# The Reception of *Photo Production Ltd* v. *Securicor Transport Ltd* in Canada: *Nec Tamen Consumebatur*

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## Introduction

It is arguable that the doctrine of freedom of contract has been all but toppled from its throne as the ruling philosophical principle of the law of contract. No longer need the law link arms with nineteenth century *laissez-faire* economics to facilitate and protect the growth of industrialization and capitalism. No longer should the law secure the grand purpose of ensuring the survival of the financially fittest who in turn would provide the barest necessities for those who must toil in their factories and subsist on their charity. Instead, some would suggest that the guiding principle of contract law should be to redress the balance of contractual bargaining power so that the powerful are no longer favoured — especially those enjoying monopolistic or near-monopolistic positions within the marketplace. Rather, legal controls should be created to encourage the good stewardship of economic wealth and power so as to provide for the common good and individual good as far as possible. It is trite to state that the concept of favouring the many rather than the privileged few is seeping into many legal nooks and crannies today. Thus in tort law, for example, there has been a steady expansion of the notion of negligence, and in contract, judicial and legislative protections for consumers and other parties of lesser bargaining power have developed, especially in the last decade. Nowhere have these basic policy issues been more apparent than in regard to the attempts, such as those of the Master of the Rolls, to underpin the modern law of contract with the foundation of reasonableness and fairness once associated with the simple equitable notion of doing justice on the facts of the case. And nowhere has this attempted judicial revolution been more evident and, indeed, perhaps at its most significant, than in respect to the widespread use of that legal inheritance of nineteenth century freedom of contract, the standard-form contract, with its exclusion clauses, which is the legal companion of the mass provision of goods and services.[1]

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[1] A superb analysis of the trends in the modern law of obligations is found in P.S. Atiyah, *The Rise and Fall of Freedom of Contract* (1979). See also P.S. Atiyah, *From Principles to Pragmatism*, Inaugural Lecture delivered before the University of Oxford on 17 February 1978, and Reiter, *The Control on Contract Power* (1981) 1 Oxford J. of Legal Studies 347 and the references cited therein.

The express espousal of a public policy of redressing bargaining imbalances was not made in the past by judges who nevertheless implicitly adopted the principle when applying the construction rules, the *contra proferentem* rule or the doctrine of fundamental breach of contract. However, Lord Denning M.R. has been less reticent in explicitly advocating a judicial role in redressing grievances arising from marketplace inequalities. Other judges have increasingly proved willing to adopt expressly the rubric of inequality of bargaining power without expressly searching too deeply into its meaning in written decisions on the facts before them. It is widely accepted that judicial pronouncements should not be in the vanguard of social engineering, and with few exceptions judges subscribe to the view that the law ought to reflect rather than shape socio-economic changes. Yet it seems clear that the willingness of the judiciary to acknowledge, if hesitantly, that the law should play a role in the protection of the less powerful in the marketplace, indicates judicial perception that the time has come for the assessment of contractual relationships in terms of basic fairness and justice in the use of socio-economic advantages, rather than in terms of a systematic complex of rules founded upon the principle of freedom of contract, too often enjoyed by one party only. In any case, the legislators have now given the required lead.

Past judicial equivocation in acknowledging the "rise and fall of freedom of contract" is perhaps best exemplified in the two steps forward and one step back routine of *Karsales (Harrow) Ltd* v. *Wallis*,[2] *Suisse Atlantique Société d'Armement Maritime S.A.* v. *N.V. Rotterdamsche Kolen Centrale*,[3] *Harbutt's "Plasticine" Ltd* v. *Wayne Tank and Pump Co.*[4] and *Photo Production Ltd* v. *Securicor Transport Ltd*,[5] as well as in the Canadian responses to those decisions which have paid lip service to one principle while applying the other without acknowledgement.[6] The effect of the

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[2] [1956] 1 W.L.R. 936 (C.A.).

[3] [1967] 1 A.C. 361 (H.L.).

[4] [1970] 1 Q.B. 447 (C.A.).

[5] [1980] A.C. 827 (H.L.), *rev'g* [1978] 1 W.L.R. 856 (C.A.).

[6] The Supreme Court of Canada approved the rule of construction approach of *Suisse Atlantique* in *B.G. Linton Construction Ltd* v. *C.N.R. Co.* [1975] 2 S.C.R. 678. However, other courts have been unwilling to uphold exclusion clauses on construction if they were unfair; see, *e.g.*, *Lightburn* v. *Belmont Sales Ltd* (1969) 6 D.L.R. (3d) 692 (B.C.S.C.); *R.G. McLean Ltd* v. *Canadian Vickers Ltd* [1971] 1 O.R. 207 (C.A.); *Canso Chemicals Ltd* v. *Canadian Westinghouse Co.* (1975) 10 N.S.R. (2d) (S.C., App. Div.). See also the comments of S. Waddams, *The Law of Contracts* (1977), 285 *et seq.*, and Ziegel, *Comment* (1979) 57 Can. Bar Rev. 105, 109, where he notes that the Canadian lower courts have "paid lip service to the House of Lords' constructional rule but, with surprising ease, almost unfailingly managed to find that the parties could not have intended the clause to apply to a fundamental breach. *Suisse Atlantique* changed the form of judicial reaction to disclaimer clauses but not its substance."

House of Lords' decision in *Photo Production* and Canadian judicial reaction to that decision bears out the view that whatever else *Photo Production* may have decided, it did not, despite its express restatement of the freedom of contract principle within certain defined limits, reinstate the principle as the broad basis on which the modern law of contract is to be founded. But having said that, one has said little, and the question of assessing *Photo Production* and its Canadian significance remains.

The following discussion will proceed in three stages: (1) a brief assessment of *Photo Production*; (2) an assessment of several Canadian decisions in which *Photo Production* was applied or considered; and (3) a restatement of the issue derived from the case discussions.

## I. What *Photo Production Ltd* v. *Securicor Transport Ltd* Decided

The facts of *Photo Production*[7] were pleasingly simple. The plaintiff manufactured Christmas cards and kept large quantities of paper and cardboard stored at its factory. The defendant provided security services for a sum of £8 15s per week and was required to make a total of 34 visits per week at a cost of 26p per visit. On the night of 18-9 October 1973, the security guard, one Musgrove, a 23 year old employee on the job for three months and with satisfactory references, deliberately threw a match into some cardboard. No explanation was provided for this odd behaviour although Musgrove alleged that he had intended only to start a small fire and not to destroy the factory, which was damaged together with the stock to an agreed sum of £615,000. Musgrove was charged with arson, convicted of malicious damage and sentenced to three years imprisonment. No findings were made that Securicor was negligent in hiring the hapless Musgrove, nor that it should have anticipated his criminal behaviour. In the litigation which followed Securicor sought to rely on several exclusion clauses, in particular condition (1) of the contract:

> Under no circumstances shall the Company [Securicor] be responsible for any injurious act or default by any employee of the Company unless such act or default could have been foreseen and avoided by the exercise of due diligence on the part of the Company as his employer; nor, in any event, shall the Company be responsible for: (a) Any loss suffered by the customer through burglary, theft, fire or any other cause, except insofar as such loss is solely attributable to the negligence of the Company's employees acting within the course of their employment.[8]

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[7] *Supra*, note 5. The decision has provoked a number of comments including Samuel, *Note* (1979) 95 L.Q.R. 25; Sealy, *Contract — Farewell to the Doctrine of Fundamental Breach* (1980) 39 Cambridge L.J. 252; Melville, *The Nature of Fundamental Breach* (1980) 130 New L.J. 307; Ogilvie, *Suisse Atlantique Revindicated: How Long, O Lords, How Long?* (1981) 5 Can. Bus. L.J. 100; Ziegel, *The House of Lords Overrules Harbutt's Plasticine* (1980) 30 U. T. L.J. 421; Palmer & Evans, *Comment* (1980) 58 Can. Bar Rev. 773; Palmer & Yates, *The Future of Unfair Contract Terms Act, 1977* (1981) 40 Cambridge L.J. 108; Hetherington, *Contracting Out of Discharge for Breach* (1980) 3 U.N.S.W.L.J. 233; Atkin, *Fundamental Breach and the Nature of Exclusion Clauses* (1981) 9 Sydney L.R. 434.

[8] *Ibid.*, 830 (H.L.).

At first instance, McKenna J. held that the clause covered the circumstances and dismissed the action without any finding of fundamental breach. The Court of Appeal, led by Lord Denning, (Shaw and Waller LL.J. concurring) unanimously reversed this decision on the grounds that the destruction of the factory constituted a fundamental breach of contract which discharged the contract including the exclusion clause, and that it was the presumed intention of the parties that the clause should not apply in the events which had occurred. The House of Lords restored the trial judge's decision and found that Securicor was not liable on construction of the clause. The leading judgment was delivered by Lord Wilberforce with whom Lord Scarman and Lord Keith of Kinkel concurred. Lord Diplock and Lord Salmon delivered separate judgments in which they too agreed with Lord Wilberforce. It would be useful to enumerate the questions resolved by the Law Lords and also to state the problems which remain unresolved now that the dust has settled around *Photo Production.*

First, the House of Lords unanimously overruled the principle advocated by the Master of the Rolls in *Karsales*[9] and *Harbutt's,*[10] and adopted subsequently in other English cases,[11] that there was a rule of law which could be invoked by a court to deprive a defendant of the benefit of an exclusion clause where a fundamental breach of contract has occurred. Rather, in all cases the exclusion clause is subject to construction and will protect the defendant if construed to cover the events which have occurred. If the English defendant cannot invoke the *Unfair Contract Terms Act, 1977*[12] on his own behalf, then he will be bound by the construction of the contract made by the court.

