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S.M. Waddams

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Unconscionability in Canadian Contract Law

S.M. WADDAMS*

Although sales statutes in the common law provinces of Canada have no precise equivalent of section 2-302 of the Uniform Commercial Code¹ ("U.C.C."), a number of statutes in each jurisdiction provide for relief against unfair contractual provisions in various contexts. In some cases, the statutes authorize courts to exercise discretion in setting aside unfair terms.² In other contexts, specific contractual terms are prohibited³ or mandated statutorily.⁴

Canada shares with the United States the traditions of English common law and equity underlying section 2-302. As such, Canadian law recognizes the concept of relief against forfeitures and penalties.⁵ Canadian courts often exercise their general power over contract formation and interpretation either to exclude unfair provisions or modify them by incorporating implied terms.⁶

* Professor of Law, University of Toronto. B.A., University of Toronto, 1963; LL.B., University of Toronto, 1967; LL.M., University of Michigan, 1968; M.A., Cambridge University, 1969; S.J.D., University of Michigan, 1972.

1. U.C.C. § 2-302 (1990).

2. See Barristers and Solicitors Act, R.S.B.C. ch. 18, § 99(2) (1979); Insurance Act, R.S.O. ch. 218, § 106 (1980); Solicitors Act, R.S.O. ch. 478, § 26 (1980); Unconscionable Transactions Relief Act, R.S.O. ch. 513, § 2 (1980). The trade practices acts in various provinces have a similar effect on certain classes of transactions. See Trade Practice Act, R.S.B.C. ch. 406, § 4(e) (1979); Trade Practices Inquiry Act, R.S.M. ch. T110, § 2 (1979); Trade Practices Act, Nfld. R.S. ch. 10, § 6(d) (1978); Business Practices Act, R.S.O. ch. 55, § 2(b)(vi) (1980); Business Practices Act, R.S.P.E.I. ch. 31, § 3(b)(vi) (1977).

3. For example, disclaimer clauses are prohibited in consumer sales. See Sale of Goods Act, R.S.B.C. ch. 370, § 20 (1979); Consumer Protection Act, R.S.M. ch. C-200, § 58(1) (1970); Consumer Product Warranty and Liability Act, R.S.N.B. ch. C-18.1, §§ 24-26 (1978); Consumer Protection Act, R.S.N.S. ch. 53, § 20c (1967), amended by S.N.S. ch. 19 (1975); Consumer Protection Act, R.S.O. ch. 87, § 34(1) (1980); Consumer Products Warranties Act, S.S. ch. C-30, §§ 8, 11 (1978). Certain terms in residential tenancies are also prohibited. See, e.g., Landlord and Tenant Act, R.S.O. ch. 232, § 84(1) (1980).

4. Examples of mandatory terms include insurance policies and contracts for the sale of agricultural machinery. See, e.g., Farm Implement Act, S.A. ch. F-4.1 (1982); Farm Machinery and Equipment Act, R.S.M. ch. F-40 (1970); Insurance Act, R.S.O. ch. 218, § 207 (1980); Farm Implement Act, R.S.P.E.I. ch. F-3 (1974); Agricultural Implements Act, S.S. ch. A-10 (1978).

5. See S.M. WADDAMS, *THE LAW OF CONTRACTS* 327-45 (2d ed. 1984).

6. *Id.* at 362-76.

The doctrine of unconscionability is well-established in Canada. Unconscionability is generally defined as taking undue advantage of an inequality in bargaining power.⁷ Thus, a number of modern Canadian cases, relying on equity jurisdiction, have set aside contracts for unconscionability.⁸ Contracts may be set aside for duress, including economic duress.⁹ Closely related are the cases of undue influence and fiduciaries.¹⁰

In cases involving disclaimer clauses, Canadian courts often use the theory of "fundamental breach," which developed in England.¹¹ This theory ostensibly relies on the technique of construction holding that parties to a contract could not have intended that the disclaimer clause apply in cases involving a fundamental breach.¹² Nonetheless, few commentators have doubted that the doctrine originates in the desire to set aside unfair clauses.¹³ As noted, statutes in several provinces make disclaimer clauses void in consumer sales.¹⁴ Yet, following a decision of the House of Lords,¹⁵ the Canadian Supreme Court in *Hunter Engineering, Inc. v. Syncrude Canada Ltd.*¹⁶ held that disclaimer clauses in commercial contexts should be given effect according to their true construction.¹⁷ Significantly, however, the court limited this holding by recognizing its general power to set aside either, in the words of two judges, an unconscionable contractual provision, or, in the words of two others, a provision that should not be

7. See Bradley E. Crawford, Comment, *Restitution—Unconscionable Transaction—Undue Advantage Taken of Inequality Between Parties*, 44 CAN. B. REV. 142, 143 (1966); see also WADDAMS, *supra* note 5, at 380-84.

