

# Le lisible et l'illisible

## The Legible and the Illegible

*Sous la direction de  
Ysolde Gendreau  
Editor*



Les Éditions Thémis

**CRDP**

Université   
de Montréal

## **The Common Law: Where Is It Written Down?**

---

**John D. McCamus<sup>\*</sup>**

<b>Introduction.....</b>	<b>21</b>
<b>I. To Overrule or Not to Overrule? .....</b>	<b>28</b>
<b>II. Prospective or Retrospective? .....</b>	<b>42</b>
<b>Conclusion .....</b>	<b>48</b>

---

<sup>\*</sup> Professor of Law, Osgoode Hall Law School, Toronto.



History records that a number of interesting events occurred in 1776. For common law contract lawyers, perhaps it is the decision of the Court of Common Pleas, in *Flureau v. Thornhill*,<sup>1</sup> that excites the most enthusiasm. The issue in that case concerned the measure of damages available to a disappointed purchaser of land where the intending vendor has been unable to convey title. Virtually the entirety of the four-line judgment of Chief Justice De Grey is taken up by the following sentence:

“On a contract for a purchase, if the title proves bad and the vendor is (without fraud) incapable of making a good one, I do not think that the purchaser can be entitled to any damages for the fancied goodness of the bargain which he supposes he has lost.”<sup>2</sup>

At only slightly greater length, Blackstone J., in a concurring opinion, provided the reassuring news that the purchaser would, however, be entitled to “a return of the deposit with interest and costs.” That was, he said, “[A]ll that can be expected.”<sup>3</sup>

The decision in *Flureau v. Thornhill* created an exception to the general principle applicable to the calculation of damages for breach of contract. In the usual case, the victim of a breach of contract is entitled to damages for the loss of the bargain or, as is often said, expectancy

---

<sup>1</sup> (1776) 96 E.R. 635.

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*



damages.<sup>4</sup> In the context of a real estate transaction, a disappointed purchaser would be entitled, on this basis, to claim for the difference between the contract price and the amount of money required to acquire a substitute property. The decision in *Flureau v. Thornhill* creates an exception to this principle by restricting a disappointed purchaser, absent bad faith on the part of the vendor, to the recovery of the purchaser's deposit and other costs incurred by the purchaser, such as the cost of a survey, in preparing to complete the transaction.

Almost 100 years later, in 1874, the House of Lords had occasion to reconsider this doctrine in the famous decision in *Bain v. Fothergill*.<sup>5</sup> This case concerned the sale of a lease of a mining royalty. In the initial lease, the lessees had agreed not to assign the lease without the consent of the lessors. Mistakenly assuming that they would be able to obtain that consent, the lessees entered into a contract to sell the leasehold interest to the plaintiff purchasers. The sale was not conditional on obtaining the vendor's consent. When the lessor refused to consent and the transaction therefore failed to close, the plaintiff purchasers sought the return of their deposit and costs and, as well, damages for their loss of bargain. The plaintiff thought that such a claim might enjoy success, notwithstanding the decision in *Flureau v. Thornhill*, because there existed some evidence in the case law that the courts had recognized an exception to *Flureau v. Thornhill* in cases where a vendor knew, at the time of entering the contract of sale, that he did not have the present ability to transfer title.<sup>6</sup> In such a case, or so the plaintiff argued, *Flureau v. Thornhill* should not apply and full damages for loss of bargain should be available to a disappointed purchaser. When *Bain v. Fothergill* surfaced for consideration by the House of Lords, it was evidently considered to be an important matter and all of the judges were summoned. Of the three judges who eventually sat on the case, however,

---

<sup>4</sup> *Sally Wertheim v. Chicoutimi Pulp Co.*, [1911] A.C. 301, 307, per Lord Atkinson.

<sup>5</sup> [1874] L.R. 7, [1874] H.L. 158.

<sup>6</sup> *Hopkins v. Grazebrook*, (1826) 108 E.R. 364.

only two survived to render judgment. Lord Chelmsford and Lord Hatherley were both of the view that no such exception to the rule in *Flureau v. Thornhill* should be admitted. If, as in the present case, the vendor had acted in good faith, the fact that the vendor knew that he did not have title at the time of entering the transaction would not expose him to the full measure of damages for breach of contract. The rule in *Bain v. Fothergill*, as it has come to be known to subsequent generations of lawyers, was thus firmly established as the governing principle for the calculation of damages in the context of contracts for the purchase and sale of interests in land. I remember well committing the rule in *Bain v. Fothergill* to memory as a law student some years ago.

In the third week of the first year contracts course which I now offer as a teacher of contract law, I invite the students to prepare for class by reading the decision of the Supreme Court of Canada in *A.V.G. Management Science Ltd. v. Barwell Developments Ltd.*,<sup>7</sup> a decision rendered by the Court in 1979, a century and more after the decision in *Bain v. Fothergill*. In this case, the Court had occasion to consider the application of the rule in *Bain v. Fothergill* to an interesting fact situation. Barwell had agreed to sell an apartment building to one Jordan. Mistakenly believing that the deal with Jordan was not going to proceed, Barwell then entered into a second agreement to sell the building to the plaintiff. Jordan successfully sought specific performance of its agreement with Barwell, who was thus unable to convey title to the property to the plaintiff. The plaintiff sought damages for loss of the bargain and argued that the vendor should not have the benefit of the protection in *Bain v. Fothergill* since the vendor had himself made it impossible to convey title by entering into two separate agreements to convey the same title to different persons. The plaintiff argued that whether or not the vendor had acted in bad faith, the special protection of *Bain v. Fothergill* should not be available to a vendor who engages in “double-dealing”. In other words, the purchaser argued, in effect, that a new exception to the rule in *Bain v. Fothergill* should be recognized,

---

<sup>7</sup> [1979] 2 S.C.R. 43 (hereinafter *A.V.G. Management*).

enabling purchasers to recover full loss of bargain damages in circumstances of this kind.