Second, the House of Lords disapproved of the corollary notion that a fundamental breach brought the contract to an end either *ab initio* or from the date of the breach. Instead, the effect of a breach going to the root of the contract is to discharge the parties from the performance of further obligations under the contract; however, the contract survives and may determine the remedies available to the innocent party. The heresy that a contract dies with a fundamental breach had been said in *Harbutt's* to be derived from *dicta* of Lord Reid and Lord Upjohn in *Suisse Atlantique.* In *Photo Production,* Lord Wilberforce conceded that there was a "note of ambiguity or perhaps even inconsistency",[13] especially in Lord Reid 's judgment,

[9] *Supra,* note 2.

[10] *Supra,* note 4.

[11] *Charterhouse Credit Co.* v. *Tolly* [1963] 2 Q.B. 683 (C.A.); *Kenyon, Son and Craven Ltd* v. *Baxter Hoare and Co.* [1971] 1 W.L.R. 519 (Q.B.); *Wathes (Western) Ltd* v. *Austin's (Menswear) Ltd* [1976] 1 Lloyd's Rep. 14 (C.A.), were all overruled.

[12] Chapter 50.

[13] *Supra,* note 5, 842 (H.L.). In *Suisse Atlantique* Lord Reid stated, *supra,* note 3, 398: "I do not think that there is generally much difficulty where the innocent party has elected to treat the breach as a repudiation, bringing the contract to an end and sue for damages. Then

but suggested that Lord Reid was referring to the recovery of future losses arising after the repudiation, not to immediate losses resulting from past events. Putting aside the points that Lord Reid 's statement is less than clear, and that it is undesirable for Lord Wilberforce to introduce an unwarranted distinction here between future and immediate losses, it is still arguable, paradoxically, that Lord Reid is advocating a rule of law approach to future losses which is incompatible with the rule of construction approach to immediate losses.[14] If a contract contained an exclusion clause excluding liability for future losses, such as lost profits — even when a fundamental breach of contract has occurred — then according to Lord Reid the clause cannot be relied upon in case of a breach, although on construction it effectively excluded liability. Whatever the correct interpretation of Lord Reid 's statement might be, however, the House of Lords in *Photo Production* decided that Lord Porter 's statement in *Heyman* v. *Darwins Ltd*[15] — that the contract is not thereby rescinded — is the correct approach.

The fate of a contract where there is a breach going to the root was described by Lord Diplock in terms borrowed from the civil law of obligations when he distinguished primary and secondary obligations.[16] Primary obligations consist of the parties ' reciprocal duties to perform; secondary obligations are said to arise in the event of non-performance and include the obligation to compensate an innocent party for breach of a primary obligation. Secondary obligations are as much a part of the contract as primary obligations and they survive a breach. Exclusion clauses modify primary and secondary obligations, often the secondary obligation to pay damages in the event of a breach of a primary obligation to perform. Although Lord Diplock 's analysis clarifies the nature of the status of contractual obligations, it is neither innovative,[17] nor does it add anything to the more conventionally worded analysis of Lord Wilberforce. Clarification is often useful, however, and Lord Diplock 's analysis does clarify the point that secondary obligations and their modifying exclusion clauses are as much obligations as the duty to perform and are as much terms of the contract imposing contractual duties as any positively worded contractual duty. They are, in

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the whole contract has ceased to exist including the exclusion clause, and I do not see how that clause can then be used to exclude an action for loss which will be suffered by the innocent party after it has ceased to exist, such as loss of profit which would have accrued if the contract had run its full term."

[14] Atkin, *supra*, note 7, 437-8, 442.

[15] [1942] A.C. 356, 399 (H.L.): "Strictly speaking, to say that on acceptance of the renunciation of a contract the contract is rescinded is incorrect. In such a case the injured party may accept the renunciation as a breach going to the root of the whole consideration. By that acceptance he is discharged from further performance and may bring an action for damages, but the contract itself is not rescinded."

[16] *Supra*, note 5, 848-9 (H.L.).

[17] See *C. Czarnikow Ltd* v.*Koufos* [1966] 2 Q.B. 695, 725 (C.A.) *per* Diplock L.J., and *Moschi* v. *Lep Air Services Ltd* [1973] A.C. 331, 350 (H.L.) *per* Lord Diplock.

the words of Kitto J., "part and parcel of the bargain",[18] and as such merit different consideration than they did under the doctrine of fundamental breach, as we shall discuss later.

Third, the role of the term "fundamental breach" in the sense of breach of a fundamental term or "condition" was clarified by *Photo Production* in that both Lord Wilberforce and Lord Diplock impliedly limit its use to failure to perform a contractual obligation which is of the essence of the contract or is at the root of the contract. Such a failure would amount to a total failure of consideration, or as Lord Diplock says, it is a situation, "where the event resulting from the failure by one party to perform a primary obligation has the effect of depriving the other party of substantially the whole benefit which it was the intention of the parties that he should obtain from the contract."[19] Both Lord Wilberforce and Lord Diplock state that the *ratio* of *Photo Production* applies as much to breach of a fundamental term as to fundamental breach. But Lord Diplock also suggests that if the exclusion clause modified the primary obligation so as to relieve the party in breach of any obligation to perform in the first place, the agreement no longer "retains the legal characteristics of a contract".[20] This seems to contradict the view that the effect of fundamental breaches and breaches of fundamental terms should be considered in the light of the construction of an exclusion clause. Exclusion clauses are likely to contradict positive primary obligations in most contracts and must either be thrown out because of repugnancy or be accepted and construed as implied by the general approach espoused in *Photo Production*. Some further clarification of Lord Diplock's anomalous statement is required.

Fourth, Lord Wilberforce stated that the deviation cases in shipping law survive as a body of law *sui generis* with special rules derived from historical and commercial reasons unaffected by the rise and fall of the doctrine of fundamental breach in contract law generally. In shipping cases, an exemption clause ceases to apply when a ship deviates from the contractually prescribed route. The rationale is said to be that marine insurance policies cease to operate as soon as the ship deviates from its route.[21]

Four major questions remain unresolved after *Photo Production*. First, it seems that Lord Denning's view that reasonableness is a substantive test

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[18] *Sydney City Council* v. *West* (1966) 114 C.L.R. 481, 495 (H.C. Aust.); see Atkin, *supra*, note 7, 443, and Australian cases cited therein which show that the doctrine of fundamental breach was never accepted in Australia.

[19] *Supra*, note 5, 849 (H.L.).

[20] *Ibid.*, 850 *per* Lord Diplock.

[21] *Lavabre* v. *Wilson* (1779) 1 Doug. 284, 291, 99 E.R. 185, 189 (K.B.) *per* Lord Mansfield. See also *Hain Steamship Co.* v. *Tate and Lyle Ltd* (1936) Com. Cas 350, 354 (H.L.), *per* Lord Atkin and American criticisms in *Farr* v. *Hain S.S. Co.* 121 F. 2d 940, 944 (2d Cir. 1941) *per* Learned Hand J.

for the validity of exclusion clauses may have survived because only Lord Diplock expressly disapproves of it, when he states that a court is not entitled "to reject the exclusion clause, however unreasonable the court itself may think it is, if the words are clear and fairly susceptible to one meaning only."[22] If it does survive then it would appear to operate where the parties are of unequal bargaining power or where they cannot evoke the statutory reasonableness provided by the *Unfair Contract Terms Act, 1977*. The statements by both Lord Wilberforce and Lord Diplock that commercial men bargaining on equal terms should be free to establish their own *quid pro quo* and to apportion their losses serve to cut down the number of situations in which exclusion clauses would be subjected to a reasonableness test.[23] If reasonableness has indeed survived, then the longer effect of *Photo Production* may be to replace fundamental breach as a legal technique for the control of exclusion clauses with a doctrine of unconscionability. This aspect of the case will be particularly important in jurisdictions lacking unconscionability legislation or legislation restricting the application of unconscionability to certain categories of contracts, such as consumer contracts.[24] At present the survival of reasonableness is less important in England than in Canada where most provincial legislation ignores exclusion clauses in standard-form contracts.

Second, if the correct judicial approach to exclusion clauses arising in a free bargaining context is simply one of construction, the House of Lords provided little guidance to the construction process itself. To say that clear exclusion clauses are to be enforced ignores the fact that problems arise because clauses are not clear. The courts have neutralized the simple clear construction rule by the development of other construction principles such as the *contra proferentem* rule, the rule that business efficacy should be given to the contract, or the rule that exclusion clauses should not be construed so as to reduce the primary obligations to mere declarations of intent.[25] The manner in which the House of Lords construed the disputed clause itself provides an illustration, in that little discussion was directed to the words in the clause which clearly stated that Securicor was liable for losses resulting solely from the negligence of its employees acting within the course of their employment. Perhaps Lord Wilberforce's handling of the question of whether negligence included deliberate acts and his invocation of the *contra proferentem* rule to conclude that deliberate acts were included are indicative of future difficulties.[26] Since there had never been a finding that Musgrove

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[22] *Supra*, note 5, 851 (H.L.).

