COURT FILE NUMBER	1601-11552
COURT	COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL CENTRE	CALGARY
APPLICANT	NATIONAL BANK OF CANADA IN ITS CAPACITY AS ADMINISTRATIVE AGENT UNDER THAT CERTAIN AMENDED AND RESTATED CREDIT AGREEMENT DATED JANUARY 15, 2016, AS AMENDED
RESPONDENT	TWIN BUTTE ENERGY LTD. IN THE MATTER OF THE RECEIVERSHIP OF TWIN BUTTE ENERGY LTD.
PARTY FILING THIS DOCUMENT	ARGO PARTNERS AND HUSKY OIL OPERATIONS LIMITED
DOCUMENT	**WRITTEN BRIEF OF ARGO PARTNERS AND HUSKY OIL OPERATIONS LIMITED (Reply to *Ad Hoc* Committee Application re: Subordination)** ***June 30, 2017*** **Honourable Mr. Justice Jeffrey** **BOOK 2 OF 2** **(AUTHORITIES TABS 8-16)**
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TAB 8

London Drugs Limited *Appellant*

v.

Dennis Gerrard Brassart and Hank Vanwinkel *Respondents*

and

Kuehne & Nagel International Ltd. and Federal Pioneer Limited *Third Parties*

and

General Truck Drivers and Helpers Local Union No. 31 *Intervener*

INDEXED AS: LONDON DRUGS LTD. *v.* KUEHNE & NAGEL INTERNATIONAL LTD.

File No.: 21980.

1991: October 29; 1992: October 29.

Present: La Forest, L'Heureux-Dubé, Sopinka, Cory, McLachlin, Stevenson* and Iacobucci JJ.

ON APPEAL FROM THE COURT OF APPEAL FOR BRITISH COLUMBIA

Torts — Negligence — Duty of care — Transformer being stored in warehouse facility — Warehouse employees negligently damaging transformer — Whether employees owed duty of care to employer's customer — Whether employees can benefit from limitation of liability clause in contract of storage between employer and customer.

Contracts — Privity of contract — Limitation of liability clause — Transformer being stored in warehouse facility — Warehouse employees negligently damaging transformer — Whether employees owed duty of care to employer's customer — Whether employees can benefit from limitation of liability clause in contract of storage between employer and customer.

The appellant delivered a transformer to a warehouse company for storage pursuant to the terms and conditions of a standard form contract, which included a limi-

* Stevenson J. took no part in the judgment.

London Drugs Limited *Appelante*

c.

Dennis Gerrard Brassart et Hank Vanwinkel *Intimés*

et

Kuehne & Nagel International Ltd. et Federal Pioneer Limited *Mises en cause*

et

General Truck Drivers and Helpers Local Union No. 31 *Intervenant*

RÉPERTORIÉ: LONDON DRUGS LTD. *c.* KUEHNE & NAGEL INTERNATIONAL LTD.

N° du greffe: 21980.

1991: 29 octobre; 1992: 29 octobre.

Présents: Les juges La Forest, L'Heureux-Dubé, Sopinka, Cory, McLachlin, Stevenson* et Iacobucci.

EN APPEL DE LA COUR D'APPEL DE LA COLOMBIE-BRITANNIQUE

Responsabilité délictuelle — Négligence — Obligation de diligence — Transformateur gardé dans un entrepôt — Transformateur endommagé en raison de la négligence d'employés de l'entrepôt — Les employés avaient-ils une obligation de diligence à l'égard du client de l'employeur? — Les employés peuvent-ils invoquer la clause de limitation de responsabilité du contrat d'entreposage conclu par l'employeur et le client?

Contrats — Lien contractuel — Clause de limitation de responsabilité — Transformateur gardé dans un entrepôt — Transformateur endommagé en raison de la négligence d'employés de l'entrepôt — Les employés avaient-ils une obligation de diligence à l'égard du client de l'employeur? — Les employés peuvent-ils invoquer la clause de limitation de responsabilité du contrat d'entreposage conclu par l'employeur et le client?

L'appelante a livré à une entreprise d'entreposage un transformateur qui devait être entreposé conformément aux modalités d'un contrat type, qui comportait une

* Le juge Stevenson n'a pas pris part au jugement.

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the tort action are proved. The liability of the company to the plaintiff is determined under the ordinary rules applicable to cases of vicarious liability. If the tort is related to the contract, the next question to be resolved is whether any reliance by the plaintiff on the employee was reasonable. The question here is whether the plaintiff reasonably relied on the eventual legal responsibility of the defendants under the circumstances.

envers le demandeur si les éléments de l'action délictuelle sont établis. La responsabilité de la société envers la demanderesse est déterminée selon les règles ordinaires qui s'appliquent aux affaires de responsabilité du fait d'autrui. Dans le cas d'un délit lié à un contrat, il faut se demander s'il était raisonnable pour le demandeur de faire confiance à l'employé. Ici, il s'agit de savoir si, dans les circonstances, la demanderesse a compté raisonnablement sur la responsabilité éventuelle des défendeurs sur le plan juridique.

In this case, as I noted, the tort was related to the contract and any reliance by the plaintiff on Vanwinkel and Brassart was not reasonable.

En l'espèce, comme je l'ai fait remarquer, le délit était lié au contrat et il n'était pas raisonnable pour la demanderesse de se fier à Vanwinkel et à Brassart.

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Disposition

I would dismiss the appeal, allow the cross-appeal and dismiss the action against the employees, with costs throughout.

Dispositif

Je rejetterais le pourvoi, j'accueillerais le pourvoi incident et je rejetterais l'action contre les employés, avec dépens dans toutes les cours.

The judgment of L'Heureux-Dubé, Sopinka, Cory and Iacobucci JJ. was delivered by

Version française du jugement des juges L'Heureux-Dubé, Sopinka, Cory et Iacobucci rendu par

IACOBUCCI J.—This appeal and cross-appeal raise two principal issues: (1) the duty of care owed by employees to their employer's customers, and (2) the extent to which employees can claim the benefit of their employer's contractual limitation of liability clause.

LE JUGE IACOBUCCI—Les présents pourvoi principal et pourvoi incident portent essentiellement sur deux questions, soit 1) l'obligation de diligence qu'a l'employé envers la clientèle de son employeur et 2) la mesure dans laquelle l'employé peut invoquer la clause contractuelle de limitation de la responsabilité de son employeur.

I. Facts

The facts are not complicated. On August 31, 1981, London Drugs Limited (hereinafter "appellant") delivered a transformer weighing some 7,500 pounds to Kuehne and Nagel International Ltd. (hereinafter "Kuehne & Nagel") for storage pursuant to the terms and conditions of a standard form contract of storage. The transformer had been purchased from its manufacturer, Federal Pioneer Limited, and was to be installed in the new warehouse facility being built by the appellant. The contract of storage included the following limitation of liability clause:

I. Les faits

Les faits sont simples. Le 31 août 1981, London Drugs Limited (ci-après l'«appelante») a livré à Kuehne and Nagel International Ltd. (ci-après «Kuehne & Nagel») un transformateur pesant quelque 7 500 livres qui devait être entreposé conformément aux modalités d'un contrat type d'entreposage. Acquis auprès de son fabricant, Federal Pioneer Limited, le transformateur devait être installé dans le nouvel entrepôt que l'appelante était en train de construire. Le contrat d'entreposage comportait la clause suivante de limitation de la responsabilité:

LIABILITY - Sec. 11(*a*) The responsibility of a warehouseman in the absence of written provisions is the reasonable care and diligence required by the law.

(*b*) The warehouseman's liability on any one package is limited to $40 unless the holder has declared in writing a valuation in excess of $40 and paid the additional charge specified to cover warehouse liability.

With full knowledge and understanding of this clause, the appellant chose not to obtain additional insurance from Kuehne & Nagel and instead arranged for its own all-risk coverage. At the time of entering into the contract, the appellant knew, or can be assumed to have known, that Kuehne & Nagel's employees would be responsible for moving and upkeeping the transformer.

On September 22, 1981, Dennis Gerrard Brassart and Hank Vanwinkel (hereinafter "respondents"), both employees of Kuehne & Nagel, received orders to load the transformer onto a truck which would deliver it to the appellant's new warehouse. The respondents attempted to move the transformer by lifting it with two forklift vehicles when safe practice required it to be lifted from above using brackets which were attached to the transformer and which were clearly marked for that purpose. While being lifted, the transformer toppled over and fell causing damages in the amount of $33,955.41.

Alleging breach of contract and negligence, the appellant brought an action for damages against Kuehne & Nagel, Federal Pioneer Limited, and the respondents. In a judgment rendered on April 14, 1986, Trainor J. of the Supreme Court of British Columbia held that the respondents were personally liable for the full amount of damages, limiting Kuehne & Nagel's liability to $40 and dismissing the claim against Federal Pioneer Limited. On March 30, 1990, the majority of the Court of Appeal allowed the respondents' appeal and reduced their liability to $40. The appellant was granted leave to appeal to this Court on December 7, 1990, [1990] 2 S.C.R. viii. The respondents

[TRADUCTION] RESPONSABILITÉ - Al. 11*a*) En l'absence de dispositions écrites, l'entreposeur est tenu de faire preuve de la prudence et de la diligence raisonnables que requiert la loi.

b) La responsabilité de l'entreposeur à l'égard d'un colis donné est limitée à 40 $, à moins que l'entrepositaire n'ait déclaré par écrit que la valeur de l'objet en cause est supérieure à 40 $ et qu'il n'ait acquitté les frais supplémentaires spécifiés pour qu'il y ait responsabilité accrue de l'entreposeur.

Connaissant et comprenant parfaitement cette clause, l'appelante a choisi non pas de souscrire une assurance supplémentaire auprès de Kuehne & Nagel, mais plutôt de s'organiser pour souscrire sa propre assurance tous risques. Au moment de conclure le contrat, l'appelante savait que des employés de Kuehne & Nagel seraient chargés du déplacement et de l'entretien du transformateur, ou on peut présumer qu'elle le savait.

Le 22 septembre 1981, deux employés de Kuehne & Nagel, Dennis Gerrard Brassart et Hank Vanwinkel (ci-après les «intimés»), ont reçu l'ordre de charger le transformateur à bord d'un camion en vue de le livrer au nouvel entrepôt de l'appelante. Les intimés ont tenté de déplacer le transformateur en le soulevant à l'aide de deux chariots élévateurs à fourche, alors que la prudence commandait de le hisser par des points d'attache nettement prévus à cette fin. Le transformateur a alors basculé et est tombé, ce qui a entraîné des dommages s'élevant à 33 955,41 $.

Invoquant l'inexécution du contrat et la négligence, l'appelante a intenté une action en dommages-intérêts contre Kuehne & Nagel, Federal Pioneer Limited et les intimés. Dans un jugement rendu le 14 avril 1986, le juge Trainor de la Cour suprême de la Colombie-Britannique a tenu les intimés personnellement responsables de la totalité des dommages causés, a limité la responsabilité de Kuehne & Nagel à 40 $ et a rejeté l'action intentée contre Federal Pioneer Limited. Le 30 mars 1990, la Cour d'appel, à la majorité, a accueilli l'appel des intimés et a abaissé le montant de leur responsabilité à 40 $. Le 7 décembre 1990, l'appelante a reçu l'autorisation de se pourvoir devant notre

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have cross-appealed in order to argue that they should be completely free of liability. A written intervention was made by the General Truck Drivers & Helpers Local Union No. 31, the union authorized to negotiate the collective agreement with Kuehne & Nagel which, at all material times, governed the respondents' employment relationship.

II. Judgments in the Courts Below

A. *Supreme Court of British Columbia* (1986), 2 B.C.L.R. (2d) 181

Trainor J. held that Federal Pioneer Limited was not negligent in its manufacturing and packaging of the transformer. On the other hand, he found the respondent employees negligent in their handling of the transformer, but limited Kuehne & Nagel's vicarious liability to $40 in accordance with the limitation of liability clause found in the contract of storage. According to the trial judge, the main issue was whether this clause also limited the respondents' liability to $40.

After a review of the relevant jurisprudence, the trial judge held that there is no general rule in British Columbia barring an employee from being sued for a tort committed in the course of carrying out the very services for which the plaintiff had contracted with his or her employer. This was said in answer to the respondents' argument that they should be given the protection of the limitation of liability clause since their negligence was not an "independent tort" in itself, but rather negligence in the very course of performing the contract between their employer and the appellant.

An alternative submission at trial was that the respondents could benefit from the clause in question since the appellant, in the circumstances of this case, had impliedly consented to the limitation of liability extending to the conduct of Kuehne & Nagel's employees. The circumstances relied on

Cour, [1990] 2 R.C.S. viii. Les intimés ont formé un pourvoi incident afin d'être dégagés de toute responsabilité. General Truck Drivers & Helpers Local Union No. 31, le syndicat autorisé à négocier avec Kuehne & Nagel la convention collective qui, pendant toute la période pertinente, régissait les relations de travail des intimés, a produit une intervention écrite.

II. Les jugements des tribunaux d'instance inférieure

A. *Cour suprême de la Colombie-Britannique* (1986), 2 B.C.L.R. (2d) 181

Le juge Trainor a conclu que Federal Pioneer Limited n'avait pas fait preuve de négligence dans la fabrication et l'emballage du transformateur. Par contre, il a jugé que les employés intimés avaient manipulé le transformateur de manière négligente, mais il a limité à 40 $ la responsabilité du fait d'autrui imputée à Kuehne & Nagel, conformément à la clause de limitation de la responsabilité que contenait le contrat d'entreposage. Selon le juge de première instance, il s'agissait surtout de déterminer si cette clause avait également pour effet de limiter à 40 $ la responsabilité des intimés.

Après avoir examiné la jurisprudence applicable, le juge de première instance a statué qu'il n'existe, en Colombie-Britannique, aucune règle générale qui empêche de poursuivre un employé pour un délit commis pendant la prestation des services mêmes que vise un contrat intervenu entre le demandeur et l'employeur de cet employé. Il répondait ainsi à l'argument des intimés selon lequel ils devraient bénéficier de la protection de la clause de limitation de la responsabilité vu que leur négligence ne constituait pas en soi un «délit indépendant», mais une négligence survenue dans l'exécution même du contrat liant leur employeur et l'appelante.

En première instance, on a avancé un argument subsidiaire selon lequel les intimés pouvaient bénéficier de la clause en question puisque l'appelante avait, en l'occurrence, consenti implicitement à ce que la limitation de la responsabilité s'applique également à la conduite des employés de

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were the appellant's knowledge that employees would be handling its transformer, its knowledge and acceptance of the limitation of liability clause, and its decision to purchase its own insurance. In essence, the argument was that the appellant had voluntarily accepted the risk of damage flowing from the respondents' negligence and should accordingly bear the cost of the damages. While the trial judge expressed sympathy for this submission, he felt that accepting it would require rewriting the contract; a course "not open to me".

Accordingly, Trainor J. held that the limitation of liability clause in the contract was not available to the respondents who were thus liable for the full amount of damages caused to the transformer.

B. *Court of Appeal of British Columbia* (1990), 45 B.C.L.R. (2d) 1

The Court of Appeal, sitting exceptionally as a panel of five, reversed the judgment against the respondents by a four-to-one majority. With the exception of Hinkson J.A. (who was silent on the issue), all justices acknowledged that privity of contract was a major obstacle to the respondents' claim to the benefit of the limitation of liability clause. However, using different approaches, the majority concluded that the respondents' liability was nonetheless limited to $40. McEachern C.J.B.C. and Wallace J.A. adopted what has been referred to as a "tort analysis". Writing separate reasons, they were of the opinion that the duty of care owed by the respondents to the appellant was, in all the circumstances, qualified so as to limit the amount of recovery to $40. Preferring a "contract analysis", Lambert J.A. implied a term in s. 11(*b*) of the contract of storage which extended the limitation of liability to the respondents and then apparently applied the agency/unilateral contract exception to the doctrine of privity. For his part, Hinkson J.A. concluded that the respondents did not owe any duty of care towards the appellant and he would have imposed no liability whatsoever on them. Finally, Southin J.A., in dissent, said the

Kuehne & Nagel. On invoquait le fait que l'appelante savait que des employés manipuleraient le transformateur, qu'elle avait pris connaissance de la clause de limitation de la responsabilité et l'avait acceptée, et qu'elle avait décidé de souscrire sa propre assurance. On faisait valoir essentiellement que l'appelante avait volontairement accepté le risque de dommages résultant de la négligence des intimés et devait donc supporter le coût des dommages subis. Bien que le juge de première instance ait considéré d'un bon œil cet argument, il a estimé qu'y faire droit reviendrait à réécrire le contrat, ce qu'il [TRADUCTION] «ne m'est pas loisible de faire».

En conséquence, le juge Trainor a statué que les intimés ne pouvaient pas invoquer la clause de limitation de la responsabilité figurant au contrat, de sorte qu'ils étaient responsables de la totalité des dommages causés au transformateur.

B. *Cour d'appel de la Colombie-Britannique* (1990), 45 B.C.L.R. (2d) 1

Constituée exceptionnellement de cinq juges, la Cour d'appel a, à raison de quatre juges contre un, infirmé le jugement défavorable aux intimés. À l'exception du juge Hinkson (qui ne s'est pas prononcé sur la question), tous les juges ont reconnu que le principe du lien contractuel ou de la relativité des contrats constituait un obstacle majeur à la revendication par les intimés du bénéfice de la clause de limitation de la responsabilité. Cependant, les juges formant la majorité ont conclu, en procédant de manières différentes, que la responsabilité des intimés était néanmoins limitée à 40 $. Le juge en chef McEachern de la Colombie-Britannique et le juge Wallace ont eu recours à ce qu'on a appelé une analyse fondée sur la responsabilité délictuelle («analyse délictuelle»). Ils ont exprimé, dans des motifs distincts, l'opinion que, compte tenu de toutes les circonstances, l'obligation de diligence des intimés envers l'appelante était atténuée de manière à limiter le montant de l'indemnité à 40 $. Préférant une analyse fondée sur le droit des contrats («analyse contractuelle»), le juge Lambert a déduit du texte de l'al. 11*b*) du contrat d'entreposage l'existence d'une condition qui étendait la limitation de la responsabilité aux

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present action was in trespass to goods, not in negligence, and accordingly the appellant could recover against the respondents for the cost of repair to its transformer.

intimés et il a alors apparemment appliqué l'exception du mandat ou du contrat unilatéral au principe du lien contractuel. Pour sa part, le juge Hinkson a conclu que les intimés n'avaient aucune obligation de diligence envers l'appelante et il les aurait dégagés de toute responsabilité. Enfin, dans sa dissidence, le juge Southin a affirmé que l'action était fondée non pas sur la négligence, mais sur l'atteinte à la possession mobilière. Elle a donc statué que l'appelante pouvait se faire indemniser, par les intimés, des frais de réparation de son transformateur.

Because of the importance of the issues involved in this case and the variety of approaches taken by the members of the Court below, a fuller discussion of the reasons of the Court of Appeal is warranted.

Étant donné l'importance des questions en litige dans la présente affaire et la diversité des façons de procéder des juges de la Cour d'appel, il y a lieu de procéder à une analyse plus globale des motifs de cette cour.

(1) Reasons of McEachern C.J.B.C.

McEachern C.J.B.C. began his reasons with an analysis of the doctrine of privity of contract as it applies in this area of law. He reviewed the authorities, in particular *Scruttons Ltd. v. Midland Silicones Ltd.*, [1962] A.C. 446 (H.L.), *New Zealand Shipping Co. v. A. M. Satterthwaite & Co. (The Eurymedon)*, [1975] A.C. 154 (P.C.), and the decisions of this Court in *Greenwood Shopping Plaza Ltd. v. Beattie*, [1980] 2 S.C.R. 228, and *ITO—International Terminal Operators Ltd. v. Miida Electronics Inc.*, [1986] 1 S.C.R. 752. He distinguished the case at bar from *The Eurymedon* and from *ITO—International Terminal Operators* on the basis that the bills of lading in those cases clearly defined the "commercial intention" of the parties and the courts therein were simply giving effect to this intention by permitting non-party stevedores to rely on limitation of liability clauses. In the case at bar, however, McEachern C.J.B.C. felt there was no ascertainable commercial intention with respect to s. 11 of the contract of storage. Moreover, there was no evidence to support a finding of trust or agency. McEachern C.J.B.C. disagreed with the approach of Lambert J.A. who implied a term into the contract extending the benefit of the clause to the respondents. According to him, there were no pleadings or evidence in support of such an interpretation. Accordingly, he felt bound by

1) Les motifs du juge en chef McEachern

Le Juge en chef commence, dans ses motifs, par analyser le principe du lien contractuel qui s'applique dans ce domaine du droit. Il examine la jurisprudence, notamment les arrêts *Scruttons Ltd. c. Midland Silicones Ltd.*, [1962] A.C. 446 (H.L.), *New Zealand Shipping Co. c. A. M. Satterthwaite & Co. (The «Eurymedon»)*, [1975] A.C. 154 (C.P.), ainsi que les arrêts de notre Cour *Greenwood Shopping Plaza Ltd. c. Beattie*, [1980] 2 R.C.S. 228, et *ITO—International Terminal Operators Ltd. c. Miida Electronics Inc.*, [1986] 1 R.C.S 752. Il établit entre le présent cas et les affaires *Eurymedon* et *ITO—International Terminal Operators* une distinction fondée sur le fait que, dans ces deux derniers cas, les connaissements définissaient clairement l'«intention commerciale» des parties et que les tribunaux ont simplement mis à exécution cette intention en permettant à des tiers manutentionnaires d'invoquer les clauses de limitation de la responsabilité. Dans la présente affaire, le juge en chef McEachern a cependant estimé qu'il n'y avait aucune intention commerciale vérifiable relativement à l'art. 11 du contrat d'entreposage. En outre, aucun élément de preuve n'établissait l'existence d'une fiducie ou d'un mandat. Le juge en chef McEachern n'a pas souscrit à la façon de procéder du juge Lambert qui a déduit l'existence dans le

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the decision of this Court in *Greenwood Shopping Plaza, supra*, to hold that the respondents were without the protection of the contract.