The trial judge<sup>8</sup> held that the vendor was not guilty of fraud or bad faith and, accordingly, that he was entitled to the protection afforded by *Bain v. Fothergill*. On appeal, however, a majority of the British Columbia Court of Appeal<sup>9</sup> concluded that the rule should not apply where, as here, the defect could not be said to be “unexpected”. The rule in *Bain v. Fothergill*, it was said, was designed to protect a vendor who is confronted by “unexpected” defects in title. A vendor who caused the problem himself by entering into two transactions could not claim that the problem is “unexpected” in the requisite sense. These facts were therefore not captured by the rule in *Bain v. Fothergill* and the plaintiff was entitled to recover damages for loss of bargain. The majority of the Court of Appeal also indicated, however, more general reservations about the very rule in *Bain v. Fothergill* itself and suggested that, if the matter should come before the Supreme Court of Canada, consideration should be given to the possibility of overruling this familiar and well-established rule of contract law.

Upon further appeal to the Supreme Court of Canada,<sup>10</sup> these matters surfaced before a panel of five members of the Court over which Chief Justice Laskin presided. Chief Justice Laskin was very familiar with the rule in *Bain v. Fothergill*. In his distinguished career as a law professor, his areas of expertise as a teacher and scholar included the law of real property.<sup>11</sup> Writing for a unanimous Court, Chief Justice Laskin agreed with the courts below that the present facts fell outside the rule in *Bain v. Fothergill* and that the rule should not protect a vendor who, having title, has “either voluntarily disabled himself from being able to convey or has

---

<sup>8</sup> [1976] 6 W.W.R. 289 (B.C.S.C.).

<sup>9</sup> [1978] 1 W.W.R. 730 (B.C.C.A.).

<sup>10</sup> *Supra*, note 7.

<sup>11</sup> See, for example, Bora LASKIN, *Cases and Notes on Land Law*, Toronto, University of Toronto Press, 1958.

risked and lost his ability to do so by what were in effect concurrent dealings with two different purchasers.” This holding was, of course, sufficient to dispose of the matter, but the Court was unable to resist the temptation to take up the invitation of the British Columbia Court of Appeal to consider overturning the rule in *Bain v. Fothergill*. Indeed, Chief Justice Laskin indicated that were it necessary to do so in the present case, the Court would have been prepared to overrule the doctrine. There were a number of reasons for this conclusion. The decision in *Bain v. Fothergill* was a product of the factual context of mid-nineteenth century England. The original rationale of the rule in *Bain v. Fothergill* rested in the uncertainty, at that time, in the state of English title documents. There was only a voluntary system for registration of land titles registration in force in England at that time and proof of title was a notoriously difficult matter. Times had changed. With the Torrens registration systems in Western Canada and the older registration schemes in the common law East, the problem of uncertainty of titles had ceased to provide a grounding for the rule. The main rationale of the rule had, in effect, “disappeared”. The Court also noted in passing that the rule had been the subject of a report by the British Columbia Law Reform Commission<sup>12</sup> and that the Province of British Columbia, acting on the Commission’s advice, had enacted legislation abrogating the rule in 1978.<sup>13</sup> The Court further noted that the doctrine had been generally rejected in the common law of the United States.<sup>14</sup> The Court concluded that, were it necessary to do so, the doctrine should be considered to be overruled.

---

<sup>12</sup> LAW REFORM COMMISSION OF BRITISH COLUMBIA, *Report on the Rule in Bain v. Fothergill*, Victoria, Ministry of the Attorney General, 1976.

<sup>13</sup> Legislation which, at the time of this appeal, had not yet been proclaimed. See now, *Property Law Act*, R.S.B.C. 1996, c. 377, s. 37.

<sup>14</sup> Referring to A. James CASNER, *American Law of Property*, Boston, Little Brown, 1952, p. 169 and 170.

In class discussion of the *A.V.G. Management* case, I annually ask the students two questions. First, I ask for their opinion as to the current state of the common law on this point. Typically, the first response is that the rule has been overruled by the Supreme Court of Canada and that the normal measure of contract damages applies generally to cases involving a failure to make title. Soon, however, doubts creep into the discussion. One student will note that the discussion of the Supreme Court on this point is pure *obiter dicta*. It was unnecessary to the decision of the Court, as Chief Justice Laskin himself noted, and is therefore not binding on the lower courts. Another student will reply that while this may be true, it is the *obiter dicta* of one of the finest Chief Justices to serve on the Supreme Court and, indeed, a well-known expert on land law. How could a subsequent trial judge sensibly ignore the *obiter dicta*? Yet another student will note that the decision of the Court in *A.V.G. Management* has been criticized by one of the leading contract scholars in common law Canada.<sup>15</sup> Another student asks whether one's opinion of the law would be different in 1979 than it would be 21 years later when the composition of the Court has completely changed.

In the midst of this emerging consensus of confusion, I then ask the students for their opinion as to the then current law on this point immediately prior to the decision of the Supreme Court of Canada in *A.V.G. Management*. My experience is that students are not as forthcoming with their responses to this question. Typically, one or more will suggest, however, that the law is obviously, at that point in time, the rule in *Bain v. Fothergill*. Others will suggest, however, that it might be misleading to offer that advice to a client without further noting that the underpinnings of the doctrine are somewhat insecure and that the doctrine is one which might be overruled on some occasion, perhaps in the near future. Indeed, it might be quite imprudent to assume that the rule will be applied in one's own case. Other, one imagines more perplexed, students ask what it was that I meant by the phrase "the common law of Canada."

---

<sup>15</sup> Stephen M. WADDAMS, *The Law of Contracts*, 4th ed., Aurora, Canada Law Book, 1999, par. 711, p. 525.

For many students, I suspect, their discussion of the *A.V.G. Management* case leads to some disenchantment with the case law method for studying law. Indeed, I fear it is a disenchantment from which some never quite completely recover. After class, and in the following days, I am very often approached by students who normally couple a statement of their enthusiasm for study of the common law with a request for advice on an authoritative source of some kind, perhaps a textbook, where they will find the law. “If it is not to be found in the cases, or at least not exactly in the cases”, they ask, “where is it written down?” When I reply that the law is not exactly written down in textbooks either, I believe that many students see this as an obvious obfuscation or evasion of the truth.