[23] Ibid., 844 and 851 respectively; some limits of the necessity for a test of reasonableness are found in *Suisse Atlantique, supra*, note 3, 406 *per* Lord Reid.

[24] Ogilvie, *supra*, note 7, 113-4; Ziegel, *supra*, note 7, 430-3.

[25] See Ziegel, *supra*, note 7, 433-8.

[26] *Supra*, note 5, 846 (H.L.): "Whether in addition in negligence, [the clause] covers other, *e.g.*, deliberate acts, remains a matter of construction requiring, of course, clear words. I am

deliberately intended to destroy the factory, Securicor could not be made liable. First year tort students mindful of the standard definition of negligence given by Winfield and Jolowicz[27] would find Lord Wilberforce's liberal interpretation puzzling. Further difficulties seem to arise with respect to whether Musgrove's actions were within the scope of his employment. Lord Denning was adamant that they were not, yet the House of Lords apparently assumed that, but for the exclusion clause, Securicor was liable for its employees. Definition of what constitutes "within the scope of employment" would have been useful here. If the learned Law Lord's efforts are indicative of clear contractual construction, then lamentably they leave much to be desired and provide little, if any, guidance for future courts, dependent as they are on Lord Wilberforce's reading into the clause of concepts which arguably are not there.

Third, the House of Lords was divided as to the nature of Securicor's original liability. Lord Diplock held that the source of its liability was contractual, arising from the promise that its employees would exercise reasonable skill and care. The other four Law Lords held that although one source of liability was contractual, had it not been for the exclusion clause, Securicor would also have been vicariously liable in tort for Musgrove's actions on the strength of *Morris* v. *C.W. Martin and Sons Ltd.*[28] The majority assumption was that Musgrove's deliberate throwing of the match, regardless of the final outcome of that act, was within the scope of his employment thereby making Securicor vicariously liable, despite the fact that he had deliberately departed from the exercise of reasonable skill and care in guarding the factory. The majority apparently implied a primary obligation that Securicor would exercise reasonable skill and care in patrolling the factory whereas the actual contractual obligation was the somewhat less onerous one of using due diligence in employing persons who would use reasonable skill and care; that primary obligation was not breached so that, but for the exclusion clause, Securicor would have been liable. Lord Wilberforce stated that there was indeed an implied obligation, although the precise nature of that obligation was not expressed.[29] However, such an implied

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of the opinion that it does, and being free to construe and apply the clause, I must hold that liability is excluded."

[27] W. Rogers, *Winfield and Jolowicz on Tort*, 11th ed. (1979), 66: "Negligence as a tort is the breach of a legal duty to take care which results in damage, undesired by the defendant, to the plaintiff."

[28] [1966] 1 Q.B. 716 (C.A.). In *Photo Production*, Lord Salmon's words could be construed to support vicarious liability only when he says, *supra*, note 5, 852 (H.L.): "There can be no doubt that but for the clause in the contract which I have recited, Securicor would have been liable for the damage which was caused by their servant, Musgrove, whilst indubitably acting in the course of his employment [ See *Morris* v. *C.W. Martin & Sons Ltd* [1966] 1 Q.B. 716 (C.A.)]."

[29] *Supra*, note 5, 846 (H.L.).

term would be repugnant to the express obligation contained in clause (1) which would, if analyzed according to Professor Coote's approach,[30] be viewed not solely as an exclusion clause but also as a primary obligation, *i.e.*, to exercise due diligence. If one accepts that Securicor was obliged by the express words of the contract to exercise due diligence in its capacity as employee and decides that it did indeed do so, then there was never any breach of contract in the first place, as McKenna J. held. If there was no breach, then, of course, there was no liability and no need to invoke the exclusion clause as a defensive shield. Securicor was not liable for the independent acts of Musgrove performed outside the scope of his duty. No question of vicarious liability in tort would arise because condition (1) established a positive contractual standard of care, thereby precluding the imputation of a legal standard of care required by tort.[31]

This point was taken only by Lord Diplock who sought to limit the concept of vicarious liability to tort when a contractual relationship was involved — apparently "in the interests of clarity"[32] only, which is a questionable justification. He noted that apart from the exclusion clause the primary obligation of Securicor was an absolute duty to exercise reasonable skill and care for the safety of the factory, but that the exclusion clause modified this to a duty of due diligence in selecting employees who would exercise reasonable skill and care in guarding the factory. Lord Diplock did not draw the conclusion that there was no breach by Securicor in the first place. Indeed, earlier in his judgment he had asserted contradictorily that there was a breach, perhaps not fully comprehending the significance of his analysis of the exclusion clause as modifying the scope of Securicor's duty rather than merely establishing its measure of liability.

If the majority view is accepted as the correct approach, then concurrent liability in contract and tort can arise on the basis of an implied term or legal duty at variance with an express term of the contract. This seems problematic according to the Coote-Diplock approach. Furthermore, it apparently contradicts the rule of construction which the House of Lords reinstated in *Photo Production* insofar as it reintroduced judicial discretion to deal with a contract between parties of equal bargaining power as the court sees fit. A court may ignore an express exclusion clause in determining the scope of a contractual duty and imply a duty which seems suitable to it but which may be repugnant to the express terms agreed to by the parties. The question of whether or not a concurrent liability in contract and tort can arise where exclusion clauses are contained in a contract is, then, the third unresolved problem bequeathed by *Photo Production*.[33]

[30] B. Coote, *Exception Clauses* (1964).

[31] Palmer & Yates, *supra*, note 7, 118-23.

[32] *Supra*, note 5, 849 (H.L.).

[33] For an excellent discussion of concurrent liability generally, see Morgan, *The Negligent Contract-Breaker* (1980) 58 Can. Bar Rev. 299.

Fourth, the primary issue of the role of an exclusion clause generally is also raised in *Photo Production* in the light of Lord Diplock's analysis just outlined. While only one Law Lord apparently espoused the view advocated by Professor Coote in 1964,[34] the question of whether this constitutes an important breakthrough arises. English academic commentators, such as Yates and Palmer,[35] have adopted this view as has Kerr J.[36] In Australia, where the doctrine of fundamental breach never gained acceptance, the idea that exclusion clauses could modify primary obligations has also found judicial approval.[37]

The conventional view that exclusion clauses are not contractual terms in the sense that they impose obligations meant that judges interpreted their role in the contract as defensive only, to provide a shield behind which the defendant could hide and escape the responsibilities which would normally flow from his breach of contract. Judicial technique in dealing with exclusion clauses was summed up by Denning L.J. (as he then was) in *Karsales* thus: "The thing to do is to look at the contract apart from the exempting clauses to see what are the terms, express or implied, which impose an obligation on the party."[38] Judicial adoption of a procedural rather than a substantive approach to exclusion clauses was attacked by Professor Coote on the ground that, taken to its logical conclusion, the parties were being permitted to create valid contractual rights and duties and at the same time also permitted to make their contractual undertakings unenforceable. The creation of unenforceable rights has often been said to be contrary to the spirit of the common law,[39] and as Devlin J. has said, is not to create a contract at all.[40] Where they are appropriate then, exclusion clauses may

[34] *Supra*, note 30. It is, perhaps, not insignificant that Coote divides contractual obligations into primary and secondary rights in the first chapter of his book.

[35] D. Yates, *Exclusion Clauses in Contracts* (1978); Palmer & Yates, *supra*, note 7.

[36] *Trade and Transport Inc.* v. *Iino Kaiun Kaisha Ltd (The Angelia)* [1973] 1 W.L.R. 210, 230 (Q.B.); Lord Wilberforce's decision in *Port Jackson Stevedoring Pty Ltd* v. *Salmond & Spraggon (Australia) Pty Ltd (The New York Star)* [1980] 3 All E.R. 257, 259 (P.C.) suggests some ambiguity as to whether Lord Diplock's analysis has found support from the Privy Council.

[37] *The Council of the City of Sydney* v. *West* (1966) 114 C.L.R. 481, 495 (H.C. Aust.) *per* Kitto J.; *State Government Insurance Office (Queensland)* v. *Brisbane Stevedoring Pty Ltd* (1969) 123 C.L.R. 228, 243 (H.C. Aust.) *per* Barwick C.J.

[38] *Supra*, note 2, 940; see also *Istros* v. *Dahlstroem* [1931] 1 K.B. 247, 252-3 *per* Wright J. which was cited with approval in *G.H. Renton & Co.* v. *Palmyra Trading Corp.* [1956] 1 Q.B. 462, 507 (C.A.) *per* Hodson L.J.

[39] F. Bohnen, *Studies in the Law of Torts* (1926), 445, cited by Coote, *supra*, note 30, 7; see also p. 5, fn. 23 of Coote's text, for a list of English cases on the issue.