Having said this, McEachern C.J.B.C. embarked upon a tort analysis. At the outset, he stated that the respondents were "clearly under a duty to take reasonable care of the [appellant's] transformer under the law as it existed both before and after *Donoghue*" (p. 22). The real question was whether this duty, or the consequences of its breach, should be modified in this case. The Chief Justice held that *Anns v. Merton London Borough Council*, [1978] A.C. 728, applied by this Court in *Kamloops (City of) v. Nielsen*, [1984] 2 S.C.R. 2, is sufficient authority to conclude that it is necessary to look at all the circumstances before deciding the nature and consequences of a breach of the duty of care, if any, which an employee owes to his or her employer's contractual partner. The "most significant fact" in this case, according to McEachern C.J.B.C., was that the respondents were acting in a contractual setting in which the appellant had voluntarily agreed with their employer that the latter would exercise reasonable care and diligence and that the right of recovery for a breach would be limited to $40. In his words, the parties established their "own law for this transaction". In the Chief Justice's opinion, a contract between two parties may be relevant in determining tort rights and duties arising within the contractual matrix. He stated it would be unreasonable to conclude that the appellant relied on Kuehne & Nagel's obligation under the contract for the first $40 of any damage, looking to the respondents for the balance. Further, it would be unreasonable to expect the respondents to be aware that they might be relied upon beyond the extent to which their employer's liability was limited. Finally, it is reasonable that the appellant's remedy for the respondents' tort should be no greater than that which the appellant agreed would be imposed upon their employer. In view of these circum-

contrat d'une condition qui étendait aux intimés le bénéfice de la clause. Selon lui, aucun argument ni aucun élément de preuve n'étayaient une telle interprétation. Par conséquent, il s'estimait tenu, en raison de l'arrêt de notre Cour *Greenwood Shopping Plaza*, précité, de statuer que les intimés ne bénéficiaient pas de la protection du contrat.

Après avoir dit cela, le juge en chef McEachern a entrepris une analyse fondée sur la responsabilité délictuelle. Il a affirmé, au départ, que les intimés avaient [TRADUCTION] «nettement l'obligation de prendre raisonnablement soin du transformateur [de l'appelante], selon le droit applicable tant avant qu'après l'arrêt *Donoghue*» (p. 22). Il s'agissait en fait de déterminer si cette obligation ou les conséquences d'un manquement à celle-ci devraient être modifiées en l'espèce. Le Juge en chef a statué que l'arrêt *Anns c. Merton London Borough Council*, [1978] A.C. 728, appliqué par notre Cour dans *Kamloops (Ville de) c. Nielsen*, [1984] 2 R.C.S. 2, est suffisant pour conclure qu'il est nécessaire de tenir compte de toutes les circonstances pour déterminer la nature et les conséquences d'un manquement à l'obligation de diligence, s'il en est, qu'a l'employé envers le cocontractant de son employeur. Selon le juge en chef McEachern, le [TRADUCTION] «fait le plus révélateur» dans la présente affaire était que les intimés agissaient dans un cadre contractuel où l'appelante avait délibérément convenu avec leur employeur que ce dernier ferait preuve d'une prudence et d'une diligence raisonnables et que tout droit à une indemnité en cas d'inexécution serait limité à 40 $. Pour reprendre l'expression qu'il a utilisée, les parties ont établi leur [TRADUCTION] «propre droit relativement à cette opération». De l'avis du Juge en chef, un contrat liant deux parties peut être utile pour déterminer les droits et obligations en matière délictuelle qui prennent naissance dans le cadre contractuel. Il a affirmé qu'il serait déraisonnable de conclure que l'appelante invoquait l'obligation qui incombait à Kuehne & Nagel aux termes du contrat, quant à la première tranche de 40 $ de dommages, pour s'en remettre aux intimés quant au reste. De plus, il serait déraisonnable de s'attendre à ce que les intimés soient conscients qu'ils peu-

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stances, McEachern C.J.B.C. would limit the respondents' liability to $40.

vent être appelés à verser une indemnité supérieure au montant auquel la responsabilité de leur employeur a été limitée. Enfin, il est raisonnable que le redressement accordé à l'appelante pour le délit des intimés ne soit pas plus important que celui qui, selon ce que l'appelante a convenu, serait réclamé à l'employeur, le cas échéant. Compte tenu de ces circonstances, le juge en chef McEachern aurait limité à 40 $ la responsabilité des intimés.

(2) Reasons of Hinkson J.A.

The reasons of Hinkson J.A. are limited to the issue of whether the respondents owed a duty of care to the appellant. Hinkson J.A. reviewed the jurisprudence starting with *Donoghue v. Stevenson*, [1932] A.C. 562 (H.L.), and *Anns, supra*, placing considerable attention on recent English decisions which, in his words, have given "fresh consideration" to what is involved in the "concept of proximity". In particular, he relied on *Junior Books Ltd. v. Veitchi Co.*, [1983] 1 A.C. 520 (H.L.), where Lord Roskill said this concept "must always involve, at least in most cases, some degree of reliance" (p. 546), and on two Court of Appeal decisions in which a factor of "just and reasonable" has been, apparently, added to the analysis: *Norwich City Council v. Harvey*, [1989] 1 All E.R. 1180 (C.A.), and *Pacific Associates Inc. v. Baxter*, [1990] 1 Q.B. 993 (C.A.).

Hinkson J.A. conceded that, in most cases, employees such as the respondents would owe a duty of care to their employer's contractual partners. However, he added that there was no element of reliance in the case at bar. The appellant voluntarily accepted the risk of damage to its transformer and took steps to protect itself through its own policy of insurance. Hinkson J.A. concluded that the circumstances of the case did not disclose that there existed "such a close and direct relationship of proximity" between the appellant and the respondents as to give rise to a duty of care by the latter to the former. He added that in all the circumstances, it would not be "just and reasonable" to hold that the respondent employees owed a duty

2) Les motifs du juge Hinkson

Les motifs du juge Hinkson ne portent que sur la question de savoir si les intimés avaient une obligation de diligence envers l'appelante. Le juge Hinkson a examiné la jurisprudence en commençant par les arrêts *Donoghue c. Stevenson*, [1932] A.C. 562 (H.L.) et *Anns*, précité, en insistant beaucoup sur de récentes décisions anglaises qui, selon lui, jetaient un [TRADUCTION] «éclairage nouveau» sur ce que comprend la «notion du lien étroit». Il a plus particulièrement invoqué l'arrêt *Junior Books Ltd. c. Veitchi Co.*, [1983] 1 A.C. 520 (H.L.), dans lequel lord Roskill a affirmé que cette notion [TRADUCTION] «doit toujours comporter, du moins dans la plupart des cas, un certain degré de confiance» (p. 546), ainsi que deux arrêts de la Cour d'appel dans lesquels un élément de ce qui est «juste et raisonnable» a apparemment été ajouté à l'analyse, soit *Norwich City Council c. Harvey*, [1989] 1 All E.R. 1180 (C.A.), et *Pacific Associates Inc. c. Baxter*, [1990] 1 Q.B. 993 (C.A.).

Le juge Hinkson a admis que, dans la plupart des cas, des employés comme les intimés auraient une obligation de diligence envers les cocontractants de leur employeur. Toutefois, il a ajouté qu'aucun élément de confiance n'était présent en l'espèce. L'appelante avait délibérément accepté le risque d'endommagement de son transformateur et avait pris des mesures pour se protéger en souscrivant sa propre police d'assurance. Le juge Hinkson a conclu que les circonstances de l'espèce ne révélaient pas l'existence [TRADUCTION] «d'un lien suffisamment étroit et direct» entre l'appelante et les intimés pour que ces derniers aient une obligation de diligence envers l'appelante. Il a précisé que, quoi qu'il en soit, il ne serait pas «juste et raison-

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of care to the appellant. Accordingly, he would have imposed no liability on the respondents for the damages to the transformer.

(3) <u>Reasons of Lambert J.A.</u>

Lambert J.A. agreed with McEachern C.J.B.C. and Wallace J.A. that the respondents' liability should be limited to $40; however, he refused to undertake an "adventurous and perilous tort analysis" in order to reach this conclusion. He began by stating that Kuehne & Nagel and the respondents owed a duty of care to the appellant. In his opinion, an express or implied contract for services brings the customer, on the one hand, and the employer and employees, on the other, into a relationship of "sufficient proximity" to lay the foundation for a duty of care on the part of both the employer and the employee to the customer. Besides mere proximity, many factors will determine whether a duty of care arises in the end; in particular, reliance by the customer on the employer and/or employees. According to Lambert J.A., reliance can be assumed in most cases involving direct physical damage to persons or property.

Lambert J.A. held that the respondents' duty of care is unaffected by the presence of the limitation of liability clause in the contract of storage. According to him, ss. 2(4)(*b*) and 13 of the *Warehouse Receipt Act*, R.S.B.C. 1979, c. 428, support the view that the clause was intended only to limit the extent of liability consequent upon a breach of duty of care, rather than to limit or negate the scope of that duty. This clause should not be used as evidence that the appellant assumed the risk of damage and released the respondents from their duty of care. In addition, Lambert J.A. reviewed and criticized what he calls the "just and reasonable test", sometimes used by English courts to deny the existence of a duty of care which proximity and foreseeability of damage would otherwise bring into effect. He does not think that this test

nable» de conclure que les employés intimés avaient une obligation de diligence envers l'appelante. En conséquence, il n'aurait imposé aucune responsabilité aux intimés pour les dommages causés au transformateur.

3) <u>Les motifs du juge Lambert</u>

Le juge Lambert a convenu avec le juge en chef McEachern et le juge Wallace que la responsabilité des intimés devrait être limitée à 40 $, mais il a refusé de se livrer à une [TRADUCTION] «analyse délictuelle hasardeuse» pour en arriver à cette conclusion. Il a commencé par dire que Kuehne & Nagel et les intimés avaient une obligation de diligence envers l'appelante. Selon lui, l'existence d'un contrat exprès ou tacite visant la prestation de services crée entre le client, d'une part, et l'employeur et ses employés, d'autre part, un lien «suffisamment étroit» pour justifier l'existence d'une obligation de diligence de la part de l'employeur et de ses employés envers le client. Outre l'existence d'un simple lien étroit, il y a de nombreux facteurs qui permettent de déterminer si, en fin de compte, une obligation de diligence prend naissance, notamment la confiance qu'a le client en l'employeur ou ses employés, ou les deux à la fois. Selon le juge Lambert, on peut supposer qu'il existe une confiance dans la plupart des affaires où un préjudice physique a été causé directement à une personne ou à un bien.

Le juge Lambert a conclu que la présence d'une clause de limitation de la responsabilité dans le contrat d'entreposage ne change rien à l'obligation de diligence des intimés. Selon lui, l'al. 2(4)*b*) et l'art. 13 de la *Warehouse Receipt Act*, R.S.B.C. 1979, ch. 428, permettent de conclure que la clause avait uniquement pour objet de limiter la responsabilité découlant d'un manquement à l'obligation de diligence, et non de limiter ou de supprimer cette obligation. Cette clause ne devrait pas servir de preuve que l'appelante a assumé le risque d'endommagement et dégagé les intimés de leur obligation de diligence. De plus, le juge Lambert a examiné et critiqué ce qu'il a appelé le «critère de ce qui est juste et raisonnable», auquel les tribunaux anglais ont parfois recours pour nier l'existence d'une obligation de diligence à laquelle don-

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should be applied in Canada because it would "introduce into tort law a subjective factor which is unnecessary and which . . . would produce haphazard, idiosyncratic and unpredictable results" (p. 54). In any event, this test cannot operate to remove a duty of care that has long been recognized, such as the duty in the case at bar. Finally, Lambert J.A. claims that the second part of the *Anns* approach, which asks whether there are circumstances which ought "to negative, or to reduce or limit . . . the damages to which a breach of it [the *prima facie* duty] may give rise", refers to heads of damage and does not suggest that it is possible to modify the normal rules for the assessment of damages by putting a monetary limit on damages for negligence. In his opinion, the concept of a $40 duty of care is unknown to the law.

Having said this, Lambert J.A. held that the respondents were entitled to benefit from the limitation of liability clause according to well established principles of contract law. He reviewed the jurisprudence dealing with the doctrine of privity of contract and with the implication of contracual terms. In his view, it was necessary to imply a term in the contract in order to avoid the "commercial absurdity" brought about by the rights of contribution of the respondent employees against their employer, Kuehne & Nagel, pursuant to s. 4 of the *Negligence Act*, R.S.B.C. 1979, c. 298. According to him, if the respondents are found fully liable it is conceivable that they could then commence an action against Kuehne & Nagel for contribution of half the damages awarded to the appellant (i.e. $16,977.70). Such a result would render the limitation of liability clause in the contract of storage wholly ineffective; a result neither party intended. Accordingly, Lambert J.A. implied a term in s. 11(*b*) of the contract of storage to the effect that the liability of Kuehne & Nagel's employees would also be limited to $40. Having

nerait lieu, par ailleurs, l'existence d'un lien étroit et le fait que les dommages étaient prévisibles. Il ne croit pas que ce critère devrait s'appliquer au Canada parce qu'il [TRADUCTION] «introduir[ait] dans le droit de la responsabilité délictuelle un élément subjectif inutile qui [. . .] donnerait des résultats aléatoires, particuliers et imprévisibles» (p. 54). Quoi qu'il en soit, ce critère ne saurait avoir pour effet de supprimer une obligation de diligence reconnue depuis longtemps, comme celle dont il est question en l'espèce. Enfin, le juge Lambert soutient que le deuxième volet de l'approche adoptée dans l'arrêt *Anns*, qui consiste à déterminer s'il y a des circonstances qui devraient [TRADUCTION] «supprimer, atténuer ou limiter [. . .] les dommages-intérêts auxquels un manquement [à l'obligation *prima facie*] peut donner droit», renvoie aux postes de dommages-intérêts et n'implique pas qu'il est possible de modifier les règles normalement applicables à l'évaluation des dommages en limitant le montant des dommages-intérêts payables en cas de négligence. Selon lui, l'idée d'une obligation de diligence chiffrée à 40 $ est inconnue en droit.

Ceci dit, le juge Lambert a statué que, selon des principes bien établis du droit des contrats, les intimés avaient le droit de bénéficier de la clause de limitation de la responsabilité. Il a examiné la jurisprudence portant sur le principe du lien contractuel et sur l'existence de conditions contractuelles implicites. Selon lui, il était nécessaire de conclure à l'existence d'une condition dans le contrat afin d'éviter l'[TRADUCTION] «absurdité sur le plan commercial» résultant des droits à la contribution que l'art. 4 de la *Negligence Act*, R.S.B.C. 1979, ch. 298, confère aux employés intimés vis-à-vis de leur employeur, Kuehne & Nagel. Il était d'avis que, si les intimés étaient tenus entièrement responsables, il se pourrait bien qu'ils puissent intenter une action contre Kuehne & Nagel pour qu'ils versent une quote-part équivalant à la moitié des dommages-intérêts accordés à l'appelante (soit 16 977,70 $). Ce résultat rendrait totalement inopérante la clause contractuelle de limitation de la responsabilité et serait contraire à l'intention des parties. Le juge Lambert a donc conclu que l'al. 11*b*) du contrat d'entreposage avait tacitement

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implied such a term, he concluded that the agency exception to the doctrine of privity, developed in *The Eurymedon*, *supra*, and applied in *ITO—International Terminal Operators*, *supra*, applied so as to prevent the appellant from recovering more than $40 from the respondents (at p. 65).

(4) <u>Reasons of Wallace J.A.</u>

Like McEachern C.J.B.C., Wallace J.A. disposed of this case largely on the basis of tort law principles. After a review of English jurisprudence, Wallace J.A. stated that in order to determine whether a duty of care exists in a particular case, two approaches may be taken: (1) the *Anns*, *supra*, approach where, once you find there to be a *prima facie* duty of care, based on proximity and foreseeability, the surrounding circumstances must be examined to determine if the duty is negated or qualified in its nature or scope; or (2) the approach followed in *Pacific Associates Inc. v. Baxter*, *supra*, and *Norwich City Council v. Harvey*, *supra*, of considering three essential criteria to the existence of a duty of care: proximity, reliance and whether it is "just and reasonable" to impose such a duty. According to Wallace J.A., the end result is the same regardless of the approach taken: "a consideration of all the circumstances to determine whether a duty of care should fairly be imposed upon the alleged wrongdoer, and if so, its scope and its consequences" (at p. 77). He asserts that when the parties have come into a relationship of proximity because of a contract, the terms of that contract are among the circumstances that determine the existence and scope of the duties of care to be discharged by the parties.

In the case at bar, Wallace J.A. noted that by expressly agreeing to limit its claim to $40, the appellant assumed the risk of any damage in

pour effet de limiter également à 40 $ la responsabilité des employés de Kuehne & Nagel. Après avoir déduit l'existence de cette condition, il a conclu que l'exception du mandat au principe du lien contractuel, établie dans l'affaire *Eurymedon*, précitée, et appliquée dans *ITO—International Terminal Operators*, précité, s'appliquait de manière à empêcher l'appelante d'obtenir des intimés une indemnité supérieure à 40 $ (à la p. 65).

4) <u>Les motifs du juge Wallace</u>

À l'instar du juge en chef McEachern, le juge Wallace a statué sur la présente affaire en se fondant largement sur les principes du droit de la responsabilité délictuelle. Après avoir examiné la jurisprudence anglaise, il a affirmé que deux méthodes peuvent être adoptées pour déterminer s'il existe une obligation de diligence dans un cas donné: 1) la méthode de l'arrêt *Anns*, précité, selon laquelle, une fois établie l'existence d'une obligation *prima facie* de diligence fondée sur l'existence d'un lien étroit et sur la prévisibilité des dommages, il faut examiner les circonstances qui entourent l'incident pour déterminer si cette obligation est supprimée ou atténuée sur le plan de sa nature ou de sa portée, ou 2) la méthode suivie dans les arrêts *Pacific Associates Inc. c. Baxter* et *Norwich City Council c. Harvey*, précités, qui consiste à considérer trois critères essentiels à l'existence d'une obligation de diligence: le lien étroit, la confiance et la question de savoir s'il est «juste et raisonnable» d'imposer une telle obligation. Selon le juge Wallace, le résultat final est le même quelle que soit la méthode adoptée: [TRADUCTION] «l'examen de toutes les circonstances afin de déterminer s'il y a lieu, en toute équité, d'imposer une obligation de diligence à l'auteur présumé du délit et, le cas échéant, quelles en sont l'étendue et les conséquences» (à la p. 77). Il dit que, lorsqu'un lien étroit existe entre les parties en raison d'un contrat, les conditions de ce contrat font partie des circonstances qui déterminent l'existence et la portée des obligations de diligence que doivent remplir les parties.

Dans la présente affaire, le juge Wallace a fait remarquer qu'en acceptant expressément de limiter sa réclamation à 40 $, l'appelante a assumé le ris-

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excess of that sum. In his opinion, it could not be inferred that the appellant intended to retain a right to claim in tort against the respondents for the full amount of any loss, particularly since they were performing the very services which their employer, Kuehne & Nagel, was bound to provide under the contract. These circumstances were said to limit the scope of the respondents' duty of care to the same extent as the duty their employer owed, namely, to $40. Wallace J.A. did not find privity of contract to be a bar to his finding. He notes that while third parties, such as the respondents, cannot benefit from a contract unless they fall within one of the established exceptions, the existence and nature of a contract nevertheless "provides the matrix or structural background which creates the common law duties, privileges, rights and obligations of a third party whose conduct is affected by such a contractual arrangement" (p. 81).