For beginning students, then, the ability of the common law to reform itself through judicial fiat is often a source of bemusement if not frustration. For admirers of the common law, however, this capacity of the common law for self-renewal and improvement is alleged to be one of its great virtues. The ability of the common law to work itself pure enables it to adapt to changing social and economic circumstances and to eject from the body of the common law doctrines which have outlived their usefulness or which have demonstrated a capacity to work injustice. Indeed, fanatics of the common law see this as a major difference from and advantage over the Code-bound civilian tradition.

At the same time, of course, and it could hardly be otherwise, the common law tradition values stability and certainty in legal doctrine. Stability of doctrine is essential if the common law is to fulfill its role of enabling the citizenry to plan their affairs on the basis of legal rules and enabling the profession to effectively fulfill various professional roles. Doctrinal instability and uncertainty may undermine public confidence in the administration of justice.

In this paper, I want to consider briefly two questions arising from this tension between the capacity of the common law for self-reform and the need to preserve an appropriate degree of stability and certainty in the law. First, I will invite you to consider when courts should exercise their undoubted capacity to modify or overrule unsatisfactory doctrine. By

what criteria can we identify a doctrine which may be or, indeed, should be vulnerable to overruling? Second, assuming that judicial reform of the law is appropriate, I will ask you to consider whether such reforms ought to be considered to be retrospective in nature in the sense that they not only apply to the dispute in the case at hand but to past events more generally or, rather, prospective in the sense that they should be declared by the reforming court to be applicable only to future cases, thus leaving the present dispute to be resolved by the “old” law. For academic common lawyers, these are difficult questions of legal theory. For judges, however, they are important practical problems. My focus in this paper will be on recent judicial attempts to wrestle with these questions in decisions of the Supreme Court of Canada and the House of Lords. My intent is to demonstrate that although valuable judicial discussions of these issues have been offered in recent years, some questions remain as yet unanswered.

## I. To Overrule or Not to Overrule?

The judicial capacity to overrule prior doctrine, the existence of which Chief Justice Laskin appears to have assumed in the *A.V.G. Management* case, appears to run contrary to that famous hallmark of the common law, the doctrine of precedent or *stare decisis*.<sup>16</sup> The doctrine of *stare decisis* holds that courts are bound to follow prior judicial decisions, at least prior decisions of courts higher in the judicial hierarchy than the deciding court, to the extent that the reasoning or the rule pronounced in the prior case is fairly considered to be applicable to the facts at hand. Although the doctrine of *stare decisis* did not crystallize into its modern and rigid form until the late 19th century,<sup>17</sup> it is nonetheless the case that well into the 20th century, the highest courts in the judicial hierarchy both in England and in common law Canada

---

<sup>16</sup> See, generally, Rupert CROSS and J.W. HARRIS, *Precedent in English Law*, 4th ed., Oxford, Clarendon Press, 1991.

<sup>17</sup> *Id.*, p. 24-26.

assumed that the doctrine of precedent did in fact preclude the overruling of prior law. Thus, the House of Lords considered itself bound by its own previous decisions until as recently as 1966. In that year, the House issued a Practice Statement<sup>18</sup> in which it indicated that although it would, generally speaking, continue to consider its own past decisions as binding, it would nonetheless be prepared to depart from a past decision where it was felt appropriate to do so. Prior to the abolition of appeals to the Privy Council in 1949, the Supreme Court of Canada also considered itself bound by its own previous decisions.<sup>19</sup> Subsequently, however, the Court has indicated that it possesses a capacity to depart from prior authority where circumstances warrant such action.<sup>20</sup> Chief Justice Laskin's assumption of the existence of a power to overrule thus rests on a sound jurisprudential footing.

Though the judicial capacity to overrule thus unquestionably exists, it is realistic to anticipate that the power will be exercised only sparingly. The overruling of prior doctrine runs against those values of stability and certainty in the law from which the doctrine of *stare decisis* draws its strength. Further, for some jurists and for some observers, the existence of a power to overrule prior doctrine may appear to obscure the distinction between the legislative and judicial branches of government and, perhaps, undermine the legitimacy of the judicial role in the administration of justice. For reasons such as these, though the existence of the power to overrule is undoubted, the extent to which the power should be exercised remains, of course, a highly contentious matter. It is therefore of considerable interest that in recent years the Supreme Court of Canada has attempted to articulate guidelines for the exercise of this power on a number of occasions. Although the subject is obviously a

---

<sup>18</sup> *Practice Statement (Judicial Precedent)*, [1966] 1 W.L.R. 1234, departing from the previous view stated in *London Tramways v. London County Council*, [1898] A.C. 375.

<sup>19</sup> *Stuart v. Bank of Montreal*, (1909) 41 S.C.R. 516.

<sup>20</sup> See, for example, *Reference re Farm Products Marketing Act*, [1957] S.C.R. 198, 212; *Bell v. The Queen*, [1979] 2 S.C.R. 212, 219 and 220.



matter of central importance for the common law, it is rare indeed that explicit discussion of guidelines for the exercise of power to overrule is found in judicial decisions. Accordingly, it may be of some interest to provide an account of what appear to be the principal guidelines identified by the Court and, further, to examine their application in recent cases of interest.

Two different approaches could be adopted in developing a set of guidelines of this kind. On the one hand, one might attempt to describe the circumstances in which it would be inappropriate for a court to overrule prior law and leave open the inference that where such circumstances are not present, overruling might reasonably be contemplated. A second approach would be to identify, in a more positive fashion, the circumstances in which overruling is desirable. Although both approaches have been adopted by members of the Supreme Court in analysing this issue, particular emphasis has been placed on the former approach. Thus, in *Watkins v. Olafson*,<sup>21</sup> McLachlin J. began a discussion of this issue by emphasizing that “generally speaking, the judiciary is bound to apply the rules of law found in the legislation and precedents.”<sup>22</sup> Conceding that over time the law in any given area might change, McLachlin J. nevertheless went on to emphasise that

“the process of change is a slow and incremental one, based largely on the mechanism of extending an existing principle to new circumstances. While it may be that some judges are more activist than others, the courts have generally declined to introduce major and far-reaching changes in the rules hitherto accepted as governing the situation before them.”<sup>23</sup>

---

<sup>21</sup> [1989] 2 S.C.R. 750 (hereinafter *Olafson*).