[40] *Firestone Tyre Co.* v. *Vokins & Co.* [1951] 1 Lloyd's Rep. 32, 38 (K.B.): "The position then would be that the lightermen have said: 'We will deliver your goods; we promise to deliver your goods at such and such a place, and in the condition in which we receive them; but we are not liable if they are lost or damaged from any cause whatsoever.' That is not in law a contract at all. It is illusory to say: 'We promise to do a thing, but we are not liable if we do not do it.' If the matter rested there, there would be nothing in the contract."

operate to place substantive limitations or to define the primary obligations found in other clauses in the contract and would prevent the right to use the exclusion clause as a defence from accruing in the first place. Professor Coote provides the following example:

> Suppose, for example, that I sell a horse which I say is sound for jumping, but provide in a written agreement that I accept no responsibility whatever if the horse should prove unsound. What I am doing is to ensure that the purchaser has no primary contractual right to call for a horse which is sound for jumping. I am not contracting that the horse is sound and giving myself a shield in case of breaeh. I am simply refusing to contract on the point at all. This is not to say that I am under no duty, but my duty is a moral one binding in honour only.[41]

The contract in *Photo Production* did not go so far as to create repugnancy between the primary obligation of providing security services and the exclusion clause which established the degree of skill and care as one of due diligence in hiring employees who were to exercise reasonable skill and care in their duties. The effect of the exclusion clause was to modify what would otherwise have been the implied term that Securicor was to exercise reasonable skill and care. More accurately, according to Lord Diplock's analysis, the exclusion clause established by an express term the standard of care contracted for by the parties, thereby precluding the implication of a standard. No breach of the express standard occurred: Securicor had investigated Musgrove's background sufficiently. Adoption of the Coote thesis on the facts of *Photo Production* would mean that the express terms of the contract were enforced, and more significantly, that the doctrine of freedom of contract was upheld. It is no wonder that Lord Diplock was the only judge to overrule expressly a substantive test of reasonableness; his judgment is all of a piece. But the same conclusion holds true for illusory contracts where the clauses are totally repugnant. If there is no contract to enforce in the first place, the right to rely on the exclusion clause as a defence does not accrue. Therefore, there is no need for a doctrine of fundamental breach nor a substantive test of reasonableness to cope with situations thought to be inherently unfair. Restitution is sufficient. Ironically, then, the only situations in which a substantive doctrine of reasonableness or unconscionability might serve the ends of justice would be where the express terms interpreted *à la* Coote-Diplock create contractual obligations which may indeed be repugnant to commonly held views as to what is permissible public conduct in the making of contracts. Thus, if there is a role for unconscionability it will operate, despite the implied intention of the Coote thesis to eliminate it, as a branch of the doctrine of illegality; it is against public policy or morality to permit parties to contract on such terms, whether they are of equal bargaining power or not. There is no need, then, to enact sophisticated unconscionability tests. Rather, a simple statement of the existence of the legal concept

[41] Coote, *supra*, note 30, 7.

is enough, and the courts will once again have to apply it in a pragmatic case by case fashion. Sometimes the express contractual obligations including the exclusion clause will be upheld, and sometimes they will not.[42]

The fourth unresolved question remaining after *Photo Production* is whether or not Lord Diplock's adoption of the Coote thesis will attract judicial and academic converts. Although, if my analysis is correct, it does not resolve the fundamental policy issues relating to the conflict of the doctrine of freedom of contract with judicial intervention on behalf of plaintiffs perceived as being unfairly treated, it does at least have the merit of encouraging the ascertainment of the entire corpus of contractual rights and duties, rather than ignoring some clauses in favour of others. One step in the right direction is better than none at all, although one step need not result in reaching the final destination. It does, at any rate, afford an improved perspective on the real issues.

## II. The Reception of *Photo Production* in Canada

Within the past year, several Canadian courts have considered or purportedly adopted the ruling of the House of Lords in *Photo Production.* However, the reasoning of these courts, in particular, the Supreme Court of Canada, leaves much to be desired in that it would appear that some misunderstanding has already crept into Canadian judicial comprehension — even of the points of law which were resolved in *Photo Production.* Judicial capacity to imagine the existence of unresolved issues might be doubted. Several recent Canadian decisions should be examined, beginning with that of the Supreme Court of Canada in *Beaufort Realties (1964) Inc. and Belcourt Construction (Ottawa) Ltd* v. *Chomedey Aluminium Co.*[43]

*Beaufort* was a mechanics' lien action which concerned a waiver of lien clause in a contract to supply and install aluminium windows during the construction of the Lord Mountbatten Apartments in Ottawa. The main construction contract was between Beaufort Realties and Belcourt Construction which subcontracted the glazing project to Chomedey. Displeased with the quality of Chomedey's workmanship, Belcourt withheld the monthly progress payments called for by the subcontract. Numerous requests for payment went unheeded and Chomedey was forced to withdraw from the project at the end of November 1974. Another glazier, Majestic,

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[42] The inadequacies of the *Unfair Contract Terms Act, 1977,* have, in this regard, been commented upon by Coote, *Note* (1978) 41 M.L.R. 312 and by Palmer & Yates, *supra*, note 7, 123.

[43] [1980] 2 S.C.R. 718, *aff'g sub nom. Chomedey Aluminium Co.* v. *Belcourt Construction (Ottawa) Ltd* (1979) 24 O.R. (2d) 1 (C.A.). For comments on these decisions see Ogilvie, *Photo Production Ltd* v. *Securicor Transport Ltd.: An Inconclusive Unscientific (Canadian) Postscript* (1981) 5 Can. Bus. L.J. 368; Ziegel, *supra*, note 7, 438-40; Waddams, *Note* (1981) 15 U.B.C. L. Rev. 189.

completed the project in April 1975. Chomedey filed a mechanics' lien against Belcourt and sued to recover the sum of $51,553.32. Belcourt argued that Chomedey had waived its lien rights under article (6) which provided in part: "The subcontractor hereby waives, releases and renounces all privileges of rights or privilege, and all lien or rights of lien now existing or that may hereinafter exist for work done or materials furnished under this Contract".[44]

Fogarty Co. Ct J. found that Belcourt's refusal to make the progress payments amounted to a fundamental breach of contract which precluded Belcourt's right to rely on the waiver, purportedly by application of *Suisse Atlantique*. Consequently, he awarded Chomedey a lien judgment. The majority of the Divisional Court of Ontario, consisting of O'Leary and Linden JJ., agreed that there had indeed been a fundamental breach of contract, but that Chomedey had effectively waived its lien rights by article (6). Dupont J. was not convinced that failure to pay amounted to a fundamental breach although he concurred with his brother judges that a personal judgment should be awarded against Belcourt.[45] With the decisions of the Ontario Court of Appeal delivered by Wilson J.A. (as she then was), and of the Supreme Court of Canada delivered by Ritchie J., an otherwise unremarkable case becomes more interesting.

The Court of Appeal proceeded on the assumption that the trial judge's finding of fact that the fundamental breach was indeed committed by Belcourt was correct. However, that assumption might easily be questioned. It seems more likely that if there was a fundamental breach which provoked Belcourt's refusal to pay it was constituted by Chomedey's inadequate

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[44] The clause continues, *ibid.*, 720-1: "upon the premises and upon the land on which the same is situated, and upon any money or monies due to or to become due from any person or persons to Contractor, and agrees to furnish a good and sufficient waiver of the privilege and lien on said building, lands and monies from every person or corporation furnishing labour or material under the Subcontractor.

In addition to the requirements as set forth hereinabove, the Subcontractor agrees to waive to the extent of one hundred percent (100%) of the final contract amount, any privilege, lien and right of preference which he may have or which he hereafter may have upon the aforesaid building and/or the land upon which it is constructed as a result of or in connection with work to be done or materials to be supplied by him, and morcover, that he holds and will hold the Owner and Contractor harmless and indemnified from and against a registration against the said property of any privilege, lien or right of preference by or on behalf of any person, firm or corporation performing work or supplying materials under authority derived from him, and, if and when so required by the Contractor, he will obtain and deliver to the said Contractor, releases from any such privileges, liens or right of preference signed by such persons, firms or corporations.

Subcontractor also agrees to waive all liens and to execute any waiver of liens that may be required by the mortgage company or mortgagee."

[45] *Mechanics' Lien Act*, R.S.O. 1970, c. 267, s. 40; see also D. Micklem & D. Bristow, *Mechanics' Licns in Canada*, 3d ed. (1972), 9-10 and 378-81.

workmanship. If that was indeed the case, then the reason for including article (6) in the contract is evident. While it is so all-embracing as to preclude virtually any claim a subcontractor might make, its inclusion was probably primarily designed to limit Chomedey's remuneration in the event that it tendered a defective contractual performance. To infer otherwise, as one would if the logical conclusion of the higher court's approach to article (6) were accepted, would mean that Chomedey had waived all lien rights even if it had properly installed the windows, which seems absurd given the circumstances and the contract.[46]

On the assumption that Belcourt's failure to pay was a fundamental breach, however, the substantive issue was whether or not Belcourt could use the clause as a shield against Chomedey's claim. An ordinary reading of the clause would suggest that it could, and that it would indeed be able to do so if Wilson J.A. had honoured her formal affirmation of *Suisse Atlantique* as the proper approach to the question.[47] However, she added a gloss to the constructional approach when she said:

> Many exclusionary clauses (and I am now referring to clauses which are clear and unambiguous and require no construction) which in isolation seem unfair and unreasonable are not so when viewed in their contractual setting and may, indeed, constitute part of the *quid pro quo* for benefits received through hard negotiation. It seems to me, therefore, that what we are to ask ourselves is not whether the exclusionary clause is fair and reasonable in its contractual setting (this is, indeed, to be assumed in a contract between sophisticated parties) but whether it is fair and reasonable that it survive the disintegration of its contractual setting. If it is, then presumably that is what the parties must be taken to have intended. But if it is not, then such an intention is not to be attributed to the parties. The question for the Court then becomes: is it fair and reasonable in the context of this fundamental breach that the waiver of lien continue to bind the appellant?[48]

Two observations are appropriate here. First, the unprecedented and unjustified distinction between a "contract situation" which subsists and one which disintegrates ignores the point that an exclusion clause as a secondary obligation does not disintegrate; until the issues between the parties to the contract have been resolved it is incorrect to speak of the disintegration of the contractual setting at all. Second, to suggest that the Court has the discretion to decide whether it is fair and reasonable that an exclusion clause be applied in the disintegrated setting is to sanction judicial intervention in a contractual relationship regardless of the parties' expressed intentions. How this differs from the policy function of fundamental breach as a rule of law or a

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[46] There is some indication that Wilson J.A. (as she then was) perceived this point when she says in *Chomedey Aluminium*, *supra*, note 43, 10: "I think the appellant waived the security of its lien ... on the basis that progress payments would be being made on a regular basis by Belcourt .... The appellant had no reason to anticipate that as the work progressed it would ever be out of pocket any substantial amount."