(5) Dissenting Reasons of Southin J.A.

Southin J.A. agreed with McEachern C.J.B.C.'s reasons on the issue of privity of contract. She added that the limitation of liability clause in question is not a "landlubber's version of a Himalaya clause" so as to permit the respondents to rely on this Court's decision in *ITO—International Terminal Operators*, *supra*. Southin J.A. also expressed the view that there is no doctrine of "vicarious immunity" in the common law.

Differing from her colleagues, she took the view that the notion of duty of care was irrelevant in the case at bar since the appellant's action was founded on trespass to goods. In her opinion, "the modern tort of negligence, all-devouring monster though it is, has not swallowed up the tort of trespass" (p. 92). She held that the tort of trespass does not require any consideration of modern notions of duty of care. Southin J.A. thus concluded that the respondents were liable for trespass to goods by dropping the transformer and that the appellant may recover the cost of repair. In closing, Southin J.A. added: "I regret to have had to come to this

que de tout dommage excédant cette somme. À son avis, on ne pouvait conclure que l'appelante avait voulu conserver le droit d'exercer un recours délictuel contre les intimés afin d'obtenir le plein montant de toute perte subie, d'autant plus que les intimés fournissaient les services mêmes que leur employeur, Kuehne & Nagel, était tenu de fournir aux termes du contrat. On a dit que ces circonstances limitaient la portée de l'obligation de diligence des intimés dans la même mesure que celle qui incombait à leur employeur, et que leur responsabilité était ainsi limitée à 40 $. Le juge Wallace n'a pas jugé que le principe du lien contractuel faisait obstacle à cette conclusion. Il a souligné que, même si des tiers, comme les intimés, ne peuvent bénéficier d'un contrat que si l'une des exceptions prévues s'applique à leur égard, l'existence et la nature d'un contrat [TRADUCTION] «fournissent [néanmoins] le cadre où le contexte qui engendre les devoirs, privilèges, droits et obligations de common law d'un tiers dont la conduite est touchée par une telle entente contractuelle» (p. 81).

5) Les motifs de dissidence du juge Southin

Souscrivant aux motifs du juge en chef McEachern sur la question du lien contractuel, le juge Southin a ajouté que la clause de limitation de la responsabilité en question n'était pas une [TRADUCTION] «version terrestre de la clause Himalaya», de manière à permettre aux intimés d'invoquer l'arrêt de notre Cour *ITO—International Terminal Operators*, précité. Le juge Southin a également exprimé l'avis qu'il n'existe aucun principe de l'«immunité dérivée» en common law.

Dissidente, elle a exprimé l'avis que la notion d'obligation de diligence ne s'appliquait pas en l'espèce puisque l'action de l'appelante était fondée sur une atteinte à la possession mobilière. Selon elle, [TRADUCTION] «la notion contemporaine du délit de négligence, véritable monstre à l'appétit d'ogre, n'a pas encore englouti le délit d'atteinte à la possession mobilière» (p. 92). Elle a décidé qu'il n'était pas nécessaire, à l'égard du délit d'atteinte à la possession mobilière, de prendre en considération les notions contemporaines de l'obligation de diligence. Elle a donc conclu que les intimés avaient porté atteinte à la possession

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conclusion because the result is, to my mind, in a moral sense, unjust" (p. 92).

mobilière en laissant tomber le transformateur et que l'appelante pouvait être indemnisée des frais de réparation. En terminant, elle a ajouté: [TRADUCTION] «Je suis désolée d'en être venue à cette conclusion, car le résultat me semble moralement injuste» (p. 92).

III. Issues

The cross-appeal raises the following question:

(1) Did the respondents, acting in the course of their employment and performing the very essence of their employer's contractual obligations with the appellant, owe a duty of care to the appellant?

If so, it is not disputed before this Court that the respondents were negligent in their handling of the appellant's transformer. In other words, the finding of the trial judge that the respondents breached their duty of care is not contested. Moreover, it is not disputed that it is the respondents' negligence which was the cause of the damages to the transformer and that these damages amount to $33,955.41. The next question which is raised by the appeal would thus become one of the appropriate liability for this breach, namely:

(2) Can the respondents obtain the benefit of the limitation of liability clause contained in the contract of storage between their employer and the appellant so as to limit their liability to $40?

For reasons that follow, I am of the opinion that both questions should be answered in the affirmative. By so concluding, both the cross-appeal and the appeal should therefore be dismissed.

III. Les questions en litige

Le pourvoi incident soulève la question suivante:

1) Les intimés avaient-ils, dans l'exercice de leurs fonctions et dans l'exécution de ce qui constitue essentiellement les obligations contractuelles de leur employeur envers l'appelante, une obligation de diligence envers celle-ci?

Si tel est le cas, nul ne conteste, devant notre Cour, que les intimés ont fait preuve de négligence lorsqu'ils ont manipulé le transformateur de l'appelante. En d'autres termes, la conclusion du juge de première instance selon laquelle les intimés ont manqué à leur obligation de diligence n'est pas attaquée. De plus, nul ne conteste que les dommages causés au transformateur sont imputables à la négligence des intimés et que leur montant s'élève à 33 955,41 $. La question que soulève ensuite le pourvoi porte donc sur la responsabilité qu'il convient d'imposer pour ce manquement, c'est-à-dire:

2) Les intimés peuvent-ils bénéficier de la clause de limitation de la responsabilité figurant dans le contrat d'entreposage intervenu entre leur employeur et l'appelante, de manière à ce que leur responsabilité soit limitée à 40 $?

Pour les motifs énoncés ci-après, je suis d'avis qu'il convient de répondre par l'affirmative à ces deux questions. Par conséquent, il y a lieu de rejeter tant le pourvoi incident que le pourvoi principal.

IV. Analysis

A. *Duty of Care*

The trial judge impliedly held that the respondents owed a duty of care to the appellant in the handling of the transformer, adding that in British

IV. Analyse

A. *L'obligation de diligence*

Le juge de première instance a statué implicitement que les intimés avaient une obligation de diligence envers l'appelante au moment de manipuler

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Columbia there is no general rule that an employee cannot be sued for a tort committed in the course of carrying out the very services for which the plaintiff had contracted with his or her employer. McEachern C.J.B.C. stated without qualification that the respondents were "clearly under a duty to take reasonable care of the [appellant's] transformer under the law as it existed both before and after *Donoghue*" (p. 22). Lambert J.A., while embarking on a more in-depth analysis of the question, came to the same conclusion again without much difficulty. Wallace J.A., for his part, held that the respondents owed a "*prima facie* duty of care" to the appellant based on the *Donoghue v. Stevenson*, *supra*, principle. Southin J.A. did not address the issue directly as she felt the appellant's cause of action was in trespass, rather than in negligence.

le transformateur, ajoutant qu'il n'y a, en Colombie-Britannique, aucune règle générale qui empêche de poursuivre un employé pour un délit commis dans la prestation des services mêmes que vise un contrat intervenu entre le demandeur et son employeur. Le juge en chef McEachern a affirmé sans réserve que les intimés avaient [TRADUCTION] «nettement l'obligation de prendre raisonnablement soin du transformateur [de l'appelante], selon le droit applicable tant avant qu'après l'arrêt *Donoghue*» (p. 22). Même s'il a procédé à une analyse plus approfondie de la question, le juge Lambert n'a pas eu beaucoup de difficulté à tirer la même conclusion. Pour sa part, le juge Wallace a statué que les intimés avaient une [TRADUCTION] «obligation *prima facie* de diligence» envers l'appelante, selon le principe énoncé dans l'arrêt *Donoghue c. Stevenson*, précité. Le juge Southin n'a pas abordé directement la question car elle estimait que le droit d'action de l'appelante se fondait non pas sur la négligence mais sur l'atteinte à la possession mobilière.

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As noted earlier, Hinkson J.A. was alone in concluding that the respondents owed no duty of care to the appellant. He came to this conclusion by referring to a number of English authorities which, in his view, qualify the two-stage approach of Lord Wilberforce in *Anns*, *supra*, by importing notions of reliance, justness and reasonability (as well as the established requirement of foreseeability) in the determination of whether or not a duty of care arises in a particular situation. In his view, there was no duty of care mainly because of an absence of reliance on the part of the appellant and also because it would not be "just and reasonable" to hold otherwise.

Tel que mentionné précédemment, le juge Hinkson a été le seul à conclure que les intimés n'avaient aucune obligation de diligence envers l'appelante. Il a tiré cette conclusion en mentionnant un certain nombre de précédents anglais qui, selon lui, venaient modifier la méthode à deux étapes mise de l'avant par lord Wilberforce dans l'arrêt *Anns*, précité, en faisant intervenir des notions de confiance et de caractère juste et raisonnable (de même que l'exigence établie de la prévisibilité des dommages) dans la détermination de l'existence ou non d'une obligation de diligence dans une situation donnée. À son avis, l'absence d'obligation de diligence découlait surtout de l'absence de confiance de la part de l'appelante, mais aussi du fait qu'il n'aurait pas été «juste et raisonnable» de tirer une autre conclusion.

In arguing that they did not owe any duty of care to the appellant, the respondents rely in part on the approach suggested by Hinkson J.A. They argue that the concept of "neighbourhood (or proximity)" cannot be reduced to the simple principle that factual foreseeability of damage creates, without more, a duty of care. The respondents offer a list of

En prétendant qu'ils n'avaient aucune obligation de diligence envers l'appelante, les intimés se fondent en partie sur le point de vue proposé par le juge Hinkson. Ils font valoir que la notion de «lien étroit» ne peut être ramenée au simple principe que la prévisibilité effective des dommages crée sans plus une obligation de diligence. Les intimés ont

English decisions showing some discontent with the approach set out in *Anns* and suggesting alternative interpretations of the proper "test" to be applied. It is submitted that many factors, besides foreseeability of damage, must be taken into account when determining the existence of a duty of care, namely, the reasonable expectations of the parties, reliance, the nature of the damage suffered and the existence of a pre-existing commercial agreement. Like Hinkson J.A., the respondents submit there is no reliance in the case at bar. But their argument does not end there. They submit that, as a general rule, an employee acting in the course of his or her employment and performing the essence of his or her employer's contractual obligations with a "third party" does not owe an "independent duty of care" to that "third party". In such a case, it is argued, the third party — or customer — should have no cause of action against the employee in negligence. The respondents offer some cases to support this principle and submit that it is sensible in light of what they call modern economic, employment and legal conditions. In particular, they claim the "central element" of reliance is almost always absent between individual employees and their employer's customers.

produit une liste de décisions anglaises qui révèlent un certain mécontentement au sujet de la méthode énoncée dans l'arrêt *Anns* et qui proposent d'autres interprétations du «critère» qu'il convient d'appliquer. On soutient qu'outre la prévisibilité des dommages, de nombreux facteurs doivent être pris en considération pour déterminer l'existence d'une obligation de diligence, notamment les attentes raisonnables des parties, la confiance, la nature des dommages subis et l'existence préalable d'une entente commerciale. À l'instar du juge Hinkson, les intimés soutiennent qu'il n'est pas question de confiance en l'espèce. Or, leur argument ne s'arrête pas là. Ils font valoir qu'en règle générale l'employé agissant dans l'exercice de ses fonctions et exécutant ce qui constitue essentiellement les obligations contractuelles de son employeur envers un «tiers» n'a aucune [TRADUCTION] «obligation de diligence indépendante» envers ce «tiers». Ils soutiennent que, dans un tel cas, le tiers, ou le client, ne devrait avoir contre l'employé aucun droit d'action fondé sur la négligence. Les intimés invoquent certaines décisions à l'appui de ce principe et ils affirment qu'il est raisonnable compte tenu de ce qu'ils appellent les conditions actuelles de l'économie, du travail et du droit. Plus particulièrement, ils prétendent que l'«élément central» de la confiance est presque toujours absent des relations entre les employés pris individuellement et les clients de leur employeur.

For its part, the appellant relies on the decision of *Anns*, *supra*, to support a finding that the respondents were under a duty of care. Moreover, the appellant claims that the conclusion of Hinkson J.A. is contrary to the terms of the contract of storage, the provisions of the *Warehouse Receipt Act*, s. 2(4), the common law of bailment and the decisions of this Court in *Greenwood Shopping Plaza*, *supra*, *Canadian General Electric Co. v. Pickford and Black Ltd.*, [1971] S.C.R. 41, and *Cominco Ltd. v. Bilton*, [1971] S.C.R. 413.

Pour sa part, l'appelante invoque l'arrêt *Anns*, précité, à l'appui de sa conclusion que les intimés avaient une obligation de diligence. En outre, elle soutient que la conclusion du juge Hinkson est contraire aux conditions du contrat d'entreposage, aux dispositions du par. 2(4) de la *Warehouse Receipt Act*, à la common law en matière de dépôt ainsi qu'aux arrêts de notre Cour *Greenwood Shopping Plaza*, précité, *Canadian General Electric Co. c. Pickford & Black Ltd.*, [1971] R.C.S. 41, et *Cominco Ltd. c. Bilton*, [1971] R.C.S. 413.

In my opinion, the respondents unquestionably owed a duty of care to the appellant when handling the transformer. I arrive at this conclusion with as little difficulty as the judges in the courts below. I

J'estime que les intimés avaient indéniablement une obligation de diligence envers l'appelante lorsqu'ils ont manipulé le transformateur. J'arrive à cette conclusion sans plus de peine que les juges

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do not base my conclusion on the terms of the contract of storage or on s. 2(4) of the *Warehouse Receipt Act* but on well established principles of tort law. In all the circumstances of this case, it was reasonably foreseeable to the respondent employees that negligence on their part in the handling of the transformer would result in damage to the appellant's property. In sum, there was such a close relationship between the parties as to give rise to a duty on the respondents to exercise reasonable care.

des tribunaux d'instance inférieure. Je fonde ma conclusion non pas sur les conditions du contrat d'entreposage ou sur le par. 2(4) de la *Warehouse Receipt Act*, mais sur des principes bien établis du droit de la responsabilité délictuelle. Compte tenu de toutes les circonstances de l'espèce, les employés intimés pouvaient raisonnablement prévoir que leur négligence dans la manipulation du transformateur causerait un dommage au bien de l'appelante. En somme, il existait un lien suffisamment étroit entre les parties pour imposer aux intimés l'obligation de faire preuve de diligence raisonnable.

I find it unnecessary for the purposes of this appeal to consider the numerous English authorities which have, according to some, given "fresh consideration" to what is involved in determining whether a duty of care exists in a particular situation. I say this because, to borrow the words of McEachern C.J.B.C., the respondents were "clearly under a duty to take reasonable care of the [appellant's] transformer under the law as it existed both before and after *Donoghue*". We are not here dealing with the type of factual situation in which concerns about the breadth of traditional principles have arisen. A conclusion that the respondents owed no duty of care to the appellant would clearly be recognizing a new immunity where none existed before.

Il me semble inutile, aux fins du présent pourvoi, d'examiner les nombreux précédents anglais qui, selon certains, jettent un [TRADUCTION] «éclairage nouveau» sur ce qui doit être pris en considération pour déterminer s'il existe ou non une obligation de diligence dans un cas donné. Je dis cela, car, pour reprendre les termes du juge en chef McEachern, les intimés avaient [TRADUCTION] «nettement l'obligation de prendre raisonnablement soin du transformateur [de l'appelante], selon le droit applicable tant avant qu'après l'arrêt *Donoghue*». Nous n'avons pas affaire, en l'espèce, au genre de situation de fait qui a soulevé des questions au sujet de la portée des principes traditionnels. Conclure que les intimés n'avaient aucune obligation de diligence envers l'appelante aurait manifestement pour effet de reconnaître une nouvelle immunité là où il n'en existait pas auparavant.

As already mentioned, absence of reliance on the part of the appellant is a crucial factor according to Hinkson J.A. and the respondents. Hinkson J.A. made the following comments (at p. 35):

> Normally, the owner expects the warehouseman and its employees to use reasonable care in handling and storing its goods. The warehouseman and its employees know that if the goods are damaged the owner will suffer loss. Thus, the requirements of foreseeability and proximity can be said to have been met with the result that the warehouseman and its employees owe to the owner a duty of care.

Tel que mentionné précédemment, l'absence de confiance de la part de l'appelante est un facteur crucial selon le juge Hinkson et les intimés. Voici certaines observations du juge Hinkson (à la p. 35):

> [TRADUCTION] Habituellement, le propriétaire s'attend à ce que l'entreposeur et ses employés fassent preuve de diligence raisonnable en manipulant et en entreposant ses marchandises. L'entreposeur et ses employés savent que, si les marchandises sont endommagées, le propriétaire subira une perte. Par conséquent, on peut dire que les exigences de prévisibilité des dommages et d'existence d'un lien étroit ont été remplies, de sorte que l'entreposeur et ses employés ont une obligation de diligence envers le propriétaire.

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However, he then goes on to find that because the appellant knew about the limitation of liability clause and chose to obtain its own insurance, it was "not relying on the warehouseman and its employees not to damage the transformer" (p. 36). Assuming, *arguendo*, that "reliance" is relevant in the case at bar, I am of the view that Hinkson J.A. misapplied this concept.

When reliance is used in cases such as *Hedley Byrne & Co. v. Heller & Partners Ltd.*, [1964] A.C. 465 (H.L.), *Junior Books*, *supra*, and *B.D.C. Ltd. v. Hofstrand Farms Ltd.*, [1986] 1 S.C.R. 228, in order to determine the existence of a duty of care, it is concerned with the relationship between the plaintiff's position and the tortfeasor's conduct, not with the relationship between the plaintiff's position and the tortfeasor's pocketbook. In other words, reliance, as it may be used here, goes to the existence of a duty of care owed and not to liability for breach of a duty of care. In this respect, I agree with the following passage taken from Professor Joost Blom's commentary in (1991), 70 *Can. Bar Rev.* 156, at p. 168:

> Probably the line taken by Hinkson J.A. presents the most serious problems. It seems unrealistic to say, as he did, that by agreeing to a virtual exclusion of liability in a case like this, you remove potential wrongdoers from "proximity" with yourself because you give up reliance on their taking reasonable care. As McEachern C.J.B.C. pointed out, the nuisance of having your goods damaged, and the cost of making an insurance claim and paying the deductible, are strong reasons for saying that you do rely. Saying, "I will not look to you for damages if there is an accident" is not the same thing as saying, "Go ahead and be as careless as you want with my property." [Emphasis added.]

Having said this, I wish simply to add what has already become evident by my conclusion. There is no general rule in Canada to the effect that an

Il ajoute cependant que, comme l'appelante avait pris connaissance de la clause de limitation de la responsabilité et qu'elle avait choisi de souscrire sa propre assurance, elle [TRADUCTION] «ne se fiait pas à ce que l'entreposeur et ses employés n'endommageraient pas le transformateur» (p. 36). En tenant pour acquis, pour les fins de la discussion, que la «confiance» est pertinente en l'espèce, je suis d'avis que le juge Hinkson a mal appliqué ce concept.

Lorsque, dans des affaires comme *Hedley Byrne & Co. c. Heller & Partners Ltd.*, [1964] A.C. 465 (H.L.), *Junior Books*, précitée, et *B.D.C. Ltd. c. Hofstrand Farms Ltd.*, [1986] 1 R.C.S. 228, on se sert de la confiance pour déterminer l'existence d'une obligation de diligence, il s'agit de la confiance qui intervient dans le rapport entre la situation du demandeur et la conduite de l'auteur du délit, et non dans le rapport entre la situation du demandeur et la capacité de payer de l'auteur du délit. En d'autres termes, la confiance, dont on peut se servir ici, touche l'existence d'une obligation de diligence et non la responsabilité pour manquement à une obligation de diligence. À cet égard, je souscris à l'extrait suivant du commentaire du professeur Joost Blom dans (1991), 70 *R. du B. can.* 156, à la p. 168:

> [TRADUCTION] La voie empruntée par le juge Hinkson pose probablement la plus grande difficulté. Il me semble irréaliste d'affirmer, comme il l'a fait, qu'en consentant à une quasi-exonération de responsabilité dans un cas comme celui-ci, vous empêchez l'établissement d'un «lien étroit» entre les auteurs de délits éventuels et vous-mêmes du fait que vous renoncez à vous fier à ce qu'ils feront preuve de diligence raisonnable. Comme le souligne le juge en chef McEachern, l'inconvénient de voir vos biens endommagés, de même que les frais liés à la présentation d'une demande d'indemnité à l'assureur et au paiement de la franchise vous incitent fortement à dire que vous faites confiance. Dire «Je ne compterai pas sur vous pour payer les dommages en cas d'accident» ne revient pas à dire «Allez-y, soyez aussi négligents que vous voulez avec mon bien.» [Je souligne.]