<sup>22</sup> *Id.*, 760.

<sup>23</sup> *Id.*

McLachlin J. went on to suggest that there are a number of sound reasons supporting what she described as a “judicial reluctance to dramatically recast established rules of law.” These reasons she summarized as follows:

“The court may not be in the best position to assess the deficiencies of the existing law, much less problems which may be associated with the changes it might make. The court has before it a single case; major changes in the law should be predicated on a wider view of how the rule will operate in the broad generality of cases. Moreover, the court may not be in a position to appreciate fully the economic and policy issues underlying the choice it is asked to make. Major changes to the law often involve devising subsidiary rules and procedures relevant to their implementation, a task which is better accomplished through consultation between courts and practitioners than by judicial decree. Finally, and perhaps most importantly, there is the long-established principle that in a constitutional democracy it is the legislature, as the elected branch of government, which should assume the major responsibility for law reform.”<sup>24</sup>

The general thrust of this analysis appears designed to distinguish between the relative competencies of the judiciary and the legislature and assign to the legislature those problems more suited to the legislative arena. Throughout the analysis there appears to be a distinction drawn between “major” changes which are appropriate for the legislature and, by inference, “minor changes” which may be appropriate for the judicial implementation. McLachlin J. returned to this theme in the final summation of her position, as follows:

“Considerations such as these suggest that major revisions of the law are best left to the legislature. Where the matter is one of a small extension of existing rules to meet the exigencies of a new case and the consequences of the change are readily assessable,

---

<sup>24</sup> *Id.*, 760 and 761.

judges can and should vary existing principles. But where the revision is major and its ramifications complex, the courts must proceed with great caution.”<sup>25</sup>

Applying this test to the proposed reforms of the law advocated on behalf of the plaintiff in the *Olafson* case, McLachlin concluded that whereas one proposed reform was major in the requisite sense, the other was minor, and therefore, could be adopted by the court. The major and therefore unacceptable change proposed was that the plaintiff could be granted, in a personal injury case, an award requiring the defendant to make a series of periodic payments, rather than the awarding of a once and for all “lump sum payment”. The ordering of periodic payments, in the Court’s view, raised a number of administrative and other complexities that would be difficult to resolve through judicial fiat. The existence of these difficulties was confirmed, for the Court, by the range of legislative experience in other jurisdictions that had enacted statutory periodic payment schemes. On the other hand, the plaintiff’s proposal to “gross up” the lump sum award in order to take into account tax liabilities was thought to be a sufficiently minor revision to the law that it could be adopted by the Court.

The circumstances in which a prior law can be overruled have been touched upon in other recent decisions of the Court. In the recent case of *Friedmann Equity Developments Inc. v. Final Note Ltd.*,<sup>26</sup> Bastarache J. attempted to summarize “the principles which govern judicial reform of the common law”<sup>27</sup> as developed in these cases in the following terms:

“From these cases, some general principles have emerged. A change in the common law must be necessary to keep the common law in step with the evolution of society [...], to clarify a legal principle [...], or to resolve an inconsistency [...]. In

---

<sup>25</sup> *Id.*, 761.

<sup>26</sup> (2000) 188 D.L.R. (4th) 269 (S.C.C.) (hereinafter *Friedmann Equity*).

<sup>27</sup> *Id.*, 290.

addition, the change should be incremental, and its consequences must be capable of assessment.”<sup>28</sup>

Although Bastarache J., like McLachlin J., places emphasis on the “incremental” nature of the reforms permitted to the judiciary, he also usefully places emphasis on the role of the judiciary in clarifying obscurities and resolving inconsistencies in the doctrine. These responsibilities or principles are seen as being additional to the responsibility to “keep the common law in step with the evolution of society.” Bastarache J. thus offers some positive signals as to when an overruling of a prior doctrine may be appropriate.

Applying this analysis to the *A.V.G. Management* case, one might make a persuasive case for overruling on the basis of two of the guidelines identified by Bastarache J. First, overruling the rule in *Bain v. Fothergill* might be considered to be “necessary to keep the common law in step with the evolution of society” and, more particularly, in step with the development of registration systems relating to title documents for the ownership of land. Alternatively, the result in *A.V.G. Management* might be defended on the basis that the rule in *Bain v. Fothergill* is inconsistent with the general principle for calculating damages in contract cases or, in the further alternative, that the existence of the rule and its various exceptions have created a doctrine which might, in some sense, be described as inconsistent. Against the overruling of *Bain v. Fothergill*, of course, it might be argued that such a change is “major” or constitutes a “dramatic” change in a well-established rule of contract law.

Perhaps it is not surprising that the general guidelines outlined by the Court in these recent decisions do not provide a clear answer to the question of whether the decision to overrule *Bain v. Fothergill* taken in the *A.V.G. Management* is sound. While guidelines such as these cannot settle all points of difficulty, of course, it may be suggested that further guidance from the Court on these issues would be welcome. More particularly, it would be helpful to discern whether, in the Court’s view,

---

<sup>28</sup> *Id.*, 291.

the courts have a special role, differentiating them from the legislature, with respect to those broad subjects of the law, principally the law of obligations, which are essentially the invention of the courts in the common law system. The law of contracts, for example, is essentially a construct of nineteenth century judicial decisions, largely, as a matter of interest, under the influence of civilian doctrine.<sup>29</sup> There is perhaps an argument, therefore, for the view that the courts bear a particular responsibility for the stewardship of this body of doctrine. If it were plainly acknowledged by the Court that it had a particular responsibility for reform and adjustment of the basic law of obligations, this would provide us with some further insight as to the soundness of the *A.V.G. Management* decision.

