argument, in chapter 2 we examined in some detail the utility of the present consideration rule in the law of contracts and proposed a broadening of the category of agreements that should be enforceable. We have attempted to adopt a functional approach to the issue of consideration to ensure that those agreements that should be enforceable are indeed legally enforceable. In particular, we recognized the limits of the bargain theory and recommended, *inter alia*, that a person should be able, to a limited extent, to enforce a promise unsupported by consideration where there has been detrimental reliance.[89] The reduced importance of the bargain theory should be reflected throughout this Report.

Moreover, since the promisee will generally have provided consideration for the promise in favour of the third party, it is difficult to see why consideration, the bargain theory, or mutuality should stand in the way of enforcement of a promise by the third party. Where the promise bears the hallmark of enforceability *inter partes*, we believe that the law should assist in implementing the clearly expressed intentions of the parties.[90] In our view, this can best be assured by allowing those with a direct interest in performance to sue to protect that interest.[91]

Another argument that may be raised against giving a third party beneficiary the right to enforce a contract is the possibility of separate suits against the promisor being brought by the promisee and the third party beneficiary, thereby creating a potential for inconsistent verdicts. This apprehension about a change in the privity of contract rule is easily assuaged by pointing to existing procedural provisions. The Rules of Civil Procedure in Ontario already provide for the joinder of necessary parties.[92] The Rules of Civil Procedure also contain provisions that are addressed to the issue of multiplicity of legal proceedings.[93] Of course, even if there were separate actions against the promisor, it does not follow that the promisor would have to pay full damages more than once. The law has always opposed double recovery, and there is no reason to think that this is a real danger in the present context. On balance, we do not regard as persuasive the concern of a promisor who has received a benefit from a promisee that he or she not be subject to suit by a third party.

Abolishing the present third party beneficiary rule would, we believe, render the law more consistent internally, and more understandable by lay persons. As was pointed out previously, the courts have been able to circumvent the doctrine of privity by one legal device or another when the desired

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89 *Supra*, ch. 2, sec. 4(d).

90 To this effect, see Fuller, "Consideration and Form" (1941), 41 Colum. L. Rev. 799.

91 To this effect, see Corbin, *supra*, note 11, at 25.

92 O. Reg. 560/84, Rule 5.03.

93 *Ibid.*, Rule 5.02. See, also, *Courts of Justice Act, 1984*, S.O. 1984, c. 11, s. 148.

result was the enforcement of the promise by the third party beneficiary. The present state of the law, with its anomalies and unjustified distinctions, cannot and should not continue.

We note the clear trend in other jurisdictions permitting third parties to enforce contracts made for their benefit. From the discussion of the law in other jurisdictions,[94] it should be apparent that there is almost universal agreement among those who have considered the question that the existing privity of contract rule must be abandoned. In the United States, through common law developments and legislative reform, the privity of contract rule has been rendered virtually obsolete. In Ontario, there are significant areas of the law where this rule no longer holds sway.[95] We believe that the time has come for Ontario to recognize that the doctrine of privity of contract is no longer appropriate as a general principle of contract law.

It is the firmly held view of the Commission that the privity of contract rule should be abolished. In the next section, we shall canvass the two basic options for reform: the enactment of a general provision abolishing the doctrine, and the enactment of more detailed legislation not only permitting third parties to enforce contracts for their benefit, but dealing also with the subsidiary issues that arise as a result of the new legal regime.

6. OPTIONS FOR REFORM

If it is accepted that reform is appropriate, a preliminary question arises concerning the general nature of the legislation to be proposed. One option for reforming the doctrine of privity of contract is to enact detailed legislation concerning the rights of promisors, promisees, and third party beneficiaries with respect to contracts purporting to confer benefits on third parties. Such legislation could deal with, *inter alia*, the scope of the rule permitting third party beneficiaries to enforce contracts made for their benefit, the rights of the contracting parties to modify or terminate the contract, the defences available to promisors in actions brought by third party beneficiaries, and the kinds of relief available to third party beneficiaries in such actions. Such an approach can be found in the *Second Restatement*[96] and in the legislation in effect in Queensland,[97] Western Australia,[98] and New Zealand[99] and proposed in Quebec.[100]

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94 *Supra*, this ch., secs. 3 and 4.

95 *Supra*, this ch., sec. 2.

96 *Second Restatement*, *supra*, note 46, discussed *supra*, this ch., sec. 3.

97 *Supra*, this ch., sec. 4(c).

98 *Ibid.*, sec. 4(b).

99 *Ibid.*, sec. 4(a).

100 *Ibid.*, sec. 4(d).

On the other hand, there is the approach adopted in many of the American states, and in effect in some civil law systems, such as Quebec.[101] These jursidictions, rather than attempting to formulate comprehensive legislation, have enacted a simple and general enabling provision to the effect that contracts for the benefit of third parties are not unenforceable solely for lack of consideration or want of privity.

A general enabling provision would have the effect of permitting courts to enforce third party rights, if justice would thereby be served. This would simply abolish the impediment to enforcement and leave the courts free to fashion the principles to be applied on a case by case basis, without creating a new source of obligation. A detailed provision setting out the rights of third parties, on the other hand, would require the courts to enforce contracts at the suit of third parties. The statutory reformer who proceeds on these lines is then bound to attempt to foresee all possible cases in which enforcement might not be appropriate. As will be seen from the discussion which follows, this would be an exceptionally complex and difficult task. With this in mind, we favour the approach of a general enabling provision.

Third party beneficiary problems arise in cases differing as widely as contract law itself. Familiar cases include family gift promises,[102] small business rearrangements,[103] banking transactions,[104] insurance,[105] shipping contracts,[106] employment contracts[107] and building contracts.[108] It is noteworthy that the American Law Institute substantially altered its position between the *First* and *Second Restatements*.[109] It is not likely that any legislation proposed would satisfactorily solve all the problems, and it is probable that through inevitable failure of foresight a detailed set of statutory exceptions to a mandatory rule of enforceability would produce anomalies in future cases.

The principal difficulties facing the drafter of specific provisions would be first, the definition of the class of beneficiaries entitled to sue, and second, the problem of modification or rescission by the original parties. On the first question, everyone concedes that not *all* persons claiming to be damaged by breach of contracts between others should be entitled to a remedy. The usual

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101 *Ibid.*

102 *Mulholland v. Merriam*, *supra*, note 16, and *Beswick v. Beswick*, *supra*, note 8.

103 *Snelling v. John G. Snelling Ltd.*, [1973] 1 Q.B. 87, [1972] 1 All E.R. 79.

104 *McEvoy v. Belfast Banking Co. Ltd.*, [1935] A.C. 24, [1934] All E.R. Rep. 800 (H.L.), and *Urquhart Lindsay & Co. Ltd. v. Eastern Bank Ltd.*, [1922] 1 K.B. 318, [1921] All E.R. Rep. 340.

105 *Vandepitte v. Preferred Accident Ins. Co.*, *supra*, note 9.

106 *New Zealand Shipping Co. Ltd. v. A.M. Satterthwaite & Co. Ltd.*, *supra*, note 20.

107 *Young v. Can. Northern Railway*, [1931] A.C. 83, 144 L.T. 255 (P.C.).

108 *Town of Truro v. Toronto General Insurance Co.* (1972), 4 N.S.R. (2d) 459, 30 D.L.R. (3d) 242 (N.S.C.A.).

109 *Supra*, notes 46 and 47.

example given is that of a contract between a landowner and a builder for development of the land. It is generally agreed that a neighbour whose business would have benefited by the development should not be entitled to sue the builder for failure to perform.[110] A more difficult case is that of government contracts. Nevertheless, where a builder undertakes to improve a municipal street, it seems undesirable for each homeowner on the street to have an action on the builder's default.[111]

The *First Restatement* dealt with these cases by confining the right of action to two classes of beneficiaries, donee beneficiaries (where the promisee intended a gift of the benefit of performance) and creditor beneficiaries (where the promisee intended performance to discharge a prior obligation of his or her own).[112] This seems far too restrictive, but it is not easy to frame a satisfactory alternative. It is insufficient to require that the promisor must have manifested an intention to benefit the third party, because this test is probably met in both the building contract cases just mentioned. Although, in those cases, it is not the builder's motive to benefit the neighbouring business person or the individual homeowners (his or her motive is presumably to earn the price of performance from the promisee), the builder intends to do an act that he or she knows will certainly benefit the other persons, a sufficient state of mind to satisfy the usual test of intention. Similarly, a test based on expectation of benefit by the third party will not exclude the developer's disappointed neighbour. On the other hand, a test based on intention to create enforceable rights in the third party is too restrictive. Contracting parties rarely direct their minds consciously to enforceability, and the general law of contracts rightly does not require any such conscious subjective intention.[113]

The *Second Restatement* gives an action to the third party beneficiary "if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties".[114] This formulation leaves the court free to judge whether or not an action by the third party is "appropriate", or just, in light of the agreement between the contracting parties. While this test would surely provide the courts with needed flexibility, it abandons the certainty that is supposed to be the chief merit of specific provisions.

The question of modification or rescission has proven even more intractable: some contracts for the benefit of third parties seem to be made with the expectation of permitting subsequent modification by the contracting parties; others seem to be designed to create immediate vested rights in the third party, so that modification should be impossible without the third party's assent. Many contracts can probably best be construed as permitting variation before some

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[110] *First Restatement*, *supra*, note 47, § 133, illustration 11.

[111] *Ibid.*, § 145 and illustrations.

[112] *Ibid.*, § 133.

[113] See *Smith v. Hughes* (1871), L.R. 6 Q.B. 597, at 607, [1861-73] All E.R. Rep. 632, at 637, *per* Blackburn J.

[114] *Second Restatement*, *supra*, note 46, § 302, discussed *supra*, this ch., sec. 3.

event, for example, the promisee's death, thus creating vested rights in the third party thereafter.

Section 311 of the *Second Restatement* provides that the contracting parties may create rights that cannot be modified, but that otherwise they are free to modify unless the beneficiary "materially changes his position in justifiable reliance on the promise or brings suit on it or manifests assent to it at the request of the promisor or promisee". This provision raises difficulties that, in our view, illustrate the difficulty of highly specific legislation in this area. First, if reliance is the reason for enforcement, why is the recovery not limited to protection of the beneficiary's reliance? It should be noted that earlier in this Report we recommended adoption of the equivalent of section 90 of the *Second Restatement*, which permits protection of reliance of a third party on a contract.[115] Secondly, to return to section 311 of the *Second Restatement*, assent by the beneficiary does not seem obviously relevant to the question of the original party's power to modify the contract. If the contract is one that would ordinarily allow for modification it is difficult to see why the beneficiary's assent should affect the matter. The beneficiary, in hearing of a prospective benefit under a contract and signifying his or her satisfaction, assents to whatever benefits the contract may afford him or her, and if the contract, properly construed, allows for modification, the benefit afforded by the contract to the third party should fairly be described as conditional on failure of the contracting parties to modify it. There does not seem to be any reason why the beneficiary should be allowed to remove the conditional aspect of the benefit by manifesting an assent.

To conclude, we believe that the general principle approach is to be preferred on the ground that it is more likely that the law will remain current if the courts are permitted some flexibility in dealing with the variety of issues that will undoubtedly arise. Accordingly, the Commission recommends that there should be enacted a legislative provision to the effect that contracts for the benefit of third parties should not be unenforceable for lack of consideration or want of privity.

Recommendation

The Commission makes the following recommendation:

1. There should be enacted a legislative provision to the effect that contracts for the benefit of third parties should not be unenforceable for lack of consideration or want of privity.

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[115] *Supra*, ch. 2, sec. 4(d).

CHAPTER 5

CONTRACTUAL ASPECTS OF THE *STATUTE OF FRAUDS*

1. INTRODUCTION

In 1677, the English Parliament adopted an Act, subsequently known as the *Statute of Frauds*, with the declared aim of "preventing many fraudulent practices which are commonly endeavoured to be upheld by perjury and subornation of perjury".[1] The original twenty-five sections of the Act covered a broad range of topics, only two of which, sections 4 and 17, involved writing requirements related to specified types of contracts. Other provisions in the Act imposed writing requirements for the creation, assignment, and surrender of interests in land and for the declaration or creation of trusts in land and the assignment of interests held in trust generally. This chapter is concerned only with those provisions of the Statute still in force in Ontario involving writing requirements relating to contracts and other obligations. We leave the other provisions to be dealt with on another occasion.

Sections 4 and 17 were adopted in response to the particular political and legal conditions of the early Restoration period in England. However, this did not discourage the adoption of these and other provisions of the Statute, in their original or amended form, in many parts of the common law world, including all the common law provinces of Canada, the Australian states, New Zealand, and the United States. It may be assumed, therefore, that, originally, the legislatures in the adopting jurisdictions thought that sections 4 and 17 embodied enduring legal values. This assumption no longer prevails.

Sections 4 and 17 have generated an enormous amount of litigation in all the adopting jurisdictions, and entire volumes have been devoted to interpreting the complex and frequently inconsistent jurisprudence concerning the provisions of the *Statute of Frauds*. The Statute has been the subject of critical

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[1] 29 Car. 2, c. 3 (U.K.). The history of the Statute is traced in Holdsworth, *A History of English Law* (2d ed., 1937), Vol. VI, at 383-97, and in Hening, "The Original Drafts of the Statute of Frauds (29 Car. II, c. 3) and their Authors" (1913), 61 U. Pa. L. Rev. 283. See, also, Rabel, "The Statute of Frauds and Comparative Legal History" (1947), 63 L.Q. Rev. 174.

examination by law reform bodies in many parts of the Commonwealth[2] and, in many cases, their recommendations have been implemented.

The availability of these studies and legislative precedents, particularly the excellent Report of the Law Reform Commission of British Columbia and the Background Paper prepared by the Alberta Institute of Law Research and Reform,[3] makes it unnecessary for us to retrace the same ground in detail. The main purpose of this chapter, therefore, is to express our own views on the desirability of reforming the provisions concerning contracts in the *Statute of Frauds* and to indicate our reactions to the recommendations of other law reform agencies. To lay the appropriate groundwork for this objective, we must begin with a short description of the evolution and current status of the relevant *Statute of Frauds* requirements in England and Ontario. This discussion will be followed by a description of the judicial interpretation and application of the statutory provisions.

2. HISTORY OF THE *STATUTE OF FRAUDS* REQUIREMENTS IN ENGLAND AND ONTARIO

(a) INTRODUCTION

The original version of section 4 of the *Statute of Frauds* embraced the following types of contracts and promises:

(i) A promise by an executor or administrator "to answer damages out of his own estate";

(ii) A promise to answer for the debt, default, or miscarriage of another person;

(iii) An agreement made "upon consideration of marriage";

(iv) Contracts for the sale or any other disposition of an interest in land; and

(v) Contracts not to be performed within one year from the making thereof.

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[2] England, Law Revision Committee, *Sixth Interim Report (Statute of Frauds and the Doctrine of Consideration)* (Cmd. 5449, 1937) (hereinafter referred to as "*Sixth Interim Report*"); England, Law Reform Committee, *The Statute of Frauds and Section 4 of the Sale of Goods Act* (Cmd. 8809, 1953); Law Reform Commission of British Columbia, *Report on the Statute of Frauds* (1977) (hereinafter referred to as "British Columbia Report"); Alberta Institute of Law Research and Reform, Background Paper No. 12, *Statute of Frauds* (1977) (hereinafter referred to as "Alberta Background Paper"); Alberta Institute of Law Research and Reform, Report No. 44, *The Statute of Frauds and Related Legislation* (1985) (hereinafter referred to as "Alberta Report"); Manitoba Law Reform Commission, Report No. 41, *Report on the Statute of Frauds* (1980); Queensland Law Reform Commission, Q.L.R.C. 6, *A Report of the Law Reform Commission on a Review of The Statute of Frauds* (1970) (hereinafter referred to as "Queensland Report"); and Law Reform Committee of South Australia, *Thirty-fourth Report Relating to the Repeal of the Statute of Frauds and Cognate Enactments in South Australia* (1975) (hereinafter referred to as "South Australia Report").

[3] British Columbia Report and Alberta Background Paper, *supra*, note 2.

In all these cases, the Statute provided and, except as hereinafter explained, in Ontario still provides, that no action could be brought to charge a person upon a promise or contract unless the agreement upon which the action was brought, or some note or memorandum thereof, was in writing and signed by the party to be charged or by his agent.

Section 17 was restricted to contracts for the sale of goods, wares, and merchandise for the price of £10 (sterling) and upwards, but here, very significantly, the Statute recognized important evidentiary alternatives to writing to prove the existence of the contract. These were acceptance and receipt of the goods by the buyer, part payment by the buyer, or the giving of an "earnest"[4] by the buyer.

(b) Subsequent History in England

In 1828, as a result of the enactment of Lord Tenterden's Act,[5] two new categories of transactions were required to be reduced to writing. These were, first, the ratification by a person, on attaining full age, of a contract concluded during infancy, and, secondly, a representation by a person concerning the credit worthiness of another and for which it was sought to hold the representor liable.[6] Section 17 was also amended by extending it to the sale of future goods.[7] The English *Mercantile Law Amendment Act, 1856*[8] supplemented section 4 of the Statute in relation to contracts of guarantee by making it clear that the consideration for the guarantor's promise did not have to be included in the writing.

In 1893, the United Kingdom Parliament adopted the *Sale of Goods Act, 1893*,[9] and, with a minor change, section 4 of that Act replaced the evidentiary requirements in section 17 of the *Statute of Frauds*. A similar change occurred in 1925 with respect to contracts for the sale or other disposition of an interest in land, upon the adoption in that year of the *Law of Property Act, 1925*.[10]

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4 "Earnest" is defined in *Black's Law Dictionary* (5th ed., 1979), at 456, as "[t]he payment of a part of the price of goods sold, or the delivery of part of such goods, for the purpose of binding the contract. A token or pledge passing between the parties, by way of evidence, or ratification of the sale".

5 Lord Tenterden's Act, 9 Geo. 4, c. 14 (U.K.), ss. 5-6.

6 Unlike the promises and contracts in section 4 of the original Statute, these categories of obligation were not enforceable unless the promise, contract, or representation, as the case might be, was in writing (and not merely evidenced by a note or memorandum thereof) and signed by the person to be charged therewith.

7 *Supra*, note 5, s. 7.

8 19 & 20 Vict., c. 97 (U.K.), s. 3.

9 *Sale of Goods Act, 1893*, 56 & 57 Vict., c. 71 (U.K.). See now *Sale of Goods Act 1979*, c. 54 (U.K.).

10 *Law of Property Act, 1925*, 15 & 16 Geo. 5, c. 20 (U.K.), s. 40.

More significant changes, based on the recommendations of two law reform committees,[11] were introduced by the *Law Reform (Enforcement of Contracts) Act, 1954*.[12] This Act repealed section 4 of the *Sale of Goods Act, 1893* and the provisions in section 4 of the *Statute of Frauds* relating to a promise by an executor or administrator to answer damages out of his or her own estate, marriage contracts, and contracts not to be performed within one year. It will be seen, therefore, that, in England, the only section 4 contracts still required to be evidenced in writing are contracts for the sale or disposition of an interest in land and contracts of guarantee.

(c) ONTARIO HISTORY

The *Statute of Frauds* became part of the law of Upper Canada in 1792 as a result of the adoption in that year of *The Property and Civil Rights Act*.[13] The amendments in Lord Tenterden's Act affecting the ratification of infants' contracts and liability for misrepresentations of credit worthiness were adopted in 1850;[14] those in the English *Mercantile Law Amendment Act, 1856* relating to contracts of guarantee in 1863.[15] The *Statute of Frauds* was formally enacted in Ontario in an amended form (but without the recited amendments of 1850 and 1863) in the Revised Statutes of 1897.[16] A consolidating statute combining both these sources was enacted in 1913.[17] Finally, Ontario adopted the U.K. *Sale of Goods Act, 1893* in 1920[18] and, following the U.K. precedent, exchanged section 5 of the Ontario *Sale of Goods Act* for section 17 of the original *Statute of Frauds*.[19]

The subsequent history of the *Statute of Frauds* in Ontario differs materially from its history in England. In 1929, Ontario added an obscure gloss to section 4 in what is now section 5 of the Ontario *Statute of Frauds*.[20] In 1978, as a result of the adoption of *The Family Law Reform Act, 1978*,[21] Ontario deleted the section 4 requirements relating to marriage contracts. Section 55 of the

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[11] *Sixth Interim Report*, *supra*, note 2, and England, Law Reform Committee, *The Statute of Frauds and Section 4 of the Sale of Goods Act*, *supra*, note 2.

[12] *Law Reform (Enforcement of Contracts) Act, 1954*, 2 & 3 Eliz. 2, c. 34 (U.K.).

[13] 32 Geo. 3, c. 1 (U.C.), s. 3. See, now, *Property and Civil Rights Act*, R.S.O. 1980, c. 395.

[14] 13 & 14 Vict., c. 61 (Can.), ss. 5-6.

[15] 26 Vict., c. 45 (Can.), s. 1.

[16] R.S.O. 1897, c. 338.

[17] 3 & 4 Geo. 5, c. 27 (Ont.).

[18] *The Sale of Goods Act, 1920*, S.O. 1920, c. 40.

[19] The threshold figure of £10 in the English Act had previously been converted to $40 in Canadian currency.

[20] S.O. 1929, c. 23, s. 6.

[21] S.O. 1978, c. 2. See now *Family Law Act, 1986*, S.O. 1986, c. 4.

current *Family Law Act, 1986* requires domestic contracts, as defined in the Act, to be in writing and signed by the persons to be bound and witnessed.

Ontario has not adopted provisions corresponding to those in the *Law Reform (Enforcement of Contracts) Act, 1954*.[22] However, this Commission's 1979 *Report on Sale of Goods*[23] recommended, *inter alia*, the repeal of section 5 of the Ontario *Sale of Goods Act*.[24] Changes involving the writing requirements for leases and contracts of lease were also recommended in our earlier *Report on Landlord and Tenant Law*.[25] Both these sets of recommendations await implementation.

At the present time, therefore, all the writing requirements relating to contracts and other obligations contained in the original *Statute of Frauds*, except those with respect to marriage contracts, continue to apply in Ontario.[26] We turn to consider the nature of these requirements and how they have been interpreted and applied by the courts.

3. THE SCOPE AND NATURE OF THE WRITING REQUIREMENTS AND THEIR JUDICIAL INTERPRETATION

(a) TYPES OF CONTRACTS AND OTHER OBLIGATIONS AFFECTED

Judging by the number of reported cases, the requirements in section 4 of the *Statute of Frauds* involving contracts for the sale or other disposition of interests in land are unquestionably the most important; those relating to contracts of guarantee and contracts not to be performed within one year are a distant second and third. Litigation involving the other requirements is now rare.[27] It will be convenient to deal with the contracts and other obligations in the order in which they appear in sections 4, 5, 7, and 8 of the Ontario Statute.

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[22] *Supra*, note 12.

[23] Ontario Law Reform Commission, *Report on Sale of Goods* (1979) (hereinafter referred to as "Sales Report"), Vol. 1, at 131, Recommendation 13.

[24] *Sale of Goods Act*, R.S.O. 1980, c. 462.

[25] Ontario Law Reform Commission, *Report on Landlord and Tenant Law* (1976), at 17-19.

[26] See *Statute of Frauds*, R.S.O. 1980, c. 481.

[27] A non-exhaustive tabulation of Canadian cases involving the *Statute of Frauds* in all provinces and reported between 1970-1979, which was carried out during the course of the Commission's research, reveals the following figures:

Contracts involving land	26
Contracts of guarantee	4
Contracts not to be performed within one year	2
Others	0
Total	32

The above list does not include contracts for the sale of goods.

We begin with the categories of contract covered by section 4, which reads as follows:

> 4. No action shall be brought whereby to charge any executor or administrator upon any special promise to answer damages out of his own estate, or whereby to charge any person upon any special promise to answer for the debt, default or miscarriage of any other person, or to charge any person upon any contract or sale of lands, tenements or hereditaments, or any interest in or concerning them, or upon any agreement that is not to be performed within the space of one year from the making thereof, unless the agreement upon which the action is brought, or some memorandum or note thereof is in writing and signed by the party to be charged therewith or some person thereunto by him lawfully authorized.

(i) Promise by Executor or Administrator to Answer Damages Out of His or Her Own Estate

A modern reader may have difficulty in grasping the rationale for including this type of promise in a *Statute of Frauds* provision. It is explained in the Alberta Background Paper[28] as based on the ground that, ''[a]t the time of the enactment of the Statute of Frauds, the executor or administrator of an estate took beneficially if there was no residuary gift, and the estate was not liable for the wrongful acts of the deceased. This placed moral pressure on the executor or administrator to make restitution out of his own funds, so that such special promises were common.'' The law, of course, has changed and a personal representative no longer has any claim to the residuary estate of the deceased, and therefore has little incentive to assume liability for the deceased's debts. Consequently, the provision is only of historical interest. It has been repealed in the United Kingdom,[29] British Columbia,[30] New Zealand,[31] Western Australia[32] and Manitoba.[33] Its repeal has been recommended in Alberta, Queensland and South Australia.[34] Later in this chapter we make a recommendation to the same effect.[35]

(ii) Contracts of Guarantee

The second category of contracts covered by section 4 of the Ontario *Statute of Frauds* involves any special promise to answer for ''the debt, default or miscarriage of any other person''. The meaning of these words is far from

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28 *Supra*, note 2, at 128.

29 *Law Reform (Enforcement of Contracts) Act, 1954*, *supra*, note 12, s. 1.

30 *Statute of Frauds, 1958*, S.B.C. 1958, c. 18, s. 7.

31 *Contracts Enforcement Act 1956*, Repr. Stat. N.Z., 1979, Vol. 1, at 535, s. 2.

32 *Law Reform (Statute of Frauds) Act*, West Austl. Acts 1962, No. 16, s. 2.

33 *An Act to Repeal The Statute of Frauds*, S.M. 1982-83-84, c. 34.

34 Alberta Report, *supra*, note 2, at 53; Queensland Report, *supra*, note 2, at 6; and South Australia Report, *supra*, note 2, at 5.

35 See *infra*, this ch., sec. 6(a).

evident and they have required judicial clarification.[36] The following points emerge from the jurisprudence. "Debt" refers to a contractual liability already incurred,[37] whereas "default" refers to a future liability.[38] "Miscarriage" has been interpreted as applying to a liability in tort.[39] Further, it has long been well settled[40] that the Statute applies only to a contract of guarantee and does not include a promise of indemnity, that is, a promise in which the promisor assumes a primary and not a secondary or collateral liability arising out of a present or future event. While the distinction is a basic one, it is not always easy to determine on the facts of a particular case whether the promise falls into one or the other category.

The courts have carved out further exceptions. The Statute does not apply to a guarantee that constitutes an incident of a larger transaction. Examples include cases where a *del credere* agent guarantees the performance of the contract and the solvency of a purchaser,[41] and cases where a person gives a guarantee to secure the release of an encumbrance against property in which he or she has a legal interest.[42] Significantly, the latter exception does not include the promise of a person who only has a personal interest rather than a proprietary interest in the property, such as the interest of a shareholder in a company whose debt he or she is guaranteeing.[43]

(iii) "Any contract or [sic] sale of lands, tenements or hereditaments, or any interest in or concerning them"

Preliminarily, we note a difficulty presented by the disjunctive "or" between "any contract" and "sale of lands". Read literally, it suggests that the provision applies to a conveyance (a "sale") as well as to a contract to sell or otherwise transfer an interest in land. This would be an anomalous construction, since section 1 of the *Statute of Frauds* addresses itself separately to the requirements for the transfer of interests in land. "Or" has, therefore,

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36 See Alberta Background Paper, *supra*, note 2, at 116-18; British Columbia Report, *supra*, note 2, at 37-40; and *Halsbury's Laws of England* (4th ed., 1978), Vol. 20, paras. 119-28.

37 *Castling v. Aubert* (1802), 2 East 325, at 330-31, 102 E.R. 393, at 395.

38 *Re Young and Harston's Contract* (1885), 31 Ch. D. 168 (C.A.).

39 *Kirkham v. Marter* (1819), 2 B. & Ald. 613, 106 E.R. 490.

40 *Halsbury's Laws of England*, *supra*, note 36, Vol. 20, para. 124. The cases are legion. See, for example, *Birkmyr v. Darnell* (1704), 1 Salk. 28, 91 E.R. 27; *Lakeman v. Mountstephen* (1874), L.R. 7 H.L. 17; and *Yeoman Credit Ltd. v. Latter*, [1961] 1 W.L.R. 828, [1961] 2 All E.R. 294 (C.A.).

41 *Couturier v. Hastie* (1852), 8 Exch. 40, rev'd on other grounds [1843-60] All E.R. Rep. 280. A *del credere* agent is one who, for an additional commission, agrees to indemnify the seller of goods for any loss suffered as a result of credit extended to the buyers. See *Black's Law Dictionary*, *supra*, note 4, at 383.

42 *Halsbury's Laws of England*, *supra*, note 36, Vol. 20, para. 127, and *Fitzgerald v. Dressler* (1859), 7 C.B. (N.S.) 374, 141 E.R. 861.

43 *Harburg India Rubber Comb Co. v. Martin*, [1902] 1 K.B. 778 (C.A.), and *Annarva Sales Ltd. v. Lunke*, [1975] W.W.D. 32 (B.C.S.C.).

traditionally been read as "for",[44] which conveniently glosses over a difficult point of exegesis. It is also not clear why the drafters added "tenements or hereditaments" to the description of the subject matter, for the words "lands" and "any interest in or concerning them" appear wide enough to include every known category of interest in realty. We assume, as others have done,[45] that the phrase "tenements or hereditaments" was added out of an abundance of caution.

What constitutes an interest in land for the purpose of the Statute is not clear.[46] It would appear to depend, to a large extent, on judicial perceptions of the benevolent or obstructive role played by the writing requirements in section 4. Important questions of characterization have arisen concerning contracts for the sale of products of the soil (which are subdivided into *fructus naturales* and *fructus industriales*),[47] fixtures, and minerals and hydrocarbons. The picture has been complicated because the definition of "goods" in the Ontario *Sale of Goods Act*[48] includes "things attached to or forming part of the land that are agreed to be severed before sale or under the contract of sale". This overlap has led to the suggestion that the same collateral may be classified as "land" or "goods", depending on whether or not the contract is governed by the *Sale of Goods Act*.[49] In the case of fixtures, further complications arise because of provisions in the Ontario *Personal Property Security Act*.[50]

A judicial disposition to read the statutory words narrowly manifests itself in decisions that hold that agreements to divide all or part of the proceeds of a sale of land, minerals, or hydrocarbons extracted from the land, do not fall within the Statute.[51] The same conclusion has been reached with respect to the sale of partnership assets,[52] even though the partnership assets include land, and may likewise be confidently assumed with respect to the sale of shares in a company owning land. The latter type of transaction is particularly striking

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44 Corbin, *Corbin on Contracts* (1960), Vol. 2, § 396.

45 *Ibid.*, § 391.

46 See Alberta Background Paper, *supra*, note 2, at 24-30, and British Columbia Report, *supra*, note 2, at 8-13.

47 *Fructus naturales* are the spontaneous products of the earth such as grass, trees and shrubs. *Fructus industriales* are products of the soil that are produced through labour and industry, such as crops of grain.

48 *Sale of Goods Act*, *supra*, note 24, s. 1(1)(g). See, also, Sales Report, *supra*, note 23, Vol. 1, at 53-55.

49 Alberta Background Paper, *supra*, note 2, at 26.

50 See *Personal Property Security Act*, R.S.O. 1980, c. 375, s. 36. This provision deals, in part, with the priority of security interests that attach to goods before they become fixtures.

51 *Harris v. Lindeborg*, [1931] S.C.R. 235, [1931] 1 D.L.R. 945, and *Emerald Resources Ltd. v. Sterling Oil Properties Management Ltd.* (1969), 3 D.L.R. (3d) 630 (Alta. S.C., App. Div.).

52 *Archibald v. McNerhanie* (1899), 29 S.C.R. 564.

because it demonstrates how easily the *Statute of Frauds* requirements can be by-passed by use of the corporate vehicle, and because of the fiction of the separate personality of the corporation. It is also well settled that agency contracts to sell or purchase land are outside the Statute.[53] In Ontario, as in many other provinces, such contracts are now governed by separate Acts imposing their own evidentiary requirements.[54]

A peculiar difficulty affects the status of agreements for the lease of lands. *Prima facie*, they fall within section 4. However, a complication arises because of the provisions of sections 1 and 3 of the Statute. Section 1(2) provides that "all leases and terms of years of any messuages, lands, tenements, or hereditaments are void unless made by deed". The requirement is qualified by section 3, which provides that sections 1 and 2 do not apply to a lease, "or an agreement for a lease", for a term not exceeding three years from the making thereof, if the rent amounts to at least two-thirds of the full improved value of the thing demised. The words "or an agreement for a lease" did not appear in the original *Statute of Frauds* and were apparently added in Ontario in the consolidation of 1913.[55]

Two questions arise. First, ignoring the additional language, does section 3 exclude agreements to lease from the requirements of section 4? On a literal reading, the answer should be no, because section 3 only purports to exclude the requirements of sections 1 and 2, not section 4. However, the contrary view was advanced in *Lord Bolton v. Tomlin*,[56] in which it was reasoned that "it seems absurd to say that a parol lease shall be good, and yet that it cannot contain any specific stipulations or agreements." The reference here was to a lease that also contained contractual covenants. The Court's reasoning would appear to apply with equal force to an agreement to lease, yet Hudson Co. Ct. J. appears to have reached the opposite conclusion in *Hoj Industries Ltd. v. Dundas Shepard Square Ltd.*[57] *Lord Bolton v. Tomlin* does not appear to have been cited to the Court, nor did Hudson Co. Ct. J. discuss the significance of the additional words in the Ontario version of section 3.

The second question is what difference the additional words "or an agreement for a lease" make to the construction of section 3. It seems reasonable to surmise that they were inserted to confirm the interpretation of the section adopted in *Lord Bolton v. Tomlin*, but the difficulty remains that the

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53 Alberta Background Paper, *supra*, note 2, at 30.

54 See, for example, the *Real Estate and Business Brokers Act*, R.S.O. 1980, c. 431, s. 23.

55 S.O. 1913, c. 27.

56 (1836), 5 Ad. & E. 856, at 864, 111 E.R. 1391, at 1394. See, also, Ontario Law Reform Commission, *Report on Landlord and Tenant Law*, *supra*, note 25, at 12-13.

57 (1978), 23 O.R. (2d) 295, 95 D.L.R. (3d) 354 (Co. Ct.).

drafter did not expand the section to include a reference to section 4. Presumably it was an oversight on the part of the drafter. Whatever be the correct interpretation of this part of section 3,[58] it seems clear that the section needs to be revised. We return to this question in a later part of this chapter.[59]

(iv) "Contracts not to be performed within a year from the making thereof"

It has been suggested or assumed that the reason for the inclusion of this category of contract in the original *Statute of Frauds* was that it was not deemed wise to trust the memory of witnesses for a period longer than one year.[60] Whatever the justification, the courts have encountered numerous difficulties in construing the statutory language and the many fine distinctions that have been drawn.[61]

To illustrate, if a contract is for an indefinite period, but could be performed within a year, it has been held to fall outside the Statute.[62] However, if the contract provides for a specific period for performance of more than a year but also confers a power of determination that may be exercised within the year, it requires a written memorandum.[63] Again, if a contract is to be performed over a period of one year, commencing the day after the formation of the contract, it falls outside the Statute on the principle that the law takes no account of the parts of a day;[64] if, on the other hand, a contract of the same duration commences *two* days after the conclusion of the contract, the Statute will be deemed to apply even though the day immediately following the conclusion is a Sunday.[65] In addition to these constructional vagaries, it has been noted[66] that the statutory provision leads to the curious result that it is in the interest of the defendant to argue that the contract was to run for more than a year, whereas the plaintiff has an incentive to argue equally strenuously that the contract was for less than a year.

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58 The meaning of the rest of s. 3 is equally obscure.

59 *Infra*, this ch., sec. 6(c)(iii).

60 See, for example, *Smith v. Westall* (1698), 1 Ld. Raym. 316, 91 E.R. 1106, and *Sixth Interim Report*, *supra*, note 2, para. 10. For criticism of this assumption, see *ibid.*, paras. 11(B) and 12.

61 Alberta Background Paper, *supra*, note 2, at 123-24.

62 *Adams v. Union Cinemas, Ltd.*, [1939] 3 All E.R. 136 (C.A.), and *Quance v. Brown* (1926), 58 O.L.R. 578, [1926] 2 D.L.R. 824 (App. Div.).

63 *Hanau v. Ehrlich*, [1912] A.C. 39 (H.L.).

64 *Smith v. Gold Coast and Ashanti Explorers, Ltd.*, [1903] 1 K.B. 285, aff'd [1903] 1 K.B. 538 (C.A.).

65 *Britain v. Rossiter* (1879), 11 Q.B.D. 123, 48 L.J.Q.B. 362 (C.A.).

66 See, for example, the observations of du Parcq L.J. in *Adams v. Union Cinemas, Ltd.*, *supra*, note 62, at 138.

(v) Section 5 Promises

As has been previously noted,[67] section 5 of the *Statute of Frauds* is an Ontario innovation that was added in 1929. The section provides:

> 5. A promise, contract or agreement to pay a sum of money by way of liquidated damages or to do or suffer any other act, matter or thing based upon, arising out of, or relating to a promise, contract or agreement dealt with in section 4 is not of any greater validity than the last-mentioned promise, contract or agreement.

We have not been able to determine the reason for the addition and there are no reported decisions that cast any light on the matter. It has been suggested that the section is directed to a compromise of claims involving the types of contracts enumerated in section 4. That may well have been its purpose, but its language is capable of supporting a wider range of agreements, such as an agreement to rescind a contract covered by section 4. A rescinding agreement has been held to fall outside section 4,[68] and we would regard its reinstatement via section 5 as a regressive measure. Whatever its proper meaning, section 5 does not appear to have served any demonstrable purpose not already served by section 4.

(vi) Ratification of Minors' Contracts (Section 7)

The provision in the *Statute of Frauds* that deals with ratification of minors' contracts is section 7. It reads as follows:

> 7. No action shall be maintained whereby to charge a person upon a promise made after full age to pay a debt contracted during minority or upon a ratification after full age of a promise or simple contract made during minority, unless the promise or ratification is made by a writing signed by the party to be charged therewith or by his agent duly authorized to make the promise or ratification.

It will be recalled that this provision was one of two added by Lord Tenterden's Act of 1828. The purpose of what is now section 7 of the Ontario *Statute of Frauds* was to protect persons from ill-considered adoption of obligations contracted by them during infancy and not otherwise enforceable against them. The section, it should be noted, draws a troublesome distinction between a *promise* made by a person after full age to pay a debt he or she contracted in infancy and *ratification* by such a person of a promise or simple contract made during infancy.

Apart from this feature, the law of minors' contracts is complex and uncertain.[69] Theoretically, such contracts fall into one of four categories: onerous contracts that are said to be void; voidable contracts that are not binding unless ratified by the minor on attaining majority; voidable contracts that are binding until repudiated by the minor; and contracts for necessaries and

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[67] *Supra*, this ch., sec. 2(c).

[68] *Morris v. Baron and Co.*, [1918] A.C. 1 (H.L.).

[69] See *infra*, ch. 10.

beneficial services that are binding *per se*. Section 7 of the *Statute of Frauds* addresses itself to voidable contracts that are not binding unless ratified by the minor on attaining majority. However, all the categories are now somewhat suspect, and the paucity of modern authority, coupled with conflicting *dicta* and decisions, make it difficult to predict with assurance how a particular contract will be categorized by the courts. Finally, there is substantial conflicting authority[70] for the view that a minor may be deemed to have ratified a contract, even without a writing, if he or she continues to derive benefit from the contract after attaining majority.

These reasons, in our view, are more than sufficient to justify reassessment of the modern role of section 7. This reassessment forms part of our review of the law of minors' contracts in chapter 10 of this Report.

(vii) Misrepresentation as to Credit Worthiness (Section 8)

Section 8 is the second of the amendments introduced by Lord Tenterden's Act, and provides as follows:

> 8. No action shall be brought whereby to charge a person upon or by reason of a representation or assurance made or given concerning or relating to the character, conduct, credit, ability, trade or dealings of any other person, to the intent or purpose that such other person may obtain money, goods or credit thereupon, unless the representation or assurance is made by a writing signed by the party to be charged therewith.

This provision was originally added to prevent circumvention of the writing requirement in section 4 involving contracts of guarantee.[71] However, it is now firmly established that the section applies only to fraudulent representations concerning another's credit worthiness[72] and does not affect actions in contract or actions for damages for negligent misrepresentation.[73] Further, it does not apply to representations made to enable the representor to procure benefits for himself or herself.[74]

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70 See, for example, *Cornwall v. Hawkins* (1872), 41 L.J. 435, and *Re Hutton*, [1926] 4 D.L.R. 1080, [1926] 3 W.W.R. 609 (Alta. S.C., T.D.), criticized in *Butterfield v. Sibbitt*, [1950] O.R. 504, at 510-11, [1950] 4 D.L.R. 302, at 308 (H.C.J.). Compare *Rowe v. Hopwood* (1868), L.R. 4 Q.B. 1; *Lynch Bros. Dolan Co. Ltd. v. Ellis* (1909), 7 E.L.R. 14 (P.E.I.S.C.); and *Louden Mfg. Co. v. Milmine* (1907), 14 O.L.R. 532, aff'd 15 O.L.R. 53 (C.A.).

71 See the comments of Lord Wrenbury in *Banbury v. Bank of Montreal*, [1918] A.C. 626, at 711-12, [1918-19] All E.R. Rep. 1, at 27 (H.L.) (subsequent reference is to [1918] A.C.).

72 *Ibid.*, at 712.

73 *W.B. Anderson & Sons, Ltd. v. Rhodes (Liverpool) Ltd.*, [1967] 2 All E.R. 850 (Q.B.), and *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*, [1964] A.C. 465, [1963] 2 All E.R. 575 (H.L.).

74 See British Columbia Report, *supra*, note 2, at 41.

As a result, the section has lost most, if not all, of its practical importance, since it is unlikely that aggrieved persons will assume the gratuitous burden of proving fraud if they can accomplish their objective just as readily by showing that a representor acted negligently or breached a contractual duty. Nevertheless, we share the concern expressed by the Law Reform Commission of British Columbia[75] that the law not appear to shelter fraudulent conduct. For this reason, as well as others, we later endorse[76] their recommendation that section 8 be deleted in any revision of the *Statute of Frauds*.[77]

(b) Evidentiary Requirements under Section 4: Sufficient Memorandum or Note

Section 4 itself makes it clear that its evidentiary requirements may be satisfied if *either* the agreement upon which the action is brought *or* some memorandum or note thereof is in writing. In both cases, the section requires that the document be signed by the party to be charged or by some person lawfully authorized for that purpose. These undemanding requirements have been liberalized still further by a long line of decisions, the overall thrust of which has been to find compliance with the statutory requirements.[78]

So far as the memorandum or note is concerned, it was decided almost from the beginning that the writing need not be in any particular form and that it need not have been prepared with any contractual or other evidentiary intent. Thus, letters[79] or a direction in a will,[80] and even a writing repudiating the agreement,[81] will suffice, but not (obviously) a memorandum disputing the existence of the agreement or a writing expressed to be "subject to contract".[82] It is equally well settled that the writing may come into existence at any time prior to the commencement of the action.[83]

The courts have encountered substantially greater difficulty in determining the required contents of the writing, since section 4 itself is conspicuously silent on the point. The original view was that the writing must show all the terms of

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75 *Ibid.*, at 42.

76 *Infra*, this ch., sec. 6(a).

77 A similar recommendation was made in the Alberta Report, *supra*, note 2, at 53. The British Columbia equivalent of section 8 was repealed by the *Law Reform Amendment Act, 1985*, S.B.C. 1985, c. 10, s. 8.

78 See Alberta Background Paper, *supra*, note 2, at 18-24, and British Columbia Report, *supra*, note 2, at 42-45.

79 *Maybury v. O'Brien* (1911), 25 O.L.R. 229 (H.C. Div.), rev'd on other grounds (1912), 26 O.L.R. 628, 6 D.L.R. 268 (App. Div.).

80 *Re Hoyle*, [1893] 1 Ch. 84, 62 L.J. Ch. 182 (C.A.).

81 *Thirkell v. Cambi*, [1919] 2 K.B. 590, 89 L.J. K.B. 1 (C.A.).

82 *Tiverton Estates, Ltd. v. Wearwell Ltd.*, [1975] Ch. 146, [1974] 1 All E.R. 209 (C.A.).

83 *Farr, Smith & Co., Ltd. v. Messers, Ltd.*, [1928] 1 K.B. 397, 97 L.J.K.B. 126.

the agreement,[84] but this strict test was subsequently relaxed — in contracts involving land in any event — in favour of the requirement that the writing need only disclose the material terms of the agreement. In contracts for the sale of land, this has been deemed to involve a recital of the "three P's" — persons, property, and price.[85] However, other terms have also been held essential[86] and the "material terms" test is not as liberal as may appear at first sight. Indeed, it may constitute a trap for the unwary. Contracts of guarantee suffer from equal uncertainties. Section 6 of the Statute provides that a written promise of guarantee need not show the consideration given for the guarantee, thereby leaving the inference that all the other terms of the guarantee must be reduced to writing. Recent case law supports this construction.[87]

The courts have shown a remarkable willingness to facilitate proof of the terms of an agreement by permitting joinder of documents,[88] although the cases are not consistent in explaining the theory upon which such joinder is permitted. Apart from the joinder of documents, extrinsic evidence may also be admitted to explain a patent or latent ambiguity or, in the case of land contracts, to complete a description of the land.[89]

The same elasticity marks the courts' construction of the statutory requirement that the writing must be signed by the person being sued or by his or her agent.[90] The party's signature need not appear at the end of the writing being relied upon; it may appear in any part of the writing and initials will suffice. Nor is the "signature" required to be handwritten, it being settled that a writing by the party to be charged on his printed letter head may satisfy the statutory requirement.[91]

(c) Effect of and Relief from Non-Compliance with the Statutory Requirements

However easy to comply with, there will always be cases in which the party seeking to rely on the agreement has not met the statutory requirements. It is, therefore, necessary to determine the consequences of non-compliance, the circumstances in which the courts will grant relief to the defaulting party, and the kinds of relief available.

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84 Alberta Background Paper, *supra*, note 2, at 19.

85 *McKenzie v. Walsh* (1920), 61 S.C.R. 312, at 313, 57 D.L.R. 24, at 25, and *Harvie v. Gibbons* (1980), 109 D.L.R. (3d) 559, at 565, 12 Alta. L.R. (2d) 72, at 79 (C.A.).

86 For example, that the purchase price is payable in stages; the reservation of a life interest by the seller; or the buyer's responsibility for city taxes. See Alberta Background Paper, *supra*, note 2, at 20.

87 *Transco Mills Ltd. v. Louie* (1975), 59 D.L.R. (3d) 665 (B.C.S.C.), at 671.

88 See the discussions in the Alberta Background Paper, *supra*, note 2, at 22-24, and the British Columbia Report, *supra*, note 2, at 43-44.

89 *Harvie v. Gibbons*, *supra*, note 85.

90 See Alberta Background Paper, *supra*, note 2, at 21-22.

91 *Schneider v. Norris* (1814), 2 M. & S. 286, 105 E.R. 388.

(i) The Effect of Non-Compliance

Section 4 of the Ontario *Statute of Frauds* provides that "[n]o action shall be brought" unless the writing requirements of the section have been met.[92] The precise meaning of these words remained unsettled for a surprisingly long period of time. In *Carrington v. Roots*,[93] a unanimous Court of Exchequer declared that the words meant "that the contract shall be altogether void". This Draconian view was subsequently changed in favour of the interpretation that has prevailed since *Leroux v. Brown*[94] was decided in the middle of the last century, that is, that such insufficiently evidenced agreements are valid but unenforceable. This compromise has important consequences.[95] It means that an oral agreement can be relied on by way of defence, for example, to resist a claim by a defaulting purchaser of land to recover a deposit. It also means that the agreement, while unenforceable, may furnish sufficient consideration to support a negotiable instrument. Finally, it means that the writing may become enforceable in the future if the writing requirements are subsequently satisfied or if sufficient acts of performance occur to satisfy the equitable doctrine of part performance.[96]

(ii) Relief from the Effects of Non-Compliance

A party who cannot satisfy the statutory writing requirements may be able to obtain relief from the effects of non-compliance by either making a restitutionary claim for benefits conferred on the other party or invoking the doctrine of part performance.[97] There are fundamental differences between these forms of relief. In principle, a restitutionary claim should generally be available where benefits have been conferred on a defendant in any case governed by the *Statute of Frauds*, whereas the doctrine of part performance is of equitable origin and only applies in cases concerning land and, arguably, those other types of contract subject to equity's jurisdiction.[98] Another important difference is that a successful restitutionary claim only results in the

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92 Section 7 provides that "[n]o action shall be maintained", but the meaning appears to be the same.

93 (1837), 2 M. & W. 248, at 255, 150 E.R. 748, at 751. See Williams, *The Statute of Frauds Section Four* (1932), at 195-96.

94 (1852), 12 C.B. 801, 138 E.R. 1119.

95 Williams, *supra*, note 93, at 199 *et seq.*, and British Columbia Report, *supra*, note 2, at 14.

96 See *infra*, this ch., sec. 3(c)(ii)(b.).

97 In the discussion that follows, we have omitted any reference to a third form of relief based on the defendant's "fraud" because it no longer appears to have much practical importance, assuming it ever did. See British Columbia Report, *supra*, note 2, at 25-26, and Alberta Background Paper, *supra*, note 2, at 40-41.

98 The point still appears to be unsettled. For conflicting judicial views, see *Britain v. Rossiter*, *supra*, note 65, and *McManus v. Cooke* (1887), 35 Ch. D. 681, 56 L.J. Ch. 662.

plaintiff recovering the actual benefits or value conferred on the defendant.[99] The remedy falls far short of actual enforcement of the agreement, even where the plaintiff has fully performed his or her part of the bargain. Successful invocation of the doctrine of part performance, on the other hand, entitles the plaintiff either to have the agreement specifically enforced or, in appropriate circumstances, to recover damages in lieu of specific enforcement.

a. Restitutionary Claims

This head of relief is now fully recognized in Canada as a result of the decision of the Supreme Court of Canada in *Deglman v. Guaranty Trust Co.*[100]. In that case, the plaintiff rendered services to the deceased in reliance on a contract that was unenforceable because of the operation of the *Statute of Frauds*. The Supreme Court nevertheless allowed the plaintiff to recover the fair value of his services, applying "the principle of restitution against what would otherwise be unjust enrichment".[101] However valuable the decision in *Deglman* may be in mitigating the rigours of the *Statute of Frauds*, it suffers from an important limitation. This is because the doctrine offers no relief to the plaintiff who has incurred expenditures, or who has otherwise relied on the contract to his or her detriment, but without conferring a benefit on the defendant.

This problem does not appear to be addressed by the recommendations of the Alberta Institute of Law Research and Reform in its recent Report. The Institute recommended that if a contract was unenforceable, the court should be able to grant to the plaintiff such relief by way of restitution of any benefit received by the defendant as is just.[102] In British Columbia, on the other hand, the *Law and Equity Act*, which was recently amended to implement some of the recommendations of the Law Reform Commission of British Columbia, provides that:[103]

> 54.-(5) Where a court decides that an alleged gift or contract cannot be enforced, it may order either or both of
>
> (a) restitution of a benefit received, and
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> (b) compensation for money spent in reliance on the gift or contract.

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99 As in *Deglman v. Guaranty Trust Co.*, [1954] S.C.R. 725, [1954] 3 D.L.R. 785 (subsequent reference is to [1954] S.C.R.).

100 *Ibid.* See, generally, Fridman and McLeod, *Restitution* (1982), and Klippert, *Unjust Enrichment* (1982). See, also, *Lensen v. Lensen* (1985), 14 D.L.R. (4th) 611 (Sask. C.A.), leave to appeal to the Supreme Court of Canada granted April 4, 1985.

101 *Supra*, note 99, at 728.

102 Alberta Report, *supra*, note 2, at 21.

103 *Law and Equity Act*, R.S.B.C. 1979, c. 224, as am. by the *Law Reform Amendment Act, 1985*, *supra*, note 77, s. 7.

b. The Doctrine of Part Performance

(1) General

The doctrine of part performance[104] constitutes one of the most remarkable chapters in the history of the *Statute of Frauds* and represents a striking example of equity's willingness to ignore the seemingly clear language of a statute in order to prevent injustice. The doctrine was embraced within a decade of the Statute's enactment,[105] and its role is now formally recognized in the English *Law of Property Act, 1925*[106] and other Commonwealth legislation. The basis of equity's intervention was explained by Lord Selborne L.C. in the following oft-cited passage in his judgment in *Maddison v. Alderson*:[107]

> In a suit founded on such part performance, the defendant is really 'charged' upon the equities resulting from the acts done in execution of the contract, and not (within the meaning of the statute) upon the contract itself. If such equities were excluded, injustice of a kind which the statute cannot be thought to have had in contemplation would follow .... The matter has advanced beyond the stage of contract; and the equities which arise out of the stage which it has reached cannot be administered unless the contract is regarded. The choice is between undoing what has been done (which is not always possible, or, if possible, just) and completing what has been left undone.

Longevity, however, has not meant tranquillity, and the doctrine of part performance continues to suffer from important ambiguities and other unresolved difficulties. We deal below with the more important of these.

(2) Sufficient Acts of Part Performance

In the nineteenth century, in their anxiety to avoid the reproach that the statutory requirement was being flouted with impunity, the courts of equity adopted a strict test of what acts of part performance constituted acceptable evidence of the contract under consideration. Again, quoting from Lord Selborne L.C.'s judgment in *Maddison v. Alderson*,[108] the acts of part performance had to be "unequivocally, and in their own nature, referable to some such agreement as that alleged". Lord Justice Fry advanced a still stricter test, and in his celebrated work *Specific Performance of Contracts*[109] contended that "the acts of part performance must be such as not only to be referable to a contract

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104 See, generally, British Columbia Report, *supra*, note 2, at 15-25; Alberta Background Paper, *supra*, note 2, at 31-40; Alberta Report, *supra*, note 2, at 14-17; Furmston (ed.), *Cheshire & Fifoot's Law of Contract* (10th ed., 1981), at 194-99; and Williams, *supra*, note 93, ch. 8.

105 *Butcher v. Stapely* (1685), 1 Vern. 363, 23 E.R. 524.

106 *Supra*, note 10.

107 (1883), 8 App. Cas. 467, at 475-76, [1881-85] All E.R. Rep. 742, at 747-48 (H.L.) (subsequent reference is to 8 App. Cas.). See, also, British Columbia Report, *supra*, note 2, at 15.

108 *Supra*, note 107, at 479.

109 Fry (ed. Northcote), *Specific Performance of Contracts* (6th ed., 1921), § 580.

such as that alleged but to be referable to no other title''. These formulations have won the repeated support of the Supreme Court of Canada, and, with some recent exceptions,[110] have been followed consistently by other Canadian courts.[111] Accordingly, until reversed, they must be presumed to reflect the Canadian test at the present time.

In England, a liberalizing trend began to emerge in the 1960s. In *Kingswood Estate Co. Ltd. v. Anderson*,[112] Upjohn L.J. rejected the argument that acts of part performance must be referable to no other title and regarded the proposition as ''long exploded''. He adopted another of the tests formulated by Fry L.J., according to which[113] ''the acts in question be such as must be referred to some contract, and may be referred to the alleged one: that they prove the existence of some contract, and are consistent with the contract alleged''. This test was actually applied in *Wakeham v. Mackenzie*[114] and was substantially approved, although not in identical words, by the majority of the House of Lords in *Steadman v. Steadman*.[115] The headnote in the official report succinctly summarizes the effect of the elaborate and detailed majority judgments in that case:[116]

> (1) [T]hat the alleged acts of part performance had to be considered in their surrounding circumstances and, if they pointed on a balance of probabilities to some contract (*per* Lord Salmon, for the disposition of an interest in land) between the parties and either showed the nature of or were consistent with the oral agreement alleged, then there was sufficient part performance of the agreement for the purpose of section 40(2) of the Law of Property Act 1925.
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> ....
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> (2) That ... the act of part performance did not have to be referable to that part of the agreement for the disposition of an interest in land.

The law lords also rejected[117] the long held view that part payment of the price cannot satisfy the test of part performance and held that such acts are governed by the same test as other acts of part performance by the plaintiff. The radical nature of the revised test of part performance approved by the House of Lords

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[110] See *Currie v. Thomas* (1985), 3 C.P.C. (2d) 42 (B.C.C.A.). See, also, *Lensen v. Lensen*, *supra*, note 100.

[111] See Fridman, *The Law of Contract in Canada* (1976), at 222-23.

[112] [1963] 2 Q.B. 169, [1962] 3 All E.R. 593 (C.A.) (subsequent reference is to [1963] 2 Q.B.).

[113] *Ibid.*, at 189.

[114] [1968] 1 W.L.R. 1175, at 1181, [1968] 2 All E.R. 783, at 787 (Ch. D.).

[115] *Steadman v. Steadman*, [1976] A.C. 536, [1974] 2 All E.R. 977 (H.L.) (subsequent references are to [1976] A.C.).

[116] *Ibid.*, at 536-37.

[117] *Ibid.*, at 541, *per* Lord Reid; at 565, *per* Lord Simon of Glaisdale; and at 570, *per* Lord Salmon.

requires no further emphasis, and it will come as no surprise that some English commentators[118] regard *Steadman v. Steadman* as having substantially repealed the *Statute of Frauds* in its application to dealings in land.

Steadman v. Steadman has not yet received the approval of the Supreme Court of Canada, although it has been followed in a recent decision of the British Columbia Court of Appeal.[119] While it remains to be seen what influence *Steadman v. Steadman* will exert at the judicial level, its influence is clear in the recommendations of the Law Reform Commission of British Columbia[120] and in the statutory amendments arising out of those recommendations.[121] Later in this chapter, we shall consider whether effect should be given to the *Steadman* decision in any statutory restatement of the doctrine of part performance.

(3) Acts of Part Performance by the Defendant

There has been much discussion over the years concerning the true basis of the doctrine of part performance.[122] The dominant view, now strongly reinforced by *Steadman v. Steadman*,[123] is that it rests on the inequitable character of the defendant's conduct in refusing to perform his or her side of the bargain when the defendant has derived benefits under it, and on the hardship to the plaintiff if he or she is denied specific performance of the agreement. This equitable view of the nature of the relief has important implications.[124] It means, first, that acts of part performance by the defendant are irrelevant, however cogent their evidentiary value.[125] Secondly, it means that relief may be refused if the defendant has not derived benefits from the plaintiff's acts[126] or, perhaps, if the defendant is willing to and can make satisfactory restitution of

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118 Wade, Note, "Part Performance: Back to Square One" (1974), 90 L.Q. Rev. 433.

119 See *Currie v. Thomas*, *supra*, note 110. See, also, *Lensen v. Lensen*, *supra*, note 100. In the earlier case of *Toombs v. Mueller* (1974), 47 D.L.R. (3d) 709, [1974] 6 W.W.R. 577, rev'd without written reasons (1975), 54 D.L.R. (3d) 160*n* (Alta. S.C., App. Div.), the trial judge held that he was bound by the earlier decisions of the Supreme Court of Canada. In *Colberg v. Schumacher* (1978), 8 Alta. L.R. (2d) 73, 12 A.R. 183 (S.C., App. Div.), *Steadman v. Steadman* was referred to, but without any indication of its status in Alberta. On the facts, it was not necessary for the Court to decide the question since the alleged acts satisfied neither the strict nor the more liberal test of part performance.

120 British Columbia Report, *supra*, note 2, at 64 *et seq.*

121 *Law and Equity Act*, *supra*, note 103, s. 54, and *Law Reform Amendment Act, 1985*, *supra*, note 77, s. 8.

122 *Cheshire & Fifoot's Law of Contract*, *supra*, note 104, at 194-95.

123 *Supra*, note 115.

124 Compare, however, British Columbia Report, *supra*, note 2, at 20-21.

125 *Caton v. Caton* (1866), L.R. 1 Ch. App. 137, at 148, aff'd on other grounds (1867), L.R. 2 H.L. 127, 36 L.J. Ch. 886.

126 *Colberg v. Schumacher*, *supra*, note 119.

the benefits.[127] Thirdly, the essential ingredient of benefits conferred on the defendant means that merely preparatory acts engaged in by the plaintiff, albeit with the knowledge and acquiescence of the defendant, will not suffice to justify equity's intervention.[128] The final implication of the equitable character of the relief is that the plaintiff must appear in court with clean hands. Otherwise, the plaintiff may be refused relief.[129]

(4) *The Scope of the Doctrine*

As we have already noted, it remains unsettled whether the doctrine of part performance is restricted to contracts relating to land, or whether it applies to all contracts in respect of which specific performance is available. In any event, while such a restriction may be readily explicable in historical terms, it makes little sense from a functional point of view. Why, for example, should a plaintiff who, with the consent of the other party, has embarked on part performance of a contract that is to run for more than a year be denied the court's assistance because the contract is not specifically enforceable?[130]

(5) *Damages in Lieu of Specific Performance*

If the property in question has been sold,[131] or circumstances have otherwise changed, it may no longer be possible for the plaintiff to obtain an order of specific performance. Nor may the plaintiff be interested in such an order. The question then arises whether the court, in the exercise of its equitable jurisdiction, can award damages instead. In England, prior to the adoption in 1858 of the *Chancery Amendment Act*[132] (commonly referred to as Lord Cairns' Act), the answer would have been obvious, since the courts of equity had no power to award damages in such cases. Only the common law courts could award damages, but they would not have done so if the plaintiff could not satisfy the writing requirements of the *Statute of Frauds*. Section 2 of Lord Cairns' Act offered some relief from this dilemma and provided, in the language of its Ontario counterpart, section 21 of the *Judicature Act*, as follows:[133]

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127 This aspect appears to have played a much more significant role in the development of the American doctrine of part performance than in Anglo-Canadian law, and has now been given statutory form. See Uniform Land Transactions Act, National Conference of Commissioners on Uniform State Laws, Uniform Laws Annotated, Civil Procedural and Remedial Laws, 1975 [hereinafter referred to as "Uniform Land Transactions Act"], § 2-201(3), discussed *supra*, this ch., sec. 5. See, also, *Corbin on Contracts*, *supra*, note 44, §§ 427 and 429.

128 *Ogilvie v. Schumacher*, *supra*, note 119.

129 *Harris v. Robinson* (1892), 21 S.C.R. 390, at 397.

130 See, also, the discussion in the *Sixth Interim Report*, *supra*, note 2, para. 12.

131 See, for example, *Pearson v. Scarborough School Bd. Lands, St. Thomas Ltd.*, [1968] 2 O.R. 323, 67 D.L.R. (2d) 283 (H.C.J.).

132 *Chancery Amendment Act*, 1858, 21 & 22 Vict., U.K., c. 27.

133 R.S.O. 1980, c. 223. See, now, *Courts of Justice Act*, 1984, S.O. 1984, c. 11, s. 112, which provides:

> [w]here the court has jurisdiction to entertain an application for an injunction against a breach of covenant, contract or agreement, or against the commission or continuance of a wrongful act, or for the specific performance of a covenant, contract or agreement, the court may award damages to the party injured either in addition to or in substitution for the injunction or specific performance, and the damages may be ascertained in such manner as the court directs, or the court may grant such other relief as is considered just.

Unfortunately, the section did not realize its full promise because the courts were not agreed on the meaning of the phrase "[w]here the Court has jurisdiction to entertain an application".[134] One interpretation was that the section did not apply unless, in the particular case before it, the court could *actually* have made an order of specific performance. Some Canadian courts adopted this narrow construction,[135] while others favoured the view that damages might be awarded under the section so long as the contract was of a type over which the courts of equity would have assumed jurisdiction.[136] A further difficulty arose because, in *Wroth v. Tyler*,[137] Megarry J. (as he then was) held that, in awarding damages under Lord Cairns' Act, a court of equity was not bound by the common law rules for the assessment of damages. The House of Lords has subsequently expressed reservations regarding this holding,[138] and it may not survive scrutiny when the question arises for decision before the highest courts on both sides of the Atlantic.

(d) CONCLUSIONS

It will be convenient at this point to summarize some of the conclusions that appear to emerge from this review of the existing law. So far as the types of contracts, promises, and obligations governed by the *Statute of Frauds* are concerned, it is clear that several of them are obsolete or so obscurely described that they should be omitted from any revision of the Statute. This is true of promises by executors and administrators to pay damages out of their own estates, section 5 of the Statute, and representations concerning another person's credit worthiness. The ratification of minors' contracts is also problematic, and reform in this connection is discussed in chapter 10 of this Report.