Ceci dit, je souhaite simplement ajouter ce qui ressort déjà de ma conclusion. Au Canada, aucune règle générale n'a pour effet de soustraire l'em-

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employee acting in the course of his or her employment and performing the "very essence" of his or her employer's contractual obligations with a customer does not owe a duty of care, whether one labels it "independent" or otherwise, to the employer's customer. Our law of negligence has long since moved away from a category approach when dealing with duties of care. It is now well established that the question of whether a duty of care arises will depend on the circumstances of each particular case, not on pre-determined categories and blanket rules as to who is, and who is not, under a duty to exercise reasonable care. There may well be cases where, having regard to the particular circumstances involved, an employee will not owe a duty of care to his or her employer's customer. Indeed, the respondents have provided this Court with a series of decisions where this conclusion appears to have been reached: see *Sealand of the Pacific v. Robert C. McHaffie Ltd.* (1974), 51 D.L.R. (3d) 702 (B.C.C.A.); *Moss v. Richardson Greenshields of Canada Ltd.*, [1989] 3 W.W.R. 50 (Man. C.A.); *Summitville Consolidated Mining Co. v. Klohn Leonoff Ltd.*, B.C.S.C., Van. Reg. No. C880756, July 6, 1989; and *R.M. & R. Log Ltd. v. Texada Towing Co.* (1967), 62 D.L.R. (2d) 744 (Ex. Ct.).

However, this does not mean that this is the necessary result in all factual situations. Abstaining from commenting on the conclusions reached in the cases cited, I find nothing in any of them, nor have I found anything else, which supports the type of blanket rule advocated by the respondents. At best, these decisions simply confirm that the question of whether a duty of care arises between an employee and his or her employer's customer depends on the circumstances of each particular case. The mere fact that the employee is performing the "very essence" of a contract between the plaintiff and his or her employer does not, in itself, necessarily preclude a conclusion that a duty of care was present.

As conceded by the respondents, there are many decisions in which a duty of care was found to

ployé qui agit dans l'exercice de ses fonctions et dans l'exécution de ce qui constitue «l'essence même» des obligations contractuelles de son employeur envers un client, à toute obligation de diligence, qu'elle soit qualifiée d'«indépendante» ou autrement, envers le client de l'employeur. Notre droit relatif à la négligence s'est depuis longtemps écarté de la méthode fondée sur l'appartenance à une catégorie dans le cas d'obligations de diligence. Il est désormais bien établi que la question de savoir s'il existe une obligation de diligence dépend des circonstances de chaque cas et non de catégories préétablies et de règles générales applicables à la question de savoir qui a et qui n'a pas l'obligation de faire preuve de diligence raisonnable. Il peut bien y avoir des cas où, selon les circonstances particulières en cause, un employé n'aura pas d'obligation de diligence envers un client de son employeur. Les intimés ont, en effet, mentionné à notre Cour une série de décisions où l'on semble avoir tiré cette conclusion: voir *Sealand of the Pacific c. Robert C. McHaffie Ltd.* (1974), 51 D.L.R. (3d) 702 (C.A.C.-B.), *Moss c. Richardson Greenshields of Canada Ltd.*, [1989] 3 W.W.R. 50 (C.A. Man.), *Summitville Consolidated Mining Co. c. Klohn Leonoff Ltd.*, C.S.C.-B., nº du greffe de Van. C880756, 6 juillet 1989, et *R.M. & R. Log Ltd. c. Texada Towing Co.* (1967), 62 D.L.R. (2d) 744 (C. de l'É.).

Toutefois, cela ne signifie pas qu'on arrive nécessairement à ce résultat dans toutes les situations de fait. Sans me prononcer sur les conclusions tirées dans la jurisprudence citée, je n'y trouve rien, ni quoi que ce soit d'autre, qui justifie le type de règle générale préconisé par les intimés. Au mieux, ces décisions ne font que confirmer que la question de savoir si un employé a une obligation de diligence envers le client de son employeur dépend des circonstances de chaque cas. Le simple fait que l'employé exécute ce qui constitue «l'essence même» d'un contrat intervenu entre le demandeur et son employeur n'empêche pas nécessairement en soi de conclure à l'existence d'une obligation de diligence.

Comme les intimés l'ont reconnu, les tribunaux ont maintes fois conclu à l'existence d'une obliga-

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exist: see, for example, *Northwestern Mutual Insurance Co. v. J. T. O'Bryan & Co.* (1974), 51 D.L.R. (3d) 693 (B.C.C.A.); *Toronto-Dominion Bank v. Guest* (1979), 10 C.C.L.T. 256 (B.C.S.C.); *East Kootenay Community College v. Nixon & Browning* (1988), 28 C.L.R. 189 (B.C.S.C.); and *Ataya v. Mutual of Omaha Insurance Co.* (1988), 34 C.C.L.I. 307 (B.C.S.C.). In concluding discussion of this issue, I would add that the acceptance of the general rule advocated by the respondents would be at odds with the common law notion of vicarious liability. This principle, which has been well developed through years of jurisprudence, has as part of its very core the recognition that in many cases employees do owe duties of care to third parties, such as their employer's customers.

As the respondents owed a duty of care to the appellant in their handling of the transformer, I would accordingly dismiss the cross-appeal.

B. *Limitation of Liability Clause*

Accepting the finding of the trial judge that the respondents breached their duty of care thereby causing damages fixed at $33,955.41 to the appellant, I must now consider whether they are allowed to benefit from the limitation of liability clause found in the contract of storage between their employer, Kuehne & Nagel, and the appellant. The majority of the Court of Appeal reached a conclusion favourable to the respondents on this issue by using two different approaches (1) by implying a term in the contract extending the protection of s. 11(*b*) of the contract of storage to the respondents and by applying the exception to the doctrine of privity set out in *The Eurymedon* and *ITO—International Terminal Operators* (Lambert J.A.'s contract analysis); and (2) by taking into account the "contractual matrix" between Kuehne & Nagel and the appellant, including the limitation of liability clause, so as to qualify the respondents' duty of

tion de diligence: voir, par exemple, *Northwestern Mutual Insurance Co. c. J. T. O'Bryan & Co.* (1974), 51 D.L.R. (3d) 693 (C.A.C.-B.), *Toronto-Dominion Bank c. Guest* (1979), 10 C.C.L.T. 256 (C.S.C.-B.), *East Kootenay Community College c. Nixon & Browning* (1988), 28 C.L.R. 189 (C.S.C.-B.), et *Ataya c. Mutual of Omaha Insurance Co.* (1988), 34 C.C.L.I. 307 (C.S.C.-B.). Pour conclure sur le sujet, j'ajouterais que l'acceptation de la règle générale préconisée par les intimés serait difficilement compatible avec la notion de la responsabilité du fait d'autrui reconnue en common law. Au cœur même de ce principe, que la jurisprudence a bien développé au fil des ans, il y a la reconnaissance que, dans bien des cas, les employés ont une obligation de diligence envers des tiers tels que les clients de leur employeur.

Comme les intimés avaient une obligation de diligence envers l'appelante lorsqu'ils ont manipulé le transformateur, je suis d'avis de rejeter le pourvoi incident.

B. *La clause de limitation de la responsabilité*

Ayant fait mienne la conclusion du juge de première instance que les intimés ont manqué à leur obligation de diligence et, de ce fait, causé à l'appelante des dommages évalués à 33 955,41 $, je dois maintenant examiner la question de savoir s'ils peuvent bénéficier de la clause de limitation de la responsabilité que renferme le contrat d'entreposage intervenu entre leur employeur, Kuehne & Nagel, et l'appelante. La Cour d'appel, à la majorité, s'est prononcée en faveur des intimés à cet égard, en recourant à deux méthodes différentes, c'est-à-dire 1) en concluant à l'existence, dans le contrat, d'une condition implicite étendant aux intimés la protection de l'al. 11*b*) du contrat d'entreposage et en appliquant au principe du lien contractuel l'exception énoncée dans les affaires *Eurymedon* et *ITO—International Terminal Operators* (l'analyse contractuelle du juge Lambert), et 2) en tenant compte du «cadre contractuel» établi entre Kuehne & Nagel et l'appelante, y compris la clause de limitation de la responsabilité, de manière à atténuer l'obligation de diligence des intimés et à limiter à 40 $ la responsabilité qui en

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care and their ensuing liability to $40 (McEachern C.J.B.C. and Wallace J.A.'s tort analysis).

(1) Arguments of the Parties

The appellant argues that the respondents should not benefit, in any way, from a limitation of liability clause contained in a contract to which they are not parties. In its submissions, the appellant strongly, if not exclusively, relies upon the doctrine of privity of contract and upon its application by this Court in *Canadian General Electric*, *supra*, *Greenwood Shopping Plaza*, *supra*, and *ITO-International Terminal Operators*, *supra*. It is submitted that these decisions have unequivocally established the legal principles to be applied in determining whether a tortfeasor may rely upon a limitation of liability clause in a contract to which the tortfeasor is not a party. The appellant submits that, in so doing, this Court has repeatedly rejected attempts to abrogate or weaken the doctrine of privity of contract. In particular, it is argued that contractual protection can be extended to non-contracting parties only in limited circumstances where the facts support a finding of agency or trust. In the present case, the appellant states that there exists no evidence which would allow this Court to make such a finding. Accordingly, it is submitted that the majority of the Court of Appeal has abandoned "longstanding, established and fundamental principles of law" in affording contractual protection to the respondents.

More specifically, the appellant argues that, while Lambert J.A. was correct in adopting a contractual analysis, he erred in implying into the contract a term which included the respondents. On the other hand, the appellant claims that McEachern C.J.B.C. and Wallace J.A. erred in their emphasis upon the contractual relationship between the appellant and Kuehne & Nagel when considering the nature and extent of the duty of care owed by the respondents. It is submitted that such reasoning is unfounded in Canadian law and is bound to create uncertainty. Furthermore, it represents an unwarranted and unnecessary intrusion in the area of tort law. The appellant submits that

découle (l'analyse délictuelle du juge en chef McEachern et du juge Wallace).

1) L'argumentation des parties

L'appelante soutient que les intimés ne devraient nullement bénéficier d'une clause de limitation de la responsabilité contenue dans un contrat auquel ils ne sont pas parties. Dans son argumentation, elle invoque fortement, voire exclusivement, le principe du lien contractuel et son application par notre Cour dans les arrêts *Canadian General Electric*, *Greenwood Shopping Plaza* et *ITO—International Terminal Operators*, précités. Elle prétend que ces arrêts ont établi, de manière non équivoque, les principes juridiques qui doivent s'appliquer pour déterminer si l'auteur d'un délit peut invoquer une clause de limitation de la responsabilité figurant dans un contrat auquel il n'est pas partie. L'appelante fait valoir que, ce faisant, notre Cour a maintes fois repoussé les tentatives d'abroger ou d'affaiblir le principe du lien contractuel. Elle soutient, plus particulièrement, qu'une protection contractuelle ne peut être étendue à des parties non contractantes que dans les cas limités où les faits permettent de conclure à l'existence d'un mandat ou d'une fiducie. En l'espèce, l'appelante affirme qu'il n'y a aucune preuve qui permettrait à notre Cour de tirer une telle conclusion. Par conséquent, elle fait valoir que la Cour d'appel, à la majorité, a rompu avec [TRADUCTION] «des principes de droit fondamentaux établis depuis longtemps» en accordant aux intimés la protection contractuelle.

L'appelante soutient, plus précisément, que le juge Lambert a eu raison de recourir à une analyse contractuelle, mais qu'il a commis une erreur en concluant que le contrat contenait une condition implicite qui en étendait l'application aux intimés. Par ailleurs, elle fait valoir que le juge en chef McEachern et le juge Wallace ont eu tort de mettre l'accent sur le lien contractuel existant entre l'appelante et Kuehne & Nagel aux fins de déterminer la nature et la portée de l'obligation de diligence des intimés. Selon elle, pareil raisonnement n'est pas fondé en droit canadien et ne peut qu'engendrer de l'incertitude. De plus, il représente une ingérence injustifiée et inutile dans le domaine du

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to use a duty of care (tort) analysis to import contractual limitations into tort law is another attempt to circumvent the rigidity of the doctrine of privity. According to the appellant, any departure from this doctrine should be brought upon by the legislature and not by the courts. In any event, it is submitted that the application of the duty of care analysis is inappropriate in the case at bar as the foundation of liability against the respondents is the tort of trespass to goods, as advanced by Southin J.A. in dissent. In conclusion, the appellant challenges the "starting point" of the judges in the courts below to the effect that it is unjust to hold the respondent employees personally liable in the case at bar. In particular, it notes that the respondents were negligent, that more substantive injustice has been done in this case and others by a departure from orthodox and fundamental principles, and that adequate protection for employees exists within the current framework of the common law.

droit de la responsabilité délictuelle. L'appelante soutient que le recours à une analyse (délictuelle) fondée sur une obligation de diligence pour introduire des limites contractuelles dans le droit de la responsabilité délictuelle constitue une autre tentative de contourner le rigorisme du principe du lien contractuel. Selon elle, c'est au législateur et non aux tribunaux qu'il incombe de prescrire toute dérogation à ce principe. Quoi qu'il en soit, elle prétend que l'analyse fondée sur l'application de l'obligation de diligence est inopportune en l'espèce puisque la responsabilité des intimés est fondée, selon l'opinion dissidente du juge Southin, sur le délit d'atteinte à la possession mobilière. Enfin, l'appelante conteste le «point de départ» des juges d'instance inférieure selon lequel il est injuste, en l'espèce, de tenir les employés intimés personnellement responsables. Plus particulièrement, elle fait remarquer que les intimés ont été négligents, qu'une dérogation à des principes orthodoxes et fondamentaux a entraîné une injustice plus grave dans la présente affaire notamment et que la common law, dans son état actuel, offre déjà une protection adéquate aux employés.

For their part, the respondents submit that they are entitled to benefit from the limitation of liability clause and suggest three alternative ways to arrive at such a result. First, they argue for a judicial reconsideration, or a relaxation of, the doctrine of privity of contract as it applies to the case at bar. It is submitted that this doctrine, in the facts of the present case, is radically out of step with commercial reality, with the expectations of the parties and with the way in which the parties allocated the risk of loss or damage. The respondents argue that employees can, without consideration and without invoking traditional exceptions such as trust or agency, claim the benefit of their employer's contractual limitation of liability when: (1) there is a contractual limitation of liability between their employer and another party; (2) a loss occurs during the employer's performance of its contractual obligations to that third party; and (3) the employees are acting in the course of their employment when the loss occurs. Second, the respondents submit that they can benefit from the clause in question by implying a term into the contract and by

Pour leur part, les intimés soutiennent qu'ils ont le droit de bénéficier de la clause de limitation de la responsabilité et ils proposent trois façons différentes d'arriver à ce résultat. Premièrement, ils préconisent un réexamen ou un assouplissement, par les tribunaux, du principe du lien contractuel qui s'applique à la présente affaire. Ils prétendent que, compte tenu des faits de l'espèce, ce principe est tout à fait incompatible avec la réalité commerciale, les attentes des parties et la manière dont celles-ci ont réparti le risque de perte ou de dommages. Les intimés font valoir qu'indépendamment des exceptions traditionnelles comme le mandat et la fiducie, les employés peuvent invoquer la limitation contractuelle de la responsabilité de leur employeur 1) s'il existe une limitation contractuelle de la responsabilité entre leur employeur et une autre partie, 2) si une perte se produit pendant que l'employeur remplit ses obligations contractuelles envers cette tierce partie et 3) si les employés agissent dans l'exercice de leurs fonctions au moment où la perte survient. Deuxièmement, les intimés prétendent qu'ils peuvent bénéfi-

relying on the decisions in *The Eurymedon*, *supra*, and *ITO—International Terminal Operators*, *supra*, in the manner suggested by Lambert J.A. And third, the respondents adopt similar arguments to those advanced in the reasons of McEachern C.J.B.C. and Wallace J.A. and submit that the contractual setting between Kuehne & Nagel and the appellant, including the limitation of liability clause, has the effect of limiting the respondents' liability to the appellant. In this sense, it is suggested that the respondents should be allowed to benefit from the clause, albeit indirectly, via a duty of care (tort) analysis. They argue that such an analysis is not irrelevant as suggested by Southin J.A. in dissent and by the appellant. Rather, the respondents submit it is the principles of trespass, not negligence, that are inapplicable to the facts of this case.

cier de la clause en question en concluant à l'existence d'une condition implicite dans le contrat et en invoquant les arrêts *Eurymedon* et *ITO—International Terminal Operators*, précités, comme l'a proposé le juge Lambert. Troisièmement, ils avancent des arguments semblables à ceux avancés dans les motifs du juge McEachern et du juge Wallace et soutiennent que l'entente contractuelle intervenue entre Kuehne & Nagel et l'appelante, y compris la clause de limitation de la responsabilité, a pour effet de limiter leur responsabilité envers l'appelante. C'est ainsi qu'ils laissent entendre qu'ils devraient pouvoir bénéficier de la clause, quoique indirectement, grâce à une analyse (délictuelle) fondée sur l'obligation de diligence. Ils font valoir que cette analyse n'est pas hors de propos comme l'affirment le juge Southin, dissidente, et l'appelante. Les intimés affirment plutôt que sont les principes de l'atteinte à la possession mobilière, et non de la négligence, qui sont inapplicables en l'espèce.

(2) Approach to be Taken Herein

In my opinion, it is unnecessary to embark upon the type of tort analysis suggested by the respondents in order to arrive at the result that justice mandates in the case at bar. I do not say this because I disagree in principle with the reasoning of McEachern C.J.B.C. and Wallace J.A., and of my colleague Justice McLachlin, on which I refrain from expressing any opinion, but rather because I believe that a more direct approach is both available and preferable. The respondents are seeking the benefit of s. 11(*b*) of the contract of storage between their employer and the appellant in order to limit the liability that would otherwise attach to their breach of duty; in other words, in order to downwardly modify the assessment of damages currently fixed at $33,955.41. The appellant has never argued, understandably in the circumstances of this case, that s. 11(*b*) of the contract of storage was not wide enough to cover the respondents' negligence, that it had not been brought to the appellant's attention prior to the execution of the contract, or that it would be unconscionable to permit the respondents to rely on the limitation clause. The main obstacle to the

2) La méthode à suivre en l'espèce

J'estime qu'il est inutile d'entreprendre le genre d'analyse délictuelle que proposent les intimés pour atteindre le résultat que la justice commande en l'espèce. Ce n'est pas que je sois en désaccord, en principe, avec le raisonnement suivi par le juge en chef McEachern et le juge Wallace, ainsi que par ma collègue le juge McLachlin, au sujet duquel je n'exprime aucune opinion, mais je crois qu'il est possible et préférable d'adopter une méthode plus directe. Les intimés cherchent à bénéficier de l'al. 11*b*) du contrat d'entreposage intervenu entre leur employeur et l'appelante afin de limiter la responsabilité qui découlerait par ailleurs du manquement à leur obligation, en d'autres termes, afin de modifier à la baisse le montant des dommages actuellement évalué à 33 955,41 $. L'appelante n'a jamais soutenu, ce qui est naturel dans les circonstances de la présente affaire, que l'al. 11*b*) du contrat d'entreposage n'avait pas une portée assez large pour englober la négligence des intimés, qu'il n'avait pas été porté à son attention avant la signature du contrat ou qu'il serait inique de permettre aux intimés d'invoquer la clause de limitation. Comme l'a souligné l'appelante, le principal obsta-

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respondents' claim, as pointed out by the appellant, is the doctrine of privity of contract. The judges below were well aware of the difficulty presented by this doctrine and chose different routes to deal with it: the trial judge and Southin J.A., in dissent, simply applied the doctrine; Lambert J.A. applied a recognized exception to privity; and McEachern C.J.B.C. and Wallace J.A. circumvented the doctrine by resorting to a tort analysis.

For my part, I prefer to deal head-on with the doctrine of privity and to relax its ambit in the circumstances of this case. Some may argue that the same result can (and should) be reached by using a number of approaches which are seemingly less drastic and/or allegedly more theoretically sound, such as the one advanced in the Court of Appeal by McEachern C.J.B.C. and Wallace J.A., or the "no duty" approach advocated by my colleague, Justice La Forest, and authors such as B. J. Reiter, "Contracts, Torts, Relations and Reliance", in B. J. Reiter and J. Swan, eds., *Studies in Contract Law* (1980), 235, or the doctrine of "vicarious immunity" allegedly adopted by the House of Lords in *Elder, Dempster & Co. v. Paterson, Zochonis & Co.*, [1924] A.C. 522.