Some evidence of the Court's disposition on this point may be drawn from the recent decision in *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*<sup>30</sup> In this case, the Court was provided with yet another opportunity to consider the possibility of overruling the doctrine of privity of contract.<sup>31</sup> The doctrine of privity of contract is an invention of the courts of common law which will excite no envy amongst civilian colleagues. The doctrine holds that a party who is merely a third party beneficiary to a contract, that is, a person who has promised no value in return for the promised benefit, cannot enforce the agreement. In simple terms, if A hires B and promises B that A will pay C in return for the services provided to A, C will have no enforceable claim against A. C is merely a third party beneficiary of A's promise. In a famous case, an uncle sold his business to a nephew who promised, in return, to pay an

---

<sup>29</sup> With respect to the influence of Pothier and other civilian jurists on the development of the common law of contracts, see James GORDLEY, *The Philosophical Foundations of Modern Contract Doctrine*, Oxford, Oxford University Press, 1991, and Alfred William Brian SIMPSON, *Innovation in Nineteenth Century Contract Law*, (1975) 91 *L.Q.Rev.* 247.

<sup>30</sup> (1999) 176 D.L.R. (4th) 257 (S.C.C.) (hereinafter *Fraser River*).

<sup>31</sup> See, generally, John D. MCCAMUS, "Loosening the Privity Fetters: Should Common Law Canada Recognize Contracts for the Benefit of Third Parties?" (2001) 35 *Can. Bus. L.J.* 173.

annuity, after the uncle's death, to the widowed aunt. Under the doctrine of privity, the aunt has no standing to sue to enforce the nephew's promise. The privity problem arose in *Fraser River* in the following way. In this case, the owner of a boat took out a marine insurance policy which contained a waiver of the right of subrogation by the insurer against "any charterer". The boat sank when it was under the control of the defendant charterer. Thereupon, the insurer and the owner agreed to modify the agreement by rescinding the waiver of subrogation, thus enabling, in their view, the insurer to bring this claim against the charterer. Understandably, the charterer sought to rely on the waiver of subrogation clause. Under the doctrine of privity, however, the charterer would be a mere third party beneficiary of that provision and therefore would be unable to defend itself on that basis.

The doctrine of privity of contract is widely viewed as being unsatisfactory. As the fact situations described above amply demonstrate, the doctrine is capable of producing harsh results. It is not surprising, therefore, that courts and legislatures have developed a number of exceptions to the privity doctrine. This, in turn, has produced a body of doctrine which is rather subtle. One might fairly describe the relationship between the general rule and its exceptions as being one of "inconsistency". The doctrine has been the subject of persistent criticism in the reports of law reform commissions<sup>32</sup> and in the law reviews.<sup>33</sup> It has been vigorously criticized in judicial opinions.<sup>34</sup> It has been overruled by statute in a number of common law jurisdictions,<sup>35</sup> including the Province of New Brunswick<sup>36</sup> and, most recently, England.<sup>37</sup> The

---

<sup>32</sup> Including, for example, those of Manitoba, Ontario and the United Kingdom.

<sup>33</sup> See, for example, Robert FLANNIGAN, "Privity—the End of an Era (Error)", (1987) 103 *L.Q. Rev.* 564.

<sup>34</sup> A number of which are collected in the report of the U.K. LAW COMMISSION, *Privity of Contract: Contracts for the Benefit of Third Parties at*, London, Her Majesty's Stationery Office, 1991.

<sup>35</sup> New Zealand, Queensland and Western Australia.

<sup>36</sup> *Law Reform Act*, S.N.B. 1993, c. L-1.2, s. 4.

doctrine of privity has not been adopted in civilian jurisdictions nor, indeed, in the common law of contract of the United States.<sup>38</sup> For reasons such as these, the doctrine of privity of contract might seem a likely candidate for judicial overruling.

In the *Fraser River* case, however, and in an earlier recent decision,<sup>39</sup> the Supreme Court has resisted the temptation to overrule the privity doctrine. In an analysis repeated in the *Fraser River* case, the Court observed that “without doubt, major reforms to the rule denying third parties the right to enforce contractual provisions made for their benefit must come from the legislature.”<sup>40</sup> Further, the Court observed that

“privity of contract is an established principle in the law of contracts and should not be discarded lightly. Simply to abolish the doctrine of privity or to ignore it, without more, would represent a major change to the common law involving complex and uncertain ramifications. This Court has in the past indicated an unwillingness to sanction judge-made changes of this magnitude [...].”<sup>41</sup>

At the same time, it is apparent that application of the doctrine on the facts of *Fraser River* in such a way as to enable the insurer to bring an action against the charterer is unpalatable. Accordingly, the Court developed a new “principled” exception to the privity doctrine which rescued the charterer on these facts and which would, indeed, appear to be potentially applicable in virtually any privity case where application of the doctrine would produce an unjust result.<sup>42</sup> While the decision in

---

<sup>37</sup> *Contracts (Rights of Third Parties) Act*, 1999, U.K., c. 31.

<sup>38</sup> See, generally, Melvin A. EISENBERG, “Third Party Beneficiaries”, (1992) 92 *Colum. L. Rev.* 1358.

<sup>39</sup> *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*, [1992] 3 S.C.R. 299.

<sup>40</sup> *Id.*, 436 and 437.

<sup>41</sup> *Id.*, 437.

<sup>42</sup> See, generally, J.D. MCCAMUS, *loc. cit.*, note 31.

*Fraser River* thus preserves the doctrine of privity as the general governing principle, it adds to the uncertainty and complexity of privity doctrine by creating a further broad exception to that general principle.

The decision in *Fraser River* thus strongly suggests that the Court envisages a very modest role for itself in the reform of private law doctrine. Indeed, even with respect to what may be considered to be rather technical aspects of the law of contracts, the Court appears to assume that improvement of the law in any “major” as opposed to “incremental” way must come from the provincial legislatures. The presumed model of law reform underlying this approach requires Canadian legislators to take an interest in the details of the private law of obligations and, indeed, to respond to the polite suggestions of the judiciary and others, such as law reform commissions, by placing measures to reform private law doctrine on the legislative agenda. Whether it is realistic to assume that our legislators will be willing to play this role at the present time is, of course, an interesting question. Notwithstanding the recent enactment of legislation in New Brunswick reforming the privity doctrine, it is nonetheless the evidence of recent decades that provincial legislatures have little interest in questions of private law reform. Provincial law reform commissions have been dismantled in three provinces.<sup>43</sup> There remain only two governments established and funded commissions of this kind.<sup>44</sup> The prospect of securing reform of the private law of obligations through provincial legislative initiative appears, it must be said, to be somewhat remote. Indeed, if one or more provincial legislatures are moved to tackle subjects such as the doctrine of privity of contract, the most likely outcome would appear to be the enactment of a patchwork of reform involving some but not all of the common law provinces.