> 112. A court that has jurisdiction to grant an injunction or order specific performance may award damages in addition to, or in substitution for, the injunction or specific performance.

134 The conflicting case law is canvassed in the British Columbia Report, *supra*, note 2, at 21-25, and in the Alberta Background Paper, *supra*, note 2, at 37-40. It should be noted that s. 112 of the Ontario *Courts of Justice Act, 1984*, *supra*, note 133, does not resolve this problem.

135 *Pearson v. Skinner School Bus Lines (St. Thomas) Ltd.*, *supra*, note 131; *Bennett v. Stodgell* (1915), 36 O.L.R. 45 (App. Div.); and *Robinson v. MacAdam*, [1948] 2 W.W.R. 425 (B.C.S.C.).

136 *McIntyre v. Stockdale* (1912), 27 O.L.R. 460, 9 D.L.R. 293 (H.C. Div.); *Pfeifer v. Pfeifer*, [1950] 2 W.W.R. 1227 (Sask. C.A.); and *Dobson v. Winton and Robbins Ltd.*, [1959] S.C.R. 775, 20 D.L.R. (2d) 164.

137 [1974] Ch. 30, [1973] 1 All E.R. 897.

138 *Johnson v. Agnew*, [1979] 1 All E.R. 883 (H.L.), at 896.

Section 17 of the original Statute (now reproduced in section 5 of the Ontario *Sale of Goods Act*) has already been dealt with in our *Report on Sale of Goods*.[139]

We therefore conclude that, apart from minors' contracts, only contracts in relation to land, contracts of guarantee, and contracts for more than one year retain substantial practical importance.

So far as the writing requirements imposed by section 4 are concerned, the courts have generally been accommodating in finding compliance. An important exception involves the ambiguity surrounding the minimum contents of the required writing and the extent to which and the bases upon which documents may be joined in order to satisfy the statutory requirements. The doctrine of part performance is another matter. Judging by the frequency with which the doctrine is invoked in practice,[140] it plays a vital role in mitigating the rigours of the writing requirements. But, at the same time, the doctrine suffers from ambiguities and other shortcomings that prevent it from being a wholly satisfactory substitute for the statutory requirements.

Overall, the need to revise and modernize the contractual and related provisions of the *Statute of Frauds* seems to us compelling. The critical questions are whether the provisions should be retained at all, and, if retained, how they should be revised. These are the issues to which we address ourselves in the balance of this chapter.

4. ARGUMENTS FOR AND AGAINST RETENTION OF THE *STATUTE OF FRAUDS* WRITING REQUIREMENTS

Debates on the merits of the provisions concerning contracts in the *Statute of Frauds* have continued intermittently for at least two centuries. The Statute has its detractors and its equally stout defenders. The arguments have varied in their nature, some addressing themselves only to particular facets of the writing requirements, while others have been more concerned with the rationale of imposing any type of writing requirement. We reproduce below, without seeking to evaluate them at this stage, the principal arguments that have been advanced in the past for and against retaining the requirements.

(a) FUNCTION OF WRITING REQUIREMENTS

In an influential article[141] written in 1941, Professor Fuller of the Harvard Law School identified the following three important functions served by writing requirements and similar formalities imposed by the law.

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[139] Sales Report, *supra*, note 23, Vol. 1, at 107.

[140] The doctrine was invoked in 12 out of 26 land contract cases reported between 1970 and 1979 in which the *Statute of Frauds* was pleaded as a defence. Ten of the 26 cases involved the sufficiency of the writing.

[141] Fuller, "Consideration and Form" (1941), 41 Colum. L. Rev. 799, at 800 *et seq.*

(1) *Evidentiary function.* This function is self-evident and, judging by the preamble to the *Statute of Frauds*, obviously weighed most heavily with the framers of the Statute in 1677. Writing not only avoids the risks of perjury but, more importantly, by providing an objective and permanent record of the parties' agreement, avoids reliance on fallible human memories and eliminates the need to weigh possibly conflicting evidence as to what was said and with what intention.

(2) *Cautionary function.* The danger of parol agreements that are fully enforceable without being reduced to writing, it is said, is that they may result in imposing very significant obligations without the parties fully appreciating the consequences of their actions. A writing requirement introduces a note of deliberation and provides the parties with a period of reflection, thereby, it is argued, preventing unconsidered action. Equally important, a writing requirement provides the parties with a shield behind which they may safely negotiate without the threat of being deemed to have concluded a binding contract.[142]

(3) *Channelling function.* According to Professor Fuller,[143] a legal formality such as writing not only serves an evidentiary and cautionary function, but "serves also to mark or signalize the enforceable promise; it furnishes a simple and external test of enforceability." However, Professor Fuller also recognized[144] that the requirements of the *Statute of Frauds* serve only a negative effect — they indicate which promises are not enforceable without written evidence, but they do not impress the writing with the cachet of conclusive validity and effectiveness. This is because the written promise may be void or unenforceable for lack of consideration, lack of capacity, or because of duress, fraud, or other vitiating factors.

(b) CRITICISMS OF THE *STATUTE OF FRAUDS* WRITING REQUIREMENTS

Having stated the main functions of a writing requirement, it remains to be determined how effectively the *Statute of Frauds* fulfills these functions and whether the criticisms levelled against the Statute outweigh the advantages of a writing requirement in these circumstances. The criticisms that have been raised are formidable. We begin with those criticisms that have been commonly made

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142 The importance of this function is stressed in the English practice of solicitors exchanging correspondence "subject to contract" concerning the details of an agreement for the sale of real property, the principal features of which have previously been agreed upon between the parties. After initially holding in *Griffiths v. Young*, [1970] Ch. 675, [1970] 3 All E.R. 601 (C.A.), and *Law v. Jones*, [1974] Ch. 112, [1973] 2 All E.R. 437 (C.A.), that "subject to contract" was only a suspensive condition and could be waived by the parties, thus making the correspondence admissible to satisfy the statutory writing requirements, the Court of Appeal subsequently reversed itself in *Tiverton Estates, Ltd. v. Wearwell Ltd.*, *supra*, note 82. A dominant consideration in the Court's change of heart was the uncertainty caused by its earlier decisions and the fear of conveyancers that it would no longer be safe for solicitors to negotiate behind a "subject to contract" screen.

143 *Supra*, note 141, at 801.

144 *Ibid.*, at 802.

in the past and then add several further arguments that could be made in the light of recent jurisprudential developments.

(1) *A product of conditions that no longer exist.* As has been frequently observed,[145] the *Statute of Frauds* was enacted in response to a series of debilitating circumstances affecting the conduct of litigation in the seventeenth century that have long ceased to exist. At the time the Statute was enacted, parties were not free to give evidence on their own behalf; jurors were entitled to act on their own knowledge of the facts and were immune from effective judicial control; and England was just emerging from a turbulent period of social and political unrest in which there was much litigation and many unfounded claims. None of these conditions exists today in Ontario. Parties are competent witnesses; jury trials are rare in contract cases; and transactions involving many thousands of dollars are regularly proved in our courts with the aid of parol evidence without any apparent harm or ill effects.[146] With these factors in mind, the English Law Revision Committee has observed that "[a] condition of things which was advanced in relation to 1677 is backward in relation to 1937."[147]

(2) *Arbitrariness.* This alleged defect of the Statute — the absence of any relevant common qualities that identify the contracts governed by section 4 — carried considerable weight with the English Law Revision Committee,[148] but has attracted less attention in more recent reports.

(3) *Inconsistency.* The complaint made under this heading is that the law is not consistent. Parol evidence, it has been held, is not admissible to enforce a *Statute of Frauds* transaction, but is admitted by way of defence and is admissible to recover payments made to the other party and to convict a person of perjury.[149]

(4) *Not in accord with actual practices.* It is very common for parties to enter into parol agreements of the kinds regulated by section 4. The law, it is argued, should respect such practices and should not penalize parties for adopting habits that they find congenial and appropriate to their circumstances.[150]

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145 See, *inter alia*, *Sixth Interim Report*, *supra*, note 2, para. 9; British Columbia Report, *supra*, note 2, at 47-48; and Williams, *supra*, note 93, at *xxx-xxxii*.

146 See, also, Alberta Report, *supra*, note 2, at 9.

147 *Sixth Interim Report*, *supra*, note 2, para. 9(1).

148 *Ibid.*, paras. 10-13.

149 See British Columbia Report, *supra*, note 2, at 49.

150 See *Sixth Interim Report*, *supra*, note 2, para. 9(4), and British Columbia Report, *supra*, note 2, at 49. While the reports generally focus on business practices, it should be emphasized that the problem is a wider one. Consumers are sometimes more strongly affected by a writing requirement than business persons, particularly when the consumer is not familiar with the statutory requirements. For example, research done in connection

(5) *Hardship*. This is perhaps the most persistent and serious criticism of the Statute.[151] An unsuccessful plaintiff whose claim is defeated by the absence of writing not only loses the expectation interest generated by concluding the agreement, but may also be denied compensation for substantial losses incurred in reliance on the bargain. In addition, a writing requirement, if not complied with, gives a contracting party a pretext to repudiate a contract that would ordinarily be expected to be enforceable.[152]

(6) *Unnecessary Litigation*. It is also argued,[153] that because the language of the Statute is far from clear in important respects, and because of the incrustations of three centuries of decisions, the parties are often forced to litigate to establish their legal position. Much of this litigation is directed to form rather than substance.[154]

(7) *No cautionary or channelling effects*. In light of our earlier discussion of the writing requirements in section 4,[155] it will be evident that the writing requirements do not, in fact, serve a cautionary or channelling function in the case of the *Statute of Frauds*. This is because section 4 does not require the agreement itself to be in writing, but rather requires only a note or memorandum evidencing the agreement. This note or memorandum can be produced at any time and under the most informal circumstances. In our view, this is one of the most significant, and also perhaps most neglected, features in the debate on the comparative merits and disadvantages of the statutory writing requirements. It would, of course, be possible to achieve the cautionary effect by requiring the agreement itself to be reduced to writing. However, this would involve a fundamental change in section 4 of the Statute, a change that has not so far recommended itself to any of the numerous agencies that have reported on the Statute.

(8) *The Effect of Steadman v. Steadman*. The test of part performance adopted by the House of Lords in *Steadman v. Steadman*,[156] is sufficiently broad that only rarely will a plaintiff who has partially performed not be able to avoid the statutory writing requirement. In view of this fact, the question arises whether it is appropriate to retain the section 4 requirements for the small group of land contracts cases in which it is sought to enforce the contract before either party has proceeded to perform it.

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with this project indicates that in 17 of 26 land contract cases reported in Canada between 1970-1979, both parties were consumers, and in only 4 were both parties business people.

151 British Columbia Report, *supra*, note 2, at 49.

152 See Alberta Report, *supra*, note 2, at 9.

153 *Sixth Interim Report*, *supra*, note 2, para. 9(7), and Alberta Background Paper, *supra*, note 2, at 10-11.

154 See Alberta Report, *supra*, note 2, at 9.

155 *Supra*, this ch., sec. 3(b).

156 *Supra*, note 115.

We recognize that *Steadman v. Steadman* has not so far been followed in Ontario. However, we note that its liberalizing approach has won the unanimous support of the Law Reform Commission of British Columbia and that the case has been followed by the Court of Appeal of that Province.[157] Accordingly, we would expect it to exert at least an indirect influence in this jurisdiction. It would be possible to clarify the position in Ontario by recommending statutory entrenchment of the pre-*Steadman* test, but such a step does not seem to us to have much to recommend it.

5. DEVELOPMENTS IN OTHER JURISDICTIONS

Before turning to the Commission's own recommendations, it will be convenient to summarize the recommendations that have been made in other common law jurisdictions for revising the provisions concerning contracts in the *Statute of Frauds* and to indicate the extent to which they have been implemented by legislation.

The most significant change to the *Statute of Frauds* has occurred recently in Manitoba. In its 1980 *Report on The Statute of Frauds*, the Manitoba Law Reform Commission proposed a radical overhaul of the legislation applicable in that Province,[158] but recommended retention in an amended form of a writing requirement for leases, promises of guarantee and indemnity, and contracts relating to land. The Manitoba Legislative Assembly took a less cautious approach and repealed the Act *in toto*.[159]

The provision in section 4 relating to contracts by executors or administrators to answer damages out of their own estates has been repealed in England,[160] British Columbia,[161] New Zealand,[162] and Western Australia.[163] Its repeal has been recommended in Queensland,[164] South Australia,[165] and Alberta.[166]

Similarly, the provision relating to agreements not to be performed within a year has been repealed in England,[167] British Columbia,[168] and New

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157 *Currie v. Thomas*, *supra*, note 110.

158 *Supra*, note 2.

159 *An Act to Repeal The Statute of Frauds*, *supra*, note 33.

160 *Law Reform (Enforcement of Contracts) Act, 1954*, *supra*, note 12, s. 1.

161 *Statute of Frauds, 1958*, *supra*, note 30, s. 7.

162 *Contracts Enforcement Act 1956*, *supra*, note 31, s. 2.

163 *Law Reform (Statute of Frauds) Act*, *supra*, note 32, s. 2.

164 Queensland Report, *supra*, note 2, at 6.

165 South Australia Report, *supra*, note 2, at 5.

166 Alberta Report, *supra*, note 2, at 53.

167 *Law Reform (Enforcement of Contracts Act), 1954*, *supra*, note 12, s. 1.

168 *Statute of Frauds, 1958*, *supra*, note 30, s. 7.

Zealand.[169] Its repeal has been recommended in Queensland,[170] South Australia,[171] and Alberta.[172]

The provisions in section 4 dealing with contracts of guarantee and contracts relating to land have had a more varied history. The repeal of the provision relating to guarantees was recommended in England in 1937 by a majority of the Law Revision Committee.[173] Its retention was recommended by a minority of the Committee[174] and by the later Law Reform Committee in 1953.[175] It was not repealed when the law was amended in 1954.[176] Retention of the original provision was recommended by the Queensland Law Reform Committee.[177] Its repeal was recommended by the South Australia Law Reform Committee.[178]

In British Columbia, the provision dealing with contracts of guarantee was extended in 1958 to cover indemnities as well as guarantees.[179] It now appears as section 54(6) of the *Law and Equity Act*, which reads as follows:[180]

> 54.-(6) A guarantee or indemnity is not enforceable unless
>
> (a) it is evidenced by writing signed by, or by the agent of, the guarantor or indemnitor, or
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> (b) the alleged guarantor or indemnitor has done an act indicating that a guarantee or indemnity consistent with that alleged has been made.

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169 *Contracts Enforcement Act 1956*, *supra*, note 31, s. 2.

170 Queensland Report, *supra*, note 2, at 7.

171 South Australia Report, *supra*, note 2, at 8.

172 Alberta Report, *supra*, note 2, at 53.

173 *Sixth Interim Report*, *supra*, note 2, paras. 4-16.

174 *Ibid.*, at 33-34. The dissentients were Goddard J. (afterwards L.C.J.), Porter J. (afterwards Lord Porter), W.E. Mortimer, and A.F. Topham, K.C.

175 England, Law Reform Committee, *The Statute of Frauds and Section 4 of the Sale of Goods Act*, *supra*, note 2, at 2.

176 See *Law Reform (Enforcement of Contracts) Act, 1954*, *supra*, note 12. It has also been continued in force in New Zealand: see *Contracts Enforcement Act, 1956*, *supra*, note 31, s. 2(1)(d).

177 Queensland Report, *supra*, note 2, at 8.

178 South Australia Report, *supra*, note 2, at 5-6 (a majority recommendation). The recommendation appears to be based on the reasoning that the "distinction between a guarantee and an indemnity is a disgrace to the law and merely a trap to the unwary".

179 *Statute of Frauds, 1958*, *supra*, note 30, s. 5. See R.S.B.C. 1979, c. 393, s. 4, repealed by S.B.C. 1985, c. 10, s. 8.

180 *Law and Equity Act*, *supra*, note 103, s. 54(6).

In Alberta, the writing requirement for a contract of guarantee applies to persons and corporations and is supplemented by the *Guarantees Acknowledgment Act*[181] which requires additional formalities for the giving of guarantees by persons who are not corporations. The Alberta Institute of Law Research and Reform has recently recommended that a guarantee, whether by a person or a corporation,[182] should not be enforceable unless there is some evidence in writing signed by the party to be charged, or by his or her agent, which indicates that the party to be charged has given a guarantee to the party alleging the guarantee and which reasonably identifies the third person whose debt is the subject of the guarantee.[183] The Institute further recommended that the government and the legislature consider whether or not the law should continue to provide for special formalities such as those in the *Guarantees Acknowledgment Act* for the effectiveness of guarantees by persons who are not corporations.[184]

With respect to indemnities, the Alberta Institute recommended[185] that the writing requirement should apply to an agreement under which one person enters into an obligation to another person to pay an existing or future debt of a third person, whether or not the obligation is conditional upon the default of the third person.[186] The Institute recommended several exemptions from the requirement of writing for both guarantees and indemnities.[187] The Institute also recommended the reversal of the common law position that a requirement of writing did not apply to a guarantee given to preserve the guarantor's property.[188]

Turning to the provision relating to contracts for the sale of land, the writing requirement has been retained in England[189] and New Zealand.[190] The British Columbia Law Reform Commission recommended the repeal of the provision and its replacement by a substantially revised version,[191] and this was accomplished by the *Law Reform Amendment Act, 1985*,[192] which amended the

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181 *Guarantees Acknowledgment Act*, R.S.A. 1980, c. G-12.

182 Alberta Report, *supra*, note 2, at 50.

183 *Ibid.*, at 32.

184 *Ibid.*, at 42.

185 *Ibid.*, at 50.

186 The Institute considered that this group of what it referred to as "guarantee-like indemnities" was a narrower group than those referred to in the British Columbia Report and the Manitoba Report: *ibid.*, at 46-47.

187 *Ibid.*, at 51.

188 *Ibid.*, at 52.

189 *Law of Property Act, 1925*, *supra*, note 10, s. 40.

190 *Contracts Enforcement Act 1956*, *supra*, note 31, s. 2(1)(a), (b) and (c).

191 British Columbia Report, *supra*, note 2, at 59-60 and 64-74.

192 *Supra*, note 77, s. 7.

Law and Equity Act.[193] Its retention has been recommended in Queensland[194] and, with some minor changes, in South Australia.[195] In Alberta, retention of the writing requirement was recommended, but certain substitutes for writing were also suggested.[196]

In the United States, significant changes in the formal requirements relating to land contracts appear in section 2-201 of the Uniform Land Transactions Act.[197] This section requires a writing signed by the party against whom enforcement of the contract is sought. The writing must contain a description of the property sufficiently definite to make identification of the property possible with reasonable certainty; it must state the price or a method of fixing the price; and it must be sufficiently definite to indicate with reasonable certainty that a contract to convey has been made by the parties. There are several exceptions to the writing requirement. These are where the buyer has taken possession and has paid all or part of the contract price; where the buyer has accepted a deed from the seller; where a party has changed its position to its detriment in reasonable reliance on the contract; and where the party against whom enforcement is being sought admits in the pleadings or in evidence that such a contract was made. It will be seen, therefore, that, under the Uniform Land Transactions Act, while the requirement of a writing is retained, as is the doctrine of part performance, both features differ substantially in concept and in detail from their Anglo-Canadian counterparts.

In the state of New York, section 5-701 of the General Obligations Law[198] applies to contracts that are required to be in writing or to be evidenced by some note or memorandum signed by the party to be charged or signed by a lawful

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193 *Law and Equity Act*, *supra*, note 103.

194 Queensland Report, *supra*, note 2, at 8-9.

195 South Australia Report, *supra*, note 2, at 8. Note, however, the minority view of Zelling J., at 11, that the provision should be repealed.

196 Alberta Report, *supra*, note 2, at 20. Paragraphs (b), (c), (d), and (e) of Recommendation 1 outlined the substitutes for writing as follows:

> (b) the party to be charged acquiesces in conduct of the party seeking to enforce the contract which indicates that a contract consistent with that alleged has been made between the parties,
>
> (c) the conduct of the party to be charged indicates that a contract consistent with that alleged has been made between the parties,
>
> (d) either the party to be charged or the party seeking to enforce the contract has made, and the other of the two parties has accepted, a deposit or payment of part of the purchase price, or
>
> (e) the party seeking to enforce the contract has, in reasonable reliance on the contract, changed his position so that, having regard to the position of both parties, an inequitable result can be avoided only by enforcing the contract.

197 Uniform Land Transactions Act, *supra*, note 127.

198 *McKinney's Consolidated Laws of New York Annotated*, Vol. 23A, General Obligations Law (1978) (hereinafter referred to as "New York General Obligations Law").

agent. While the Uniform Land Transactions Act makes contracts within its scope "not enforceable by judicial proceedings" unless the requirements of the Act have been complied with, the New York law makes agreements, promises, or undertakings within the statute "void" in the absence of the requisite writing. Among the contracts covered by the New York law[199] are those not to be performed within a year, those involving a special promise to answer for the debt, default, or miscarriage of another, some assignments (for example, an assignment of certain insurance policies), and contracts to pay compensation for services rendered in negotiating a loan or negotiating the purchase, sale, exchange, or renting of any real estate or interest therein.

The foregoing brief survey indicates that a great majority of the law reform bodies that have reviewed the requirements concerning contracts in the *Statute of Frauds* have favoured retaining writing requirements relating to land contracts and contracts of guarantee, although, in several cases, in a form substantially different from the existing requirements, and also, in the case of land contracts, with extensive provisions relating to the acceptability of acts of part performance. A number of reports have also favoured deleting the other contractual requirements of section 4 on the ground that they no longer serve a useful function.

6. PROPOSALS FOR REFORM

In light of the preceding discussion, we are now in a position to offer our own proposals for reform of the provisions concerning contracts in the *Statute of Frauds*. Our proposals fall into five categories.

(a) Repeal of Obsolete and Anachronistic Requirements

In our view, the writing requirements with respect to the following should be repealed in their entirety: first, promises by executors and administrators to pay damages out of their own estates (section 4); secondly, agreements governed by section 5; and thirdly, representations concerning another's credit worthiness (section 8). We so recommend.

(b) Contracts Not to be Performed Within One Year

This type of contract differs from the transactions listed in our first category because long term contracts are both common and very important. Nevertheless, we have concluded that a writing requirement for long term contracts has outlived its usefulness and should be repealed. Our conclusion is based on a number of grounds. First, no other jurisdiction that has considered the question has recommended retaining this writing requirement. Secondly, we have found no support for its retention among the practitioners we have consulted. Thirdly, we are impressed by the English Law Revision Committee's criticism of the assumption that, for the purposes of the Statute, the span

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[199] Conveyances and contracts concerning real property that are required to be in writing are governed by § 5-703 of the New York General Obligations Law, *supra*, note 198.

of reliable human memory is only one year.[200] In addition, litigation in respect of a contract not to be performed within one year may commence the day after the contract is made in which case any argument regarding human memory would have no merit. The English Law Revision Committee further noted that the language of the section has forced courts to draw arbitrary distinctions between contracts that are included and those that are outside the section.[201] The latter criticism is perhaps not fatal and, if a writing requirement were otherwise desirable, the section could be revised to resolve some of its ambiguities. However, we do not consider that such a revision would be worthwhile.

Our final reason for favouring repeal is that the requirement causes as much harm as it is designed to avoid. The reported cases indicate that the litigation often arises after the contract has been partly performed by one party or the other, so that the loss to the party who has partly performed, and who is denied enforcement of the contract, may be substantial. Because the contract usually lies outside equity's jurisdiction and because of the unresolved doubt about the scope of the doctrine of part performance, the party who has partly performed does not have the benefit of the doctrine.[202] Accordingly, while he or she may be entitled to claim compensation for benefits conferred on the other party, there will be no entitlement to reimbursement for pure reliance losses. It may be that a persuasive case can be made for requiring certain types of long term contracts to which consumers are a party to be reduced to, or evidenced by, writing,[203] but in our opinion the revised *Statute of Frauds* is not the right place for such provisions. Rather, they should be dealt with in more specifically consumer-oriented legislation.

Accordingly, the Commission recommends that the provisions in section 4 of the *Statute of Frauds* imposing writing requirements in respect of contracts not to be performed within one year should be repealed.

(c) LAND CONTRACTS

(i) General Recommendation

The Commission has concluded that the existing writing requirements for contracts relating to land are inappropriate and should be repealed. Modern courts are quite capable of coping with parol agreements of all kinds. They do it successfully every day and in cases involving large sums of money. To admit the enforceability of unwritten land contracts would not, we believe, put defendants at the mercy of unscrupulous plaintiffs or the frailty of human memories. The resources of the law of contracts and evidence are sufficient to enable a court to decline enforcement in a particular case, where there is substantial doubt about whether the defendant intended to enter into a binding

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200 *Sixth Interim Report*, *supra*, note 2, paras. 11(B) and 12.

201 *Ibid.*, para. 13. See, also, *supra*, this ch., sec. 3(a)(iv).

202 See *supra*, this ch., sec. 3(c)(ii).

203 Compare *Consumer Protection Act*, S.B.C. 1977, c. 6, ss. 19-25 (now R.S.B.C. 1979, c. 65, ss. 19-25, ss. 20 and 25 not yet proclaimed in force).

contract and what the terms of the bargain were. Moreover, if the plaintiff has been guilty of overreaching, the doctrine of unconscionability that we shall recommend, in chapter 6 of this Report, be given statutory recognition would be a much more effective instrument to deal with such conduct than a writing requirement that affords the weaker party very little protection.[204]

We would draw attention, as well, to the hardship of imposing writing requirements on non-business people who are not familiar with them, and who may see no need to consult a lawyer in what may be a purely domestic transaction, or who may not do so until it is too late. To ameliorate the hardship that would otherwise arise, the courts of equity have added to section 4 glosses of formidable complexity and subtlety that are almost guaranteed to encourage litigation rather than avoid it. The net result has been to attenuate the writing requirements to such a degree that they retain their potency in only a small number of cases. Further, the repeal in the United Kingdom and other jurisdictions of what was formerly section 17 of the *Statute of Frauds*, relating to contracts for the sale of goods, does not appear to have had adverse effects and, so far as we have been able to ascertain, has not led to the difficulties usually associated with the absence of a writing.

Finally, we are of the view that the existing requirements do little to promote the cautionary and channelling effects claimed for formal requirements. Section 4 serves an evidentiary purpose only, and leads to the anomalous result that an entry in a diary by a deceased person may be sufficient proof of the alleged contract[205] while an admission in open court by the defendant that a contract has been concluded has no probative value at all. No doubt it would be possible to introduce the desired cautionary and channelling effects by imposing strict writing requirements,[206] but this would lead to a new set of difficulties[207] and, significantly, no one has seriously recommended such a change.

Once a determination has been made that the existing writing requirements for land contracts are inappropriate and should be repealed, there would appear to be three options for reform. First, the writing requirements could be repealed without qualification. Secondly, the writing requirements could be clarified and relaxed, with statutory recognition given to the doctrine of part performance. Thirdly, the writing requirements could be repealed subject to the proviso that a contract concerning land would not be enforceable unless the plaintiff's claim were corroborated by some other material evidence.

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204 This is because the stronger party is often careful to observe legal formalities and the weaker party may be incapable of adequately protecting his or her interests.

205 *Re Hoyle*, *supra*, note 80.

206 As has been done for "executory" consumer contracts in the *Consumer Protection Act*, R.S.O. 1980, c. 87, s. 19, and for domestic contracts under the *Family Law Act, 1986*, *supra*, note 21, s. 55(1). It is notorious that, because of its wide reach, section 19 of the *Consumer Protection Act* is more honoured in breach than in observance.

207 *J. Schofield Manuel Ltd. v. Rose* (1975), 9 O.R. (2d) 404 (Co. Ct.).

The simplicity of the first option is attractive. However, we are mindful of the degree to which contracts relating to land have received special treatment in law, and we are not averse to retaining some elements of this tradition provided undue rigidity is avoided. While we wish to avoid the complexities that have grown up around section 4 of the *Statute of Frauds*, we do consider it desirable to retain some safeguards against the pitfalls of self-serving evidence. Accordingly, we have rejected this option.

The second option would, in essence, involve a substantially revised version of section 4. An important advantage to be gained from putting the doctrine of part performance on a statutory footing is that it would by-pass the difficulties of Lord Cairns' Act[208] and enable a court to award damages for breach of contract, whether or not an order of specific performance is sought by the plaintiff or is feasible.[209] Although, in the final result, the Commission rejected the second option, it received very careful consideration. Accordingly, we wish to comment upon it at some length.

Matters to be addressed in this type of reform of section 4 include first, the nature of the writing necessary to comply with a writing requirement and, secondly, the "acts" of the party to be charged that would be sufficient to satisfy the part performance alternative to writing.

With respect to clarification of the writing requirement, we have previously noted[210] that existing law apparently requires all material terms of a land contract to be evidenced in writing. We believe that this requirement is too stringent and note the lengths to which courts have gone to admit the joinder of documents.[211] One alternative would be for a revised section 4 to spell out the minimum contents of the required writing, as has been done in the Uniform Land Transactions Act. This requires the writing to contain a description of the land, the price (where relevant) and to indicate that a contract to convey has been concluded.[212] A second alternative would be to provide that the requirement is satisfied if the writing establishes the existence of *some* contract involving the land. The recommendations made in the British Columbia Report[213] and the Alberta Report[214] lean towards this alternative.[215] Ultimately, British Columbia adopted legislation requiring only that the writing show that a

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208 *Supra*, note 132.

209 See discussion, *supra*, this ch., sec. 3(c)(ii)(b.)(5).

210 *Supra*, this ch., sec. 3(b).

211 *Supra*, note 88.

212 Uniform Land Transactions Act, *supra*, note 127, § 2-201(a).

213 British Columbia Report, *supra*, note 2, at 73.

214 Alberta Report, *supra*, note 2, at 20.

215 The Alberta Institute of Law Research and Reform recommended that there must be some evidence in writing which indicates that a contract has been made between the parties and reasonably identifies the subject matter of the contract and which is signed by the party to be charged or his or her agent: *ibid.*

contract has been made and that it reasonably indicates the subject matter of the contract.[216] We consider that the second of these alternatives would be more likely to obviate the difficulties of the existing law.

Turning to the second matter that would have to be addressed in any revision of the section 4 writing requirements relating to land contracts, we have previously discussed the important shortcomings from which the doctrine of part performance suffers at present in Canada.[217] In particular, we have referred to the hardship caused by the retention of the unequivocal reference test and the doubt concerning the status in Canada of the decision in *Steadman v. Steadman*.[218] We believe that these shortcomings and doubts would have to be resolved to make the second reform option viable and that it would not be sufficient to provide, as is done in section 40 of the U.K. *Law of Property Act, 1925*,[219] that the doctrine of part performance is retained. This would merely perpetuate its defects.

Once again, there are two alternatives. The first is illustrated by section 2-201(b) of the Uniform Land Transactions Act[220] which reads as follows:

> A contract not evidenced by a writing satisfying the requirements of subsection (a), but which is valid in other respects, is enforceable if:
>
> (1) it is for the conveyance of real estate for one year or less;
>
> (2) the buyer has taken possession of the real estate, and has paid all or a part of the contract price;
>
> (3) the buyer has accepted a deed from the seller;
>
> (4) the party seeking to enforce a contract, in reasonable reliance upon the contract and upon the continuing assent of the party against whom enforcement is sought, has changed his position to his detriment to the extent that an unjust result can be avoided only by enforcing the contract; or

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216 Section 54(3)(a) of the *Law and Equity Act*, *supra*, note 103, reads as follows:

> 54.-(3) A contract respecting land or a disposition of land is not enforceable unless
>
> (a) there is, in a writing signed by the party to be charged or by his agent, both an indication that it has been made and a reasonable indication of the subject matter
>
> ....

The British Columbia statute also contains a supplemental provision to the following effect:

> 54.-(7) A writing can be sufficient for the purpose of this section even though a term is left out or is wrongly stated.

217 *Supra*, this ch., sec. 3(c)(ii)(b.).

218 *Supra*, note 115.

219 *Supra*, note 10.

220 Uniform Land Transactions Act, *supra*, note 127.

(5) the party against whom enforcement is sought admits in his pleading, testimony, or otherwise in court that the contract for conveyance was made.

The second is illustrated by the British Columbia *Law and Equity Act*.[221] The relevant provisions in that Act read as follows:

54.-(3) A contract respecting land or a disposition of land is not enforceable unless

....

(b) the party to be charged has done an act, or acquiesced in an act of the party alleging the contract or disposition, that indicates that a contract or disposition not inconsistent with that alleged has been made, or

(c) the person alleging the contract or disposition has, in reasonable reliance on it, so changed his position that an inequitable result, having regard to both parties' interests, can be avoided only by enforcing the contract or disposition.

(4) For the purposes of subsection (3)(b), an act of a party alleging a contract or disposition includes a payment or acceptance by him or on his behalf of a deposit or part payment of a purchase price.

In the case of the Uniform Land Transactions Act automatic entitlement to enforcement of the contract only arises under certain limited circumstances.[222] In all other cases, the remedy is essentially discretionary and the party seeking to enforce must show detrimental reliance to the extent that an unjust result can be avoided only by enforcing the contract.[223]

Section 54(3)(b) of the *Law and Equity Act*, on the other hand, gives effect to the decision in *Steadman v. Steadman*, but to some extent deprives it of its equitable character. The plaintiff need not always show that enforcement is necessary to avoid an inequitable result. Acts of part performance by the party to be charged, and acquiescence of the party to be charged in acts of the party alleging the contract, are both admissible to establish the contract. This is an important reversal of existing law[224] which treats such evidence as irrelevant for the purpose of the doctrine of part performance.

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221 *Law and Equity Act*, *supra*, note 103, ss. 54(3)(b), 54(3)(c), and 54(4). A similar recommendation is made in the Alberta Report, *supra*, note 2, at 20. Its provisions equivalent to sections 54(3)(b) and (c) require that the conduct indicate the existence of a contract consistent with that alleged between the parties. The Alberta Report also recommends that the contract be enforceable if either the party to be charged or the party seeking to enforce it has made, and the other of the two parties has accepted, a deposit or payment of part of the purchase price.

222 See Uniform Land Transactions Act, *supra*, note 127, § 2-201(b)(1), (2), (3), and (5).

223 *Ibid.*, § 2-201(b)(4).

224 *Caton v. Caton*, *supra*, note 125.

Attention should also be drawn to section 54(3)(c) of the British Columbia Act. This provision is directed to preparatory acts by the plaintiff not amounting to acts contemplated in section 54(3)(b) and therefore not providing the degree of proof necessary for *per se* enforcement of the contract. This provision gives the court a discretionary power to relieve against hardship that would otherwise be caused.

We endorse the approach of section 54(3)(b) of the British Columbia Act. As former section 17 of the *Statute of Frauds* shows,[225] there is no need to link concepts of part performance to issues of fairness and conscionable conduct, although, no doubt, there is some overlap between the two. Once the doctrine of part performance is given statutory status, the defendant's acts of part performance and the plaintiff's acts, acquiesced in by the defendant, provide cogent support for the plaintiff's allegation of a parol agreement. Moreover, the discretionary element in the equitable doctrine of part performance no longer plays an active role in Anglo-Canadian law, and we think it would lead to greater certainty if it were eliminated altogether.[226]

If Ontario were to adopt the second option, there would be no need, in our view, for a provision comparable to section 54(3)(c) of the British Columbia Act.[227] Its enactment might cause confusion, since it is not obvious why proof of an inequitable result is necessary under this section but not necessary under section 54(3)(b). Another difficulty is that a claim is apparently admissible under section 54(3)(c) even though the acts in question do not indicate any contract between the parties, and even though the defendant has not acquiesced in the acts. In our view, section 54(3)(b) is already so generously worded that only rarely will a plaintiff not be able to support his or her claim under it, even without the benefit of written evidence of the contract.

Two other features of section 54(3)(b) require comment. First, it does not define the meaning of "an act of the party alleging the contract or disposition" or "an act" of the party to be charged.[228] It is clear from the British Columbia Report that what was contemplated were acts of part performance by the party in question. We do not think this needs to be expressly stated. Since section 54(3)(b) serves only an evidentiary function it ought not to matter whether the acts are performance-oriented so long as they satisfactorily indicate the existence of a contract.

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225 Now s. 5 of the *Sale of Goods Act*, *supra*, note 24. See discussion, *supra*, this ch., sec. 2(a).

226 This would not, of course, affect the discretionary element in the granting of an order for specific performance.

227 A similar provision was recommended in the Alberta Report, *supra*, note 2, at 20, Recommendation 1(e).

228 Section 54(4) of the *Law and Equity Act*, *supra*, note 103, merely enlarges the meaning that "an act of the party alleging the contract or disposition" normally bears.

The other noteworthy feature of section 54(3)(b) is that the acts in question need not prove the existence of a contract relating to land; it is sufficient if they indicate the existence of "a" contract.[229] This formulation clearly reflects the opinion of the majority in *Steadman v. Steadman* that it would be too restrictive, in a multipurpose contract, to require the acts to point unambiguously to the land component in the agreement. We agree with this approach.

As previously noted,[230] section 2-201(1)(b)(5) of the Uniform Land Transactions Act allows a land contract to be enforced if, *inter alia* "the party against whom enforcement is sought admits in his pleading, testimony, or otherwise in court that the contract for conveyance was made".[231] While we accept the evidentiary value of formal admissions, it must be obvious that such a provision attenuates still further the cautionary role of writing requirements,[232] and encourages the plaintiff to litigate in the hope of extracting a damaging admission from the defendant.[233] The combined effect of the relaxed writing requirements and generous part performance rules should be sufficient, we would suggest, to prevent cases of hardship and should enable a plaintiff to prove his or her case without having to rely on the defendant's admission. We do not, therefore, see any need to adopt a similar provision.

The third option for reform is the replacement of the present law by a requirement that a contract relating to land not be enforceable on the evidence of the party alleging the contract unless such evidence is corroborated by some other material evidence. The Commission favours this option. Under this proposal, a writing signed by or on behalf of the defendant (present in the overwhelming majority of cases) would constitute corroboration. So would many of the kinds of acts that have been held to constitute part performance. Our proposal would undoubtedly enlarge the enforceability of contracts, but in view of the wide scope given in recent cases to the doctrine of part performance, our recommendation will not make so drastic a change as might appear at first sight.

Evidence amounting to corroboration under our proposal would not infrequently support the application of the doctrine of part performance under existing law. But the scope, and indeed the purpose, of the doctrine of part performance are complex and obscure, and attempts to amend the doctrine (as under the second option discussed above) would only add further complexities.

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229 See, also, Alberta Report, *supra*, note 2, at 20, Recommendations 1(b) and 1(c).

230 *Supra*, this ch., sec. 5.

231 The Uniform Commercial Code contains an almost identical provision in relation to contracts for the sale of goods. See American Law Institute, Uniform Commercial Code, Official Text (9th ed., 1978), § 2-201(3)(b).

232 Holahan, "Contract Formalities and the Uniform Commercial Code" (1958), 3 Vill. L. Rev. 1, at 9-12.

233 There has been lingering doubt whether the Code provision covers involuntary, as well as voluntary, admissions. See, *inter alia*, *Cargill Incorporated, Commodity Marketing Division v. Hale*, 537 S.W. 2d 667 (Mo. Ct. App. 1976), and *Farmers Elevator Co. of Reserve v. Anderson*, 552 P. 2d 63 (Mont. Sup. Ct. 1976).

The principal merit of the third option is that it simplifies the law and puts it on a principled and consistent basis.

We turn now to two other issues relevant to our recommendation.

(ii) Definition of Land

We have previously discussed[234] the uncertainty that surrounds the classification of certain types of contracts involving land. Nevertheless, we would not recommend including a definition of land in any provision requiring corroboration by some other material evidence of any contract concerning land. We rest this conclusion on several grounds. First, the number of cases in which the problem has arisen is relatively small. Secondly, it would be difficult to frame a satisfactory definition that would be sufficiently flexible to allow for future developments. Thirdly, the definition of goods in our *Report on Sale of Goods*[235] should help to clarify important aspects of the relationship between "goods" and interests in land. Finally, the new requirements for the proof of land contracts can be met so easily that only exceptionally are issues of classification likely to arise for decision.

(iii) Agreements to Lease

We earlier commented[236] on the ambiguous wording of section 3 of the *Statute of Frauds* and noted that it is unsettled in Ontario whether agreements to lease for three years or less are excluded from the requirements of section 4. The Commission's *Report on Landlord and Tenant Law* recommended that all "tenancy agreements"[237] and all agreements to lease for a year or less should be excluded from the *Statute of Frauds* requirements,[238] and that tenancy agreements and agreements to lease for a longer period should be required to be in writing.[239] The Report also recommended that the provisions in the *Statute of Frauds* relating to leases should be deleted, that agreements to lease should be excluded from section 4, and that the revised provisions should be incorporated in the new *Landlord and Tenant Act*.[240]

These recommendations must be reconsidered in the light of the recommendations in this Report. First, the recommendation that agreements to lease as well as tenancy agreements be required to be in writing, and not merely

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234 *Supra*, this ch., sec. 3(a)(iii).

235 Sales Report, *supra*, note 23, Vol. 1, at 64-65. The definition of "goods" provides that "goods" means "movable things, and includes the unborn young of animals, growing crops and other things attached to or forming part of land as provided in section 2.5, but does not include money in which the price is to be paid or things in action".

236 *Supra*, this ch., sec. 3(a)(iii).

237 This is the new terminology recommended in the Report to replace the term "lease": *Report on Landlord and Tenant Law*, *supra*, note 25, at 7.

238 *Ibid.*, at 14.

239 *Ibid.*, at 18.

240 *Ibid.*, at 15.

evidenced by a writing, introduces a novel feature into the *Statute of Frauds* requirements. It is also inconsistent with our own recommendations with respect to the evidentiary requirements for the enforceability of land contracts. In our view, it would lead to serious anomalies to impose writing requirements for agreements to lease that are more onerous than evidentiary requirements applied to other types of land contracts.

It should be noted that, in Alberta, it was recommended that there be no requirement of writing for either the creation or the assignment of a lease, if the term granted by the lease together with any additional term provided for in the lease was three years or less, or for a contract to create or assign such a lease.[241] In British Columbia, amendments to the *Law and Equity Act* provide that section 54 of that Act does not apply to a contract to grant a lease for a term of three years or less, or a grant of a lease of land for a term of three years or less.[242]

In light of this discussion, we recommend that any future legislation involving writing or other evidentiary requirements for agreements to lease should be harmonized with the proposed revised evidentiary requirements for land contracts.

(d) CONTRACTS OF GUARANTEE

(i) General

The majority of the law reform bodies that have considered the question have concluded that contracts of guarantee should continue to be subject to the *Statute of Frauds* requirements. The rationale for retaining the existing requirements is put with seeming persuasiveness in the minority report of the English Law Revision Committee:[243]

> [I]f oral contracts of guarantee are allowed, we feel that there is a real danger of inexperienced people being led into undertaking obligations that they do not fully understand, and that opportunities will be given to the unscrupulous to assert that credit was given on the faith of a guarantee which in fact the alleged surety had no intention of giving .... [T]he necessity of writing would at least give the proposed surety an opportunity of pausing and considering, not only the nature of the obligation he is undertaking, but also its terms .... [I]n the vast majority of cases the surety is getting nothing out of the bargain; hence the greater reason for securing, if possible, that no mistake shall occur.

While we support the retention of a writing requirement for some contracts of guarantee, we do not entirely agree with the Committee's reasoning. First, section 4 is not restricted to guarantees given by inexperienced persons, nor is it always correct to claim that the guarantor derives no benefit from the guarantee. Many guarantees are given by business persons in order to promote a business interest, for example, a guarantee given by a shareholder or director to

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241 Alberta Report, *supra*, note 2, at 26-27.

242 *Law and Equity Act*, *supra*, note 103, s. 54(2).

243 *Sixth Interim Report*, *supra*, note 2, at 33.

secure an obligation of the company. To some extent, the case law already recognizes this fact because, as we have seen,[244] section 4 has been held not to apply where the guarantee is only incidental to a larger transaction or the guarantee is given to secure the release of property in which the guarantor has a proprietary interest. However, the decisions fall significantly short of excluding all business guarantees. We are of the view that a writing requirement should not apply to a guarantee "given by a person in the course of a business" and that this expression should be defined as including a shareholder, officer, or director of a company who guarantees a debt or other obligation of the company.[245] We believe that this extended definition is desirable in order to recognize a familiar form of business guarantee and to preclude the argument that the guaranteeing shareholder, officer, or director is not acting in the course of a business because of the doctrine of the separate personality of even closely held corporations.[246]

It seems to us equally questionable whether the reasoning of the minority members of the English Law Revision Committee applies to cases where the guarantee is given in a wholly domestic or other non-business context, for example, a guarantee given by one member of a family in favour of another. It is unlikely that either party will be acquainted with the formal requirements of section 4, and considerable hardship may be caused to the party receiving the guarantee if the parol agreement is not enforceable.

Accordingly, we recommend that a writing requirement for guarantees should only be imposed where a guarantee is given by a person otherwise than in the course of business to a person acting in the course of business.

This leads us to a further issue, identified in the British Columbia *Report on the Statute of Frauds*.[247] As that Report notes, consumers often need more than the protection of a formal requirement, since the existence of a signed guarantee (usually in standard form) provides no assurance that the consumer understood what he or she was doing. The British Columbia Commission, therefore, was of the opinion that special safeguards should be adopted for consumer guarantees, and it has since published a Report elaborating its proposals.[248] We have not considered whether similar safeguards are necessary in Ontario. It may be that the common law principles of undue influence and the expanding doctrine of unconscionability are sufficient to protect consumers against guarantees obtained by unfair means. In any event, it will be appreciated that, if more detailed legislation is thought to be desirable for consumer

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244 *Supra*, this ch., sec. 3(a)(ii).

245 The Alberta Institute of Law Research and Reform specifically recommended that the writing requirement for guarantees continue to apply to corporations. See Alberta Report, *supra*, note 2, at 50.

246 *Salomon v. Salomon & Co.*, [1897] A.C. 22, [1895-99] All E.R. Rep. 33 (H.L.).

247 British Columbia Report, *supra*, note 2, at 63.

248 Law Reform Commission of British Columbia, *Report on Guarantees of Consumer Debts* (1979).

guarantees, then no office may be left for a writing requirement in respect of guarantees and the provisions relating to contracts of guarantee should be deleted in their entirety.

We proceed now to discuss a number of consequential issues that arise as a result of our decision to retain formal requirements for the enforceability of some types of guarantee.

(ii) Inclusion of Indemnities

In light of the difficulty of distinguishing in practice between a contract of guarantee and a contract of indemnity, we recommend that our proposals relating to guarantees apply also to indemnities. This would be justified even if the difficulty did not exist because the need to protect inexperienced consumers is equally strong in both cases. We would note that contracts of indemnity were included in the British Columbia *Statute of Frauds* as a result of an amendment adopted in 1958.[249] When the British Columbia *Statute of Frauds* was repealed in 1985,[250] provisions regarding writing requirements for guarantees and indemnities[251] were added to the *Law and Equity Act*. The Alberta Institute of Law Research and Reform, on the other hand, recommended that the writing requirements apply only to "guarantee-like indemnities".[252]

(iii) Definition of Guarantee

Section 4 of the *Statute of Frauds* does not use the word "guarantee". It speaks instead of a promise to answer for the "debt, default or miscarriage" of another person. The amended British Columbia *Statute of Frauds* substituted the term "guarantee" for the more descriptive language of the original Statute.[253] "Guarantee" is not a term of art and, without a definition, its meaning could give rise to much litigation. We therefore recommend retaining the original language of section 4, and with it the benefit of the case law clarifying its meaning.

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249 *Statute of Frauds, 1958*, *supra*, note 30, s. 5. Section 5 provided:

> 5.-(1) No guarantee or indemnity shall be enforceable by action unless evidenced in writing, signed by the party to be charged or by his agent, but any consideration given for the guarantee or indemnity need not appear in the writing.
>
> (2) This section does not apply to a guarantee or indemnity arising by operation of law.

The section, with minor amendments, later became section 4 of the *Statute of Frauds*, R.S.B.C. 1979, c. 393.

250 *Law Reform Amendment Act, 1985*, *supra*, note 77, s. 8.

251 *Law and Equity Act*, *supra*, note 103, s. 54(6).

252 See Alberta Report, *supra*, note 2, at 46-47.

253 *Statute of Frauds, 1958*, *supra*, note 30, s. 5.

(iv) Scope of Writing Requirements

Two questions must be considered under this heading. First, should the existing section 4 provisions be expanded to require that the agreement itself be reduced to writing in all cases? The British Columbia Law Reform Commission was sympathetic to the suggestion, but decided against it because of potential constitutional complications where the guarantee is incorporated in a negotiable instrument, and also because the Commission envisaged that its later proposals for consumer guarantees would provide the additional protection needed in such cases.[254] We agree with the Commission's conclusion, but on the simpler ground that stringent writing requirements would encourage unmeritorious defences and might compound some of the technical difficulties that have arisen in the past.

If a guarantee or indemnity is not itself required to be reduced to writing, how much of the agreement must be evidenced in writing, and must it be signed by the guarantor or indemnitor, or an agent? The British Columbia Act[255] provides little guidance on the point. Section 54(6)(a) simply provides that a guarantee or indemnity is not enforceable unless evidenced by a writing signed by, or by the agent of, the guarantor or indemnitor. In addition, the legislation contains a subsection, applicable to all writings governed by section 54, stating that "[a] writing can be sufficient for the purpose of this section even though a term is left out or is wrongly stated".[256] In Alberta, the Institute of Law Research and Reform recommended that a guarantee should not be enforceable unless there was some evidence in writing signed by the party to be charged, or by his agent, which indicated that the party to be charged had given a guarantee to the party alleging the guarantee and which reasonably identified the third person whose debt was the subject of the guarantee.[257]

The British Columbia Act does not seem to us to go far enough, since it does not indicate the minimum amount of information required to be contained in the evidentiary writing. In our view, it should be sufficient that a contract of guarantee or indemnity is evidenced by some kind of writing signed by the person to be charged or an agent. In addition, the writing should identify the parties and reasonably indicate that a guarantee or indemnity is being or has been given, and we so recommend.

(v) Relief in Cases of Non-Compliance

We agree with the British Columbia *Report on the Statute of Frauds*[258] that it would undermine the cautionary and protective purposes of a writing requirement if part performance by the party seeking to enforce the guarantee

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254 British Columbia Report, *supra*, note 2, at 76-77.

255 *Law and Equity Act*, *supra*, note 103.

256 *Ibid.*, s. 54(7).

257 Alberta Report, *supra*, note 2, at 32.

258 British Columbia Report, *supra*, note 2, at 77.

or indemnity were to be admitted as a substitute for the writing.[259] We have experienced greater difficulty in weighing the merits of section 54(6)(b) of the *Law and Equity Act*,[260] which provides that, even without a writing, the guarantee or indemnity may be enforceable if "the alleged guarantor or indemnitor has done an act indicating that a guarantee or indemnity consistent with that alleged has been made". This provision is similar to provisions adopted by British Columbia with respect to land contracts. The difficulty with it is that it is based solely on evidentiary grounds, and disregards the cautionary and protective functions usually given as the reasons for retaining the formal requirements for contracts of guarantee. Here, as elsewhere in the *Statute of Frauds*, there appears to be an unresolved conflict between the different policies sought to be achieved, and in particular between the desire to protect the guarantor and to afford equitable treatment to the person in whose favour the guarantee has been given. In view of the restricted role that we envisage in the future for writing requirements in relation to contracts of guarantee, we see no need to adopt a provision comparable to section 54(6)(b) of the British Columbia legislation. It also appears to us to be inconsistent to reject the evidentiary value of part performance when rendered by the promisee and to accept its admissibility when the performance is by the guarantor.

(e) DISPOSITION OF NON-CONTRACTUAL PROVISIONS

As noted at the beginning of this chapter,[261] the *Statute of Frauds* contains a substantial number of provisions dealing with the creation, assignment, and surrender of interests in land, including leases of land, and with the creation or declaration of trusts in land or assignment of trusts generally. These provisions are not internally consistent and do not appear to be consistent with provisions in the *Conveyancing and Law of Property Act*.[262] These aspects of the *Statute of Frauds* are considered in the Alberta Background Paper[263] and in the Alberta Report[264] and the British Columbia Report.[265] In our opinion, they should also be reviewed in Ontario at an appropriate time.

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259 We would question, however, the Commission's other reason, namely, the comparative lack of reliance in many cases by the promisee upon the guarantee. We would have thought, on the contrary, that frequently the guarantee is the element without which the promisee would not be willing to proceed with the transaction.

260 *Supra*, note 103.

261 *Supra*, this ch., sec. 3.

262 *Supra*, note 61, ss. 2, 3, and 9.

263 Alberta Background Paper, *supra*, note 2.

264 Alberta Report, *supra*, note 2.

265 British Columbia Report, *supra*, note 2.

Recommendations

The Commission makes the following recommendations:

1. The writing requirements in the *Statute of Frauds* with respect to the following should be repealed:

   (a) promises by executors and administrators to pay damages out of their own estates;

   (b) agreements governed by section 5; and

   (c) representations concerning another's credit worthiness.

2. The writing requirement for contracts not to be performed within one year should be repealed.

3. (1) The existing writing requirements for contracts relating to land should be repealed subject to a requirement that a contract concerning land is not enforceable on the evidence of the party alleging the contract unless such evidence is corroborated by some other material evidence.

   (2) A definition of land should not be included in any provision requiring corroboration by some other material evidence of any contract concerning land.

   (3) Any further legislation involving writing or other evidentiary requirements for agreements to lease should be harmonized with the proposed revised evidentiary requirements for land contracts.

4. (1) A writing requirement for guarantees should only be imposed where a guarantee is given by a person otherwise than in the course of business to a person acting in the course of business.

   (2) A guarantee "given in the course of a business" should be defined as including a guarantee given by a shareholder, officer or director of a company who guarantees a debt or other obligation of the company.

   (3) Recommendations with respect to guarantees should apply also to contracts of indemnity.

   (4) The original language of section 4 — that is, "debt, default or miscarriage" — should be retained in any legislation dealing with writing requirements for guarantees.

   (5) A contract of guarantee or indemnity that is required to be in writing should be evidenced by some kind of writing signed by the person to be charged or by an agent. In addition, the writing should

identify the parties and reasonably indicate that a guarantee or indemnity is being or has been given.

(6) Part performance either by the party seeking to enforce the guarantee or indemnity or by the guarantor or indemnitor should not be admitted as a substitute for the writing.

5. The provisions in the *Statute of Frauds* dealing with the creation, assignment and surrender of interests in land, including leases of land, and with the creation or declaration of trusts in land or assignment of trusts generally, should be reviewed in Ontario at an appropriate time.

CHAPTER 6

UNCONSCIONABILITY

1. THE PRESENT LAW

(a) JUDICIAL DEVELOPMENTS

In our *Report on Sale of Goods* we recommended that a doctrine of unconscionability[1] be incorporated into a revised *Sale of Goods Act*, stating that "the doctrine is rapidly becoming, if indeed it has not already become, a thoroughly respectable landmark in the modern law of sales".[2] Consideration of the wisdom of a statutory formulation of the doctrine with respect to the law of contracts generally was deferred to the Law of Contract Amendment Project.[3]

Judicial intervention in contracts on the ground of unconscionability may be explicit, as when statute law allows judicial intervention on the specific basis that the bargain between the parties or some aspect of it is harsh and unconscionable. As well, the concept of unconscionability may serve to explain and unify a number of discrete parts of the law of excuse for non-performance of a contract that do not overtly refer to unconscionability but that do allow certain harsh consequences of particular contracts to be avoided. In light of the foregoing, the emergence of the modern doctrine of unconscionability does not signal a radical break with the past.

Lord Denning, in *Lloyd's Bank Ltd. v. Bundy*,[4] discerned a common thread behind the long-established doctrines of undue influence, duress of goods, undue pressure, unfair salvage agreements and equity's protection of vulnerable persons such as expectant heirs. The unifying principle, he considered, was that the courts may provide relief against the consequences of inequality of bargaining power:[5]

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[1] For discussion of the doctrine, see Waddams, *The Law of Contracts* (2d ed., 1984), at 326-407, and Trebilcock, "An Economic Approach to the Doctrine of Unconscionability", in Reiter and Swan (eds.), *Studies in Contract Law* (1980) 379, at 379-421.

[2] Ontario Law Reform Commission, *Report on Sale of Goods* (1979) (hereinafter referred to as "Sales Report"), Vol. 1, at 156.

[3] *Ibid.*, at 32.

[4] [1975] Q.B. 326, [1974] 3 W.L.R. 501 (C.A.) (subsequent references are to [1975] Q.B.).

[5] *Ibid.*, at 339.

> By virtue of it, the English law gives relief to one who, without independent advice, enters into a contract upon terms which are very unfair or transfers property for a consideration which is grossly inadequate, when his bargaining power is grievously impaired by reason of his own needs or desires, or by his own ignorance or infirmity, coupled with undue influences or pressures brought to bear on him by or for the benefit of the other. When I use the word 'undue' I do not mean to suggest that the principle depends on proof of any wrongdoing. The one who stipulates for an unfair advantage may be moved solely by his own self-interest, unconscious of the distress he is bringing to the other. I have also avoided any reference to the will of the one being 'dominated' or 'overcome' by the other. One who is in extreme need may knowingly consent to a most improvident bargain, solely to relieve the straits in which he finds himself. Again, I do not mean to suggest that every transaction is saved by independent advice. But the absence of it may be fatal.

It is possible to range even more widely, and find in other existing categories of excuse for non-performance of a contract an underlying principle of unconscionability. In particular, this principle may serve to explain such seemingly diverse matters as the rules against forfeiture of leases and against clogs on the equity of redemption, relief against penalty clauses and against certain contracts in restraint of trade, and the devices used by the courts to circumvent exemption clauses of various kinds.[6]

Some recent judicial decisions reflect an acceptance of a generalized doctrine of unconscionability, particularly with respect to cases of a consumer or quasi-consumer character.[7] In this vein, in a leading Ontario decision, *Black v. Wilcox*,[8] Evans J.A. stated that, in order to set aside a transaction, the court must find as follows:

> ... that the inadequacy of the consideration is so gross or that the relative positions of the parties is so out of balance in the sense that there is a gross inequality of bargaining power or that the age or disability of one of the contracting parties places him at such a decided disadvantage that equity must intervene to protect the party of whom undue advantage has been taken.

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[6] See Waddams, *supra*, note 1, at 327-40, 345-47, and 393-94.

[7] See, for example, *McKenzie v. Bank of Montreal* (1975), 7 O.R. (2d) 521, 55 D.L.R. (3d) 641 (H.C.J.), aff'd (1976), 12 O.R. (2d) 719 (C.A.); *Beach v. Eames* (1978), 18 O.R. (2d) 486, 82 D.L.R. (3d) 736 (Co. Ct.), aff'd 18 O.R. (2d) 486*n* (C.A.); and *Harry v. Kreutziger* (1978), 95 D.L.R. (3d) 231, 9 B.C.L.R. 166 (C.A.). See, also, the recent decision of the British Columbia Court of Appeal in *Dusik v. Newton* (1985), 62 B.C.L.R. 1.

It should be noted that there are also a number of nineteenth century cases which suggest that contracts may be set aside on the ground of unconscionability. See, for example, *Waters v. Donnelly* (1884), 9 O.R. 401 (Div. Ct.); *Gough v. Bench* (1884), 6 O.R. 702 (Div. Ct.); and *Widdifield v. Simmons* (1882), 1 O.R. 483 (Q.B. Div.).

[8] (1976), 12 O.R. (2d) 759, at 762, 70 D.L.R. (3d) 192, at 195 (C.A.). Leave to appeal to the Supreme Court of Canada refused [1976] 1 S.C.R. xi.

Nevertheless, although unconscionability is an issue in many cases, the doctrine has neither been clearly recognized by the Supreme Court of Canada, nor uniformly applied by lower courts. Many cases in which a general doctrine of unconscionability might have been applied continue to be decided on other grounds.[9]

We appreciate that, in a recent decision,[10] the House of Lords expressed reservations about the wisdom of a generalized doctrine of unconscionability, but in that case Lord Scarman expressly limited his observations to a judicially evolved doctrine and omitted any discussion of the merits of a legislatively prescribed doctrine of unconscionability.[11] This chapter addresses only that question.

(b) LEGISLATION

It has been observed that legislative control of unconscionability in Ontario comes in two forms.[12] First, there are statutory provisions prohibiting or rendering void certain clauses in particular types of contracts or, alternatively, requiring that certain clauses be included in particular types of contracts. Secondly, some statutes authorize the courts to give relief from specified contractual obligations on the basis that they are "harsh or unconscionable" or some similar general formula. The former approach may be appropriate where "it is possible to isolate desirable or undesirable terms in more or less standardized transactions".[13] The latter approach, involving judicial discretion, may be appropriate where it is not possible to specify what is unconscionable in advance.

Of particular significance in the first category is section 34(2) of the *Consumer Protection Act*[14] which, in certain instances, voids written contractual provisions that attempt to negative or vary any implied conditions and warranties applying to the sale of goods by virtue of the *Sale of Goods Act*.[15] Among the restrictions on the operation of this section are that it does not apply to goods purchased for resale, purchases made in the course of carrying on a business, sales to associations of individuals, partnerships or corporations, or

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9 See, for example, *Heffron v. Imperial Parking Co.* (1974), 3 O.R. (2d) 722, 46 D.L.R. (3d) 642 (C.A.); *Murray v. Sperry Rand Corp.* (1979), 23 O.R. (2d) 456, 96 D.L.R. (3d) 113 (H.C.J.); and *Beaufort Realties (1964) Inc. v. Chomedey Aluminum Co. Ltd.*, [1980] 2 S.C.R. 718, 116 D.L.R. (3d) 193.

10 *National Westminster Bank v. Morgan*, [1985] 1 All E.R. 821.

11 *Ibid.*, at 830.

12 Waddams, *supra*, note 1, at 395-96.

13 *Ibid.*, at 395.

14 *Consumer Protection Act*, R.S.O. 1980, c. 87.

15 *Sale of Goods Act*, R.S.O. 1980, c. 462.

sales by trustees in bankruptcy, receivers, liquidators or persons acting under a court order.[16] Moreover, the sale must be made "in the ordinary course of business"[17] and for the purchaser's own consumption or use.[18] Section 33 of the *Consumer Protection Act*[19] is also significant. It provides that the Act is to apply notwithstanding any agreement or waiver to the contrary.

Examples of legislative provisions that prohibit specific types of clauses in specific types of contracts include section 84(1) of the *Landlord and Tenant Act*,[20] which states that a landlord shall not require or receive a security deposit from a tenant other than rent for a period not exceeding one month, and section 207 of the *Insurance Act*[21] which states that no variation or omission of or addition to certain statutory conditions is binding on certain insured persons.

Examples of legislative provisions that require specific types of clauses in particular types of contracts include the following: section 19 of the *Consumer Protection Act*[22] which requires certain specific information and certain types of clauses to be included in executory contracts; section 24 of the *Consumer Protection Act*[23] which requires disclosure of the cost of borrowing; and sections 125 and 207 of the *Insurance Act*,[24] which require specified conditions to be included in certain types of insurance policies.

An example of legislation permitting the courts to interfere in particular types of agreements on the general ground of unconscionability may be found in section 2 of the *Unconscionable Transactions Relief Act*.[25] Under that statute, a court, after looking at the risks and all other circumstances, may reopen a money-lending transaction if the cost of the loan is excessive and harsh and

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16 *Consumer Protection Act*, *supra*, note 14, s. 34(1).

17 *Ibid.*

18 *Ibid.*

19 *Supra*, note 14.

20 *Landlord and Tenant Act*, R.S.O. 1980, c. 232.

21 *Insurance Act*, R.S.O. 1980, c. 218.

22 *Supra*, note 14.

23 *Ibid.*

24 *Supra*, note 21.