In this respect, I have had the opportunity to read the reasons of my colleague McLachlin J. in the case at bar but, with respect, cannot agree with her characterization of my reasons or with her approach to the questions raised herein. Except for a rigid adherence to the doctrine of privity of contract, I do not see any compelling reason based on principle, authority or policy demonstrating that this Court, or any other, must embark upon a complex and somewhat uncertain "tort analysis" in order to allow third parties such as the respondents to obtain the benefit of a contractual limitation of liability clause, once it has been established that they breached a recognized duty of care. In my view, apart from privity of contract, it is contrary to neither principle nor authority to allow such a party, in appropriate circumstances, to obtain the

cle auquel se heurte la demande des intimés est le principe du lien contractuel. Les juges d'instance inférieure étaient bien conscients de la difficulté que présentait ce principe et ils ont choisi d'en traiter de différentes façons. Le juge de première instance et le juge Southin, dissidente, ont simplement appliqué le principe, le juge Lambert a appliqué une exception reconnue au principe du lien contractuel et le juge en chef McEachern et le juge Wallace ont contourné le principe en recourant à une analyse délictuelle.

Pour ma part, je préfère m'attaquer de front au principe du lien contractuel et en assouplir la portée dans les circonstances de la présente affaire. D'aucuns peuvent soutenir que le même résultat peut (et devrait) être atteint en recourant à un certain nombre de méthodes qui sont apparemment moins draconiennes ou qui, prétend-on, sont théoriquement plus saines ou les deux à la fois, comme celle proposée en Cour d'appel par le juge en chef McEachern et le juge Wallace, ou la méthode de l'absence d'obligation préconisée par le juge La Forest et des auteurs comme B. J. Reiter dans «Contracts, Torts, Relations and Reliance», dans B. J. Reiter et J. Swan, dir., *Studies in Contract Law* (1980), 235, ou encore le principe de l'«immunité dérivée» qu'aurait adopté la Chambre des lords dans l'arrêt *Elder, Dempster & Co. c. Paterson, Zochonis & Co.*, [1924] A.C. 522.

À cet égard, j'ai pris connaissance des motifs rédigés en l'espèce par ma collègue le juge McLachlin, mais, en toute déférence, je ne puis être d'accord avec son interprétation de mes motifs ou avec la façon dont elle aborde les questions soulevées en l'espèce. Sauf si on veut observer strictement le principe du lien contractuel, je vois aucune raison sérieuse, fondée sur les principes, la jurisprudence, la doctrine ou l'ordre public, qui démontre que notre Cour ou tout autre tribunal doit procéder à une «analyse délictuelle» complexe et quelque peu incertaine, pour permettre à des tiers comme les intimés de bénéficier d'une clause contractuelle de limitation de la responsabilité, une fois qu'il a été établi qu'ils ont manqué à une obligation de diligence reconnue. À mon avis, hormis le principe du lien contractuel, il est contraire à

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benefit directly from the contract (i.e. in the same manner as would the contracting party) by resorting to what may be referred to as a "contract analysis". The main obstacle to such an approach resides in the fact that the party relying on the limitation of liability clause is not a party to the contract, not in the alleged principle that if one starts in tort, one must end in tort.

quelque principe, jurisprudence ou doctrine de permettre à une telle partie, dans des circonstances appropriées, de bénéficier directement du contrat (c'est-à-dire comme ce serait le cas pour la partie contractante), en recourant à ce qu'on peut appeler une «analyse contractuelle». Le principal obstacle auquel se heurte cette méthode réside dans le fait que la partie qui invoque la clause de limitation de la responsabilité n'est pas une partie au contrat, et non dans le prétendu principe selon lequel qui commence en matière délictuelle doit terminer en matière délictuelle.

I accept the respondents' submission that this is both the time and the case for a judicial reconsideration of the rule regarding privity of contract as applied to employers' contractual limitation of liability clauses. Furthermore, I find wide support for the contract approach I adopt, including my view as to how a contractual limitation of liability clause may become relevant in a tort case such as the present one (i.e. as a juridical reason affecting the consequences—liability—of the breach of a duty of care), both in the jurisprudence and in a number of commentaries dealing specifically with the case at bar: see *Dyck v. Manitoba Snowmobile Association Inc.*, [1985] 1 S.C.R. 589; *Crocker v. Sundance Northwest Resorts Ltd.*, [1988] 1 S.C.R. 1186; *ITO—International Terminal Operators, supra*; W. J. Swadling, "Privity, Tort and Contract: Exempting the Careless Employee" (1991), 4 *Journal of Contract Law* 208, at p. 229; and J. Swan, "Privity of Contract and Third Party Beneficiaries: the Selective Use of Precedent" (1991), 4 *Journal of Contract Law* 129, at pp. 133-34.

J'accepte l'argument des intimés voulant que ce soit le temps et qu'il convienne de procéder à un réexamen judiciaire de la règle concernant le lien contractuel qui s'applique aux clauses de limitation de la responsabilité des employeurs. De plus, je trouve, tant dans la jurisprudence que dans un certain nombre de commentaires portant précisément sur la présente affaire, un appui considérable pour la méthode contractuelle que j'adopte, y compris ma perception de la façon dont une clause de limitation de la responsabilité peut devenir pertinente dans une affaire délictuelle comme celle dont nous sommes saisis (c'est-à-dire à titre de motif juridique modifiant les conséquences, savoir la responsabilité, du manquement à une obligation de diligence): voir *Dyck c. Manitoba Snowmobile Association Inc.*, [1985] 1 R.C.S. 589, *Crocker c. Sundance Northwest Resorts Ltd.*, [1988] 1 R.C.S. 1186, *ITO—International Terminal Operators*, précité, W. J. Swadling, «Privity, Tort and Contract: Exempting the Careless Employee» (1991), 4 *Journal of Contract Law* 208, à la p. 229, et J. Swan, «Privity of Contract and Third Party Beneficiaries: the Selective Use of Precedent» (1991), 4 *Journal of Contract Law* 129, aux pp. 133 et 134.

In my view, the respondents were third party beneficiaries to the limitation of liability clause found in the contract of storage between their employer and the appellant and, in view of the circumstances involved, may benefit directly from this clause notwithstanding that they are not a signing party to the contract. I recognize that such a conclusion collides with privity of contract in its strictest sense; however, for reasons that follow, I

Selon moi, les intimés étaient des tiers bénéficiaires de la clause de limitation de la responsabilité figurant dans le contrat d'entreposage intervenu entre leur employeur et l'appelante et, dans les circonstances, ils peuvent bénéficier directement de cette clause même s'ils ne sont pas signataires du contrat. J'admets qu'une telle conclusion est contraire au principe du lien contractuel au sens le plus strict, mais, pour les motifs énoncés ci-

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believe that this Court is presented with an appropriate factual opportunity in which to reconsider the scope of this doctrine and decide whether its application in cases such as the one at bar should be limited or modified. It is my opinion that commercial reality and common sense require that it should.

Before proceeding with my analysis I wish to state that, in view of the approach I adopt, it will be unnecessary for me to determine whether or not the respondents' liability is, as argued by Southin J.A. in dissent, governed by the law of trespass and not the law of negligence. Indeed, as I am of the opinion that the respondents owed a duty of care and that they may benefit from the limitation of liability clause without resorting to a tort analysis, a conclusion that they are liable in trespass rather than in negligence would change nothing in the disposition of this appeal. I must add, however, that I have some doubts as to the correctness of the conclusions of law made by Southin J.A. on this matter. In this respect, I would adopt the comments made by Professor Swadling, *supra*, at pp. 221-23 of his commentary.

I will now turn to the heart of the present appeal, namely, privity of contract and third party beneficiaries. In dealing with this issue, I would like briefly to review what is understood by the doctrine of privity of contract, the decisions that support it, the reasons behind the doctrine, criticisms of the doctrine, and its treatment in other jurisdictions. I shall then go on to discuss previous decisions of this Court on the matter before turning to the doctrine in the circumstances of this appeal.

(3) The Doctrine of Privity of Contract and Third Party Beneficiaries

(a) *Introduction*

The doctrine of privity of contract has been stated by many different authorities sometimes with varying effect. Broadly speaking, it stands for the proposition that a contract cannot, as a general

après, je crois que notre Cour a ici l'occasion de réexaminer la portée de ce principe et de décider si son application à des cas semblables à l'espèce devrait être limitée ou modifiée. J'estime que la réalité commerciale et le bon sens exigent qu'elle le soit.

Avant d'entreprendre mon analyse, je tiens à préciser qu'en raison de la méthode que j'adopte, il ne me sera pas nécessaire de déterminer si la responsabilité des intimés est, comme l'a prétendu le juge Southin dans sa dissidence, régie par le droit relatif à l'atteinte à la possession mobilière plutôt que par le droit relatif à la négligence. En effet, comme je suis d'avis que les intimés avaient une obligation de diligence et qu'ils peuvent bénéficier de la clause de limitation de la responsabilité sans qu'il soit nécessaire de recourir à une analyse délictuelle, conclure qu'ils ont commis une atteinte à la possession mobilière et non une négligence ne modifierait en rien l'issue du présent pourvoi. Je dois néanmoins ajouter que je doute quelque peu de la justesse des conclusions de droit tirées par le juge Southin sur ce point. À cet égard, je mentionnerais les propos que tient le professeur Swadling, *loc. cit.*, aux pp. 221 à 223 de son commentaire.

Je reviens maintenant au cœur du présent pourvoi, savoir le principe du lien contractuel et les tiers bénéficiaires. En abordant cette question, j'aimerais examiner brièvement ce qu'on entend par le principe du lien contractuel, les décisions qui l'appuient et les motifs qui le sous-tendent, les critiques exprimées à son égard et la façon de le traiter dans d'autres ressorts. J'analyserai ensuite les arrêts déjà prononcés par notre Cour en la matière avant de passer à l'examen du principe dans le contexte du présent pourvoi.

3) Le principe du lien contractuel et les tiers bénéficiaires

a) *Introduction*

Le principe du lien contractuel a été énoncé à maintes reprises dans la doctrine et la jurisprudence, avec parfois plus ou moins d'effet. De manière générale, ce principe veut qu'un contrat

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rule, confer rights or impose obligations arising under it on any person except the parties to it: see, for example, *Anson's Law of Contract* (25th ed. 1979), at p. 411, cited by McIntyre J. for this Court in *Greenwood Shopping Plaza Ltd.*, *supra*, at p. 236; G. H. Treitel, *The Law of Contract* (8th ed. 1991), at pp. 523-75; *Cheshire, Fifoot and Furmston's Law of Contract* (12th ed. 1991), at pp. 450-68; and *Chitty on Contracts* (25th ed. 1983), vol. I, at pp. 662-91. It is now widely recognized that this doctrine has two very distinct components or aspects. On the one hand, it precludes parties to a contract from imposing liabilities or obligations on third parties. On the other, it prevents third parties from obtaining rights or benefits under a contract; it refuses to recognize a *jus quaesitum tertio* or a *jus tertii*. This latter aspect has not only applied to deny complete strangers from enforcing contractual provisions but has also applied in cases where the contract attempts, either expressly or impliedly, to confer benefits on a third party. In other words, it has equally applied in cases involving third party beneficiaries. This appeal is concerned only with the second aspect of privity, and particularly with its application to third party beneficiaries. Nothing in these reasons should be taken as affecting in any way the law as it relates to the imposition of obligations on third parties.

The decisions most often cited in Canadian courts in support of the doctrine of privity are: *Tweddle v. Atkinson* (1861), 1 B. & S. 393, 121 E.R. 762; *Dunlop Pneumatic Tyre Co. v. Selfridge & Co.*, [1915] A.C. 847 (H.L.); *Scruttons Ltd. v. Midland Silicones Ltd.*, *supra*; *Canadian General Electric*, *supra*; and *Greenwood Shopping Plaza*, *supra*. As confirmed by these and other decisions, privity of contract is an established principle of contract law. It is not, however, an ancient principle. As noted by this Court in *Greenwood Shopping Plaza*, at p. 237, the doctrine "has not always been applied with the rigor which has developed during modern times". Indeed, many have noted earlier decisions in the English com-

ne confère des droits ou n'impose des obligations qu'aux personnes qui y sont parties: voir, par exemple, *Anson's Law of Contract* (25e éd. 1979), à la p. 411, cité par le juge McIntyre, au nom de notre Cour, dans *Greenwood Shopping Plaza Ltd.*, précité, à la p. 236, G. H. Treitel, *The Law of Contract* (8e éd. 1991), aux pp. 523 à 575, *Cheshire, Fifoot et Furmston's Law of Contract* (12e éd. 1991), aux pp. 450 à 468, et *Chitty on Contracts* (25e éd. 1983), vol. I, aux pp. 662 à 691. Il est désormais généralement admis que ce principe comporte deux éléments ou aspects très distincts. D'une part, il empêche les parties à un contrat d'imposer des responsabilités ou des obligations à des tiers. D'autre part, il empêche les tiers de bénéficier des droits ou des avantages que confère un contrat; il fait obstacle à la reconnaissance des droits des tiers (*jus quaesitum tertio* ou *jus tertii*). Ce dernier aspect a été appliqué non seulement pour empêcher de parfaits étrangers au contrat de faire exécuter des dispositions de celui-ci, mais également lorsque les parties tentent expressément ou implicitement, dans le contrat, de conférer un avantage à un tiers. En d'autres termes, il s'est également appliqué dans des cas où il était question de tiers bénéficiaires. Le présent pourvoi ne porte que sur le second aspect du principe du lien contractuel et, plus particulièrement, sur son application aux tiers bénéficiaires. Les présents motifs ne doivent pas être interprétés comme modifiant de quelque manière le droit applicable à l'imposition d'obligations à des tiers.

Voici les arrêts qui sont le plus souvent cités, devant les tribunaux canadiens, à l'appui du principe du lien contractuel: *Tweddle c. Atkinson* (1861), 1 B. & S. 393, 121 E.R. 762, *Dunlop Pneumatic Tyre Co. c. Selfridge & Co.*, [1915] A.C. 847 (H.L.), *Scruttons Ltd. c. Midland Silicones Ltd.*, précité, *Canadian General Electric*, précité, et *Greenwood Shopping Plaza*, précité. Ces arrêts ainsi que d'autres décisions confirment que le principe du lien contractuel est un principe établi du droit des contrats. Ce principe n'est cependant pas ancien. Comme l'a fait remarquer notre Cour dans *Greenwood Shopping Plaza*, à la p. 237, ce principe «n'a pas toujours été appliqué [. . .] avec la rigueur que l'on connaît aujourd'hui».

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mon law which have allowed third party beneficiaries to enforce contracts made for their benefit: see, for example, the review of the history by Windeyer J. in *Coulls v. Bagot's Executor and Trustee Co.*, [1967] Aust. Argus L.R. 385 (H.C.), at pp. 407-9; R. Flannigan, "Privity—The End of an Era (Error)" (1987), 103 *L.Q. Rev.* 564, at pp. 565-68; and *Carver's Carriage by Sea* (13th ed. 1982), at pp. 241-47. It is generally recognized that the law in this respect was not "settled" until the mid-nineteenth century. It is also accepted that there are certain exceptions to the doctrine of privity such as trust and agency: see *Greenwood Shopping Plaza, supra*, at pp. 238-41 and *ITO—International Terminal Operators, supra*, at pp. 784-94.

En fait, plusieurs ont souligné des décisions antérieures, dans la common law anglaise, où on a permis à des tiers bénéficiaires de faire exécuter des contrats conclus à leur profit: voir par exemple, l'historique que fait le juge Windeyer dans *Coulls c. Bagot's Executor and Trustee Co.*, [1967] Aust. Argus L.R. 385 (H.C.), aux pp. 407 à 409, R. Flannigan, «Privity—The End of an Era (Error)» (1987), 103 *L.Q. Rev.* 564, aux pp. 565 à 568, et *Carver's Carriage by Sea* (13e éd. 1982), aux pp. 241 à 247. On admet généralement que le droit applicable en la matière n'a pas été «établi» avant le milieu du XIXe siècle. On accepte également qu'il existe certaines exceptions, comme la fiducie et le mandat, au principe du lien contractuel: voir *Greenwood Shopping Plaza*, précité, aux pp. 238 à 241, et *ITO—International Terminal Operators*, précité, aux pp. 784 à 794.

Closely related to the doctrine of privity, but conceptually distinct, is the rule that consideration for a promise must move from the person entitled to sue or rely on that promise. Both rules have been used in the past, sometimes in an interchangeable manner, in order to deny third parties the right to enforce contractual provisions made for their benefit. There is some debate in academic circles, supported by *obiter dicta*, as to whether or not privity and consideration are really distinct concepts. For our purposes, however, I find it unnecessary to consider this question. I proceed on the basis that the major obstacle to the respondents' claim, as stated by the appellant, is that they are not a party to the contract from which they seek to obtain a benefit.

Liée de près au principe du lien contractuel, mais pourtant distincte, il y a la règle voulant que la contrepartie à un engagement provienne de la personne qui a le droit d'engager des poursuites fondées sur cet engagement ou de s'y fier. Les deux règles ont été invoquées dans le passé, parfois indifféremment, pour refuser à des tiers le droit de faire exécuter des dispositions contractuelles stipulées à leur profit. Certains débats théoriques, appuyés d'opinions incidentes, portent sur la question de savoir si le lien contractuel et la contrepartie constituent vraiment des notions distinctes. Toutefois, aux fins du présent pourvoi, j'estime qu'il n'est pas nécessaire d'examiner cette question. Je tiens pour acquis que le principal obstacle auquel se heurte la demande des intimés, comme l'a mentionné l'appelante, réside dans le fait qu'ils ne sont pas parties au contrat dont ils cherchent à tirer un avantage.

The reasons behind the doctrine of privity have received very little judicial attention. Professor Treitel offers perhaps the most often cited (and debated) justifications for this doctrine in his treatise *The Law of Contract, supra*, at pp. 527-28. Maintaining a certain distance, he claims that the denial of third party rights under a contract may be justified for four reasons: (1) a contract is a very personal affair, affecting only the parties to it; (2)

Les tribunaux se sont peu attardés aux motifs qui sous-tendent le principe du lien contractuel. Dans son ouvrage intitulé *The Law of Contract*, *op. cit.*, aux pp. 527 et 528, le professeur Treitel expose peut-être les justifications les plus citées (et discutées) de ce principe. Avec une certaine réserve, il prétend que le refus de reconnaître les droits des tiers aux termes d'un contrat peut être justifié pour quatre raisons: 1) le contrat revêt un

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it would be unjust to allow a person to sue on a contract on which he or she could not be sued; (3) if third parties could enforce contracts made for their benefit, the rights of contracting parties to rescind or vary such contracts would be unduly hampered; and (4) the third party is often merely a donee and a "system of law which does not give a gratuitous promisee a right to enforce the promise is not likely to give this right to a gratuitous beneficiary who is not even a promisee".

Professor Atiyah in *The Rise and Fall of Freedom of Contract* (1979) offers an economic explanation for the doctrine (at p. 414):

> There is a sense in which the new doctrine of privity was an important development in the law at a time of increasing complexity in multilateral commercial relationships. The appearance of middlemen in all sorts of commercial situations served to separate the parties at either end of the transaction, and it was generally accepted that no privity existed between them. Economically, this may have served a useful purpose, in that it encouraged the development of a more market-based concept of enterprise liability. But on some occasions the results were not only economically dubious but socially disastrous.

Other possible justifications include preventing the promisor from being subject to double recovery and avoiding a floodgate of litigation brought about by third party beneficiaries.

(b) *Criticisms of the Doctrine*

Few would argue that complete strangers to a contract should have the right to enforce its provisions. When it comes to third party beneficiaries, however, the doctrine of privity of contract has received much criticism in this century by law reformers, commentators, and judges. To date, three major law reform bodies in the Common-

caractère très personnel et n'a d'effet que sur les parties qui le concluent, 2) il serait injuste de permettre à une personne d'engager des poursuites fondées sur un contrat aux termes duquel elle ne pourrait pas être poursuivie, 3) si des tiers pouvaient faire exécuter des contrats conclus à leur profit, les droits des parties contractantes de résilier ou de modifier ces contrats seraient indûment compromis, et 4) souvent, le tiers n'est qu'un donataire et [TRADUCTION] «il est peu probable qu'un système de droit qui ne reconnaît pas au créancier d'un engagement à titre gratuit le droit de faire exécuter cet engagement conférera ce droit au bénéficiaire à titre gratuit qui n'est même pas créancier de l'engagement».