---

<sup>43</sup> British Columbia, Manitoba and Ontario.

<sup>44</sup> Alberta and Nova Scotia.



Indeed, it may be wondered whether this model of law reform has ever functioned successfully. With respect to privity doctrine, in particular, the English Law Revision Committee recommended its abolition in 1937.<sup>45</sup> Thirty years later the proposed reform had not been implemented. In *Beswick v. Beswick*<sup>46</sup> the House of Lords reaffirmed the existence of this, as they conceded, unsatisfactory doctrine. Lord Reid observed that "if one had to contemplate a further long period of Parliamentary procrastination, this House might find it necessary to deal with this matter."<sup>47</sup> Indeed, Parliament procrastinated another thirty years before bringing in reform legislation a few years ago.<sup>48</sup> The legislative mind, it appears, is preoccupied with more pressing matters. Considerations such as these tend to suggest that it might indeed be appropriate for the Court to assume a greater responsibility for adjustment of common law doctrine in the field of private law at least than appears to be implicit in the decision in the *Fraser River* case.

Moreover, the history of so-called "leading" cases in private law doctrine offers abundant evidence that the courts have often assumed responsibility for effecting what could only be considered to be quite significant doctrinal reforms. A brief survey of such cases suggests a number of recurring patterns or guidelines as to when such reforms are likely to occur.<sup>49</sup> On some occasions, the courts appear to reform existing doctrine in order to bring it into closer accord with contemporary expectations or understandings of the just result. The recognition of direct tortious liability to consumers by the manufacturers of defective

---

<sup>45</sup> Cmd. 5449.

<sup>46</sup> [1968] A.C. 58.

<sup>47</sup> *Id.*, 72.

<sup>48</sup> *Contracts (Rights of Third Parties) Act*, *supra*, note 37.

<sup>49</sup> See, generally, Melvin A. EISENBERG, *The Nature of the Common Law*, Cambridge, Harvard University Press, 1988, which, though based on American experience, is rich with insights equally applicable to Canadian common law.

products,<sup>50</sup> the recognition of tortious liability for negligent misstatement,<sup>51</sup> and the imposition of an obligation on married and other similarly situated couples to share property upon separation of their relationships<sup>52</sup> may be examples of this. On other occasions, as Bastarache J. suggested in *Friedmann Equity Developments Inc. v. Final Note Ltd.*,<sup>53</sup> the courts may be concerned to clarify or render consistent doctrine which has become unsatisfactory. Sometimes an exception to a general rule which no longer appears justifiable is jettisoned. *A.V.G. Management v. Barwell Developments Ltd.*<sup>54</sup> is such a case. On other occasions, a general principle, the unsatisfactory nature of which is demonstrated by the growth of exceptions which are fundamentally inconsistent with it, will be overruled. The recent eclipse of the mistake of law rule illustrates this type of reform.<sup>55</sup> These are significant, some would say dramatic, changes in the law. Indeed, in the basic subject areas of the common law of obligations—contract, tort and restitution—it is the courts, not the legislatures, that have been the principal agents of even quite major reform.

On the other hand, it must be conceded that the role of the court in reforming unsatisfactory law doctrine is, at best, an uncomfortable one. There is an understandable concern that, at least to the unsophisticated observer, this “legislative” role is considered to be unsuited to an unelected judiciary. Moreover, a plain overruling of prior doctrine may be seen to carry with it a concession that the prior law is unsatisfactory and capable of producing injustice. The decision of the Supreme Court in

---

<sup>50</sup> *Donoghue v. Stevenson*, [1932] A.C. 562 (H.L.).

<sup>51</sup> *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.*, [1964] A.C. 365 (H.L.).

<sup>52</sup> *Pettikus v. Becker*, [1980] 2 S.C.R. 834.

<sup>53</sup> *Supra*, note 26.

<sup>54</sup> *Supra*, note 7.

<sup>55</sup> *Air Canada v. British Columbia*, (1989) 59 D.L.R. (4th) 161 (S.C.C.); *Kleinwort Benson Ltd. v. Lincoln County Council*, [1998] 4 All E.R. 513 (H.L.).

*Greenwood Shopping Plaza Ltd. v. Beattie*,<sup>56</sup> which reaffirmed the privity doctrine and applied it in circumstances that many would consider to be unjust, was rendered as recently as 1980. It is, perhaps, asking a great deal of the Court to publicly concede, in effect, that its own previous decision of such recent vintage is deeply flawed. And yet, it is not obviously a preferable alternative to persist in adherence to a doctrine which appears to be capable of producing such unsatisfactory results.

A further barrier to the exercise of the judicial capacity to overrule prior doctrine is illustrated in the *Friedmann Equity* case itself. In this case, the plaintiff sought an overruling of the "sealed contract" rule. The sealed contract rule holds that whenever a contract is executed under seal, only those parties named in the agreement may sue or be sued on the contract. The sealed contract rule thus creates an exception to more general principles of the law of agency which will permit, in some circumstances, undisclosed principals, that is, principals whose identity is not disclosed when their agents contract on their behalf, to sue and be sued on agreements entered into on their behalf.<sup>57</sup> In *Friedmann Equity*, the Court declined to abolish the sealed contract rule in part because abolition "would have the unfair result of creating uncertainty for those who had relied on the rule in executing their contracts."<sup>58</sup> The fact that detrimental reliance on the current status of a rule is likely to have occurred no doubt creates a persuasive consideration weighing against reform. On the other hand, it is important to note that reliance is only one of the factors to weigh in the balance and, moreover, that the weight attributable to reliance will vary considerably from one context to another. Thus, in the privity context, it appears very unlikely that detrimental reliance would be counted to weigh heavily in the balance against reform. The doctrine of privity affords, one might say, unwarranted protection to individuals who have promised to confer benefits on

---

<sup>56</sup> [1980] 2 S.C.R. 228.

<sup>57</sup> For discussion of the undisclosed principals doctrine, see Raphael POWELL, *The Law of Agency*, 2d ed., London, Pitman, 1961, p. 151-166.