25 *Unconscionable Transactions Relief Act*, R.S.O. 1980, c. 514. Related to this legislation is section 305.1 of the *Criminal Code* (R.S.C. 1970, c. C-34), which provides that it is an offence to enter into an agreement or arrangement to receive interest at a criminal rate or to receive a payment or partial payment of interest at a criminal rate. Subsection 305.1(2) defines the term "criminal rate" as an effective annual rate of interest that exceeds sixty per cent. See Ziegel, "Bill C-44: Repeal of the Small Loans Act and Enactment of a New Usury Law" (1981), 59 Can. B. Rev. 188, and Ziegel, "The Usury Provisions in the Criminal Code: The Chickens Come Home to Roost" (1986), 11 Can. Bus. L.J. 233. An exception to the *Criminal Code* provisions, however, is the practice of tax rebate discounting, regulated by the federal *Tax Rebate Discounting Act*, S.C. 1977-78, c. 25, as am. by S.C. 1985, c. 53.

unconscionable features are present. As might well be expected, the jurisprudence developed under the statute very largely parallels the developments in the case law on the equity unconscionability doctrine.[26]

Perhaps the most significant statutory provision (conceptually, at least) permitting interference by the courts on the general ground of unconscionability is section 2(b) of the *Business Practices Act*,[27] which provides that "an unconscionable consumer representation made in respect of a particular transaction" shall be deemed to be an unfair practice, entitling the consumer to rescission and damages under section 4 of the Act. Other statutory provisions taking this approach, but in a more limited compass, include section 26 of the *Solicitors Act*[28] which states that if it appears to the court that an agreement between a solicitor and client in respect of fees is not "fair and reasonable", the agreement may be declared void and the court may order an assessment, and section 247(2) of the Ontario *Business Corporations Act, 1982*,[29] which provides for interference by the courts in circumstances of oppression or unfair prejudice.[30]

2. THE POSITION IN OTHER JURISDICTIONS

(a) UNITED STATES

The Uniform Commercial Code[31] contains a general unconscionability provision, section 2-302, which provides:

> 2-302.-(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 that 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 an unconscionable result.
>
> (2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

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[26] For a good outline of the authorities interpreting such legislation, see the judgment of Grant J. in *Adams v. Fahrngruber* (1975), 10 O.R. (2d) 96, 62 D.L.R. (3d) 256 (H.C.J.).

[27] *Business Practices Act*, R.S.O. 1980, c. 55.

[28] *Solicitors Act*, R.S.O. 1980, c. 478.

[29] *Business Corporations Act, 1982*, S.O. 1982, c. 4.

[30] A recent case has held that this section may give relief in the face of a provision in a contract valid between the parties: *Re Bury and Bell Gouinlock Ltd.* (1985), 12 D.L.R. (4th) 451 (Ont. H.C.J.).

[31] American Law Institute, Uniform Commercial Code, Official Text (9th ed., 1978) (hereinafter referred to as "Uniform Commercial Code").

The Code has been adopted in forty-nine states, the District of Columbia, the Virgin Islands, and Guam. Louisiana has only adopted certain parts of the Code. Section 2-302, which appears in the sales portion of the Code, has been included by Louisiana and all the adopting jurisdictions[32] except California.[33] Despite this legislative acceptance of a general unconscionability provision, the section has generated an ever-increasing amount of academic literature,[34] some of it extremely critical.

The general doctrine of unconscionability developed by equity was, for the most part, applied to dramatic examples of overreaching in the course of individual negotiations that commonly involved the sale of land.[35] It would appear that the intent of the drafters of the Code was a significant extension of the doctrine, particularly with respect to standard form contracts. This intent is borne out not only by the legislative history,[36] but also by the use of standard form examples in all the illustrative cases in the Official Comment.[37] However, the drafters of the legislation did little or nothing to assist the courts in the task of settling this old doctrine comfortably in its new and larger home. The Official Comment states:[38]

> The principle is one of the prevention of oppression and unfair surprise ... and not of disturbance of allocation of risks because of superior bargaining power.

This is, however, no more than a statement of the competing interests involved. It does nothing to suggest how those interests might be accommodated.

Given this background, it is not surprising to find that the courts, when they ultimately came to deal with litigation under section 2-302, had difficulty in formulating criteria for judgment and produced seemingly inconsistent results.[39] Later codifications, in the United States and elsewhere, have specified criteria that the courts should take into account. Thus, section 1-311 of the Uniform Land Transactions Act,[40] in dealing with real estate transactions, lists

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[32] *Ibid.*, Cumulative Annual Pocket Part 1985, at 1-2.

[33] *Ibid.* However, California has enacted an identical provision. See *West's California Codes*, The Civil Code of the State of California (1985), § 1670.5.

[34] See, for example, Dawson, "Unconscionable Coercion: The German Version" (1976), 89 Harv. L. Rev. 1041; Ellinghaus, "In Defence of Unconscionability" (1969), 78 Yale L.J. 757; Leff, "Unconscionability and the Code — The Emperor's New Clause" (1967), 115 U. Pa. L. Rev. 485; and Schwartz, "A Reexamination of Nonsubstantive Unconscionability" (1977), 63 Va. L. Rev. 1053.

[35] See Leff, *supra*, note 34, at 537.

[36] *Ibid.*, at 489-517.

[37] *Ibid.*, at 503.

[38] Uniform Commercial Code, *supra*, note 31, § 2-302, Comment 1.

[39] Deutch, *Unfair Contracts* (1977), at 137.

[40] Uniform Land Transactions Act, National Conference of Commissioners on Uniform State Laws, Uniform Laws Annotated: Civil Procedural and Remedial Laws (1975) (hereinafter referred to as "Uniform Land Transactions Act").

matters on which the parties may present evidence. In addition to the commercial setting, which is referred to in section 2-302 of the Uniform Commercial Code, section 1-311(b) lists the following as matters that are considered relevant:

> (2) whether a party has knowingly taken advantage of the inability of the other party reasonably to protect his interests by reason of physical or mental infirmity, illiteracy, or inability to understand the language of the agreement, or similar factors;
>
> (3) the effect and purpose of the contract or clause; and
>
> (4) if a sale, any gross disparity, at the time of contracting, between the amount charged for the real estate and the value of the real estate measured by the price at which similar real estate was readily obtainable in similar transactions, but a disparity between the contract price and the value of the real estate measured by the price at which similar real estate was readily obtainable in similar transactions does not, in itself, render the contract unconscionable.

(b) NEW SOUTH WALES

New South Wales adopted unconscionability legislation with its *Contracts Review Act, 1980*.[41] An important restriction on the scope of this legislation is that it does not apply to contracts entered into in the course of, or for the purpose of, a trade, business or profession, other than farming.[42] A court, on finding a contract to which the Act applies to be ''unjust in the circumstances relating to the contract at the time it was made'',[43] may do any one or more of the following: refuse to enforce all or any of the contract's provisions; declare the contract void in whole or in part; and vary in whole or in part any contractual provision.[44] Linked to these principal species of relief is a range of ancillary relief specified in Schedule 1 to the Act and including the possibility of damages by way of compensation or otherwise.[45] There is also provision for the appropriate Minister or the Attorney General to apply to the court for an order prescribing or restricting the terms on which a person may enter contracts of a particular class. Such an order may be granted if the court is satisfied ''that a person has embarked, or is likely to embark, on a course of conduct leading to the formation of unjust contracts''.[46]

''Unjust'' is defined to include ''unconscionable, harsh and oppressive''.[47] The legislation contains an extensive list of factors that the court must consider in making a decision under the Act, ranging from the public interest, through

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41 *Contracts Review Act, 1980*, Stat. N.S.W. 1980, Vol. 1, No. 16.

42 *Ibid.*, s. 6(2).

43 *Ibid.*, s. 7(1).

44 *Ibid.*

45 *Ibid.*, Schedule 1, s. 1(b).

46 *Ibid.*, s. 10.

47 *Ibid.*, s. 4(1).

various types of conduct and status, to the intelligibility of the contractual language.[48]

(c) UNITED KINGDOM

The most important legislation in the United Kingdom dealing with unconscionability is the *Unfair Contract Terms Act 1977*.[49] Despite the title, the Act is not, in fact, a general unconscionability statute. Rather, as revealed in the preamble, its purpose is "to impose further limits on the extent to which civil liability ... can be avoided by means of contract terms and otherwise". The Act prohibits outright certain limitation of liability clauses,[50] while others are made subject to a test of reasonableness.[51] Some content is given to the reasonableness requirement by section 11, which provides that a term is reasonable if it is "fair and reasonable ... 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". Schedule 2 of the Act adds more specific guidelines as to reasonableness,[52] but these apply only with respect to those sections of the Act covering the sale or possession of goods.[53]

Accordingly, the Act contains a combination of various devices already identified[54] as potential methods for controlling unconscionability in general or specific instances thereof: namely, direct prohibition of certain types of clauses; adoption of a broad general standard against which to judge certain situations, with the development of that standard left to the discretion of the courts; and adoption, in certain circumstances, of guidelines to be referred to in determining whether the general standard has been met.

This overview of legislative developments in other jurisdictions would be incomplete without a brief reference to the important, and increasing, volume of civil law legislation in the postwar era. Of particular significance are the legal rules regulating unfair contracts that are found in Germany, where the 1976 Act for the Regulation of the Law concerning Terms in Standard Form Contracts complements the general unconscionability provisions of the German Civil Code.[55]

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[48] *Ibid.*, s. 9.

[49] *Unfair Contract Terms Act 1977*, c. 50 (U.K.).

[50] See, for example, *ibid.*, ss. 2(1) and 6(1) and (2).

[51] See, for example, *ibid.*, ss. 3 and 4(1).

[52] Matters listed include the relative bargaining strengths of the parties, whether an inducement was given to secure acceptance of the challenged term, whether there were alternative contracts available without the challenged term, and whether the customer should reasonably have known about the existence and extent of the challenged term.

[53] *Unfair Contract Terms Act 1977*, *supra*, note 49, ss. 6 and 7.

[54] See *supra*, this ch., sec. 1(b).

[55] See, generally, Hahlo, "Unfair Contract Terms in Civil Law Systems" (1979-80), 4 Can. Bus. L.J. 429, esp. at 434-35.

3. THE CASE FOR LEGISLATIVE REFORM

Since at least some courts have recognized a general doctrine of unconscionability,[56] it may be asked whether a statutory affirmation of the doctrine is necessary and whether it would serve a useful purpose. Our answer to both these questions is yes. As we mentioned above, the doctrine has not yet been clearly recognized by the Supreme Court of Canada, nor has it been uniformly applied by lower courts. No less important, even those courts that have accepted the doctrine of unconscionability as part of modern contract law have not addressed their minds comprehensively to the types of relief that should be made available in cases of unconscionability.

In our view, statutory affirmation of the doctrine would stress its pervasive importance and encourage the courts to evaluate realistically the significance of standard form terms and manifestly unfair bargains. It ought also to encourage the courts to abandon such anachronistic tools as the doctrine of fundamental breach and adverse construction. Fictitious techniques of this kind do harm to the law, because they conceal the reasons for judicial decisions and prevent the development of clear principles. Statutory recognition of a generalized doctrine of unconscionability would fill the gaps in legislative intervention, and enable judges to direct their minds to the truly relevant criteria for decisions.

Accordingly, we recommend that legislation should be enacted expressly conferring on the courts power to grant relief from unconscionable contracts and unconscionable terms in a contract and spelling out the remedies available where unconscionability is found. However, as was emphasized in our *Report on Sale of Goods*,[57] legislative recognition of the doctrine of unconscionability should not be construed as a life jacket for persons who have entered into a bad bargain; nor should it interfere with the right of parties to bargain freely with respect to the terms of their contract. The thrust of the legislative doctrine that we support is to redress the imbalance where parties are *not* bargaining from equal positions and where the stronger party has taken advantage of its superior power to impose harsh and oppressive conditions on the weaker party.

We recognize the concerns of some critics of the doctrine of unconscionability that its statutory adoption may lead to uncertainty and that it will enable judges to impose their view of public policy on the market place. In our view, both these concerns can be satisfactorily answered. The numerous jurisdictions that have now adopted some form of statutory unconscionability doctrine have not found it giving rise to a flood of uncertainty. In fact, the volume of litigation has been extremely modest. So far as the exercise of the judicial power is concerned, this would be subject to the statutory guidelines that we propose below, and also subject to the usual rights of appeal that are open to an aggrieved litigant.

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[56] See *supra*, this ch., sec. 1(a).

[57] Sales Report, *supra*, note 2, at 162-63.

The balance of this chapter will focus on the design of a desirable set of statutory provisions that would empower the courts to grant relief from unconscionable contract provisions.

4. SPECIFIC ISSUES

(a) SUBSTANTIVE AND PROCEDURAL UNCONSCIONABILITY

In our *Report on Sale of Goods*, we did not favour drawing a rigid distinction between issues of procedural and substantive unconscionability, because of the difficulty of distinguishing between the two.[58] Procedural unconscionability would appear to refer to unconscionability in the process of making the contract. Substantive unconscionability would seem to refer to an unacceptable one-sidedness in the terms of the contract. We recognize that it may be argued that to allow an attack on the basis of substantive unconscionability alone is to negate the concept of freedom of contract. It may be further argued that certain avenues of inquiry should be closed to the courts because the issues may be too complex, or inappropriate for handling by regular adjudicative methods. One example of this is provided by the prohibition in the Uniform Land Transactions Act on the use of inadequacy of consideration alone as a ground for giving relief on the basis of unconscionability.[59]

However, we note that the *Business Practices Act*,[60] the *Consumer Protection Act*,[61] and the *Unconscionable Transactions Relief Act*[62] do not draw distinctions between procedural and substantive unconscionability. We favour an approach which would allow the courts to consider all aspects of a bargain, without having to categorize particular aspects as either procedural or substantive. This becomes particularly important with respect to cases where one of the parties has no contractual alternatives. We believe that there is little danger of the courts jumping to hasty conclusions solely because of a disparity in bargaining power or a significant differential in value.

Accordingly, we recommend that the proposed formulation of the doctrine of unconscionability should not distinguish between procedural and substantive unconscionability.

(b) DECISIONAL CRITERIA

As discussed earlier, the general unconscionability provision of the Uniform Commercial Code, section 2-302, provides only minimal guidance to the courts. Consequently, the courts have not formulated clear criteria by which unconscionability may be judged, and seemingly inconsistent results have been

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58 *Ibid.*, at 157.

59 Uniform Land Transactions Act, *supra*, note 40, § 1-311(b)(4).

60 *Supra*, note 27.

61 *Supra*, note 14.

62 *Supra*, note 25.

reached.[63] It has been suggested that the difficulties involved in the invocation of section 2-302 have contributed to continued resort by the courts to the covert method of rendering exemption clauses ineffective by restrictive interpretation.[64]

The American experience suggests the wisdom of including decisional criteria in legislation dealing with unconscionability. Statutory criteria would encourage the courts to be explicit about the bases of decisions. Such elaboration should provide some definition to the concept of unconscionability, without unduly limiting judicial flexibility.

We therefore recommend that the proposed formulation of the doctrine of unconscionability should include a non-exclusive list of decisional criteria to guide the courts in determining questions of unconscionability.

We now turn to the question of what those criteria should be. In formulating a set of criteria, we draw on statutory precedents, including section 2(b) of the Ontario *Business Practices Act*,[65] Schedule 2 of the U.K. *Unfair Contract Terms Act 1977*,[66] and section 9 of the New South Wales *Contracts Review Act, 1980*.[67] The criteria that we favour are very similar to those found in section 5.2(2) of the Draft Bill included in our *Report on Sale of Goods*,[68] which were, in turn, approved with minor changes by the Sale of Goods Committee of the Uniform Law Conference of Canada.[69]

We therefore recommend that, in determining whether a contract or part thereof is unconscionable having regard to the circumstances obtaining at the time the contract was made, the court may have regard, among other factors, to evidence of the following factors:

(a) the degree to which one party has taken advantage of the inability of the other party reasonably to protect his or her interests because of his or her physical or mental infirmity, illiteracy, inability to understand the language of an agreement, lack of education, lack of business knowledge or experience, financial distress, or because of the existence of a relationship of trust or dependence or similar factors;

(b) the existence of terms in the contract that are not reasonably necessary for the protection of the interests of any party to the contract;

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63 See *supra*, this ch., sec. 2(a).

64 Deutch, *supra*, note 39, at 159.

65 *Supra*, note 27.

66 *Supra*, note 49.

67 *Supra*, note 41.

68 Sales Report, *supra*, note 2, at 161.

69 Uniform Law Conference of Canada, *Proceedings of the Sixty-fourth Annual Meeting* (1982), Appendix HH, s. 31(2).

(c) the degree to which the contract requires a party to waive rights to which he or she would otherwise be entitled;

(d) gross disparity between the considerations given by the parties to the contract and the considerations that would normally be given by parties to a similar contract in similar circumstances;

(e) knowledge by one party, when entering into the contract, that the other party will be substantially deprived of the benefit or benefits reasonably anticipated by that other party under the contract;

(f) the degree to which the natural effect of the transaction, or any party's conduct prior to, or at the time of, the transaction, is to cause or aid in causing another party to misunderstand the true nature of the transaction and his or her rights and duties thereunder;

(g) whether the complaining party had independent advice before or at the time of the transaction or should reasonably have acted to secure such advice for the protection of the party's interest;

(h) the bargaining strength of the parties relative to each other, taking into account the availability of reasonable alternative sources of supply or demand;

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

(j) in the case of a provision that purports to exclude or limit a liability that would otherwise attach to the party seeking to rely on it, which party is better able to guard against loss or damages;

(k) the setting, purpose and effect of the contract, and the manner in which it was formed, including whether the contract is on written standard terms of business; and

(l) the conduct of the parties in relation to similar contracts or courses of dealing to which any of them has been a party.

Factor (a) covers the traditional area of equity unconscionability. The reference to the existence of a relationship of trust or dependence does not appear in the relevant section of the draft legislation included in our *Report on Sale of Goods*.[70] However, as indicated by the case law,[71] a relationship of trust or dependence can be a factor that contributes to unconscionability.

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[70] Sales Report, *supra*, note 2, at 161, s. 5.2(2)(a).

[71] See, for example, *McKenzie v. Bank of Montreal*, *supra*, note 7, and *Lloyd's Bank Ltd. v. Bundy*, *supra*, note 4.

Factor (b) was not included in our proposed *Sale of Goods Act*, and deals with the imposition of terms not reasonably necessary for the protection of the interests of any party to the contract. This circumstance has been recognized as bearing on unconscionability in the New South Wales *Contracts Review Act, 1980*[72] and in the case law.[73] It is but one kind of lack of equivalence that may arise in a contract, analogous to excessive waiver of rights by one party, and gross disparity in considerations exchanged. These last two circumstances are addressed in factors (c) and (d) respectively, and were included as criteria relevant to unconscionability in the draft legislation that accompanied our *Report on Sale of Goods*.[74]

Factors (e) and (f) are also found in our proposed *Sale of Goods Act*.[75] Factor (g), relating to independent legal or other expert advice, does not appear in the draft *Sale of Goods Act*, but is included as one of the criteria listed as relevant to unconscionability in the New South Wales *Contracts Review Act, 1980*.[76]

Factors (h), (i) and (j) have their counterparts in our draft *Sale of Goods Act*.[77] Clause (k), insofar as it deals with the setting, purpose and effect of a contract, may also be found in our proposed *Sale of Goods Act*.[78] Factor (k), however, goes on to include specifically "whether the contract is on written standard terms of business". This addition has been made because of problems posed by the pervasive use of standard form contracts, particularly relating to failure on the part of a party to read or understand all of the terms. As Lord Devlin has commented of certain standard form contracts: "This sort of document is not meant to be read, still less to be understood".[79] We note that this factor is listed in the *Unfair Contract Terms Act 1977* as relevant to the enforceability of certain contractual terms.[80]

Factor (l), dealing with prior conduct of the parties, has no direct analogue in our proposed *Sale of Goods Act* and is drawn from the New South Wales *Contracts Review Act, 1980*.[81] We believe that, in appropriate cases, the way in

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72 *Supra*, note 41, s. 9(2)(d).

73 See, for example, *Laurin v. Iron Ore Co. of Canada* (1977), 82 D.L.R. (3d) 634, 19 Nfld. & P.E.I. R. 111 (Nfld. S.C., T.D.), and *In Re Elkins-Dell Mfg. Co.*, 253 F. Supp. 864 (E.D. Pa. 1966), at 871, discussed by Deutch, *supra*, note 39, at 138-39.

74 Sales Report, *supra*, note 2, at 161, s. 5.2(2)(d) and (b), respectively.

75 *Ibid.*, s. 5.2(2)(c) and (e), respectively.

76 *Supra*, note 41, s. 9(2)(h). This factor was also stressed by Lord Denning in *Lloyd's Bank Ltd. v. Bundy*, *supra*, note 4, at 339.

77 Sales Report, *supra*, note 2, at 161, s. 5.2(2)(f), (g) and (h), respectively.

78 *Ibid.*, s. 5.2(2)(i).

79 *McCutcheon v. David MacBrayne, Ltd.*, [1964] 1 W.L.R. 125, at 133, [1964] 1 All E.R. 430, at 436 (H.L.).

80 *Supra*, note 49, s. 3(1).

81 *Supra*, note 41, s. 9(2)(k).

which a party has behaved towards other contracting parties may be relevant to the determination of unconscionability, as, for example, where there is a pattern of contracting that demonstrates a situational monopoly (that is, circumstances give one contracting party abnormal market power over the other) or market-wide control.[82]

(c) Power of the Court to Raise Unconscionability of its Own Accord

Some of the factors that contribute to unconscionability in contract formation — for example, ignorance and lack of intellectual capacity — may also lead to a failure to argue unconscionability in court. We recommended in our *Report on Sale of Goods* that a court should be able, in the context of contracts for the sale of goods, to raise the issue of unconscionability of its own motion.[83] We see no reason why this recommendation should not apply also to the law of contracts generally, and we so recommend.

(d) Scope of Provisions

It would be possible to limit the application of the proposed provisions so as to exempt certain types of contract — for example, insurance and consumer contracts — that are already subject to extensive regulation. However, while it might be argued that contracts that are already highly regulated need not and should not be subject to the proposed unconscionability provisions, a limitation of this kind could lead to considerable complexity. It might also be argued that the proposed provisions should not apply to executed contracts, on the ground that reopening such contracts on the basis of unconscionability would lead to uncertainty and lack of finality. We have concluded, however, that certainty and finality should yield to flexibility and the avoidance of injustice. In our view, the doctrine of unconscionability should be statutorily recognized as a basic and pervasive contract norm. We therefore recommend that the proposed provisions on unconscionability should apply to all types of contracts.

In chapter 2 of this Report, we recommended changes to the doctrine of consideration that would enlarge the class of promises that are enforceable. We believe that the doctrine of unconscionability should apply to all enforceable promises. Accordingly, we further recommend that the term "contract" in the proposed provisions on unconscionability should be defined to include any enforceable promise.

(e) Remedies

(i) Rescission, Restitution and Expectancy Damages

Section 2-302 of the Uniform Commercial Code provides that, if a court makes a finding of unconscionability, it may refuse to enforce the contract, enforce the unoffending part of the contract, or limit the application of any

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82 Situational and market-wide monopolies are discussed in relation to unconscionability by Trebilcock, *supra*, note 1, at 392-404.

83 Sales Report, *supra*, note 2, at 159.

unconscionable clause to avoid an unconscionable result.[84] Power to order rescission of unconscionable contracts, with accompanying restoration of the parties to their pre-contractual position, is not provided. In contrast, the New South Wales *Contracts Review Act, 1980* does provide for rescission, allowing the court to "make an order declaring the contract void, in whole or in part".[85] In addition, as noted above,[86] Schedule 1 to the New South Wales statute allows for "the payment of money (whether or not by way of compensation) to a party to the contract".[87]

In our *Report on Sale of Goods*, we considered that the remedies provided in section 2-302 of the Uniform Commercial Code were insufficient.[88] Given the range of circumstances in which the courts may be called upon to intervene, including not only the type of contract and unconscionability involved but also the timing of the intervention, it seemed to us desirable that the courts be given flexible remedial alternatives. Accordingly, we included the following provision in our proposed *Sale of Goods Act*:[89]

> 5.2-(1) If, with respect to a contract of sale, the court finds the contract or a part thereof to have been unconscionable at the time it was made, the court may
>
> (a) refuse to enforce the contract or rescind it on such terms as may be just;
>
> (b) enforce the remainder of the contract without the unconscionable part; or
>
> (c) so limit the application of any unconscionable part or revise or alter the contract as to avoid any unconscionable result.

This provision would enable the courts to do justice as the circumstances require.

We consider that the position taken in our *Report on Sale of Goods* in connection with contracts for the sale of goods applies with equal force to contracts of all types. Accordingly, we recommend that a provision similar to section 5.2(1) of our proposed *Sale of Goods Act* should be incorporated, with the necessary modifications, into the proposed legislation dealing with unconscionability.

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84 See *supra*, this ch., sec. 2(a).

85 *Supra*, note 41, s. 7(1)(b).

86 *Supra*, this ch., sec. 2(b).

87 *Supra*, note 41, Schedule 1, s. 1(b).

88 Sales Report, *supra*, note 2, at 159.

89 *Ibid.*, at 160-61.

(ii) Injunctions

The New South Wales *Contracts Review Act, 1980*[90] provides for injunctive relief at the behest of a Minister of the Crown with respect to contracts of a specified class. Section 10 of the Act provides as follows:

> 10. Where the Supreme Court is satisfied, on the application of the Minister or the Attorney General, or both, that a person has embarked, or is likely to embark, on a course of conduct leading to the formation of unjust contracts, it may, by order, prescribe or otherwise restrict, the terms upon which that person may enter into contracts of a specified class.

This raises the question of whether a form of public law relief should be included in a general statute governing the law of contracts. We consider that injunctive power might well be useful in cases where a person or corporation has demonstrated a pattern of contractual unconscionability. Accordingly, we recommend that the courts should be empowered, at the behest of the Attorney General or other prescribed Minister, to issue injunctions against conduct leading to unconscionability, either in the formation or in the execution of contracts. We would note that the notion of standing for a public official in this sort of context is not novel in Ontario.[91]

We wish to emphasize that it is not our intention that the availability of this kind of injunctive power should, in any way, restrict the right of a party to injunctive relief with respect to a particular contract.

(f) Exemption from Liability Clauses

The doctrine of unconscionability developed as a brake on overreaching in the contractual process, and quite plainly sets limits on contractual freedom. As such, it would not make sense to permit a contracting party to exclude liability arising under a statutory provision dealing with unconscionability. Out of an abundance of caution, we made this explicit in section 5.2(5) of our proposed *Sale of Goods Act*,[92] which provides as follows:

> 5.2-(5) The powers conferred by this section apply notwithstanding any agreement or waiver to the contrary.

We recommend that a similar provision be included in the proposed legislation governing unconscionability.

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[90] *Supra*, note 41, s. 10.

[91] For example, section 247 of the *Business Corporations Act, 1982*, *supra*, note 29, vests standing in the Director or the Ontario Securities Commission, as appropriate, to apply to the court in cases of oppression or unfair prejudice.

[92] Sales Report, *supra*, note 2, at 162.

(g) Outright Prohibitions and Presumptions of Unconscionability

The statutory formulation of the doctrine of unconscionability that we are recommending does not single out particular types of objectionable clauses that might appropriately be subject to outright prohibition. Nor are particular types of clauses made subject to a presumption of unconscionability, so as to shift the onus of proof to the party seeking to rely on such a clause to show that it is not unconscionable. There are precedents for such prohibitions[93] and presumptions.[94] However, while it is true that some unconscionable clauses are readily identifiable, it would be impossible to list all clauses to which a presumption or prohibition should apply. Accordingly, we do not recommend that provisions be included either prohibiting, or shifting the onus of proof for, specific types of clauses.

We would emphasize that we do not oppose prohibitions and presumptions of unconscionability. In our *Report on Sale of Goods*, for example, we recommended that an exclusion or limitation of damages for breach of warranty for injury to the person be considered *prima facie* unconscionable.[95] However, we believe that prohibitions and presumptions with respect to particular types of clauses are best dealt with in specific legislation.

(h) Consumer Protection

In concluding this chapter we wish to add an important observation. Our recommendations are addressed to all types of unconscionable contract provisions and we do not distinguish between consumer and non-consumer contracts. We wish, however, to make the point that the implementation of our recommendations would not by itself accord consumers the protection they need against unconscionable conduct. To effectuate this goal, additional legislation, together with appropriate administrative supports, is needed.

Fortunately, in Ontario much of the machinery is already in place in the *Business Practices Act*[96] and in other consumer legislation.[97] It may be that these provisions are in need of review and updating.[98] We have treated this question as being outside our terms of reference. Nevertheless, it should be emphasized that nothing in this chapter should be interpreted as dispensing with the need for a business practices act or other legislation dealing with specific types of unconscionable practices and their policing in the consumer area.

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93 See, for example, *Unfair Contract Terms Act 1977*, *supra*, note 49, s. 2(1).

94 See, for example, *ibid.*, s. 2(2), and Uniform Commercial Code, *supra*, note 31, § 2-719(3).

95 Sales Report, *supra*, note 2, at 232-33.

96 *Supra*, note 27.

97 See discussion of Ontario legislation on unconscionability, *supra*, this ch., sec. 1(b).

98 See Belobaba, "Some Features of a Model Consumer Trade Practices Act", in Ziegel (ed.), *Proceedings of the Seventh Annual Workshop on Commercial and Consumer Law* (1979) 1.

Recommendations

The Commission makes the following recommendations:

1. Legislation should be enacted expressly conferring on the courts power to grant relief from contracts and contractual provisions that are unconscionable.

2. The proposed legislation should not distinguish between procedural and substantive unconscionability.

3. The proposed legislation should include a non-exclusive list of decisional criteria to guide the courts in determining questions of unconscionability (See *infra*, Recommendation 4).

4. In determining whether a contract or part thereof is unconscionable in the circumstances relating to the contract at the time it was made, the court may have regard, among other factors, to evidence of:

   (a) the degree to which one party has taken advantage of the inability of the other party reasonably to protect his or her interests because of his or her physical or mental infirmity, illiteracy, inability to understand the language of an agreement, lack of education, lack of business knowledge or experience, financial distress, or because of the existence of a relationship of trust or dependence or similar factors;

   (b) the existence of terms in the contract that are not reasonably necessary for the protection of the interests of any party to the contract;

   (c) the degree to which the contract requires a party to waive rights to which he or she would otherwise be entitled;

   (d) gross disparity between the considerations given by the parties to the contract and the considerations that would normally be given by parties to a similar contract in similar circumstances;

   (e) knowledge by one party, when entering into the contract, that the other party will be substantially deprived of the benefit or benefits reasonably anticipated by that other party under the contract;

   (f) the degree to which the natural effect of the transaction, or any party's conduct prior to, or at the time of, the transaction, is to cause or aid in causing another party to misunderstand the true nature of the transaction and his or her rights and duties thereunder;

(g) whether the complaining party had independent advice before or at the time of the transaction or should reasonably have acted to secure such advice for the protection of the party's interest;

(h) the bargaining strength of the parties relative to each other, taking into account the availability of reasonable alternative sources of supply or demand;

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

(j) in the case of a provision that purports to exclude or limit a liability that would otherwise attach to the party seeking to rely on it, which party is better able to guard against loss or damages;

(k) the setting, purpose and effect of the contract, and the manner in which it was formed, including whether the contract is on written standard terms of business; and

(l) the conduct of the parties in relation to similar contracts or courses of dealing to which any of them has been a party.

5. The proposed legislation should expressly authorize the court to raise the issue of unconscionability of its own motion.

6. The proposed provisions on unconscionability should apply to all types of contracts.

7. The term ''contract'' in the proposed provisions on unconscionability should be defined to include any enforceable promise.

8. The proposed legislation should incorporate a provision, similar to section 5.2(1) of the proposed *Sale of Goods Act*, with the necessary modifications. Accordingly, the court should be able, in the case of an unconscionable contract to

(a) refuse to enforce the contract or rescind it on such terms as may be just;

(b) enforce the remainder of the contract without the unconscionable part; or

(c) so limit the application of any unconscionable part or revise or alter the contract as to avoid any unconscionable result.

9. The courts should be empowered, at the behest of the Attorney General or other prescribed Minister, to issue injunctions against conduct leading to unconscionability, either in the formation of or in the execution of contracts.

10. A provision, similar to section 5.2(5) of the proposed *Sale of Goods Act*, preventing a party from excluding liability or waiving rights under the provisions dealing with unconscionability, should be included in the proposed legislation.

CHAPTER 7

PENALTY CLAUSES AND RELIEF FROM FORFEITURE OF MONIES PAID

1. INTRODUCTION

This chapter examines the law governing two important types of contractual clause whose validity the common law, including equity, refuses to recognize in whole or in part, notwithstanding the normal principle that freely consented to bargains are binding. The first type of clause to be examined is the penalty clause, which may be defined as a promise to pay a stipulated sum of money,[1] otherwise than by way of liquidated damages, if the promisor breaches a term of the contract. The second type of clause involves an express or implied agreement that monies paid by way of deposit or towards the purchase price of the thing bargained for will be forfeited in favour of the payee if the agreement is cancelled because of the payor's breach. Both types of clause, to a greater or lesser degree, have attracted the hostility of the courts because of the opportunity they are seen to provide for oppressive or unconscionable bargains and their repugnancy to basic principles governing the assessment of damages.

2. CONTRACTS TO PAY A STIPULATED SUM ON BREACH

(a) THE PRESENT LAW AND THE CASE FOR REFORM

It is very common for parties to agree that on breach of a particular contractual obligation a certain sum of money will be paid by the defaulting party. Such agreements are not in themselves objectionable. On the contrary, they serve several purposes useful to both parties. They enable the promisee to put a value on performance and to avoid the risks of undercompensation inherent in litigation. They enable the promisor to offer an assurance of performance while limiting liability, thereby making the cost of breach predictable. They reduce the cost to the parties and the costs to the state of resolving disputes. On the other hand, there are cases where the stipulated sum greatly exceeds the actual loss caused to the promisee by the breach. In such cases,

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[1] In Anglo-Canadian law the discussion almost invariably focuses on clauses requiring the payment of a sum of money. There is no reason, however, why the doctrine should be confined to monetary payments and in civil law systems it is not so confined. See, for example, *Ringuet v. Bergeron*, [1960] S.C.R. 672, 24 D.L.R. (2d) 449, applying Quebec law to a penalty clause requiring the transfer of shares.

strict enforcement of the agreement would lead to an extravagant and oppressive result. It is not surprising, then, that equity has found means to relieve against such results.

In 1801 it was said that "[t]he jurisdiction of Courts of Equity in relieving on penalties is of very high antiquity".[2] Before the eighteenth century, penalties were usually cast in the form of penal bonds. These were theoretically enforceable at common law, but equity granted relief against enforcement.[3] The general power of the courts of equity to relieve against penal bonds, and against penalty clauses in contracts which, since the nineteenth century, have replaced penal bonds, is confirmed by section 111 of the *Courts of Justice Act, 1984*.[4]

The courts, while retaining the power to relieve against penalties, have nevertheless been anxious not to lose the advantages of enforcing fair and reasonable agreements stipulating in advance the sum to be paid on breach. In an era when the values represented by freedom of contract were highly prized, it seemed anomalous that freely made and clear agreements should be struck down. Lacking a general principle of unconscionability, the courts sought to limit intervention by drawing a distinction between "penalty clauses", which were unenforceable, and "liquidated damages clauses", which were enforceable.

Unfortunately, however, no satisfactory test has evolved for distinguishing the two kinds of clause. The generally accepted test was summarized by the Supreme Court of Canada in 1915 as follows:[5]

> A penalty is the payment of a stipulated sum on breach of the contract, irrespective of the damage sustained. The essence of liquidated damages is a genuine covenanted pre-estimate of damage.

The difficulty of applying this test is illustrated by the leading English case, *Dunlop Pneumatic Tyre Co., Ltd. v. New Garage and Motor Co., Ltd.*[6] In that case, a retailer agreed to pay a manufacturer £5 for every breach of a resale price maintenance scheme. The House of Lords unanimously held that the agreement was enforceable. On the assumption that the scheme did not, at that

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[2] *Astley v. Weldon* (1801), 2 Bos. & Pul. 346, at 354, 126 E.R. 1318, at 1323 (subsequent reference is to 126 E.R.).

[3] See *Re Dixon*, [1900] 2 Ch. 561 (C.A.), at 576.

[4] S.O. 1984, c. 11. Section 111 provides as follows:

> A court may grant relief against penalties and forfeitures, on such terms as to compensation or otherwise as are considered just.

For discussion of this provision see *infra*, this ch., sec. 3(a).

[5] *Canadian General Electric Co. v. Canadian Rubber Co.* (1915), 52 S.C.R. 349, at 351, 27 D.L.R. 294, at 295, *per* Fitzpatrick C.J.

[6] *Dunlop Pneumatic Tyre Co., Ltd. v. New Garage and Motor Co., Ltd.*, [1915] A.C. 79, [1914-15] All E.R. Rep. 739 (H.L.) (subsequent references are to [1915] A.C.).

time, offend public policy on competition, this result seems reasonable. It is, however, hard to imagine that the figure of £5 was in any sense a genuine attempt to pre-estimate actual damage caused by specific breaches. It seems plain that its intended effect was wholly deterrent.

The reason for enforcing the clause appears to be, not that it represented a genuine pre-estimate of damage, but that it was thought to be fair and reasonable. One law lord said that the question was whether the sum stipulated was "extravagant";[7] another said that the agreement contained nothing "unreasonable, unconscionable or extravagant";[8] another, that the sum was not "extravagant or extortionate".[9] Similar phrases also appear in Canadian cases.[10]

A serious problem with the current law is that relief against penalty clauses only applies to clauses requiring payment of money on breach of contract. Clauses requiring payment in other circumstances are not penalty clauses, although they may have the same practical effect. Thus, where a hirer terminated a chattel lease contract in accordance with an option to terminate, the contract providing for a certain sum to be payable on such termination, it was held that the clause was not a penalty clause and that the court was powerless to relieve.[11] Said one judge, "Let no one mistake the injustice of this. It means that equity commits itself to this absurd paradox: it will grant relief to a man who breaks his contract but will penalise the man who keeps it."[12]

Another difficulty with the present approach to penalty clauses is that it is capable of leading to the striking down of agreements that are perfectly fair and reasonable. Indeed, the resale price maintenance scheme in *Dunlop Pneumatic Tyre Co., Ltd. v. New Garage and Motor Co., Ltd.*[13] might well have been struck down on a strict application of the test announced in the case itself.

The Supreme Court of Canada suggested in *H.F. Clarke Ltd. v. Thermidaire Corp. Ltd.* that a liquidated damages clause would be struck down if it required the defendant to pay a larger sum than the Court would have

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7 *Ibid.*, at 88, *per* Lord Dunedin.

8 *Ibid.*, at 97, *per* Lord Atkinson.

9 *Ibid.*, at 101, *per* Lord Parmoor.

10 *Canadian General Electric Co. v. Canadian Rubber Co.*, *supra*, note 5. See, also, *Henderson v. Nichols* (1849), 5 U.C.Q.B. 398 (C.A.), at 400.

11 *Bridge v. Campbell Discount Co. Ltd.*, [1962] A.C. 600, [1962] 1 All E.R. 385 (H.L.) (subsequent reference is to [1962] A.C.). See, also, *Ellis v. Frughtman* (1912), 8 D.L.R. 353, 3 W.W.R. 558 (Alta. S.C., App. Div.).

12 *Bridge v. Campbell Discount Co. Ltd.*, *supra*, note 11, at 629, *per* Denning L.J.

13 *Supra*, note 6.

awarded as damages.[14] It may be, as certain passages suggest,[15] that the Court in the *Thermidaire* case in fact applied a test of unconscionability, but, in our view, the mere fact that the stipulated sum exceeds the amount that the Court would award should not be sufficient reason for striking down the clause. Indeed, in the case where the promisee has a special interest in the contractual performance that might not be reflected in a judicial award of damages, an agreement for the payment of a stipulated sum is most useful.[16]

Thus, where rules of law respecting certainty of proof or remoteness, or failure fully to protect intangible interests, would lead to undercompensation, there is strong reason for permitting the parties to set their own value on performance and for enforcing their agreement.[17]

(b) Responses to the Problem and the Position in Other Jurisdictions

(i) England

With the exception of a Working Paper published by the English Law Commission in 1975,[18] the current law of penalty clauses has not received much critical attention in England. The Law Commission was of the view that there was nothing radically wrong with the current rules, and concentrated its attention on a number of subsidiary issues. However, while the Commission rejected the possibility of substituting a test of reasonableness for the existing rule, it did not subject to serious analysis the basis of the common law distinction between penalty clauses and liquidated damages clauses and the reasons for refusing to enforce penalty clauses.

(ii) The United States

American law with respect to penalties and liquidated damages clauses differs in important respects from Anglo-Canadian law. The particular rules, both legislative and common law, vary among the states, and the most that can be done is to give a broad approximation of current trends.

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[14] [1976] 1 S.C.R. 319, 54 D.L.R. (3d) 385 (subsequent reference is to [1976] 1 S.C.R.).

[15] See *ibid.*, at 331, where Laskin C.J. suggested that judicial interference with the enforcement of penalty clauses is "simply a manifestation of a concern for fairness and reasonableness".

[16] The statement of Dickson, J., in *Elsley v. J.G. Collins Insurance Agencies Ltd.*, [1978] 2 S.C.R. 916, at 937, 83 D.L.R. (3d) 1, at 15 (subsequent reference is to [1978] 2 S.C.R.), that the court's jurisdiction is for the sole purpose of relieving against oppression suggests also that a reasonable agreement ought to be enforced.

[17] See *Astley v. Weldon*, *supra*, note 2, at 1323: "A man in possession of his own estate may set his own value upon the view, the timber, or other ornaments and conveniences of the estate ...". See, also, Goetz and Scott, "Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach" (1977), 77 Colum. L. Rev. 554.

[18] England, Law Commission, Working Paper No. 61, *Penalty Clauses and Forfeiture of Monies Paid* (1975) (hereinafter referred to as "Working Paper No. 61").

The current position in most American jurisdictions with respect to contracts to pay a stipulated sum on breach is reflected in section 2-718 of the Uniform Commercial Code[19] and section 356 of the *Second Restatement of the Law of Contracts*.[20] Section 2-718(1) of the Uniform Commercial Code permits damages to be liquidated in an agreement but only in an amount that is

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[19] American Law Institute, Uniform Commercial Code, Official Text (9th ed., 1978) (hereinafter referred to as "Uniform Commercial Code"). Section 2-718 reads as follows:

> 2-718.-(1) Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or non-feasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.
>
> (2) Where the seller justifiably withholds delivery of goods because of the buyer's breach, the buyer is entitled to restitution of any amount by which the sum of his payments exceeds
>
> (a) the amount to which the seller is entitled by virtue of terms liquidating the seller's damages in accordance with subsection (1), or
>
> (b) in the absence of such terms, twenty per cent of the value of the total performance for which the buyer is obligated under the contract or $500, whichever is smaller.
>
> (3) The buyer's right to restitution under subsection (2) is subject to offset to the extent that the seller establishes
>
> (a) a right to recover damages under the provisions of this Article other than subsection (1), and
>
> (b) the amount or value of any benefits received by the buyer directly or indirectly by reason of the contract.
>
> (4) Where a seller has received payment in goods their reasonable value or the proceeds of their resale shall be treated as payments for the purposes of subsection (2); but if the seller has notice of the buyer's breach before reselling goods received in part performance, his resale is subject to the conditions laid down in this Article on resale by an aggrieved seller (Section 2-706).

[20] American Law Institute, *Restatement of the Law, Second — Contracts, 2d* (1979) (hereinafter referred to as "*Second Restatement*"). Section 356 reads as follows:

> 356.-(1) Damages for breach by either party may be liquidated in the agreement but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty.
>
> (2) A term in a bond providing for an amount of money as a penalty for non-occurrence of the condition of the bond is unenforceable on grounds of public policy to the extent that the amount exceeds the loss caused by such non-occurrence.

The predecessor to section 356 (American Law Institute, *Restatement of the Law, Contracts* (1932), § 339) took a more restrictive approach and provided that an agreement made in advance of a breach fixing damages for a breach was not enforceable unless the amount fixed was a reasonable forecast of just compensation for harm caused by the breach and the harm caused by the breach was incapable of accurate estimation or very difficult to estimate accurately.

reasonable in light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or non-feasibility of otherwise obtaining an adequate remedy. It also makes void a term fixing unreasonably large liquidated damages. The provisions of section 356 of the *Second Restatement* are, generally speaking, similar.[21]

In California, in 1977, as a result of recommendations by the California Law Revision Commission,[22] the provisions of the California Civil Code relating to liquidated damages clauses were revised to provide[23] that, in non-

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The *Restatements* have, of course, only persuasive force, whereas section 2-718 of the Uniform Commercial Code has statutory force in all states that have adopted the Code.

21 The *Second Restatement*, *supra*, note 20, determines reasonableness by referring, *inter alia*, to the "anticipated or actual *loss* caused by the breach", while the Uniform Commercial Code refers to the "anticipated or actual *harm* caused by the breach". Neither of the provisions refers specifically to damages suffered or recoverable in an action at law. There is, therefore, a question whether the reasonableness of the stipulated amount is restricted by the quantity of damages recoverable under the rule in *Hadley v. Baxendale* ((1854), 9 Ex. 341, 156 E.R. 145). The position that the reasonableness of the stipulated amount is not so restricted finds support in cases enforcing liquidated damages clauses allowing recovery of attorney's fees. (See *Equitable Lumber Corp. v. IPA Land Development Corp.*, 38 N.Y. 2d 516 (1976)). In most American jurisdictions, an unsuccessful party is not normally responsible for the other party's costs.

22 California Law Revision Commission, *Recommendation Relating to Liquidated Damages* (1976), 13 Cal. L. Revision Comm'n. Reports, at 1735.

23 *West's Annotated California Codes*, The Civil Code of the State of California (1985) (hereinafter referred to as "California Civil Code"), § 1671. The former provisions, sections 1670 and 1671, were repealed by Stats. 1977, c. 198, p. 718, § 5, operative July 1, 1978. Section 1671 is as follows:

> 1671.-(a) This section does not apply in any case where another statute expressly applicable to the contract prescribes the rules or standard for determining the validity of a provision in the contract liquidating the damages for the breach of the contract.
>
> (b) Except as provided in subdivision (c), a provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made.
>
> (c) The validity of a liquidated damages provision shall be determined under subdivision (d) and not under subdivision (b) where the liquidated damages are sought to be recovered from either:
>
> (1) A party to a contract for the retail purchase, or rental, by such party of personal property or services, primarily for the party's personal, family, or household purposes; or
>
> (2) A party to a lease of real property for use as a dwelling by the party or those dependent upon the party for support.
>
> (d) In the cases described in subdivision (c), a provision in a contract liquidating damages for the breach of the contract is void except that the parties to such a contract may agree therein upon an amount which shall be presumed to be the amount of damage sustained by a breach thereof, when, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage.

consumer transactions and subject to the provisions of any other statute expressly applicable to the contract, a liquidated damages provision is valid unless the party seeking to invalidate it establishes that the provision was "unreasonable under the circumstances existing at the time the contract was made".[24] In the consumer transactions specified by section 1671(c), a liquidated damages provision is stated to be void pursuant to section 1671(d) except where it satisfies the requirements outlined under the pre-1977 law.[25]

Essentially, the amendments favour the enforcement of liquidated damages provisions except against a consumer in a consumer transaction. Their overall effect, other than in consumer transactions not involving the purchase of real property,[26] is to substitute a test of reasonableness for the more exacting requirements under the old law.

(c) CONCLUSIONS

We have concluded that the law governing penalty clauses is in need of rationalization and reform. Given our proposed recognition of a general principle of unconscionability,[27] however, we believe that there is no need for specific and detailed legislative provisions of the sort outlined in the preceding section. Rather, the law relating to agreements to pay a stipulated sum on breach can, and should, be subsumed under the general principle of unconscionability.

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[24] The new provision does not itself provide any criteria of unreasonableness, but the concept is explained in the Report of the California Law Revision Commission (*supra*, note 22, at 1751-52) as including such factors as the relative bargaining powers of the parties, whether the contract was drafted by lawyers, and whether the provision was in a standard form contract. The California Law Revision Commission reasoned that the new section would reverse the bias against liquidated damages clauses and allow parties with relatively equal bargaining power to enter into a reasonable liquidated damages agreement with the assurance that it would be held valid (*supra*, note 22, at 1742). It is worthy of note that the circumstances which may be taken into account in the determination of reasonableness in non-consumer transactions are limited to those in existence "at the time the contract was made" and not as it appears in retrospect. Accordingly, the amount of damage actually suffered would have no bearing on the validity of the liquidated damages provisions. This contrasts with section 2-718 of the Uniform Commercial Code, *supra*, note 19, pursuant to which damages may be liquidated at an amount which is reasonable in light of "anticipated or actual harm".

[25] Prior to 1977, the California Civil Code provided that liquidated damages clauses were void except where the parties had agreed on an amount in circumstances where, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage. Judicial interpretation of these provisions had resulted in a requirement that the stipulated amount "must represent the result of a reasonable endeavour by the parties to estimate a fair average compensation for any loss that may be sustained". (*Better Foods Markets Inc. v. American District Telegraph Co.*, 40 Cal. 2d 179, at 185, 253 P. 2d 10, at 15 (Cal. Sup. Ct. 1953)).

[26] The 1977 California amendments also contain provisions respecting the validity of liquidated damages clauses in contracts for the purchase of real property: see California Civil Code, *supra*, note 23, §§ 1675-79.

[27] See *supra*, ch. 6.

We do not anticipate that this change would affect the outcome of many cases, since principles of unconscionability have long been at work in the decided cases, even when not openly acknowledged. Indeed, the doctrine of penalty clauses represents one of the earliest examples of equity's willingness to intervene in cases of unconscionability: an express agreement was set aside because its enforcement would lead to results considered to be extravagant, extortionate, oppressive and unconscionable.[28] However, in an era in which unconscionability was not openly recognized as a ground for relief, the intervention of the courts in this field was explained as a special doctrine peculiar to penalty clauses.

We believe that this failure to recognize unconscionability as the underlying basis of the court's intervention has led to complexities and anomalies. In our view, the open recognition of a test of unconscionability will provide a far more coherent and frank explanation of such results than the present distinction between penalties and liquidated damages. The assimilation of this area of law with unconscionability will ensure that agreements are not struck down by the application of a mechanical rule, but are assessed in accordance with consistent and rational criteria.

A further advantage of subsuming this area of the law under the general rubric of unconscionability is that it would enable the courts to relieve against clauses requiring the payment of money in circumstances other than upon breach of a contractual obligation.[29] Under the unconscionability doctrine, the court would have the power to refuse to enforce a clause, if it was found to be unconscionable, whether the sum was payable on breach of contract or in any other circumstances. In effect, the court would be enabled to look at the substance and not only the form of the obligation.

Having concluded that penalty clauses should be governed by our proposed general doctrine of unconscionability, we turn to consider whether special provisions should be recommended to deal with two particular aspects of stipulated sum clauses. One question concerns the time at which the test of unconscionability should be applied. At common law, the validity of penalty clauses is to be assessed at the date of contract.[30] In principle this seems to us to be correct. The natural time to test the validity of a contractual agreement is at the time a contract is formed. Since our proposed criteria of unconscionability[31]

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28 In *Protector Endowment Loan and Annuity Co. v. Grice* (1880), 5 Q.B.D. 592 (C.A.), at 596, Bramwell L.J. said: "equity in truth refused to allow to be enforced what was considered to be an unconscientious bargain." In *Elsley v. J.G. Collins Insurance Agencies Ltd.*, *supra*, note 16, at 937, Dickson J., as he then was, said the jurisdiction to interfere with penalties "is designed for the sole purpose of providing relief against oppression".

29 See discussion *supra*, this ch., sec. 2(a), at text to notes 11 and 12.

30 See *Clydebank Engineering and Shipbuilding Co. Ltd. v. Castaneda*, [1905] A.C. 6, [1904-7] All E.R. Rep. 251 (H.L. (Scot.)), and *Commissioner of Public Works v. Hills*, [1906] A.C. 368, [1904-7] All E.R. Rep. 919 (P.C. (Cape Good Hope)).

31 *Supra*, ch. 6, Recommendation 4.

require the application of the test at the time of the contract, no special provision is needed on this point in respect of stipulated sum clauses.

A second point requiring consideration is whether a stipulated sum clause should operate as a limit on the defendant's liability in a case where the actual loss exceeds the stipulated sum. In our opinion, there can be no rigid rule on this question. Often the parties will intend that the sum should represent a limit that will operate for the benefit of both parties, and that will usually be the proper conclusion where the sum is described as liquidated damages.[32] In some cases, however, it will be found that the parties did not intend a clause to limit the defendant's liability, and in that case the proper conclusion will be that the plaintiff can disregard the clause and recover the actual loss.[33] In our opinion, this is a question of the construction of the true meaning of the clause in all the circumstances of the particular contract, and we consider that no statutory provision is likely to be of assistance.

Accordingly, we recommend that legislation should be enacted to provide that a contractual provision for payment of a stipulated sum in the event of breach shall not be struck down as penal unless it is unconscionable in accordance with our recommendations relating to unconscionability.

3. RELIEF FROM FORFEITURE OF MONIES PAID

(a) THE PRESENT LAW

It frequently happens in practice that a buyer of goods or services or of land is required to make a deposit at the time the contract is made or to pay part of the purchase price before the contract has been executed by the seller. If the buyer subsequently repudiates his obligations and the contract is cancelled, to what extent can the buyer recover the monies he has paid? The common law takes a different view of the position than does equity, and accordingly we distinguish between the two approaches in the account that follows of the existing law.

The Anglo-Canadian position at common law has been well settled for a considerable time. Penalty doctrines do not apply to the retention of such payments. If the payment is in the form of a deposit the seller is entitled to retain it even though there is no forfeiture clause in the agreement. This has been the authoritative rule since the leading decision of the English Court of Appeal in *Howe v. Smith*[34] and is based on the history of the payment of deposits in Western European law and its security function.[35] It is equally well settled that forfeiture of a deposit does not deprive the seller of the right to sue

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[32] *Elsley v. J.G. Collins Insurance Agencies Ltd.*, *supra*, note 16.

[33] See *Lozcal Holdings Ltd. v. Brassos Developments Ltd.* (1980), 111 D.L.R. (3d) 598, 12 Alta. L.R. (2d) 227 (C.A.).

[34] (1884), 27 Ch. D. 89 (C.A.).

[35] *Ibid.*, at 101-02, *per* Fry L.J.

for damages.[36] If, however, the payment does not satisfy the elusive criterion of a deposit,[37] the seller will not be entitled to retain the payment unless the agreement contains a forfeiture clause. Of course, if there is no forfeiture clause the seller still has the right to sue for damages and to claim a set-off if the buyer seeks the return of his payments. These fairly straightforward propositions were stated by Denning L.J. with his usual clarity in *Stockloser v. Johnson*:[38]

> It seems to me that the cases show the law to be this: (1) *When there is no forfeiture clause*. If money is handed over in part payment of the purchase price, and then the buyer makes default as to the balance, then, so long as the seller keeps the contract open and available for performance, the buyer cannot recover the money; but once the seller rescinds the contract or treats it as at an end owing to the buyer's default, then the buyer is entitled to recover his money by action at law, subject to a cross-claim by the seller for damages ... (2) *But when there is a forfeiture clause or the money is expressly paid as a deposit (which is equivalent to a forfeiture clause)*, then the buyer who is in default cannot recover the money at law at all.

In the same case, Denning L.J. attempted to justify the common law's disparate treatment of penalty clauses and forfeiture clauses on the ground that, in the former case, a seller is seeking to exact a penalty whereas in the latter the seller is merely seeking to retain what he or she already has. Many commentators have not been persuaded by the validity of the distinction and we are not persuaded by it either. We return to this question below. For the moment, it is sufficient to draw attention to some of the practical difficulties engendered by the distinction. First, it raises nice questions of characterization where a seller, after rescission, seeks to enforce a promise to pay a deposit made before the contract was terminated,[39] or where an owner seeks to retain a security deposit made pursuant to a building contract.[40] Second, in Canada at any rate, the parties themselves frequently provide that a deposit or part payment may be retained by the seller as liquidated damages and "not as a penalty",[41] thus suggesting that the distinction is also not drawn in standard contractual documents.

For over a century, equity has been willing to grant some form of relief to a buyer in default under an agreement for the sale of land, by giving the buyer an extension of time to meet his or her obligations under the contract.[42]

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36 *Ibid.*

37 *Gallagher v. Shilcock*, [1949] 2 K.B. 765, at 769, [1949] 1 All E.R. 921, at 922.

38 [1954] 1 Q.B. 476, at 489, [1954] 1 All E.R. 630, at 637 (C.A.) (footnotes omitted, emphasis in original) (subsequent references are to [1954] 1 Q.B.).

39 *Hinton v. Sparkes* (1868), L.R. 3 C.P. 161.

40 *Public Works Commissioner v. Hills*, [1906] A.C. 368; *Waugh v. Pioneer Logging Co.*, [1948] 1 W.W.R. 929 (B.C.C.A.), aff'd [1949] S.C.R. 299, [1949] 2 D.L.R. 577.

41 As, for example, in *Lozcal Holdings Ltd. v. Brassos Developments Ltd.*, *supra*, note 33.

42 See, for example, *In re Dagenham (Thames) Dock Co.* (1873), L.R. 8 Ch. 1022; *Kilmer v. British Columbia Orchard Lands Ltd.*, [1913] A.C. 319, 110 D.L.R. 172 (P.C.); *Steedman v. Drinkle*, [1916] 1 A.C. 275, 9 W.W.R. 1146; *Walsh v. Willaughan* (1918), 42 O.L.R. 455 (App. Div.); and *Mussen v. Van Diemen's Land Co.*, [1938] 1 Ch. 253.

However, until *Stockloser v. Johnson*,[43] it was not clear whether equity's intervention included the power to grant relief from forfeiture of payments made by the buyer by allowing the recovery of such payments. In *Stockloser v. Johnson* the majority of the English Court of Appeal affirmed that power, whether or not the buyer was willing to complete the contract and whether or not the vendor has rescinded. Denning L.J.'s judgment in this case also clarified the conditions under which equity would accede to a request for relief:[44] "first, the forfeiture clause must be of a penal nature, in this sense, that the sum forfeited must be out of all proportion to the damage, and, second, it must be unconscionable for the seller to retain the money." He used the term unconscionable in a broad, non-technical sense and unconscionability, it would seem, is to be determined as of the time of forfeiture and not as of the time when the contract was made.

The wide jurisdiction enunciated in *Stockloser v. Johnson* has been greeted coolly by subsequent lower courts in England[45] and there is apparently no reported case where an English court has granted relief to a defaulting buyer from forfeiture of payments made. Canadian courts have been much more positive in their response. The buyer has sought relief from forfeiture in at least thirteen reported cases between 1954 and 1985,[46] and has succeeded in four. The buyer failed in the other nine cases not because the courts denied their jurisdiction to grant relief, but because they did not feel the buyer had made out a meritorious case. *Stockloser v. Johnson* was also referred to by the Supreme Court of Canada in *Dimensional Investments Ltd. v. The Queen*,[47] but the Court reserved its opinion on the status of the equitable doctrine in Canada.

In Canada, the common law and equitable positions are also affected by various statutory provisions, which are both general and particular in character. The general provision in Ontario is section 111 of the *Courts of Justice Act*,

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43 *Supra*, note 38.

44 *Ibid.*, at 490.

45 See *Galbraith v. Mitchenall Estates Ltd.*, [1965] 2 Q.B. 473, [1964] 2 All E.R. 653; and compare Treitel, *The Law of Contract* (6th ed., 1983), at 757.

46 See *Mitchell v. Agrai-Dairy Mart Ltd.* (1984), 54 A.R. 368 (Q.B.); *British Columbia Development Corp. v. NAB Holdings Ltd.* (1984), 53 B.C.L.R. 240 (S.C.); *Greyhound Lines of Canada Ltd. v. Highfield Corp. Ltd.* (1984), 60 A.R. 304, 35 Alta. L.R. (2d) 15 (Q.B.); *Shelson Investments Ltd. v. Durkovich* (1984), 34 Alta. L.R. (2d) 319, 56 A.R. 367 (Q.B.); *Bordo v. 403512 Ontario Inc.* (1983), 41 O.R. (2d) 68 (H.C.J.); *Dimensional Investments Ltd. v. The Queen*, [1968] S.C.R. 93, (1967), 64 D.L.R. (2d) 632; *Re Province & Central Properties Ltd. and City of Halifax* (1969), 2 N.S.R. (1965-69) 221, 5 D.L.R. (3d) 28 (S.C., App. Div.); *Deber Investments Ltd. v. Roblea Estates Ltd.* (1976), 21 N.S.R. (2d) 158 (S.C., T.D.); *Hughes v. Lukuvka* (1970), 14 D.L.R. (3d) 110, 75 W.W.R. 464 (B.C. C.A.); *Craig v. Mohawk Metal Ltd.* (1975), 9 O.R. (2d) 716, 61 D.L.R. (3d) 588 (H.C.J.); *Can. Union College v. Cansteel Industries Ltd.* (1979), 9 Alta. L.R. (2d) 167 (Dist. Ct.); *Popyk v. Western Savings & Loan Assn.* (1969), 67 W.W.R. 684, 3 D.L.R. (3d) 511 (Alta. C.A.); and *Buck v. Cooper* (1955), 1 D.L.R. (2d) 282 (B.C.S.C.).

47 *Supra*, note 46.

1984[48] affirming the courts' jurisdiction to grant relief from penalties and forfeitures.[49] The significance of the provision is not clear. In *Snider v. Harper*,[50] Stuart J.A. of the Appellate Division of the Supreme Court of Alberta expressed the view that the parallel section in the Alberta Act created a new source of judicial power, whereas in *Emerald Christmas Tree Co. v. Boel & Sons Enterprises Ltd.*[51] the British Columbia Court of Appeal held that the parallel British Columbia provision was only declaratory of the existing law and did not confer a new type of discretion. In any event it seems unlikely that section 111 of the *Courts of Justice Act, 1984* and its predecesors were meant to freeze the courts' discretionary powers to the types of relief available at the time the section was first adopted.

The particular statutory provisions in Canada protecting a buyer's payments differ widely in character. Some, like the provisions in conditional sales legislation,[52] now superseded in Ontario by the *Personal Property Security Act*,[53] seek to protect the buyer's payments by giving him a statutory right to redeem the goods even after they have been repossessed by the seller. The personal property security Acts,[54] on the other hand, contain comprehensive statutory regimes regulating the parties' rights after the debtor's default and in effect making it difficult for a seller to retain the goods *and* any payments made by the buyer without the buyer's consent. Still another example is provided by the Saskatchewan *Agreements of Sale Cancellation Act*[55] which does not permit cancellation of instalment agreements for the sale of land without a court order. These provisions apply only to particular types of transaction. While they may be helpful in indicating what types of relief may be afforded in cases where the normal equitable approach is inadequate or inappropriate, they provide little guidance about the proper scope of the courts' power to grant relief from forfeiture as a matter of general principle. This problem is addressed in the next section.

(b) Issues and Conclusions

The first issue to be considered is whether the law should retain the distinction currently drawn between penalty clauses and forfeiture clauses. There is a superficial attraction to the argument that a contracting party who seeks to recover money under a stipulated damages clause is in a different

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48 *Supra*, note 4.

49 *Ibid.*

50 (1922), 18 Alta. L.R. 82, at 84, 66 D.L.R. 149, at 151 (C.A.).

51 (1979), 13 B.C.L.R. 122, 8 R.P.R. 143 (C.A.). See, also, *Liscumb v. Provanzo* (1986), 55 O.R. (2d) 404 (C.A.), aff'g (1985), 51 O.R. (2d) 129 (H.C.J.).

52 The earliest Ontario provisions appeared in 1888: see *An Act respecting Conditional Sales of Chattels*, S.O. 1888, c. 19, ss. 4-5. Similar provisions were subsequently adopted in many of the other provincial conditional sales Acts.

53 R.S.O. 1980, c. 375.

54 See, for example, the Ontario *Personal Property Security Act*, *ibid.*, Part V.

55 R.S.S. 1978, c. A-7.

position from a party who merely seeks to retain what he or she already has. As we have already indicated, however,[56] the distinction breaks down in practice. It is further undermined by the fact that in the very case in which he justified the distinction, *Stockloser v. Johnson*,[57] Denning L.J. was prepared to give the courts broad powers to relieve against forfeiture of monies paid. In our view, once this concession is made, the distinction becomes wholly untenable. In reaching this conclusion we have the support of an impressive list of precedents, including section 2-718(2) and (3) of the American Uniform Commercial Code,[58] section 2-516(c) of the American Uniform Land Transactions Act,[59] and section 374 of the *Second Restatement of the Law of Contracts*.[60] These provisions all afford relief to a party in breach from the effects of a forfeiture clause on the same basis as relief from the terms of a liquidated damages clause. We note as well that the English Law Commission has argued in favour of

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56 *Supra*, this ch., sec. 3(a).

57 *Supra*, note 38.

58 *Supra*, note 19.