[47] *Chomedey Aluminium*, *ibid.*, 5-8.

[48] *Ibid.*, 8.

substantive test of reasonableness as applied by the Master of the Rolls is unclear.[49] At any rate, she concludes predictably that "it is not fair and reasonable to attribute to the parties the intention that, if Belcourt were deliberately to refuse to perform its basic obligations under the contract (as the learned trial judge found), the appellant would nevertheless continue to be bound by its waiver."[50]

Wilson J.A.'s reason for this decision is quite clear. It would be unfair to permit Belcourt to commit a fundamental breach of contract with impunity and then to shelter behind the waiver clause which, if construed literally, did indeed permit Belcourt to escape liability. The policy aim of the Court of Appeal is clearly that of forbidding an outrageous transgression which, in the doctrine of illegality, is controlled by the application of the maxim, *ex turpi causa non oritur actio.* It is lamentable that the legal circumvention of a substantive test of reasonableness is prised from its conventional context to perform such a simple function, because it creates confusion as to the nature of the Canadian response to *Photo Production.* More importantly, it disguises the significant fact that the Court of Appeal is condemning a transaction which offended its basic sense of morality without expressly saying so. Judicial avoidance of explicit acknowledgement of the issues involved in redressing unfair bargains can only delay the Utopian day when only those contracts which are fair will be enforced.

That Wilson J.A. was not unaware that the real decisions must be policy decisions in such cases is evident not only in the general tenor of her judgment but also specifically in her discussion of ss. 4 and 5 of the *Mechanics' Lien Act* which, Belcourt argued, provided that a party can contract out of a statutory lien by signing an express agreement to that effect.[51] In the companion case, *Shill-Brand Inc.* v. *Belcourt Construction*

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[49] Wilson J.A. later expressed her preference for the dissenting opinion of O'Leary J. in the *Beaufort* companion case, *Shill-Brand Inc.* v. *Belcourt Construction (Ottawa) Ltd* (1978) 19 O.R. (2d) 606 (H.C., Div. Ct) in which a rule of law approach was taken to an identical waiver clause: see, *ibid.*, 10.

[50] *Chomedey Aluminium, supra,* note 43, 10.

[51] 4(1) Every agreement, oral or written, express or implied, on the part of any workman that this Act does not apply to him or that the remedies provided by it are not available for his benefit is void.

(2) Subsection 1 does not apply.

(a) to a manager, officer or foreman; or

(b) to any person whose wages are more than $50 a day.

(3) No agreement deprives any person otherwise entitled to a lien under this Act, who is not a party to the agreement, of the benefit of the lien, but it attaches, notwithstanding such agreement.

5(1) Unless he signs an express agreement to the contrary and in that case subject to section 4, any person who does any work upon or in respect of, or places or furnishes any materials to be used in, the making, constructing, erecting, fitting, altering, improving or repairing of any land, building, structure of works or the appurtenances to any of them

*(Ottawa) Ltd*, Linden J. in the Divisional Court, dealing with an identical article (6) in the light of s. 5(1) held that once the parties had effectively contracted out of the *Act*, then the lien was forever extinguished. He stated that there was no inequality of bargaining power here and no need to invoke the doctrine of fundamental breach. Indeed, he said that if waivers were upset by a fundamental breach, "[t]hey could never be relied upon".[52] While one might have thought that the legislature had expressed its intention to permit contracting out of liens fairly clearly and that Linden J. had correctly interpreted that intention, Wilson J.A. asserted that still clearer words were required. She said, "[i]t seems to me that the Legislature could not have intended to introduce such disparity into the position of the contracting parties, *i.e.*, that one party could be assured that, irrespective of the non-performance by him of any of his contractual obligations, the other party's waiver of lien would continue to bind him."[53] Although mindful of the desirability that waivers be reliable, Wilson J.A. surmised that had that been the specific public interest in the mind of the legislature, it would have prescribed a statutory waiver form rather than consigning the issue to the contractual context and the vagaries of the common law of contract. To expect that the legislators should be required to go to such lengths seems unrealistic, if not ridiculous; indeed, as Linden J. suggested, it seems that they could not have permitted a voluntary contracting out of a lien more clearly. Linden J.'s approach acknowledged legislative intention to permit freedom of contract whereas Wilson J.A.'s did not. Instead, she acknowledged the existence of a judicial discretion to assess legislative intention in the light of good public policy as to judicial intervention in the free bargaining contractual process. The conclusion that Wilson J.A. is a tacit advocate of judicial intervention is inescapable.

More problematical and regrettable still is the too brief adoption of this decision in the light of the subsequently decided *Photo Production* by the Supreme Court of Canada. Ritchie J., for the Court, expressly adopted the Court of Appeal's interpretation of s. 5(1)[54] and further, simply concurred with "Madam Justice Wilson [who] adopted the same considerations as

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for any owner, contractor or subcontractor by virtue thereof has a lien for the price of the work or material upon the estate or interest of the owner in the land, building, structure or works and appurtenances and the land occupied thereby or enjoyed therewith or upon or in respect of which the work is done, or upon which the materials are placed or furnished to be used, limited, however, in amount to the sum justly due to the person entitled to the lien and to the sum justly owing, except as herein provided, by the owner, and the placing or furnishing of the materials to be used upon the land or such other place in the immediate vicinity of the land designated by the owner or his agent is good and sufficient delivery for the purpose of this Act, but delivery on the designated land does not make such land subject to a lien.

[52] *Supra*, note 49, 609.

[53] *Chomedey Aluminium*, *supra*, note 43, 10.

[54] *Beaufort Realties*, *ibid.*, 725-6.

those which governed the House of Lords in the *Photo* case in holding that the question of whether such a clause was applicable where there was a fundamental breach was to be determined according to the true construction of the contract."[55] How the decision of the Court of Appeal in *Beaufort* and the decision of the House of Lords in *Photo Production* can be so easily reconciled is baffling!

Assessment of the decisions of Wilson J.A. and Ritchie J. in the light of the four resolved and four unresolved issues after *Photo Production*, insofar as they relate to *Beaufort*, reveals some confusion. With respect to the resolved issues considered *seriatim*, the following observations may be made. First, the concept of fundamental breach operating as a rule of law undermines the Canadian judgments despite lip service to the principle that the exclusion clause should be subjected to strict construction only. The Canadian approach continues to be one of deciding first whether the events constitute a fundamental breach of contract, whatever that might be, and then of deciding whether the exclusion clause is relevant. In contrast, *Photo Production* appears to suggest that it is not necessary to decide at all whether there has been a fundamental breach of contract. Rather, it is enough to construe the exclusion clause to decide whether or not it contemplated and provided for the events which have occurred. There is no need to denominate a fundamental breach at all, unless, of course, the exclusion clause clearly operates where there has been a fundamental breach of contract, so that one must determine whether the events constitute such a breach. *Beaufort*, then, suggests a Canadian failure to understand that once the rule of construction approach has been adopted the concept of fundamental breach is eliminated along with the rule of law concept. The rule of construction operates like Occam's razor.[56]

Second, while Wilson J.A. correctly stated that one effect of a fundamental breach is to discharge the parties from further performance of the primary obligations, she did not appreciate that the so-called secondary obligations subsist and are to be applied, according to *Photo Production*, to determine the final allocation of loss and damages between the parties. Unlike even Lord Denning in *Photo Production*,[57] she does not anywhere in her judgment specifically construe the contract nor come close to acknowledging what would appear to most reasonable people to be the clear intention of article (6). Rather, after formal adoption of *Suisse Atlantique*, she then proceeds to the reasonableness issue. The fundamental perception that the exclusion clause is part and parcel of the bargain, is lacking.

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[55] *Ibid.*, 725.

[56] *Nunquam ponenda est pluralitas sine necessitate.* 1 Sent. d. 27, q. 2k (1497).

[57] *Supra*, note 5, 864 (C.A.).

Third, the restricted definition of "fundamental breach" as a breach of a fundamental term or as a total failure of consideration is not acknowledged at all by the Supreme Court — perhaps predictably, in the light of the first point. Thus in Canada, at any rate, one must assume that the phrases "fundamental breach", "breach of a fundamental term", "breach of a condition" and so on, are still interchangeable and but inadequately defined. The fourth point in respect of the deviation cases is irrelevant here.