8. See, e.g., *Morrison v. Coast Fin. Ltd.*, [1966] 54 W.W.R. 257 (B.C.C.A.); *Degman v. Guaranty Trust Co.*, 1954 S.C.R. 725 (Can.); *County of Carleton v. City of Ottawa*, 52 D.L.R.2d 220 (1965) (Can.).

9. WADDAMS, *supra* note 5, at 376-80; see also *North Ocean Shipping Co. v. Hyundai Constr. Co.*, [1979] 1 Q.B. 705 (Eng.); *The "Siboen" and the "Sibotre"*, [1976] 1 Lloyd's Rep. 293 (Eng.); *The "Alev"*, [1989] 1 Lloyd's Rep. 138 (Eng.); *Atlas Express Ltd. v. Kafco (Importers and Distributors) Ltd.*, [1989] 1 Q.B. 833 (Eng.); *Williams v. Roffey Bros. & Nicholls (Contractors) Ltd.*, [1991] 1 Q.B. 1 (Eng. C.A.).

10. WADDAMS, *supra* note 5, at 384-89.

11. *Id.* at 350-51.

12. *Id.*

13. See, e.g., *id.* at 350, 356; Brian Coote, *The Effects of Discharge by Breach on Exception Clauses*, CAMBRIDGE L.J. 221 (1970); J.A. Weir, Comment, *Nec Tamen Consumebatur . . . —Frustration and Limitation Clauses*, 28 CAMBRIDGE L.J. 189 (1970).

14. See *supra* note 3.

15. *Photo Prod. Ltd. v. Securicor Transp. Ltd.* [1980] App. Cas. 827 (appeal taken from Eng.).

16. 57 D.L.R.4th 321 (1989).

17. See *id.*

enforced in the particular circumstances of the case.¹⁸ Some uncertainty remains about the precise scope of relief because the majority of the court was evenly divided.¹⁹ Nevertheless, whichever form of words prevails in future cases, the decision of the Canadian Supreme Court in *Hunter Engineering, Inc.* establishes that a general power exists to set aside contractual provisions on what may broadly be called grounds of unfairness.

In contrast, English courts generally do not recognize unconscionability as a contractual defense.²⁰ This is partly on account of the United Kingdom's Unfair Contract Terms Act²¹ and the general mood of judicial conservatism prevailing in English courts.²² Although Canadian contract law traditionally follows English law, recent cases indicate that Canadian law will, on this point, take its own path. Reference has already been made to the Canadian Supreme Court decision in *Hunter Engineering, Inc.*,²³ dealing with the issue of disclaimer clauses. Since Canada's 1982 adoption of a bill of rights,²⁴ the Canadian courts, unlike the English courts, have become accustomed to dealing with general policy issues. It seems unlikely that Canadian courts will retreat from recognizing a general defense of unfairness. Whether unconscionability is the term that will ultimately be adopted remains to be seen.

Karl Llewellyn, the principal drafter of section 2-302, favored open recognition of a general principle of unconscionability.²⁵ He thought that such a principle was more reliable and rational than the tortuous use of judicial techniques, such as construction.²⁶ There is much in the Canadian experience to bear out Llewellyn's thesis. For

18. See *id.* at 382. The court also discussed "the context of the particular breach which had occurred," and "a residual power residing in the court to withhold its assistance on policy grounds in appropriate circumstances." *Id.* at 378, 381.

19. See *id.* at 382.

20. See *National Westminster Bank Plc. v. Morgan*, [1985] 1 App. Cas. 686 (appeal taken from Eng.).

21. Unfair Contract Terms Act, 1977, ch. 50.

22. In the tort context, see *Murphy v. Brentwood Dist. Council*, [1991] 1 App. Cas. 398 (appeal taken from Eng.) (repudiating an earlier willingness to recognize a general principle of liability for economic loss in negligence cases).

23. 57 D.L.R.4th 321 (1989). For a discussion of the Canadian Supreme Court's decision, see *supra* notes 16-19.

24. CAN. CONST. (Constitution Act, 1982), pt. I (Canadian Charter of Rights and Freedoms).

25. Karl Llewellyn, *The Standardization of Commercial Contracts in English and Continental Law*, 52 HARV. L. REV. 700, 702-03 (1939) (book review).

26. *Id.*

example, under the influence of the fundamental breach doctrine, the law of disclaimer clauses became arbitrary and unpredictable, and led the courts to wrong results in both directions: courts enforced unfair clauses and struck down clauses that were fair and reasonable. The same has happened with the law relating to penalty clauses. General recognition of a judicial power to control contracts for unfairness is welcomed, though it is a power to be used with restraint. Such power must always be balanced against the need for a measure of certainty, stability, and predictability.