59 National Conference of Commissioners on Uniform State Laws, Uniform Laws Annotated: Civil Procedural and Remedial Laws (1975). Section 2-516 provides as follows:

> 2-516.-(a) Damages for breach by either party may be liquidated in the agreement, but only in an amount that is not unreasonable in the light of the anticipated or actual harm caused by the breach, the time the real estate is withheld from the market, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A provision for unreasonably large liquidated damages is void.
>
> (b) A party entitled to recover under a valid liquidated-damages clause has no other remedy for any breach to which the liquidated-damages clause applies unless other remedies are expressly reserved in the contract.
>
> (c) Except as provided in subsection (d), if a seller justifiably withholds conveyance of real estate because of the buyer's breach, the buyer is entitled to restitution of any amount by which the sum of his payments exceeds the amount to which the seller is entitled under provisions liquidating the seller's damages in accordance with subsection (a).
>
> (d) The buyer's right of restitution under subsection (c) is subject to offset to the extent of:
>
> (1) the seller's right to recover damages under the provisions of this Article other than subsection (a); and
>
> (2) the amount or value of any benefits received by the buyer under the contract.
>
> (e) If a seller has received payment in property other than money, its value determined by the provisions of the contract or, if not so determinable, the fair market value on the date of the agreement shall be treated as payments for the purposes of subsection (c).

60 *Supra*, note 20. Section 374 provides as follows:

> 374.-(1) Subject to the rule stated in Subsection (2), if a party justifiably refuses to perform on the ground that his remaining duties of performance have been discharged by the other party's breach, the party in breach is entitled to restitution for any benefit that he has conferred by way of part performance or reliance in excess of the loss that he has caused by his own breach.

assimilating the law of forfeiture of deposits to that of liquidated damages and penalties, subject to an exception for deposits on contracts for the purchase of land.[61]

The second issue is what should be the common basis of relief. Since we have recommended a test of unconscionability for relief from penalty clauses, the same test should logically be applied to forfeiture clauses, and we so recommend. We do not support the double test for relief from forfeiture clauses favoured by Denning L.J. in *Stockloser v. Johnson* because it seems to us unnecessarily complicated. In any event we believe that, in determining the reasonableness of a forfeiture provision, the courts will take into consideration the damages likely to be suffered by the party not in breach if the other party fails to honour his or her obligations.

We note that the English Law Commission considered, but rejected, the possibility of giving the courts a general power to relieve against forfeiture if it is reasonable to do so, on the ground that this approach would lead to too much uncertainty.[62] The same charge could be levelled against our proposal. However, we have already indicated why, in our view, the existing law is considerably less certain and more intrusive on freely bargained agreements than the criteria we have proposed to determine unconscionability.[63]

A more persuasive case can perhaps be made in favour of allowing the party not in breach to retain payments received by him or her up to a maximum amount or an amount that does not exceed a prescribed percentage of the sale price. Precedents along these lines can be found in the Uniform Commercial Code[64] and in the California Civil Code.[65] The adoption of similar provisions was also considered by the English Law Comission.[66] Their justification is that they avoid unnecessary litigation and promote greater certainty. While we are obviously sympathetic to both these goals, we have reached the conclusion after careful consideration that any fixed dollar amount or percentage of the price allowed to be retained by the party not in breach is bound to be arbitrary and that using such criteria even as presumptive guidelines in general legislation may do more harm than good. We have not investigated the desirability of adopting this approach for particular types of contract and express no views on the question one way or the other.

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(2) To the extent that, under the manifested assent of the parties, a party's performance is to be retained in the case of breach, that party is not entitled to restitution if the value of the performance as liquidated damages is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss.

61 Working Paper No. 61, *supra*, note 18, paras. 59 and 60, at 44-45.

62 *Ibid.*, para. 65, at 48.

63 *Supra*, this ch., sec. 2(c).

64 *Supra*, note 19, § 2-718(2).

65 *Supra*, note 23, § 1675.

66 Working Paper No. 61, *supra*, note 18, para. 66, at 49.

A third, and more particular, issue is whether special legislation is desirable with respect to land instalment contracts. Such contracts are in substance realty mortgages, since the buyer is already in possession of the land and the vendor is only retaining title by way of security until the buyer has completed paying the price. Accordingly, there is much to be said for collapsing the distinction between mortgage transactions and instalment sales of land, as has been done in Article 3 of the Uniform Land Transactions Act.[67] However, we have not found it necessary to reach a firm conclusion on the point in the context of this Project, in view of our current Project on the Law of Mortgages, now near completion. That Project deals with all transactions that are in substance realty mortgages, and the *Report on the Law of Mortgages* will contain the Commission's recommendations concerning what statutory changes, if any, are desirable with respect to the common law treatment of land instalment contracts.

A final issue to which we wish to direct attention concerns the disposition of section 111 of the *Courts of Justice Act, 1984*. As we have noted,[68] there is some doubt about the scope of the powers conferred on Ontario courts under this section. We would expect the courts to follow the reasoning of the British Columbia Court of Appeal in *Emerald Christmas Tree Co. v. Boel & Sons Enterprises Ltd.*[69] but, whether or not this assumption is correct, the section does no harm and we would leave it alone.

Recommendations

The Commission makes the following recommendations:

1. The existing penalty doctrine to determine the validity of stipulated damages clauses should be replaced by a test of unconscionability, the criteria for which should be the same as those recommended in this Report for other types of contractual provisions alleged to be unconscionable.

2. Relief from forfeiture of payments made under a contract should be based on the same test of unconscionability, and the existing distinction between the basis of relief for penalty clauses and relief from forfeiture clauses should be abolished.

3. Section 111 of the *Courts of Justice Act, 1984* should be retained.

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67 *Supra*, note 59.

68 *Supra*, this ch., sec. 3(a).

69 *Supra*, note 51.

CHAPTER 8

PAROL EVIDENCE RULE

1. THE PRESENT LAW AND THE CASE FOR REFORM

The traditional statement of the parol evidence rule is, "if there be a contract which has been reduced into writing, verbal evidence is not allowed to be given of what passed between the parties, either before the written instrument was made, or during the time that it was in a state of preparation, so as to add to or subtract from, or in any manner to vary or qualify the written contract".[1] Theoretically, the rule should not preclude the parties from establishing that their real agreement does not consist in the document before the court, but rather in: (1) some other document; (2) a mixture of documents; (3) a mixture of documentary material and an oral agreement; or (4) simply an oral agreement. That is, evidence going to whether or not an agreement has been reduced to writing should be relevant to a decision whether the parol evidence rule applies.

Nevertheless, a great deal of ambiguity surrounds the rule with the result that, as applied by the courts, the rule does have the effect, in many situations, of excluding extrinsic evidence of arrangements allegedly agreed to by the parties, but not included in and conflicting with the written document presented by one party as representing the whole agreement.[2] This is particularly true

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[1] *Goss v. Nugent* (1833), 5 B. & Ad. 58, at 64-65, 110 E.R. 713, at 716, *per* Denman C.J. The rule is not limited to *parol* (oral) evidence, it also applies to other forms of extrinsic evidence including written evidence. See Treitel, *The Law of Contract* (6th ed., 1983), at 151.

For a general discussion of the rule and exceptions to it, see: Sopinka & Lederman, *The Law of Evidence in Civil Cases* (1974), at 269-78; Treitel, *supra*, this note, at 151-58; Fridman, *The Law of Contract in Canada* (1976), at 245-48; Waddams, *The Law of Contracts* (2d ed., 1984), at 233-56; Cross, *Evidence* (5th ed., 1979), at 611-15; and Ontario Law Reform Commission, *Report on Sale of Goods* (1979) (hereinafter referred to as "Sales Report"), Vol. I, at 110-17.

[2] See, for example, *Hawrish v. Bank of Montreal*, [1969] S.C.R. 515, 2 D.L.R. (3d) 600; *Bauer v. Bank of Montreal*, [1980] 2 S.C.R. 102, 110 D.L.R. (3d) 424 (subsequent references are to [1980] 2 S.C.R.); *Carman Construction Ltd. v. Canadian Pacific Railway Co.*, [1982] 1 S.C.R. 958, 136 D.L.R. (3d) 193; *Hayward v. Mellick* (1984), 45 O.R. (2d) 110, 5 D.L.R. (4th) 740 (C.A.); and *Chant v. Infinitum Growth Fund* (1986), 55 O.R. (2d) 366, 28 D.L.R. (4th) 577 (C.A.); but compare *Gallen v. Allstate Grain Co.* (1984), 9 D.L.R. (4th) 496, 53 B.C.L.R. 38 (C.A.), leave to appeal to the Supreme Court of Canada denied (1984), 56 N.R. 233 (subsequent references are to (1984), 9 D.L.R. (4th)).

where a written version of an agreement contains an integration clause.[3] To the extent that the rule is applied to exclude extrinsic evidence of additional or inconsistent terms, it reflects a judicial preference for written over oral evidence. Regardless of whether such a preference is justified in some or even most circumstances, courts often have not made it clear that the rule operates only where it is possible to conclude that the parties have intended the writing to constitute their whole agreement.[4]

In addition, the methods by which a court may arrive at the conclusion that a document represents the parties' whole agreement are not clear. It is obvious that a written memorandum that records only a part of an agreement between the parties should not be enforced by the courts as though it represented the entire agreement. At the same time, when parties have agreed to reduce their contract to writing, and have intended that prior representations be superseded by that writing, those intentions should be respected by the courts. The confusion associated with the parol evidence rule arises from the difficulty of differentiating between evidence going to whether the writing represents the parties' agreement, and evidence that adds to, varies, or contradicts the writing. At times, courts have resolved this difficulty by considering all the evidence, so that the parol evidence rule would seem redundant to the principle that the parties' real agreement should be enforced.[5] At other times, courts have given emphasis to the rule as an exclusionary device, reasoning that where the writing "appears" to be the whole contract further evidence of the parties' intentions and negotiations should not be considered.[6] It has been suggested that a document in writing raises a strong presumption that it contains the whole agreement between the parties.[7]

Uncertainty associated with the parol evidence rule also arises from the many exceptions to it developed by the courts.[8] For example, it is generally

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[3] See, for example, *Hawrish v. Bank of Montreal*, *supra*, note 2. An integration clause states that the writing contains the whole agreement between the parties.

[4] Corbin, *Corbin on Contracts* (1960), Vol. 3, § 573, and Dawson, "Parol Evidence, Misrepresentation and Collateral Contracts" (1982), 27 McGill L.J. 403, at 405.

[5] *J. Evans & Son (Portsmouth) Ltd. v. Andrea Merzario Ltd.*, [1976] 1 W.L.R. 1078, [1976] 2 All E.R. 930 (C.A.) (subsequent references are to [1976] 1 W.L.R.); *Mendelssohn v. Normand Ltd.*, [1970] 1 Q.B. 177, [1969] 2 All E.R. 1215 (C.A.) (subsequent reference is to [1970] 1 Q.B.); *Canadian Acceptance Corp. v. Mid-Town Motors Ltd.* (1970), 72 W.W.R. 365 (Sask. Dist. Ct.); and see, also, Dawson, *supra*, note 4, at 403.

[6] See *Inglis v. Buttery & Co.* (1878), 3 App. Cas. 552 (H.L.), at 558, 572, and 577; *Henderson v. Arthur*, [1907] 1 K.B. 10 (C.A.); and *Kaplan v. Andrews*, [1955] 4 D.L.R. 553 (Ont. C.A.).

[7] Wedderburn, "Collateral Contracts", [1959] Camb. L.J. 58, at 60-62. See, also, England, The Law Commission, Report No. 154, *Law of Contract: The Parol Evidence Rule* (Cmnd. 9700, 1986) (hereinafter referred to as "Law Com. No. 154"), para. 2.13, at 11-12.

[8] For a more detailed discussion of the exceptions to the rule see: England, The Law Commission, Working Paper No. 70, *Law of Contract: The Parol Evidence Rule* (1976)

accepted that if assent to a document is obtained by fraud or as a result of innocent misrepresentation as to the effect of the document or any of its terms, at the very least the document may not bind totally.[9] As well, the courts have always been willing to listen to and to give effect to evidence that a document is conditional[10] or that a consideration stated in a deed was not paid.[11] Rectification may be allowed where an agreed term of a contract is incorrectly recorded in or omitted from the signed document,[12] and may be available in cases where one party knowingly takes advantage of another party's mistake.[13] Indeed, the fictions of independent representations and separate collateral contracts have been called in aid to allow the courts to look beyond apparently complete written contracts.[14]

The English Court of Appeal took a very open approach to the admissibility of extrinsic evidence in *J. Evans & Son (Portsmouth) Ltd. v. Andrea Merzario Ltd.*[15] In that case, it was held that breach of an oral assurance that goods would be carried below deck gave rise to a cause of action in damages and overrode exemption clauses in the written contract, including a clause giving the defendants complete freedom as to the mode of carriage. Lord

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(hereinafter referred to as "Working Paper No. 70"), paras. 10-21, at 6-13; Law Com. No. 154, *supra*, note 7, paras. 2.30-2.31, at 18-19; and Law Reform Commission of British Columbia, *Report on Parol Evidence Rule* (1979) (hereinafter referred to as "British Columbia Report"), at 8-10.

9 See, for example, *Curtis v. Chemical Cleaning and Dyeing Co.*, [1951] 1 K.B. 805, [1951] 1 All E.R. 631 (C.A.); *Mendelssohn v. Normand Ltd.*, *supra*, note 5; *Royal Bank v. Hale* (1961), 30 D.L.R. (2d) 138 (B.C.S.C.); and *Ballard v. Gaskill*, [1955] 2 D.L.R. 219, 14 W.W.R. 519 (B.C.C.A.). See, also, *Bauer v. Bank of Montreal*, *supra*, note 2, at 111, and *Bank of Nova Scotia v. Zackheim* (1983), 44 O.R. (2d) 244, 3 D.L.R. (4th) 760 (C.A.).

10 See, for example, *Pym v. Campbell* (1856), 6 E1. & B1. 370, 119 E.R. 903. There, the defendants agreed to pay a price for a share in an invention. The court allowed evidence to show that the agreement was dependent on the approval of the invention by the defendants' engineers.

11 See, for example, *In Re Lang Estate*, [1919] 1 W.W.R. 651 (Sask. K.B.). There, the defendant bought land and gave her husband a quit claim deed to enable him to vote in the area where the land was situated. Although the deed stated a consideration, evidence was permitted to show that it was not paid and that therefore the defendant was the rightful owner of the property.

12 See, for example, *Bercovici v. Palmer* (1966), 59 D.L.R. (2d) 513, 58 W.W.R. 111 (Sask. C.A.).

13 See, for example, *Coderre (Wright) v. Coderre*, [1975] 2 W.W.R. 193 (Alta. S.C.).

14 See, for example, *Gallen v. Allstate Grain Co.*, *supra*, note 2; *Sperry Rand Canada Ltd. v. Thomas Equipment Ltd.* (1982), 135 D.L.R. (3d) 197, 40 N.B.R. (2d) 271 (C.A.); *Canadian Acceptance Corp. v. Mid-Town Motors Ltd.*, *supra*, note 5; *DeLassalle v. Guildford*, [1901] 2 K.B. 215, [1900-3] All E.R. Rep. 495 (C.A.); *Brikom Investments Ltd. v. Carr*, [1979] Q.B. 467, [1979] 2 All E.R. 753 (C.A.); and *Ferland v. Keith* (1958), 15 D.L.R. (2d) 472 (Ont. C.A.).

15 *J. Evans & Son (Portsmouth) Ltd. v. Andrea Merzario Ltd.*, *supra*, note 5.

Denning M.R. was not prepared to attribute much presumptive weight to such clauses in standard form contracts, and quoted[16] from his own earlier judgment in *Mendelssohn v. Normand*[17] to the effect that such contracts may be rejected when repugnant to an express oral promise or misrepresentation. In *Evans*, Lord Denning held that the oral assurance constituted a collateral contract. Roskill and Lane L.J.J., on the other hand, were of the opinion that it was simply a case of looking at all the evidence to ascertain the real bargain between the parties.[18] That evidence revealed a promise to carry the cargo below deck, notwithstanding appearances to the contrary in the writing. The parol evidence rule was said to have "little or no application where one is not concerned with a contract in writing ... but with a contract which ... was partly oral, partly in writing, and partly by conduct".[19]

The decision of the Court of Appeal evinces judicial confidence in the ability of the courts to work out the real terms of a bargain by reference to all of the circumstances, including, but not limited to, the existence of a written contract that appears to embody the whole agreement. This assertion of competence accords with the courts' willingness in the past to look at the surrounding circumstances where the applicable legal doctrine so demands.

So far in Ontario, legislative modification of the parol evidence rule has been quite limited. However, it is important to note that section 4(7) of the Ontario *Business Practices Act*[20] provides that extrinsic evidence is admissible in civil actions to prove false, misleading, deceptive or unconscionable consumer representations, notwithstanding the existence of a written agreement or "that the evidence pertains to a representation of a term, condition or undertaking that is or is not provided for in the agreement".

2. THE POSITION AND PROPOSALS FOR REFORM IN OTHER JURISDICTIONS

(a) UNITED STATES

Section 2-202 of the Uniform Commercial Code[21] provides:

> 2-202. Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included

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16 *Ibid.*, at 1082.

17 *Mendelssohn v. Normand Ltd.*, *supra*, note 5, at 184.

18 *J. Evans & Son (Portsmouth) Ltd. v. Andrea Merzario Ltd.*, *supra*, note 5, at 1083, *per* Roskill, L.J.

19 *Ibid.*

20 R.S.O. 1980, c. 55.

21 American Law Institute, Uniform Commercial Code, Official Text (9th ed., 1978).

> therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented
>
> (a) by course of dealing or usage of trade (Section 1-205) or by course of performance (Section 2-208); and
>
> (b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

All of the states except Louisiana, as well as the District of Columbia, the Virgin Islands and Guam have adopted section 2-202 of the Uniform Commercial Code as part of Article 2 of the Code.[22] The section reflects the view that what constitutes the parties' contract depends on what the parties intended. Force is attributed to a seeming contractual document only to the extent that the parties so intended and such documents are to be regarded as complete and exhaustive only if the parties so intended. While this suggests a very liberal view of the admissibility of extrinsic evidence, in practice American courts have often shown themselves quite conservative. This is due to a variety of factors, including the widespread use of merger clauses in agreements, frequent resort to jury trials in civil suits, and a deeply seated judicial conservatism.

(b) ENGLAND

The English Law Commission, in a Working Paper published in 1976,[23] provisionally recommended that the parol evidence rule be abolished.[24] In the opinion of the Law Commission, as expressed in the Working Paper, the rule "at best, adds to the complications of litigation without affecting the outcome and, at worst, prevents the courts from getting at the truth".[25] In reaching its conclusion, the Law Commission emphasized the extensive exceptions to the rule, and wondered whether the rule itself had not been "largely destroyed".[26] In its view, judicial efforts at adapting the parol evidence rule to take account of "the habits of mankind" had substantially undermined the certainty and finality that were supposed to be the advantages of the rule.[27]

The Law Commission expected that, even with the abolition of the rule, most cases would be resolved exactly as before, with the difference that judicial reasons would refer openly to the parties' intentions rather than to a technical rule of uncertain ambit or one of the exceptions to it.[28]

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22 *Ibid.*, Cumulative Annual Pocket Part 1985, at 1-2.

23 Working Paper No. 70, *supra*, note 8.

24 *Ibid.*, para. 43, at 25.

25 *Ibid.*

26 *Ibid.*, para. 21, at 13.

27 *Ibid.*, para. 25, at 16.

28 *Ibid.*, para. 41, at 24.

The Commission's final *Report on the Parol Evidence Rule*[29] was issued in 1986. In that Report, the Commission reversed its earlier position concerning abolition of the rule. Based upon its analysis of the law, the Commission concluded as follows:[30]

> [T]he parol evidence rule, in so far as any such rule of law can be said to have an independent existence, does not have the effect of excluding evidence which ought to be admitted if justice is to be done between the parties. Those authorities which, it may be argued, support the existence of a rule which would have that effect would, in our view, be distinguished by a court today and not followed. Evidence will only be excluded when its reception would be inconsistent with the intention of the parties. While a wider parol evidence rule seems to have existed at one time, no such wider rule could, in our view, properly be said to exist in English law today.

The Commission accordingly recommended against legislation that would effect any change in the law. Acknowledging that the conclusions contained in the final Report differed from those expressed in the Working Paper, the Law Commission stated:[31]

> [T]he fact that different conclusions are expressed in the working paper and this report as to the nature of the parol evidence rule is, in our opinion, almost entirely irrelevant to the practical working of the law and to the way in which cases are decided or settled. Acceptance of the conclusions reached in this report will, for all practical purposes, lead to the same end result as that intended by those who wrote the working paper. When the working paper was published there was then no evidence of courts being compelled by the working of any parol evidence rule to decide cases in a way which appeared to be unjust. The working paper stated that so effective and extensive were the exceptions to the rule that 'the scope of the rule, if not its existence, is doubtful'. This report, in short, is concerned with a question of legal analysis which is of importance in legal theory but does not, in our view, affect the way in which cases are required by law to be decided in courts or tribunals.

The Commission also recommended against legislation to clarify or declare the effect of the law. In the view of the Commission, such legislation would be "difficult to draft, uncertain of effect and ... unnecessary".[32]

(c) BRITISH COLUMBIA

The Law Reform Commission of British Columbia has recommended abolition of the parol evidence rule. In its 1979 *Report on Parol Evidence Rule*,[33] the Commission reviewed the arguments in favour of retaining the rule, including certainty, finality and the economic benefits of narrowing the issues

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[29] Law Com. No. 154, *supra*, note 7.

[30] *Ibid.*, para. 2.45, at 27.

[31] *Ibid.*, para. 1.8, at 4 (footnote reference deleted).

[32] *Ibid.*, para. 1.7, at 4 (footnote reference deleted).

[33] British Columbia Report, *supra*, note 8.

by excluding extrinsic evidence.[34] With respect to certainty, the Commission commented that the rule merely "promotes a sense of security that may not always be warranted regarding the potency of the written document *vis-à-vis* the parol agreement".[35] Moreover, the Commission observed, there is no clear evidence that the rule in fact contributes to finality, or to a narrowing of the issues in litigation.[36] In favour of abrogation of the rule, the Commission considered that, in the context of contract law, "fairness and justice means meeting the legitimate expectations of the parties by giving effect to the whole of their agreement".[37] This end would not be furthered, in the opinion of the British Columbia Commission, by a technical rule the effect of which has been to exclude evidence relevant to that agreement.

The Commission recognized that abrogation of the rule might in some cases be unfair to a party who, in the interests of certainty, has attempted to reduce an agreement to writing. However, the Commission concluded that, on balance, justice would best be served by permitting the courts "to examine *all* the evidence and give it whatever weight is appropriate ... ".[38]

3. PROPOSALS FOR REFORM

In our *Sales Report* we considered whether the parol evidence rule should be abolished or relaxed in connection with the law of sale of goods.[39] We concluded in that context that the rule caused greater harm than it was designed to avoid and should be abolished, and that merger or integration clauses should have no conclusive effect. Section 4.6 of the draft Bill accompanying that Report provides as follows:[40]

> 4.6 The parol evidence rule does not apply to contracts for the sale of goods and a provision in a writing purporting to state that the writing represents the exclusive expression of the parties' agreement has no conclusive effect.

The Uniform Law Conference of Canada adopted this section in principle, but opted for less compressed language, as follows:[41]

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[34] *Ibid.*, at 14.

[35] *Ibid.*

[36] *Ibid.*

[37] *Ibid.*, at 15.

[38] *Ibid.*, at 16.

[39] *Supra*, note 1, at 110-17.

[40] *Ibid.*, Vol. 3, at 20.

[41] Uniform Law Conference of Canada, *Proceedings of the Sixty-third Annual Meeting* (1981), at 34 and 189-90. And see Uniform Law Conference of Canada, *Proceedings of the Sixty-fourth Annual Meeting* (1982), Appendix HH, s. 17.

> 17. No rule of law or equity respecting parol or extrinsic evidence and no provision in a writing prevents or limits the admissibility of evidence to prove the true terms of the agreement, including evidence of any collateral agreement or representation or evidence as to the true identity of the parties.

The question for us now is whether we should extend our recommendations on the parol evidence rule in the *Sales Report* beyond the sales context. It seems to us that the reasons we gave in 1979 favouring abolition of the rule are as cogent today as they were then, and apply as forcefully to the law of contracts generally as to the law of sale of goods. It is clear from recent Ontario decisions that the parol evidence rule continues to have force in Ontario,[42] so that we cannot conclude, as could the English Law Commission, that the common law has arrived at a satisfactory state.

We recognize that it may be argued that the parol evidence rule, insofar as it serves to increase the weight attaching to written documents, contributes to certainty. Seaton J.A. has commented to this effect, although with the *caveat* that he is "not attracted to deciding a point by refusing to hear evidence on an aspect of it":[43]

> I would favour retention of a respect for the written contract that makes it difficult to persuade the court that a term not recorded was intended to be part of the bargain.
>
> I do not see how people can safely act through an agent or take an assignment of a contract if written documents are not treated with some respect. Lawyers cannot give useful advice to people considering whether to contract if the written part is of little importance. Certainty, though no longer the only aim, remains an important aim in contract law.

We agree that written documents should not be set aside lightly in favour of evidence of oral representations. At the same time, we do not believe that the parol evidence rule is necessary to ensure continued judicial respect for written documents. Rather, we would endorse the approach taken by the English Court of Appeal in *Evans*,[44] which held that the court is best able to gauge the real agreement between the parties by reviewing all the relevant evidence. We believe that the rule is at odds with the principle that contracts should be enforceable. To exclude evidence of the terms of a contract is to contradict that principle.

Particularly in light of the prevalence of standard form contracts, we worry about a rule that reinforces the position of the party in a stronger position and enables that party, if the rule is rigorously applied, to walk away from prior or contemporaneous statements with impunity. Moreover, given the lack of clarity in the case law as to the proper interpretation and application of the rule, and the many exceptions to the rule, we are not convinced that it conduces to

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[42] See text accompanying notes 2 and 3, *supra*, this ch., sec. 1.

[43] *Gallen v. Allstate Grain Co.*, *supra*, note 2, at 501 (in dissent).

[44] *J. Evans & Son (Portsmouth) Ltd. v. Andrea Merzario Ltd.*, *supra*, note 5.

certainty in the law. On the contrary, we believe that the rule often has the effect of obscuring the real reasons for decisions. The rule invites judicial recourse to technical exceptions to it, and fictitious devices to avoid it.

Accordingly, we conclude that our recommendations with respect to the parol evidence rule and merger and integration clauses in the *Sales Report* should be extended to the law of contracts generally. We consider the language of section 17 of the *Uniform Sale of Goods Act* effective, and recommend that a similar provision be enacted in Ontario, which would be applicable to all types of contract.

Recommendations

The Commission makes the following recommendations:

1. (a) Evidence of oral agreement to terms not included in, or inconsistent with, a written document should be admissible to prove the real bargain between the parties.

   (b) Conclusive effect should not be attached to merger and integration clauses.

2. In order to give effect to the abovementioned recommendations, a provision similar to section 17 of the *Uniform Sale of Goods Act*, but applicable to all types of contracts, should be enacted.

CHAPTER 9

GOOD FAITH

1. THE PRESENT LAW

(a) INTRODUCTION

While the conceptual roots of a good faith requirement in contract law can be traced back to Roman times,[1] the status of such a requirement in Canadian contract law remains uncertain. Strictly speaking, the common law of contracts has yet to acknowledge good faith as a generalized and independent doctrine. In an important lecture delivered in 1956 on the nature and extent of good faith in English contract law, Professor Powell concluded that "in English law there is no overriding general positive duty of good faith imposed on the parties to a contract".[2] A more recent study by an American scholar has prompted an even more radical assessment: "[T]he English courts appear to be moving *away* from the Roman concept of 'good faith' in contractual dealings".[3]

Although this latter assessment is probably overstated, the basic point remains beyond dispute. None of the leading English textbooks list "good faith" in either the table of contents or in the index.[4] Amongst the Canadian texts only Waddams, in *The Law of Contracts*,[5] has attempted to unravel and identify the various strands of good faith analysis that seem to permeate many of the more traditional judicial techniques and legal doctrines in Canadian contract law. Other Canadian textbooks appear to follow the lead of their English counterparts and make no mention of good faith, either in the table of contents or in the index.[6] Thus, thirty years later, Professor Powell's assessment of the status of good faith as a doctrinally independent contractual concept remains correct.

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[1] See Powell, "Good Faith in Contracts" (1956), 9 Current Legal Prob. 16, at 20.

[2] *Ibid.*, at 25.

[3] Thigpen, "Good Faith Performance Under Percentage Leases" (1980-81), 51 Miss. L.J. 315, at 321 (emphasis added).

[4] The sample surveyed included: Atiyah, *An Introduction to the Law of Contract* (3d ed., 1981); Guest, *Anson's Law of Contract* (25th ed., 1984); Furmston (ed.), *Cheshire and Fifoot's Law of Contract* (10th ed., 1981); Guest *et. al.* (eds.), *Chitty on Contracts* (25th ed., 1983); and Treitel, *The Law of Contract* (6th ed., 1983).

[5] Waddams, *The Law of Contracts* (2d ed., 1984), at 365-76 and 400-05.

[6] The sample surveyed included Fridman, *The Law of Contract in Canada* (1976), and Mueller, *Contracts* (1981).

This is not to suggest, however, that good faith plays no role in contract law in Canada. The language of good faith appears in literally hundreds of Canadian federal and provincial statutes. A recent computer search of federal legislation, for example, revealed no less than forty-seven statutes with 153 statutory provisions using the language of good faith, and doing so virtually without further definition.[7] A further computer search of provincial legislation employing good faith language resulted in equally impressive findings: in British Columbia, some ninety-six statutes with 168 statutory provisions requiring good faith were found; in New Brunswick, the search revealed fifty-five such statutes, with 101 statutory good faith provisions; and, in Ontario, some 285 statutory provisions, in 156 statutes, were found to have a good faith requirement.[8] The statutory good faith provisions related to a variety of substantive areas, including banking, trade marks, assignment of book debts and warehouse receipts;[9] and seemed to perform a variety of functions, including procedural, prescriptive and proprietary functions.[10]

It is also significant that, while good faith is not yet an openly recognized contract law doctrine, it is very much a factor in everyday contractual transactions.[11] To the extent that the common law of contracts, as interpreted and developed by our courts, reflects this reality, it is accurate to state that good faith is a part of our law of contracts.

In this vein, a great many well-established concepts in contract law reflect a concern for good faith, fair dealing and the protection of reasonable expectations, creating a legal behavioural baseline. We propose now to consider

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[7] Belobaba, "Good Faith in the Law of Contract" (1982), Appendix A. Unpublished paper undertaken for the Ontario Law Reform Commission's Law of Contract Amendment Project. A copy of this paper is available at the Legislative Library, Legislative Building, Queen's Park, Toronto.

[8] *Ibid.*, Appendix B. Of the provincial legislation found to require good faith, definitions of good faith were found only in sale of goods legislation. See Belobaba, *ibid.*, at 6, *n.* 27.

[9] *Ibid.*, Appendices A and B.

[10] *Ibid.*, at 6, *n.* 29. Procedural good faith provisions include, for example, the wide range of good faith defences for technical irregularities in statutory procedures, or for non-compliance with certain orders or requirements. Prescriptive good faith provisions include various good faith obligations imposed on bodies or persons charged with statutory responsibilities. Proprietary good faith provisions include the many statutory protections of purchasers for value in good faith without notice.

[11] See, generally, Beale and Dugdale, "Contracts Between Businessmen: Planning and the Use of Contractual Remedies" (1975), 2 Brit. J. L. & Soc. 45; Macaulay, "Non-Contractual Relations in Business: A Preliminary Study" (1963), 28 Am. Soc. Rev. 55; Macaulay, "The Use and Non-Use of Contracts in the Manufacturing Industry" (1963), 9(7) Prac. Law. 13; Macaulay, "Elegant Models, Empirical Pictures, and the Complexities of Contract" (1977), 11 Law & Soc. Rev. 507; Macneil, "Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law" (1978), 72 Nw. U. L. Rev. 854; and Macneil, *The New Social Contract: An Inquiry into Modern Contractual Relations* (1980).

judicial recourse to notions of good faith in our law of contracts.[12] For convenience, the discussion may be divided into two parts: good faith in contract negotiation and formation, and good faith in the performance and enforcement of contracts.

(b) Good Faith in Contract Negotiation and Formation

In contrast to the well-developed range of remedies available at common law for breach of contract, there is no comprehensive set of remedies for wrongdoing in contract formation and negotiation. Nonetheless, our courts have provided remedies in situations where pre-contractual negotiations were conducted in what might commonly be perceived as bad faith. Some of these remedies — for example, in negligence and by way of promissory estoppel — were discussed in chapter 2 of this Report, in the context of the doctrine of consideration. We there expressed the view that the existing law is inadequate in its protection of reasonable reliance on pre-contractual representations, and recommended legislative intervention in this connection.[13]

As we stated in our *Report on Sale of Goods*,[14] if reforms of the sort that we have now proposed in respect of the doctrine of consideration were implemented, the need for a general legislated requirement of good faith in bargaining would be much diminished, although not totally eliminated. The question whether such a requirement should be enacted to supplement our proposed increased protection of reliance interests is addressed in a later section of this chapter.[15]

(c) Good Faith in Contract Performance and Enforcement

Although good faith is not explicitly recognized as an independent doctrine in Anglo-Canadian contract law, there are many instances where good faith and fair dealing can be said to be required in the performance and enforcement of contracts. While it would be almost impossible to list all such instances, it may be useful to review some of the more common ways in which concepts of good faith and fair dealing shape our law of contracts.

It is not unusual for a court to imply a term in a contract that is suggestive of good faith and fair dealing. In some cases, a court may imply terms that give effect to the presumed intentions of the parties to produce results that are not

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[12] See, also, Bridge, "Does Anglo-Canadian Contract Law Need a Doctrine of Good Faith?" (1984), 9 Can. Bus. L.J. 385, at 409-12.

[13] *Supra*, ch. 2, sec. 4(d).

[14] Ontario Law Reform Commission, *Report on Sale of Goods* (1979) (hereinafter referred to as "Sales Report"), Vol. 1, at 169.

[15] *Infra*, this ch., sec. 4.

absurd or unfair.[16] For example, courts have required that a party give reasonable notice of termination of employment,[17] and that a party give reasonable notice before cancelling a licensing agreement.[18]

In situations where parties have agreed to a bargain and are less than diligent in performing or wilfully refuse to perform their contractual obligations, the courts have employed interpretive techniques, including the implication of a "best efforts" or "due diligence" obligation to ensure some level of good faith behaviour.[19] Where a party interferes or fails to cooperate with the other party's performance of the contract, judicial remedies are likewise available.[20]

Canadian courts have also required that contracting parties not abuse their discretionary powers to specify contractual terms in open term contracts[21] or to terminate contracts unilaterally.[22] Furthermore, in instances where the right to determine contractual compliance rests with a party to the contract or with a third party, that determination must be made in good faith.[23]

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16 See, for example, *Town of Fort Frances v. Boise Cascade Canada Ltd.*, [1983] 1 S.C.R. 171, 143 D.L.R. (3d) 193, and *Mercantile Bank v. Sigurdson* (1978), 86 D.L.R. (3d) 680, [1978] 3 W.W.R. 523 (B.C.S.C.); and compare *Liverpool City Council v. Irwin*, [1977] A.C. 239, [1976] 2 W.L.R. 562 (H.L.).

17 *Pilon v. Peugeot Canada Ltd.* (1980), 29 O.R. (2d) 711, 114 D.L.R. (3d) 378 (H.C.J.).

18 *Philip F. Levine Marketing Ltd. v. 3SM Tours Ltd.*, [1983] 4 W.W.R. 149, amended [1983] 6 W.W.R. 436 (Alta. Q.B.).

19 *Mason v. Freedman*, [1958] S.C.R. 483, 14 D.L.R. (2d) 529; *Aldercrest Developments Ltd. v. Hunter*, [1970] 2 O.R. 562, 11 D.L.R. (3d) 439 (C.A.); and *Metropolitan Trust Co. of Canada v. Pressure Concrete Services Ltd.*, [1973] 3 O.R. 629, 37 D.L.R. (3d) 649 (H.C.J.), aff'd (1975), 9 O.R. (2d) 375 (C.A.).

20 *Stirling v. Maitland* (1864), 5 B. & S. 840, 122 E.R. 1043; *Schrider v. Lang Bay Lumber Co.* (1961), 34 W.W.R. 319 (B.C.C.A.); *Barque Quilpué Ltd. v. Brown*, [1904] 2 K.B. 264 (C.A.); and *Shoot v. Shoot* (1956), 6 D.L.R. (2d) 366, [1957] O.W.N. 22 (C.A.).

21 *Auto-Body Rustproofing (Canada) Ltd. v. Canadian National Sportsmen's Show*, [1971] 3 O.R. 39, 19 D.L.R. (3d) 276 (H.C.J.), and *Winsco Manufacturing Ltd. v. Raymond Distributing Co.*, [1957] O.R. 565, 10 D.L.R. (2d) 699 (H.C.J.).

22 *Hurley v. Roy* (1921), 50 O.L.R. 281, 64 D.L.R. 375 (App. Div.), and *Moir v. J.P. Porter Co.* (1979), 33 N.S.R. (2d) 674, 57 A.P.R. 674 (C.A.), aff'g 33 N.S.R. (2d) 685 (S.C., T.D.).

23 See, for example, *Brennan Paving Co. v. City of Oshawa*, [1955] S.C.R. 76, [1955] 1 D.L.R. (2d) 321; *Gordon Leaseholds Ltd. v. Metzger*, [1967] 1 O.R. 580, 61 D.L.R. (2d) 562 (H.C.J.); *Wallace v. Temiskaming and Northern Ontario Railway Commission* (1906), 12 O.L.R. 126 (C.A.), aff'd (1906), 37 S.C.R. 696; and *Canada Egg Products Ltd. v. Canadian Doughnut Co.*, [1955] S.C.R. 398, [1955] 3 D.L.R. (2d) 1. It is questionable whether the requirement to decide compliance in good faith extends beyond cases where operational fitness or mechanical utility is in question. Where matters of fancy, taste and sensibility are involved, a party may not, at present, be required to act in good faith when rejecting contractual performance. See *Truman v. Ford Motor Co. of Canada*, [1926] 1 D.L.R. 960 (Ont. App. Div.).

2. WEAKNESSES IN THE PRESENT LAW AND THE CASE FOR LEGISLATIVE REFORM

From our review in the preceding section, it appears that elements of good faith analysis are already an important part of the Anglo-Canadian law of contracts. However, these have not been synthesized into a settled and independent doctrine. Judicial efforts to incorporate good faith standards into contract law remain piecemeal and difficult to analyze.

In our view, an unsettled and incoherent body of law, particularly in an area as pervasively important as good faith in contracting, is unsatisfactory. Predictability in contract planning, as well as in contract dispute resolution, is an important value that may be compromised when a relevant doctrine is unclear. A question arises, then, whether change should come about through the common law or through legislative intervention.

Continued doctrinal uncertainty could prompt judicial efforts at clarification and rationalization. However, judges necessarily proceed on a case by case basis, and there are many available conceptions of good faith, ranging from "fair conduct"[24] to "solidarity"[25] and "community standards",[26] that could be applied in any given case. The array of definitions that might result could make the law even more uncertain than it is at present. If, on the other hand, the courts do not have recourse to generalized concepts of good faith, the desire to do justice in the individual case will perpetuate the doctrinal manipulation that now serves to maintain minimum behavioural standards, however unevenly. In this vein, Powell has described the current law as being riddled with "contortions and subterfuge".[27]

In contrast to the slow and unpredictable pace of common law developments, it is a relatively easy matter to frame legislation clarifying and rationalizing a contractual doctrine of good faith. We believe that a legislated obligation of good faith, to apply in specified circumstances, would be conducive to greater certainty and to more straightforward judicial reasoning.

3. A SURVEY OF SUGGESTED APPROACHES

(a) THE EUROPEAN CIVIL CODES

Section 242 of the German Civil Code provides as follows:[28]

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[24] Holmes, "A Contextual Study of Commercial Good Faith: Good Faith Disclosure in Contract Formation" (1978), 39 U. Pitt. L. Rev. 381, at 442.

[25] Unger, *Law in Modern Society* (1976), at 210.

[26] Thigpen, *supra*, note 3, at 320.

[27] Powell, *supra*, note 1, at 26.

[28] For discussion, see Trebilcock, "Good Faith in Sales Transactions" (1974), at 6-11. Unpublished paper undertaken for the Ontario Law Reform Commission's Sale of Goods Project. A copy of this paper is available at the Legislative Library, Legislative Building, Queen's Park, Toronto.

> The debtor is bound to effect performance according to the requirements of good faith, common habits being duly taken into consideration.

The French, Italian and Swiss Civil Codes contain similar provisions.[29]

It should be noted that each of the four European Code provisions limits the scope of good faith scrutiny to contractual performance. In Germany, pre-contractual injurious reliance is protected by a judicially developed *culpa in contrahendo* doctrine, the purpose of which is similar to that of section 90 of the American *Second Restatement of the Law of Contracts*.[30] It is also noteworthy that good faith is not defined in any of the Codes.

The critical literature discussing the good faith provisions of the European Codes is mixed. Powell's assessment is positive. In his view, the success of section 242 of the German Civil Code is assured because it rests on the Roman foundation of common sense.[31] Gordley, on the other hand, is critical of the European approach:[32]

> The German 'general clauses' are examples of cloudy rules. No one really knows what 'immorality' and 'good faith' might mean. As one German joke has it, the only principles yet discovered to explain 'good faith' are *das geht zu weit* and *die arme Frau* — 'that's going too far' and 'the poor woman'.

(b) Uniform Commercial Code

Good faith is mentioned in no less than fifty of the 400 or so provisions of the American Uniform Commercial Code.[33] The most general good faith provision is section 1-203, to the effect that "every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." "Good faith" is defined as "honesty in fact in the conduct or transaction concerned."[34] This generally prescribed definition requiring merely subjective honesty is bolstered, however, in the sales context: "Good faith in the case of a

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[29] *Ibid.*, at 11-14. See, also, Dawson, *Oracles of the Law* (1968), at 461-79, and Powell, *supra*, note 1, at 29-37.

[30] American Law Institute, *Restatement of the Law, Second — Contracts, 2d* (1979) (hereinafter referred to as "*Second Restatement*"). Section 90 of the *Restatement* is discussed *supra*, ch. 2, sec. 4(d). For further discussion of this doctrine, see, also, Trebilcock, *supra*, note 28, at 8-11; and Kessler and Fine, "*Culpa in Contrahendo*, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study" (1964), 77 Harv. L. Rev. 401.

[31] Powell, *supra*, note 1, at 37.

[32] Gordley, "European Codes and American Restatements: Some Difficulties" (1981), 81 Colum. L. Rev. 140, at 147.

[33] American Law Institute, Uniform Commercial Code, Official Text (9th ed., 1978), (hereinafter referred to as "Uniform Commercial Code"). See, generally, Farnsworth, "Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code" (1963), 30 U. Chi. L. Rev. 666, at 667.

[34] Uniform Commercial Code, *supra*, note 33, § 1-201(19).

merchant'', states section 2-103(1)(b), ''means honesty in fact and the observance of reasonable standards of fair dealing in the trade''.

Contracting out of the duty of good faith is not permitted under the Uniform Commercial Code, but contracting parties are given some opportunity for self regulation. Section 1-102(3) provides that:

> The obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.

The approach of the Uniform Commercial Code to good faith has been extensively reviewed in the literature.[35] One issue that has received a great deal of attention is the scope of scrutiny, and suggestions have been made that the obligation of good faith should not be limited to contractual performance and enforcement but should extend to precontractual negotiation.[36] A second concern has to do with the definition of good faith in Article 1.[37] Most commentators agree with Farnsworth that the definition of good faith, requiring only ''honesty in fact'', has so enfeebled the requirement of good faith that ''it could scarcely qualify ... as an over-riding or supereminent principle.''[38]

Thirdly, even the more rigorous ''good faith in the case of a merchant'' definition[39] is vulnerable to serious criticism. Its application is restricted to situations where Article 2 imposes a duty of good faith and this occurs in only thirteen of the 104 provisions in the Article.[40] As well, the definition is applicable only to the dealings of ''merchants'' as defined in the Code,[41] so that

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35 See, generally, Burton, ''Breach of Contract and the Common Law Duty to Perform in Good Faith'' (1980), 94 Harv. L. Rev. 369; Dugan, ''Standardized Forms: Unconscionability and Good Faith'' (1979), 14 New England L. Rev. 711; Dugan, ''Good Faith and the Enforceability of Standardized Terms'' (1980), 22 Wm. & Mary L. Rev. 1; Eisenberg, ''Good Faith Under the Uniform Commercial Code — A New Look at an Old Problem'' (1971), 54 Marq. L. Rev. 1; Farnsworth, *supra*, note 33; Hillman, ''Policing Contract Modifications under the UCC: Good Faith and the Doctrine of Economic Duress'' (1979), 64 Ia. L. Rev. 849; Holmes, *supra*, note 24; Holmes, ''Is There Life After Gilmore's Death of Contract? — Inductions From a Study of Commercial Good Faith in First-Party Insurance Contracts'' (1980), 65 Cornell L. Rev. 330; Note, ''Good Faith Under the Uniform Commercial Code'' (1962), 23 U. Pitt. L. Rev. 754; Sales Report, *supra*, note 14, at 164 *et seq.*; Peters, ''Remedies for Breach of Contracts Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two'' (1963), 73 Yale L. J. 199; Summers, '' 'Good Faith' in General Contract Law and the Sales Provisions of the Uniform Commercial Code'' (1968), 54 Va. L. Rev. 195; Thigpen, *supra*, note 3; and Trebilcock, *supra*, note 28.

36 See discussion *infra*, this ch., sec. 4.

37 *Supra*, note 34.

38 Farnsworth, *supra*, note 33, at 674.

39 Uniform Commercial Code, *supra*, note 33, § 2-103(1)(b).

40 See Sales Report, *supra*, note 14, at 165.

41 Uniform Commercial Code, *supra*, note 33, § 2-104(1).

many buyers and sellers, and other kinds of contracting parties such as franchisors and lessees, are not covered. It should also be noted that the Article 2 definition of good faith presupposes "reasonable standards of fair dealing in the trade". Such standards may not exist for all trades.

Finally, it has been suggested that the Code does not provide adequate guidance to contracting parties, lawyers and judges.[42]

(c) *SECOND RESTATEMENT OF THE LAW OF CONTRACTS*

Section 205 of the *Second Restatement* provides as follows:[43]

> 205. Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.

The prescribed good faith requirement applies to all types of contracts and to all types of contracting parties. The core of the definition is simply "good faith and fair dealing", without further amplification. The Comment to section 205 explains that "good faith performance or enforcement ... emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness".[44]

While broader in scope and arguably broader in definition than the Uniform Commercial Code, the *Restatement* requirement nonetheless limits the scope of scrutiny to contractual performance and enforcement. According to the Comment,[45] problems of bad faith in bargaining are often problems of contractual capacity, mutual assent and consideration, or pre-contractual injurious reliance, all of which can be handled under other heads of the *Restatement*, such as, for example, the protection of reliance under section 90.[46]

According to Farnsworth, section 205 "reflects a substantial body of pre-Code case law".[47] A recent survey of American good faith jurisprudence revealed that at least thirty-two state jurisdictions have openly adopted a generalized and independent good faith obligation.[48]

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[42] See Burton, "Good Faith Performance of a Contract within Article 2 of the Uniform Commercial Code" (1981), 67 Ia. L. Rev. 1, at 1-2.

[43] *Second Restatement*, *supra*, note 30.

[44] *Ibid.*, Comment a.

[45] *Ibid.*

[46] For a discussion of § 90 of the Restatement, see *supra*, ch. 2, sec. 4(d).

[47] Farnsworth, "Ingredients in the Redaction of the Restatement (Second) of Contracts" (1981), 81 Colum. L. Rev. 1, at 10.

[48] Burton, *supra*, note 35, at 404.

(d) ONTARIO LAW REFORM COMMISSION, *REPORT ON SALE OF GOODS*

Before turning to our recommendations for legislative reform of the doctrine of good faith in contract law generally, it would be useful to summarize the recommendations that we made with respect to good faith in our *Report on Sale of Goods*.[49] In that Report, we proposed that good faith "be enshrined in the revised *[Sale of Goods Act]* as a minimal behavioural baseline in the exercise of contractual statutory rights and obligations".[50] The relevant provision of the proposed revised Act provides as follows:[51]

> (1) Every right and duty that is created by a contract of sale or by this Act imposes an obligation of good faith in its enforcement or performance whether or not it is expressly so stated.
>
> (2) 'Good Faith' means honesty in fact and the observance of reasonable standards of fair dealing.

This provision reflected our concerns, first, that the proposed good faith obligation not be confined to merchants; secondly, that the basic behavioural guideline be higher than the "pure heart and empty head" criterion of honesty in fact; and thirdly, that the legislatively prescribed requirement encompass notions of reasonableness and fair dealing.[52] We did not recommend that the proposed good faith requirement apply to contract negotiation and formation, preferring to defer consideration of that issue until the law of consideration and injurious reliance had been reviewed.[53]

4. PROPOSALS FOR REFORM

We have already expressed our view that a legislated requirement of good faith would conduce to greater certainty in the law and would encourage more straightforward judicial reasoning.[54] We recognize the concern of some critics

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[49] Sales Report, *supra*, note 14.

[50] *Ibid.*, at 166.

[51] *Ibid.*, at 167, and Draft Bill, ss. 3.2 and 1.1(1)15.

The Committee on a Uniform Sale of Goods Act of the Uniform Law Conference of Canada adopted the following modified version of the Ontario Law Reform Commission's proposed provision on good faith in the sale of goods:

> 14. Every duty that is created by a contract of sale or by this Act requires good faith in its performance, whether or not it is expressly so stated.

The effect of this provision would be to limit the doctrine of good faith to the performance of duties, and to exclude it from the exercise of rights. See Uniform Law Conference of Canada, *Proceedings of the Sixty-third Annual Meeting* (1981), at 217-18, and Uniform Law Conference of Canada, *Proceedings of the Sixty-fourth Annual Meeting* (1982), Appendix HH, *Uniform Sale of Goods Act*, s. 14.

[52] Sales Report, *supra*, note 14, at 167.

[53] *Ibid.*, at 169.

[54] *Supra*, this ch., sec. 2.

that the adoption of an explicit doctrine of good faith might lead judges "to abandon the duty of legally reasoned decisions and to produce an unanalytical incantation of personal values".[55] However, the considerable American experience with the doctrine does not support these fears.

It is our view that a legislated requirement would not conflict with existing contract law principles. Rather, statutory recognition of the doctrine of good faith would serve to synthesize the various strands of good faith analysis in the case law. Moreover, the literature reveals that a generalized doctrine of good faith would conform to commercial realities.[56] Accordingly, we recommend that legislation give recognition to the doctrine of good faith.

There appears to be agreement among commentators that an obligation of good faith should apply to all contracts and contracting parties.[57] In the words of Lord Kenyon, in *Mellish v. Motteux*:[58]

> *In contracts of all kinds*, it is of the highest importance that courts of law should compel the observance of honesty and good faith.

We agree with this view, and accordingly recommend that the proposed statutory obligation of good faith should explicitly and generally apply to all contracts and contracting parties.

A question arises whether the proposed obligation of good faith should apply to contract negotiation and formation. It is evident that good faith in pre-contractual dealings can play an important role, and we acknowledged this to be the case in our *Report on Sale of Goods*.[59] However, in the context of reform of the law of consideration, we have recommended legislative protection for pre-contractual injurious reliance.[60] As we stated in our *Report on Sale of Goods*, this sort of protection would greatly reduce recourse to a pre-contractual good faith obligation.[61] Remedies in tort, for fraud and negligent misrepresentation, for example, would also be available in cases of wrongdoing at the pre-contractual stage (as would the general doctrine of unconscionability and the doctrine of mistake).[62] Without suggesting that a general obligation of good faith in contract negotiation and formation would be redundant, we are not convinced of the need to legislate such an obligation specifically. We observe that the relevant provisions in the European Civil Codes and the Uniform

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55 Bridge, *supra*, note 12, at 413.

56 See authorities cited, *supra*, note 11.

57 See Summers, *supra*, note 35, at 215-16; Holmes (1980), *supra*, note 35, at 375; and Williston (ed. Jaeger), *Williston on Contracts* (3d ed., 1961), Vol. 5, § 670, at 159.

58 (1792), Peake 156, at 157, 170 E.R. 113, at 113-14 (emphasis added).

59 Sales Report, *supra*, note 14, at 169.

60 *Supra*, ch. 2, sec. 4(d).

61 Sales Report, *supra*, note 14, at 169.

62 See, respectively, *supra*, ch. 6, and *infra*, ch. 14.

Commercial Code, as well as section 205 of the *Restatement*, similarly limit the scope of good faith scrutiny to exclude contract negotiation and formation.[63]

As discussed above, in our *Report on Sale of Goods* we favoured a definition of good faith that encompassed reasonableness and fair dealing, in addition to subjective honesty in fact. The proposed good faith obligation, we recommended, should apply to contract performance and enforcement. In light of the foregoing review of the current law,[64] we have concluded that this approach is as appropriate to the general law of contracts as it is to sale of goods law.

We note that section 205 of the *Restatement* is the same, in principle, as our recommendations in the sale of goods context.[65] Adopting the wording of section 205 would provide our courts with an Official Comment as to the scope and meaning of the provision, and with a substantial number of American precedents.

Accordingly, we recommend that the proposed statutory good faith provision should take the form of section 205 of the American *Second Restatement of the Law of Contracts*.

The final question is whether contracting parties should be permitted to vary or exclude the statutorily prescribed good faith requirement. As noted above,[66] section 1-102(3) of the Uniform Commercial Code provides that the prescribed good faith obligations may not be disclaimed, but that the parties "may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable". In our *Report on Sale of Goods*, we recommended the adoption of a provision similar to section 1-102(3).[67] We reasoned that good faith should be viewed as a "minimum rule of decent behaviour", which it would be unreasonable to disclaim by agreement. At the same time, we saw no disadvantage to permitting parties to determine by agreement the standards by which performance of good faith obligations would be judged. Again, we consider this approach to be as appropriate to the general law of contracts as it is to sale of goods law.

Accordingly, we recommend that legislation should provide that contracting parties may not vary or disclaim the statutorily imposed good faith obligations, but that parties should be able, by agreement, to determine the standards by which the performance of such good faith obligations is to be measured if such standards are not manifestly unreasonable.

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63 *Supra*, this ch., sec. 3.

64 *Supra*, this ch., sec. 1.

65 *Supra*, this ch., sec. 3(c).

66 *Supra*, this ch., sec. 3(b).

67 Sales Report, *supra*, note 14, at 168.

Recommendations

The Commission makes the following recommendations:

1. Legislation should give recognition to the doctrine of good faith in the performance and enforcement of contracts.

2. The proposed statutory obligation of good faith should apply explicitly and generally to all contracts and contracting parties.

3. The proposed statutory good faith provision should take the form of section 205 of the American *Second Restatement of the Law of Contracts*.

4. Legislation should provide that contracting parties may not vary or disclaim the statutorily imposed good faith obligations, but that parties should be able, by agreement, to determine the standards by which the performance of such good faith obligations is to be measured if such standards are not manifestly unreasonable.

CHAPTER 10

MINORS' CONTRACTS

1. THE PRESENT LAW

(a) INTRODUCTION

The object of the law respecting minors' contracts has been to protect minors from the consequences of their bargains.[1] However, the goals of protecting minors, avoiding unjust enrichment by persons under age, and not excessively discouraging the commercial community from dealing with minors can be difficult to reconcile. Perhaps in part because of this, the law of minors' contracts is complex, confused, and highly technical.

The principal difficulties may be briefly summarized at the outset. The common law recognizes at least four different types of minors' contracts, although it is not clear that underlying values are well served by such classification. Determining the scope of each category is, moreover, problematic. Further uncertainties arise in determining rights and liabilities associated with unenforceable minors' contracts. In addition, it is not clear when a minor can be successfully sued for tortious conduct arising out of an unenforceable contract. Finally, there are problems in the current law relating to enforceability of guarantees of minors' obligations, and whether minors can appoint or act as agents.

Before turning to a more detailed examination of existing law, it should be noted that, in Ontario, legislation has lowered the age of majority from twenty-one to eighteen.[2] While it is likely that this change has resulted in fewer legal problems related to minors' contracts, it has not directly altered the law governing such contracts.

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[1] See *Zouch v. Parsons* (1765), 3 Burr. 1794, 97 E.R. 1103.

[2] *Age of Majority and Accountability Act*, R.S.O. 1980, c. 7, s. 1.

(b) CLASSIFICATION OF MINORS' CONTRACTS

(i) Preface

In order to analyze the effect of a contract made by an minor, it is necessary to differentiate the following categories of contract developed at common law:[3]

1. void contracts;
2. contracts invalid unless ratified after attaining majority;
3. contracts valid unless repudiated during minority, or within a reasonable time after attaining majority; and
4. valid contracts.

Contracts falling into the second and third categories are referred to as voidable, although it may be that, properly speaking, only contracts in the third category should be termed voidable.[4]

(ii) Void Contracts

In Ontario, the common law determines whether a contract made by a minor will be treated as void *ab initio*.[5] Unfortunately, there does not seem to be any settled definition of the kind of contract that attracts this consequence. Judges have expressed themselves in different language at different times. To Ferguson J., in *Butterfield v. Sibbitt*,[6] "[a]ll contracts entered into by an infant must be for his benefit, otherwise they are void". A narrower view of the category of void minors' contracts was expressed by Laidlaw J.A. in *McBride v. Appleton*:[7] for a minor's contract to be void, not merely voidable, it must be "as a whole ... so much to the detriment of ... the infant, as to render it unfair that he should be bound by it".[8] In *Re Staruch*,[9] prejudice to the infant was advanced as the criterion of voidness.

In determining when a contract is so unfair, prejudicial, or not beneficial, that it goes beyond being voidable and becomes void, the language of the

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[3] *R. v. Rash* (1923), 53 O.L.R. 245, 41 C.C.C. 215 (App. Div.) (subsequent references are to 53 O.L.R.), and *Toronto Marlboro Major Junior "A" Hockey Club v. Tonelli* (1977), 18 O.R. (2d) 21, 81 D.L.R. (3d) 403 (H.C.J.), aff'd (1979), 23 O.R. (2d) 193 (C.A.).

[4] See Percy, "The Present Law of Infants' Contracts" (1975), 53 Can. B. Rev. 1, at 12-13.

[5] But see the *Infants Relief Act, 1874*, 37 & 38 Vict., c. 62 (U.K.), s. 1.

[6] [1950] O.R. 504, at 509, [1950] 4 D.L.R. 302, at 307 (H.C.J.) (subsequent references are to [1950] O.R.); and *R. v. Leduc*, [1972] 1 O.R. 458, at 459, 5 C.C.C. (2d) 422, at 423 (Dist. Ct.) (subsequent reference is to [1972] 1 O.R.).

[7] [1946] O.R. 17, [1946] 2 D.L.R. 16 (C.A.) (subsequent references are to [1946] O.R.).

[8] *Ibid.*, at 30.

[9] [1955] 5 D.L.R. 807 (Ont. H.C.J.), at 809.

judges, while intended to be helpful, leaves much to be desired.

(iii) Contracts Not Binding on the Minor Unless Ratified After Attaining Majority

This category appears to comprise all minors' contracts that do not fit into any of the other categories.[10] Contracts that fall into this category do not bind the minor during minority, or after attaining majority unless ratified by the minor after majority.[11]

However, Canadian judges have not been consistent in distinguishing between contracts that are binding on a minor unless repudiated, and those in the category now under discussion. It has sometimes been implied, for example, that all contracts that are neither void nor valid without qualification are subject to repudiation by the minor.[12] On other occasions, judges have asked whether the contract has been ratified, even though the contract could properly have been characterized as one that was valid unless repudiated.[13] In other words, Canadian judges have sometimes tended to confuse both classes of so-called voidable contracts.

Further complexity arises from the requirement of ratification. At common law there seem to have been no special rules governing ratification, provided the minor, on attaining majority, demonstrated an intention to adopt and approve the contract made during minority. This has been changed by legislation in Ontario. Section 7 of the *Statute of Frauds* provides as follows:[14]

> 7. No action shall be maintained whereby to charge a person upon a promise made after full age to pay a debt contracted during minority or upon a ratification after full age of a promise or simple contract made during minority, unless the promise or ratification is made by a writing signed by the party to be charged therewith or by his agent duly authorized to make the promise or ratification.

The requirement that ratification be by writing does not seem to have been rigorously applied, perhaps because it is viewed as overly rigid. In *Re Hutton*,[15]

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[10] *R. v. Rash*, *supra*, note 3, at 263, and *Butterfield v. Sibbitt*, *supra*, note 6, at 509.

[11] See discussion in *R. v. Rash*, *supra*, note 3, at 264-65.

[12] *Blackwell v. Farrow*, [1948] O.W.N. 7 (H.C.J.); *Noble's Ltd. v. Bellefleur* (1963), 37 D.L.R. (2d) 519, 49 M.P.R. 279 (N.B.C.A.); *LaFayette v. W.W. Distributors and Co. Ltd.* (1965), 51 W.W.R. 685 (Sask. Dist. Ct.); *Coull v. Kolbuc* (1969), 68 W.W.R. 76 (Alta. Dist. Ct.); and *Henderson v. Minneapolis Steel & Mach. Co.*, [1931] 1 D.L.R. 570, [1930] 3 W.W.R. 613 (Alta. S.C., T.D.).

[13] *Re Paterson*, [1918] 1 W.W.R. 105 (Man. Q.B.), and *Re Sovereign Bank of Canada; Clark's Case* (1916), 35 O.L.R. 448 (App. Div.).

[14] *Statute of Frauds*, R.S.O. 1980, c. 481, s. 7.

[15] *Re Hutton*, [1926] 4 D.L.R. 1080, [1926] 3 W.W.R. 609 (Alta. S.C., T.D.) (subsequent reference is to [1926] 4 D.L.R.). Lord Tenterden's Act (1828), 9 Geo. 4, c. 14 (U.K.), s. 5, which required written evidence of a minor's ratification of a contract, was incorporated as part of the law of Alberta in 1870. However, the provision has never been part of the published statutes of that Province.

a minor had not ratified by writing a contract entered into by him during his minority. However, he had done nothing to avoid the contract during the course of the three years following his majority. The Court considered that he had acquiesced in the contract and that, the contract being completed, ratification did not have to be in writing. More recently, in *Blackwell v. Farrow*,[16] it was held that certain conduct by a minor amounted to ratification by implication; no mention was made of the writing requirement of the *Statute of Frauds*.[17]

(iv) Contracts Binding on the Minor Unless Repudiated

Contracts in this category bind the minor unless he or she takes appropriate steps to repudiate during minority or within a reasonable time after attaining majority.[18] Commentators appear to agree that this category comprehends the following:[19] contracts concerning land; share contracts; partnership agreements; and marriage settlements.

As noted earlier, Canadian courts have not always been clear and consistent in distinguishing this type of contract from a contract that will not bind a minor in the absence of an act of ratification.[20]

(v) Valid Contracts

There are two types of contracts that may be legally binding on the minor as soon as they are made and that cannot be repudiated by the minor, whether before or after majority. These are, first, contracts for necessaries and, secondly, contracts of employment or service.

a. Contracts for Necessaries

According to the case law, ''necessaries'' consist of those things ''without which an individual cannot reasonably exist''.[21] The concept presupposes that the minor is in short supply of such things and that they are ''essential to the

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16 *Supra*, note 12.

17 *Supra*, note 14.

18 *Hilliard v. Dillon*, [1955] O.W.N. 621 (H.C.J.), and *Murray v. Dean* (1926), 30 O.W.N. 271 (H.C. Div.).

19 Percy, *supra*, note 4, at 13; Treitel, *The Law of Contract* (6th ed., 1983), at 416-17; Furmston (ed.), *Cheshire and Fifoot's Law of Contract* (10th ed., 1981), at 385-86; and Payne, ''The Contractual Liability of Infants'' (1966), 5 Western L. Rev. 136, at 143.

20 *Supra*, note 13.