With respect to the unresolved issues after *Photo Production* considered *seriatim*, the following points may be made. First, the suspicion that a substantive test of reasonableness has survived the House of Lords' ruling in *Photo Production* is confirmed, at least in Canada. It would, however, on the facts of *Beaufort*, appear to be applicable to a wider range of contractual situations than in England. Indeed, since there was apparently no inequality of bargaining power in *Beaufort*, substantive reasonableness may be judicially invoked in virtually all commercial and consumer transactions other than those falling within the express orbit of consumer protection and unfair trade practices legislation. It may well be that between the parties in *Beaufort* there was inequality of bargaining power, as, of course, there can be between commercial men dealing at arm's length, or that the bargain may indeed have been unfair in some ways perceived by the courts in *Beaufort*, although not expressed in their judgments as it should have been. As Professor Waddams has already noted, the tacit assumptions should have been expressed by the Court of Appeal and the Supreme Court, otherwise misunderstanding will arise.[58] However, on the basis of the few facts recorded in the written decisions at all curial levels in *Beaufort*, there would appear to be no misunderstanding in asserting that substantive reasonableness has been invoked to control a bargain between commercial men of equal bargaining power. Therefore, even if it were right to consider that Ritchie J.'s express adoption of *Photo Production* resulted in the removal of fundamental breach as a rule of law from the Canadian legal scene, it would also be correct to surmise that it has been replaced by a substantive test of reasonableness which bestows on the courts at least as much judicial discretion to intervene in contractual relationships as fundamental breach ever did. Does *Beaufort* really differ from *Harbutt's*? This comment should not be construed to signify disapproval of reasonableness or of the development of an unconscionability doctrine; rather, its aim is to clarify the logical confusion which characterizes the reception of *Photo Production* in Canada as the first necessary step in the process of defining an acceptable judicial role in the control of unfair contracts.

Second, the absence of guidance from the Law Lords on the construction process is reflected in the distortion mirror of *Beaufort*. The

[58] *Note*, *supra*, note 43, 192-5.

clear meaning of the waiver clause was overlooked by Wilson J.A. and Ritchie J., which raises the question whether substantive reasonableness should be interpreted as operating to neutralize the simple construction rule. If reasonableness operated as a neutralizing factor, it is difficult to see how it differs from Lord Denning's presumed intention rule which effectively negates the principle of construction *à la Suisse.*

The third unresolved issue relating to whether there was a concurrent obligation in contract and tort is not relevant to *Beaufort.* However, the fourth issue as to the status of the Coote thesis is. Wilson J.A. did not have the advantage of having Lord Diplock's decision in *Photo Production* before her when rendering the judgment of the Court of Appeal in *Beaufort.* Nonetheless, she shows familiarity with the thesis that exclusion clauses can contain contractual obligations or modify rights and duties set down in the primary obligations when she states that "[i]t is not, ... one of those exclusionary clauses which must be resorted to in order to determine whether there has been a breach at all or the extent to which there has been a breach. It does not modify the obligation or restrict the liability of the party in default: it deprives the party not in default of an additional remedy."[59] In view of the fact that Wilson J.A. does not elaborate upon this approach, it would probably be wrong, or at least premature, to state that Lord Diplock's breakthrough has found judicial support in the Ontario Court of Appeal or in the Supreme Court of Canada. *Beaufort* would not have been an appropriate fact situation, in any case. However, it is comforting to note that at least one Canadian judge perceives the significance of the Coote thesis.

Two other construction contracts in Ontario have raised *Photo Production* issues although they have not inspired detailed jurisprudential analysis. *Woollatt Fuel and Lumber (London) Ltd* v. *Matthews Group Ltd*[60] concerned a contract for the construction of a two-building apartment complex in London, Ontario for the defendant Matthews, a local development company. Woollatt had supplied materials to Debuka Enterprises which was doing the work and was not involved in the litigation once its lien on the materials was discharged by Matthews. The substantive issues arose between Debuka and Matthews.[61] Debuka was a small, successful one-man company which specialized in the installation of lathing and acoustic tile ceilings. Prior to agreeing to supply and install lathing and acoustic tile ceilings in the two apartments, Mr Slade, the owner of Debuka, was shown a construction progress schedule which stipulated, *inter alia,* the timing of the Debuka subproject. The schedule was posted in the site office. The contract was concluded in early March 1973 with a contract price of $152,000, and the work was to be completed in one building by 13 August

[59] *Chomedy Aluminium, supra,* note 43, 9.
[60] (1979) 25 O.R. (2d) 730 (H.C., Div. Ct), *rev'g* in part (1978) 18 O.R. (2d) 454 (Co. Ct).
[61] (1978) 18 O.R. (2d) 454, 455 *et seq.*

1973 and in the other building by 31 December 1973. Delays in completion of the work to be done before Debuka began, as early as 5 June 1973, prompted Slade to ask for an increase in the contract price to cover extra work resulting from design changes and Matthews agreed to increase the price to $155,349. Debuka started to work on 7 July 1973, behind schedule because of incompetence on the part of a Matthews subsidiary company and of the project manager who was later fired for his mismanagement of the project. The delay of several months in starting meant that Debuka incurred uncontemplated losses of about $15,000 due to shortages of materials and failure by Matthews to provide a crew, thereby increasing Debuka's labour costs. However, Matthews proved unsympathetic to a request for a further increase in the contract price and threatened to hire someone else to do the job. Finally, on 4 January 1974, Slade withdrew his employees from the site and sued for damages incurred due to Matthews' fundamental breach of contract. Several clauses in the contract were relevant:

> 3. The Sub-Contractor ... shall commence, perform and complete the several portions of the sub-contract work as directed by the Contractor in a prompt, diligent, good and workmanlike manner ... in accordance with the project schedule ... .
>
> 4. [I]n the event of delay in performance of the sub-contract work caused by the act, neglect or default of the Contractor or by any damage caused by fire or other casualty at the project site in no way caused by or related to an act or default on the part of the Sub-Contractor or any other person, firm or corporation working on the sub-contract work, or by any other cause beyond the Sub-Contractor's control, then the time for the completion of the sub-contract work shall be extended for a period equivalent to the time lost by reason of all causes aforesaid, which extended period shall be determined by the Contractor, but no such allowance shall be made unless written claim is presented to the Contractor within 3 days from the beginning of such delay. Such extension shall discharge the Contractor of any claims which the Sub-Contractor may have on account of any of the aforesaid causes of delay.[62]

At the time of Debuka's withdrawal from the contract it was two and one-half months behind the adjusted schedule and five months behind the original schedule. Matthews sought to shield behind clause (4), which Killeen Co. Ct J. described as "a specific and unambiguous clause";[63] it purported "to grant *only* the remedy of an extension time to the sub-contractor and its last words are absolute in character"[64] in discharging the contractor from any claims which the subcontractor may have. The only question for the trial judge then was whether or not Matthews' delays constituted a fundamental breach of contract precluding reliance on clause (4). After adopting the rule of construction approach and citing the appropriate cases,[65] the learned

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[62] *Ibid.*, 461.

[63] *Ibid.*, 462.

[64] *Ibid.*, 463.

[65] *Suisse Atlantique*, *supra*, note 3; *B.G. Linton Construction Ltd* v. *C.N.R. Co.*, *supra*, note 6. See also *Perini Pacific Ltd* v. *Greater Vancouver Sewerage and Drainage District* [1967] S.C.R. 189 which involved a similar clause.

judge concluded, albeit "reluctantly",[66] that clause (4) exonerated Matthews for the losses suffered as a result of its own delays.

On appeal, Matthews conceded that it had committed a fundamental breach of contract in light of the then recent Court of Appeal decision in *Beaufort*: this entitled Debuka to elect to terminate the contract, and Matthews' claim for damages resulting from extra completion costs died. The sole issue then was Debuka's claim for damages for losses sustained as a result of Matthews' delay and whether clause (4) exonerated Matthews. Robins J., for the Divisional Court, (O'Leary and Saunders JJ. concurring) decided that the trial judge had correctly construed the contract.[67] However, the question was how the clause governed the situation. He decided that clause (4) contemplated the probability — "hardly an unlikely one" — that delay would be caused by the contractor and provided the remedy of an extension of time.[68] Debuka did not exercise the option to request an extension of time and therefore had to suffer the penalty prescribed by clause (4). That was the intention of the contract.

A clearer case of strict construction could hardly be hoped for. Yet on closer examination of the reported facts, the absence of judicial techniques in the face of application of precedent could be said to have produced an offensive result. The trial judge, as noted above, was reluctant to render the decision which he believed himself obliged to give, and some factual evidence substantiating his reluctance is found in the reports in relation to Matthews' conduct throughout the proceedings. The trial judge described Matthews' evidence of the losses incurred in completion of the project after its abandonment by Debuka as "difficult", "high", containing "curiosities", containing a "substantial mathematical error" and an "excess error"; they were also described as "irreconcilable" and "unsatisfactory".[69] Matthews' reaction to Debuka's request for an increased contract price to reflect losses suffered as a result of Matthews' delays was described as "totally obdurate".[70] Matthews proved reluctant to admit to the existence of the project schedule when it suited them,[71] then relied upon it in respect to the three day extension option in clause (4). It is difficult to avoid the conclusion that from start to finish Matthews was embarked on a well-defined pattern of deceptive behaviour and that the trial judge was restrained by the applieable legal principles from taking this into account in his decision.