<sup>58</sup> *Friedmann Equity Developments Inc. v. Final Note Ltd.*, *supra*, note 26, 295.

third parties and who then refuse to do so. To the extent that they have relied on the existence of privity doctrine in giving such promises, one might be tempted to conclude that they have engaged in misleading conduct by giving promises which they knew could not be enforced at law. Further, even in the context of doctrines where reliance may be more attractive from a moral point of view, it is possible to exaggerate the extent to which individual citizens are likely to rely on the details of contract law. Few members of the public will be aware of the sealed contracts rule. My personal experience suggests that knowledge of the rule is not as widespread amongst members of the legal profession as one might assume.<sup>59</sup> Further, with doctrines such as the privity doctrine, the existence of a series of exceptions to the general principle will bedevil the exercise of giving clear and confident legal advice. With doctrines which are plainly unsatisfactory and, on this basis, ripe for overruling, such inconsistency and obscurity is, indeed, likely.

In summary, it appears that the court has adopted as a defining feature of its approach to the exercise of the capacity to overrule prior law, a distinction between “major” reforms which are the appropriate domain of the legislature and merely “incremental” reforms which may be achieved through judicial decision-making. I have suggested above that it may be useful to give further consideration to the question of whether this type of guideline strikes the appropriate balance in the particular context of the reform of private law doctrine. The basic law of obligations is not likely to be the subject of legislative attention. It is at least arguable, I would suggest, that the judiciary has a particular responsibility for the improvement of the private law of obligations which, under the common law system, is not only essentially its creation but, for reasons of practical politics, essentially its preserve. An examination of leading cases indicates that the courts have traditionally

---

<sup>59</sup> Indeed, it may well be that solicitors who are aware of the rule and are concerned to exclude potential liability to undisclosed principals in a particular transaction would be inclined to draft an explicit provision to this effect rather than rely on the sealed contract rule and ensure that the transaction is entered into under seal.

assum  
pheno  
impor  
contex  
assum  
the ph  
proble  
judicia  
cases?  
reform  
detrim  
overru  
topic, 1

If one subscribes to the declaratory theory, then, a justification of the retrospective effect of judicial decisions which appear to alter the existing law can be fashioned. To the extent that the decisions of the Court provide only imperfect evidence of the true doctrine, it is perhaps less surprising that, from time to time, subsequent decisions can provide better evidence than prior decisions of the true nature of the law. The declaratory theory provides little comfort to my first year law students on course. Indeed, it confirms their worst suspicions that an authoritative source of the doctrine of the common law is not to be found on this planet. The declaratory theory is attractive to those who wish to obscure from public view the role played by the courts in reforming the common law. And it does, of course, provide a justification of sorts for the retrospective effect of judicial reform of the common law.

## II. P

In  
doctrin  
be eith  
attracti  
at least  
maintai  
those w  
law and  
purpose  
prospec  
the refo  
resoluti  
under th  
Court is  
parties.  
party w  
success  
hand, if  
losing p

The declaratory theory does suffer from a major flaw. Sir James Fyfe expressed, it is based on a false premise. The theory essentially denies the reality of the law-making capacity of judicial decisions in the common law system. But if we expose the falsity of the declaratory theory of law, does the retrospective effect of common law decisions making not also come tumbling down? The House of Lords recently confronted this interesting dilemma in its decision in *Kleinwortz Ltd. v. Lincoln City Council*.<sup>62</sup> The decision is one of a series of important decisions dealing with the interesting phenomenon of interest rate swaps transactions. It is not necessary for present purposes to describe the nature of interest rate swaps. Essentially, they are investment transactions of a somewhat speculative character. Unlike transactions of this kind, municipalities in England were able to achieve the objective of borrowing money without entering into straightforward borrowing transactions. This enabled municipalities which were subject to caps or limits on their ability to raise tax revenues to effectively borrow money without subjecting themselves to the normal regulatory controls. Hundreds, perhaps thousands, of these transactions, many of very large amounts of money, were entered into between borrow-

<sup>62</sup> [1998] 4 All E.R. 513 (H.L.) (hereinafter *Lincoln City Council*), no longer cited; see Lionel Smith in [1999] Rest. L.R. 148.

municipalities and investors and bankers of various kinds. In many of these transactions, we may safely assume, the parties were advised that the transactions were perfectly lawful. We can imagine that many lawyers and their clients were ultimately surprised to learn, from a decision of the House of Lords,<sup>63</sup> that the interest rate swaps transactions were *ultra vires* the municipalities and therefore void and unenforceable.

The *Lincoln City Council* case involved a claim brought by a number of bankers who sought to recover monies paid to the defendant municipalities under transactions of this kind. The first hurdle for them to overcome was the traditional rule that denies recovery of monies paid under a mistake of law, as opposed to a mistake of fact. The bankers paid money to the municipalities under the mistaken assumption that the swaps transactions were lawful and enforceable. This view ultimately proved to be erroneous. Under the traditional rule, then, monies paid under a mistake of law could not be recovered. Much of the interest in the *Lincoln City Council* case stems from the fact that on this occasion the House of Lords simply overruled the mistake of law doctrine and held that monies paid under such mistakes could be recovered. The next line of defence of the municipalities was, however, to suggest that the bankers were not, in any event, mistaken at the time the monies were advanced. Indeed, in their view, the bankers had a correct view of the law as it existed at the time of payment—indeed, it was a view widely shared by members of the profession giving advice with respect to these transactions—and, arguably, the law was changed by the decision of the House of Lords holding these transactions to be *ultra vires* and void. This argument confronted the House of Lords directly with a need to reconsider the declaratory theory of the law and the question of whether judicial reform of the common law should be considered to have a retrospective effect.

---

<sup>63</sup> *Hazell v. Hammersmith and Fulham London B.C.*, [1992] 2 A.C. 1.