21 *Chapple v. Cooper* (1844), 13 M. & W. 252, at 258, 153 E.R. 105, at 107 (subsequent reference is to 153 E.R.). See, also, *Equality Rights Statute Law Amendment Act, 1986*, Bill 7, 1986 (33d Leg. 2d Sess.), s. 18(4), dealing with contracts for accommodation entered into by a sixteen or seventeen year old person who has withdrawn from parental control.

existence and reasonable advantage and comfort of the infant ...''[22]. Necessaries include things needed to maintain the minor in his or her accustomed social position, and accordingly vary with the individual.[23] With respect to contracts governed by the *Sale of Goods Act*,[24] necessaries means ''goods suitable to the conditions in life of the minor ... and to his actual requirements at the time of the sale and delivery''.[25]

It should be noted that both at common law and under the *Sale of Goods Act*, the minor's condition in life is a material factor. It follows that the determination of what is necessary must be made on a case by case basis, with the result that, often, neither party to a given contract can be certain of its validity.[26] Moreover, it has been suggested that a contract for necessaries will not be considered valid if it is penal in nature,[27] or, according to other authority, if the contract as a whole does not benefit the minor.[28]

Assuming a contract does fall within the category of valid minors' contracts for necessaries, the nature of the minor's liability is unclear. With respect to contracts for necessary goods, the governing principles are expressed in section 3(1) of the *Sale of Goods Act*:[29] the capacity to buy and sell is regulated by the general law of contractual capacity, ''but where necessaries are sold and delivered to a minor ... he shall pay a reasonable price therefor''.

One view of the provision suggests that the minor's liability under a contract for necessary goods is restitutionary rather than contractual.[30] Since the minor need only pay a reasonable price for goods actually delivered, the minor should not be liable on an executory contract for the sale of goods.[31] The contrary view is that the statutory imposition of a reasonable price does not alter the contractual nature of the minor's liability, and that the provision does not purport to cover the situation in which goods sold or agreed to be sold are not yet delivered.[32]

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22 *Ibid.*, at 107.

23 *Peters v. Fleming* (1840), 6 M. & W. 43, 151 E.R. 314.

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

25 *Ibid.*, s. 3(2).

26 For a discussion of cases illustrating this point, see Percy, *supra*, note 4, at 2-6.

27 *R. v. Leduc*, *supra*, note 6, at 459; *Pyett v. Lampman* (1922), 53 O.L.R. 149, [1923] 1 D.L.R. 249 (App. Div.); and *Coull v. Kolbuc*, *supra*, note 12.

28 *Roberts v. Gray*, [1913] 1 K.B. 520, [1911-13] All E.R. Rep. 870 (C.A.), and *Fawcett v. Smethurst* (1915), 84 L.J.K.B. (N.S.) 473.

29 *Supra*, note 24.

30 *Nash v. Inman*, [1908] 2 K.B. 1 (C.A.), at 8; *R. v. Rash*, *supra*, note 3, at 256; *Cheshire and Fifoot's Law of Contract*, *supra*, note 19, at 382; and Payne, *supra*, note 19, at 139.

31 Miles, ''The Infant's Liability for Necessaries'' (1927), 43 L.Q.R. 389, and *Cheshire and Fifoot's Law of Contract*, *supra*, note 19, at 382.

32 Percy, *supra*, note 4, at 7-9.

The nature of a minor's liability to pay for necessary services is also unclear. *Roberts v. Gray*[33] provides some authority for the proposition that contracts for necessary services in the nature of tuition and education may be binding even though executory. However, it is a matter of debate whether the principle in this case would apply generally to contracts for necessary services.[34] From a policy viewpoint, it is difficult to see why different principles should apply depending on whether goods or services are the subject of the contract.

b. Contracts of Service

Minors may also be bound by contracts of service, that is, contracts that provide them with employment or permit them to earn a livelihood or to be trained for some trade or profession.[35] There is a question, however, whether contracts of this kind form a separate category of enforceable minors' contracts, or are a subcategory of contracts for necessaries.[36]

There seems to be agreement that minors' contracts of service, like contracts for necessaries, will only be binding if they are considered by the court to be beneficial to the minor. While the weight of authority appears to favour a strictly pecuniary test,[37] there have been suggestions that a broader test should be applied.[38] It appears that contracts of service are distinguishable from contracts for necessaries in that executory beneficial contracts of service bind the minor to the same extent as do executed contracts of service.[39] It is difficult to appreciate why executory contracts of service should be enforceable if executory contracts for necessaries are not.

The category of contracts of service does not seem to include trading contracts, that is, contracts for goods or services required by the minor to further his or her business activities, even where the contract enables the minor

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33 *Supra*, note 28.

34 See, for example, Payne, *supra*, note 19, at 141-42; Percy, *supra*, note 4, at 8-9; and *Cheshire and Fifoot's Law of Contract, supra*, note 19, at 383.

35 *De Francesco v. Barnum* (1890), 45 Ch. D. 430, at 439, [1886-90] All E.R. Rep. 414, at 419 (C.A.) (subsequent reference is to 45 Ch. D.); *Millar v. Smith & Co.*, [1925] 3 D.L.R. 251, at 267, [1925] 2 W.W.R. 360, at 367 (Sask. C.A.); and Percy, *supra*, note 4, at 9.

36 See Payne, *supra*, note 19, at 141-42, and Percy, *supra*, note 4, at 9.

37 *Clements v. London and North Western Railway Co.*, [1894] 2 Q.B. 482 (C.A.), and *Chaplin v. Leslie Frewin (Publishers) Ltd.*, [1966] Ch. 71, [1965] 3 All E.R. 764 (C.A.) (subsequent references are to [1966] Ch.).

38 See the judgment of Lord Denning M.R., in dissent, in *Chaplin v. Leslie Frewin (Publishers) Ltd.*, *ibid.*, at 88, and the judgment of Zuber J.A., in dissent on this issue, in *Toronto Marlboro Major Junior "A" Hockey Club v. Tonelli*, *supra*, note 3, at 200, relying on *De Francesco v. Barnum*, *supra*, note 35, at 439.

39 *Clements v. London and North Western Railway Co.*, *supra*, note 37. See, also, Percy, *supra*, note 4, at 9, and *Cheshire and Fifoot's Law of Contract, supra*, note 19, at 383.

to carry on a livelihood. For example, in *Pyett v. Lampman*[40] a contract to purchase a car was not binding even though the minor required the car to carry on his business. However, it can be difficult to distinguish trading contracts from contracts of service. This is illustrated by *Chaplin v. Leslie Frewin (Publishers) Ltd.*[41] There, a minor's contract to publish a book he had written was held enforceable because it enabled him to make a start as an author and thus earn money to keep himself and his wife.[42]

(c) Rights and Liabilities Associated With Unenforceable Minors' Contracts

(i) Minors' Rights

To some extent, the rights and liabilities associated with minors' contracts flow from the categorization of those contracts, discussed above. If a minor's contract is valid, subject to uncertainties surrounding executory contracts for necessaries, it is enforceable by both parties. If it is void, neither party can enforce it. And if the contract falls into either of the so-called voidable categories, the minor can choose to avoid it or to enforce it. However, a minor who has induced a contract by fraudulent misrepresentation will not, apparently, be permitted to enforce the contract.[43] There is also authority that a minor cannot obtain a decree of specific performance in respect of a contract that does not bind the minor.[44] If the minor fails to repudiate, or chooses to ratify, a voidable contract the other party may enforce it.

Should a minor choose to avoid a voidable contract, questions arise as to the recovery of money or property transferred under the contract. What rights of recovery does the minor have? Again, the law of minors' contracts is uncertain. In particular, it is unclear whether the minor's right to recover is based on failure of consideration from the other party or on the minor's ability to effect restitution. It may be that the basis of recovery varies according to whether the contract is subject to ratification or repudiation and whether the minor is seeking recovery of money or property.[45]

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[40] *Supra*, note 27. See, also, *R. v. Rash*, *supra*, note 3. Contrast, however, *McGee v. Cusack*, [1936] 1 D.L.R. 157 (P.E.I. Co. Ct.).

[41] *Supra*, note 37.

[42] *Ibid.*, at 95.

[43] *Gregson v. Law* (1914), 15 D.L.R. 514, 5 W.W.R. 1017 (B.C.S.C.), and *Lemprière v. Lange* (1879), 12 Ch. D. 675.

[44] *Flight v. Bolland* (1828), 4 Russ. 298, 38 E.R. 817, and *Farnham v. Atkins* (1670), 1 Sid. 445, 82 E.R. 1208.

[45] The cases and commentators present various versions of the law on this issue. See, for example, Percy, *supra*, note 4, at 20-30; Payne, *supra*, note 19, at 144-48; and McCamus, "Restitution of Benefits Conferred Under Minors' Contracts" (1979), 28 U.N.B. L.J. 89, at 99-103.

If the basis of recovery is failure of consideration, a minor who has received a benefit under a voidable contract cannot recover. If the basis is restitutionary, the minor can recover so long as the other party can be restored to the pre-contractual position. While the restitutionary basis would seem to be the wider of the two, both can, in some instances, result in the minor being unable to recover money or property transferred under a voidable contract.[46]

It appears that a minor can recover money or property transferred under a void contract, regardless of whether there has been a failure of consideration from the other party or whether the minor can effect restitution.[47] It has been suggested by some commentators that the minor's extensive right of recovery under a void contract can work an unfairness, at least in those cases where the other party's conduct was not exploitative.[48]

(ii) Minors' Liabilities

The law concerning the liability of a minor to restore benefits received under an avoided contract is also unsettled. Again, liability may vary depending on how the contract is categorized. As has been discussed, the minor may be required to effect restitution as a condition of recovering money or property. In addition, avoidance of a contract by a minor may serve to revest title to property transferred under the contract in the original owner, so that an action in detinue may be brought.[49] As well, there have been suggestions that a court might, in some circumstances, require the minor to restore benefits received as a condition of avoiding a contract.[50] There have also been suggestions that a minor must restore the goods retained *in specie* after disaffirming a contract[51] and that a minor may be required to make restitution of benefits retained upon reaching majority, whether or not the benefits exist at the time of an action for their recovery.[52] The liability of a minor to restore money received under an avoided contract is even more uncertain because of the difficulties involved in tracing money.[53]

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46 McCamus, *ibid.*, at 99-103.

47 *Re Staruch*, *supra*, note 9, and *Upper v. Lightning Fastener Employees' Credit Union (St. Catherines) Ltd.* (1967), 9 C.B.R. (N.S.) 211 (Ont. Co. Ct.).

48 See, for example, Percy, *supra*, note 4, at 35-36; and McCamus, *supra*, note 45, at 104.

49 See McCamus, *supra*, note 45, at 106-07; Percy, *supra*, note 4, at 28-29; and *Louden Mfg. Co. v. Milmine* (1907), 14 O.L.R. 532 (H.C.J.), aff'd (1908), 15 O.L.R. 53 (Div.Ct.).

50 See *Re Hutton*, *supra*, note 15, at 1082, and *Blackwell v. Farrow*, *supra*, note 12, at 10. But see *Butterfield v. Sibbitt*, *supra*, note 6, at 510, where Ferguson J. noted that such a suggestion was far too wide as stated, and unsupported by any authority.

51 *Louden Mfg. Co. v. Milmine*, *supra*, note 49; *Noble's Ltd. v. Bellefleur*, *supra*, note 12.

52 *Louden Mfg. Co. v. Milmine*, *supra*, note 49; *Molyneux v. Traill* (1915), 32 W.L.R. 292, 9 W.W.R. 137 (Sask. Dist. Ct.); and McCamus, *supra*, note 45, at 107.

53 See McCamus, *ibid.*, at 108.

Turning to rights of recovery from a minor under a void contract, there seems to be no general duty of full restitution by the minor.[54] This is true even though, as noted above,[55] the minor has extensive rights of recovery of benefits conferred under a void contract, and even though the other party cannot be restored to the pre-contractual position. However, the other party may be able to recover money or goods retained by the minor at the time of suit, or at the age of majority.[56] If property obtained by a minor pursuant to a void contract has been sold to a third party, it has been suggested that the original owner would be able to recover it under the doctrine of *nemo dat quod non habet*,[57] unless the third party can establish that the original owner is estopped from claiming the property in the circumstances.[58] It has been suggested that the transfer of the risk of loss from the original owner to a good faith purchaser is unfair.[59] This result may be contrasted with the position with respect to voidable contracts under section 24 of the *Sale of Goods Act*,[60] allowing good title to a good faith purchaser of goods from a seller with a voidable title to them.

(d) Minors' Liability for Tortious Conduct Associated With Unenforceable Minors' Contracts

Minors are generally liable for their torts, subject to minors of tender years being incapable of forming certain mental attitudes involved in specific torts.[61] Nevertheless, courts will not hold a minor liable in tort if the effect of so doing is, indirectly, to enforce an unenforceable contract.[62] Generally, if the minor's conduct is directly connected to the contract, so that it can be seen as a breach of contract, the minor will not be held liable.[63] If, on the other hand, the conduct complained of can be considered to be independent of the contract, even though the opportunity to commit it might not have arisen but for the

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54 *Re Staruch*, *supra*, note 9, and *Upper v. Lightning Fastener Employees' Credit Union (St. Catherines) Ltd.*, *supra*, note 47.

55 *Supra*, note 45.

56 McCamus, *supra*, note 45, at 109.

57 Percy, *supra*, note 4, at 36.

58 For a discussion of estoppel in these circumstances, see the dissenting judgment of Roach J.A. in *McBride v. Appleton*, *supra*, note 7.

59 Percy, *supra*, note 4, at 36.

60 *Supra*, note 24.

61 See, for example, *Tillander v. Gosselin*, [1967] 1 O.R. 203 (H.C.J.), and *Continental Guaranty Corp. of Can. v. Mark*, [1926] 4 D.L.R. 707, [1926] 3 W.W.R. 428 (B.C.C.A.).

62 See, for example, *Noble's Ltd. v. Bellefleur*, *supra*, note 12.

63 See, for example, *Jennings v. Rundall* (1799), 8 Term Rep. 335, 101 E.R. 1419; *Noble's Ltd. v. Bellefleur*, *supra*, note 12; and *Dickson Bros. Garage & U-Drive Ltd. v. Woo Wai Jing* (1957), 11 D.L.R. (2d) 477, 23 W.W.R. 485 (B.C.C.A.), aff'g (1957), 10 D.L.R. (2d) 652, 22 W.W.R. 143.

contract, the minor will be held liable.[64] Not surprisingly, this has given rise to fine and often artificial distinctions among similar fact situations, with results being difficult to predict and to justify.[65]

Existing law also protects minors from liability for fraudulent misrepresentation in obtaining a contract. Such fraud apparently creates no right of action in tort against the minor[66] and does not estop the minor from relying on his or her minority.[67] However, fraudulent misrepresentation as to age may deprive the minor of the right to resort to equitable remedies[68] and may impose an equitable obligation on the minor in respect of property or money transferred under the fraudulently induced contract.[69] The law is uncertain as to what amounts to fraud in this context.[70]

(e) Enforceability of Guarantees of Minors' Obligations

The case law is unsettled whether adults can be sued successfully on guarantees of minors' unenforceable obligations.[71] The argument in favour of enforceability can be put on the basis that the minor's immunity is a personal privilege, so that third parties should not be able to rely on it. It would defeat the obvious purpose of a guarantee and constitute a trap for unwary creditors if adult guarantors were automatically relieved. On the other hand, it may be argued that guarantees, by their very nature, depend on the existence of some primary obligation, so that the guarantor should not be liable if the primary obligation is void or has been avoided. In any event, it appears to be well settled that an independent indemnity, rather than a guarantee, given by an adult in respect of a minor's obligation is enforceable.[72] Accordingly, the characterization of an adult's promise — as guarantee or indemnity — may well determine enforceability. The distinction between these two kinds of promises can be difficult to draw, and it is hard to see why, on policy grounds, the distinction should be determinative.

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64 See, for example, *Burnard v. Haggis* (1863), 14 C.B. (N.S.) 45, 143 E.R. 360, and *Victoria U Drive Yourself Auto Livery Ltd. v. Wood*, [1930] 2 D.L.R. 811, [1930] 1 W.W.R. 522, 634 (B.C.C.A.).

65 For a discussion of unpredictability and artificiality in the case law in this area, see Percy, *supra*, note 4, at 37-40.

66 *Re Darnley* (1908), 14 B.C.R. 15, 9 W.L.R. 20 (B.C.S.C.).

67 *Jewell v. Broad* (1909), 19 O.L.R. 1, aff'd (1910), 20 O.L.R. 176 (Div. Ct.).

68 *Gregson v. Law*, *supra*, note 43.

69 *Jewell v. Broad*, *supra*, note 67. There is some question whether this obligation extends to proceeds of property transferred to the minor under the contract. See *Stocks v. Wilson*, [1913] 2 K.B. 235, and *R. Leslie, Ltd. v. Shiell*, [1914] 3 K.B. 607, [1914-15] All E.R. Rep. 511 (C.A.).

70 See Atiyah, "Liability of Infants in Fraud and Restitution" (1959), 22 Mod. L. Rev. 273, and Percy, *supra*, note 4, at 41-42.

71 For a discussion of the case law, see Percy, *supra*, note 4, at 50-53.

72 *Yeomen Credit v. Latter*, [1961] 1 W.L.R. 828, [1961] 2 All E.R. 294 (C.A.).

(f) MINORS' CONTRACTS AND AGENTS

It appears to be settled in Canada that a minor has the same capacity to appoint an agent to execute a contract as to enter into that contract personally.[73] That is, contracts entered into by agents on behalf of minors are characterized as void, voidable, or valid, with rights and liabilities depending on the characterization. In the event that the contract entered into by the agent is unenforceable, the agent may be liable for breach of implied warranty of authority.[74] The capacity of a minor to give a power of attorney, on the other hand, seems to be more restricted,[75] although it is difficult to appreciate the reason for this.

It appears that a minor may act as an agent and that a principal cannot rely on an agent's minority to avoid a contract.[76] However, a third party's recourse against a minor agent, whether for breach of warranty of authority or where the agent acted for an undisclosed principal, is likely to be quite circumscribed.[77]

2. LEGISLATIVE INTERVENTION IN OTHER JURISDICTIONS

(a) PREFACE

This section reviews the law of minors' contracts in New Zealand, New South Wales and British Columbia, where the common law of minors' contracts has been substantially altered by statute. As will be seen, legislation has attempted to respond both to the uncertainty of the common law and to its potential unfairness to parties contracting with minors.

(b) NEW ZEALAND

In effect, the New Zealand *Minors' Contracts Act 1969*[78] codifies the law of minors' contracts.[79] The legislation distinguishes between minors over the age of eighteen, and minors under eighteen, with greater protection being afforded to the latter. Contracts entered into by minors over eighteen,[80] and contracts of service as well as certain life insurance contracts entered into by any minor, have the same effect, in the first instance, as if entered into by a

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[73] *Johannsson v. Gudmundson* (1909), 19 Man. R. 83, 11 W.L.R. 176 (C.A.), rev'g 10 W.L.R. 254 (subsequent reference is to 19 Man. R.).

[74] Fridman, *The Law of Agency* (5th ed., 1983), at 212.

[75] *Zouch v. Parsons*, *supra*, note 1, and *Johannsson v. Gudmundson*, *supra*, note 73, at 90 and 94.

[76] Powell, *The Law of Agency* (2d ed., 1961), at 173.

[77] O'Hare, "Agency, Infancy and Incapacity" (1970), 3 U. Tas. L.J. 312, at 322-23.

[78] *Minors' Contracts Act 1969*, Repr. Stat. N.Z. 1979, Vol. 3, at 639.

[79] *Ibid.*, s. 15.

[80] Pursuant to section 4 of the *Age of Majority Act 1970*, Stat. N.Z. 1970, Vol. 1, No. 137, the age of majority in New Zealand is twenty.

person of full age.[81] However, if a court determines that the consideration given to the minor under such a contract was so inadequate as to be unconscionable, or that a provision in such a contract imposed a harsh or oppressive obligation on the minor, the court may cancel the contract, decline to enforce it against the minor, or declare it unenforceable, in whole or in part, against the minor.[82]

Contracts entered into by minors under eighteen, other than contracts of service and certain life insurance contracts are, in the first instance, unenforceable against the minor, but otherwise have effect as if the minor were of full age.[83] If a court determines that such a contract was fair and reasonable at the time it was entered into, the court may enforce the contract against the minor, declare the contract binding on the minor, in whole or in part, or make an order entitling the other party to the contract to cancel it, on such conditions as the court thinks just.[84]

When a court exercises its discretion to disaffirm or approve a minor's contract, it may order such compensation or restitution of property as it thinks just.[85] Such awards may be made to a party to the contract, a guarantor or indemnifier of the contract, or to any person claiming through, under, or on behalf of a party, guarantor or indemnifier.[86] The New Zealand Act also provides that any contract entered into by a minor has effect as if the minor were of full age, if court approval of the contract is obtained in advance.[87] An application for such approval may be made by the minor, the minor's guardian, or any other person who would be a party to the contract.[88]

The uncertainty in the common law with respect to guarantees of minors' unenforceable contracts is resolved by the legislation. Guarantees, like indemnities, are enforceable against the guarantor as if the minor had been of full age.[89] The common law limits on a minor's liability in tort for fraudulent representations in procuring a contract are confirmed by statute,[90] but the court is empowered to take any such representation into account in deciding whether to

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81 *Minors' Contracts Act 1969*, *supra*, note 78, s. 5(1).

82 *Ibid.*, s. 5(2).

83 *Ibid.*, s. 6(1).

84 *Ibid.*, s. 6(2)(a).

85 *Ibid.*, ss. 5(2), 6(2), and 7. Section 6(3) sets out the circumstances to which the court must have regard in exercising its jurisdiction to affirm contracts of minors under eighteen years of age.

86 *Ibid.*, s. 7(1).

87 *Ibid.*, s. 9(1).

88 *Ibid.*, s. 9(2).

89 *Ibid.*, s. 10.

90 *Ibid.*, s. 15(4).

disaffirm or approve a contract and in making an order for compensation or restitution of property.[91]

While the New Zealand legislation has gone some distance towards responding to uncertainty and potential unfairness in the common law, we would question whether the division of minors into two classes is warranted. As well, the legislation, in effect, requires that contracts of minors under eighteen be treated differently depending on how they are categorized. Certain insurance contracts and contracts of service are enforceable against a minor under eighteen in the first instance, and all other contracts are unenforceable against such a minor in the first instance. In view of the difficulties that have arisen under common law categorizations, the wisdom of this approach may be questioned.

(c) NEW SOUTH WALES

New South Wales undertook a major revision of the law relating to minors in 1970. The *Minors (Property and Contracts) Act, 1970*[92] provides that persons eighteen years and over have full capacity to participate in civil acts,[93] defined to include, in part, contracts and dispositions of property.[94] Minors, defined as persons under eighteen,[95] are not bound by their civil acts except as provided by the legislation.[96] The legislation provides that certain categories of civil acts are presumptively binding on minors.[97] A civil act participated in by a minor that is presumptively binding has effect as if the minor had not been under the disability of minority at the time of participation.[98]

A civil act that was for the benefit of the minor at the time the minor participated in the act is presumptively binding.[99] Dispositions of property by a minor are presumptively binding if the consideration is not manifestly inadequate at the time of disposition, and the whole or any part of the consideration is received by the minor.[100] Dispositions of property to a minor are presumptively binding if the consideration given or to be given by the minor is not manifestly excessive at the time of disposition.[101] Certain other civil acts are also presumptively binding, such as a disposition made wholly or partly as a gift,

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91 *Ibid.*

92 *Minors (Property and Contracts) Act, 1970*, Stat. N.S.W. 1970, Vol. 2., No. 60.

93 *Ibid.*, s. 8.

94 *Ibid.*, s. 6(1).

95 *Ibid.*

96 *Ibid.*, s. 17.

97 *Ibid.*, ss. 19-25.

98 *Ibid.*, s. 6(3).

99 *Ibid.*, s. 19.

100 *Ibid.*, s. 20(1).

101 *Ibid.*, s. 20(2).

where the disposition was reasonable at the time it was made.[102] A civil act is presumptively binding in favour of a third party if that party has, for value and without notice of the minority, acquired property affected by the civil act or altered his or her position in reliance on that act.[103]

A very significant limit on these presumptions is that they do not apply to a civil act participated in by a minor who, by reason of youth, lacked the understanding necessary for the participation.[104] Accordingly, the legislation requires that minors, as well as the type of civil act, be categorized. The Act also distinguishes between married and unmarried minors for limited purposes: "a receipt by a married minor for rents, profits or other income or for accumulations of income is presumptively binding".[105]

Capacity to participate in civil acts may be granted by a court, where it appears to the court that the grant is for the benefit of the minor.[106] A civil act by a minor authorized by court order is presumptively binding.[107] As well, dispositions of property by or to a minor may be certified by an independent solicitor or by the Public Trustee, to the effect that the minor understands the disposition and makes it voluntarily and for consideration that is not manifestly inadequate.[108] Dispositions certified in this way are presumptively binding.[109] Again, the presumptions relating to court-approved civil acts and certified dispositions appear not to apply to a civil act participated in by a minor who, by reason of youth, lacked the understanding necessary for the participation.[110]

A civil act participated in by a minor may be affirmed by the minor after reaching the age of eighteen or, after the death of the minor, by the personal representative.[111] A civil act by a minor may be affirmed by a court on application of the minor or other interested person if it appears to the court that such affirmation is for the benefit of the minor.[112] Civil acts affirmed in any of

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102 *Ibid.*, s. 21. Sections 22 and 23 set out other circumstances under which a civil act by a minor will be presumptively binding.

103 *Ibid.*, s. 24.

104 *Ibid.*, s. 18.

105 *Ibid.*, s. 25. Again, the presumption would only apply where the minor did not, by reason of youth, lack the understanding necessary to the receipt.

106 *Ibid.*, ss. 26 and 27.

107 *Ibid.*

108 *Ibid.*, s. 28(2).

109 *Ibid.*, s. 28(1).

110 *Ibid.*, s. 18.

111 *Ibid.*, s. 30.

112 *Ibid.*

these ways are presumptively binding[113] except where the minor lacked, by reason of youth, the understanding necessary for participation in the civil act.[114]

A minor may repudiate a civil act during minority or until the age of nineteen, unless the act was for his or her benefit.[115] Such repudiation may also be effected by a deceased minor's personal representative,[116] or by a court.[117] However, repudiation is not effective as against a party or any other person where the civil act is presumptively binding on the minor in favour of such person.[118] If a civil act is not repudiated within the appropriate time, it becomes presumptively binding.[119] Again, this would not apply to a minor who lacked, by reason of youth, the understanding necessary for participation in the civil act.[120]

Where a civil act is repudiated in accordance with the legislation, a court may confirm the civil act, wholly or in part, or may adjust rights associated with it.[121] Where a civil act is presumptively binding in favour of any person, the court may not make orders adversely affecting that person's rights without his or her consent.[122] Subject to this limitation, where a civil act is repudiated the court may make orders to secure, "so far as practicable", just compensation and restitution.[123]

It should be noted that a civil act participated in by a minor cannot be enforced by the minor against any other person unless the act is presumptively binding in favour of that person.[124] A minor cannot obtain compensation for or restoration of property under a civil act that is not presumptively binding unless the act is repudiated: the court's jurisdiction to adjust the rights of the parties arises only once the civil act has been repudiated.[125] Accordingly, some pressure is brought to bear on the minor to repudiate or affirm.[126] As well, a person interested in a civil act may apply to a court to have the status of the civil act determined, and where it appears to the court on such an application that the

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113 *Ibid.*

114 *Ibid.*, s. 18.

115 *Ibid.*, s. 31.

116 *Ibid.*, s. 32.

117 *Ibid.*, ss. 34 and 36.

118 *Ibid.*, s. 35(1).

119 *Ibid.*, s. 38.

120 *Ibid.*, s. 18.

121 *Ibid.*, s. 37(1).

122 *Ibid.*, s. 37(3).

123 *Ibid.*, s. 37(4).

124 *Ibid.*, s. 39.

125 *Ibid.*, s. 37.

126 *Ibid.*, s. 38.

civil act is not presumptively binding, the court must either affirm or repudiate it on behalf of the minor.[127]

The New South Wales legislation also addresses specific problems that have arisen in connection with minors' contracts. Guarantors of minors' contracts are liable as they would be if the principal debtor were not a minor.[128] Persons under the age of twenty-one are answerable for their torts, whether or not the tort is connected with the contract, and whether or not the cause of action for the tort is in substance a cause of action in contract.[129] Persons under twenty-one may appoint an agent by power of attorney or otherwise, and a civil act in which a minor participates by agent has the same effect as if carried out by the minor without an agent.[130]

The legislation does provide clear answers where the common law was confused in connection with guarantees, tort liability and agency. However, the basic scheme of minors' contractual capacity set out in the legislation seems unduly complex, and establishes categories of contract and classes of minority that may be difficult to apply. On a policy level, the legislation expands the potential contractual liability of minors considerably, presumably to encourage commercial dealings with minors. Apart from the issue of whether this policy should be tempered to a greater degree by the desire to protect minors, it is questionable whether the legislation provides the kind of certainty required to increase significantly confidence in contracting with minors.

(d) BRITISH COLUMBIA

The *Law Reform Amendment Act, 1985*,[131] amends the *Infants Act*[132] and implements many of the recommendations made by the Law Reform Commission of British Columbia in its 1976 *Report on Minors' Contracts*.[133] The legislation attempts to balance the protection of minors from contractual liability against the rights of those who contract with minors.

The Act, which applies to both executed and executory contracts,[134] makes contracts unenforceable against minors and enforceable against other parties.[135] This rule is qualified by making a contract enforceable against the minor if it is

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127 *Ibid.*, s. 36.

128 *Ibid.*, s. 47(1).

129 *Ibid.*, s. 48.

130 *Ibid.*, s. 46.

131 *Law Reform Amendment Act, 1985*, S.B.C. 1985, c. 10, ss. 1 and 2.

132 R.S.B.C. 1979, c. 196.

133 Law Reform Commission of British Columbia, *Report on Minors' Contracts* (1976) (hereinafter referred to as "British Columbia Report").

134 *Law Reform Amendment Act, 1985*, *supra*, note 131, s. 1, adding to the *Infants Act* s. 16.1.

135 *Ibid.*, s. 16.2.

enforceable under any other legislative provision; affirmed by the minor after attaining majority; performed or partially performed by the minor within one year of attaining majority; or not repudiated within one year after the minor attains majority.[136] In addition, the court is given broad powers to order compensation or restitution to a party to a repudiated or breached minor's contract.[137]

The legislation also entitles a minor to apply to the court for an order granting full capacity to contract or the capacity to enter into a particular contract or class of contracts.[138] A minor may also apply to the Public Trustee for an order granting contractual capacity or for an order ratifying a specific contract.[139]

A party who contracts with a minor may, within one year from the date of the minor's majority, request that the minor either affirm or repudiate the contract.[140] If the contract is not affirmed within sixty days of receipt of the notice, the contract is deemed to be repudiated.[141] In the absence of a request for affirmation or repudiation, a minor would have one year, after reaching majority, to repudiate a contract made during minority.[142]

Under the British Columbia Act, the common law limits on minors' tort liability where the tort is connected with a contract remain unchanged.[143] However, a minor would not be able to make fraudulent age representations with impunity. The court could take such representations into account, where they induced a person to enter into a contract, when determining the measure of relief available to a party to the contract.[144] Dispositions of property under an unenforceable minor's contract would be effective to transfer title unless and until otherwise ordered by the court.[145] Dispositions to *bona fide* transferees for value would not be invalid.[146]

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136 *Ibid.*, s. 16.2(1).

137 *Ibid.*, s. 16.3(1)(b).

138 *Ibid.*, s. 16.4(1).

139 *Ibid.*, s. 16.5(1).

140 *Ibid.*, s. 16.9(1).

141 *Ibid.*, s. 16.9(2). The Law Reform Commission of British Columbia proposed that a minor who had attained the age of majority should have to repudiate a contract within sixty days of receiving a written notice. If repudiation did not take place within that time then the contract would be enforceable. See British Columbia Report, *supra*, note 133, at 47.

142 *Law Reform Amendment Act, 1985*, *supra*, note 131, s. 1, adding to the *Infants Act* s. 16.11.

143 *Ibid.*, s. 16.8.

144 *Ibid.*, s. 16.3(3)(b) and 16.3(4).

145 *Ibid.*, s. 16.3(6).

146 *Ibid.*, s. 16.3(5).

With respect to the liability of guarantors, the Act provides[147] that both guarantors and indemnifiers are bound, even though the contract may be unenforceable against the minor.

3. REFORM PROPOSALS IN OTHER JURISDICTIONS

(a) ALBERTA

In 1975, the Alberta Institute of Law Research and Reform reviewed the law of minors' contracts and concluded that it was uncertain, sometimes harsh, and in need of change.[148] It recommended that, in general, contracts made by minors should not be enforceable against them but should be enforceable against other parties.[149] However, the courts should have a broad discretionary power to grant relief to any party by way of compensation or restitution.[150] The majority of the Institute's members also favoured the creation of a category of contract that would be enforceable against minors: an adult would be able to enforce a contract against a minor party if a court was satisfied that the adult reasonably believed, at the time the contract was made, that it was "fair and reasonable in itself and in the circumstances of the minor".[151] The court could, nonetheless, refuse to enforce the contract if it was satisfied that the contract was improvident from the minor's point of view and that restitution or compensation would put the adult in as good a position as if the contract had not been made.[152] A minority of the Institute's members opposed the creation of this special category of contract, considering that it would lead to uncertainty and complexity and was not necessary in view of the court's broad powers to order relief under an unenforceable contract.[153]

The Institute's recommendations would apply to executory as well as executed contracts.[154] Subject to a dissent, the provisions of the proposed Act would also apply where the minor had misrepresented his or her age.[155] However, a minor's misrepresentations as to age would not result in tort liability.[156] Except for such misrepresentations, a minor would be liable for tortious conduct, regardless of whether the tort was connected with a contract

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147 *Ibid.*, s. 16.6.

148 Alberta Institute of Law Research and Reform, Report No. 14, *Minor's Contracts* (1975) (hereinafter referred to as "Alberta Report"), at 27.

149 *Ibid.*, at 28.

150 *Ibid.*, at 29.

151 *Ibid.*, at 32.

152 *Ibid.*, at 33.

153 *Ibid.*

154 *Ibid.*, at 34.

155 *Ibid.*, at 36.

156 *Ibid.*, at 37.

or whether the cause of action in tort was, in substance, a cause of action in contract.[157]

Under the recommendations of the Institute, a minor's contract would become enforceable if affirmed by the minor after attaining majority or if not repudiated by the minor within one year of attaining majority.[158] Subject to a dissent,[159] the Institute would also allow an adult party to a contract to give notice to a minor party who had attained majority requiring that the contract be affirmed or repudiated within 30 days, failing which it would become enforceable against the minor.[160]

A minor's contract would be enforceable if approved by the court.[161] Approval could be obtained by the minor or an adult party, before or after the contract was made, if the court was satisfied that the approval was for the benefit of the minor.[162] As well, the court would be empowered to grant capacity to enter contracts, or any description of contracts, to a minor if satisfied that the grant would be for the minor's benefit.[163] Contracts made by a minor under such a grant would be enforceable against the minor.[164]

The Institute also addressed the position of a *bona fide* third party transferee of property for value, and recommended that the title of such a person should not be invalid by reason only that the transferor acquired the property under a contract unenforceable against a minor.[165] On the issue of guarantees, the Institute proposed that a guarantor of a minor's obligation should be liable to the same extent as if the minor had been an adult.[166] The guarantor's recourse against the minor for indemnity would turn on whether the primary obligation was enforceable against the minor, although the court would have power to grant just relief to the guarantor in any event.[167] The final collateral issue dealt with by the Institute was a minor's power to appoint an agent. It was recommended that such an appointment, by power of attorney or otherwise, should be valid.[168]

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157 *Ibid.*

158 *Ibid.*, at 35.

159 *Ibid.*, at 34.

160 *Ibid.*, at 35.

161 *Ibid.*, at 39.

162 *Ibid.*

163 *Ibid.*, at 40.

164 *Ibid.*

165 *Ibid.*, at 41.

166 *Ibid.*, at 42.

167 *Ibid.*

168 *Ibid.*, at 43.

The recommendations of the Alberta Institute would correct certain problems in the common law concerning tort liability, agency, guarantees, and the position with respect to executory contracts. The Institute also focused clearly on the central issue of the law of minors' contracts, namely, the extent to which minors ought to be protected at the expense of other parties. It concluded that contracts should, in general, be unenforceable against minors subject to a broad discretion in the court to relieve against unfairness by ordering compensation or restitution. This basic approach would be modified by the majority of the Institute, which would create a category of contract to be enforceable against minors.

(b) ENGLAND

The Law Commission produced its final Report on the law of minors' contracts in 1984.[169] Prior to the release of that Report, the Commission had prepared and circulated for discussion an extensive Working Paper,[170] which explored the issues of minors' contracts and suggested certain reforms.

In the Working Paper, two alternative sets of proposals were advanced. The more radical set of proposals would have conferred full contractual capacity on minors aged sixteen and over and would have rendered contracts of minors under the age of sixteen unenforceable.[171] Some limited protection would have been given to persons contracting with minors under the age of sixteen with respect to the recovery of benefits retained by the minor *in specie*.[172] After receiving public comment on these proposals, the Law Commission concluded that this approach should not be pursued.[173]

The second set of proposals in the Working Paper advocated changes to, and the codification of, the law of minors' contracts. Public consultation following the release of the Working Paper persuaded the Law Commission that codification of the law of minors' contracts was not required.[174] The Law Commission concluded that any legislation relating to the law of minors' contracts should be confined to those areas of the current law that were likely to cause difficulty or lead to injustice.[175]

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169 England, The Law Commission, Report No. 134, *Law of Contract: Minors' Contracts* (1984) (hereinafter referred to as "English Law Commission Report").

170 England, The Law Commission, Working Paper No. 81, *Law of Contract: Minors' Contracts* (1982) (hereinafter referred to as "Working Paper No. 81").

171 *Ibid.*, paras. 13.5 and 13.6.

172 *Ibid.*, para. 13.8.

173 English Law Commission Report, *supra*, note 169, para. 2.3.

174 *Ibid.*, paras. 3.2-3.4.

175 *Ibid.*, para. 3.5.

In its final Report, the Law Commission recommended that the law governing minors' contracts should continue to be based on the principle of ''qualified unenforceability'',[176] a term coined in the Working Paper for the general rule that minors' contracts are unenforceable against them subject to a number of specific exceptions covering contracts of a class likely to benefit minors.[177] In particular, it was recommended that, with the exception of contracts for necessaries, contracts of employment, and contracts involving certain lasting property rights or obligations, minors' contracts should be enforceable by a minor but unenforceable against a minor.[178]

In its Working Paper, the Law Commission had tentatively recommended that a minor, on reaching majority, should not be able to ratify a contract made during minority.[179] It had further suggested that, in an action on a ''new contract'' that reproduced the effect of the earlier unenforceable contract, it should be a defence to the action that the terms of the contract were unfair to the minor.[180] This proposal was not well received. In light of the criticism, the Law Commission took the view in its final Report that ratification of a contract upon reaching majority should be permitted and that there should be no limits placed on the effectiveness of ''new contracts''.[181]

The Working Paper had provisionally recommended that guarantees of unenforceable minors' contracts should be enforceable.[182] This proposal was endorsed by those consulted and is included in the Law Commission's final Report.[183]

With respect to property acquired by a minor under an unenforceable contract the Law Commission concluded that, when it would be equitable to do so, a minor should return such property or any property representing it to the other contracting party.[184] This requirement would not extend to situations where the property had been sold and the proceeds dissipated. The Law

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176 *Ibid.*, paras. 1.5 and 1.12.

177 Working Paper No. 81, *supra*, note 170, para. 13.10.

178 English Law Commission Report, *supra*, note 169, para. 1.5. Contracts in the latter class would include: contracts for the sale, acquisition or lease of an interest in land; marriage settlements; agreements to pay calls on shares; and contracts of partnership.

179 Working Paper No. 81, *supra*, note 170, para. 13.30.

180 *Ibid.*

181 English Law Commission Report, *supra*, note 169, paras. 4.4-4.8.

182 Working Paper No. 81, *supra*, note 170, para. 13.37.

183 English Law Commission Report, *supra*, note 169, paras. 4.12-4.14.

184 *Ibid.*, para. 4.22. In its Working Paper the Law Commission provisionally recommended that a minor should only have to return property *in specie*. If the minor was unable to return the property he or she should pay for it unless it could be shown that the property was not disposed of in order to defeat a claim for its return. See Working Paper No. 81, *supra*, note 170, para. 13.14.

Commission reasoned that to require full payment of the value of the property would be to enforce an otherwise unenforceable contract against the minor.[185]

The Working Paper had tentatively suggested that a minor should be liable for the tort of deceit, even if associated with a contract that was unenforceable against the minor,[186] and that no other changes should be made to the common law protection of minors from liability for torts connected with unenforceable minors' contracts. In its final Report, the Law Commission stated that it was not persuaded that there were difficulties in practice relating to the protection of minors from liability for deceit. Accordingly, it concluded that legislation on this issue was unnecessary.[187]

The proposals of the Law Commission would not, if enacted, constitute a major departure from existing law. It would still be necessary to categorize minors' contracts. The courts would have some discretion to order compensation and restitution, but persons who chose to deal with minors would still do so at their own risk.

(c) SCOTLAND

In 1985, the Scottish Law Commission produced a Consultative Memorandum relating to legal capacity and responsibility of minors and pupils.[188] This memorandum explored the issues of legal capacity and responsibility for those under eighteen years of age and sought comments on proposals for reform. The memorandum dealt not only with contractual capacity and responsibility, but also with capacity in respect of other legal acts. Since these other legal acts are beyond the scope of this Report, we shall refer to the work of the Scottish Law Commission only insofar as it relates to contracts.

Scots law divides persons under the age of eighteen into pupils (boys under fourteen years of age and girls under twelve years of age) and minors (boys between fourteen and eighteen and girls between twelve and eighteen).[189] Tutors and curators are the two categories of guardians for pupils and minors respectively.[190] A child's tutors and curators are usually his or her parents.[191]

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185 English Law Commission Report, *supra*, note 169, para. 4.23. In its Working Paper the Law Commission also recommended that an adult should not be entitled to recover the proceeds of a sale of the property. See Working Paper No. 81, *supra*, note 170, para. 13.14.

186 *Ibid.*, paras. 13.34 and 13.35.

187 English Law Commission Report, *supra*, note 169, para. 5.3.

188 Scottish Law Commission, Consultative Memorandum No. 65, *Legal Capacity and Responsibility of Minors and Pupils* (1985) (hereinafter referred to as "Scottish Memorandum").

189 *Ibid.*, para. 2.1.

190 *Ibid.*

191 *Ibid.*

The basis of Scots law in this area is the incapacity of pupils whose tutors must, generally, act on their behalf in all legal transactions, and the limited capacity of minors who, if they have a curator, must generally act with their curator's consent,[192] and who, if they do not have a curator[193] or are married or forisfamiliated,[194] have full capacity to perform all legal acts.[195]

Where a pupil purports to contract on his or her own behalf, or where a minor who has a curator purports to contract without the curator's consent, the law is unsettled whether the contract is completely void or merely unenforceable against the pupil or minor.[196]

Valid transactions entered into by or on behalf of pupils and minors are subject to the qualification that, in general, they may be set aside or "reduced" at the instance of the pupil or minor within four years of majority on the grounds of minority and lesion.[197] The standard of lesion is "enorm lesion", or considerable prejudice to the pupil or minor. The existence of lesion is determined as at the time of the transaction, rather than the time of suit, and in

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192 *Ibid.*

193 *Ibid.*, para. 2.7.

194 *Ibid.*, paras. 2.24 and 2.25. A minor who has, with parental consent, set out on an independent course of life is forisfamiliated.

195 There are two exceptions to this rule. First a minor cannot dispose of heritable property by a gratuitous *inter vivos* deed (Scottish Memorandum, *supra*, note 188, para. 2.8). Secondly, while a minor without curators can give a valid receipt or discharge for payment of capital or income, he or she cannot compel a debtor to make a capital payment, as opposed to a payment of interest or income, unless security is first given that the money will be properly invested or otherwise used for the minor's benefit (Scottish Memorandum, *supra*, note 188, para. 2.8). A minor acting with the consent of a curator is under the same disability as a minor without curators in relation to gratuitous disposition of heritable property and the power to compel payment of a capital debt (Scottish Memorandum, *supra*, note 188, para. 2.9).

196 Scottish Memorandum, *supra*, note 188, paras. 2.2 and 2.10. See *ibid.* for references to literature that suggests that such contracts may be valid and enforceable by the minor or the pupil if beneficial.

The general rule of incapacity for pupils is subject to two qualifications. The first is that if money is lent to a pupil and expended on the pupil's estate or otherwise spent for his or her benefit the pupil will be liable to the extent of any enrichment (Scottish Memorandum, *supra*, note 188, para. 2.4). The second is that, by analogy to cases relating to minors, a pupil may be obliged at common law to pay for necessaries supplied to him. It is also thought that the statutory obligation to pay a reasonable price for necessaries in section 3 of the *Sale of Goods Act, 1979*, c. 54 (U.K.) applies to pupils (Scottish Memorandum, *supra*, note 188, para. 2.4).

As well, there are certain contracts that a minor with a curator is entitled to enter into alone. These include contracts for the supply of necessaries (Scottish Memorandum, *supra*, note 188, para. 2.14), contracts of apprenticeship and employment (Scottish Memorandum, *supra*, note 188, para. 2.23) and contracts in the course of the minor's profession, trade or business (Scottish Memorandum, *supra*, note 188, para. 2.20).

197 *Ibid.*, para. 2.7.

making the determination the court must consider not only the financial circumstances, but all of the circumstances of the transaction.[198]

The right of challenge on the ground of minority and lesion is not available in respect of contracts beneficial to minors or pupils, contracts entered into in the course of a minor's profession, trade or business, and contracts fraudulently induced by the minor.[199] The right of challenge will also be lost if the minor ratifies the transaction after attaining eighteen years of age.[200] Ratification may be express or by any free and deliberate act implying approval of the contract. What amounts to ratification depends on the circumstances of the case. In order for ratification to be effective, the ratifying party must be aware at the time of ratification of the right to reduce the contract, and the ratification must not have been induced by fraud.[201]

Finally, if a transaction is either void or reduced the party contracting with the pupil or the minor is bound to return anything received under the contract, whether or not the pupil or minor is in a position to do the same.[202] Restitution is mutual, however, and a minor must repay or restore anything obtained under the contract if it is still part of his or her estate.[203] The general obligation to return anything received under the contract is relaxed in favour of a minor if he or she has destroyed or squandered the property received under the contract.[204]

If a contract is void no rights of any kind can be passed to a third party.[205] If a contract is merely voidable, the rights of a third party depend on the classification of the third party's right to the property and whether the third party took the property in good faith, for value, and without notice of the defect.[206]

The Scottish Law Commission put forward two options for reform. Its preferred option was a single tier of incapacity (with some minor exceptions) extending to sixteen years of age and full legal capacity thereafter.[207] The Scottish Commission viewed this as a realistic dividing line between those who need special protection on account of immaturity and those who do not.

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198 *Ibid.*, para. 2.34.

199 *Ibid.*, para. 2.36. Note that a mere assertion of age in a deed by which a contract is constituted may not be enough if the minor was induced by the other party to make that declaration.

200 *Ibid.*, para. 2.37.

201 *Ibid.*

202 *Ibid.*, paras. 2.39 and 2.42.

203 *Ibid.*, para. 2.39.

204 *Ibid.*

205 *Ibid.*, para. 2.43.

206 *Ibid.*

207 *Ibid.*, paras. 5.12-5.15.

Under this option, the Scottish Commission suggested that all legal acts of persons under sixteen years of age should be performed on their behalf by their guardian, and any transactions that they purported to enter into on their own behalf would be invalid.[208] It proposed that this general rule should be subject to an exception for "everyday" transactions of a kind commonly entered into by persons of the age of the contracting party.[209] This exception was felt to cover the range of transactions commonly entered into by young persons of various ages.

With respect to the consequences of invalidity, the Scottish Commission suggested that the adult party should be obliged to return anything received under the transaction in accordance with common law principles, but that the court should be empowered to modify the young person's obligation to make restitution or recompense in any way it considered equitable in the circumstances.[210]

The second option put forward by the Scottish Commission was a modification of its preferred option, which incorporated an intermediate stage of qualified legal capacity for persons between sixteen and eighteen years of age.[211] Persons up to sixteen years of age were to be fully protected from the legal consequences of entering into transactions but were to be entitled to enter into "everyday transactions".[212] Persons between sixteen and eighteen years of age were to have capacity to enter into any transaction with the proviso that the court would have the power to set aside prejudicial transactions.[213] The right to take action to have such a transaction set aside would be exercisable until the young person reached the age of twenty-one years.[214] If a transaction was set aside, the court would have the power to modify the young person's obligation to return anything received under it.[215]

The Scottish Law Commission suggested that under its second option it might be appropriate to exclude the right of challenge in the following circumstances: where the transaction was one ordinarily entered into by a person of equal age;[216] where a sixteen or seventeen year old fraudulently misrepresented his or her age, thereby inducing the other party to enter into the contract;[217] where a *bona fide* third party had acquired rights for value that

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208 *Ibid.*, paras. 5.24 and 5.25.

209 *Ibid.*, paras. 5.28-5.35.

210 *Ibid.*, para. 5.99.

211 *Ibid.*, para. 5.22.

212 *Ibid.*, para. 5.63.

213 *Ibid.*, para. 5.22.

214 *Ibid.*, para. 5.122.

215 *Ibid.*, para. 5.123.

216 *Ibid.*, para. 5.110.

217 *Ibid.*, para. 5.112.

depended on the validity of the transaction;[218] where there were any "actings or events" after the young person in question attained the age of eighteen that amounted to ratification or any other personal bar to reduction;[219] and, possibly, where parental consent had been given[220] or where the transaction had been ratified by the courts.[221]

4. PROPOSALS FOR REFORM

(a) INTRODUCTION

The difficulties with the existing law of minors' contracts were reviewed in the first section of this chapter. The current law is complex, replete with anomalies, and difficult to apply. Results are uncertain, and the interests of fairness are not adequately served, particularly as regards compensation and restitution under an unenforceable contract. For these reasons, we believe that legislative reform would be appropriate.

The law of minors' contracts should, in our view, respond to three policy goals. First, protection should be provided to minors who, by reason of inexperience and lack of knowledge, enter into imprudent contracts. Secondly, innocent parties who contract with minors should be treated fairly. Thirdly, the law, in the interests of both minors and commerce, should not unnecessarily discourage commercial dealings with minors. While it is apparent that these goals conflict one with the other to some extent, we believe that it is possible to strike a reasonable balance among them that would be significantly simpler and more certain than the *status quo*. We favour a scheme under which some minors' contracts would be enforceable, and under which questions of fairness to the parties would be explicitly addressed in the case of an unenforceable minor's contract. To this end, we shall now consider specific reform issues.

(b) THE GENERAL RULE

The reason for special legal rules to govern minors' contracts is the need to protect minors. Consistent with this, we recommend that, as a general rule, minors' contracts should not be enforceable against them. However, it does not follow that these contracts should not be enforceable against adult parties. None of the policy goals require such reciprocity, and it would be strange if a minor, the person whom we are trying to protect, could not exercise such contractual rights as would be available to an adult.

Accordingly, we recommend that while minors' contracts should not be enforceable against them, minors should have the right to enforce their contracts, subject to the provisions recommended below and to the provisions of other legislation.

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218 *Ibid.*, para. 5.117.

219 *Ibid.*, paras. 5.114 and 5.116.

220 *Ibid.*, paras. 5.118 and 5.119.

221 *Ibid.*, para. 5.120.

(c) AFFIRMATION

Originally, the English Law Commission objected to providing for binding affirmation, after majority, of an obligation undertaken during minority.[222] In the view of the Law Commission, such a provision would have resulted in untoward pressure being brought to bear on persons who had recently attained majority. However, following consultation, the Law Commission was convinced that ratification after attaining the age of majority should be permitted.[223]

We are not aware of significant problems with ratification under the common law of Ontario of the kind projected by the Law Commission in its Working Paper. We would agree with the Law Commission's final proposal and with the position taken by the Law Reform Commission of British Columbia[224] that, while minors require the protection of special rules in relation to contracts, adults do not need protection against affirmation of obligations undertaken during minority.

Accordingly, we recommend that legislation should provide that a contract may be affirmed by a minor who has attained the age of majority, and that after such affirmation the contract may be enforced against the minor. However, to prevent affirmation from becoming a broad concept, we believe that an act of affirmation should be a conscious, positive one. Accordingly, we recommend that legislation should indicate that the mere receipt or retention of a benefit, after the age of majority, pursuant to a minor's contract, is not conclusive evidence of affirmation of the contract.

We have discussed the requirement, under section 7 of the *Statute of Frauds*, that ratification of minors' contracts be in writing.[225] In our view, this requirement is unduly rigid. In support of this view, we note that judicial interpretation of the requirement has tended to be very liberal, presumably in response to the injustice that would be caused by its strict application.

Accordingly, we recommend that section 7 of the *Statute of Frauds* should be repealed.[226]

(d) REPUDIATION

We have proposed, as a general rule, that minors' contracts should be unenforceable against minors but enforceable against other parties. However, the policy of protecting minors does not require that other parties be exposed indefinitely to one-sided liability. It would seem reasonable to place some time limit on the period after majority during which a minor may hold another party

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222 Working Paper No. 81, *supra*, note 170, paras. 9.8-9.9.

223 English Law Commission Report, *supra*, note 169, paras. 4.4-4.8.

224 British Columbia Report, *supra*, note 133, at 34-35.

225 *Supra*, this ch., sec. 1(b)(iii).

226 Further recommendations relating to contractual aspects of the *Statute of Frauds* are discussed *supra*, ch. 5.

to a contract, while not affirming the contract. As well, the other party should be permitted to require a decision, within a fairly short period after the minor reaches the age of majority, as to whether the contract is to be affirmed or repudiated.

Accordingly, we recommend that legislation should provide that a party who contracts with a minor may, by notice in writing after the minor has attained the age of majority, require the minor to affirm or repudiate the contract within thirty days from receipt of the notice. Unless the minor repudiates the contract within the thirty day period, or within one year after attaining the age of majority, whichever period expires first, the contract may be enforced against the minor. Because of the important consequences that follow a notice to affirm or repudiate a contract, we further recommend that the notice should refer to the consequences of a failure to respond to the notice.

We also believe it to be important to indicate the kinds of conduct that would amount to repudiation. Accordingly, we recommend that legislation should provide that repudiation of a contract by a minor includes:

(1) a refusal to perform the contract or a material term thereof;

(2) the making of a claim for relief under a contract unenforceable against a minor; and

(3) the giving of an oral or written notice of repudiation to the other party.

(e) Relief Under an Unenforceable Contract

One of the most difficult issues in the current law of minors' contracts is that of relief to parties to a contract that is unenforceable against a minor. It is far from clear what the governing principles are at the present time, and whether there are different principles to govern different categories of contract.[227] In our view, relief should not hinge on technical rules; nor should it depend on how a contract is categorized.

Accordingly, we recommend that legislation should provide that, where a contract is unenforceable against a minor because of minority, an action for relief may be brought by the minor, before or after attaining majority, or by the other party to the contract after the minor has repudiated the contract. In any such action, the court should be empowered to grant to any party such relief — for example, by way of restitution or compensation — as may be just.

(f) Contracts in the Best Interests of the Minor

We have discussed the problems caused by the fine distinctions drawn in the current law between necessaries and non-necessaries, beneficial contracts, trading contracts and contracts of service, contracts valid until repudiated, contracts not binding unless ratified, and so on. The current law has attempted

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[227] *Supra*, this ch., sec. 1(c).

to achieve the policy goal of treating innocent parties who contract with minors fairly through the use of these various exceptions to the basic rule of unenforceability. However, as legislation and reform proposals from other jurisdictions reveal, there are other ways of achieving just results for innocent parties who contract with minors that are less technical and rigid.

While we do not believe that the protection of minors requires that they be relieved of contractual liability in every case, we would not enlarge the class of contracts now enforceable against minors. Rather, we prefer to replace the current technical exceptions with a single exception to the general rule of unenforceability. We believe that contracts should be enforceable against minors where the other party to the contract can satisfy the court that the contract was in the best interests of the minor. We would note that the enforcement of contracts that benefit minors is consistent with the three policy goals outlined above.[228]

Accordingly, we recommend that legislation should provide that a contract may be enforced against a minor if the other party to the contract satisfies the court that the contract was in the best interests of the minor.

(g) Executed and Executory Contracts

As we have discussed in an earlier section of this chapter, there is some uncertainty under the present law as to the enforceability of executory contracts for necessaries.

The status of executed contracts was considered by the English Law Commission in its Working Paper.[229] The Commission suggested that, where a contract had been performed by both sides, the law should not interfere merely because the minor had acted improvidently or suffered hardship. The Law Commission provisionally recommended[230] that an executed contract should only be re-opened where the adult party had taken advantage of the minor's youth and thereby induced a contract that caused hardship to the minor.

The Law Reform Commission of British Columbia also addressed this issue and reached a different conclusion.[231] It stressed that an improvident contract does not lose its character as such by virtue of being executed. While acknowledging the advantages of finality and certainty that would accompany a rule against reopening executed contracts, it considered that the protection of minors should not be limited to cases where the minor had not performed the

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228 *Supra*, this ch., sec. 4(a).

229 Working Paper No. 81, *supra*, note 170, para. 13.29. In its final Report, the Law Commission made no recommendation on this issue. See English Law Commission Report, *supra*, note 169, para. 5.2.

230 Working Paper No. 81, *supra*, note 170, para. 13.29.

231 British Columbia Report, *supra*, note 133, at 33-34.

contract.[232] Under our proposed scheme, a distinction between executed and executory contracts would be anomalous. Minors' contracts would be enforceable only in limited circumstances, under which there would be no need to protect minors from liability. Accordingly, we agree with the conclusions of the Law Reform Commission of British Columbia.

We therefore recommend that the proposed legislation should apply to executed as well as executory contracts.

(h) JUDICIAL APPROVAL OF CONTRACTS AND GRANTS OF CAPACITY

In some circumstances, the basic rule of unenforceability of minors' contractual obligations would prove very inconvenient. For example, a minor might wish to enter into a contract that would be beneficial, but be unable to do so because the other party is unwilling to take the risk. A provision for court approval of a minor's contract would meet this problem, at least where the contract is of sufficient importance to the parties to warrant an application to court. In other cases, a minor might wish to have capacity to enter into a class of contracts or to enter into contracts generally, in order to carry on a business. It is true that judicial conferral of capacity to enter into contracts not specifically reviewed by the court might result in a minor entering into a particular contract that is improvident. However, there might well be circumstances in which, on balance, it would be in the minor's interests, to confer contractual capacity, and the risk of improvident contracts being made by the minor could be met by attaching terms and conditions to the court's approval.

Accordingly, we recommend that legislation should provide that a contract entered into by a minor is enforceable against the minor if it is approved by the court. A party to the contract should be able to apply for the approval of the court either before or after the contract is entered into. Approval should not be given unless the court is satisfied that the contract would be for the benefit of the minor.

We further recommend that legislation should provide that, on application by a minor, the court may grant to the minor capacity to enter into contracts generally, or into any description of contract, subject to such terms and conditions as the court thinks fit. The court should not make such an order unless satisfied that it would be for the benefit of the minor.

(i) DISPOSITIONS OF PROPERTY

Like the Alberta Institute of Law Research and Reform,[233] we believe that questions of title to property transferred pursuant to a contract that is unenforceable against a minor should not be left unresolved until the contract becomes binding or the court makes an order regarding title. As between the parties to

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[232] *Ibid.* See, also, *Law Reform Amendment Act, 1985*, *supra*, note 131, s. 1, adding to the *Infants Act* s. 16.1.

[233] Alberta Report, *supra*, note 148, at 40.

such a contract, a transfer should be valid unless and until the contract is repudiated and restitution is ordered by the court. As regards *bona fide* third party transferees for value, we believe that the third party's title should not be invalid only because the transferor acquired the property under a contract that is unenforceable against a minor. As noted earlier, an analogous position is taken under section 24 of the *Sale of Goods Act*, which allows good title to a good faith purchaser of goods from a seller with a voidable title to them.[234]

We do not, however, recommend altering existing statute law regarding conveyances of real property by a minor.[235] The focus of our current project is the law of contracts, and it would be inadvisable, in our view, to attempt reform of the law of conveyancing in this context.

Accordingly, we recommend that legislation should provide that, subject to the provisions of any other legislation, a disposition of property or a grant of a security or other interest therein made pursuant to a contract that is unenforceable against a minor is effective to transfer the property or interest unless and until the court orders otherwise. The legislation should further provide that, subject to the provisions of any other legislation, a subsequent disposition of property or a grant of a security or other interest therein to a *bona fide* transferee or grantee for value is not invalid only because the transferor or grantor acquired the property under a contract that was unenforceable against a minor.

(j) AGENCY

We have commented on the anomalous restriction in the common law on the granting of a power of attorney by a minor.[236] We see no reason why a minor should not be able to do through an agent what he or she can do in person. At the same time, it should be emphasized that the fact that a minor acts through an agent should not in itself give rise to liability on the minor's part. That is, the minor should be liable on a contract entered into by an agent only to the extent he or she would have been liable had the contract been made by the minor personally. Again, we are mindful of restrictions in the existing law on conveyancing of real property by minors, and would make our recommendations subject to these restrictions.

Accordingly, we recommend that legislation should provide that, subject to the provisions of any other legislation, a minor may appoint an agent by power of attorney or otherwise to enter into any contract or make any disposition of property or grant any security or other interest. However, any contract, disposition, or grant by such agent should have no greater validity or effect as against the minor than it would have had if participated in or effected by the minor without an agent. The legislation should further provide that a person may, by an agent under the age of majority, make any contract, dispose

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234 *Supra*, note 24. See, also, this ch., sec. 1(c)(ii).

235 See, for example, *Children's Law Reform Act, 1982*, S.O. 1982, c. 20, s. 60.

236 *Supra*, this ch., sec. 1(f).

of any property or grant any security or other interest that a person may make, dispose of, or grant by an agent who has attained the age of majority.

(k) GUARANTEES

We have discussed the uncertainty in the common law as to whether adults can be sued successfully on guarantees of minors' unenforceable obligations.[237] In our view, there is no policy justification why an adult should not be liable on such a guarantee. We also cannot justify the existing distinction between guarantees and indemnities.

Accordingly, we recommend that legislation should provide that a guarantor of an obligation of a minor is bound by the guarantee as if the minor were an adult. If the obligation is enforceable against the minor, the guarantor should be entitled to be indemnified by the minor to the same extent as if the minor were an adult. If the obligation is not enforceable against the minor, the court should be empowered to grant the guarantor such relief against the minor as is just. For the purposes of the proposed legislation, "guarantor" should include a person who enters into a guarantee or indemnity or otherwise undertakes to be responsible for the failure of a minor to carry out a contractual obligation.

(l) TORT LIABILITY

Under present law, subject to the capacity of a minor to form certain mental attitudes involved in specific torts, minors are generally held liable for their torts. However, as a result of the general rule that minors' contracts should not be enforceable against them, minors have not been held liable for tortious conduct where the effect of such a holding would be indirectly to enforce an unenforceable contract. A distinction has developed between situations where the conduct in question can be considered as directly connected to the contract (in which case there is no liability) and situations where the conduct can be seen as independent of the contract (in which case liability is imposed). The question that arises is whether this distinction should be maintained.

If one takes the view that the law of torts and the law of contracts fulfill different purposes and that, while minors should be protected from the world of commerce, they should be held accountable for their wrongful acts, then it is logical that minors should be liable for their torts regardless of whether the cause of action in tort is, in substance, also a cause of action in contract. If, however, one takes the view that the law of contracts and the law of torts are not very different in function, then it appears that the protection of minors from contractual liability would be subverted if there were not special rules limiting minors' liability for torts associated with contracts.

Reform proposals from other jurisdictions have varied considerably in approach. The Latey Committee, in England, was tentatively prepared to leave the common law rule in place,[238] except as regards fraud unrelated to age. In the

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[237] *Supra*, this ch., sec. 1(e).

[238] England, *Report of the Committee on the Age of Majority* (Cmnd. 3342, 1967), at 91-93.

case of fraud unrelated to age, the Committee proposed that minors should be liable even if the effect would be indirectly to enforce an otherwise unenforceable contract.[239] The Committee considered, however, that the common law limits on tort liability should continue to apply to fraud related to age.[240]

The Law Commission provisionally affirmed the general common law rule relating to minors' liability in tort[241] except as regards a minor's fraud.[242] In the view of the Law Commission, a minor should be held liable for the tort of deceit whether or not the result would be indirectly to enforce a contract. It was apparently not considered that fraud related to age should be dealt with differently than fraud in general.