The role of the project schedule and of clause (4) in the judge's analysis raises questions as to whether the doctrine of rule of construction was

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[66] *Supra*, note 61, 465.
[67] *Supra*, note 60, 732.
[68] *Ibid.*, 733.
[69] *Supra*, note 61, 465-7 *per* Killeen Co. Ct J.
[70] *Ibid.*, 463.
[71] *Ibid.*, 455.

appropriate.[72] If Matthews' initial reluctance to admit to the importance of the schedule reflected its importance within the contractual nexus, it may be asked why Debuka should have taken seriously the three day period within which to ask for an extension. Debuka admitted knowledge of the schedule prior to signing the contract, yet it was not given a copy of the entire schedule, or at least of the part pertaining to its work. Nor was there evidence that Matthews gave it notice of the importance of keeping to the schedule; indeed, Matthews' own conduct would reinforce the conclusion that the schedule only mattered to Matthews when it lost money, but not when the subcontractors lost money as a result of Matthews' incompetence and dilatoriness. If the circumstances suggest the relative unimportance of the project schedule, then the appropriatencss of judicial enforcement of the three day provision in clause (4) is also questionable. In relation to the duration of the contract with Debuka, three days within which to request an extension is an extremely short period of time. It might be difficult to decide when a delay has begun given the complexities of a large and complex construction project, and it will be equally difficult to determine whether the delay will be of sufficient duration and manner to affect the project schedule seriously. Therefore, it is difficult to justify the enforcement of such a clause in the first place on grounds of its manifest absurdity. It is even more difficult to justify in the light of the circumstances of Matthews' performance of its part of the bargain.

It is also interesting to speculate as to what might have happened had Debuka not been forced by economic factors to withdraw from the contract, but rather elected to complete the contract despite Matthews' fundamental breach. It seems more than likely that had it sued for increased costs due to inflation, labour problems and materials shortages resulting from Matthews' delays, the growing body of opinion that damages should be awarded in such circumstances would have produced a result in Debuka's favour.[73] The development of the notion of economic duress might have served this end; indeed, the invocation of economic duress may have been the better argument for Debuka.[74] At any rate, it is submitted that it would be absurd to permit Matthews' blameworthy conduct to count when there was no exclusion clause but not to count where there was one. The apartment blocks had to be completed, no matter by whom, and one can be certain that Matthews would have computed its increased costs into the rentals so that it

[72] *Ibid.*, 462-5.

[73] Swan, *Consideration and the Reason for Enforcing Contracts* (1976) 15 U.W.O.L. Rev. 83; Reiter, *Courts, Consideration and Common Sense* (1977) 27 U.T.L.J. 493.

[74] See the recent cases in England and Ontario discussed in Ogilvie, *Economic Duress, Inequality of Bargaining Power and Threatened Breach of Contract* (1980) 26 McGill L.J. 289 and Ogilvie, *Contracts — Economic Duress — Inequality of Bargaining Power — Quo Vadis?* (1981) 59 Can. Bar Rev. 179; Dodson, *The Atlantic Baron: Consideration, Economic Duress and Coerced Bargains* (1980) 38 U.T. Fac. L. Rev. 223; Evans, *Economic Duress* [1981] J.B.L. 188.

was unlikely to be out of pocket whatever decision the Court reached in respect to Debuka's claim.

These criticisms are reducible to one conclusion: if ever there was a case where a substantive test of reasonableness or a doctrine of unconscionability was required to do justice, this was it. Moreover, it is interesting to note that the Divisional Court dimly perceived the survival of such a test. In relation to Matthews' counterclaim for damages resulting from Debuka's withdrawal from the project, Robins J. noted that had that issue been pressed (which it was not because Matthews conceded that they were in fundamental breach) he would have had to decide whether the first paragraph of clause (4) was fair and reasonable in light of Wilson J.A.'s decision in *Beaufort*. That paragraph provided that where there was loss to the contractor resulting from the subcontractor's failure to perform his contractual promises, the subcontractor was bound to indemnify the contractor for his losses. Why would a substantive reasonableness test have applied in respect to the first paragraph of clause (4) but not to the second paragraph? It is, then, difficult to avoid the conclusion that although the Divisional Court in *Woollatt* purported to apply the *Beaufort* decision in the Court of Appeal, in fact it did not do so. Indeed, *Woollatt* is unlike the customary Canadian approach to the entire issue of fundamental breach in that the Court really did apply the rule of construction to the clause in question, rather than pay lip service to it, and then decide what was the fairest result in the case!

It would be unjustifiable to judge the decision in *Woollatt* in the light of *Photo Production* since the House of Lords' decision had not been reported at the time of the *Woollatt* appeal in the Divisional Court. Nevertheless, several conclusions may be drawn. First, there is confusion in the mind of the Divisional Court as to the relationship of fundamental breach and the rule of construction in that it would appear that had Matthews not conceded that it had committed a fundamental breach, the Court apparently would have proceeded by first determining whether there was such a breach, and then as a second step deciding whether on construction clause (4) precluded liability for such a breach. As suggested earlier, a separate finding of fundamental breach is not required if *Photo Production* is followed; rather, a court need merely decide whether or not the events which have taken place preclude reliance on the exclusion clause. Second, the Court adopted too narrow an interpretation of its role in the light of *Beaufort* in that it was perfectly free to adopt a substantive test of reasonableness which, it is submitted, would have done justice on the facts of the case.

A similar approach was taken in the post-*Photo Production* decision, *Uni-Form Builders Ltd* v. *City of Ottawa*,[75] a decision of Osler J. in the High

[75] (1980) 29 O.R. (2d) 266 (H.C.).

Court of Ontario. The contract in that case provided that Uni-Form would construct a building in the Byward market consisting of several levels of parking space and a number of shops for the City of Ottawa. The builders were suing to recover $157,362 as costs incurred beyond the contract price due to delays in the performance of their contractual obligations occasioned by various contractual breaches by the City including, *inter alia*, failure to hand over the building site by the date called for in the contract, the issuance of hold orders on parts of the job and over sixty change orders which required Uni-Form to make tenders which had to be approved by the City which spent a protracted period over each decision. Although the original completion date was April 1975, Uni-Form employees were on the job until February 1976. To avoid a lengthy trial, the parties agreed to certain facts. The City admitted that the delays were substantial and that the change orders, in particular, contributed to the delays. Since the determinative issue would be the construction of an exclusion clause in the contract, they agreed to proceed directly to the construction of clause (3.24.11):

> Unless otherwise particularly provided in the contract, the contractor shall have no claim or right of action against the Municipality for damages, costs, expenses, loss of profits or otherwise howsoever because of or by reason of any delay in the fulfillment of the contract within the time limited therefore occasioned by any cause or event within or without the contractor's control, and whether or not such delay may have resulted from anything done or not done by the Municipality under this contract.[76]

In addition, clause (3.24.7) provided for liquidated damages for the municipality in the event that Uni-Form failed to complete on time; thus the possibility that delay could occur was clearly contemplated and provided for by the parties. After reviewing *Suisse Atlantique*, *R.G. McLean Ltd* v. *Canadian Vickers Ltd*,[77] *Belcourt* and *Photo Production*, the Court found on construction that even if the City's conduct constituted a fundamental breach of contract, it could use clause (3.24.11) to shield itself from Uni-Form's claim for damages, although in the opinion of the Court there had been no breach in the first place.[78] As an exercise in strict construction of a commercial contract between parties of equal bargaining power, the decision is simple and faultless. Even if it were necessary to do so, it seems difficult to argue that there was a fundamental breach because although the contract was completed almost a year behind schedule, the claim was relatively small in relation to the full contract price of $2.3 million plus additional agreed sums.

However, one disconcerting fact arises in that when the judge was dealing with costs in the action he decided not to award any, noting that many of the difficulties arose because the City of Ottawa had requested that the contract period be reduced from eighteen to thirteen months, or by about

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[76] *Ibid.*, 269.
[77] *Supra*, note 6.
[78] *Supra*, note 75, 272 *per* Osler J.

28 per cent of the original time allotted. Perhaps too much should not be made of that fact in the absence of more complete details because the parties agreed to go straight to the construction issue. However, the question of whether or not this too was a case for a substantive test of reasonableness may be raised.[79]

Prior to assessment of the impact of *Photo Production* generally, one other recent Canadian case which deals with the issue of concurrent liability in contract and tort must be examined. *Canadian Western Natural Gas Co.* v. *Pathfinder Surveys Ltd*[80] concerned a damage suit in respect to an error in staking out an underground gas transmissions line. The gas company contracted with the surveyor for the staking out of a pipeline to be laid along a three mile route in Calgary. An error was made in the survey but the gas company did not realize this until it was in the process of laying the pipeline. Its employees improvised and as a result the line was significantly misplaced. In an action for damages the Alberta Supreme Court, Trial Division held for the gas company and the surveyors appealed. On appeal, the main issues were the availability of an action in the tort of negligence and the gas company's duty to mitigate. The specific amount claimed was for consequential loss in that the other parts of the pipeline could not be used until the portion in question was properly placed. There was no exclusion clause involved.