Dans son ouvrage intitulé *The Rise and Fall of Freedom of Contract* (1979), le professeur Atiyah propose, à la p. 414, une explication économique de ce principe:

> [TRADUCTION] À une époque où les liens commerciaux multilatéraux deviennent de plus en plus complexes, le nouveau principe du lien contractuel a, dans un sens, marqué une évolution importante du droit. L'avènement d'intermédiaires dans toutes sortes d'opérations commerciales a contribué à séparer les parties à une opération, et il était généralement admis qu'aucun lien contractuel n'existait entre eux. Du point de vue économique, cela peut avoir été utile en encourageant l'établissement d'un concept de responsabilité de l'entreprise fondé davantage sur le marché. Toutefois, il est parfois arrivé que les résultats aient été non seulement économiquement douteux, mais aussi socialement catastrophiques.

Parmi les autres justifications possibles, il y a la volonté d'empêcher le débiteur d'un engagement de s'exposer à la double indemnisation et celle d'éviter une avalanche de poursuites de la part de tiers bénéficiaires.

b) *Critiques formulées au sujet du principe*

Rares sont ceux qui soutiennent que de parfaits étrangers à un contrat devraient avoir le droit d'en faire exécuter les dispositions. Cependant, lorsqu'il s'agit de tiers bénéficiaires, le principe du lien contractuel a, au cours de ce siècle, fait l'objet de nombreuses critiques de la part de réformateurs du droit, de commentateurs et de juges. Dans le Com-

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wealth have examined the doctrine; each has recommended its abolition.

In 1937, the Law Revision Committee of the United Kingdom in its *Sixth Interim Report*, noting the difficulties created by privity of contract, recommended that it be abolished subject to three provisos: (1) no third party right can be acquired unless given by the express terms of the contract; (2) the promisor should be entitled to raise against the third party any defence that would have been valid against the promisee; and (3) the parties to the contract should retain the right to cancel it at any time, unless the third party has received notice of the agreement and has adopted it. The English Parliament has yet to legislate in this area and the whole matter is once again before the law reformers of that country: Law Commission, *Twenty-fifth Annual Report: 1990* (Law Comm. No. 195), para. 2.14. The Commission recently published a Consultation Paper in which it makes the provisional recommendation that a reform to the law of privity should be made in order to allow third parties to enforce contractual provisions made in their favour: Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Consultation Paper No. 121 (1991).

In New Zealand, a similar recommendation was made in the 1981 *Report on Privity of Contract* of the New Zealand Contracts and Commercial Law Reform Committee following a review of the problems created by a strict adherence to privity of contract and of the legal techniques sometimes used to avoid unjust results. The many recommendations of the Committee, including a reference to limitation of liability clauses and third parties, were implemented in the *Contracts (Privity) Act 1982*, Stat. N.Z., No. 132.

In Canada, the Ontario Law Reform Commission in its 1987 *Report on Amendment of the Law of Contract* recommended, persuasively in my view, the enactment of a general legislative provision to the effect that "contracts for the benefit of third parties should not be unenforceable for lack

monwealth, trois importants organismes de réforme du droit ont examiné ce principe et chacun en a recommandé l'abolition.

En 1937, dans son *Sixth Interim Report*, le Law Revision Committee du Royaume-Uni, soulignant les difficultés que posait le principe du lien contractuel, en a recommandé l'abolition sous réserve de trois conditions, soit 1) qu'un droit ne puisse être conféré à un tiers qu'au moyen d'une disposition expresse du contrat, 2) que le débiteur de l'engagement puisse opposer à un tiers tout moyen de défense qu'il aurait pu opposer au créancier de l'engagement et 3) que les parties au contrat conservent le droit de l'annuler à tout moment, à moins que le tiers n'ait été avisé de l'entente et ne l'ait acceptée. Le Parlement anglais n'a pas encore légiféré dans ce domaine et les réformateurs du droit de ce pays se trouvent de nouveau saisis de toute la question: Law Commission, *Twenty-fifth Annual Report: 1990* (Law Comm. No. 195), par. 2.14. La Commission a récemment publié un document d'étude dans lequel elle recommande provisoirement que l'on modifie la règle du lien contractuel de manière à permettre aux tiers de faire exécuter les dispositions contractuelles stipulées en leur faveur: Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Consultation Paper No. 121 (1991).

En Nouvelle-Zélande, une recommandation similaire a été faite dans le *Report on Privity of Contract* de 1981 par le New Zealand Contracts and Commercial Law Reform Committee, suite à une analyse des problèmes causés par l'observation stricte du principe du lien contractuel et des techniques juridiques parfois utilisées pour éviter des résultats injustes. Les nombreuses recommandations du comité, notamment en ce qui concerne les clauses de limitation de la responsabilité et les tiers, ont été mises en œuvre dans la *Contracts (Privity) Act 1982*, Stat. N.Z., nº 132.

Au Canada, la Commission de réforme du droit de l'Ontario a, dans son *Report on Amendment of the Law of Contract* de 1987, recommandé, de façon persuasive selon moi, l'adoption d'une disposition législative générale selon laquelle [TRADUCTION] «les contrats conclus au profit de tiers ne

of consideration or want of privity" (at p. 71). The Commission, in the chapter of its *Report* entitled "Third Party Beneficiaries and Privity of Contract", offered the following general reasons for its recommendation: (1) the present state of the law is very complex and uncertain; (2) the traditional justifications for the doctrine of privity (only those in privity should be allowed to sue; consideration gives the right to sue; and preventing double recovery) are largely unfounded; (3) the doctrine impairs the enforcement of sensible commercial and personal arrangements made on a daily basis; (4) exceptions to the doctrine have developed with no rational basis except to avoid the application of the doctrine; (5) it is difficult, if not impossible, to reconcile the exceptions with the doctrine; (6) the exceptions are of limited use in many situations; (7) the possibility remains that meritorious claims will be defeated by the application of the doctrine; (8) the doctrine has been subject to legislative inroads as well as academic and judicial criticism; (9) many jurisdictions around the world (United States, New Zealand, Western Australia, Queensland and Quebec) have recognized third party rights by abolishing or modifying the doctrine of privity. The Commission concluded its canvass of the reasons for reform with the following comments (at pp. 67-68):

> Abolishing the present third party beneficiary rule would, we believe, render the law more consistent internally, and more understandable by lay persons. As was pointed out previously, the courts have been able to circumvent the doctrine of privity by one legal device or another when the desired result was the enforcement of the promise by the third party beneficiary. The present state of the law, with its anomalies and unjustified distinctions, cannot and should not continue.
>
> We note the clear trend in other jurisdictions permitting third parties to enforce contracts made for their benefit. From the discussion of the law in other jurisdictions, it should be apparent that there is almost universal

devraient pas être inexécutoires en raison de l'absence de contrepartie ou de lien contractuel» (à la p. 71). Dans le chapitre de son rapport intitulé «Third Party Beneficiaries and Privity of Contract», la Commission justifie sa recommandation par les motifs généraux suivants: 1) le droit, dans son état actuel, est très complexe et incertain, 2) les justifications traditionnelles du principe du lien contractuel (c.-à-d., celles voulant que seuls les cocontractants devraient pouvoir engager des poursuites, que la contrepartie confère le droit d'engager des poursuites et qu'il y a lieu d'empêcher la double indemnisation) sont en grande partie non fondées, 3) le principe compromet l'exécution d'ententes commerciales et personnelles raisonnables, conclues chaque jour, 4) les exceptions au principe ont été établies sans fondement rationnel, si ce n'est pour éviter l'application du principe, 5) il est difficile, voire impossible, de concilier les exceptions et le principe, 6) dans bien des cas, les exceptions ont une utilité restreinte, 7) il demeure possible que des demandes valables soient rejetées par application du principe, 8) celui-ci a fait l'objet d'incursions législatives ainsi que de critiques de la part d'auteurs de doctrine et de membres de la magistrature, 9) de nombreux ressorts dans le monde (États-Unis, Nouvelle-Zélande, Australie-Occidentale, Queensland et Québec) ont reconnu les droits des tiers en abolissant ou en modifiant le principe du lien contractuel. La Commission a conclu son examen approfondi des motifs qui justifient une réforme, en faisant les observations suivantes (aux pp. 67 et 68):

> [TRADUCTION] Nous croyons que l'abolition de la règle actuelle applicable aux tiers bénéficiaires rendrait le droit plus cohérent sur le plan interne et plus intelligible pour les profanes. Tel que mentionné précédemment, les tribunaux ont réussi à contourner le principe du lien contractuel en ayant recours à un moyen juridique ou à un autre lorsque le résultat voulu était de permettre à un tiers bénéficiaire de faire exécuter l'engagement pris. Étant donné ses anomalies et ses distinctions injustifiées, le droit, dans son état actuel, ne peut pas et ne devrait pas subsister.
>
> Nous constatons qu'il y a, dans d'autres ressorts, une nette tendance à permettre à des tiers de faire exécuter les contrats conclus à leur profit. Il ressort de l'examen du droit applicable dans d'autres ressorts que la quasi-

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agreement among those who have considered the question that the existing privity of contract rule must be abandoned. In the United States, through common law developments and legislative reform, the privity of contract rule has been rendered virtually obsolete. In Ontario, there are significant areas of the law where this rule no longer holds sway. We believe that the time has come for Ontario to recognize that the doctrine of privity of contract is no longer appropriate as a general principle of contract law.

It is the firmly held view of the Commission that the privity of contract rule should be abolished.

The Commission opted for a reform based on the enactment of a general provision abolishing the doctrine, rather than detailed legislation. This approach was considered to be more flexible, permitting courts to fashion principles on a case by case basis in order to enforce third party rights where justice required such a result. Moreover, it would avoid the many difficulties facing the drafter of specific legislation. It is apparent throughout the *Report* that the reform was also directed towards third parties seeking to enforce limitation of liability clauses made for their benefit.

While noting that legislative reform along the lines mentioned above would be most welcome in this area of the law, many commentators have noted that uniform reform is unlikely in Canada owing to our present constitutional framework: see, for example, S. M. Waddams, "Contracts—Carriage of Goods—Exemptions for the Benefit of Third Parties" (1977), 55 *Can. Bar Rev.* 327, at p. 333; S. M. Waddams, "Third Party Beneficiaries in the Supreme Court of Canada" (1981), 59 *Can. Bar Rev.* 549, at p. 556; and L. C. Reif, "A Comment on *ITO Ltd.* v. *Miida Electronics Inc.*—The Supreme Court of Canada, Privity of Contract and the Himalaya Clause" (1988), 26 *Alta. L. Rev.* 372, at p. 382. Despite the difficulty in the way of uniform legislative reform, Professor Reif is of the opinion that "the legislatures are still the most appropriate sites for any substantial amendment to the principle" since courts are limited in their response to "sporadic and factually limited opportunities" (p. 382). While this may be true, it does

totalité des personnes ayant étudié la question favorise l'abandon de la règle existante du lien contractuel. Aux États-Unis, par suite de l'évolution de la common law et de réformes législatives, la règle du lien contractuel est devenue presque désuète. En Ontario, cette règle n'a plus d'emprise dans des domaines importants du droit. Nous estimons que l'heure est venue, en Ontario, de reconnaître que le principe du lien contractuel n'a plus sa place comme principe général du droit des contrats.

La Commission croit fermement que la règle du lien contractuel devrait être abolie.

La Commission a opté pour une réforme basée sur l'adoption d'une disposition générale abolissant le principe, au lieu de dispositions législatives détaillées. Cette méthode était jugée plus souple car elle permet aux tribunaux d'établir des principes, dans chaque cas, en vue d'assurer l'exécution des droits des tiers lorsque la justice l'exige. En outre, elle permet d'éviter les innombrables difficultés auxquelles fait face le rédacteur de dispositions législatives précises. Il ressort du rapport de la Commission que la réforme vise également les tiers qui demandent l'application de clauses de limitation de la responsabilité stipulées à leur profit.

Tout en soulignant qu'une réforme législative suivant les paramètres susmentionnés serait très opportune dans ce domaine du droit, bon nombre de commentateurs ont fait remarquer qu'il est peu probable qu'une réforme homogène ait lieu au Canada en raison du cadre constitutionnel actuel: voir, par exemple, S. M. Waddams, «Contracts—Carriage of Goods—Exemptions for the Benefit of Third Parties» (1977), 55 *R. du B. can.* 327, à la p. 333, S. M. Waddams, «Third Party Beneficiaries in the Supreme Court of Canada» (1981), 59 *R. du B. can.* 549, à la p. 556, et L. C. Reif, «A Comment on *ITO Ltd.* v. *Miida Electronics Inc.*—The Supreme Court of Canada, Privity of Contract and the Himalaya Clause» (1988), 26 *Alta. L. Rev.* 372, à la p. 382. Malgré les obstacles auxquels se heurte une réforme législative homogène, le professeur Reif est d'avis que [TRADUCTION] «des législatures sont encore l'endroit le plus approprié pour modifier substantiellement le principe» puisque les tribunaux ne peuvent réagir qu'à des [TRADUCTION]

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not mean that this Court should refuse to assist in the evolution of the common law when faced with appropriate circumstances.

«occasions sporadiques et limitées sur le plan des faits» (p. 382). Bien que cela puisse être vrai, il ne s'ensuit pas que notre Cour devrait s'abstenir de contribuer à l'évolution de la common law lorsque les circonstances s'y prêtent.

Most of the specific criticisms of the doctrine of privity and its application to third party beneficiaries have come from commentators. Some have questioned the application of the doctrine in general terms, that is, in its application to cases where a third party is attempting to enforce a contractual provision either by suit or by a defence to a suit, while others have dealt exclusively with the question of third party beneficiaries and limitation of liability (or exemption or exclusion) clauses. See, for example, A. L. Corbin, "Contracts for the Benefit of Third Persons" (1930), 46 *L.Q. Rev.* 12; S. M. Waddams, "Contracts—Carriage of Goods—Exemptions for the Benefit of Third Parties", *supra*; S. M. Waddams, "Third Party Beneficiaries in the Supreme Court of Canada", *supra*; S. M. Waddams, *The Law of Contracts* (2nd ed. 1984), at pp. 200-16; *Carver's Carriage by Sea*, *supra*, at pp. 241-64; M. Tedeschi, "Consideration, Privity and Exemption Clauses; Port Jackson Stevedoring Pty. Ltd. v. Salmond and Spraggon (Australia) Pty. Ltd." (1981), 55 *Aust. L.J.* 876; J. Swan and B. J. Reiter, "Developments in Contract Law: The 1979-80 Term" (1981), 2 *Sup. Ct. L. Rev.* 125; W. J. Swadling, "Privity, Tort and Contract: Exempting the Careless Employee", *supra*; J. Swan, "Privity of Contract and Third Party Beneficiaries: the Selective Use of Precedent", *supra*; R. Flannigan, "Privity — The End of an Era (Error)", *supra*; J. N. Adams and R. Brownsword, "Privity and the Concept of a Network Contract" (1990), 10 *Legal Studies* 12; G. Battersby, "Exemption Clauses and Third Parties" (1975), 25 *U.T.L.J.* 371; G. Battersby, "Exemption Clauses and Third Parties: Recent Decisions" (1978), 28 *U.T.L.J.* 75; B. Coote, *Exception Clauses* (1964), at pp. 117-36; J. Livermore, *Exemption Clauses and Implied Obligations in Contracts* (1986), at pp. 175-207. See also the articles cited by McIntyre J. in *ITO—International Terminal Operators*, *supra*, at

La plupart des critiques qui vise précisément le principe du lien contractuel et son application aux tiers bénéficiaires proviennent de commentateurs. Certains ont mis en doute l'application du principe en général, c'est-à-dire son application dans les cas où un tiers tente de faire exécuter une disposition contractuelle en engageant ou en contestant des poursuites, tandis que d'autres n'ont examiné que la question des tiers bénéficiaires et des clauses de limitation (d'exonération ou d'exclusion) de la responsabilité. Voir, par exemple, A. L. Corbin, «Contracts for the Benefit of Third Persons» (1930), 46 *L.Q. Rev.* 12, S. M. Waddams, «Contracts—Carriage of Goods—Exemptions for the Benefit of Third Parties», *loc. cit.*, S. M. Waddams, «Third Party Beneficiaries in the Supreme Court of Canada», *loc. cit.*, S. M. Waddams, *The Law of Contracts* (2e éd. 1984), aux pp. 200 à 216, *Carver's Carriage by Sea*, *op. cit.*, aux pp. 241 à 264, M. Tedeschi, «Consideration, Privity and Exemption Clauses; Port Jackson Stevedoring Pty. Ltd. v. Salmond and Spraggon (Australia) Pty. Ltd.» (1981), 55 *Aust. L.J.* 876, J. Swan et B. J. Reiter, «Developments in Contract Law: The 1979-80 Term» (1981), 2 *Sup. Ct. L. Rev.* 125, W. J. Swadling, «Privity, Tort and Contract: Exempting the Careless Employee», *loc. cit.*, J. Swan, «Privity of Contract and Third Party Beneficiaries: the Selective Use of Precedent», *loc. cit.*, R. Flannigan, «Privity—The End of an Era (Error)», *loc. cit.*, J. N. Adams et R. Brownsword, «Privity and the Concept of a Network Contract» (1990), 10 *Legal Studies* 12, G. Battersby, «Exemption Clauses and Third Parties» (1975), 25 *U.T.L.J.* 371, G. Battersby, «Exemption Clauses and Third Parties: Recent Decisions» (1978), 28 *U.T.L.J.* 75, B. Coote, *Exception Clauses* (1964), aux pp. 117 à 136, et J. Livermore, *Exemption Clauses and Implied Obligations in Contracts* (1986), aux pp. 175 à 207. Voir aussi les articles cités par le juge McIntyre dans *ITO—International*

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p. 783 dealing specifically with the application of the rule to "*Himalaya* clauses".

These comments and others reveal many concerns about the doctrine of privity as it relates to third party beneficiaries. For our purposes, I think it sufficient to make the following observations. Many have noted that an application of the doctrine so as to prevent a third party from relying on a limitation of liability clause which was intended to benefit him or her frustrates sound commercial practice and justice. It does not respect allocations and assumptions of risk made by the parties to the contract and it ignores the practical realities of insurance coverage. In essence, it permits one party to make a unilateral modification to the contract by circumventing its provisions and the express or implied intention of the parties. In addition, it is inconsistent with the reasonable expectations of all the parties to the transaction, including the third party beneficiary who is made to support the entire burden of liability. The doctrine has also been criticized for creating uncertainty in the law. While most commentators welcome, at least in principle, the various judicial exceptions to privity of contract, concerns about the predictability of their use have been raised. Moreover, it is said, in cases where the recognized exceptions do not appear to apply, the underlying concerns of commercial reality and justice still militate for the recognition of a third party beneficiary right.

There have been numerous calls from the judiciary for a reconsideration of the doctrine of privity and its refusal to allow third party beneficiaries to enforce provisions made for their benefit. Lord Denning has probably been the most outspoken, if not the least subtle, in this respect. In cases such as *Smith and Snipes Hall Farm Ltd. v. River Douglas Catchment Board*, [1949] 2 K.B. 500, at p. 514, *Drive Yourself Hire Co. (London) Ltd. v. Strutt*, [1954] 1 Q.B. 250, at pp. 272-75, *Adler v. Dickson*, [1955] 1 Q.B. 158, at p. 183 (a case involving an exemption of liability clause and an action against

Terminal Operators, précité, à la p. 783, concernant précisément l'application de la règle aux «clauses *Himalaya*».

Il ressort de ces commentaires, notamment, que le principe du lien contractuel soulève de nombreuses préoccupations dans la mesure où il concerne des tiers bénéficiaires. Aux fins du présent pourvoi, je crois qu'il suffit de formuler les observations suivantes. Bien des personnes ont souligné que l'application du principe aux fins d'empêcher un tiers d'invoquer une clause de limitation de la responsabilité qui était destinée à lui profiter est contraire à la pratique commerciale et à la justice. Elle ne respecte pas la répartition et l'acceptation des risques par les parties au contrat et elle fait fi des réalités pratiques de la garantie d'assurance. Elle permet essentiellement à une partie de modifier unilatéralement le contrat en contournant ses dispositions et l'intention expresse ou implicite des parties. En outre, elle est incompatible avec les attentes raisonnables de chacune des parties à l'opération, y compris le tiers bénéficiaire qui doit alors assumer l'entière responsabilité. On a également reproché au principe de rendre le droit incertain. Bien que la plupart des commentateurs soient favorables, du moins en principe, aux diverses exceptions reconnues par les tribunaux à l'égard du principe du lien contractuel, on s'est s'interrogé sur la prévisibilité de leur utilisation. De plus, on affirme que, dans les cas où les exceptions reconnues ne semblent pas s'appliquer, les intérêts sous-jacents de la réalité commerciale et de la justice militent encore en faveur de la reconnaissance d'un droit aux tiers bénéficiaires.