The New South Wales legislation provides that a minor is liable for a tort whether or not the tort is connected with a contract.[243] The legislation in New Zealand appears to have maintained the common law distinction, except that a minor's fraud may be taken into account by a court in an action for restitution or compensation.[244]

The Law Reform Commission of British Columbia would maintain the common law rule notwithstanding the problems with its application. As to fraud, the Commission favoured the New Zealand solution, that is, courts should be permitted to take a minor's fraud into account in determining the measure of relief available to parties to a contract unenforceable against a minor.[245]

The Alberta Institute of Law Research and Reform considered that the common law distinction between independent torts and torts connected with contracts was artificial and uncertain, and should therefore be abolished. However, the Institute suggested that an exception be made with respect to fraud related to age and that minors should not be held liable for damages resulting from false representations as to age.[246]

We would agree with the position taken by the New South Wales legislation and the Alberta Institute of Law Research and Reform to the effect that minors should be liable for both independent torts and torts connected with contracts. We believe that minors should be liable for their tortious conduct even in respect of age misrepresentation. Accordingly, we recommend that legislation should provide for the imposition of liability in tort on minors,

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239 *Ibid.*, at 92.

240 *Ibid.*, at 93.

241 Working Paper No. 81, *supra*, note 170, para. 11.4.

242 *Ibid.*, para. 11.2.

243 *Minors (Property and Contracts) Act, 1970*, *supra*, note 92, s. 48.

244 *Minors' Contracts Act 1969*, *supra*, note 78, s. 15(4).

245 British Columbia Report, *supra*, note 133, at 36-37.

246 Alberta Report, *supra*, note 148, at 37.

regardless of whether the tort is connected with a contract and regardless of whether the cause of action in tort is in substance a cause of action in contract, except where the contract would provide a defence to an individual who had attained majority.

In order to prevent the worst kinds of overreaching, however, we further recommend that a minor's liability for damages resulting from a false representation as to age should be subject to two limitations. First, legislation should provide that, where the false representation has induced the making of a contract, a minor's liability in damages for the false representation only arises where the person to whom the representation was made had reasonable grounds to believe that the representation was true. Secondly, legislation should provide that a minor will not be liable in damages for false representations as to age by reason only of the fact that the minor has signed or otherwise adopted a document relevant to the transaction that contains a statement that the minor has attained the age of majority or otherwise has contractual capacity, that was prepared and tendered by the person to whom the representation was made or with whom the contract was made, and that was preprinted and used by such person in like transactions. These limitations, in our view, are necessary to prevent potential exploitation of minors and are in accordance with the general policy of protecting minors from contractual liability.

Recommendations

The Commission makes the following recommendations:

1. Subject to the provisions recommended below and to the provisions of other legislation, minors' contracts should not, as a general rule, be enforceable against them, but minors should have the right to enforce their contracts.

2. Legislation should provide that a contract may be affirmed by a minor who has attained the age of majority, and that after such affirmation the contract may be enforced against the minor.

3. Legislation should provide that the mere receipt or retention of a benefit, after the age of majority, pursuant to a minor's contract, is not conclusive evidence of affirmation of the contract.

4. Section 7 of the *Statute of Frauds* should be repealed.

5. Legislation should provide that a party who contracts with a minor may, by notice in writing after the minor has attained the age of majority, require the minor to affirm or repudiate the contract within thirty days from receipt of the notice. Unless the minor repudiates the contract within the thirty day period, or within one year after attaining the age of majority, whichever period expires first, the contract may be enforced against the minor.

6. The notice to affirm or repudiate a contract referred to in Recommendation 5 should refer to the consequences of a failure to respond to the notice.

7. Legislation should provide that repudiation of a contract by a minor includes:

   (a) a refusal to perform the contract or a material term thereof;

   (b) the making of a claim for relief under a contract unenforceable against a minor; and

   (c) the giving of an oral or written notice of repudiation to the other party.

8. Legislation should provide that, where a contract is unenforceable against a minor because of minority, an action for relief may be brought by the minor, before or after attaining majority, or by the other party to the contract after the minor has repudiated the contract. In any such action, the court should be empowered to grant to any party such relief as may be just.

9. Legislation should provide that a contract may be enforced against a minor if the other party to the contract satisfies the court that the contract was in the best interests of the minor.

10. The proposed legislation should apply to executed as well as executory contracts.

11. Legislation should provide that a contract entered into by a minor is enforceable against the minor if it is approved by the court. A party to the contract should be able to apply for the approval of the court either before or after the contract is entered into. Approval should not be given unless the court is satisfied that the contract would be for the benefit of the minor.

12. Legislation should provide that, on application by a minor, the court may grant to the minor capacity to enter into contracts generally, or into any description of contract, subject to such terms and conditions as the court thinks fit. The court should not make such an order unless satisfied it would be for the benefit of the minor.

13. Legislation should provide that, subject to the provisions of any other legislation, a disposition of property or a grant of a security or other interest therein made pursuant to a contract that is unenforceable against a minor is effective to transfer the property or interest unless and until the court orders otherwise.

14. Legislation should further provide that, subject to the provisions of any other legislation, a subsequent disposition of property or a grant of a security or other interest therein to a *bona fide* transferee or grantee for value is not invalid for the reason only that the transferor or grantor acquired the property under a contract that was unenforceable against a minor.

15. Legislation should provide that, subject to the provisions of any other legislation, a minor may appoint an agent, by power of attorney or otherwise, to enter into any contract or make any disposition of property or grant any security or other interest. Any contract, disposition or grant by such agent should have no greater validity or effect as against the minor than it would have had if participated in or effected by the minor without an agent.

16. Legislation should further provide that a person may, by an agent under the age of majority, make any contract, dispose of any property or grant any security or other interest that a person may make, dispose of or grant by an agent who has attained the age of majority.

17. Legislation should provide that a guarantor of an obligation of a minor is bound by the guarantee as if the minor were an adult. If the obligation is enforceable against the minor, the guarantor should be entitled to be indemnified by the minor to the same extent as if the minor were an adult. If the obligation is not enforceable against the minor, the court should be empowered to grant the guarantor such relief against the minor as is just.

18. For the purposes of Recommendation 17, ''guarantor'' should include a person who enters into a guarantee or indemnity or otherwise undertakes to be responsible for the failure of a minor to carry out a contractual obligation.

19. Subject to Recommendation 20, legislation should provide for the imposition of liability in tort on minors, regardless of whether the tort is connected with a contract and regardless of whether the cause of action in tort is in substance a cause of action in contract, except where the contract would provide a defence to an individual who had attained majority.

20. A minor's liability for damages resulting from a false representation as to age should be subject to the following limitations:

    (a) where the false representation has induced the making of a contract, a minor's liability in damages for the false representation should only arise where the person to whom the representation was made had reasonable grounds to believe that the representation was true; and

(b) a minor's liability in damages for false representations as to age should not arise by reason only of the fact that the minor has signed or otherwise adopted a document relevant to the transaction that contains a statement that the minor has attained the age of majority or otherwise has contractual capacity, that was prepared and tendered by the person to whom the representation was made or with whom the contract was made, and that was preprinted and used by such person in like transactions.

Chapter 11

CONTRACTS THAT INFRINGE PUBLIC POLICY

1. INTRODUCTION

Courts face a difficulty when a contract is made that infringes the public policy of the community. Contract law represents a part of our attempt to secure justice between individuals. Often the principles of contract law require enforcement of a contract either by a specific remedy or by awarding compensation for the loss caused by breach. However, where the contract infringes an important public policy,[1] enforcement, compensation and other remedies must, at least in some cases, be denied. Thus, in an unreported but often cited case said to have been decided in 1725, the Court vigorously repudiated the idea that it could hold an accounting between highwaymen.[2] In another case it was said, "[n]o polluted hand shall touch the pure fountains of justice".[3]

2. THE PRESENT LAW

(a) INTRODUCTION

Illegal contracts can be divided into two classes: contracts illegal at common law, and contracts illegal by statute.

Common law illegality includes a wide variety of cases in which contracts, although not prohibited by any statute, have been declared by the courts to be contrary to public policy. In a sense, the term "illegal" is not strictly appropriate for these contracts, since they are not expressly forbidden by

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[1] In the vast majority of cases, questions of infringement of public policy arise in the context of contractual disputes. However, there are instances in which property or some other benefit is transferred under an arrangement which cannot be characterized as a contract. It may be, as was suggested by the Law Reform Commission of British Columbia, that such transactions should be dealt with in the same manner as contracts. However, such transactions are beyond the scope of this Report and we have not addressed them here. See Law Reform Commission of British Columbia, *Report on Illegal Transactions* (1983) (hereinafter referred to as "British Columbia Report (Illegal Transactions)").

[2] *Everet v. Williams* (1725), referred to in Note, "The Highwayman's Case (*Everet v. Williams*)" (1893), 9 L.Q. Rev. 197. See, also, Palmer, *The Law of Restitution* (1978), Vol. 2, § 8.4.

[3] *Collins v. Blantern* (1767), 2 Wils K.B. 341, at 350, 95 E.R. 850, at 852.

legislation but rather fall into a class of contracts that a court will decline to enforce on the ground that they infringe some public policy.

There is no agreed scheme of classification of the heads of common law illegality.[4] The modern view appears to be that the categories are not fixed, but are capable of expansion and reduction to reflect the changing values of society.[5] The most significant of the heads of common law illegality at the current time would appear to be contracts in restraint of trade. Such contracts are not contrary to public policy *per se*, but may be contrary to public policy if the degree of restraint is unreasonable.

A further difficulty arises because some authors (though not all) draw a distinction between contracts that are illegal and void because they offend public policy and contracts that are only void.[6] However, even among authors that adopt this distinction there is no agreement about the categories of contract that are only void. The importance of the distinction is said by some to reside in the fact that benefits conferred may be recoverable under contracts that are void but not illegal, and that the courts may be prepared to sever the objectionable parts of such contracts from the unobjectionable and enforce the latter.[7]

Statutory illegality has assumed a growing importance in this century because of the widespread regulation of almost every aspect of modern life. There must be few long term contracts that do not potentially involve, in the course of performance, some infringement of the terms or object of a statute or regulation.

We turn now to discuss illegal contracts generally. Contracts in restraint of trade raise particular issues and will be discussed separately.

(b) GENERAL

As noted above, where contracts infringe important public policy, enforcement, compensation and other remedies must be denied, at least in some situations. In addition to denying enforcement in these cases, the courts will not, save in exceptional circumstances, grant restitution of benefits conferred under an illegal contract. Looking at the matter as between the parties only, this failure to intervene could be considered unjust: it may be said that the plaintiff

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[4] See Furmston, "The Analysis of Illegal Contracts" (1966), 16 U. Toronto L. J. 267.

[5] Contracts formerly categorized as sexually immoral might be enforced today: see *Farrar v. MacPhee* (1971), 19 D.L.R. (3d) 720 (P.E.I.S.C.). Contracts that are discriminatory on racial or sexual grounds, which were formerly enforced, might be struck down today: see *Nagel v. Feilden*, [1966] 2 Q.B. 633, [1966] 1 All E.R. 689 (C.A.).

[6] See, for example, Furmston (ed.), *Cheshire and Fifoot's Law of Contract* (10th ed., 1981), at 308-78; and compare Treitel, *The Law of Contract* (6th ed., 1983), at 321-22.

[7] See *Cheshire and Fifoot's Law of Contract*, *supra*, note 6, at 329-78; and compare Treitel, *supra*, note 6, at 370-86. See, also, *Carney v. Herbert*, [1985] A.C. 301, [1985] 1 All E.R. 438 (P.C.), which suggests that the doctrine of severance may be available even for illegal contracts. *Carney v. Herbert* is discussed in Ziegel, "Comment" (1986), 11 Can. Bus. L.J. 233, at 241-46.

is unjustly treated *vis-à-vis* the defendant if a remedy that, in the absence of any considerations of public policy would otherwise be appropriate, is withheld. Lord Mansfield pointed this out in *Holman v. Johnson*,[8] where he stated, "[t]he objection, that a contract is immoral or illegal as between plaintiff and defendant, sounds at all times very ill in the mouth of the defendant."[9] He explained the rule of non-intervention as follows:[10]

> It is not for his sake, however, that the objection is ever allowed; but it is founded in general principles of policy, which the defendant has the advantage of, contrary to the real justice, as between him and the plaintiff, by accident, if I may so say. The principle of public policy is this: *ex dolo malo non oritur actio*. No Court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act. If, from the plaintiff's own stating or otherwise, the cause of action appears to arise *ex turpi causâ*, or the transgression of a positive law of this country, there the Court says he has no right to be assisted. It is upon that ground the Court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff. So if the plaintiff and the defendant were to change sides, and the defendant was to bring his action against the plaintiff, the latter would then have the advantage of it; for where both are equally in fault, *potior est conditio defendentis*.

The Latin maxims referred to by Lord Mansfield in the passage quoted above have often been repeated and applied by modern courts. The maxims, taken together, establish the general rule of non-intervention.

As a result of the rule of non-intervention, property transferred under a contract that infringes public policy has been held to have passed to the transferee.[11] The effect of non-intervention, therefore, is simply to allow the chips to lie where they have fallen. One who has benefitted by such a transaction may retain the benefit because, if either party requires the aid of the court, he or she will be turned away.

As Lord Mansfield said, the failure to apply the ordinary principles of contract law will have the effect of giving an accidental advantage to the defendant "contrary to the real justice" between the parties. The defendant gains what is, as between the parties, an unjust enrichment. The problem for contract law is to determine whether and in what circumstances the evil of permitting such an unjust enrichment is outweighed by the importance of upholding the public policy in question.

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[8] (1775), 1 Cowp. 341, 98 E.R. 1120 (subsequent references are to 98 E.R.).

[9] *Ibid.*, at 1121.

[10] *Ibid.*

[11] See *Taylor v. Chester* (1869), L.R. 4 Q.B. 309, [1861-73] All E.R. Rep. 154; *Alexander v. Rayson*, [1936] 1 K.B. 169, [1935] All E.R. Rep. 185 (C.A.); *Walsh v. Walsh*, [1948] O.R. 81, [1948] 1 D.L.R. 630 (H.C.J.), aff'd [1948] 4 D.L.R. 876 (C.A.); and *Elford v. Elford* (1922), 64 S.C.R. 125, [1922] 3 W.W.R. 339. *Clark v. Hagar* (1894), 22 S.C.R. 510, has been cited for the contrary view but appears to support the general rule that title passes.

The anomalous and, as between the parties, unjust, results of the application of the rule of non-intervention can be tolerated in the case of a proposed accounting between highwaymen. However, where the contravention of public policy or the illegality is trivial, it is difficult to avoid the conclusion that any benefit gained by society from upholding public policy is outweighed by the injustice of the result between the parties. Achieving a just result in disputes between individuals is itself, after all, an important public policy.

The difficulty with the rule of non-intervention is illustrated by the case of *Kingshott v. Brunskill*.[12] In that case, one farmer sold and delivered his apple crop to another farmer without grading the apples as required by regulations under *The Farm Products Grades and Sales Act*.[13] A dispute arose concerning the amount due by the buyer to the seller and the sale was found to have been illegal because the apples were not graded. The infringement of the regulations was entirely technical. Both parties expected that the apples would be graded by the buyer before being sold to the public, and the Court went so far as to say that it was not unreasonable for a small farmer to sell his crop to a neighbour who had the necessary equipment for grading. Because the Act did not provide for such a case, the contract was held to be illegal and no part of the price could be recovered by the seller. Consequently, in a case of an illegality so trivial that no enforcing authority would prosecute, and where, if a prosecution were brought, no substantial penalty would be imposed, the Court reached a decision that deprived the plaintiff of the value of his entire crop. The penalty was wholly disproportionate to the offence and, as Lord Devlin said in a different context, the penalty goes not "into the public purse but into the pockets of someone who is lucky enough to pick up the windfall or astute enough to have contrived to get it."[14] The same judge said, extrajudicially,[15] "[t]hese legal attitudes promote neither morality nor obedience to the law. On the contrary they shock the conscience and reward knavery."

Although exacerbated by the proliferation in the present century of regulatory statutes like that involved in *Kingshott v. Brunskill*, the anomalous consequences of a strict refusal to intervene were recognized even in the eighteenth century. In *Sanders v. Kentish*,[16] the defendant obtained a loan of stock from the plaintiff and then refused to pay for it on the ground that the contract was illegal under a statute designed to prevent stock jobbing. Lord Kenyon's comments on the merits of this defence are striking:[17]

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[12] [1953] O.W.N. 133 (C.A.).

[13] R.S.O. 1950, c. 130.

[14] *St. John Shipping Corp. v. Joseph Rank Ltd.*, [1957] 1 Q.B. 267, at 288, [1956] 3 All E.R. 683, at 690-91.

[15] Devlin, *The Enforcement of Morals* (1965), at 55.

[16] (1799), 8 T.R. 162, 101 E.R. 1323 (subsequent reference is to 101 E.R.).

[17] *Ibid.*, at 1325.

> To be sure, if such were the positive provisions of that statute, the consequence must follow, however hard it might press upon the plaintiff: but before we assented to so monstrous a proposition, we would look with eagles' eyes into every part of the statute to see that such was the intention of the Legislature. Their intention is to be collected from the whole Act taken together. The Act is entitled 'An Act to Prevent the Infamous Practice of Stock-Jobbing:' but if the defendant's objection were to prevail, the title of the Act ought to be altered; and it should run thus: 'An Act to Encourage the Wickedness of Stock-Jobbers, and to give them the Exclusive Privilege of Cheating the Rest of Mankind'.

It is not surprising to find that the courts have developed a number of ways of avoiding the harshest consequences of the rule of non-intervention.

One of the ways in which the consequences of non-intervention have been avoided, as illustrated by *Sanders v. Kentish*, has been for the court to find that it was not the intention of the legislature to prohibit the contract in question,[18] or to affect contractual obligations.[19] In some cases, the consequences of non-intervention have been avoided by distinguishing between prohibition of conduct and prohibition of an agreement.[20] Similarly, if a contract can be performed in one of two ways, legally or illegally, it may be held that the contract itself is initially legal.[21] Moreover, if one party undertakes to secure compliance with the law but fails to do so, that party may be liable for breach of a collateral contract.[22]

The courts have also avoided the worst consequences of illegality by permitting restitution in a number of circumstances. Courts have held that, where a statute is designed for the protection of persons of a particular class, restitution is permitted in favour of a plaintiff who belongs to that class,[23] and that restitution may also be available if the plaintiff withdraws from the transaction at an early stage,[24] or if the plaintiff can rely on an independent

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[18] See, for example, *Sidmay Ltd. v. Wehttam Investments Ltd.*, [1967] 1 O.R. 508, 61 D.L.R. (2d) 358 (C.A.), aff'd [1968] S.C.R. 828, and *Maschinenfabrik Seydelmann K-G. v. Presswood Bros. Ltd.*, [1966] 1 O.R. 316, 53 D.L.R. (2d) 224 (C.A.) (subsequent reference is to [1966] 1 O.R.).

[19] *Ames v. Investo-Plan Ltd.* (1973), 35 D.L.R. (3d) 613, [1977] 5 W.W.R. 451 (B.C.C.A.).

[20] *St. John Shipping Corp. v. Joseph Rank Ltd.*, *supra*, note 14.

[21] *Maschinenfabrik Seydelmann K-G. v. Presswood Bros. Ltd.*, *supra*, note 18, at 321.

[22] *Strongman (1945), Ltd. v. Sincock*, [1955] 2 Q.B. 525, [1955] 3 All E.R. 90 (C.A.).

[23] *Kiriri Cotton Co. Ltd. v. Dewani*, [1960] A.C. 192, [1960] 1 All E.R. 177 (P.C. (Eastern Africa)).

[24] *Lowry v. Bourdieu* (1780), 2 Doug. 468, at 471, 99 E.R. 299, at 300-01; *Taylor v. Bowers* (1876), 1 Q.B.D. 291; and see Goff and Jones, *The Law of Restitution* (2d ed., 1978), at 333-36.

property interest[25] or an independent tort.[26] The Privy Council has also recently held that severence is permissible even if part of the contract is prohibited by statute.[27] Some more recent Ontario cases have asserted, more directly, that the courts should weigh the seriousness of the illegality or contravention of public policy in determining whether to refuse aid to the plaintiff, and that, in an appropriate case, an illegal transaction can be enforced.[28]

(c) CONTRACTS IN RESTRAINT OF TRADE

As noted above, the general rule with respect to illegal contracts is that they are unenforceable by action. Moreover, the courts will not entertain an action based on any matters arising out of a contract that is illegal. On the other hand, as will be seen in the following discussion, a contract in restraint of trade is unenforceable *unless* the restraint is no broader than is "reasonable" in the circumstances.[29]

A detailed discussion of the history of judicial attitudes to covenants in restraint of trade is contained in the 1984 Report of the British Columbia Law Reform Commission[30] dealing with restraint of trade and will not be repeated here. Suffice it to state that, at present, contracts in restraint of trade, while generally unenforceable, may be enforced if shown to be reasonable as between the parties and in the public interest.[31] The general principles were stated by

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25 *Bowmakers, Ltd. v. Barnet Instruments, Ltd.*, [1945] 1 K.B. 65, [1944] 2 All E.R. 579 (C.A.).

26 *Shelley v. Paddock*, [1980] Q.B. 348, [1980] 1 All E.R. 1009 (C.A.), aff'g [1979] 1 Q.B. 120.

27 *Carney v. Herbert*, *supra*, note 7.

28 See *Re Lambton Farmers Ltd.* (1978), 21 O.R. (2d) 516, 91 D.L.R. (3d) 290 (H.C.J.); *Royal Bank of Canada v. Grobman* (1977), 18 O.R. (2d) 636, 83 D.L.R. (3d) 415 (H.C.J.); and *Berne Development Ltd. v. Haviland* (1983), 40 O.R. (2d) 238, 27 R.P.R. 56 (H.C.J.).

29 See discussion, *infra*, this sec.

30 Law Reform Commission of British Columbia, *Report on Covenants in Restraint of Trade* (1984) (hereinafter referred to as "British Columbia Report (Restraint of Trade)").

31 *Esso Petroleum Co. Ltd. v. Harper's Garage (Stourport) Ltd.*, [1968] A.C. 269, [1967] 1 All E.R. 699 (H.L.); *Stephens v. Gulf Oil Canada Ltd.* (1975), 11 O.R. (2d) 129, 65 D.L.R. (3d) 193 (C.A.), leave to appeal to Supreme Court of Canada denied, 11 O.R. (2d) 129*n*; and *Elsley v. J.G. Collins Insurance Agencies Ltd.*, [1978] 2 S.C.R. 916, at 923-24, 83 D.L.R. (3d) 1, at 5-6. The artificiality of the rules respecting severance (see *infra*, this ch., this sec.) combined with the possibility of unjust results if a covenant is struck down have led some Canadian courts to take a flexible approach to unreasonable covenants in restraint of trade even while affirming the general rule that the court should not rewrite the contract between the parties. See *Betz Laboratories Ltd. v. Klyn* (1969), 70 W.W.R. (N.S.) 304 (B.C.S.C.); *Maxwell v. Gibsons Drugs Ltd.* (1979), 103 D.L.R. (3d) 433, at 441-42 (B.C.S.C.); and *Nili Holdings Limited v. Rose* (1981), 123 D.L.R. (3d) 454 (B.C.S.C.).

Dickson, J. (as he then was) in the Supreme Court of Canada decision in *Elsley v. J.G. Collins Insurance Agencies Ltd.*:[32]

> A covenant in restraint of trade is enforceable only if it is reasonable between the parties and with reference to the public interest. As in many of the cases which come before the Courts, competing demands must be weighed. There is an important public interest in discouraging restraints on trade, and maintaining free and open competition unencumbered by the fetters of restrictive covenants. On the other hand, the Courts have been disinclined to restrict the right to contract, particularly when that right has been exercised by knowledgeable persons of equal bargaining power. In assessing the opposing interests the word one finds repeated throughout the cases is the word 'reasonable'. The test of reasonableness can be applied, however, only in the peculiar circumstances of the particular case. Circumstances are of infinite variety. Other cases may help in enunciating broad general principles but are otherwise of little assistance.

In assessing reasonableness, the courts also look to both the temporal and geographical dimensions of the restraint.[33] Moreover, it is clear that a covenant restraining trade that is not necessary to protect some legitimate business interest is not reasonable between the parties, nor is it in the public interest.[34]

It should be noted that, although the test of reasonableness applies no matter what the nature of a covenant in restraint of trade, the courts have displayed reluctance to uphold restraints on a person's ability to earn a living and, accordingly, employee covenants have always been treated by the courts as requiring a higher standard of proof.

The time for assessing the reasonableness of a covenant is the time it was entered into.[35] Courts will consider the probable consequences of applying the covenant and will not find it "unreasonable" by reference to extreme situations that may never arise.[36]

The current law sometimes permits partial enforcement of a contract in restraint of trade by application of what is known as the "blue pencil" or "deletion of words" test,[37] whereby illegal portions of a contract are severed from legal portions thereof and the covenant is enforced to the extent reasonable. The power of severance, however, has generally been held to be limited to cases in which the court can delete words from the contractual document and

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[32] *Supra*, note 31.

[33] Waddams, *The Law of Contracts* (2d ed., 1984), at 417.

[34] *Connors v. Connors Bros. Ltd.*, [1939] S.C.R. 162, at 168, and *B.A.C.M. Limited v. Kowall Holdings Ltd.*, [1972] 5 W.W.R. 297 (Man. Q.B.), at 303.

[35] *Doerner v. Bliss & Laughlin Industries Inc.* (1980), 117 D.L.R. (3d) 547 (S.C.C.), at 556.

[36] *Greening Industries Ltd. v. Penny* (1965), 53 D.L.R. (2d) 643 (N.S.S.C., T.D.), at 651.

[37] This doctrine has occasionally been extended to illegal contracts other than those in restraint of trade.

leave words in place that make grammatical sense and are enforceable.[38] As noted by the British Columbia Commission,[39] "[c]ourts in Canada have disclaimed any power to enforce a covenant in part by rewriting it ...", or to modify a covenant to conform to a judge's view of what would be reasonable in the circumstances.

Although the "blue pencil" test may have anomalous results,[40] it has deterred covenantees from overreaching. If the rule were that an excessive covenant could be amended, a covenantee with superior bargaining power would have nothing to lose by stipulating for a covenant against world wide competition for life; the worst that could happen would be that the court would reduce the restraint to a reasonable size.

3. EXISTING LAW AND PROPOSALS FOR REFORM IN OTHER JURISDICTIONS

(a) INTRODUCTION

In the light of the foregoing discussion it will be seen that the existing law of illegality is unsatisfactory in several important respects. First, there is no consensus with respect to the classification of the different types of illegality and, more particularly, whether there is a separate class of contracts that is treated as being void in contemplation of law but not illegal.[41] Secondly, and more importantly, the common law rule of non-intervention in illegal contracts can often operate harshly on a party who has, often inadvertently, breached some relatively minor statutory provision. This will give the other party a quite unjustified windfall.[42] Thirdly, while the doctrine of severance may relieve some of the hardship it does not go far enough and suffers from rigidities of its own. This is particuarly true of the "blue pencil" test involving covenants in restraint of trade.[43]

In our view, therefore, a very persuasive case can be made for statutory modification of the existing illegality rules. This conclusion is far from novel and it will be convenient at this stage, before putting forward our own proposals, to review the recommendations for reform made, and in some cases adopted, in other common law jurisdictions.

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[38] *Atwood v. Lamont*, [1920] 3 K.B. 571, [1920] All E.R. Rep. 55 (C.A.), and *Bassman v. Deloitte, Haskins & Sells of Can.* (1984), 44 O.R. (2d) 329, 79 C.P.R. (2d) 43 (H.C.J.).

[39] British Columbia Report (Restraint of Trade), *supra*, note 30, at 15.

[40] *Ibid.*

[41] *Supra*, this ch., sec. 2(a).

[42] *Supra*, this ch., sec. 2(b).

[43] *Supra*, this ch., secs. 2(b) and 2(c).

(b) GENERAL

(i) New Zealand

Several law reform agencies have examined the problem of contracts that infringe public policy.[44] New Zealand has both examined the problem and adopted legislation specifically relating to such contracts.[45] The Draft Bill proposed by the New Zealand Contracts and Commercial Law Reform Committee in its 1969 *Report on Illegal Contracts* was enacted almost *verbatim* as the *Illegal Contracts Act 1970*. The Act has since been amended in a number of minor respects,[46] but its principal features remain intact.

The New Zealand Act applies to all illegal contracts, whether the illegality arises at common law or by statute.[47] The Act does not otherwise define the meaning of "illegal contract". However, section 5 of the Act provides:[48]

> 5. A contract lawfully entered into shall not become illegal or unenforceable by any party by reason of the fact that its performance is in breach of any enactment, unless the enactment expressly so provides or its object clearly so requires.

Moreover, section 11 of the New Zealand Act expressly excludes contracts in restraint of trade, except insofar as they are dealt with in section 8 of the Act, and contracts that purport to oust the jurisdiction of any court.

The Act is remedial in focus and provides in section 6 that, notwithstanding any rule of law or equity to the contrary, every illegal contract is of no effect and that no person shall become entitled to any property under a disposition made pursuant to an illegal contract. There is, however, an exception in favour of third parties who have acquired such property in good faith and without knowledge of its illegal antecedents.

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44 New Zealand Contracts and Commercial Law Reform Committee, *Illegal Contracts* (1969) (hereinafter referred to as "New Zealand Report"); New South Wales Law Reform Commission, L.R.C. 9, *Report on Covenants in Restraint of Trade* (1970) (hereinafter referred to as "New South Wales Report"); Law Reform Committee of South Australia, *Thirty-Seventh Report Relating to the Doctrines of Frustration and Illegality in the Law of Contract* (1977) (hereinafter referred to as "South Australia Report"); British Columbia Report (Illegal Transactions), *supra*, note 1; British Columbia Report (Restraint of Trade), *supra*, note 30.

45 *Illegal Contracts Act 1970*, Stat. N.Z. 1970, No. 129. The Act received a mixed reception from academic commentators. See Niggins and Fletcher, *Law of Partnership in Australia and New Zealand* (3d ed., 1975), at 42; Sutton, "Illegal Contracts Act" (1972), 7 N.Z. Recent Law 28, 56 and 89; and Furmston, "The Illegal Contracts Act 1970 — An English View" (1972-73), 5 N.Z.U.L. Rev. 151, at 155.

46 See Stat. N.Z. 1975, No. 53, s. 6(7); Stat. N.Z. 1976, No. 35, s. 45; Stat. N.Z. 1979, No. 124, s. 12; and Stat. N.Z. 1979, No. 125, ss. 2(3), 16(1), and 18(2).

47 *Illegal Contracts Act 1970*, *supra*, note 45, s. 3.

48 *Ibid.*, s. 5.

Section 7 of the New Zealand Act contains the most innovative provisions. The section empowers the court, in the course of any proceedings or in an application made for the purpose, to grant to any party to an illegal contract, or any person claiming through or under any such party, the widest possible relief from the normal consequences of illegality by way of compensation, variation of the contract, validation of the contract in whole or in part or for any particular purpose, "or otherwise howsoever as the court in its discretion thinks just".[49] In exercising its discretion, the court is required to consider the conduct of the parties and, in the case of a breach of an enactment, the object of the enactment, the gravity of the penalty provided for a breach of its provisions, and such other matters as it thinks proper.[50] The only restriction on the court's discretion is that relief shall not be granted if it would not be in the public interest to do so.[51] Knowledge of the facts or the applicable law by the party seeking relief is not an absolute bar but only another factor to be taken into consideration.[52]

The effect of the New Zealand Act is to abolish the common law consequences of illegality and to substitute a new and exclusive statutory scheme. The Act has been criticized, however, because of its failure to define illegal contracts and because of the wide discretion that it confers on the courts.[53] On the face of it, the express exclusion in section 11 of the Act of certain void but not illegal contracts seems illogical. The result is that contracts that are truly illegal at common law are treated more favourably than contracts considered to be merely void at common law. It would appear that serious thought should be given to the desirability of assimilating void contracts and illegal contracts in any scheme of legislative reform. In our view, there is little to commend in the perpetuation of the distinction between void contracts and illegal contracts.

There is also some question as to the soundness of section 6 of the New Zealand Act. Even in terms of existing law, it is debatable whether it is correct to describe an illegal contract as being of no effect. In addition, it seems somewhat contradictory, section 6 having declared an illegal contract to be of no effect, to confer on a court, under section 7(1), power to validate an ineffective contract. Section 6 also raises important interpretational questions as to the types of property and conveyances that are caught by it, and it may greatly complicate transactions by forcing parties to the original bargain, or

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49 *Ibid.*, s. 7(1).

50 *Ibid.*, s. 7(3).

51 *Ibid.*

52 *Ibid.*, s. 7(4).

53 Furmston, *supra*, note 45. But see Schwartz, "Law Reform Commission of British Columbia, Report on Illegal Contracts" (1985), 10 Can. Bus. L.J. 83, at 88, where he states:

> Despite initial doubts about the soundness of its key provisions and rather cumbersome drafting, the Act has been tested on a number of occasions and most commentators agree that it has worked well in practice.

those claiming from or under them, to seek a judicial validation order whenever there is any suggestion of illegality affecting it. Even third parties may feel insecure although section 6 purports to protect them.[54]

(ii) South Australia

The Law Reform Committee of South Australia examined the doctrine of illegality in the law of contracts in its 1977 *Report Relating to the Doctrines of Frustration and Illegality in the Law of Contract*.[55]

Essentially, the South Australia Committee endorsed the New Zealand approach. However, the Committee recommended that the term "illegal" contract be given a wider definition than under the New Zealand Act.[56] The South Australia Committee also diverged from the New Zealand position in that it recommended that any remedies available under the statutory scheme be in addition to those available at common law.[57]

(iii) British Columbia

Following publication in 1982 of a Working Paper in respect of Illegal Contracts[58] the Law Reform Commission of British Columbia issued, in November, 1983, its *Report on Illegal Transactions*.[59] The Report dealt not only with contracts, but also with non-contractual arrangements such as trusts and gifts.[60] The Report did not deal with covenants in restraint of trade on the ground that, while they might infringe public policy, they raise issues different from those that arise with respect to other contracts infringing public policy. In April, 1984, the British Columbia Commission issued a separate Report examining covenants in restraint of trade.[61]

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54 See Sutton, *supra*, note 45, at 60-63.

55 South Australia Report, *supra*, note 44.

56 The South Australia Committee wished to include both contracts illegal at common law and contracts considered to be void at common law, including, specifically, contracts void as being in restraint of trade, in derogation or ouster of the jurisdiction of the courts, or in derogation of the interdependent rights and liabilities of husband and wife or parent and child (South Australia Report, *supra*, note 44, at 24).

57 South Australia Report, *supra*, note 44, at 25-26.

58 Law Reform Commission of British Columbia, Working Paper No. 38, *Illegal Contracts* (1982).

59 British Columbia Report (Illegal Transactions), *supra*, note 1.

60 The British Columbia Commission concluded that, while extending a scheme for relief to non-contractual transactions and arrangements went beyond recommendations for reform made in other jurisdictions that had considered the problem, the application of the general rule in the cases of trusts, gifts and other transactions might lead to unjust results and that problems raised by such transactions were "amenable to reform paralleling that which applies to illegal contracts". See British Columbia Report (Illegal Transactions), *supra*, note 1, at 63.

61 British Columbia Report (Restraint of Trade), *supra*, note 30.

The British Columbia Commission was of the view that retention of the current law with respect to illegal transactions was undesirable. It noted that other Commonwealth law reform agencies that had considered the question of illegal contracts had settled on schemes that vested in the courts a discretion to depart from the strictures of the general rule when necessary in the interests of justice, and that support for this approach was found in existing provincial legislation in British Columbia.[62]

The British Columbia Commission considered several possible models for reform, including the New Zealand *Illegal Contracts Act 1970*, which, as will be recalled, substituted an exclusive statutory scheme for the common law consequences of illegality. In the end, the Commission concluded that the appropriate vehicle for reform was a model somewhere between the New Zealand statutory scheme and a model at the other end of the spectrum.[63] The model proposed by the British Columbia Commission entailed legislation vesting in the courts a discretionary power to deviate, in an appropriate case, from the result dictated by the application of the common law rule. The Commission's conclusion rested, in part, on what was perceived to be a generally favourable reaction to the New Zealand statute. Accordingly, the Commission recommended that legislation be enacted to reform the law governing illegal transactions as follows: the common law rules would continue to apply to illegal transactions, subject to a discretionary power in the court under such legislation to grant relief from the consequences of illegality.[64]

(c) CONTRACTS IN RESTRAINT OF TRADE

(i) New South Wales

In its *Report on Covenants in Restraint of Trade*,[65] the New South Wales Law Reform Commission recommended the enactment of legislation respecting the partial enforcement of covenants in restraint of trade. Its recommendations were implemented by the *Restraints of Trade Act*.[66] Section 4(1), (2), and (3) of that Act provides as follows:

> 4.-(1) A restraint of trade is valid to the extent to which it is not against public policy, whether it is in severable terms or not.
>
> (2) Subsection (1) does not affect the invalidity of a restraint of trade by reason of any matter other than public policy.
>
> (3) Where, on application by a person subject to the restraint, it appears to the Supreme Court that a restraint of trade is, as regards its application to the applicant, against public policy to any extent by reason of, or partly by reason of, a manifest failure by a person who created or joined in creating the restraint to

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62 British Columbia Report (Illegal Transactions), *supra*, note 1, at 55.

63 See, generally, Schwartz, *supra*, note 53, at 87-89.

64 British Columbia Report (Illegal Transactions), *supra*, note 1, at 56.

65 New South Wales Report, *supra*, note 44.

66 No. 67 of 1976.

attempt to make the restraint a reasonable restraint, the Court, having regard to the circumstances in which the restraint was created, may, on such terms as the Court thinks fit, order that the restraint be, as regards its application to the applicant, altogether invalid or valid to such extent only (not exceeding the extent to which the restraint is not against public policy) as the Court thinks fit and any such order shall, notwithstanding subsection (1), have effect on and from such date (not being a date earlier than the date on which the order was made) as is specified in the order.

In its 1984 *Report on Covenants in Restraint of Trade*, the Law Reform Commission of British Columbia criticized the New South Wales approach. It considered the *Restraints of Trade Act* both complex and confusing and noted that, insofar as the wording of section 4(3) of the statute seemed to require as a precondition to relief that there be a ''manifest failure'' to attempt to draw a reasonable covenant, it was arguable that partial enforcement would only be available if there had been deliberate overreaching.[67]

(ii) New Zealand

Section 8 of the *Illegal Contracts Act 1970*[68] deals with contracts in restraint of trade, and provides as follows:

8.-(1) Where any provision of any contract constitutes an unreasonable restraint of trade, the Court may —

(a) Delete the provision and give effect to the contract as so amended; or

(b) So modify the provision that at the time the contract was entered into the provision as modified would have been reasonable, and give effect to the contract as so modified; or

(c) Where the deletion or modification of the provision would so alter the bargain between the parties that it would be unreasonable to allow the contract to stand, decline to enforce the contract.

(2) The Court may modify a provision under paragraph (b) of subsection (1) of this section, notwithstanding that the modification cannot be effected by the deletion of words from the provision.

Two features of section 8 should be emphasized. First, the court's power to cure a covenant that is too wide is not as extensive as the powers given to the court with respect to illegal contracts. Secondly, the court's powers under section 8 go well beyond its common law powers. Section 8(2) makes it clear that the court may modify a provision even though the modification cannot be effected by the deletion of words from the provision. It is clearly intended to override the restrictions of the ''blue pencil'' test previously applied by the courts.

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[67] See British Columbia Report (Restraint of Trade), *supra*, note 30, at 55.

[68] *Supra*, note 45.

Section 8 is open to criticism on the ground that it does not require the party seeking to enforce the term to have included the term in the contract in good faith and in accordance with reasonable standards of fair dealing.[69] Moreover, because the power under section 8(b) to modify the contract would include substitution and reformulation and not just a reduction in extent, the danger exists that it may be construed by the parties as an invitation to overreach in the hope that an excessive covenant will be cured by an accommodating court.

(iii) South Australia

The Law Reform Committee of South Australia in its *Report Relating to the Doctrines of Frustration and Illegality in the Law of Contract*, discussed above, concluded that a provision similar to section 8 of the New Zealand Statute should be adopted, with minor revisions, in that State.[70]

(iv) British Columbia

The Law Reform Commission of British Columbia concluded, in its 1984 *Report on Covenants in Restraint of Trade*,[71] that the current law, "under which covenants in restraint of trade are wholly unenforceable if a court finds them to be unreasonable, is becoming increasingly unworkable in the modern day marketplace".[72]

The Commission observed that the general rule as it currently stands "represents a compromise between the public policy favouring freedom of trade and that favouring the protection of legitimate business interests".[73] Consequently, the content of the test of reasonableness that governs the enforceability of contracts in restraint of trade is uncertain, with the result that some such contracts are enforceable while others are not. Judicial reaction to a contract in restraint of trade is, in many cases, unpredictable, and the traditional test can place onerous burdens on a covenantee seeking to justify the ambit of the restrictive covenant on which he or she relies.[74]

The Commission noted[75] that the difficulty of gauging the requirements of public policy can lead to adverse consequences if the covenantee falls into error and draws his covenants in restraint of trade too widely. The penalty for any overreaching is complete invalidity, with the result that the covenantee is left only with the remedies he may have at common law or in equity. Moreover, the

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69 See American Law Institute, *Restatement of the Law, Second — Contracts, 2d* (1979) (hereinafter referred to as "*Second Restatement*"), § 184.

70 South Australia Report, *supra*, note 44, at 27.

71 British Columbia Report (Restraint of Trade), *supra*, note 30.

72 *Ibid.*, at 46.

73 *Ibid.*, at 50.

74 *Ibid.*, at 48.

75 *Ibid.*, at 47.

striking down of an invalid covenant will result in unjust enrichment for the party who has been paid for what he has succeeded in recovering.

The British Columbia Commission considered that the best approach to reforming the law was to address the consequences of infringing the general rule. It considered that the law would operate more equitably if courts were not bound to refuse to enforce an unreasonable convenant without regard to the difficulty faced by the covenantee in drawing a covenant in restraint of trade that does not infringe the test of reasonableness.[76]

On the whole, the British Columbia Commission preferred the New Zealand formulation as a model for reform in respect of covenants in restraint of trade. It considered that the New Zealand statute clearly and succinctly set out the options open to the court and, in particular, made it plain that the power to modify a covenant did not depend on the "blue pencil" test.[77] Moreover, the New Zealand legislation makes it clear that the court need not rewrite the covenant; that relief is purely discretionary.

The Commission did, however, express some reservations concerning certain aspects of the New Zealand legislation. Section 8 of the New Zealand Act is framed in terms of a "modification" of the invalid covenant. The British Columbia Commission considered "modification" a broad term that could be read as authorizing the court to extend the ambit of the covenant, and therefore preferred to speak of a power to limit a covenant, so that there could be no doubt that the plaintiff cannot have greater protection than is provided for in the contract itself.[78]

As well, the British Columbia Commission noted that the New Zealand legislation refers only to "provisions in contracts" and suggested that the remedial jurisdiction of the courts should not be restricted to "provisions", since an entire contract may be in restraint of trade.[79]

The Commission also referred to section 8(c) of the New Zealand legislation, which authorizes the court to decline to enforce a contract where "the deletion or modification of the provision would so alter the bargain between the parties that it would be unreasonable to allow the contract to stand". Although the British Columbia Commission agreed that the "commercial unreasonableness of a covenant is a proper concern when the court

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[76] *Ibid.*, at 51.

[77] *Ibid.*, at 55. The British Columbia Report (Illegal Transactions), *supra*, note 1, also considered the law governing severance in some detail. The Commission suggested that the power to sever be reformulated and recommended that the court be empowered to make an order that "certain rights or obligations arising out of the illegal transaction are not binding on the parties and that the remainder of the rights and obligations constitute a binding and enforceable transaction" (*ibid.*, at 79). This amounts to a power of severance divorced from the "blue pencil" test.

[78] British Columbia Report (Restraint of Trade), *supra*, note 30, at 55-56.

[79] *Ibid.*, at 56.

exercises its discretion to decline to limit an overly broad covenant'', it believed that ''reforming legislation should expressly provide for a wider discretion which would permit a court to take any relevant factor into account''.[80]

The basic recommendation of the British Columbia Commission in respect of covenants in restraint of trade was that legislation should be enacted to provide as follows:[81]

> (a) If a contract or a portion of a contract constitutes an unreasonable restraint of trade, a court may, by order:
>
> (i) delete a portion of the contract, or
>
> (ii) limit the effect of that contract so that, as modified, the contract would have been a reasonable restraint of trade at the time it was entered into, and
>
> (iii) subject to the rules of law and equity, enforce the contract as modified.
>
> (b) The court may refuse relief under paragraph (a) and decline to enforce the contract where
>
> (i) the deletion or limitation would so alter the bargain between the parties that it would be unreasonable to give effect to the contract as modified, or
>
> (ii) the conduct of the party seeking to enforce the contract with or without modification disentitles him to relief.

The British Columbia Commission was of the view that the above recommendation was sufficiently broad to enable a court to examine the circumstances surrounding the formation of the contract and to decline to enforce it when it was obtained by culpable overreaching.[82] Accordingly, the British Columbia Commission concluded that there was no need for a special provision to discourage overreaching by covenantees.[83]

With respect to covenants in restraint of trade found in employment contracts the Commission considered that the judicial discretion exercisable under its main recommendation was sufficient to deter deliberate or negligent overreaching.[84] Nevertheless, in order to emphasize that the main recommendation was not intended to affect rigorous tests imposed in respect of employee

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80 *Ibid.*

81 *Ibid.*, at 56 and 72.

82 *Ibid.*, at 70.

83 *Ibid.*, at 71.

84 *Ibid.*

convenants in restraint of trade, the British Columbia Commission recommended that reforming legislation should specify that, in exercising its discretion to enforce partially a covenant in restraint of trade contained in a contract of employment, the court should have special regard to the circumstances of the formation of the contract.[85]

4. PROPOSALS FOR REFORM

(a) GENERAL

In a previous section of this chapter we referred to the various techniques used to avoid the consequences of the rule of non-intervention.[86] Unfortunately, these techniques have no coherence among themselves and do not operate predictably or reliably. Many modern cases have continued to assert the strict rule exemplified by *Kingshott v. Brunskill*.[87] We have concluded therefore that remedial legislation should make it clear that the court has the power, in a proper case, to give some measure of relief to a party to a contract that infringes public policy.

We are not engaged in a project to codify the law of contracts. Accordingly, we see no need to define and list the heads of common law illegality. In our view this would not be desirable even if it were feasible, for the courts should, in our opinion, maintain the ultimate power to decide whether the values represented by freedom of contract are outweighed in a particular case by other values held by society.

Another question that we have considered is whether reforming legislation should specify the consequences of illegality. It will be recalled that the New Zealand *Illegal Contracts Act 1970* provides that all illegal contracts are of no effect and do not transfer property.[88] It seems to us that there are dangers in this approach. As the British Columbia Law Reform Commission pointed out, a provision stating that illegal contracts are ineffective to transfer title would have the effect of throwing into doubt the title to property, including land titles, and might create anomalies by enabling the transferor to resort to self-help or proprietary remedies to recover the property.[89] There might also be criminal law problems if the transferee attempted to put the property to a use inconsistent with the transferor's ownership.[90]

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[85] *Ibid.*

[86] *Supra*, this ch., see 2(b).

[87] *Supra*, note 12.

[88] *Illegal Contracts Act 1970*, *supra*, note 45, s. 6.

[89] British Columbia Report (Illegal Transactions), *supra*, note 1, at 81-82.

[90] See *Criminal Code*, R.S.C. 1970, c. C-34, s. 283, which creates the offence of criminal conversion of another's property.

It may be said that these problems can be overcome by giving the court wide powers of the sort contained in the New Zealand Act, including the power to validate illegal contracts.[91] However, the exercise of this power would be dependent on an application to the court, which would be a time consuming and expensive process. Moreover, we have doubts about the wisdom of a general power of the court to validate such contracts. This would seem, in some cases, to go too far, by enabling a court to declare valid what the legislature may have expressly intended to declare invalid. The problem of when a specific statute had the effect of displacing the general provision would be acute. We consider therefore that the wiser course is to omit any provision making ineffective the transfer of title to property and to omit any general power to declare valid, contracts that are illegal.

In the absence of a power of validation, we consider that the existing common law should be left in place, for if the existing devices whereby courts have held contracts to be enforceable were removed, with nothing put in their place, there would be a danger of exacerbating, rather than alleviating, the anomalies and injustices caused by the law of illegal contracts. While we would retain the existing law as to unenforceability of illegal contracts, we would give the court power to relieve against the consequences of illegality, in particular by granting an order for restitution and compensation for loss. However, in order to avoid any unintended anomalies that might be caused by disputes concerning the exact boundaries of restitution and compensation, we believe that the power of relief should not be rigidly confined to those categories.

For these reasons, we recommend that legislation should be enacted to provide that where a contract, or any term thereof, is unenforceable by reason of public policy (including the effect of any statutory provision), the court may grant such relief by way of restitution, compensation, or otherwise, as it thinks just and as is not inconsistent with the policy underlying the unenforceability of the contract.

Our recommendation does not invite the court to validate or even to enforce an illegal contract. It assumes that the contract itself has been found to be unenforceable for good reason. It does not enlarge the class of illegal contracts, nor does it restrict the existing powers of courts to enforce illegal contracts. It does not empower the court to contravene the policy of other statutes. It does, however, enable the court to do justice in cases like *Kingshott v. Brunskill*[92] where, under the present law, injustices have occurred. We consider that this is as much as can be expected of statutory reform in the area, but that it is an object well worth achieving.

We wish to emphasize, however, that the relieving power we favour conferring on the courts is not one to be exercised lightly or automatically. It is not an invitation to contracting parties to ignore legal prohibitions with impunity. In every application for relief the court must always balance the

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[91] *Illegal Contracts Act 1970*, *supra*, note 45, s. 7.

[92] *Supra*, note 12.

importance of protecting the public interest represented by the prohibition against a policy opposed to unjustly enriching one of the parties.[93] We have in mind that the court might, for example, take into account such factors as the gravity of the violation committed by the parties, whether it goes to the heart of the contract, and whether the parties knew or ought to have known that they were breaching the law.

(b) RESTRAINT OF TRADE

As discussed in a previous section of this chapter,[94] contracts in restraint of trade are unenforceable unless shown to be reasonable between the parties and in the public interest. In our view, it would not be desirable to alter the general test of reasonableness as the criterion of validity. This is already a flexible test that enables the court to take account of all relevant factors.

We consider, however, that a separate remedial provision relating to contracts in restraint of trade is desirable. This is because contracts in restraint of trade, particularly those between employer and employee, often exemplify a use of superior bargaining power by the covenantee.

Earlier in this chapter, we discussed the difficulties with the "blue pencil" test whereby partial enforcement of an unreasonable contract in restraint of trade is sometimes permitted by severing the illegal from the legal portions of the contract. The Commission considers that, while the "blue pencil" test should be abolished, some provision is necessary to deal directly with the problem of overreaching. The Commission bases its proposal on a modified version of section 8 of the New Zealand legislation that would limit the power of the court to a reduction, rather than a reformulation, of the extent of the restrictive covenant and would make this power contingent on the covenantee having acted in good faith and in accordance with reasonable standards of fair dealing.[95]

Accordingly we recommend that, where any provision of a contract constitutes an unreasonable restraint of trade, and where the party seeking to enforce the provision has acted in good faith and in accordance with reasonable standards of fair dealing, the court should have the following powers: to delete the provision and to give effect to the contract as so amended; or to so reduce the scope of the provision that, at the time the contract was entered into, the provision as so reduced would have been reasonable, and to give effect to the contract as so modified. The court should have the latter power notwithstanding that the reduction of scope cannot be effected by the deletion of words from the provision. We further recommend that, where the deletion or reduction of scope would so alter the bargain between the parties that it would be unreasonable to

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[93] The need to balance those considerations appears to have been overlooked by the Court in *Berne Development Ltd. v. Haviland*, *supra*, note 28.

[94] *Supra*, this ch., sec. 2(c).

[95] These words are derived from § 184(2) of the *Second Restatement*, *supra*, note 69.

allow the contract to stand, the court should have the power to decline to enforce the contract.

Recommendations

The Commission makes the following recommendations:

1. The existing common law doctrines with respect to illegal contracts should be retained, but the court should be given power to relieve against the consequences of illegality. Accordingly, legislation should be enacted to provide that, where a contract or any term thereof is unenforceable by reason of public policy (including the effect of any statutory provision) the court may grant such relief by way of restitution and compensation for loss or otherwise as it thinks just and as is not inconsistent with the policy underlying the unenforceability of the contract.

2. Where any provision of any contract constitutes an unreasonable restraint of trade, the court should have the power to

   (a) delete the provision and give effect to the contract as so amended;

   (b) so reduce the scope of the provision that at the time the contract was entered into the provision as so reduced would have been reasonable, and give effect to the contract as so modified; or

   (c) where the deletion or reduction of scope of the provision would so alter the bargain between the parties that it would be unreasonable to allow the contract to stand, decline to enforce the contract.

3. The court should also be able to reduce the scope of a provision under Recommendation 2(b) notwithstanding that the reduction of scope cannot be effected by the deletion of words from the provision.

4. The court should not exercise its powers under Recommendation 2(a) or (b) unless the party seeking to enforce the provision has acted in good faith and in accordance with reasonable standards of fair dealing.

CHAPTER 12

MISREPRESENTATION

1. THE LEGAL BACKGROUND

(a) INTRODUCTION

Misrepresentation in its widest sense means simply a false statement. In the contractual context, it means a false statement made by one party to a contract that induces another party to the contract to enter into the contract. The present law of contractual misrepresentation is quite complex, and cuts across the three main areas of the law of obligations, namely, contracts, torts, and restitution. Misrepresentations that induce contracts may amount to promises that are part of a contract, or they may constitute legal wrongs in themselves. They often result in contractual exchanges of unequal value.

(b) MISREPRESENTATION AND CONTRACTUAL TERMS

The question whether a representation constitutes a part or term of a contract has important practical consequences. While a statement that is regarded as a term of a contract gives a person who has suffered loss as a result of a breach of the term a right to damages measured by the value of the expected contractual performance, a representation that is not a term of the contract gives rise to different remedies and, in some cases, no remedy at all.

The test for determining when a statement is a term of a contract is generally said to be whether the statement is made with contractual intention.[1] This has often been criticized as an elusive test. It has, however, the merit of flexibility, and the courts have, in practice, quite often found a remedy in cases they consider deserving by categorizing the statement as a contractual term or warranty, while refusing to find the necessary intention when damages are claimed that the courts consider extravagant. Lord Denning has been very open about this judicial flexibility. He commented, extrajudicially:[2]

> Whenever a judge thinks that damages ought to be given he finds that there was a collateral contract rather than an innocent representation. In practice whenever I get a misrepresentation prior to a contract which is broken and the man ought to pay damages I treat it as a collateral contract. I have never known any of my colleagues to do otherwise.

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[1] *Heilbut, Symons & Co. v. Buckleton*, [1913] A.C. 30, [1911-13] All E.R. Rep. 83 (H.L.).

[2] See Allan, "The Scope of the Contract" (1967), 41 Aust. L.J. 274, at 293.

In *Esso Petroleum Co. Ltd. v. Mardon* the same judge said:[3]

> Ever since *Heilbut, Symons & Co. v. Buckleton* [1913] A.C. 30, we have had to contend with the law as laid down by the House of Lords that an innocent misrepresentation gives no right to damages. In order to escape from that rule, the pleader used to allege — I often did it myself — that the misrepresentation was fraudulent, or alternatively a collateral warranty. At the trial we nearly always succeeded on collateral warranty. We had to reckon, of course, with the dictum of Lord Moulton, at p. 47 that 'such collateral contracts must from their very nature be rare'. But more often than not the court elevated the innocent misrepresentation into a collateral warranty: and thereby did justice.
>
> ....
>
> Besides that experience, there have been many cases since I have sat in this court where we have readily held a misrepresentation — which induces a person to enter into a contract — to be a warranty sounding in damages.

The adjective "collateral" is ambiguous in that it may, but does not always, imply the existence of two, theoretically separate, contracts. In an earlier case Lord Denning had said: "It is not necessary to speak of [the warranty] as being collateral. Suffice it that the representation was intended to be acted on and was in fact acted on".[4]

Suggestions have often been made that the distinction between representations and terms should be abolished. This seems attractive in light of the elusive test of intention. The difficulty, however, is that the normal measure of damages for breach of a contractual term includes damages measured by the promisee's expectation and, subject to the rules of remoteness, consequential damages including, for example, compensation for loss caused by personal injuries.[5] These measures may be excessive in the case of an entirely innocent misstatement by a private person who is not in a position to absorb or spread large losses. As will be indicated below, the measure of damages for fraudulent misrepresentation does not include compensation for the plaintiff's expectation losses. It would be anomalous to introduce a higher measure of damages for innocent misrepresentation, and anomalous, in the light of general tort principles, to impose damages for consequential losses such as personal injuries in the absence of proof of fraud or negligence.

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[3] [1976] Q.B. 801, at 817, [1976] 2 All E.R. 5, at 13 (C.A.).

[4] *Dick Bentley Productions Ltd. v. Harold Smith (Motors) Ltd.*, [1965] 1 W.L.R 623, at 627, [1965] 2 All E.R. 65, at 67 (C.A.).

[5] Expectation damages do not, however, figure prominently in cases involving the distinction between non-promissory and promissory representations; nor do they appear to have given rise to difficulties under s. 12 of the American Uniform Sales Act (National Conference of Commissioners on Uniform State Laws (1906)), applying a reliance test to determine whether an express warranty has been given.

(c) Misrepresentation and Tort

A misrepresentation may constitute a tort. A fraudulent misrepresentation, that is, one made with knowledge of its falsity or made recklessly without regard to its truth or falsity, constitutes the tort of deceit. The misrepresentor is liable for the plaintiff's out-of-pocket loss,[6] including consequential damages,[7] but not for the benefit of the bargain the plaintiff would have gained had the misrepresentation been true.[8] It is now established that a negligent misrepresentation is also actionable in tort.[9]

The extension of the law of negligence over the past twenty years has greatly enlarged the number of cases in which damages are available for misrepresentation, but, as indicated, there remains the category of purely innocent, that is, neither fraudulent nor negligent, misrepresentation for which damages cannot be recovered. In such a case, no action in tort will be available.

(d) Misrepresentation and Rescission

In the case of fraudulent misrepresentation, it is clearly established that the contract may be rescinded at the option of the defrauded party,[10] although rescission may be barred by inability to restore benefits under the contract,[11] by intervention of third party rights,[12] or by affirmation.[13]

The courts of equity extended the right of rescission to cases of innocent misrepresentation, on the principle that a person should not profit by his or her own false statement at another's expense.[14] It should be noted that the underlying basis of relief was not the enforcement of promises, nor compensation for wrongful conduct, but, rather, avoidance of unjust enrichment. Rescission, however, was unavailable in the cases, mentioned above, where rescission for fraud was barred, that is, in cases of inability to restore benefits, intervention of third party rights, or affirmation. In addition, some cases, particularly those involving land sales, have held that rescission for innocent misrepresentation is barred by execution or performance of the contract,[15]

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6 *McConnel v. Wright*, [1903] 1 Ch. 546, 72 L.J. Ch. 347 (C.A.).

7 *Doyle v. Olby (Ironmongers) Ltd.*, [1969] 2 Q.B. 158, [1976] 2 All E.R. 119 (C.A.).

8 *Parna v. G. & S. Properties Ltd.*, [1971] S.C.R. 306, 15 D.L.R. (3d) 336.

9 *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*, [1964] A.C. 465, [1963] 2 All E.R. 575 (H.L.); *Haig v. Bamford*, [1977] 1 S.C.R. 466, [1976] 3 W.W.R. 331; and *Esso Petroleum Co. Ltd. v. Mardon*, *supra*, note 3.

10 *Jarvis v. Maguire* (1961), 28 D.L.R. (2d) 666, 38 W.W.R. 289 (B.C.C.A.).

11 *Clarke v. Dickson* (1858), El. Bl. & El. 148, 120 E.R. 463.

12 *Clough v. London & Northwestern Ry. Co.* (1871), L.R. 7 Exch. 26, at 35.

13 *United Shoe Machinery Co. of Canada v. Brunet*, [1909] A.C. 330 (P.C. (Can.))

14 *Redgrave v. Hurd* (1881), 20 Ch.D. 1 (C.A.).

15 *Redican v. Nesbitt*, [1924] S.C.R. 135, [1924] 1 D.L.R. 536.

although other cases have denied that there is any general rule to this effect.[16] Other bars to rescission have also been suggested.[17]

The net effect is that, in the case of a wholly innocent misrepresentation, that is, a non-fraudulent and non-negligent misrepresentation, there is a *prima facie* right to rescission but, if rescission is barred, there may be no remedy available at all. One can accept that there may be sound reasons for refusing to reopen an executed contract, particularly in the case of a complex transaction where positions may have changed beyond recall and a long interval of time has passed. However, the rational conclusion would then seem to be not to deny the plaintiff any remedy, but to permit an award of money in substitution for rescission. This award of damages would not be measured by promissory or tortious principles but, rather, would be a sum of money designed to have the same economic effect as rescission.

2. PRECEDENTS FOR REFORM

(a) SOLUTIONS THAT TREAT REPRESENTATIONS AS CONTRACTUAL TERMS

A number of jurisdictions have enacted legislation that departs from the common law test for determining when a statement is a term of the contract. To varying degrees, these jurisdictions, in effect, have treated as terms of the contract, or warranties, representations that at common law would not satisfy the test of contractual intention.

(i) The United States

The American Uniform Sales Act,[18] adopted in 1906, defined as an express warranty "any affirmation of fact or any promise by the seller relating to the goods if the natural tendency of such affirmation or promise is to induce the buyer to purchase the goods, and if the buyer purchases the goods relying thereon".[19] The Uniform Commercial Code has now superseded the Uniform Sales Act, and adds the rather ambiguous requirement that the statement must become "part of the basis of the bargain".[20]

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16 *Solle v. Butcher*, [1950] 1 K.B. 671, [1947] 2 All E.R. 1107 (C.A.).

17 For example, in *Leaf v. International Galleries*, [1950] 2 K.B. 86, at 90, [1950] All E.R. 693, at 695 (C.A.), Denning L.J. (as he then was) suggested that a buyer's right to rescind a contract of sale for innocent misrepresentation would be barred if the right to reject for breach of a condition were barred.

18 *Supra*, note 5.

19 *Ibid.*, s. 12. See, further, Ontario Law Reform Commission, *Report on Sale of Goods* (1979) (hereinafter referred to as "Sales Report"), Vol. I, at 135-36.

20 American Law Institute, Uniform Commercial Code, Official Text (9th ed., 1978), § 2-313 (i)(a).

(ii) Ontario

In our *Report on Consumer Warranties and Guarantees in the Sale of Goods*[21] published in 1972, we recommended that all statements by business sellers inducing consumer sales should be treated as warranties. This proposal, although not implemented in Ontario, has been adopted in Saskatchewan[22] and New Brunswick[23] in consumer product warranty statutes.

In our 1979 *Report on Sale of Goods*,[24] we recommended that all representations relating to goods, by both business and non-business sellers, should be treated as warranties. While we were concerned about the possibility of imposing heavy damages on non-business sellers, we decided, in the end, to make no special provision on the point.[25]

When the Commission's Report came to be considered by the Uniform Law Conference of Canada,[26] the Conference felt it necessary to maintain the distinction between representations and terms, and the Draft Bill approved by the Conference included a provision empowering the court to depart from the normal remedy in the case of a breach of warranty not constituting a term of the contract of sale.[27]

(iii) New Zealand

The New Zealand *Contractual Remedies Act 1979*[28] also contains a provision that treats a representation as a contractual term. Section 6(1) provides as follows:

> 6.-(1) If a party to a contract has been induced to enter into it by a misrepresentation, whether innocent or fraudulent, made to him by or on behalf of another party to that contract —

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21 Ontario Law Reform Commission, *Report on Consumer Warranties and Guarantees in the Sale of Goods* (1972), at 29.

22 *The Consumer Products Warranties Act*, R.S.S. 1978, c. C-30, s. 8.

23 *Consumer Product Warranty and Liability Act*, S.N.B. 1978, c. C-18.1, s. 4(1).

24 Sales Report, *supra*, note 19, Vol. I, at 136, and Draft Bill, s. 5.10.

25 *Ibid.*, at 140-41, and Vol. 2, at 489-91.

26 Initially, the *Report on Sale of Goods* was considered at the Annual Meeting of the Uniform Law Conference of Canada in 1979. A Sale of Goods Committee was struck and reported in 1981. (See Uniform Law Conference of Canada, *Proceedings of the Sixty-third Annual Meeting* (1981), at 185). The Draft Uniform Sale of Goods Act that formed part of the 1981 Report was referred to the Legislative Drafting Section and, as amended, was adopted as the *Uniform Sale of Goods Act*. (See Uniform Law Conference of Canada, *Proceedings of the Sixty-fourth Annual Meeting* (1981), Appendix HH (hereinafter referred to as "*Uniform Sale of Goods Act*")).