The surveyor pleaded that it could only be sued in the tort of negligence in response to the gas company's claim in contract, which raised the issue of whether there could be concurrent claims in contract and tort. The majority of the Court of Appeal, consisting of Prowse and Harradence JJ.A., thought that there could indeed be concurrent claims, provided the claim in tort was founded on an "independent tort".[81] In reaching this decision, they cited not only the well-known Canadian cases on the issue but also several recent English cases, including *Photo Production.*[82] However, only the Master of the Rolls' views on the matter were considered since the Alberta appeal was decided prior to the House of Lords' decision in *Photo Production.* It should be recalled that while concurrent liability has been accepted in England when the same duty arises in contract and tort, this rule is limited in

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[79] A potential revival of strict construction in other contexts, as prompted by the Canadian adoption of *Photo Production*, is also seen in the bankruptcy case, *Skyrotors Ltd* v. *Bank of Montreal* (1980) 34 C.B.R. (N.S.) 238, 241 (Ont. S.C.) *per* Osborne J.

[80] (1980) 21 A.R. 459 (Alta C.A.).

[81] *Ibid.*, 474 *per* Prowse J.A. citing *J. Nunes Diamonds Ltd* v. *Dominion Electric Protection Co.* [1972] 2 S.C.R. 769, 777-8 *per* Pigeon J.; *Rivtow Marine Ltd* v. *Washington Iron Works* [1974] S.C.R. 1189; *Giffels Assoc.* v. *Eastern Construction Co.* [1978] 2 S.C.R. 1346. See also Morgan, *supra*, note 33.

[82] *Esso Petroleum Co.* v. *Mardon* [1976] 1 Q.B. 801 (C.A.); *Anns* v. *Merton London Borough Council* [1978] A.C. 728 (H.L.); *Batty* v. *Metropolitan Property Realizations Ltd* [1978] 1 Q.B. 554 (C.A.); *Midland Bank Trust Co.* v. *Hett, Stubb and Kemp* [1979] Ch. 384.

Canada by the view that concurrent liability arises only when the tortious action is somehow independent of the contract; that is, it merely occurs within the general setting of the transaction. In view of the fact that the Alberta Court of Appeal adopted the *Nunes Diamond*[83] limitation rather than the English precedents, and also in view of the fact that four of the Law Lords found concurrent liability, albeit on the basis of an implied term which imposed a heavier duty of care than the exclusion clause, one need only note that *Photo Production* has had no effect to date on the concurrent liability issue in Canada.

**Conclusion**

The Canadian reception of the House of Lords' decision in *Photo Production* ranges from confusion about the nature of the decision through obfuscation of the policy issues underlying it to the superficial application of one aspect of the decision in isolation from other issues. *Photo Production* itself is far from satisfactory which, admittedly, does not help. In a nutshell, the fundamental problem is judicial failure, both English and Canadian, to acknowledge that the underlying issue is the propriety of judicial control of the socio-economic realities underpinning the modern contractual nexus. The courts, perhaps mindful of the legislative lead, could be said to be backing unwillingly into the role of arbiters of unfair agreements.

The underlying paradox of the *Photo Production* decision exemplifies the problem. The Law Lords expressly adopted the traditional rubric of freedom of contract for commercial men dealing on terms of equality, yet four out of five declined to overrule a substantive test of reasonableness to assess the applicability of exclusion clauses. Translation of this conflict to Canada has produced several reflections. At the Court of Appeal level in *Beaufort* the traditional Canadian approach of express adoption of the construction rule which honours contractual bargaining freedom is ridiculed by the actual application of a substantive reasonableness test to exclude the clause in question. It seems that Ritchie J., in the Supreme Court, did not understand *Photo Production* to do more than re-establish the construction rule so that while, ironically, he is in one sense correct in stating that the Court of Appeal decision was in line with *Photo Production*, he was not aware of how true that observation was. Homer had indeed nodded! But the more serious consequences of Canadian failure to appreciate the ambit of *Photo Production* are apparent in *Woollatt* where the Court felt constrained to a simple, strict, superficial application of the construction rule although the circumstances suggested its inappropriateness to the end of doing justice between the parties. *Uni-Form* may also be a similar case, although insufficient facts preclude any firm conclusion. The survival, then, of a substantive reasonableness test in the face of strict construction, and

[83] *Supra*, note 81.

especially, the application of reasonableness to a contract between commercial parties, apparently of equal bargaining power, means that further judicial consideration must be given to the policy issues shirked in this latest round of cases. The issue is clear, if hardly simple: should the courts permit one party to contract out of his obligations — even out of liability in the event of his fundamental breach of contract — or should they be prepared to state boldly (and sometimes wrongly) that certain contractual promises offend commonly perceived standards of fairness and reasonableness and that a promisee should not be permitted to benefit from his own blameworthy acts?

If the survival of substantive reasonableness raises unconscionability issues, the restoration of the rule of construction creates other problems. To assert that exclusion clauses should be clearly construed is all very well, but past experience has shown the necessity for more specific rules to deal with less than specific clauses. *Photo Production* suggests that the construction process need no longer include a determination as to whether there was a fundamental breach, only that the clause made no provision for the events which have occurred. But does it not also suggest that where the clause clearly excludes liability for fundamental breach, such a clause would be honoured by the courts, even though its effect is to deprive the contract of contractual content? Clear construction alone is unrealistic and past judicial concoction of supplementary construction rules has, to a large extent, been prompted by a desire to avoid unreasonable solutions. How long will it be before a court is required to invoke the rule that contractual promises should not be reduced to "mere declarations of intent" in order to circumvent an exclusion clause excluding liability for fundamental breach? Indeed, such an approach could have been taken in *Beaufort* in that it could be argued that the clause which had the effect of depriving the innocent party of its right to remuneration by the mechanics lien had the effect of invalidating the contractor's contractual duty to pay for work done so that that an unenforceable legal duty had been created. In other words, there was no contractual promise to pay, merely a morally binding promise, and restitution would follow. How much simpler to do what Wilson J.A. did and determine that it was unreasonable to enforce the clause in the first place, even if she did not fully acknowledge that that was what she was doing. The proliferation of construction rules and such tortured legal argumentation seems to be the corollary of *Photo Production. Woollatt*, and perhaps *Uni-Form*, exemplify a different type of difficulty, namely, that clear construction of clearly drafted clauses judicially rubberstamps the possibly offensive use of socio-economic bargaining superiority. Even when clear construction is possible, it may not be enough to do justice, and may seduce lazy judges into easy decisions and the avoidance of hard issues.

One particular construction issue is the extent to which individual contract clauses are interrclated, or, to what extent the court should construe

the entire "contract parcel". In *Photo Production* only Lord Diplock expressed the view that a clause which purported to exclude liability could also establish contractual duties of performance. That the English courts may prove reluctant to adopt that position or to expand it to equate performance and remedy clauses is shown in the Privy Council decision delivered by Lord Wilberforce in *Port Jackson Stevedoring Pty Ltd* v. *Salmond and Spraggon (Australia) Pty Ltd*[84] in which the goods' owner argued that the stevedores' default was a repudiation of the contract entitling him to be discharged from other terms of the contract, including one which required an action upon a breach to be brought within one year. In other words, the clause was a condition of the contract with which an innocent party was obliged to comply. The Privy Council declined to accept this argument which it said equated a clause intended to operate upon a breach with clauses related to performance, and which are indistinguishable from arbitration or forum clauses which survive a repudiatory breach. The clause in question related to the modification of a secondary obligation to pay a monetary compensation, not to a primary obligation of performance. While little difficulty is experienced in the abstract categorization of contractual terms into those relating to performance and those relating to remedies, the distinction is arguably superficial. A clause precluding a remedy in the event of a breach or of a delay in performance, whether immediately or after the expiry of a stipulated period of time, could also be viewed as a clause which modifies a primary obligation of performance that is a contractual duty to pay or to perform on time. But if the duty to pay or to perform on time is unenforceable, as argued above in respect to *Beaufort*, it may be questioned whether a contractual duty arose in the first place. Rather, a mere moral obligation to perform was created. The inextricable interrelationship of rights and remedies lies at the basis of all promises which the law will enforce. It is difficult, then, to distinguish when a particular clause pertains to remedies only and when it pertains to rights and duties only. The hesitancy of the Privy Council in fully embracing Lord Diplock's analysis and Wilson J.A.'s expressed view that the Coote approach was inappropriate to the contract under consideration in *Beaufort* suggests the unlikelihood that the Coote thesis will find judicial approval in Canada or England in the near future.

In conclusion, the reception of *Photo Production Ltd* v. *Securicor Transport Ltd* in Canada has been open and warm, if problematical and puzzling. Purported applications of the decision have overlooked its inherent difficulties to such an extent that its actual intellectual digestion by

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[84] [1981] 1 W.L.R. 138 (P.C.) Not only did the Privy Council consist of Lord Scarman, but also Lord Diplock, as well as Lords Fraser and Roskill.

Canadian courts may be doubted. The Latin tag adopted by an English commentator[85] over a decade ago to describe *Harbutt's* applies, *mutatis mutandis*, to the Canadian reception of *Photo Production*: *nec tamen consumebatur*. The Canadian judiciary has partaken of *Photo Production*, yet it has not consumed its significance.

[85] Weir, *Nec Tamen Consumebatur — Frustration and Limitation Clauses* (1970) 28 Cambridge L.J. 189.