In a most interesting series of opinions in this case, the members of the panel of the House of Lords in *Lincoln City Council* concluded that the declaratory theory of the law in its traditional form at least, does not provide an accurate account of judicial decision-making. At the same time, however, the retrospective effect of judicial reform of the law was reaffirmed. Lord Goff, for example, noted that the declaratory theory failed to take account of judicial development of the law, a phenomenon which he viewed as “inevitable”.<sup>64</sup> He went on to observe that

“if it had never taken place, the common law would be the same now as it was in the reign of King Henry II; it is because of it that the common law is a living system of law, reacting to new events and new ideas, and so capable of providing the citizens of this country with a system of practical justice relevant to the times in which they live.”<sup>65</sup>

When a judge decides a case, according to Lord Goff, “he does so on the basis of what he understands the law to be.”<sup>66</sup> Yet, at the same time, the judge may “develop the common law in the perceived interests of justice.”<sup>67</sup> Although this development will normally be “interstitial”, it will occasionally “be of a more radical nature, constituting a departure, even a major departure, from what has previously been considered to be established principle.”<sup>68</sup> Nonetheless, in Lord Goff’s view, when the deciding judge pronounces on the state of the doctrine, it is to be taken as a declaration of the existing state of the law. This revised version of the declaratory theory was explained by Lord Goff in the following terms:

---

<sup>64</sup> *Kleinwort Benson Ltd. v. Lincoln City Council*, *supra*, note 62, 534.

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*, 534 and 535.

<sup>68</sup> *Id.*, 535.

“It is in this context that we have to reinterpret the declaratory theory of judicial decision. We can see that, in fact, it does not presume the existence of an ideal system of the common law, which the judges from time to time reveal in their decisions. The historical theory of judicial decision, though it may in the past have served its purpose, was indeed a fiction. But it does mean that, when the judges state what the law is, their decisions do, in the sense I have described, have a retrospective effect. That is, I believe, inevitable. It is inevitable in relation to the particular case before the court, in which the events must have occurred some time, perhaps some years, before the judge’s decision is made. But it is also inevitable in relation to other cases in which the law as so stated will in future fall to be applied. I must confess that I cannot imagine how a common law system, or indeed any legal system, can operate otherwise if the law is to be applied equally to all and yet be capable of organic change.”<sup>69</sup>

In this truncated form, then, the declaratory theory appears to persist as an apparent justification of the alleged “inevitability” of the retrospective effect of judicial reform of pre-existing common law doctrine.

It is not obvious, of course, that the declaratory theory, in this version at least, retains any continuing capacity to explain or justify the persistence of the view that judicial law reform must have retrospective effect. Indeed, by virtue of the fact that prospective overruling has been undertaken, in a limited range of circumstances, in American private law,<sup>70</sup> it is a difficult to mount a convincing argument in support of the notion that retrospectivity is inevitable. On the other hand, there are arguments that can be made in support of the retrospective theory. First, retrospectivity avoids some of the unattractive features of prospective overruling. For example, once the prospective overruling has been announced, similar cases will be decided in dissimilar fashion in the short term future. Thus, cases which arise on facts which occur before

---

<sup>69</sup> *Id.*

<sup>70</sup> See, generally, M.A. EISENBERG, *op. cit.*, note 49, p. 127-132.



the pronouncement will be decided on the basis of the old law; cases which have arisen on the basis of subsequent events will be subject to the new doctrine. Injustices perpetrated by the old rule will thus persist through the limitations period while other contemporaneous litigants achieve more just outcomes under the new doctrine. Like cases will be decided in starkly different fashions.

A second justification for retrospectivity can be rooted in the values of stability and certainty in common law doctrine. The fact that a judicial change to the law will have a retrospective effect is likely to have a chastening effect on would-be judicial reformers. In order to achieve a seemingly reform of common law doctrine, it will be necessary to be able to justify that reform in a context of retrospectivity. Thus, reform is likely to be confined to circumstances where the unsatisfactory state of prior doctrine is such that members of the profession are likely to predict that change will occur. Where this is so, reliance on the pre-existing doctrine will be risky and therefore less likely to occur. Accordingly, the achievement of judicial reform will be less destabilizing than it might otherwise be. If, on the other hand, the courts are free to change the existing doctrine with only a prospective effect, there may exist a greater temptation to reform the law through judicial pronouncement since the burden of retrospectivity—the need to explain that a changed legal doctrine applies to the matter in dispute—has been alleviated. In this indirect way, then, it may be that the doctrine of retrospectivity has an important role to play in achieving an appropriate balance between the competing objectives of doctrinal stability and necessary or desirable reform of the law.

## Conclusion

How then are we to answer my student's question, "Where is the common law written down?" The answer to the question will not be satisfying to the typical first year student because, in truth, there is in fact no one place in which the common law on an interesting point is written down. As Lord Goff explained in *Lincoln City Council*, where a judge

attempts to determine what he understands the law to be, a judge discovers this

“from the applicable statutes, if any, and from precedents drawn from reports of previous judicial decisions. Nowadays, he draws much assistance from academic writings and statutes and, more especially, the effect of important cases; and he has regard, where appropriate, to decisions of judges in other jurisdictions.”<sup>71</sup>

Somewhere in all of this material and in the arguments of counsel and in his or her own ruminations, the judge will discover the true principle and may well express it in words which have never been uttered in precisely the same way on a previous occasion.

At the same time, and this is a more comforting thought for the beginning student, it must be remembered that one is not always at sea. In many situations, authoritative guidance can be found in the leading cases and in the secondary literature of the law with respect to the current state of common law doctrine. But it is an important and hard lesson for the beginner that the common law system is not closed and that the current state of the doctrine is, to varying degrees, vulnerable to change. Accordingly, it is perhaps quite useful that judges and other jurists discuss more openly than has been done in the past the criteria or guidelines for the appropriate exercise of the judicial capacity to adjust and reform the doctrines of the common law. Greater transparency of the mechanisms by which the common law reforms itself should enhance our professional capacity to anticipate and accommodate doctrinal change. From this perspective, the recent decisions of the Supreme Court of Canada which have explicitly analyzed these issues are very welcome indeed. It is very much to be hoped that the Court will have begun, in this fashion, a professional dialogue in which these principles and guidelines can be further discussed and refined.

---

<sup>71</sup> *Kleinwort Benson Ltd. v. Lincoln City Council*, *supra*, note 62, 534 and 535.