27 *Uniform Sale of Goods Act*, *supra*, note 26, s. 114(1)(b). See, also, Uniform Law Conference of Canada, *Proceedings of the Sixty-third Annual Meeting* (1981), Appendix S, Draft Bill, s. 9.19 and Comment.

28 *Contractual Remedies Act 1979*, Stat. N.Z., No. 11, s. 6(1)(a).

(a) He shall be entitled to damages from that other party in the same manner and to the same extent as if the representation were a term of the contract that has been broken; and

(b) He shall not, in the case of a fraudulent misrepresentation, or of an innocent misrepresentation made negligently, be entitled to damages from that other party for deceit or negligence in respect of that misrepresentation.

This provision is criticized by Dawson and McLauchlan in their book on the New Zealand Act[29] on the ground that the imposition of damages measured by the contractual expectation would place "an unfair burden" on an innocent misrepresentor.[30]

(b) OTHER SOLUTIONS

(i) United Kingdom

The *Misrepresentation Act 1967*[31] is a complex piece of legislation that modifies the law relating to representations in several respects. Section 1 enlarges the common law power of rescission, making it available even where the representation has become a term of the contract[32] or where the contract has been performed. Section 2(1) entitles a representee to claim damages unless the representor proves that the representation was not negligently made. Section 2(2) reduces the right to rescission by giving the court power to refuse rescission and to award damages in lieu thereof, but only in cases where the representee "would be entitled, by reason of the misrepresentation, to rescind the contract". Thus, in a case where rescission is barred, for example because of the inability of the plaintiff to restore benefits received under the contract, the Act still makes no provision for a money award in substitution for rescission.

(ii) Ontario *Business Practices Act*

The Ontario *Business Practices Act*[33] gives a right of rescission in respect of misrepresentations inducing contracts for the sale of goods and certain services supplied to consumers.[34] The Act also provides, in section 4(1)(b), that:

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[29] Dawson and McLauchlan, *The Contractual Remedies Act 1979* (1981).

[30] *Ibid.*, at 35.

[31] (1967), c. 7 (U.K.).

[32] At common law, there was authority for the view that the representation "merged" with the term so that no remedies would be available for the misrepresentation. See *Pennsylvania Shipping Co. v. Compagnie Nationale de Navigation*, [1936] 2 All E.R. 1137 (K.B.D.).

[33] R.S.O. 1980, c. 55.

[34] *Ibid.*, s. 4(1)(a).

> ... where rescission is not possible because restitution is no longer possible, or because rescission would deprive a third party of a right in the subject matter of the agreement that he has acquired in good faith and for value, the consumer is entitled to recover the amount by which the amount paid under the agreement exceeds the fair value of the goods or services received under the agreement or damages, or both.

This provision empowers the court to make a money award in lieu of rescission, for which the primary measure envisaged rests on restitutionary principles.

3. PROPOSALS FOR REFORM

The defects in the present law may be summarized as follows. A misrepresentation that is neither fraudulent nor negligent and that does not constitute a term of a contract is actionable neither in tort nor in contract. While a plaintiff who has been induced to enter into a transaction by a defendant's false statement may seek rescission of the transaction, in some cases the right of rescission may be too narrow and, in others, too broad. For example, if the law is that rescission is barred merely by execution of a contract, the right of rescission may be too narrow. Moreover, cases can be envisaged in which a *prima facie* right of rescission should be restricted because of the difficulty of unwinding a contractual transaction or the intervention of third party rights. Finally, the court has no power to make a money award in substitution for, or in addition to, rescission.

A simple amalgamation of representations with contractual terms would, in our opinion, impose too great a liability on the innocent non-business representor. Rather, we would propose the following modifications to the existing law. First, we believe that the right to rescind on the basis of misrepresentation should be enlarged by removing execution as an automatic bar, even in land sale cases. Accordingly, we recommend that, subject to the following recommendation, a representee should be able to rescind a contract that has been induced by misrepresentation even though the contract has been wholly or partly performed and even though, in the case of a contract for the sale of an interest in land, the interest has been conveyed to the representee.

Secondly, and balancing this enlarged right of rescission, we recommend that, where a party to a contract would otherwise have a *prima facie* right to rescission, the court should have power to deny rescission, or to declare it ineffective, awarding damages in lieu thereof. We further recommend that, in exercising this power, the court should take into consideration, *inter alia*, the following factors: undue hardship to the representor or to third parties; difficulty in reversing performance or long lapse of time after performance; whether a money award would give adequate compensation to the representee; the nature and scope of the representation; and the conduct of the representor and whether or not he or she was negligent in making the representation.

We recognize that in some cases there will be a period of uncertainty during which it will not be clear whether or not a purported rescission is valid, but this is bound to occur under any system. The Rules of Civil Procedure make

provision for interim preservation orders of property, which can be used in appropriate cases.[35]

Thirdly, we recommend that, whether or not a contract is rescinded, the court should have power to allow just compensation by way of restitution, or for losses incurred in reliance on the representation. In exercising this power the court should take into account such factors as whether the misrepresentation was made in the course of a business, whether the representor had personal knowledge of the facts, and whether he or she used reasonable care.

There has been some uncertainty about whether the law relating to misrepresentation applies to misrepresentations of law.[36] Since misrepresentations of law can be just as misleading as misrepresentations of fact, we recommend that legislation should make it clear that misrepresentation includes a misrepresentation of law.

We have directed our attention to innocent, that is, non-fraudulent misrepresentations, intending to leave in place the existing law relating to fraudulent misrepresentations. However, it would seem that there is no need to exclude fraudulent misrepresentations from the scope of our first recommendation, removing certain bars to rescission. We would not want to open the door to an argument that the rights of a misrepresentee were less in the case of fraud than in the case of innocent misrepresentation. In respect of the other recommendations, it should be made clear that they apply to innocent misrepresentations, including negligent misrepresentations.

On one matter that was dealt with in the U.K. *Misrepresentation Act 1967*[37] we make no recommendation. This is the question of control of contractual clauses excluding liability for misrepresentation. In our opinion, such clauses can be satisfactorily dealt with under our general recommendations on unconscionability.[38]

Recommendations

The Commission makes the following recommendations:

1. Subject to Recommendation 2, a representee should be able to rescind a contract that has been induced by misrepresentation even though the contract has been wholly or partly performed and even though, in the case of a contract for the sale of an interest in land, the interest has been conveyed to the representee.

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[35] Rules of Civil Procedure, O. Reg. 560/84, Rule 45.

[36] *Lewis v. Jones* (1825), 4 B. & C. 506, 107 E.R. 1148. But see *MacKenzie v. Royal Bank of Canada*, [1934] A.C. 477 (P.C. (Can.)).

[37] *Supra*, note 31, s. 3.

[38] See *supra*, ch. 6.

2. (1) The courts should have power to deny rescission for misrepresentation or to declare it ineffective, awarding damages in lieu thereof.

(2) In exercising the power referred to in Recommendation 2(1), the courts should take into consideration, *inter alia*,

(a) undue hardship to the representor or to third parties;

(b) difficulty in reversing performance or long lapse of time after performance;

(c) whether a money award would give adequate compensation to the representee;

(d) the nature and scope of the representation;

(e) the conduct of the representor; and

(f) whether or not the representor was negligent in making the representation.

3. (1) Whether or not a contract is rescinded, the court should have power to allow just compensation by way of restitution, or for losses incurred in reliance on the representation.

(2) In deciding whether to award compensation, the court should take into account such factors as whether the representation was made in the course of a business, whether the representor had personal knowledge of the matters represented by him or her, and whether he or she used reasonable care in making the representation.

4. Legislation should make it clear that a misrepresentation includes a misrepresentation of law.

5. With the exception of Recommendation 1, which should apply to all misrepresentations including fraudulent misrepresentations, the foregoing recommendations should apply to innocent misrepresentations, including negligent misrepresentations.

CHAPTER 13

WAIVER OF CONDITIONS

1. THE PRESENT LAW AND THE CASE FOR REFORM

This chapter deals with the rights of parties to a contract to waive conditions of that contract. The term "condition" has many meanings in Anglo-Canadian contract law.[1] For the purposes of this chapter, we use express condition to mean "an *explicit contractual provision* which provides either: (1) that a party to the contract is not obliged to perform one or more of his duties thereunder unless some state of events occurs or fails to occur; or, (2) that if some state of events occurs or fails to occur, the obligation of a party to perform one or more of his duties thereunder is suspended or terminated".[2] An implied condition has the same effect as an express condition, that is, it offers an excuse for a party's refusal to perform or to continue performance.

As a practical matter, the problems related to waiver of conditions have arisen mainly in the context of express conditions in contracts for the purchase and sale of land. A prospective purchaser of land is commonly concerned to ensure that his or her proposed use of the land will be permitted. The use may require a decision from a planning authority that cannot be obtained instantly. Where both parties wish to enter into a binding contract immediately, the purchaser's concerns are usually met by the simple expedient of providing that performance will be conditional upon the desired decision being obtained by a certain date. It sometimes happens that the terms of the condition are not met but the purchaser wishes to waive the condition and proceed in any event, while the vendor seeks to avoid the transaction by relying on non-fulfilment of the condition.

In Canada, the position, as held by the Supreme Court of Canada in *Barnett v. Harrison*,[3] relying on *Turney v. Zhilka*,[4] would seem to be that if a

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[1] See *Wickman Machine Tool Sales Ltd. v. Schuler A.G.*, [1972] 1 W.L.R. 840, at 849-51, [1972] 2 All E.R. 1173, at 1179-81 (C.A.), *per* Denning M.R.

[2] Fuller and Eisenberg, *Basic Contract Law* (4th ed., 1981), at 956. See, also, Treitel, *The Law of Contract* (6th ed., 1983), at 47-50, and Waddams, *The Law of Contracts* (2d ed., 1984), at 436-37.

[3] *Barnett v. Harrison*, [1976] 2 S.C.R. 531, 57 D.L.R. (3d) 225 (subsequent references are to [1976] 2 S.C.R.).

[4] *Turney v. Zhilka*, [1959] S.C.R. 578, 18 D.L.R. (2d) 447 (subsequent reference is to [1959] S.C.R.).

condition can be characterized as a "true condition precedent"[5] it cannot be waived by one party unilaterally even though it has been inserted solely for the benefit of that party and even if it is wholly severable, unless the contract expressly provides for the waiver.

It is possible to suppose circumstances in which, from the beginning, the vendor has a genuine interest in avoiding the transaction if the condition is not fulfilled. For example, if the vendor retains adjoining land, as was the case in *Turney v. Zhilka*,[6] he or she may have an interest in the future use of the land to be sold. In such cases, there can be no objection to the vendor relying on the condition. In many cases, however, at the time of the agreement, the vendor has no interest in the condition. Usually the vendor prefers an unconditional sale, but the condition is inserted for the purchaser's benefit. Subsequently, the vendor concludes that he or she has made a bad bargain and seizes on non-fulfilment of the condition as a ground for avoiding the contract. In *Barnett v. Harrison*, the Supreme Court of Canada permitted a vendor to avoid a contract on such grounds, relying on *Turney v. Zhilka* and holding that it was irrelevant to show that the condition was inserted for the sole benefit of the purchaser.

This conclusion gives us some difficulty. The function of the court in such a case, as the Supreme Court of Canada itself stressed,[7] is to give effect to the parties' intentions. There are no overriding considerations of justice apart from giving a fair construction to the agreement. In most cases it seems improbable that the parties intended, or reasonably expected, that the failure to secure planning approval would afford an excuse to the vendor to avoid the contract.

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[5] In *Turney v. Zhilka*, *ibid.*, at 583, the Court said the following with respect to a true condition precedent:

> But here there is no right to be waived. The obligations under the contract, on both sides, depend upon a future uncertain event, the happening of which depends entirely on the will of a third party — the Village council. This is a true condition precedent — an external condition upon which the existence of the obligation depends. Until the event occurs there is no right to performance on either side. The parties have not promised that it will occur. In the absence of such a promise there can be no breach of contract until the event does occur. The purchaser now seeks to make the vendor liable on his promise to convey in spite of the non-performance of the condition and this to suit his own convenience only. This is not a case of renunciation or relinquishment of a right but rather an attempt by one party, without the consent of the other, to write a new contract. Waiver has often been referred to as a troublesome and uncertain term in the law but it does at least presuppose the existence of a right to be relinquished.

There are, however, difficulties with the concept of a true condition precedent. See discussion, *infra*, this ch., sec. 2.

[6] *Turney v. Zhilka*, *supra*, note 4.

[7] See *Barnett v. Harrison*, *supra*, note 3, *per* Dickson J. (as he then was), where he stated at 558 that "the Court [should not run] roughshod over the agreement", and at 559 that, "[i]f in any case the parties agree that the rule shall not apply, that can be readily written into the agreement."

The vendor's legitimate interest is usually to obtain the agreed price. If he or she is permitted to avoid the contract for a reason not contemplated by the parties, the vendor will be afforded an excuse for which he or she has not bargained.

A single case, or even a number of cases, on the interpretation of individual contracts would hardly justify legislative intervention, however much one might disagree with the results. However, *Barnett v. Harrison*, while purporting to concede supremacy to the parties' intentions, appears to enshrine some sort of rule of interpretation that, as some passages in the judgment suggest, can only be displaced by express language.[8]

We consider it contrary to the general spirit of contract law to demand that parties express their intentions in a particular verbal formula. To do so is to set a trap for the unwary. Indeed, many courts seem to have recognized this, whether implicitly or explicitly, and have declined to follow *Turney v. Zhilka* and *Barnett v. Harrison*, either by distinguishing these cases on less than convincing grounds, or by ignoring them.[9] The result is uncertainty and unevenness in the law.

It may be argued, of course, that if the parties retain legal advisers no problem should arise. Thus, in the case of an agreement for the sale of land, the agreement can be drafted to provide expressly either that the non-satisfaction of the condition is an event that either party can claim as an excuse for non-performance, or that only the purchaser can rely upon the non-satisfaction of the condition to excuse his or her performance. Similarly, the agreement can specifically provide that the purchaser may waive the condition at will.

However, parties do not always have legal advice; nor should the law be such as to increase their transaction costs unnecessarily. It cannot be desirable for a court to refuse to give effect to what the parties obviously and reasonably wanted their agreement to achieve just because they have not had legal advice.

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[8] See *ibid.*, at 559, where Dickson J. (as he then was) stated that, "[i]n the interests of certainty and predictability in the law, the rule should endure unless compelling reason for change be shown."

[9] See, for example, *Beauchamp v. Beauchamp*, [1973] 2 O.R. 43, 32 D.L.R. (3d) 693 (C.A.), aff'd (1974), 40 D.L.R. (3d) 160*n* (S.C.C.); *McCauley v. McVey*, [1980] 1 S.C.R. 165, 98 D.L.R. (3d) 577; *Re Crema and Blake* (1981), 33 O.R. (2d) 121, 123 D.L.R. (3d) 427 (H.C.J.); *Whitehall Estates Ltd. v. McCallum* (1975), 63 D.L.R. (3d) 320 (B.C.C.A.); *Brooks v. Alker* (1975), 9 O.R. (2d) 409, 60 D.L.R. (3d) 577 (H.C.J.); *Cameron v. Albrecht* (1981), 121 D.L.R. (3d) 767 (B.C.S.C. (Chambers)); and *Re Grandby Investments Ltd. and Wright* (1981), 33 O.R. (2d) 341, 20 R.P.R. 30 (H.C.J.).

There is no reason, in effect, to impose formal requirements to cope with situations where no one is caught by unfair surprise or where the agreement is commercially reasonable. This is, however, precisely what can happen if the approach taken in *Barnett v. Harrison*[10] is followed.

We believe that a legislative provision that would re-establish the court's power to give effect to the parties' intentions is warranted, and we now turn to a discussion of the form that such a provision should take.

2. PROPOSALS FOR REFORM

The difficulty with the existing law is that a fairly rigid rule of interpretation may function to override the intentions of the parties. In seeking a legislative solution to this difficulty, it is important to reaffirm the primacy of the parties' intentions. The circumstances of contracts are so many and varied that an overprecise provision might do more harm than good, and might produce unexpected results in unforeseen circumstances.

British Columbia has enacted legislation dealing with this problem. Section 49 of the *Law and Equity Act* provides as follows:[11]

> 49. Where the performance of a contract is suspended until the fulfilment of a condition precedent, a party to the contract may waive the fulfilment of the condition precedent, notwithstanding that the fulfilment of the condition precedent is dependent upon the will or actions of a person who is not a party to the contract if
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> (a) the condition precedent benefits only that party to the contract;
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> (b) the contract is capable of being performed without fulfilment of the condition precedent; and
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> (c) where a time is stipulated for fulfilment of the condition precedent, the waiver is made before the time stipulated, and where a time is not stipulated for fulfilment of the condition precedent, the waiver is made within a reasonable time.

This provision appears to us to be unduly specific, and we see several problems with it. First, the opening words "[w]here the performance of a contract is suspended" may not deal with cases where the condition does not suspend the performance of the whole contract. Many cases make it clear that the contract is, in the types of case we have been discussing, in force from the moment of the agreement. The condition that provides an excuse in certain

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[10] *Supra*, note 3.

[11] *Law and Equity Act*, R.S.B.C. 1979, c. 224.

circumstances is a term of the contract, not something that suspends the operation of it.[12]

Secondly, the use of the term "condition precedent" should, in our opinion, be avoided. It is an ambiguous term sometimes used to describe circumstances where the contract does not come into existence until the condition is fulfilled, and sometimes used to indicate a term of a valid contract that excuses a party in certain circumstances from one or more contractual obligations.[13]

Thirdly, the reference to fulfilment of the condition depending on the will and actions of third parties gives an unduly narrow focus and can hardly be understood without a reading of *Turney v. Zhilka*.[14]

Fourthly, section 49(a) may give rise to difficulties in that the provision does not make it clear that the time to test the question of benefit must be the time the contract is formed rather than the time of the purported reliance on the condition.

Finally, paragraphs (b) and (c) of section 49, in our opinion, are unnecessarily detailed and constitute potential pitfalls. The phrase "capable of being performed" does not have an obvious meaning. Presumably it means reasonably capable of being performed, or capable of being performed without injustice to the other party, and it would perhaps be so interpreted. Similarly, the provision dealing with time seems redundant.

Where it is appropriate for the courts to proceed on a common sense basis by way of interpretation of an agreement, detailed legislation is, in our opinion, undesirable. There is a great danger in drafting overly precise and detailed legislation applicable to every kind of contract, while having in mind a particular problem that has arisen mainly in land sales cases. Such legislation may lead to consequences that are unforeseen and unintended at the time of drafting. We favour a provision that is as simple and spare as possible, and that would give effect to the parties' intentions.

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[12] This can be noted from the fact that one party may be under an obligation to seek, in good faith, to have a condition satisfied: see *Dynamic Transport Ltd. v. O.K. Detailing Ltd.*, [1978] 2 S.C.R. 1072, 85 D.L.R. (3d) 19, and *Hamelin v. Hore* (1976), 16 O.R. (2d) 170, 77 D.L.R. (3d) 546 (C.A.). Such an obligation can be enforced by a decree of specific performance that orders one party, for example, to seek development permission: see *Dynamic Transport Ltd. v. O.K. Detailing Ltd.* Similarly, damages may be awarded for breach of such an obligation: see *BEM Enterprises Ltd. v. Campeau Corp.* (1981), 32 B.C.L.R. 116, 22 R.P.R. 240 (C.A.), and *Multi-Malls Inc. v. Tex-Mall Properties Ltd.* (1980), 28 O.R. (2d) 6, 108 D.L.R. (3d) 399 (H.C.J.), aff'd (1981), 37 O.R. (2d) 133 (C.A.), leave to appeal denied (1982), 41 N.R. 360*n*.

[13] The different meanings are explained in *Trans Trust S.P.R.L. v. Danubian Trading Co., Ltd.*, [1952] 2 Q.B. 297, at 304, [1952] 1 All E.R. 970, at 976-77 (C.A.).

[14] *Supra*, note 4.

Accordingly, we recommend that legislation should provide that, unless a contrary intention appears, a party to a contract may waive a provision inserted into the contract solely for his or her own benefit.

Recommendation

The Commission makes the following recommendation:

1. Legislation should provide that, unless a contrary intention appears, a party to a contract may waive a provision inserted into the contract solely for his or her own benefit.

CHAPTER 14

MISTAKE AND FRUSTRATION IN THE LAW OF CONTRACT

1. INTRODUCTION

We find it convenient to treat mistake and frustration in the law of contract in the same chapter since there is a close connection between the two.[1] At one end of the spectrum, the question arises whether the parties should be bound, or continue to be bound, by a bargain that they were induced to enter into as the result of a mistaken assumption about a basic factor affecting the contract. At the other end of the spectrum, the question for consideration is whether an adversely affected party should be excused from further performance of a contract because of an unexpected event arising *after* the conclusion of the contract making performance impossible or much more onerous. It will be seen therefore that both types of case present the important policy question whether the law should give effect to an extrinsic event for which no provision has been made in the parties' bargain. Again, if relief is deemed appropriate because of an operative mistake or frustrating event, then similar questions must be addressed about the remedies to be afforded the parties and, in particular, to what extent reliance and restitutionary remedies should be made available. Finally, the close relationship between mistake and frustration is shown by the fact that the same facts, or a slight variation in them, can be characterized as a mistake affecting the formation of the contract or as an event frustrating the parties' expectations with respect to performance of the contract, depending on how the facts are viewed or the type of question being asked.

We turn first to the role of mistake.

2. MISTAKE IN THE LAW OF CONTRACT

Some aspects of the law of mistake were dealt with in our *Report on Sale of Goods*,[2] but we made it clear that the other aspects should be dealt with in a law of contract amendment project. We must confess that we have found our

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[1] Atiyah, *An Introduction to the Law of Contract* (3d ed., 1981), at 199-200; Farnsworth, *Contracts* (1982), at 647-49; and Waddams, *The Law of Contracts* (2d ed., 1984), at 265-66.

[2] Ontario Law Reform Commission, *Report on Sale of Goods* (1979) (hereinafter referred to as "Sales Report"), Vol. I, at 103-07, and Vol. II, at 285-88.

mandate one of unusual difficulty. There is great uncertainty about what the present Anglo-Canadian law of mistake is. No two authors agree in their analysis of it and the same confusion exists in the case law. Reputable scholars often disagree about the interpretation of the same case.[3] Some scholars deny altogether that English contract law recognizes an independent doctrine of mistake.[4] Others acknowledge its existence but give it a very limited scope[5] while a third group is prepared to concede the doctrine of mistake a substantially larger role.[6] American law with respect to mistake has developed along very different lines from Anglo-Canadian law and is exerting increasing influence on doctrinal thinking in Canada as well as in other parts of the Commonwealth.

Further difficulties arise because equity has asserted a jurisdiction in this area that is significantly wider and more flexible than the jurisdiction exercised by the common law courts. However, no one is quite sure how the two bodies of rules mesh (if indeed they mesh at all) and what the precise boundary is between them. Again some scholars question altogether the existence of an independent equitable doctrine of mistake.[7]

These differences and uncertainties reflect the intractable character of one of the most difficult branches of contract law. Needless to say, they are not due to a lack of goodwill or intelligence; rather, they express an underlying concern that the protection of expectation interests, generally viewed as one of the basic goals of modern contract law, not be undermined by too expansive a role for the mistake defence.

We too share this concern and are fully conscious of the dangers of trying to legislate in an area so peculiarly fraught with pitfalls. Were the alternative open to us, an Ontario type restatement of the law of contractual mistake — persuasive for, but not binding on, the courts — might be a superior alternative to the legislative solution; but it is not. Nor is it realistic to rely on judicial developments to rectify the anomalies from which the existing rules suffer and to put the whole subject on a sounder conceptual footing, since the difficulties and uncertainties are themselves the product of judicial doubts and hesitations. We have accordingly reached the conclusion that a package of legislative

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[3] This is particularly true of the House of Lords decision in *Bell v. Lever Bros., Ltd.*, [1932] A.C. 161, [1931] All E.R. Rep. 1 (subsequent references are to [1932] A.C.), the leading English case on the scope of the doctrine of mistaken assumptions.

[4] For example, Slade, "The Myth of Mistake in the English Law of Contract" (1954), 70 L.Q.R. 385.

[5] For example, Furmston (ed.), *Cheshire & Fifoot's Law of Contract* (10th ed., 1981), at 200.

[6] Canadian authors, on the whole, appear to fall into this category. See, for example, Swan, "The Allocation of Risk in the Analysis of Mistake and Frustration", in Reiter and Swan (eds.), *Studies in Contract Law* (1980), at 181-233, and Waddams, *supra*, note 1, at 262-300.

[7] For example, Atiyah and Bennion, "Mistake in the Construction of Contracts" (1961), 24 Modern L. Rev. 421, and Slade, *supra*, note 4, esp. at 403-07.

reforms is the best compromise solution, although we recognize that not everyone will agree that we have struck the right balance in every case. We proceed to divide our discussion into the well accepted distinction between mistakes in assumption and mistakes in understanding.

(a) MISTAKES IN ASSUMPTION

A mistake in assumption is said to occur when one or more of the parties has been induced to enter into a contract on the basis of a false assumption involving a material aspect of the bargain. Definitionally, the assumption is not a term of the contract, but without the belief in its correctness it may fairly be assumed that the mistaken party or parties would not have been willing to enter into the contract, or, at least, not on the same terms. The false assumption may be shared by all the parties (''common mistake'') or it may be limited to only one of the parties (''unilateral mistake''). In the latter case it is also customary to distinguish between those situations where the other party knew or had reason to know of the first party's mistake and those where the other party was not aware of it at the time of the conclusion of the contract.

(i) Common Mistakes

a. General Considerations

There is no doubt that some types of common mistake are recognized by the common law, but it is not clear what the test of recognition is. Mistakes concerning the existence of specific goods at the time of their sale[8] or of the ownership of other property[9] have long been accepted as vitiating factors. The same is true of the subsistence of a valid marriage as the underpinning for a separation agreement[10] or the existence of a person whose life is being insured under a life insurance policy[11] or who is the annuitant in a contract for the sale of an annuity contract.[12] These cases, and others like them, led some of the law lords comprising the majority in *Bell v. Lever Bros., Ltd.*[13] to express the opinion that common mistake was only an available defence when it went to the identity or very existence of the subject matter of the contract. This rationalization, however, has been questioned by scholars who find it difficult to reconcile with many of the decided cases.[14]

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[8] *Couturier v. Hastie* (1856), 5 H.L.C. 673, 10 E.R. 1065; *McRae v. Commonwealth Disposals Commission* (1951), 84 C.L.R. 377 (Aust. H.C.).

[9] *Bingham v. Bingham* (1748), 1 Ves. Sen. 126, 27 E.R. 934, and *Cochrane v. Willis* (1865), 1 Ch. App. 58, 35 L.J. Ch. 36.

[10] *Galloway v. Galloway* (1914), 30 T.L.R. 531 (Div. Ct.).

[11] *Scott v. Coulson*, [1903] 2 Ch. 249, 19 T.L.R. 440 (C.A.).

[12] *Strickland v. Turner* (1852), 7 Exch. 208, 155 E.R. 919.

[13] *Supra*, note 3.

[14] Waddams, *supra*, note 1, at 286-89.

As noted previously, it may also be fairly claimed, based on past precedents, that equity takes a wider view of its jurisdiction than does the common law. In *Solle v. Butcher*,[15] a leading if controversial case, Lord Denning asserted that equity will grant relief "if the parties were under a common misapprehension either as to facts or as to their relative and respective rights, provided that the misapprehension was fundamental and that the party seeking to set it aside was not himself at fault".[16] However, the correctness of this proposition has been challenged,[17] and both this and the existence of an independent mistake doctrine in equity must be regarded as unsettled in English law until such time as the disagreement is authoritatively resolved by the House of Lords.

We find it disturbing that there should be two such divergent if disputed bases on which the courts will recognize mistakes in assumption, and equally unsatisfactory that the consequences of an operative mistake should differ so markedly at common law and in equity. At common law a mistake meeting the requisite test wholly avoids the contract.[18] This result has serious implications for the rights of third parties who may have acquired property in good faith from one of the parties to the transaction. It also precludes the courts from giving more flexible and appropriate forms of relief. In equity, on the other hand, the contract is not void *ab initio* but only voidable[19] and the adversely affected party will only be allowed to avoid the contract if he or she acts promptly and can do so without prejudicing the rights of third parties. Equity can, and frequently does, attach terms to an order of rescission in favour of an adversely affected party.[20] We are of the view that the equitable approach should apply to all cases where a defence of mistaken assumption is raised and, as will be explained more fully hereafter, that the actual remedy should be in the court's discretion subject, in every case, to the protection of third party interests.

The questions remain, however, what type of mistake should trigger the court's jurisdiction and what conditions should qualify the availability of relief. We recognize that not to impose any restrictions would create too much uncertainty and interfere unduly with the rights of parties to have their contractual expectations respected. On the other hand, a test that is too

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[15] [1950] 1 K.B. 671, [1949] 2 All E.R. 1107 (C.A.) (subsequent references are to [1950] 1 K.B.).

[16] *Ibid.*, at 692-93. See, also, Denning L.J.'s observations in *Frederick E. Rose (London) Ltd. v. William H. Pim Jr. & Co. Ltd.*, [1953] 2 Q.B. 450, at 460-61, [1953] 2 All E.R. 739, at 746-47 (C.A.).

[17] See Atiyah and Bennion, *supra*, note 7, and Slade, *supra*, note 4. See, also, Goff and Jones, *The Law of Restitution* (2d ed., 1978), at 146-47.

[18] *Cheshire & Fifoot's Law of Contract*, *supra*, note 5, at 202-10.

[19] *Ibid.*, at 210-13.

[20] See, for example, *Solle v. Butcher*, *supra*, note 15, and compare *Devald v. Zigeuner*, [1958] O.W.N. 381, 16 D.L.R. (2d) 285 (H.C.J.), discussed *infra*, this ch., sec. 2(b)(ii).

demanding would undermine equally important objectives of the law of mistake — the prevention of unjust enrichment or the imposition of onerous obligations as a result of the mistaken assumption.

Slightly varying answers to these questions are given in the New Zealand *Contractual Mistakes Act 1977*,[21] and in the First and Second American *Restatements of the Law of Contracts*.[22] In the New Zealand Act the test is whether the parties have made a "material mistake" which, in the absence of judicial relief, would result in a "substantially unequal exchange of values".[23] In the *First Restatement*,[24] the parties' mistaken assumption must have formed "the basis" on which they entered into the transaction and enforcement of the contract must make it "materially more onerous" to the mistaken party. In the *Second Restatement*,[25] the test is whether the mistake relates to a "basic assumption on which the contract was made" and whether it has "a material effect on the agreed exchange of performances".

The point has been made in a frequently cited article by Professor Rabin[26] that the critical issue is less the quality of the mistake than its impact on the agreed exchange of values. He proposes a test that would require only that the mistake be "material", in the sense that the mistaken party would not have entered into the transaction but for the error in question, rather than "basic" or "fundamental". Rabin defends this on the basis that the essential consideration in a mistake case is whether the mistake results in a grossly more unequal exchange of values. Because, according to Rabin, the "basic" or "fundamental" test appears to operate so as to identify such cases, it would, in his view, be more straightforward to place the criterion on the explicit basis of inequality of exchange. It should be noted that his formulation is designed to capture unilateral as well as common mistakes in assumption, and this is an aspect to which we return later in this chapter.

Our own view is that the quality of the common mistake as well as its consequences are essential considerations. Merely to focus on the consequences of a mistake would, we believe, lead to the undesirable result of allowing a contract to be set aside where the mistaken assumption involves a matter of secondary importance. After all, it is the existence of the mistake that motivates the law's interference with the parties' bargain. Inequality of exchange alone, however marked, would not, in our view, justify that interference. Accordingly, we favour the test set out in the *Second Restatement*.

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21 Stat. N.Z. 1977, Vol. I, No. 54.

22 American Law Institute, *Restatement of the Law, Contracts* (1932) (hereinafter referred to as "*First Restatement*"), § 502; *Restatement of the Law, Second — Contracts, 2d* (1981) (hereinafter referred to as "*Second Restatement*"), § 152.

23 *Supra*, note 21, s. 6(1)(a) and (b).

24 *Supra*, note 22, § 502.

25 *Supra*, note 22, § 152.

26 Rabin, "A Proposed Black-Letter Rule Concerning Mistaken Assumptions in Bargain Transactions" (1967), 45 Tex. L. Rev. 1273, at 1282-84.

b. Allocation of Risk

Modern commentators generally agree[27] that any test for granting relief from a mistake in assumption is seriously incomplete if it does not also take into account whether the parties have, expressly or impliedly, made provision for allocating the risk of a mistake to one or other of them and, if they have not done so, whether a court should be free to do so on a proper consideration of all the factors. The need for this additional inquiry arises because an unqualified right to relief could lead to abuses. It is only when all the relevant factors have been canvassed and the court is satisfied that the risk has not been allocated by agreement, custom of the trade or other circumstances that it will be appropriate to grant relief to the adversely affected party.

The risk factor is expressly recognized in the New Zealand Act[28] and plays a central role in the design of the *Second Restatement* provisions. Section 154 of the *Second Restatement* provides that a party bears the risk of a mistake in three circumstances, when:

(a) the risk is allocated to him by agreement of the parties, or

(b) he is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the mistake relates but treats his limited knowledge as sufficient, or

(c) the risk is allocated to him by the court on the ground that it is reasonable in the circumstances to do so.

With respect to subparagraph (c), the Comment to the section explains that "[i]n some instances it is reasonably clear that a party should bear the risk of a mistake for reasons other than those stated in Subparagraphs (a) and (b)."[29] This explanation is not particularly helpful. We think a better justification for a provision of this sort is that since the court is exercising a discretionary remedy the court should be satisfied that it is not contrary to sound social, economic or business interests to do so or, as it is put more succinctly by Professor Rabin,[30] that there are no countervailing social policies. This said, we agree with the design of the *Second Restatement* with respect to allocation of risk.

c. Remedies

We have already stated our conclusion that the distinction between the common law and equitable remedies should be abolished and that all mistakes in assumption should be governed by a common remedial regime. It remains for us to consider what those remedies should be.

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[27] For example, Atiyah, *supra*, note 1; Rabin, *supra*, note 26; Swan, *supra*, note 6; and *Second Restatement*, *supra*, note 22, § 152, Comment e.

[28] *Supra*, note 21, s. 6(1)(c).

[29] *Supra*, note 22, Comment d.

[30] *Supra*, note 26.

It is sometimes said that in equity the effect of an operative mistake is to make the contract voidable. If this means (as, in the American context, section 152 of the *Second Restatement* suggests it does) that once the mistake is proven and the other tests of eligibility for relief have been satisfied the mistaken party has a *right* to rescind the contract, this, in our view, would unreasonably fetter the hands of the court. In the past, equity courts have not construed their powers so narrowly and conditions have often been attached to the granting of rescissionary relief. Just as frequently, the non-adversely affected party to the contract has been given the option of retaining the benefits of the contract if he or she will agree to a revision of its terms. So, for example,[31] in *Solle v. Butcher*[32] a landlord was only allowed rescission of a lease if he gave the tenant the option of staying on in the premises at a rent that would have obtained absent the operative mistake in assumption. Likewise, in *Grist v. Bailey*,[33] a house was sold for £850, both parties believing that it was in the occupation of a protected tenant. In fact the protected tenant had died before the sale so that vacant possession of the house could be obtained. This would have made it worth much more. Goff J. dismissed the vendor's claim for specific performance only on condition that the defendant agree to enter into a fresh contract at a proper vacant possession price.

These precedents point clearly to the desirability of allowing the court to make such order as seems just without fettering its discretion. However, we also favour adding an illustrative list of remedies to assist the court in making its determination. This would be consistent with what we have done in the chapters in this Report dealing with the consequences of unconscionable contracts,[34] and illegal contracts.[35] The New Zealand *Contractual Mistakes Act 1977*[36] lists the following illustrative orders that the court can make:[37]

(a) Declare the contract to be valid and subsisting in whole or in part or for any particular purpose:

(b) Cancel the contract:

(c) Grant relief by way of variation of the contract:

(d) Grant relief by way of restitution or compensation.

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31 See Treitel, *The Law of Contract* (6th ed., 1983), at 239-41. The account that follows of the orders made in *Solle v. Butcher*, *supra*, note 15, and *Grist v. Bailey*, [1967] Ch. 532, [1966] 2 All E.R. 875, is based in part on Professor Treitel's summary of them.

32 *Supra*, note 15.

33 *Supra*, note 31.

34 *Supra*, ch. 6.

35 *Supra*, ch. 11.

36 *Supra*, note 21.

37 *Ibid.*, s. 7(3).

While we agree with this list as far as it goes, we believe that it should be clarified and amplified in two respects. First, it should be made clear that the restitution referred to in clause (d) is for benefits conferred on a contracting party, including benefits conferred on a third party at the request of a contracting party, and that the compensation is for expenses (that is, reliance losses) incurred by a party. Second, the court should be given an explicit power to apportion reliance losses between the contracting parties where it appears just to do so.

Legislation should also address the difficult question how far the negligence of the adversely affected party should preclude him or her from obtaining relief. Section 157 of the *Second Restatement* provides that a mistaken party's fault in failing to know or discover the facts before making the contract does not "bar" him from seeking avoidance or reformation of the contract "unless his fault amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing".

If section 157 means that a self-induced mistake is not an absolute bar to relief then we have no quarrel with it,[38] but if it means that the court must disregard it in all cases then we think it goes too far. It appears from the reported cases[39] that the courts have taken the factor into consideration, especially where the other party has altered his or her position in reliance on the contract, and in our view rightly so. Where the contract is still fully executory on both sides and the other party has not acted on it to his or her detriment, the fault of the mistaken party may well be disregarded although, in a close case, the court may still wish to take it into account. It would be anomalous if, in determining the allocation of risk, the court could take every circumstance into consideration other than the fault of the party seeking relief. In any event, we do not think it desirable to lay down any rigid rules with respect to the role of negligence. In our view, it is best left as a discretionary element for the court to consider in determining whether relief should be granted and on what basis.[40]

The same reasoning applies to other equitable defences that have been raised in actions for rescission for mistake. We have in mind unreasonable delay by the adversely affected party in seeking relief or that the non-mistaken party can no longer be restored to its original position. We consider that the court should be explicitly empowered to take those matters into consideration in determining whether relief should be granted, and if so what type.

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[38] *Second Restatement*, *supra*, note 22, § 157, Comment a is to this effect. A familiar example of a self-induced mistake is where a party bidding for a contract fails to exercise reasonable care in tallying and verifying his or figures.

[39] For example, *Solle v. Butcher*, *supra*, note 15, *per* Denning L.J., at 693.

[40] This is the approach adopted in the New Zealand Act, *supra*, note 21, s. 7(2).

We have already mentioned our view that no order for relief made by the court should impair the rights obtained by a third party acting in good faith and for valuable consideration. The New Zealand Act so provides[41] and this too should be made explicit in the Ontario legislation.

d. Mistakes of Law

Since Lord Ellenborough's controversial and much discussed judgment in *Bilbie v. Lumley*,[42] it has often been said that a contract entered into under a mistake of law will not entitle the mistaken party to relief even though he or she would have been eligible for it had the mistake been one of fact. The distinction between mistakes of fact and mistakes of law has been repeatedly criticized as mischievous and untenable, and over the years the courts have carved out many exceptions to the rule in *Bilbie v. Lumley*.[43] We believe the distinction should now be abolished.

The distinction was convincingly criticized by Mr. Justice Dickson (as he then was) in his dissenting judgment in *Hydro-Electric Commission of Nepean v. Ontario Hydro Commission*.[44] The distinction is not adopted in American law and does not appear in the *Restatement*. It has been abolished in the New Zealand Act[45] and its abolition is also recommended in the British Columbia Law Reform Commission's *Report on Benefits Conferred Under a Mistake of Law*.[46] The Report recommends the abolition of the distinction in the contractual area as well as generally. It will be seen, therefore, that our own recommendation is supported by an impressive body of precedent.

(ii) Unilateral Mistakes in Assumption

a. Unilateral Mistake Known to the Other Party or Where he or she had Reason to Know of it

A unilateral mistake in assumption is said to occur when the mistake is made by only one of the parties although the other party may know or have reason to know of the mistake. We consider first the position where the non-mistaken party does know or have reason to know of the mistake.

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41 *Ibid.*, s. 8.

42 (1802), 2 East 469, 102 E.R. 448 (K.B.).

43 In his dissenting judgment in *Hydro-Electric Commission of Nepean v. Ontario Hydro Commission*, [1982] 1 S.C.R. 347, 132 D.L.R. (3d) 193 (subsequent references are to [1982] 1 S.C.R.), Dickson J., at 365-67, identified five such exceptions.

44 *Ibid.*, at 358-70.

45 *Supra*, note 21, s. 2, definition of "mistake".

46 Law Reform Commission of British Columbia, Report No. 51, *Report on Benefits Conferred Under a Mistake of Law* (1981), at 92.

Since the decision of the Court of Queen's Bench in *Smith v. Hughes*,[47] it has been said to be the established rule of Anglo-Canadian law that relief is not available for a unilateral mistake in assumption (as distinct from a mistake affecting the terms of an offer) made by one of the parties even if the other party knew of it. In this case Cockburn C.J. said,[48] "The question is not what a man of scrupulous morality or nice honour would do under such circumstances," and Blackburn J. said,[49] "whatever may be the case in a court of morals, there is no legal obligation on the vendor to inform the purchaser that he is under a mistake, not induced by the act of the vendor". This view of the law has subsequently been confirmed by high authority[50] but was criticized in his non-judicial capacity by Lord Wright on the ground that it is not in "accord with the feelings of ordinary decent people".[51] American courts have rejected the Anglo-Canadian position for a considerable time and the voidability of such contracts is recognized in section 153 of the *Second Restatement*. It is also recognized in the New Zealand Act.[52]

In our view, Ontario law should follow the *Second Restatement* position, not merely because of the dubious ethical conduct of the party who remains silent but for other reasons as well. When considered against a spectrum of misapprehensions that can occur when a person enters an agreement, the rule in *Smith v. Hughes* appears anomalous. One who is induced to enter an agreement by fraudulent or innocent misrepresentation can rescind. So too can a person who shares a fundamental mistake with the other party. But where the other party has full knowledge and exploits it to his or her advantage, the rule denies relief to the mistaken party.

It occasions no surprise, then, that the courts have found methods for departing from the spirit of *Smith v. Hughes*. Duties of disclosure, for example, have been imposed on fiduciaries and on parties to so-called *uberrimae fidei* agreements.[53] Failure to disclose material facts has been deemed to be a misrepresentation in cases where a partial disclosure has been viewed as

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47 (1871), 6 L.R.Q.B. 597, 25 L.T. 329 (subsequent references are to 6 L.R.Q.B.).

48 *Ibid.*, at 603.

49 *Ibid.*, at 607.

50 *Bell v. Lever Brothers Ltd.*, *supra*, note 3, at 227, *per* Lord Atkin. See, also, *Cheshire & Fifoot's Law of Contract*, *supra*, note 5, at 240-41, and Waddams, *supra*, note 1, at 322-25.

51 Lord Wright, Book Review (1943), 59 L.Q. Rev. 122, at 128.

52 *Supra*, note 21, s. 6(a)(i).

53 See Waddams, *supra*, note 1, at 323. *Uberrimae fidei* agreements are agreements requiring the most abundant good faith and the absence of any concealment or deception, however slight: see *Black's Law Dictionary* (5th ed., 1979).

misleading.[54] Further, the courts have developed elaborate doctrines of implied terms, particularly in the law of sale of goods,[55] imposing liability of certain kinds regardless of the fact that neither misrepresentation nor express warranty is present.[56] And the recently developed negligent misstatement doctrine has been employed to rescue victims of silent deception.[57] While it could not be seriously maintained that the *Smith v. Hughes* line of authority has been completely discredited by these developments, it is suggested that their cumulative effect, coupled with the rule's rather anomalous nature, present a persuasive case for reform.

Of course, the availability of relief for the self-deceived party should not be unqualified lest this in turn lead to its own injustices, and we favour limitations similar to those recommended by us for common mistakes in assumption.[58] This means that the mistake must be as to a basic assumption and that it must also have a material effect on the agreed exchange of values. Moreover, as with common mistakes, the question of risk allocation should be addressed. It may be thought that the actual or constructive knowledge of the non-mistaken party should be sufficient to justify the granting of relief. However, in our view, it should still be open to the mistaken party, expressly or impliedly, to assume the risk of his or her own mistake, unlikely though that may be in a case of this kind. Likewise, if the circumstances justify it, a court should be able to find that the custom of the trade or established business practices relieve a party from having to disabuse the other party of the self-induced mistake. In short, the duty of disclosure of the non-mistaken party ought to yield to exceptions.[59]

The *Second Restatement* rule is that the mistaken party is entitled to seek relief where the other party knew of his mistake or had reason to know of it.[60] The reason for including a test of constructive knowledge (''or had reason to

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[54] See *Aaron's Reefs Ltd. v. Twist*, [1896] A.C. 273, 74 L.T. 794 (H.L.); *R. v. Kyslant (Lord)*, [1932] 1 K.B. 442, 146 L.T. 21; *Kerr on Fraud and Mistake* (7th ed., 1952), at 97 *et seq.*; *Bank of British Columbia v. Wren* (1973), 38 D.L.R. (3d) 759 (B.C.S.C.); *Royal Bank of Canada v. Hale* (1961), 30 D.L.R. (2d) 138 (B.C.S.C.). But compare *Bank of Nova Scotia v. Boehm*, [1973] 3 W.W.R. 757 (B.C.S.C.).

[55] See now *Sale of Goods Act*, R.S.O. 1980, c. 462, ss. 13-16.

[56] See, generally, Atiyah, ''Judicial Techniques and the English Law of Contract'' (1968), 2 Ottawa L. Rev. 337.

[57] *Walter Cabott Construction Ltd. v. The Queen* (1974), 44 D.L.R. (3d) 82 (F.C., T.D.).

[58] The *Second Restatement*, *supra*, note 22, §§ 153 and 154, is to the same effect.

[59] In view of this general conclusion we find it unnecessary to consider Professor Kronman's interesting suggestion, based on an economic analysis of mistake doctrine, that a distinction should be drawn in unilateral mistake cases between information casually acquired by the non-mistaken party and information deliberately acquired in the course of his or her business or profession. Only in the former case would the non-mistaken party be under a duty of disclosure to the other party: see Kronman, ''Mistake, Disclosure, Information and the Law of Contracts'' (1978), 7 J. Legal Studies 1.

[60] Section 153(b) only speaks of the other party having reason to know of the mistake. Obviously this includes the case where the other party actually knew of the mistake.

know'') is that it is often difficult to prove a person's state of mind and that the evidentiary difficulties can be avoided by allowing a court to impute knowledge on the strength of evidence that would have put the average person on notice.[61] A good illustration of such a case is where a subcontractor's bid for a job is markedly below the contractor's own estimate of the likely cost and markedly less than the bids received from other subcontractors. Though the contractor may fairly deny knowledge of the subcontractor's mistake in calculation, the ''reason to know'' test will still enable the court to grant relief to the mistaken party if the court is satisfied that an average person in the contractor's position would have appreciated that a mistake had been made.[62]

Section 153(b) of the *Second Restatement* also applies to a case where the ''fault'' of the non-mistaken party caused the mistake. Although the accompanying Comment does not explain its rationale, the justification for including a fault test is obvious. If a party by his or her negligent conduct induces a mistaken belief by the other party about an important feature relevant to the contract he or she cannot in good conscience insist on strict performance of the contract.[63] Often the mistaken party may also have a defence based on other doctrines, such as negligent misrepresentation. Under the *Hedley Byrne* doctrine,[64] there may also be a claim in damages. However, the mistaken party should not be limited to these alternatives and we agree that the fault of the non-mistaken party should by itself trigger the court's power to grant relief to the mistaken party.

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61 Corbin, *Corbin on Contracts* (1972), Vol. 3, § 610, at 692-97.

62 A point of difficulty that has been much litigated in Canada and the United States is whether a contractor who has put in an irrevocable bid for a construction project is entitled to relief where the contractor discovers a mistake in its calculations and so advises the offeree before the bid is accepted. The Canadian case law is unsettled. See, for example, *Imperial Glass Ltd. v. Consolidated Supplies Ltd.* (1960), 22 D.L.R. (2d) 759 (B.C.C.A.); *McMaster University v. Wilchar Construction Ltd.*, [1971] 3 O.R. 801, 22 D.L.R. (3d) 9 (H.C.J.), aff'd (1973), 12 O.R. (2d) 512*n*, 69 D.L.R. (3d) 400*n* (C.A.); *Belle River Community Arena Inc. v. W.J.C. Kaufmann Co. Ltd.* (1978), 20 O.R. (2d) 447, 87 D.L.R. (3d) 761 (C.A.); *R. v. Ron Engineering*, [1981] 1 S.C.R. 111, 119 D.L.R. (3d) 267; and *Calgary v. Northern Construction Company Division of Morrison-Knudsen Co. Inc.* (1985), 42 Alta. L.R. (2d)1, [1986] 2 W.W.R. 426 (C.A.), leave to appeal to the Supreme Court of Canada granted June 12, 1986. See also Carr, ''Case Comment'' (1961), 39 Can. B. Rev. 625; Blom, ''Case Comment'' (1982), 6 Can. Bus. L.J. 80; and Swan, ''Case Comment'' (1981), 15 U.B.C. L. Rev. 447. In our view, a unilateral mistake in an irrevocable offer should *prima facie* be treated in the same manner as a unilateral mistake in a revocable offer that has been accepted. Accordingly, we do not propose in this Report a special statutory rule to govern mistakes in irrevocable offers. However, this would not preclude further judicial development of this area. See further, *infra*, this ch., sec. 2(b)(i).

63 Compare the position where the negligent conduct of one party induces a mistake by the other party with respect to the proposed terms of the contract. See *A. Roberts & Co. Ltd. v. Leicestershire County Council*, [1961] Ch. 555, [1961] 2 All E.R. 545, and *infra*, this ch., sec. 2(b)(ii).

64 *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*, [1964] A.C. 465, [1963] 2 All E.R. 575 (H.L.).

b. Unilateral Mistake not Known to the Other Party and Where he or she had No Reason to Know of it

Modern American restitutionary theory favours relief for the mistaken party not only where the other party was aware or should have realized that a mistake was being made but also where he or she was wholly innocent of knowledge. The *Second Restatement* formally endorses this position.[65] On the other hand, this broader basis of relief was consciously omitted from the New Zealand Act because the Contracts and Commercial Law Reform Committee, whose Report led to the enactment of the legislation,[66] was of the view that "the law of contract is concerned with the enforcement of agreements independently of the question whether such agreements were prudently or imprudently made".[67]

We have given the question careful consideration and have concluded that it would not be wise at this stage in the evolution of Canadian mistake theory for Ontario law to adopt a much expanded rule for unilateral mistakes that has no basis in precedent (in fact the great majority of precedents and *dicta* are firmly opposed to it)[68] and that, so far as we are aware, has only limited or little support in the business community or in the community at large.

The justification given in the *Second Restatement* for the adoption of the extended jurisdiction is that "[t]here has, in addition, been a growing willingness [among American courts] to allow avoidance where the consequences of the mistake are so grave that enforcement of the contract would be unconscionable."[69] The cases relied upon appear principally to involve unilateral mistakes in bidding for construction jobs. We appreciate that section 153 of the *Second Restatement* does not entitle the mistaken party to obtain relief without also meeting the other important tests imposed by the section. While this may reduce some of the objections to the rule (although, it seems to us, only at the expense of adding a new dimension of uncertainty), it does not remove the objection of principle.

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65 *Second Restatement*, *supra*, note 22, § 153. The *First Restatement*, *supra*, note 22, did not recognize this type of unilateral mistake. Note also that where the other party had no reason to know of the mistake, § 153(a) of the *Second Restatement* requires the mistaken party to prove, in addition, that the effect of the mistake is such that enforcement of the contract would be unconscionable.

66 New Zealand, Contracts and Commercial Law Reform Committee, *Report on the Effect of Mistakes on Contracts* (1976).

67 *Ibid.*, at 17.

68 For example, *Devald v. Zigeuner*, *supra*, note 20; *Bell v. Lever Bros. Ltd.*, *supra*, note 3; *Riverlate Properties Ltd. v. Paul*, [1975] Ch. 133, [1974] 2 All E.R. 656 (C.A.); *Tamplin v. James* (1880), 15 Ch. D. 215, 43 L.T. 520 (C.A.), *per* Baggallay L.J.; and *Stewart v. Kennedy* (1890), 15 A.C. 108 (H.L.), cited in Goff & Jones, *supra*, note 17, at 147.

69 *Second Restatement*, *supra*, note 22, Comment a.

Until now the general principle in our law has been that if an agreement has not been procured by unfair or unlawful means it will be enforced even though one party may gain much more from the transaction than the other. This principle has recently been reaffirmed by the Privy Council in dealing with the contractual capacity of a person suffering from mental illness.[70] Mere disparity in gains and losses, even very great disparity, has not in the past been deemed a sufficient ground for interfering with the agreement.[71] If such a principle were now to be introduced into Ontario law it would be difficult to justify limiting its operation to unilateral mistakes. It is true that the prevention of unjust enrichment underlies the granting of relief in cases of common mistake and unilateral mistake where the mistake is known to the other party. But unjust enrichment or hardship *per se* is not the basis of relief. It is unjust enrichment *plus* something else that triggers the court's jurisdiction. It is that "something else" that is missing where the other party is not privy to the mistake and had no reason to know of it.

Although, as indicated by the foregoing discussion, we do not believe that the availability of relief for a unilateral mistake not known to the other party would be consistent with the existing state of Anglo-Canadian contract law, we recognize that this branch of contract law, like most others, is not static. We conclude that reform legislation addressing this area of the law should explicitly state that courts should not be precluded from further developing it if changes in circumstances, trade usage, or new insights into the problem should justify further development.

(iii) Conclusions

We shall here gather together our conclusions relating to mistakes in assumption. In view of the complexity of this area of the law, we considered that it would be helpful to cast these conclusions in draft statutory form, as follows:

Mistakes in Assumption

1.-(1) This section applies to a contract where at the time of the making of the contract,

(a) a mistake common to both parties, or

(b) a mistake of one of the parties known to the other party, or where the other party had reason to know of the mistake or where his or her fault caused the mistake,

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[70] *Hart v. O'Connor*, [1985] A.C. 1000, [1985] 3 W.L.R. 214 (P.C.).

[71] This is true even in the case of consumer transactions governed by the *Business Practices Act*, R.S.O. 1980, c. 55. Section 4 of the Act gives a court broad powers to set aside an agreement procured by an "unfair" practice, but the power is always predicated on deceptive or unconscionable conduct on the part of the other contracting party: see *ibid.*, ss. 2 and 4.

as to a basic assumption on which the contract was made has a material effect on the agreed exchange of performance.

(2) This section does not apply where the adversely affected party bears the risk of the mistake.

(3) In a case to which this section applies, a court may grant such relief as may be just, including one or more of the following types of relief:

(a) a declaration that the contract is valid and subsisting in whole or in part or for any particular purpose;

(b) cancellation of the contract;

(c) variation of the contract;

(d) restitution for benefits conferred under the contract; and

(e) indemnification in whole or in part for expenses incurred by one or more of the parties in relation to the contract, and such expenses may be divided equally among the parties or otherwise as the court may deem just,

but no order made pursuant to this subsection shall prejudice or invalidate the rights of a third party acquired by him or her from or under any party to the contract in good faith, for valuable consideration, and without notice of the mistake.

(4) In determining whether relief should be granted and if so what type, the court may take into consideration the following factors:

(a) the conduct of the party seeking relief;

(b) the extent to which the other party to the contract has changed his or her position in reliance on the contract; and

(c) the fault of the party seeking relief in failing to know or discover the facts before making the contract,

but none of the above factors shall necessarily be a bar to relief.

(5) In this section, mistake includes a mistake of law.

Allocation of Risk

2. A party bears the risk of a mistake where,

(a) the risk is allocated to him or her by agreement of the parties, expressly or impliedly;

(b) that party is aware, at the time of the formation of the contract, that he or she has only limited knowledge with respect to the facts to which the mistake relates but treats that limited knowledge as sufficient; or

(c) having regard to all the circumstances it is reasonable that that party should do so.

Unilateral Mistake Not Known to Other Party

3. Nothing in section 1 shall preclude a court from giving, or require the court to give, relief in the case of a mistake of one party where the mistake was not known to the other party to the contract and he or she had no reason to know of the mistake.

(b) MISTAKES AS TO CONTRACTUAL TERMS (MISTAKES IN UNDERSTANDING)

As we have noted, a mistake in understanding involves the actual terms of the contract and thus rests on a different conceptual footing from mistakes in assumption. A mistake in understanding raises the question whether the parties to an apparent agreement have in fact concluded an agreement valid at law.[72] The present law is, in our view, unclear or unsatisfactory in a number of respects and these are discussed in the present section.

(i) Unilateral Mistake Not Known to the Other Party and Where he or she had No Reason to Know of it

This is parallel to the problem discussed by us in relation to mistakes in assumption.[73] Since we have opposed the introduction of statutory relief for a unilateral mistake in understanding not known to the other party and of which he or she could not reasonably be expected to know, consistency dictates that our answer should be the same in this context.

It was at one time thought that Bacon V.C.'s judgment in *Paget v. Marshall*,[74] which was followed by McRuer C.J. in *Devald v. Zigeuner*,[75] as well as earlier nineteenth century cases lent support for a broadly based jurisdiction in equity to grant relief where the mistake in the terms of an offer was not known to the other party, and where seemingly he or she could not reasonably have been expected to be aware of it. However, any such proposition was firmly rejected by the English Court of Appeal in *Riverlate Properties Ltd. v. Paul*[76] and is no longer good law in England, assuming it ever was.[77] The basis then for conferring such jurisdiction on the courts would be not that it exists now but that it is desirable to do so on policy grounds. For the reasons we have previously given, we do not believe the arguments in its favour are

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[72] See *Cheshire & Fifoot's Law of Contract*, *supra*, note 5, at 199 *et seq.*, and Waddams, *supra*, note 1, at 189-209.

[73] *Supra*, this ch., sec. 2(a)(ii)b.

[74] (1884), 28 Ch. D. 255, 54 L.J. Ch. 575.

[75] *Supra*, note 20.

[76] *Supra*, note 68. See, also, Waddams, "Comment" (1975), 53 Can. B. Rev. 340.

[77] See Goff & Jones, *supra*, note 17, at 154-55.

sufficiently convincing to justify the introduction of such an important new principle in Ontario law.

We wish to emphasize that our conclusion is addressed to cases where the other party neither knew nor had reason to know of the first party's mistake. Some commentators[78] have interpreted *Riverlate Properties Ltd. v. Paul* as denying relief even where the defendant should have realized the mistake, although the evidence fell short of showing that he or she actually knew of it. If the case goes this far, then we do not agree with it, particularly since we have previously indicated our view that sound policy reasons argue in favour of a "reason to know" test in cases of a unilateral mistake in assumption.

Finally, while we do not recommend that reform legislation provide that relief should be available in the case of a unilateral mistake in understanding not known to the other party or where that party had no reason to know of it, neither would we preclude judicial developments in this area. As we noted in connection with unilateral mistakes in assumption not known to the other party,[79] it should be open to the courts to respond to changes in circumstances or theoretical developments.

(ii) Unilateral Mistake Known to the Other Party or Where he or she had Reason to Know of it

Our concern in this section is with the following problem. If B purports to accept an offer in the terms expressed by A knowing or suspecting that A has made a mistake and really intended to make a different offer, is there a binding contract between the parties and, if so, what are its terms? Surprising as it may seem, there is no firm answer to the question.[80] The reported cases and the views of authors support widely divergent theories. One theory is that the parties are not *ad idem* (A intended to make one offer and B intended to accept another) and there is therefore no contract. This approach is reflected in such cases as *Hartog v. Colin & Shields*.[81] At the other end of the spectrum is the theory that there is a binding agreement based on the terms previously discussed between the parties although the document signed by A, to the knowledge of B, contains different terms. The rationale for this conclusion is that B is estopped from arguing that A agreed to the written terms since he was aware of the true position. This solution was adopted by Pennycuick J. in *A. Roberts & Co. Ltd.*

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78 For example, Waddams, *supra*, note 76.

79 *Supra*, this ch., sec. 2(a)(ii)b.

80 A variation of the same problem arises where, after the parties have been negotiating on the basis of one set of terms, B sends an offer to A containing different terms, without drawing A's attention to the changes. See *A. Roberts & Co. Ltd. v. Leicestershire County Council*, *supra*, note 63.

81 [1939] 3 All E.R. 566 (K.B.).

v. Leicestershire County Council,[82] and was referred to with approval by the Court of Appeal in *Riverlate Properties Ltd. v. Paul*.[83]

Another approach focuses on flexible relief and fair results rather than on strict characterization of the contractual position. This approach was taken by the Vice-Chancellor in *Paget v. Marshall*[84] and earlier nineteenth century cases and was followed by McRuer C.J. in *Devald v. Zigeuner*.[85] It accepts the proposition that the parties were never *ad idem* and that A is therefore entitled to have the agreement rescinded. However, it allows the court to impose terms for the granting of rescissionary relief and gives B the option of agreeing to rectification of the agreement to reflect the true intentions of A.

Whether *Paget v. Marshall* and the earlier cases are still sound law in England is unclear in view of the doubts expressed about them in *Riverlate Properties*. Nevertheless, it appears to us that *Paget v. Marshall* represents a sound and equitable approach. Analytically it cannot be right to say, following *A. Roberts & Co. Ltd.*, that B has agreed to accept the offer that A intended to make when all B did was to express assent to the offer that A actually made.[86] The real questions, it seems to us, are whether A should be entitled to obtain relief from his or her mistake and whether the court should be entitled to give relief on terms. In our view, the answer in both cases should be yes, and we recommend that this be made clear in reform legislation.

(iii) Agreements That Fail Because of Ambiguity

This section addresses cases where it appears that there is no binding agreement because the parties have misunderstood each other. An objective meaning cannot be given to the apparent agreement because, unbeknown to the parties, the terms of the contract have more than one meaning and the parties have not made clear which meaning they intend to apply, or have in fact adopted different meanings.[87] Such agreements therefore fail for ambiguity and are considered, under existing law, to be void.[88] The remedies available to the parties in such cases are, in our view, seriously deficient since existing law provides only limited restitutionary relief and no relief at all where one or more of the parties has incurred reliance expenditures on the assumption that there is

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82 *Supra*, note 63.

83 *Supra*, note 68.

84 *Supra*, note 74.

85 *Supra*, note 20.

86 See Waddams, *supra*, note 1, at 202.

87 The classical example of such misunderstanding remains *Raffles v. Wichelhaus* (1864), 2 H. & C. 906, 159 E.R. 375 (Ex.), where the contract of sale stipulated for the arrival of goods "*ex Peerless* from Bombay". There were in fact two vessels called *Peerless*, one of which sailed from Bombay in October and the other in December. Each party had a different vessel in mind: the buyer meant the October vessel and the seller the December vessel. The Court held that there was no binding agreement between the parties.

88 *Raffles v. Wichelhaus*, *ibid*. See, also, Waddams, *supra*, note 1, at 66-67.

a valid contract.[89] We therefore recommend that reform legislation should confer on the courts a broad power to grant such relief as may be just.

(iv) Position of Third Parties

A consequence of the existing law with respect to mistakes in understanding is that it may nullify the property rights of third parties acquired by them in good faith from one of the contracting parties to whom they were transferred under the terms of a defective agreement. In our *Report on Sale of Goods*[90] we attempted to meet this problem by recommending that mistakes in a contract of sale involving a mistake of such character as to render the agreement void at common law be treated as only making the contract voidable. We recommended as well that a person with a voidable title should have power to transfer a good title to a buyer who receives the goods in good faith, for value, and without notice of the defect in the title of the transferor. We see no reason why a similar rule in favour of third parties should not be adopted to cover the transfer of property other than goods, and we so recommend.

(v) Apportionment of Losses

In our *Report on Sale of Goods*[91] we discussed a proposal empowering the courts to apportion losses where an owner has been fraudulently induced to part with goods and those goods have been sold by the rogue to a third party, who has acquired them in good faith. We were unable to reach agreement on the proposal in the Sales Report, but put forward for discussion purposes a draft provision[92] that would only apply where goods have been negligently entrusted to a person and disposed of by him or her to a third person who also fails to exercise reasonable care in their acquisition.