Les tribunaux ont, à maintes reprises, invité une reconsidération du principe du lien contractuel et son refus de permettre à des tiers bénéficiaires de faire exécuter des dispositions stipulées à leur profit. Lord Denning est probablement celui qui s'est exprimé avec le plus de franchise, voire le plus directement, à cet égard. Dans des affaires comme *Smith and Snipes Hall Farm Ltd. c. River Douglas Catchment Board*, [1949] 2 K.B. 500, à la p. 514, *Drive Yourself Hire Co. (London) Ltd. c. Strutt*, [1954] 1 Q.B. 250, aux pp. 272 à 275, *Adler c. Dickson*, [1955] 1 Q.B. 158, à la p. 183 (une cause

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employees), *Midland Silicones*, *supra*, at pp. 483-89 (a case involving a limitation of liability clause and stevedores) and in his Court of Appeal judgment in *Beswick v. Beswick*, [1966] Ch. 538, Lord Denning questioned the accuracy and necessity of the "fundamental principle" that no one who is not a party to a contract can sue or be sued on it or take advantage of the stipulations or conditions that it contains. He has been quick to note that the principle is far from being an ancient one and that there are judicial ways to avoid its application when desired. However, his efforts have been largely ignored, and sometimes criticized, by the English judiciary.

But often judges have expressed similar discontent and have called for a reconsideration of the doctrine prohibiting a third party from enforcing contractual provisions made for his or her benefit: *Beswick v. Beswick*, [1967] 2 All E.R. 1197 (H.L.), at p. 1201 *per* Lord Reid; *Olsson v. Dyson* (1969), 120 C.L.R. 365 (Aust. H.C.), at pp. 392-93 *per* Windeyer J.; *Woodar Investment Development Ltd. v. Wimpey Construction U.K. Ltd.*, [1980] 1 All E.R. 571 (H.L.), at pp. 588-89 *per* Lord Keith and at p. 591 *per* Lord Scarman; *Swain v. Law Society*, [1983] 1 A.C. 598 (H.L.), at p. 611 *per* Lord Diplock. Lord Scarman's comments are particularly forceful:

> I respectfully agree with Lord Reid that the denial by English law of a jus quaesitum tertio calls for reconsideration. In *Beswick v Beswick*, Lord Reid, after referring to the Law Revision Committee's recommendation that the third party should be able to enforce a contractual promise taken by another for his benefit, observed: "If one had to contemplate a further long period of Parliamentary procrastination, this House might find it necessary to deal with this matter." The committee reported in 1937; *Beswick v Beswick* was decided in 1967. It is now 1979; but nothing has been done. If the opportunity arises, I hope the House will reconsider *Tweddle v Atkinson* and the other cases which stand guard over this unjust rule.

portant sur une clause de limitation de la responsabilité et une poursuite contre des employés), et *Midland Silicones*, précité, aux pp. 483 à 489 (une cause où il était question d'une clause de limitation de la responsabilité et de manutentionnaires), ainsi que dans les motifs de jugement qu'il a rendu au nom de la Cour d'appel dans *Beswick c. Beswick*, [1966] Ch. 538, lord Denning s'est interrogé sur la justesse et la nécessité du «principe fondamental» selon lequel la personne qui n'est pas partie à un contrat ne peut engager des poursuites fondées sur ce contrat ni être poursuivie en vertu de celui-ci, pas plus qu'elle ne peut tirer profit des stipulations ou des conditions qu'il contient. Il n'a pas tardé à constater que ce principe était loin d'être ancien et que les tribunaux peuvent en éviter l'application à leur gré. Toutefois, ses efforts ont été largement ignorés et parfois critiqués par la magistrature anglaise.

Cependant, d'autres juges ont exprimé un mécontentement semblable et ont demandé le réexamen du principe interdisant à un tiers de faire exécuter des dispositions contractuelles stipulées à son profit: *Beswick c. Beswick*, [1967] 2 All E.R. 1197 (H.L.), à la p. 1201, lord Reid, *Olsson c. Dyson* (1969), 120 C.L.R. 365 (H.C. Aust.), aux pp. 392 et 393, le juge Windeyer, *Woodar Investment Development Ltd. c. Wimpey Construction U.K. Ltd.*, [1980] 1 All E.R. 571 (H.L.), aux pp. 588 et 589, lord Keith, et à la p. 591, lord Scarman, et *Swain c. Law Society*, [1983] 1 A.C. 598 (H.L.), à la p. 611, lord Diplock. Les observations de lord Scarman sont particulièrement éloquentes:

> [TRADUCTION] En toute déférence, je partage l'opinion de lord Reid selon laquelle la dénégation du droit d'un tiers par le droit anglais devrait être réexaminée. Dans *Beswick c. Beswick*, lord Reid, après avoir mentionné la recommandation du Law Revision Committee qu'un tiers puisse faire exécuter un engagement contractuel pris par une autre personne à son profit, fait remarquer ce qui suit: «Si le législateur devait faire preuve de procrastination encore longtemps, notre Chambre pourrait juger nécessaire d'examiner la question». Le comité a déposé son rapport en 1937 et l'arrêt *Beswick c. Beswick* a été rendu en 1967. Nous sommes en 1979 et rien n'a encore été fait. Si l'occasion se présente, j'ose espérer que notre Chambre réexaminera *Tweddle c. Atkinson* et les autres décisions qui ont maintenu cette règle injuste.

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More recently, the High Court of Australia was faced with an opportunity in which to reconsider the doctrine of privity. The majority of the Court accepted the invitation made by those calling for reform. It strongly criticized the doctrine and permitted a third party beneficiary to enforce a provision in an insurance contract notwithstanding that it was not a party to the contract and had provided no consideration, and that neither agency nor trust (nor any other exception) was applicable: *Trident General Insurance Co. v. McNiece Bros. Pty. Ltd.* (1988), 80 A.L.R. 574.

Trident General Insurance Co. had entered into a contract of insurance with Blue Circle Southern Cement Ltd., a limestone crushing plant, with respect to its operation. The contract, among other things, attempted to extend certain benefits of coverage to third parties such as contractors and subcontractors. Following an accident in which a third party was held liable (McNiece Bros. Pty. Ltd.), Trident refused coverage on the ground that said party was not privy to the contract of insurance and had given no consideration. Notwithstanding that the facts could not support an agency argument and that trust had not been pleaded, the lower courts allowed McNiece's claim under the insurance policy thus creating, in effect, a new exception to the doctrine of privity. Trident appealed to the High Court of Australia making arguments very similar to ones made by the appellant in the case at bar; namely, that the High Court should confirm and apply "fundamental", "settled" and "established" contract principles relating to privity of contract and consideration, and asking that courts reject any judicial developments outside the scope of existing exceptions to the doctrine. These submissions were, in essence, accepted by three members of the High Court: Brennan, Deane and Dawson JJ. Each wrote individual dissenting reasons in which they defended the orthodox doctrine of privity and rejected attempts at judicial reform. However, a majority of the High Court (Mason C.J. and Wilson, Toohey and Gaudron JJ.) decided to examine the propriety of the rule denying third party beneficiary rights and held that this was an appropriate case in which to relax the rule. In the

Plus récemment, dans l'arrêt *Trident General Insurance Co. c. McNiece Bros. Pty. Ltd.* (1988), 80 A.L.R. 574, la Haute Cour d'Australie a eu l'occasion de réexaminer le principe du lien contractuel. La cour à la majorité s'est rendue à l'invitation de ceux qui demandaient une réforme. Après avoir vigoureusement critiqué le principe, elle a permis à un tiers bénéficiaire de faire exécuter une clause d'un contrat d'assurance, même s'il n'était pas partie à ce contrat et n'avait fourni aucune contrepartie, et même si l'exception du mandat ou de la fiducie (ou toute autre exception) ne s'appliquait pas.

Dans cette affaire, Trident General Insurance Co. avait conclu un contrat d'assurance avec Blue Circle Southern Cement Ltd., une entreprise de concassage de pierre à chaux, relativement à son exploitation. Dans le contrat, on tentait notamment d'accorder à des tiers, comme les entrepreneurs et les sous-traitants, certains avantages liés à la garantie d'assurance. À la suite d'un accident dont un tiers (McNiece Bros. Pty. Ltd.) avait été tenu responsable, Trident a refusé la protection pour le motif que ce tiers n'était pas partie au contrat d'assurance et n'avait fourni aucune contrepartie. Même si les faits ne permettaient pas de conclure à l'existence d'un mandat et que l'exception de la fiducie n'avait pas été invoquée, les tribunaux d'instance inférieure ont fait droit à la demande de McNiece fondée sur le contrat d'assurance et ont ainsi créé, dans les faits, une nouvelle exception au principe du lien contractuel. Trident a interjeté appel devant la Haute Cour d'Australie en avançant des arguments semblables à ceux de l'appelante dans la présente affaire, c'est-à-dire que la Haute Cour devrait confirmer et appliquer les principes «fondamentaux», «établis» et «consacrés» du droit des contrats en ce qui concerne le lien contractuel et la contrepartie, et en demandant que les tribunaux rejettent toute évolution jurisprudentielle qui ne s'en tient pas aux exceptions existantes à ce principe. Trois juges de la Haute Cour, soit les juges Brennan, Deane et Dawson ont fait droit, pour l'essentiel, à ces arguments. Chacun a rédigé ses propres motifs de dissidence dans lesquels il a défendu le principe traditionnel du lien contractuel et rejeté toute tentative d'obtenir une réforme par

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end, Trident's appeal was dismissed and McNiece was permitted to obtain the benefit of a contract to which it was not a party without resorting to notions of agency or trust.

(c) *Treatment in Other Jurisdictions*

As long ago as 1937, the English Law Revision Committee observed in its *Sixth Interim Report* that "the common law of England stands alone among modern systems of law in its rigid adherence to the view that a contract should not confer any rights on a stranger to the contract, even if the sole object may be to benefit him" (para. 48). This observation is still appropriate today, although it may be said that the common law of England has, for better or worse, found allegiance in Canada.

I need not engage in a thorough review of how third party beneficiary questions are dealt with in other jurisdictions or systems of law; that has been done on a number of occasions: see, for example, M. A. Millner, "*Ius Quaesitum Tertio*: Comparison and Synthesis" (1967), 16 *Int'l & Comp. L. Rev.* 446; A. J. Waters, "The Property in the Promise: A Study of the Third Party Beneficiary Rule" (1985), 98 *Harv. L. Rev.* 1109; S. P. de Cruz, "Privity in America: A Study in Judicial and Statutory Innovation" (1985), 14 *Anglo-American L. Rev.* 265; D. M. Walker, *The Law of Contracts and Related Obligations in Scotland* (2nd ed. 1985), at pp. 454-60; A. L. Corbin, *Corbin on Contracts*, 1 vol. ed. (1952), at pp. 723-82; and Ontario Law Reform Commission, *Report on Amendment of the Law of Contract*, *supra*, at pp. 55-65. I will simply take this opportunity to note what is obvious to anyone considering the issue, that is, that many jurisdictions have recognized, in varying degrees, that third party beneficiaries to a contract are entitled to enforce contractual provisions made for

les tribunaux. Toutefois, la Haute Cour à la majorité (le juge en chef Mason et les juges Wilson, Toohey et Gaudron) a décidé d'examiner la justesse de la règle qui ne reconnaît pas des droits aux tiers bénéficiaires et a statué qu'il s'agissait d'un cas où il convenait d'assouplir cette règle. En définitive, l'appel de Trident a été rejeté et le tribunal a permis à McNiece de bénéficier d'un contrat auquel elle n'était pas partie, et ce, sans recourir aux notions de mandat ou de fiducie.

c) *La façon dont le principe est traité dans d'autres ressorts*

Dès 1937, dans son *Sixth Interim Report*, l'English Law Revision Committee faisait remarquer que [TRADUCTION] «la common law anglaise est le seul système juridique contemporain à adhérer strictement au point de vue qu'un contrat ne devrait pas conférer de droits à un étranger à ce contrat, même si le seul objet poursuivi est de lui accorder un avantage» (par. 48). Cette observation demeure valable de nos jours, bien que l'on puisse dire que la common law anglaise a, pour le meilleur ou pour le pire, trouvé écho au Canada.

Je n'ai pas à entreprendre un examen approfondi de la question de savoir comment les questions de tiers bénéficiaires sont réglées dans d'autres ressorts ou systèmes juridiques, puisque cela a été fait à un certain nombre d'occasions: voir, par exemple, M. A. Millner, «*Ius Quaesitum Tertio*: Comparison and Synthesis» (1967), 16 *Int'l & Comp. L. Rev.* 446, A. J. Waters, «The Property in the Promise: A Study of the Third Party Beneficiary Rule» (1985), 98 *Harv. L. Rev.* 1109, S. P. de Cruz, «Privity in America: A Study in Judicial and Statutory Innovation» (1985), 14 *Anglo-American L. Rev.* 265, D. M. Walker, *The Law of Contracts and Related Obligations in Scotland* (2e éd. 1985), aux pp. 454 à 460, A. L. Corbin, *Corbin on Contracts*, édition en un volume (1952), aux pp. 723 à 782, et la Commission de réforme du droit de l'Ontario, *Report on Amendment of the Law of Contract*, *op. cit.*, aux pp. 55 à 65. Je saisis simplement cette occasion pour faire remarquer ce qui est évident pour quiconque examine la question, savoir que bon nombre de ressorts ont

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their benefit without necessarily resorting to notions such as agency or trust.

For example, in Quebec, the general principle of privity of contract (*relativité des contrats*) endorsed in art. 1023 of the *Civil Code of Lower Canada* is qualified by art. 1029 so as to permit contracting parties to stipulate in favour of third parties. Courts have interpreted this latter provision as giving to the third party a right, under certain circumstances, to enforce a contract made for his or her benefit. Such an interpretation is now codified in arts. 1444 to 1450 of the amendments to the Quebec *Civil Code*, S.Q. 1991, c. 64, which were recently passed by the National Assembly.

In a similar vein, while Scottish law adheres to the general rule that persons who are not parties to a contract cannot sue upon it, it nevertheless recognizes an exception when a *jus quaesitum tertio* has been created; that is, a right vested in and secured to a third party in and by a contract between two other parties. If an intention to confer a benefit on a third party can be gathered from the terms of the contract and the conduct of the parties, a *jus quaesitum tertio* will arise and the third party will have a right to enforce the contractual provision.

As stated above, in New Zealand, the *Contracts (Privity) Act 1982* abolishes to a very large extent the doctrine of privity of contract. Section 4 of the Act states that when a promise contained in a contract confers, or purports to confer, a benefit on a third party, the promisor shall be under an obligation, enforceable at the suit of the third party, to perform the promise. Section 2 of the Act defines "benefit" as including, *inter alia*, any immunity and any limitation or qualification of an obligation to which a person (other than a party to the contract) is or may be subject. Similar statutory inroads on privity include Western Australia's *Property Law Act, 1969*, W. Austl. Acts 1969,

reconnu, à divers degrés, que le tiers bénéficiaire d'un contrat a le droit de faire exécuter les dispositions contractuelles qui ont été stipulées à son profit, sans devoir nécessairement recourir à des notions comme le mandat ou la fiducie.

Au Québec, par exemple, le principe général de la relativité des contrats, consacré à l'art. 1023 du *Code civil du Bas-Canada*, est atténué par l'art. 1029 de manière à permettre aux parties contractantes de stipuler au profit d'un tiers. Les tribunaux ont interprété cette dernière disposition comme conférant à un tiers, dans certaines circonstances, le droit de faire exécuter un contrat conclu à son profit. Cette interprétation est désormais codifiée aux art. 1444 à 1450 des modifications au *Code civil* du Québec, L.Q. 1991, ch. 64, récemment sanctionnées par l'Assemblée nationale.

Dans la même veine, même si le droit écossais souscrit à la règle générale selon laquelle les personnes qui ne sont pas parties à un contrat ne peuvent engager des poursuites fondées sur ce contrat, il reconnaît néanmoins une exception lorsqu'il y a *jus quaesitum tertio*, c'est-à-dire lorsqu'un contrat liant deux parties confère un droit à un tiers. Si l'intention de conférer un avantage à un tiers peut être déduite des conditions du contrat et de la conduite des parties, il y a *jus quaesitum tertio* et le tiers a le droit de faire exécuter la disposition contractuelle.

Tel que mentionné précédemment, en Nouvelle-Zélande, la *Contracts (Privity) Act 1982* abolit dans une très large mesure le principe du lien contractuel. Selon l'art. 4 de cette loi, lorsqu'un engagement stipulé dans un contrat confère ou a pour objet de conférer un avantage à un tiers, le débiteur de l'engagement a l'obligation, que le tiers peut faire exécuter en justice, de respecter cet engagement. L'article 2 de la Loi définit le mot «avantage» (*benefit*) comme incluant notamment toute exonération, limitation ou restriction d'une obligation à laquelle une personne (qui n'est pas partie au contrat) est ou peut être assujettie. Parmi les autres incursions législatives dont a fait l'objet le principe du lien contractuel, il y a la *Property Law Act, 1969* d'Australie-Occidentale, W. Austl. Acts

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No. 32, s. 11, and Queensland's *Property Law Act 1974*, Queensl. Stat. 1974, No. 76, s. 55.

Finally, in the United States, third party rights are now recognized in every State, to a varying degree, by common law, uniform statutory legislation and/or specific state legislation. See, for example, §§ 302-315 of the *Restatement of Law (Second): Contracts 2d.* Ever since the cornerstone decision of the New York Court of Appeal in *Lawrence v. Fox*, 20 N.Y. 268 (1859), there has emerged what Professor Corbin refers to as a "trend" in the law, both judge-made and statutory, recognizing that third party beneficiaries are entitled, as a general rule, to enforce contractual provisions made for their benefit. The decision of the Massachussetts State Supreme Court in *Choate, Hall & Stewart v. SCA Services, Inc.*, 392 N.E.2d 1045 (1979), demonstrates that this trend has apparently now swept the entire country.

(d) *Previous Decisions of This Court*

As mentioned above, the appellant in its argument places considerable if not exclusive reliance on the decisions of this Court in *Canadian General Electric*, *supra*, *Greenwood Shopping Plaza*, *supra*, and *ITO—International Terminal Operators*, *supra*. From these decisions it is submitted that a tortfeasor's liability cannot be excluded, limited or modified by the terms of a contract to which he or she is not a party absent facts that can support a finding of trust or agency.

In *Canadian General Electric*, *supra*, an owner of goods brought an action against a firm of stevedores for negligence in the stowing of certain heavy electrical equipment belonging to the plaintiff on board a steamship destined for the Republic of Ghana. Writing reasons for the Court, Ritchie J. began by finding that the stevedoring company owed a duty of care to the owner of the goods, because in carrying out the work which it had undertaken for the shipowners, the stevedores should have had the owner of the goods in contem-

1969, nº 32, art. 11, et la *Property Law Act 1974* du Queensland, Queensl. Stat. 1974, nº 76, art. 55.

Enfin, aux États-Unis, les droits des tiers sont désormais reconnus dans tous les États, à divers degrés, par la common law, les lois d'application uniforme ou les lois applicables dans un État en particulier, ou les deux à la fois. Voir, par exemple, les par. 302 à 315 de la *Restatement of the Law (Second): Contracts 2d.* Depuis l'arrêt de principe de la Cour d'appel de New York *Lawrence c. Fox*, 20 N.Y. 268 (1859), il s'est dégagé ce que le professeur Corbin appelle une [TRADUCTION] «tendance» dans le droit, tant d'origine prétorienne que législative, à reconnaître que les tiers bénéficiaires ont, en général, le droit de faire exécuter les dispositions contractuelles stipulées à leur profit. La décision de la Cour suprême de l'État du Massachussetts *Choate, Hall & Stewart c. SCA Services, Inc.*, 392 N.E.2d 1045 (1979), démontre que cette tendance semble désormais se faire sentir partout au pays.

d) *Les arrêts antérieurs de notre Cour*

Tel que mentionné précédemment, dans son argumentation, l'appelante s'en remet en grande partie, sinon exclusivement, aux arrêts de notre Cour *Canadian General Electric*, *Greenwood Shopping Plaza* et *ITO—International Terminal Operators*, précités. S'appuyant sur ces décisions, l'appelante soutient que la responsabilité de l'auteur d'un délit ne saurait être exclue, limitée ou modifiée par les dispositions d'un contrat auquel il n'est pas partie lorsqu'il n'y a pas de faits permettant de conclure à l'existence d'une fiducie ou d'un mandat.