Further consideration of the proposal has led us to the conclusion, though with considerable regret, that it raises as many difficulties as it solves and that it should not be adopted. The major difficulties are as follows. First, a power of apportionment is quite inconsistent with the policy of security in transactions intended to be promoted by making the initial transaction voidable and not void. If the third party can still be involved in litigation, and perhaps be required to absorb a substantial loss, his or her title is not secure after all. Secondly, if apportionment is to be allowed where the transfer from the owner has been procured by fraud, it must likewise be considered with respect to the other numerous exceptions to the *nemo dat* rule recognized under existing law. We note that in our *Report on Sale of Goods* we recommended[93] several significant extensions of the exceptions to the rule. Some of the existing and recommended exceptions involve predominantly commercial transactions in which, it is safe to

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89 We appreciate, of course, that where fraud or negligent misrepresentation is involved the mistaken party may have adequate remedies in tort.

90 Sales Report, *supra*, note 2, Vol. II, at 285-88, and Vol. III, Draft Bill, s. 6.5.

91 *Ibid.*, Vol. II, at 310-11.

92 *Ibid.*, Vol. III, Draft Bill, s. 6.4(3).

93 *Ibid.*, Vol. II, at 316-18.

predict, a power of apportionment would meet with much opposition from the commercial community. Difficult and cumbersome distinctions would therefore have to be drawn between those situations where an apportionment power would be appropriate and those where it would not.

Finally, as the English Law Reform Committee pointed out in 1966,[94] further complications would arise where the property has passed through a succession of hands. How would the power of apportionment be affected by this circumstance and how would it be applied among the different links in the chain of title?

(vi) Conclusions

Again, for the sake of clarity we have cast our recommendations in draft statutory form. The section numbers follow from the draft statutory provisions respecting mistake in assumption, above.[95]

Accordingly, we recommend that legislation should be enacted dealing with mistakes in understanding along the following lines:

Mistakes in Understanding

4.-(1) This section applies where the parties believe themselves to have entered into a binding contract but such a contract is defective because of a misunderstanding between the parties as to the terms of the contract.

(2) Where, apart from this section, a contracting party would be entitled to relief by reason of the matters mentioned in subsection 1, the contract shall be deemed to be voidable and not void and a court may grant such relief as may be just and the provisions of subsection 1(3) of this Act shall apply *mutatis mutandis*.

(3) No order made by a court under subsection (2) shall prejudice or invalidate the rights of a third party acquired by him or her from or under any party to the contract in good faith, for valuable consideration, and without notice of the defect in the contract.

(4) Nothing in this section shall preclude a court from giving, or require the court to give, relief in the case of a mistake of one party where the mistake was not known to the other party to the contract and he or she had no reason to know of the mistake.

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94 England, Law Reform Committee, *Twelfth Report (Transfer of Title to Chattels)* (Cmnd. 2958, 1966), paras. 9-12, at 6-8.

95 *Supra*, this ch., sec. 2(a)(iii).

3. FRUSTRATION IN THE LAW OF CONTRACT

(a) THE SUBSTANTIVE BASES OF FRUSTRATION

(i) Introduction

In our *Report on Sale of Goods*, we pointed out that much uncertainty still surrounds important aspects of the Anglo-Canadian law of frustration.[96] In particular, it is not clear to what extent, if at all, impracticability of performance, as distinct from impossibility, constitutes an excuse to the promisor and whether frustration of purpose is also a solidly established defence. Again, existing law does not adequately spell out the consequences of the promisor's excused performance on the obligations of the promisee. The uncertainty is largely due to a conceptual confusion in the case law between performance that is excused because of a frustrating event and a frustrating event that also leads to the discharge of the contract. The two issues are quite distinct. This may be seen when the question arises whether a temporary or partial impracticability of performance or frustration of purpose excuses one or both parties from further performance of the obligations not affected by the frustrating event. The accepted rule that it does not affect them indicates that discharge of the contract and excuse from performance are two discrete concepts that must be considered separately.

Article 2 of the Uniform Commercial Code contains important provisions on these questions[97] and, with some modifications, our *Report on Sale of Goods* recommended their adoption in Ontario in the sale of goods context.[98] We did so both because we deemed it desirable to bring Ontario law into alignment with American law in this important branch of commercial law, and because we believed that the Article 2 rules were clearer conceptually and better reflected contemporary business practices and the expectations of the commercial community than the existing position.

The American Law Institute has since adapted the Code rules and incorporated them in the *Second Restatement* as part of its provisions on impracticability of performance and frustration of purpose.[99] The question we have asked ourselves is whether we should follow this precedent in addressing ourselves to the same issues in relation to the general law of contracts. We are satisfied that the answer should be yes, and this on two grounds. First, we consider that the same principles apply here as in the context of sale of goods. The recommendations made below, together with those in the *Report on Sale of Goods*, form an internally consistent whole. It would be manifestly unsatisfactory for Ontario to have one set of frustration rules in the sales context and another set in the non-sales area, particularly if those rules proceed from

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96 Sales Report, *supra*, note 2, Vol. II, at 365.

97 American Law Institute, Uniform Commercial Code, Official Text (9th ed., 1978) (hereinafter referred to as "Uniform Commercial Code"), §§ 2-613—2-616.

98 Sales Report, *supra*, note 2, Vol. II, at 382-85.

99 *Second Restatement*, *supra*, note 22, §§ 261-72.

different conceptual bases. In the second place, we believe that a statutory statement of the impracticability and frustration of purpose rules along the lines proposed would materially clarify the Ontario law and put it on a sounder footing.

Having reached this general conclusion, we now proceed to consider the individual *Restatement* provisions and the extent to which we favour their adoption in Ontario.

(ii) The *Second Restatement* Sections on Frustration

The general organization and titles of the *Second Restatement* provisions dealing with frustration are as follows:

261. Discharge by Supervening Impracticability

262. Death or Incapacity of Person Necessary for Performance

263. Destruction, Deterioration or Failure to Come into Existence of Thing Necessary for Performance

264. Prevention by Governmental Regulation or Order

265. Discharge by Supervening Frustration

266. Existing Impracticability or Frustration

267. Effect on Other Party's Duties of a Failure Justified by Impracticability or Frustration

268. Effect on Other Party's Duties of a Prospective Failure Justified by Impracticability or Frustration

269. Temporary Impracticability or Frustration

270. Partial Impracticability

271. Impracticability as Excuse for Non-Occurrence of a Condition

272. Relief Including Restitution

Sections 261, 265 and 267 are the key sections and filter out the critical strands of modern frustration doctrine. Section 261[100] spells out the kinds of post-contract formation changes that will excuse the promisor from further

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[100] Section 261 reads:

> § 261. Discharge by Supervening Impracticability
>
> Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary.

performance and corresponds to section 2-615 of the Uniform Commercial Code. The test is not impossibility but "impracticability", and impracticability is determined by criteria similar to those used in the *Second Restatement* provisions on mistakes in assumption.[101] The essential elements of impracticability are, first, that it must not have been self-induced; secondly, that its occurrence was a basic assumption on which the contract was made; and, thirdly, that there is nothing in the language of the contract or the circumstances surrounding its conclusion to indicate a different intention. The third test echoes the allocation of risk provisions in the mistake sections of the *Second Restatement*.[102] As we pointed out in the Sales Report,[103] American courts have applied the impracticability provisions in section 2-615 of the Uniform Commercial Code cautiously and have shown little disposition to allow them to be invoked simply on the grounds that economic circumstances have changed and that the contract has become much less profitable for the promisor.

Section 265[104] is the mirror image of section 261 in determining when frustration of a party's principal purpose will excuse further performance. Finally, section 267[105] prescribes the effect on the promisee's duties of the promisor being discharged from further performance. The cross-reference in the section to sections 237 and 238 is to the *Restatement* provisions dealing with the effect of breach of contract on the other party's obligations. We have not in this Report recommended the enactment of provisions parallel to sections 237 and 238. In the absence of such provisions it could be provided, in the same vein as section 267, that a party's failure to render or offer performance will affect the other party's performance in the same manner as if the frustrating event were a breach of contract. Subject to this, we recommend that legislation should be enacted in Ontario along the lines of sections 261, 265 and 267 of the *Restatement*.

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101 *Second Restatement*, *supra*, note 22, §§ 152 and 153.

102 *Ibid.*, § 154.

103 *Supra*, note 2, Vol. II, at 376-77.

104 Section 265 reads:

> § 265. Discharge by Supervening Frustration
>
> Where, after a contract is made, a party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his remaining duties to render performance are discharged, unless the language or the circumstances indicate the contrary.

105 Section 267 reads:

> § 267. Effect on Other Party's Duties of a Failure Justified by Impracticability or Frustration
>
> (1) A party's failure to render or to offer performance may, except as stated in Subsection (2), affect the other party's duties under the rules stated in §§ 237 and 238 even though the failure is justified under the rules stated in this Chapter.
>
> (2) The rule stated in Subsection (1) does not apply if the other party assumed the risk that he would have to perform despite such a failure.

Section 262, 263 and 264[106] simply provide specific instances of the application of the general principle enunciated in section 261. For this reason we see no need to include them in the proposed Ontario legislation dealing with frustration. Section 266[107] extends the doctrine of frustration to *existing* impracticability or frustration of purpose. Since these cases are also covered by the *Restatement's* mistake rules (and the same is true, *mutatis mutandis*, of Ontario law), it is not clear why the drafters thought it desirable to have two, not necessarily identical, sets of rules covering the same situations. In any event, we do not recommend including section 266 in the proposed Ontario legislation dealing with frustration.

Section 268[108] is an extension of section 267 and addresses itself to the effect on the promisee's duties of the promisor's prospective failure of performance on grounds of frustration. The *Restatement* entitles the promisee to suspend or terminate further performance, and to exercise rights to require an

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[106] These sections read:

§ 262. Death or Incapacity of Person Necessary for Performance

If the existence of a particular person is necessary for the performance of a duty, his death or such incapacity as makes performance impracticable is an event the non-occurrence of which was a basic assumption on which the contract was made.

§ 263. Destruction, Deterioration or Failure to Come into Existence of Thing Necessary for Performance

If the existence of a specific thing is necessary for the performance of a duty, its failure to come into existence, destruction, or such deterioration as makes performance impracticable is an event the non-occurrence of which was a basic assumption on which the contract was made.

§ 264. Prevention by Governmental Regulation or Order

If the performance of a duty is made impracticable by having to comply with a domestic or foreign governmental regulation or order, that regulation or order is an event the non-occurrence of which was a basic assumption on which the contract was made.

[107] Section 266 reads:

§ 266. Existing Impracticability or Frustration

(1) Where, at the time a contract is made, a party's performance under it is impracticable without his fault because of a fact of which he has no reason to know and the non-existence of which is a basic assumption on which the contract is made, no duty to render that performance arises, unless the language or circumstances indicate the contrary.

(2) Where, at the time a contract is made, a party's principal purpose is substantially frustrated without his fault by a fact of which he has no reason to know and the non-existence of which is a basic assumption on which the contract is made, no duty of that party to render performance arises, unless the language or circumstances indicate the contrary.

[108] Section 268 reads:

§ 268. Effect on Other Party's Duties of a Prospective Failure Justified by Impracticability or Frustration

assurance of performance, conformably with the *Restatement*'s earlier provisions on anticipatory repudiation. This Report does not deal with anticipatory repudiation or the giving of assurances and accordingly we do not deem it appropriate to recommend the enactment in Ontario of a provision corresponding to section 268 of the *Restatement*.

Section 269 of the *Restatement*[109] deals with the effect of temporary impracticability or frustration of purpose and adopts the rule that the promisor's duty to perform is revived after the impediment has been removed unless the performance would be materially more burdensome than if there had been no frustrating event. The applicability of frustration doctrine to interruptions of prolonged or uncertain duration is well established in Anglo-Canadian law,[110] though the result has usually been couched in terms of what the parties intended should happen in such circumstances, or the effect of the interruption on the "foundation" of the adventure, rather than in terms of the burden that a duty to perform would impose on the promisor after the interruption has ceased. In our view, to the extent that there is any practical difference between the several tests, the section 269 test is to be preferred. It focuses on what may fairly be regarded as the single most important element in determining whether further performance should be required — the burden it would impose on the promisor. Accordingly, we recommend that legislation should be enacted in Ontario along the lines of section 269 of the *Restatement*.

Section 270 deals with the different situation of partial impracticability, as, for example, where only part of a parcel of specific goods agreed to be delivered under a contract of sale has been destroyed prior to delivery, or where a fire has reduced but not destroyed a supplier's productive capacity. Existing law, in the absence of a clearly divisible contract, treats the contract as wholly

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(1) A party's prospective failure of performance may, except as stated in Subsection (2), discharge the other party's duties or allow him to suspend performance under the rules stated in §§ 251(1) and 253(2) even though the failure would be justified under the rules stated in this Chapter.

(2) The rule stated in Subsection (1) does not apply if the other party assumed the risk that he would have to perform in spite of such a failure.

[109] Section 269 reads:

§ 269. Temporary Impracticability or Frustration

Impracticability of performance or frustration of purpose that is only temporary suspends the obligor's duty to perform while the impracticability or frustration exists but does not discharge his duty or prevent it from arising unless his performance after the cessation of the impracticability or frustration would be materially more burdensome than had there been no impracticability or frustration.

[110] For example, *Geipel v. Smith* (1872), L.R. 7 Q.B. 404, [1861-73] All E.R. Rep. 861; *Tamplin S.S. Co. v. Anglo-Mexican Petroleum Products Co.*, [1916] 2 A.C. 397, [1916-17] All E.R. Rep. 104; *Metropolitan Water Board v. Dick*, [1918] A.C. 119, [1916-17] All E.R. Rep. 122; and see further *Williston on Contracts* (3d ed., 1957), Vol. 18, § 1957, at 151-53.

discharged[111] and apparently does not give the promisee the option of requiring performance of the balance of the contract, even though he or she is willing to pay for it, unless the contract manifests such an intention.

Section 270 adopts a different approach, as follows:

> § 270. Partial Impracticability
>
> Where only part of an obligor's performance is impracticable, his duty to render the remaining part is unaffected if
>
> (a) it is still practicable for him to render performance that is substantial, taking account of any reasonable substitute performance that he is under a duty to render; or
>
> (b) the obligee, within a reasonable time, agrees to render any remaining performance in full and to allow the obligor to retain any performance that has already been rendered.

We have encountered difficulties with this section. First, it does not appear to apply to partial frustration of purpose. The *Restatement*'s Reporter envisaged this type of situation being dealt with under section 272(2),[112] a broad discretionary relief provision that reads:

> § 272.-(2) In any case governed by the rules stated in this Chapter, if those rules together with the rules stated in Chapter 16 will not avoid injustice, the court may grant relief on such terms as justice requires including protection of the parties' reliance interests.

In our view, it would be clearer and more consistent with the rest of the provisions relating to frustration to address partial impracticability and partial frustration of purpose in one provision.

Secondly, we find the requirements in clauses (a) and (b) of section 270 too rigid. Circumstances may well arise where performance could reasonably be required of a promisor whether or not substantial performance by him or her is still practicable, and whether or not the promisee agrees to render any remaining performance in full. This is recognized in the Comment to section 270, but the restrictive terms of section 270 are justified on the ground that they represent two situations in which it is "relatively easy" "to salvage at least some of the unexecuted part of the agreement."[113] In more complex situations, where the promisee's duty to perform must be adjusted to avoid injustice, the

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[111] See *Barrow, Lane & Ballard Ltd. v. Phillip Phillips & Co. Ltd.*, [1929] 1 K.B. 574, [1928] All E.R. Rep. 74; *Lovatt v. Hamilton* (1839), 5 M. & W. 639, 151 E.R. 271 (Exch.); and compare *H.R. & S. Sainsbury Ltd. v. Street*, [1972] 3 All E.R. 1127, [1972] 1 W.L.R. 834 (Q.B.D.). See, also, *Sale of Goods Act*, R.S.O. 1980, c. 462, ss. 8 and 30.

[112] *Second Restatement*, *supra*, note 22, § 270, Comment a.

[113] *Ibid.*

Restatement contemplates recourse to section 272(2) to salvage part of the agreement.[114]

In our view, this approach is unnecessarily circuitous. We would prefer the enactment in Ontario of a provision that addressed both partial impracticability and partial frustration of purpose, and that embraced a wide range of circumstances in which performance of the unaffected part of the agreement may reasonably be required. We further conclude that such a provision should be supplemented by a companion provision conferring on the court such powers to adjust the terms of the agreement as may be just. We adopt this approach because it appears to us that, even where substantial performance is practicable, some adjustments in the terms of the agreement are likely to be needed, for example with respect to the time or manner of the promisor's performance, or the price recoverable by him or her.

Sections 269 and 270 of the *Restatement* do not refer to any duty by the promisee to render any performance due after the impediment justifying suspension of the promisor's performance has been lifted or where impracticability or frustration is only partial. Section 267[115] only purports to apply to events totally frustrating the promisor's duty to perform. There is evidence, however, that the *Restatement*'s Reporter expected section 267 to be applied analogically to these other situations.[116] Once again, we would prefer that legislation make this explicit, and we so recommend. Again, as in connection with the consequences of partial impracticability or frustration, we conclude that the court should be empowered to adjust the terms of the agreement as seems just.

Section 271[117] of the *Restatement* addresses another aspect of frustration doctrine that does not appear to be adequately covered by existing Anglo-Canadian law. If a party to a contract, for reasons beyond his or her control, is unable to satisfy a contractual condition requisite to his or her claiming an entitlement under the contract, as where, for example, a builder must produce an architect's certificate of completion before he or she can be paid and the architect has died, should relief be denied? Section 271 sensibly answers this in the negative, and excuses non-occurrence of the condition if occurrence of the condition is not a material part of the agreed exchange of promises and forfeiture would otherwise result. We recommend the inclusion of a similar provision in Ontario legislation dealing with frustration of contracts.

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[114] *Ibid.*

[115] *Supra*, note 105.

[116] See Farnsworth, *supra*, note 1, at 699. Professor Farnsworth was the Reporter for the *Second Restatement*.

[117] Section 271 reads:

> § 271. Impracticability as Excuse for Non-Occurrence of a Condition
>
> Impracticability excuses the non-occurrence of a condition if the occurrence of the condition is not a material part of the agreed exchange and forfeiture would otherwise result.

We have already mentioned section 272(2), providing the court with discretion to grant relief on such terms as justice requires. It remains for us to add that section 272(1)[118] recognizes that either party may have a claim for relief, including restitutionary relief, where a contract has been wholly or partly frustrated or performance has been justifiably suspended in accordance with the preceding *Restatement* provisions. It is indeed a striking feature of American frustration law that American courts were able to fashion satisfactory remedial tools without the need for statutory intervention.[119] Unfortunately, this has not been true of the Anglo-Canadian law, and we will turn our attention to the protection of restitutionary and reliance interests shortly.

(iii) Conclusions

Again, because of the complexity of this area of the law, we have concluded that it would be helpful to cast our recommendations in draft statutory form, as follows:

Discharge by Supervening Impracticability

1. Where, after a contract is made, a party's performance is made impracticable without his or her fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his or her duty to render that performance is discharged unless the language of the contract or the circumstances surrounding its conclusion indicate the contrary.

Discharge by Supervening Frustration

2. Where, after a contract is made, a party's principal purpose is substantially frustrated without his or her fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his or her remaining duties to render performance are discharged unless the language of the contract or the circumstances surrounding its conclusion indicate the contrary.

Temporary Impracticability or Frustration

3. Where impracticability of performance or frustration of purpose is only temporary, it suspends the obligor's duty to perform while the impracticability or frustration exists but shall not discharge his or her duty or prevent it from arising unless his or her performance after the impracticability or frustration has ceased would be materially more burdensome than if there had been no impracticability or frustration.

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[118] Section 272(1) reads:

> § 272. Relief Including Restitution
>
> (1) In any case governed by the rules stated in this Chapter, either party may have a claim for relief including restitution under the rules stated in §§ 240 and 377.

[119] This is shown by the fact that, to our knowledge, no American state has deemed it necessary to adopt a Frustrated Contracts Act or comparable legislation. The explanation for this lies in the much more highly developed and complete concepts of unjust enrichment and restitution in American law, which makes it easy to adapt them to cases of frustrated contracts.

Partial Impracticability or Frustration

4. Where only a part of an obligor's performance is impracticable or only a part of the principal purpose of an obligor's agreement is frustrated, his or her duty to perform the remaining part of the agreement is unaffected if the other party so elects and it is not unduly burdensome to require partial performance by the obligor.

Adjustment of Contract

5. Where, pursuant to sections 3 and 4, an obligor is required to continue with performance after the impracticability or frustration has ceased or to render the remaining performance where only a part of the contract has been made impracticable or has been frustrated, the court may make such consequential adjustments in the terms of the parties' contract as may be necessary to avoid injustice.

Effect on Other Party's Duties of a Failure Justified by Impracticability or Frustration

6.-(1) Where sections 1 to 4 apply, the failure of a party to render or to offer performance shall affect the other party's duties in the same manner as if the frustrating event were a breach of contract.

(2) Subsection (1) does not apply if the other party assumed the risk that he or she would have to perform despite such a failure.

Impracticability as Excuse for Non-Occurrence of a Condition

7. If a party is unable to comply with a condition in a contract or the condition can otherwise not be met because of impracticability, the non-occurrence of the condition is excused if its occurrence is not a material part of the agreed exchange and the non-performing party would otherwise suffer serious prejudice.

(b) RELIEF FOLLOWING FRUSTRATION

(i) The Common Law Position

Three principal issues arise in considering what relief should be made available following the frustration of a contract. The first is whether compensation should be allowed for benefits conferred on a party prior to frustration even though the contract does not provide for it and, where the benefit consists of non-pecuniary performance, performance is only partial. The second issue is whether reliance expenditures incurred by the parties in performance of their obligations should be recoverable and to what extent. The third issue is whether a court should be free to examine the surrounding circumstances to determine whether it is appropriate to allocate the reliance losses on some other basis than would otherwise be appropriate because of the implied agreement of the parties, trade usages, or general economic considerations.

The common law answers to these questions are both rigid and unsatisfactory. Briefly, the general position at common law regarding compensation for

benefits conferred may be considered under two heads: recovery of monies paid and recompense for non-pecuniary benefits conferred. Turning first to recovery of monies paid, the 1904 case of *Chandler v. Webster*[120] held that money paid under a frustrated contract could not be recovered on the theory that the action for money had and received would not lie unless the contract was void *ab initio*. A frustrated contract was avoided, it was thought, only from the occurrence of the frustrating event. Moreover, obligations accrued before the frustrating event would remain enforceable on the same theory.

The decision of the House of Lords in *Fibrosa Spolka Akcyjna v. Fairbairn Lawson Combe Barbour, Ltd.*[121] overruled *Chandler* and discredited the theory underlying it. In *Fibrosa*, a buyer who had made partial payment before the frustrating event sought recovery. The House of Lords recognized the buyer's right to recover money paid, provided that the seller's consideration wholly failed. In the absence of total failure of consideration, however, it would seem that restitutionary relief would be denied.

As to recompense for non-pecuniary benefits conferred, in England, recovery for the value of partial performance is made difficult by the rule in *Appleby v. Myers*.[122] This case held that, in the case of non-pecuniary benefits conferred under a contract that has been frustrated, recovery is not available for partial performance of an entire contract: the performing party must perform fully to earn his or her payment.

In Canada, the position of a party who has partly performed should be more promising in the light of the Supreme Court of Canada's embrace of a general doctrine of unjust enrichment in *Deglman v. Guaranty Trust Co. of Canada*.[123] However, the *Deglman* doctrine only applies (assuming it is applied to frustration cases) to restitutionary claims for benefits conferred. Neither Canadian nor English law offers indemnification to a party who has incurred reliance expenditures in preparation for, or partial performance of, contractual obligations not resulting in benefits conferred on the other party. The loss lies where it falls. Given this rule, the common law courts obviously do not have to concern themselves with any implied agreement between the parties for the allocation of reliance expenditures. The common law rule on the non-recoverability of reliance expenditures is defensible on policy grounds, but it may lead to anomalies. It means, for example, that a party who has prepaid all or part of the price but received no return benefits is entitled to recover his payments in

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[120] [1904] 1 K.B. 493, 20 T.L.R. 222 (C.A.).

[121] [1943] A.C. 32, [1942] 2 All E.R. 122.

[122] (1867), L.R. 2 C.P. 651, [1861-73] All E.R. Rep. 452 (Ex.).

[123] [1954] S.C.R. 725, [1954] 3 D.L.R. 785.

full, while the other party who may have spent as much or more in part performance of his obligations is entitled to nothing.

(ii) Legislative Developments

In the United Kingdom the *Law Reform (Frustrated Contracts) Act, 1943*[124] was adopted to remedy the shortcomings in the common law position. The Act was approved shortly afterwards by the Uniform Law Conference of Canada as a *Uniform Frustrated Contracts Act*[125] and was enacted, more or less *verbatim*, in many of the common law provinces, including Ontario.[126]

The principal features of the Ontario Act are these. The Act abolishes the rule in *Chandler v. Webster* by relieving a contracting party from liability to make payments accruing before the date of frustration, but without affecting any claim against him or her for damages,[127] and allows recovery of any payments made before this time.[128] So far as non-pecuniary benefits are concerned, the court may, not must, allow recovery of their value.[129] The recovery of reliance expenditures is still more circumscribed. Section 3(2) of the Act provides that the court may permit the party incurring such expenses to retain so much of any payments received from the other party as is necessary to indemnify him or her for such expenses or to recover them from the other party if monies were payable to the other party before the date of frustration. These limited rights of recovery for reliance expenditures appear to have been animated by the theory that prepayment of the price is intended to protect the other party's reliance interests. The theory has little to commend it and has justly been criticized.[130]

Finally, certain exclusions in the Ontario Act that follow those in the British Act should be noted. The Ontario Act does not apply to maritime contracts, insurance contracts, or to a contract for the sale of specific goods.[131]

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[124] 6 & 7 Geo. 6, c. 40 (U.K.).

[125] Uniform Law Conference of Canada, *Proceedings of the Thirtieth Annual Meeting* (1948), at 18. The text of the Uniform Act is set out at Appendix G.

[126] For the Ontario version, see *Frustrated Contracts Act*, R.S.O. 1980, c. 179.

[127] *Ibid.*, s. 3(1).

[128] *Ibid.*, s. 3(2).

[129] *Ibid.*, s. 3(3).

[130] See Goff and Jones, *supra*, note 17, at 567.

[131] *Supra*, note 126, s. 2(2).

Whatever might be said in favour of the first two exclusions, we noted in our *Report on Sale of Goods*[132] that there was no justification for the third. We shall return to this point.

In 1974 British Columbia enacted a new *Frustrated Contracts Act*.[133] The Act was also adopted at the same time by the Uniform Law Conference of Canada as a new *Uniform Frustrated Contracts Act*.[134] The British Columbia Act (''the Act'') was based on the recommendations in a Report of the British Columbia Law Reform Commission[135] and was designed to remove the shortcomings in the first Uniform Act. It was largely successful in this objective although, in our view, a number of further improvements are desirable.

The Act introduces three important changes. First, it removes a discretionary element in the first Uniform Act in allowing, as of right, the recovery of compensation for non-pecuniary benefits conferred before discharge of the contract.[136] Second, it provides that reliance losses shall be divided equally between the parties without regard to any prepayments that may have been made under the contract.[137] Third, it recognizes explicitly that the parties may have intended to allocate the risk of loss of reliance expenditures on a basis different from that provided for in the Act, and establishes criteria for determining whether they have done so in fact.[138]

The first change is entirely satisfactory and requires only a small comment. The point has been made by Professor Mullan that the British Columbia Act makes no provision for benefits that may have been conferred after frustration by a party not aware that the contract had been frustrated.[139] We would ourselves expect a court to grant compensation for this type of performance either by analogy to the statutory provisions or on common law grounds.

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132 Sales Report, *supra*, note 2, Vol. II, at 381-82.

133 S.B.C. 1974, c. 37.

134 Uniform Law Conference of Canada, *Proceedings of the Fifty-sixth Annual Meeting* (1974), at 28. For the text of the Uniform Act, see Uniform Law Conference of Canada, *Proceedings of the Fifty-fifth Annual Meeting* (1973), Appendix Q.

135 Law Reform Commission of British Columbia, *Report on the Need for Frustrated Contracts Legislation in British Columbia* (1971).

136 *Supra*, note 133, s. 5(1).

137 *Ibid.*, 5(3). Section 5(3) provides as follows:

> 5.-(3) Where the circumstances giving rise to the frustration or avoidance cause a total or partial loss in value of a benefit to a party required to make restitution under subsection (1), that loss shall be apportioned equally between the party required to make restitution and the party to whom such restitution is required to be made.

138 *Ibid.*, s. 6.

139 Nova Scotia Law Advisory Commission, *Frustrated Contracts Law*, Study Paper by David Mullan (1976), at 26-27.

However, we see no harm in adding suitable language to the proposed Ontario legislation to make it clear that post-frustration benefits are included.

The second important change made in the British Columbia Act and involving the recovery of reliance expenditures is sound in principle but achieves its objective in a curiously roundabout way. Section 5(4) defines "benefit" somewhat artificially as meaning something done in the fulfillment of contractual obligations, whether or not the person for whose benefit it was done received the benefit of them. Section 5(1) then entitles the creator of these benefits to restitution from the imputed beneficiary. However, section 5(3) recognizes that the benefit constructively attributed to the recipient may in fact be a total or partial loss and therefore provides that the loss shall be apportioned equally between the parties. In our view, the commendable goal of section 5(3) could be achieved much more simply by relegating the subsection to a separate section providing for the recovery of reliance expenditures.

The allocation of risk provisions in section 6 of the British Columbia Act are also not free from difficulty. Section 6 is as follows:

> 6.-(1) A person who has performed or partly performed a contractual obligation is not entitled to restitution under section 5 in respect of a loss in value, caused by the circumstances giving rise to the frustration or avoidance, of a benefit within the meaning of section 5, if there is
>
> (a) a course of dealing between the parties to the contract; or
>
> (b) a custom or a common understanding in the trade, business, or profession of the party so performing; or
>
> (c) an implied term of the contract,
>
> to the effect that the party so performing should bear the risk of such loss in value.
>
> (2) The fact that the party performing such an obligation has in respect of previous similar contracts between the parties effected insurance against the kind of event that caused the loss in value is evidence of a course of dealing under subsection (1).
>
> (3) The fact that persons in the same trade, business, or profession as the party performing such obligations, on entering into similar contracts, generally effect insurance against the kind of event that caused the loss in value is evidence of a custom or common understanding under subsection (1).

The section appears to overlap with section 2, which is to the effect that the Act only applies insofar as the parties' contract contains no contrary provisions. Section 2 reads:

> 2. This Act applies to a contract referred to in section 1(1) only to the extent that, upon the true construction of that contract, it contains no provision for the consequences of frustration or avoidance.

Applying normal canons of statutory construction, section 2 is broad enough to include contractual risk provisions. Presumably, section 6 was perceived by the drafter as a particular application of section 2 although, arguably, the drafter may also have thought implied contractual risk provisions would fall outside section 2 because section 6 only deals with implied exclusions of the entitlements under section 5. In our view, a cross-reference in section 2 to the provisions in section 6 would resolve this apparent ambiguity.

A further difficulty is that section 6 is deficient as a comprehensive statement of factors pointing to a different allocation of reliance losses from those contemplated in section 5(3),[140] assuming, as appears to be the case, that the drafter was aiming for comprehensiveness. It does not allow for an express contractual stipulation varying or excluding the statutory apportionment provision. Section 6 also appears to confine its reach to circumstances pointing to a greater assumption of risk by the performing party than is presumed under the Act; the same test ought surely also to apply to assumption of risk by the non-performing party. Finally, section 6 leaves the impression that the implied terms of the agreement and the other circumstances enumerated in the section are not relevant in determining whether the parties intended to vary or exclude restitutionary rights that would otherwise arise under the Act on frustration of the contract.[141] Presumably this too was not intended. In any event, the position should be clarified.

Attention should also be drawn to two provisions in the first Uniform Act that are omitted in the British Columbia Act. First, the provision indicating that an arbitration provision in an agreement will survive its frustration[142] has been deleted. Secondly, section 4(4) of the first Uniform Act providing that benefits conferred on a third party may be treated as benefits received by a party to the contract for the purpose of the remedial scheme of the Act has been omitted. These provisions might well be reinstated. The British Columbia Act also omits the provision in the first Uniform Act[143] excluding contracts for the sale of specific goods. This is a welcome correction of an error in the earlier Act.

(iii) *Report on Sale of Goods*

The *Report on Sale of Goods*[144] dealt only marginally with the consequences of a frustrated contract of sale. It noted the exclusion of contracts for the sale of specific goods from the Ontario *Frustrated Contracts Act* and recommended the deletion of this provision.[145] The Report recommended a detailed review of the Ontario Act in light of the new *Uniform Frustrated*

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140 *Supra*, note 137.

141 It will be borne in mind that the reference to restitution in s. 6(1) is not to be read literally, and in fact means reliance losses recoverable under s. 5.

142 *Uniform Frustrated Contracts Act*, *supra*, note 125, s. 1, definition of "court".

143 *Ibid.*, s. 4(5).

144 Sales Report, *supra*, note 2, Vol. II, at 381-82.

145 *Ibid.*

Contracts Act and the improvements introduced in it. This review we have attempted to offer, albeit in cursory form.

(iv) Conclusions

In light of the foregoing discussion we recommend the adoption by Ontario of a modified version of the scheme for relief following frustration set out in the new *Uniform Frustrated Contracts Act*, in lieu of the scheme set out in the existing Ontario *Frustrated Contracts Act*. The modifications recommended by us are the following:

(1) A straightforward section providing for the equal apportionment of reliance expenditures should be included in substitution for the circuitous provisions in the Uniform Act.

(2) The allocation of risk provisions should be properly coordinated with the general section in the Uniform Act enabling the Act's provisions to be varied or excluded by agreement of the parties.

(3) The allocation of risk provisions should be extended to include circumstances indicating the parties' intention to vary or deny the availability of restitutionary claims for benefits conferred.

(4) The allocation of risk provisions should be amended to permit the drawing of an inference that the risk of reliance losses has shifted to the non-performing party.

(5) The list of criteria to determine whether the parties intended to vary the statutory allocation of reliance expenditures should be non-exhaustive and include the express terms of the agreement.

(6) The proposed legislation should permit recovery of benefits conferred on the mistaken assumption that the agreement was not frustrated.

(7) The arbitration provision in the old Uniform Act should be retained in the proposed Ontario legislation.

(8) The provision in the old Uniform Act relating to benefits conferred on third parties should also be included in the proposed Ontario legislation.

Recommendations

The Commission makes the following recommendations:

1. In view of the substantial uncertainty in the existing law with respect to the availability of relief for mistakes in assumption and the scope of the relief where relief is available at all, the following remedial legislation should be adopted:

(a) The distinction between common law and equitable approaches to contractual mistake should be abolished.

(b) Relief should be available where, at the time of the making of the contract,

(i) there is a mistake common to both parties, or

(ii) one of the parties is operating under a mistake known to the other party, or where the other party had reason to know of the mistake or where his or her fault caused the mistake,

and, in either event, the mistake is as to a basic assumption on which the contract was made and has a material effect on the agreed exchange of performance.

(c) Relief should not be available where the adversely affected party may be deemed to have assumed the risk of the mistake.

(d) Where relief is available, a court should be able to grant such relief as may be just, including one or more of the following types of relief:

(i) a declaration that the contract is valid and subsisting in whole or in part or for any particular purpose;

(ii) cancellation of the contract;

(iii) variation of the contract;

(iv) restitution for benefits conferred under the contract; and

(v) indemnification in whole or in part for expenses incurred by one or more of the parties in relation to the contract, and such expenses may be divided equally among the parties or otherwise as the court may deem just,

but no such order should prejudice the rights of a third party acquired from or under any party to the contract in good faith, for valuable consideration, and without notice of the mistake.

(e) In determining whether or not to grant relief, the court should be permitted to take into consideration the following factors:

(i) the conduct of the party seeking relief;

(ii) the extent to which the other party to the contract has changed his or her position in reliance on the contract; and

(iii) the fault of the party seeking relief in failing to know or discover the facts before making the contract,

but none of these factors should necessarily be a bar to relief.

(f) A party should be deemed to bear the risk of a mistake where,

(i) the risk is allocated to him or her by agreement of the parties, expressly or impliedly;

(ii) that party is aware, at the time of the formation of the contract, that he or she has only limited knowledge with respect to the facts to which the mistake relates but treats that limited knowledge as sufficient; or

(iii) having regard to all the circumstances it is reasonable that that party should do so.

(g) For the purposes of the above recommendations, mistake should include a mistake of law.

(h) The court should not be precluded from giving, or required to give, relief in the case of a mistake of one party where the mistake was not known to the other party to the contract and he or she had no reason to know of the mistake.

2. In order to clarify the existing law and in particular to enlarge the remedies available to the parties where there is a mistake in understanding, remedial legislation along the following lines should be adopted:

(a) The legislation should apply where the parties believe themselves to have entered into a binding contract but where such a contract is defective because of a misunderstanding between the parties as to the terms of the contract.

(b) Where, apart from the proposed legislation, a contracting party would be entitled to relief by reason of the matters mentioned in the preceding paragraph, the contract should be deemed to be voidable and not void and a court should be empowered to grant such relief as may be just. The types of relief the court should be empowered to grant should be the same as those mentioned in Recommendation 1(d) concerning mistakes in assumption.

(c) Any such court order should not affect rights acquired by a third party in good faith, for valuable consideration, and without notice of the defect in the contract.

(d) The court should not be precluded from giving, or required to give, relief in the case of a mistake of one party where the mistake was not known to the other party to the contract and he or she had no reason to know of the mistake.

3. The approach to the treatment of frustration doctrines recommended in our *Report on Sale of Goods* should be adopted with respect to the general law of contract.

4. More particularly, legislative provisions along the following lines should be adopted in Ontario:

(a) Where, after a contract is made, a party's performance is made impracticable without his or her fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his or her duty to render that performance should be discharged unless the language of the contract or the circumstances surrounding its conclusion indicate the contrary.

(b) Where, after a contract is made, a party's principal purpose is substantially frustrated without his or her fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his or her remaining duties to render performance should be discharged unless the language of the contract or the circumstances surrounding its conclusion indicate the contrary.

(c) Where impracticability of performance or frustration of purpose is only temporary, it should suspend the obligor's duty to perform while the impracticability or frustration exists but should not discharge his or her duty or prevent it from arising unless his or her performance after the impracticability or frustration has ceased would be materially more burdensome than if there had been no impracticability or frustration.

(d) Where only a part of an obligor's performance is impracticable or only a part of the principal purpose of an obligor's agreement is frustrated, his or her duty to perform the remaining part of the agreement should be unaffected if the other party so elects and it is not unduly burdensome to require partial performance by the obligor.

(e) Where, pursuant to the recommendations made in paragraphs 4(c) and (d) above, an obligor is required to continue with performance after the impracticability or frustration has ceased

or to render the remaining performance where only a part of the contract has been made impracticable or has been frustrated, the court should be permitted to make such consequential adjustments in the terms of the parties' contract as may be necessary to avoid injustice.

(f) (i) In the cases described in paragraphs 4(a) to 4(d), the failure of a party to render or to offer performance should affect the other party's duties in the same manner as if the frustrating event were a breach of contract.

(ii) The recommendation contained in the preceding subparagraph should not apply if the other party assumed the risk that he or she would have to perform despite such a failure.

(g) If a party is unable to comply with a condition in a contract or the condition can otherwise not be met because of impracticability, the non-occurrence of the condition should be excused if its occurrence is not a material part of the agreed exchange and the non-performing party would otherwise suffer serious prejudice.

5. So far as the consequences of a frustrated contract are concerned, a modified version of the scheme for relief following frustration set out in the new *Uniform Frustrated Contracts Act* should be adopted in Ontario in place of the scheme set out in the existing Ontario *Frustrated Contracts Act*. The modifications recommended are the following:

(a) A straightforward section providing for the equal apportionment of reliance expenditures should be included in substitution for the circuitous provisions in the Uniform Act.

(b) The allocation of risk provisions should be properly coordinated with the general section in the Uniform Act enabling the Act's provisions to be varied or excluded by agreement of the parties.

(c) The allocation of risk provisions should be extended to include circumstances indicating the parties' intention to vary or deny the availability of restitutionary claims for benefits conferred.

(d) The allocation of risk provisions should be amended to permit the drawing of an inference that the risk of reliance losses has shifted to the non-performing party.

(e) The list of criteria to determine whether the parties intended to vary the statutory allocation of reliance expenditures should be non-exhaustive and include the express terms of the agreement.

(f) The proposed legislation should permit recovery of benefits conferred on the mistaken assumption that the agreement was not frustrated.

(g) The arbitration provision in the old Uniform Act should be retained in the proposed Ontario legislation.

(h) The provision in the old Uniform Act relating to benefits conferred on third parties should also be included in the proposed Ontario legislation.

SUMMARY OF RECOMMENDATIONS

The Commission makes the following recommendations:

CONSIDERATION

1. Section 16 of the *Mercantile Law Amendment Act* should be amended to make it clear that an agreement, whether executed or executory, by an obligee to accept part performance of an obligation in place of full performance, as well as an agreement to waive performance of an obligation, need no consideration to be binding.

2. An agreement under the proposed revised section 16 of the *Mercantile Law Amendment Act* should be revocable by the obligee for breach, unless the breach of the obligation of part performance by the obligor is merely trivial or technical.

3. A provision similar to section 4.8 of the proposed *Sale of Goods Act* should be enacted to provide as follows:

   (a) an agreement in good faith modifying a contract should not require consideration in order to be binding;

   (b) an agreement that excludes modification or rescission except by a signed writing should not be otherwise subject to modification or rescission but, except as between parties acting in the course of business, such a requirement on a form supplied by a party acting in the course of a business should be required to be signed separately by the other party;

   (c) an attempt at modification or rescission that does not satisfy the requirements of the preceding paragraph or that does not satisfy any statutory requirement of writing or corroboration should be capable of operating as a waiver or equitable estoppel; and

   (d) where paragraph (c) applies, a party who has waived compliance with an executory portion of a contract should be able to retract the waiver by reasonable notification received by the other party that strict performance will be required of any term waived unless it would be unjust in view of a material change in position in reliance on the waiver to allow the waiver to be retracted. In the case of an equitable estoppel, a similar principle should apply.

4. A promise made in recognition of a benefit previously received by the promisor or by any third party from the promisee, should be enforceable to the extent necessary to prevent unjust enrichment.

5. A promise made in recognition of a benefit previously received by the promisor or by any third party from the promisee, should not be enforceable where the promisee conferred the benefit as a gift or where for other reasons the promisor has not been unjustly enriched.

6. Promises supported by past consideration, where enforceable, should be enforceable only to the extent that the value of the promise is not disproportionate to the benefit.

7. An offer, made by a person in the course of a business, which expressly provides that it will be held open should not be revocable for lack of consideration during the time stated or, if no time is stated, for a reasonable time not to exceed three months.

8. There should be no change in the law relating to firm offers not made in the course of business; that is, in order to be enforceable, a firm offer, when made by a non-merchant, should be supported by consideration or comply with the requisite formalities (See *infra*, Recommendation 13).

9. A promise that the promisor would reasonably expect to induce action or forbearance on the part of a promisee or a third person and that does induce such action or forbearance should be binding if injustice can be avoided only by enforcing the promise.

10. The remedy granted for breach of a promise inducing reliance should be limited as justice requires.

11. No special rule should be adopted for the enforceability of charitable subscriptions or promises to make a marriage settlement.

FORMAL CONTRACTS

12. The seal should be denied all legal effect in the law of contracts.

13. (1) A witnessed signed writing should take the place of the seal for the purposes of contract law.

    (2) A witnessed signed writing should be defined as a writing executed by the party to be bound in the presence of a witness and signed by the witness in the presence of the executing party.

14. An action for breach of a promise contained in a witnessed signed writing should be governed by the same limitation period as that applicable to contracts generally, that is, six years from the date the cause of action arose.

15. The *Courts of Justice Act, 1984* should be amended to empower a court, in any action upon a gratuitous promise where it is determined that damages could be given for breach of such promise, to grant an injunction or order specific performance thereof if it considers it proper to do so, notwithstanding that the promise was gratuitous.

THIRD PARTY BENEFICIARIES AND PRIVITY OF CONTRACT

16. There should be enacted a legislative provision to the effect that contracts for the benefit of third parties should not be unenforceable for lack of consideration or want of privity.

CONTRACTUAL ASPECTS OF THE *STATUTE OF FRAUDS*

17. The writing requirements in the *Statute of Frauds* dealing with the following should be repealed:

    (a) promises by executors and administrators to pay damages out of their own estates;

    (b) agreements governed by section 5; and

    (c) representations concerning another's credit worthiness.

18. The writing requirement for contracts not to be performed within one year should be repealed.

19. (1) The existing writing requirements for contracts relating to land should be repealed subject to a requirement that a contract concerning land is not enforceable on the evidence of the party alleging the contract unless such evidence is corroborated by some other material evidence.

    (2) A definition of land should not be included in any provision requiring corroboration by some other material evidence of any contract concerning land.

    (3) Any further legislation involving writing or other evidentiary requirements for agreements to lease should be harmonized with the proposed revised evidentiary requirements for land contracts.

20. (1) A writing requirement for guarantees should only be imposed where a guarantee is given by a person otherwise than in the course of business to a person acting in the course of business.

    (2) A guarantee "given in the course of a business" should be defined as including a guarantee given by a shareholder, officer or director of a company who guarantees a debt or other obligation of the company.

    (3) Recommendations with respect to guarantees should apply also to contracts of indemnity.

    (4) The original language of section 4 — that is, "debt, default or miscarriage" — should be retained in any legislation dealing with writing requirements for guarantees.

    (5) A contract of guarantee or indemnity that is required to be in writing should be evidenced by some kind of writing signed by the person to be charged or by an agent. In addition, the writing should identify the parties and reasonably indicate that a guarantee or indemnity is being or has been given.

    (6) Part performance either by the party seeking to enforce the guarantee or indemnity or by the guarantor or indemnitor should not be admitted as a substitute for the writing.

21. The provisions in the *Statute of Frauds* dealing with the creation, assignment and surrender of interests in land, including leases of land, and with the creation or declaration of trusts in land or assignment of trusts generally, should be reviewed in Ontario at an appropriate time.

UNCONSCIONABILITY

22. Legislation should be enacted expressly conferring on the courts power to grant relief from contracts and contractual provisions that are unconscionable.

23. The proposed legislation should not distinguish between procedural and substantive unconscionability.

24. The proposed legislation should include a non-exclusive list of decisional criteria to guide the courts in determining questions of unconscionability (See *infra*, Recommendation 25).

25. In determining whether a contract or part thereof is unconscionable in the circumstances relating to the contract at the time it was made, the court may have regard, among other factors, to evidence of:

    (a) the degree to which one party has taken advantage of the inability of the other party reasonably to protect his or her interests because of his or her physical or mental infirmity, illiteracy, inability to understand the language of an agreement, lack of education, lack of business knowledge or experience, financial distress, or because of the existence of a relationship of trust or dependence or similar factors;

    (b) the existence of terms in the contract that are not reasonably necessary for the protection of the interests of any party to the contract;

    (c) the degree to which the contract requires a party to waive rights to which he or she would otherwise be entitled;

    (d) gross disparity between the considerations given by the parties to the contract and the considerations that would normally be given by parties to a similar contract in similar circumstances;

    (e) knowledge by one party, when entering into the contract, that the other party will be substantially deprived of the benefit or benefits reasonably anticipated by that other party under the contract;

    (f) the degree to which the natural effect of the transaction, or any party's conduct prior to, or at the time of, the transaction, is to cause or aid in causing another party to misunderstand the true nature of the transaction and his or her rights and duties thereunder;

    (g) whether the complaining party had independent advice before or at the time of the transaction or should reasonably have acted to secure such advice for the protection of the party's interest;

(h) the bargaining strength of the parties relative to each other, taking into account the availability of reasonable alternative sources of supply or demand;

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

(j) in the case of a provision that purports to exclude or limit a liability that would otherwise attach to the party seeking to rely on it, which party is better able to guard against loss or damages;

(k) the setting, purpose and effect of the contract, and the manner in which it was formed, including whether the contract is on written standard terms of business; and

(l) the conduct of the parties in relation to similar contracts or courses of dealing to which any of them has been a party.

26. The proposed legislation should expressly authorize the court to raise the issue of unconscionability of its own motion.

27. The proposed provisions on unconscionability should apply to all types of contracts.

28. The term ''contract'' in the proposed provisions on unconscionability should be defined to include any enforceable promise.

29. The proposed legislation should incorporate a provision, similar to section 5.2(1) of the proposed *Sale of Goods Act*, with the necessary modifications. Accordingly, the court should be able, in the case of an unconscionable contract to

(a) refuse to enforce the contract or rescind it on such terms as may be just;

(b) enforce the remainder of the contract without the unconscionable part; or

(c) so limit the application of any unconscionable part or revise or alter the contract as to avoid any unconscionable result.

30. The courts should be empowered, at the behest of the Attorney General or other prescribed Minister, to issue injunctions against conduct leading to unconscionability, either in the formation of or in the execution of contracts.

31. A provision, similar to section 5.2(5) of the proposed *Sale of Goods Act*, preventing a party from excluding liability or waiving rights under the provisions dealing with unconscionability, should be included in the proposed legislation.

PENALTY CLAUSES AND RELIEF FROM FORFEITURE OF MONIES PAID

32. The existing penalty doctrine to determine the validity of stipulated damages clauses should be replaced by a test of unconscionability, the criteria for which should be the same as those recommended in this Report for other types of contractual provisions alleged to be unconscionable.

33. Relief from forfeiture of payments made under a contract should be based on the same test of unconscionability, and the existing distinction between the basis of relief for penalty clauses and relief from forfeiture clauses should be abolished.

34. Section 111 of the *Courts of Justice Act, 1984* should be retained.

PAROL EVIDENCE RULE

35. (1) Evidence of oral agreement to terms not included in, or inconsistent with, a written document should be admissible to prove the real bargain between the parties.

(2) Conclusive effect should not be attached to merger and integration clauses.

36. In order to give effect to the abovementioned recommendations, a provision similar to section 17 of the *Uniform Sale of Goods Act*, but applicable to all types of contracts, should be enacted.

GOOD FAITH

37. Legislation should give recognition to the doctrine of good faith in the performance and enforcement of contracts.

38. The proposed statutory obligation of good faith should apply explicitly and generally to all contracts and contracting parties.

39. The proposed statutory good faith provision should take the form of section 205 of the American *Second Restatement of the Law of Contracts*.

40. Legislation should provide that contracting parties may not vary or disclaim the statutorily imposed good faith obligations, but that parties should be able, by agreement, to determine the standards by which the performance of such good faith obligations is to be measured if such standards are not manifestly unreasonable.

MINORS' CONTRACTS

41. Subject to the provisions recommended below and to the provisions of other legislation, minors' contracts should not, as a general rule be enforceable against them, but minors should have the right to enforce their contracts.

42. Legislation should provide that a contract may be affirmed by a minor who has attained the age of majority, and that after such affirmation the contract may be enforced against the minor.

43. Legislation should provide that the mere receipt or retention of a benefit, after the age of majority, pursuant to a minor's contract, is not conclusive evidence of affirmation of the contract.

44. Section 7 of the *Statute of Frauds* should be repealed.

45. Legislation should provide that a party who contracts with a minor may, by notice in writing after the minor has attained the age of majority, require the minor to affirm or repudiate the contract within thirty days from receipt of the notice. Unless the minor repudiates the contract within the thirty day period, or within one year after attaining the age of majority, whichever period expires first, the contract may be enforced against the minor.

46. The notice to affirm or repudiate a contract referred to in Recommendation 45 should refer to the consequences of a failure to respond to the notice.

47. Legislation should provide that repudiation of a contract by a minor includes:

    (a) a refusal to perform the contract or a material term thereof;

    (b) the making of a claim for relief under a contract unenforceable against a minor; and

    (c) the giving of an oral or written notice of repudiation to the other party.

48. Legislation should provide that, where a contract is unenforceable against a minor because of minority, an action for relief may be brought by the minor, before or after attaining majority, or by the other party to the contract after the minor has repudiated the contract. In any such action, the court should be empowered to grant to any party such relief as may be just.

49. Legislation should provide that a contract may be enforced against a minor if the other party to the contract satisfies the court that the contract was in the best interests of the minor.

50. The proposed legislation should apply to executed as well as executory contracts.

51. Legislation should provide that a contract entered into by a minor is enforceable against the minor if it is approved by the court. A party to the contract should be able to apply for the approval of the court either before or after the contract is entered into. Approval should not be given unless the court is satisfied that the contract would be for the benefit of the minor.

52. Legislation should provide that, on application by a minor, the court may grant to the minor capacity to enter into contracts generally, or into any description of contract, subject to such terms and conditions as the court thinks fit. The court should not make such an order unless satisfied it would be for the benefit of the minor.

53. Legislation should provide that, subject to the provisions of any other legislation, a disposition of property or a grant of a security or other interest therein made pursuant to a contract that is unenforceable against a minor is effective to transfer the property or interest unless and until the court orders otherwise.

54. Legislation should further provide that, subject to the provisions of any other legislation, a subsequent disposition of property or a grant of a security or other interest therein to a *bona fide* transferee or grantee for value is not invalid for the reason only that the transferor or grantor acquired the property under a contract that was unenforceable against a minor.

55. Legislation should provide that, subject to the provisions of any other legislation, a minor may appoint an agent, by power of attorney or otherwise, to enter into any contract or make any disposition of property or grant any security or other interest. Any contract, disposition or grant by such agent should have no greater validity or effect as against the minor than it would have had if participated in or effected by the minor without an agent.

56. Legislation should further provide that a person may, by an agent under the age of majority, make any contract, dispose of any property or grant any security or other interest that a person may make, dispose of or grant by an agent who has attained the age of majority.

57. Legislation should provide that a guarantor of an obligation of a minor is bound by the guarantee as if the minor were an adult. If the obligation is enforceable against the minor, the guarantor should be entitled to be indemnified by the minor to the same extent as if the minor were an adult. If the obligation is not enforceable against the minor, the court should be empowered to grant the guarantor such relief against the minor as is just.

58. For the purposes of Recommendation 57, ''guarantor'' should include a person who enters into a guarantee or indemnity or otherwise undertakes to be responsible for the failure of a minor to carry out a contractual obligation.

59. Subject to Recommendation 60, legislation should provide for the imposition of liability in tort on minors, regardless of whether the tort is connected with a contract and regardless of whether the cause of action in tort is in substance a cause of action in contract, except where the contract would provide a defence to an individual who had attained majority.

60. A minor's liability for damages resulting from a false representation as to age should be subject to the following limitations:

(a) where the false representation has induced the making of a contract, a minor's liability in damages for the false representation should only arise where the person to whom the representation was made had reasonable grounds to believe that the representation was true; and

(b) a minor's liability in damages for false representations as to age should not arise by reason only of the fact that the minor has signed or otherwise adopted a document relevant to the transaction that contains a statement that the minor has attained the age of majority or otherwise has contractual capacity, that was prepared and tendered by the person to whom the representation was made or with whom the contract was made, and that was preprinted and used by such person in like transactions.

CONTRACTS THAT INFRINGE PUBLIC POLICY

61. The existing common law doctrines with respect to illegal contracts should be retained, but the court should be given power to relieve against the consequences of illegality. Accordingly, legislation should be enacted to provide that, where a contract or any term thereof is unenforceable by reason of public policy (including the effect of any statutory provision) the court may grant such relief by way of restitution and compensation for loss or otherwise as it thinks just and as is not inconsistent with the policy underlying the unenforceability of the contract.

62. Where any provision of any contract constitutes an unreasonable restraint of trade, the court should have the power to

(a) delete the provision and give effect to the contract as so amended;

(b) so reduce the scope of the provision that at the time the contract was entered into the provision as so reduced would have been reasonable, and give effect to the contract as so modified; or

(c) where the deletion or reduction of scope of the provision would so alter the bargain between the parties that it would be unreasonable to allow the contract to stand, decline to enforce the contract.

63. The court should also be able to reduce the scope of a provision under Recommendation 62(b) notwithstanding that the reduction of scope cannot be effected by the deletion of words from the provision.

64. The court should not exercise its powers under Recommendation 62(a) or (b) unless the party seeking to enforce the provision has acted in good faith and in accordance with reasonable standards of fair dealing.

MISREPRESENTATION

65. Subject to Recommendation 66, a representee should be able to rescind a contract that has been induced by misrepresentation even though the contract has been wholly or partly performed and even though, in the case of a contract for the sale of an interest in land, the interest has been conveyed to the representee.

66. (1) The courts should have power to deny rescission for misrepresentation or to declare it ineffective, awarding damages in lieu thereof.

(2) In exercising the power referred to in Recommendation 66(1), the courts should take into consideration, *inter alia*,

(a) undue hardship to the representor or to third parties;

(b) difficulty in reversing performance or long lapse of time after performance;

(c) whether a money award would give adequate compensation to the representee;

(d) the nature and scope of the representation;

(e) the conduct of the representor; and

(f) whether or not the representor was negligent in making the representation.

67. (1) Whether or not a contract is rescinded, the court should have power to allow just compensation by way of restitution, or for losses incurred in reliance on the representation.

(2) In deciding whether to award compensation, the court should take into account such factors as whether the representation was made in the course of a business, whether the representor had personal knowledge of the matters represented by him or her, and whether he or she used reasonable care in making the representation.

68. Legislation should make it clear that a misrepresentation includes a misrepresentation of law.

69. With the exception of Recommendation 65, which should apply to all misrepresentations including fraudulent misrepresentations, the foregoing recommendations should apply to innocent misrepresentations, including negligent misrepresentations.

WAIVER OF CONDITIONS

70. Legislation should provide that, unless a contrary intention appears, a party to a contract may waive a provision inserted into the contract solely for his or her own benefit.

MISTAKE AND FRUSTRATION IN THE LAW OF CONTRACT

71. In view of the substantial uncertainty in the existing law with respect to the availability of relief for mistakes in assumption and the scope of the relief where relief is available at all, the following remedial legislation should be adopted:

(a) The distinction between common law and equitable approaches to contractual mistake should be abolished.

(b) Relief should be available where, at the time of the making of the contract,

(i) there is a mistake common to both parties, or

(ii) one of the parties is operating under a mistake known to the other party, or where the other party had reason to know of the mistake or where his or her fault caused the mistake,

and, in either event, the mistake is as to a basic assumption on which the contract was made and has a material effect on the agreed exchange of performance.

(c) Relief should not be available where the adversely affected party may be deemed to have assumed the risk of the mistake.

(d) Where relief is available, a court should be able to grant such relief as may be just, including one or more of the following types of relief:

(i) a declaration that the contract is valid and subsisting in whole or in part or for any particular purpose;

(ii) cancellation of the contract;

(iii) variation of the contract;

(iv) restitution for benefits conferred under the contract; and

(v) indemnification in whole or in part for expenses incurred by one or more of the parties in relation to the contract, and such expenses may be divided equally among the parties or otherwise as the court may deem just,

but no such order should prejudice the rights of a third party acquired from or under any party to the contract in good faith, for valuable consideration, and without notice of the mistake.

(e) In determining whether or not to grant relief, the court should be permitted to take into consideration the following factors:

(i) the conduct of the party seeking relief;

(ii) the extent to which the other party to the contract has changed his or her position in reliance on the contract; and

(iii) the fault of the party seeking relief in failing to know or discover the facts before making the contract,

but none of these factors should necessarily be a bar to relief.

(f) A party should be deemed to bear the risk of a mistake where,

(i) the risk is allocated to him or her by agreement of the parties, expressly or impliedly;

(ii) that party is aware, at the time of the formation of the contract, that he or she has only limited knowledge with respect to the facts to which the mistake relates but treats that limited knowledge as sufficient; or

(iii) having regard to all the circumstances it is reasonable that that party should do so.

(g) For the purposes of the above recommendations, mistake should include a mistake of law.

(h) The court should not be precluded from giving, or required to give, relief in the case of a mistake of one party where the mistake was not known to the other party to the contract and he or she had no reason to know of the mistake.

72. In order to clarify the existing law and in particular to enlarge the remedies available to the parties where there is a mistake in understanding, remedial legislation along the following lines should be adopted:

(a) The legislation should apply where the parties believe themselves to have entered into a binding contract but where such a contract is defective because of a misunderstanding between the parties as to the terms of the contract.

(b) Where, apart from the proposed legislation, a contracting party would be entitled to relief by reason of the matters mentioned in the preceding paragraph, the contract should be deemed to be voidable and not void and a court should be empowered to grant such relief as may be just. The types of relief the court should be empowered to grant should be the same as those mentioned in Recommendation 71(d) concerning mistakes in assumption.

(c) Any such court order should not affect rights acquired by a third party in good faith, for valuable consideration, and without notice of the defect in the contract.

(d) The court should not be precluded from giving, or required to give, relief in the case of a mistake of one party where the mistake was not known to the other party to the contract and he or she had no reason to know of the mistake.

73. The approach to the treatment of frustration doctrines recommended in our *Report on Sale of Goods* should be adopted with respect to the general law of contract.

74. More particularly, legislative provisions along the following lines should be adopted in Ontario:

(a) Where, after a contract is made, a party's performance is made impracticable without his or her fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his or her duty to render that performance should be discharged unless the language of the contract or the circumstances surrounding its conclusion indicate the contrary.

(b) Where, after a contract is made, a party's principal purpose is substantially frustrated without his or her fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his or her remaining duties to render performance should be discharged unless the language of the contract or the circumstances surrounding its conclusion indicate the contrary.

(c) Where impracticability of performance or frustration of purpose is only temporary, it should suspend the obligor's duty to perform while the impracticability or frustration exists but should not discharge his or her duty or prevent it from arising unless his or her performance after the impracticability or frustration has ceased would be materially more burdensome than if there had been no impracticability or frustration.

(d) Where only a part of an obligor's performance is impracticable or only a part of the principal purpose of an obligor's agreement is frustrated, his or her duty to perform the remaining part of the agreement should be unaffected if the other party so elects and it is not unduly burdensome to require partial performance by the obligor.

(e) Where, pursuant to the recommendations made in paragraphs 74(c) and (d) above, an obligor is required to continue with performance after the impracticability or frustration has ceased or to render the remaining performance where only a part of the contract has been made impracticable or has been frustrated, the court should be permitted to make such consequential adjustments in the terms of the parties' contract as may be necessary to avoid injustice.

(f) (i) In the cases described in paragraphs 74(a) to 74(d), the failure of a party to render or to offer performance should affect the other party's duties in the same manner as if the frustrating event were a breach of contract.

(ii) The recommendation contained in the preceding subparagraph should not apply if the other party assumed the risk that he or she would have to perform despite such a failure.

(g) If a party is unable to comply with a condition in a contract or the condition can otherwise not be met because of impracticability, the non-occurrence of the condition should be excused if its occurrence is not a material part of the agreed exchange and the non-performing party would otherwise suffer serious prejudice.

75. So far as the consequences of a frustrated contract are concerned, a modified version of the scheme for relief following frustration set out in the new *Uniform Frustrated Contracts Act* should be adopted in Ontario in place of the scheme set out in the existing Ontario *Frustrated Contracts Act*. The modifications recommended are the following:

(a) A straightforward section providing for the equal apportionment of reliance expenditures should be included in substitution for the circuitous provisions in the Uniform Act.

(b) The allocation of risk provisions should be properly coordinated with the general section in the Uniform Act enabling the Act's provisions to be varied or excluded by agreement of the parties.

(c) The allocation of risk provisions should be extended to include circumstances indicating the parties' intention to vary or deny the availability of restitutionary claims for benefits conferred.

(d) The allocation of risk provisions should be amended to permit the drawing of an inference that the risk of reliance losses has shifted to the non-performing party.

(e) The list of criteria to determine whether the parties intended to vary the statutory allocation of reliance expenditures should be non-exhaustive and include the express terms of the agreement.

(f) The proposed legislation should permit recovery of benefits conferred on the mistaken assumption that the agreement was not frustrated.

(g) The arbitration provision in the old Uniform Act should be retained in the proposed Ontario legislation.

(h) The provision in the old Uniform Act relating to benefits conferred on third parties should also be included in the proposed Ontario legislation.

CONCLUSION

In this Project we have been concerned to identify areas of the law of contract in need of reform, whether because of undue complexity, uncertainty or substantive unfairness; to canvass the options for reform; and to recommend particular legislative reforms. Our goal has been to arrive at a set of recommendations that would, if implemented, contribute to greater justice among individuals.

We have been assisted in this task by many persons, whose contributions we have gratefully acknowledged in the Introduction to this Report. We wish, however, to reiterate our thanks to the joint Project Directors, Professors S.M. Waddams and J.S. Ziegel, both of the Faculty of Law, University of Toronto, for their scholarship, patience, and assistance at all stages of the Project.

All of which is respectfully submitted,

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