Dans *Canadian General Electric*, précité, une entreprise d'arrimage a été poursuivie pour négligence dans l'arrimage du matériel électrique lourd appartenant à la demanderesse à bord d'un navire à destination de la République du Ghana. S'exprimant au nom de la Cour, le juge Ritchie a tout d'abord conclu que l'entreprise d'arrimage avait une obligation de diligence envers la propriétaire des marchandises, puisqu'en exécutant les travaux qu'ils s'étaient engagés à effectuer pour le compte des propriétaires du navire, les arrimeurs auraient

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plation as a person affected by their acts. One argument raised by the firm of stevedores was that, even if they were in breach of this duty, their liability would be nonetheless limited in accordance with the provisions of the *Water Carriage of Goods Act*, R.S.C. 1952, c. 291, Schedule, Article IV(5), which were incorporated in the contracts of carriage between the owner of the goods and other parties, as evidenced by certain bills of lading. In response to this argument, Ritchie J. made the following observations (at pp. 43-44):

> ... as the stevedoring company is a complete stranger to the contract of carriage it would not be affected by any provisions for limitation of liability or otherwise contained in the bills of lading and if the respondent was in breach of its duty to take reasonable care of the goods which it was stowing in the ship, it must accept the normal consequences of its tort. The law in this regard is, in my opinion, correctly stated in the reasons for judgment of the majority of the House of Lords in *Midland Silicones v. Scruttons Limited*, where the relevant cases are fully discussed. [Emphasis added.]

It is important to note that the provisions of the *Water Carriage of Goods Act* relied on by the stevedoring company only made the "carrier" and the "ship" beneficiaries of a limited liability. There was no "*Himalaya* clause" involved as this expression is commonly understood. In other words, the limitation of liability clause contained in the contracts of carriage (i.e. the provisions of the *Water Carriage of Goods Act* incorporated by reference) did not confer, nor did it attempt to confer, any benefits whatsoever on the stevedoring company. There was no specific reference to stevedores and the terms "carrier" and "ship" could not be interpreted as including stevedores according to jurisprudence: see *Midland Silicones*, *supra*, and *Robert C. Herd & Co. v. Krawill Machinery Corp.*, 359 U.S. 297 (1959). In sum, nothing in the contracts expressly or impliedly limited the liability of the stevedoring company. The firm of stevedores was not a third party beneficiary under the contracts but rather a "complete stranger" who was attempting to acquire a benefit (i.e. a limitation of liability) from contracts which did not even

dû considérer la propriétaire des marchandises comme une personne touchée par leurs actes. L'un des arguments invoqués par l'entreprise d'arrimage était que, même si celle-ci avait manqué à cette obligation, sa responsabilité serait néanmoins limitée conformément aux dispositions de l'art. IV, règle 5 de l'annexe de la *Loi sur le transport des marchandises par eau*, S.R.C. 1952, ch. 291, qui étaient intégrées aux contrats de transport intervenus entre la propriétaire des marchandises et d'autres parties, comme en faisaient foi certains connaissements. Le juge Ritchie répond ainsi à cet argument (aux pp. 43 et 44):

> ... l'arrimeur n'étant aucunement partie au contrat de transport, n'est touché par aucune disposition tendant à limiter la responsabilité ou autrement contenue dans les connaissements. Si l'intimée a manqué à son devoir d'apporter un soin raisonnable en faisant l'arrimage de la marchandise sur le navire, elle doit subir les conséquences normales de sa faute. À mon avis, le droit qui s'applique à cette question est correctement énoncé dans les motifs du jugement majoritaire de la Chambre des Lords dans *Midland Silicones v. Scruttons Limited*, où les précédents pertinents sont discutés à fond. [Je souligne.]

Il importe de souligner que les dispositions de la *Loi sur le transport des marchandises par eau* invoquées par l'entreprise d'arrimage n'avaient pour effet de limiter que la responsabilité du «transporteur» et celle du «navire». Aucune «clause *Himalaya*», au sens où on l'entend habituellement, n'était en cause dans cette affaire. En d'autres termes, la clause de limitation de la responsabilité figurant dans les contrats de transport (c'est-à-dire les dispositions de la *Loi sur le transport des marchandises par eau* intégrées par renvoi) ne conférait ni ne tentait de conférer aucun avantage à l'entreprise d'arrimage. Les contrats ne faisaient nullement mention des arrimeurs, et les termes «transporteur» et «navire» ne pouvaient être interprétés comme incluant les arrimeurs, selon la jurisprudence: voir *Midland Silicones*, précité, et *Robert C. Herd & Co. c. Krawill Machinery Corp.*, 359 U.S. 297 (1959). En somme, rien dans les contrats ne limitait expressément ou implicitement la responsabilité de l'entreprise d'arrimage. Celle-ci était non pas un tiers bénéficiaire aux termes des contrats, mais une «parfaite étran-

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acknowledge its existence. Accordingly, while *Canadian General Electric* confirms the doctrine of privity to the extent that a stranger cannot obtain a benefit from a contract to which he or she is not a party, it says nothing about the aspect of the doctrine which refuses to recognize a third party beneficiary right.

Much of the same can be said about *Greenwood Shopping Plaza, supra*. In that case, employees of a company which was leasing premises in a shopping centre, while acting in the course of their employment, negligently caused a fire which destroyed part of the shopping centre. The lease between the owner of the centre and the company included in paragraphs 14 and 15 the provisions which dealt with the insurance of the demised premises. Although neither party to the contract took any steps towards the performance of the insurance undertakings, both were partially insured. Following the fire, an action was brought against the company and its employees on behalf of the owner of the shopping centre for the recovery of its uninsured loss and on behalf of its fire insurers by way of subrogation for moneys paid. The company, even though it was vicariously liable for the negligence of its employees, was held to be protected from liability through the provisions of the lease. The sole question before this Court, as stated by McIntyre J., was the following (at pp. 235-36):

> . . . whether the respondents, held to have been guilty of negligence which caused the loss, but not parties to the lease and the insuring agreement in paras. 14 and 15, may claim the benefit of those provisions and thereby receive the same protection as that afforded to the company, their employer, who was otherwise equally liable with them for their negligence.

McIntyre J. answered the question in the negative by resorting to the doctrine of privity of contract. He noted that while certain exceptions to this doctrine had developed, such as agency and trust,

gère» qui tentait de tirer un avantage (c.-à-d. une limitation de la responsabilité) de contrats qui ne reconnaissaient même pas son existence. En conséquence, bien que l'arrêt *Canadian General Electric* confirme le principe du lien contractuel dans la mesure où un étranger ne saurait tirer un avantage d'un contrat auquel il n'est pas partie, il ne dit rien au sujet de cet aspect du principe qui refuse de reconnaître un droit aux tiers bénéficiaires.

On pourrait en dire autant de l'arrêt *Greenwood Shopping Plaza*, précité. Dans cette affaire, les employés d'une société qui louait des locaux dans un centre commercial avaient causé par négligence, dans l'exécution de leurs fonctions, un incendie qui avait détruit une partie du centre commercial. Les clauses 14 et 15 du bail intervenu entre le propriétaire du centre et la société traitaient de l'assurance des lieux loués. Même si aucune des parties au contrat n'avait fait de démarches pour donner suite aux engagements en matière d'assurance, les deux parties étaient partiellement assurées. À la suite de l'incendie, une action a été intentée contre la société et ses employés, d'une part, au nom du propriétaire du centre commercial en vue d'obtenir l'indemnisation de sa perte non assurée et, d'autre part, au nom de ses assureurs contre l'incendie par voie de subrogation, en vue de recouvrer le montant des indemnités versées. Même si elle avait une responsabilité du fait d'autrui pour la négligence de ses employés, la société a été exonérée de toute responsabilité grâce à l'application des dispositions du bail. Voici la seule question dont était saisie notre Cour, d'après le juge McIntyre (aux pp. 235 et 236):

> . . . si les intimés qui ont été jugés coupables de la négligence qui a entraîné la perte, mais qui ne sont pas parties au bail et aux ententes sur l'assurance des clauses 14 et 15, peuvent se prévaloir de ces dispositions et, de ce fait, recevoir la même protection que celle accordée à la compagnie, leur employeur, qui était, par ailleurs, responsable au même titre que ses employés de la négligence de ces derniers.

Le juge McIntyre a répondu à la question par la négative en recourant au principe du lien contractuel ou de la relativité des contrats. Il a fait remarquer que, même si certaines exceptions, comme le

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on the limited evidence before this Court none was available to permit the employees to claim the benefit from the provisions of the lease.

I should like to make four observations concerning this decision. First, the contract involved in *Greenwood Shopping Plaza* was a lease of premises rather than a contract for services such as a contract of storage. The contract was between a lessor (the owner of the shopping centre) and the lessee (the company) and the intervention of the lessee's employees was not at all necessary for the execution of this agreement. It was irrelevant to any aspect of this agreement, especially to paragraphs 14 and 15, whether the lessee had any employees and whether they would be present on the leased premises. Second, the provisions of the contract which the employees were seeking to obtain a benefit from in *Greenwood Shopping Plaza* were not general limitation of liability clauses. Rather they were stipulations containing mutual undertakings by the lessor and the lessee with respect to insurance of the premises and the granting of subrogation rights. Third, it was inferentially observed that there was little, if any, evidence to support a finding that the parties to the contract intended to confer a benefit on the employees by the provisions of the lease relied on. This appears from the comments made by McIntyre J. in the context of his analysis of both the agency exception (at pp. 238-39) and the trust exception (at p. 240) and, more clearly, in the following closing observations (at pp. 240-41):

> It must also be observed that the clear and precise words of paras. 14 and 15 limit the application of the insurance provisions to the parties to the lease, the appellant and the company. Courts must, in cases of this sort, be wary against drawing inferences upon vague and scanty evidence, where the result would be to contradict the clear words of a written agreement and where rectification is not sought or may not be had. [Emphasis added.]

Finally, and closely related to the preceding comment, there is the fact that, as in *Canadian General Electric*, *supra*, the parties seeking to obtain benefits from the contract in *Greenwood Shopping*

mandat et la fiducie, avaient été reconnues à l'application de ce principe, la preuve limitée dont notre Cour était saisie ne permettait pas aux employés d'invoquer les dispositions du bail.

Je tiens à faire quatre observations relativement à cet arrêt. Premièrement, dans *Greenwood Shopping Plaza*, il s'agissait d'un contrat de location de locaux et non d'un contrat de prestation de services, tel un contrat d'entreposage. Le contrat liait un bailleur (le propriétaire du centre commercial) et le locataire (la société), et l'intervention des employés du locataire n'étaient aucunement requise pour exécuter l'entente. Il importait peu, à l'égard de quelque aspect de cette entente, spécialement les clauses 14 et 15, que le locataire ait des employés et que ceux-ci soient présents dans les locaux loués. Deuxièmement, dans *Greenwood Shopping Plaza*, les dispositions du contrat que les employés cherchaient à invoquer n'étaient pas des clauses générales de limitation de la responsabilité. Il s'agissait plutôt d'engagements réciproques de la part du bailleur et du locataire concernant l'assurance des locaux et l'attribution de droits de subrogation. Troisièmement, on a déduit qu'il y avait peu d'éléments de preuve, si vraiment il y en avait, que les parties au contrat avaient eu l'intention de conférer un avantage aux employés au moyen des dispositions du bail invoquées. C'est ce qui ressort des observations du juge McIntyre dans son analyse des exceptions du mandat (aux pp. 238 et 239) et de la fiducie (à la p. 240) et, plus clairement, des observations finales suivantes (à la p. 241):

> Il faut également souligner que le texte clair et précis des clauses 14 et 15 restreint aux parties au bail, savoir l'appelante et la compagnie, l'application des dispositions en matière d'assurance. Dans ce genre d'affaire, les tribunaux doivent faire attention de ne pas tirer des conclusions à partir d'éléments de preuve vagues et insuffisants lorsque cela aurait pour résultat de contredire le texte clair d'une entente écrite qu'on ne cherche pas à corriger ou qu'il serait impossible de corriger. [Je souligne.]

Enfin, en étroite relation avec l'observation qui précède, il y a le fait que, tout comme dans l'affaire *Canadian General Electric*, précitée, les parties qui cherchaient à bénéficier du contrat dans

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Plaza were viewed as complete strangers and not third party beneficiaries. This appears clearly from the wording of the provisions in question as noted by McIntyre J. in the underlined passage reproduced above.

In sum, the decision of this Court in *Greenwood Shopping Plaza*, while containing certain general statements relating to privity of contract, involved a contract and provisions which are different from the contract and provision in the case at bar. More importantly, however, is the fact that that case was not decided with reference to third party beneficiaries and with the aspect of privity denying a *jus tertii*, but rather with reference to complete strangers to a contract. Accordingly, *Greenwood Shopping Plaza*, like *Canadian General Electric*, is of limited use in a determination of whether third party beneficiary rights should be recognized in certain limited circumstances.

I now come to *ITO—International Terminal Operators*, *supra*. In that case, Mitsui O.S.K. Lines Ltd., a carrier, entered into a contract of carriage with Miida Electronics Inc. to carry some of the latter's electronic calculators from Japan to Montreal. The bill of lading contained what has become known as a "*Himalaya* clause" by which the carrier Mitsui sought to extend expressly the benefit of a limitation of liability to those it employed in connection with the shipment and unloading of the cargo, including stevedores. The carrier arranged for the goods to be picked up on arrival and stored at the port on a short-term basis by ITO–International Terminal Operators, a stevedoring and cargo-handling company. The contract between Mitsui and ITO stated that the stevedoring company was to be an express beneficiary of all limitation of liability provisions in its bills of lading. Many cartons of calculators were stolen from ITO's shed and Miida brought an action against both the carrier and the stevedoring company. The action was dismissed at trial. The Federal Court of Appeal dismissed the owner's appeal against the

Greenwood Shopping Plaza étaient considérées comme de parfaits étrangers et non comme des tiers bénéficiaires. C'est ce qui ressort clairement du texte des dispositions en cause, comme le fait remarquer le juge McIntyre dans la partie soulignée de la citation qui précède.

En somme, l'arrêt de notre Cour *Greenwood Shopping Plaza*, même s'il renferme un certain nombre d'énoncés généraux concernant le principe du lien contractuel, portait sur un contrat et des dispositions qui diffèrent du contrat et de la disposition qui sont en cause dans la présente affaire. Toutefois, ce qui importe encore davantage c'est que cette affaire n'a pas été tranchée en fonction de tiers bénéficiaires et de cet aspect du principe du lien contractuel qui nie les droits des tiers, mais plutôt en fonction de parfaits étrangers à un contrat. En conséquence, l'arrêt *Greenwood Shopping Plaza*, tout comme l'arrêt *Canadian General Electric*, est d'une utilité restreinte pour déterminer si les droits de tiers bénéficiaires devraient être reconnus dans certaines circonstances limitées.

J'analyserai maintenant la décision *ITO—International Terminal Operators*, précitée. Dans cette affaire, le transporteur Mitsui O.S.K. Lines Ltd. avait conclu un contrat avec Miida Electronics Inc. pour le transport de calculatrices électroniques de cette dernière depuis le Japon jusqu'à Montréal. Le connaissement renfermait ce qu'on en est venu à appeler une «clause *Himalaya*» par laquelle le transporteur Mitsui cherchait à étendre expressément la limitation de la responsabilité à ceux qu'il employait aux fins de l'expédition et du déchargement de la cargaison, y compris les manutentionnaires. Le transporteur s'était organisé pour qu'à l'arrivée des marchandises celles-ci soient prises en charge et entreposées à court terme au port par ITO—International Terminal Operators, une compagnie de manutention et d'acconage. Le contrat intervenu entre Mitsui et ITO prévoyait que la compagnie de manutention bénéficierait expressément de toutes les clauses de non-responsabilité contenues dans son connaissement. Plusieurs cartons contenant des calculatrices ont été volés dans le hangar d'ITO et Miida a intenté une action con-

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carrier but allowed its appeal against ITO. Both ITO and the owner appealed to this Court.

tre le transporteur et la compagnie de manutention. L'action a été rejetée en première instance. La Cour d'appel fédérale a rejeté l'appel interjeté par le propriétaire contre le transporteur, mais a accueilli son appel contre ITO. ITO et le propriétaire ont formé un pourvoi devant notre Cour.

One of the issues raised was the effect of the "*Himalaya* clause" in the bill of lading, particularly, whether such clauses are to be recognized as a feature of Canadian maritime law. McIntyre J., writing for the majority, began by noting that the major obstacle to the recognition of the "*Himalaya* clause" was the common law doctrine of privity of contract. However, observing that academic writers had revealed a gap between contractual theory and commercial reality in refusing to recognize such clauses, that exceptions to the doctrine had been inferentially recognized in *Greenwood Shopping Plaza*, *supra*, and that the "route" left open by Lord Reid in *Midland Silicones* (i.e. the four-part "agency test") had been applied by Lord Wilberforce, speaking for the majority of the Privy Council, in *The Eurymedon*, *supra*, a case later affirmed in the Privy Council in *Salmond and Spraggon (Australia) Pty. Ltd. v. Port Jackson Stevedoring Pty. Ltd. (The "New York Star")*, [1980] 3 All E.R. 257, McIntyre J. held that "*Himalaya* clauses" could be effective in Canadian maritime law. His conclusion was largely based on the reasoning of Lord Wilberforce in *The Eurymedon* and the latter's application of Lord Reid's agency "four-step" exception to the doctrine of privity, especially the fourth step which involves the use of the concept of a unilateral contract in order to show consideration moving from the stevedores to the owner of goods. McIntyre J. stressed that he was not resorting to a general third party right (or *jus tertii*) in order to dispose of the matter; however, he did not foreclose the possibility that such a right might one day be recognized. His comments in this respect merit citation (at pp. 787-88):

Dans cette affaire, il s'agissait notamment de déterminer l'effet de la «clause *Himalaya*» du connaissement et, plus particulièrement, si pareilles clauses doivent être reconnues comme une caractéristique du droit maritime canadien. S'exprimant au nom de la majorité, le juge McIntyre a commencé par souligner que le principal obstacle à la reconnaissance de la «clause *Himalaya*» était le principe du lien contractuel applicable en common law. Toutefois, le juge McIntyre a statué que les «clauses *Himalaya*» pouvaient être opérantes en droit maritime canadien, après avoir fait observer qu'en refusant de reconnaître ces clauses, des auteurs avaient révélé l'existence d'un écart entre la théorie en matière contractuelle et la réalité commerciale, que des exceptions à l'application du principe avaient été tacitement reconnues dans *Greenwood Shopping Plaza*, précité, et que l'«avenue» laissée ouverte par lord Reid dans *Midland Silicones* (soit le «critère du mandat» à quatre volets) avait été empruntée par lord Wilberforce, au nom de la majorité du Conseil privé, dans l'affaire *Eurymedon*, précitée, un arrêt confirmé par la suite par le Conseil privé dans *Salmond and Spraggon (Australia) Pty. Ltd. c. Port Jackson Stevedoring Pty. Ltd. (The «New York Star»)*, [1980] 3 All E.R. 257. Sa conclusion se fondait en grande partie sur le raisonnement de lord Wilberforce dans l'affaire *Eurymedon* ainsi que sur l'application, par ce dernier, de l'exception du mandat «à quatre volets» mise de l'avant par lord Reid à l'égard du principe du lien contractuel, plus particulièrement sur le quatrième volet qui fait appel à la notion de contrat unilatéral pour établir que les manutentionnaires ont fourni une contrepartie au propriétaire des marchandises. Le juge McIntyre a insisté sur le fait qu'il ne recourait pas à un droit général d'un tiers (ou *jus tertii*) pour trancher la question, mais il n'a pas exclu la possibilité qu'un tel droit soit un jour reconnu. Les observations qu'il fait à ce propos méritent d'être citées (aux pp. 787 et 788):

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Of interest on this point is the thirteenth edition of Carver, *Carriage by Sea* (1982), in which is found a different approach to the question of liability of stevedores and other agents of the carrier. The learned author rejects the proposition that the concept of the *jus tertii* is unknown to the common law and refers to early authorities which support its application. In essence, the view is expressed that there is nothing wrong in principle or authority with the clear application of the principle of *jus tertii*. There is nothing offensive, it is argued, in a contract of affreightment in giving effect to that which was intended by the parties. The essence of the proposition advanced by the learned author may be found at vol. 1, p. 262, where he says, at paragraph 410:

> **Importance of the Himalaya Clause**
>
> It will be a happy day when the *Himalaya Clause* and *The Eurymedon* have run their full course. The *Himalaya Clause* has proved to have been a most effective dyke to stem the tide threatening to overwhelm the barrier against incursion on shipowners' pockets of perils of the sea. But exceptions of perils of the sea can be preserved more thoroughly by simpler and more rational means once it was generally apparent that the fundamental principle of *jus tertii* covers all. It is clearly the available protective principle to apply now to ensure that the will of the parties to a contract of affreightment can simply be secured by saying in the bill of lading what that will is.
>
> An omnibus clause, of *Himalaya* vintage, could be devised, but it need no longer go into awkward concepts, which vary as between one country and another such as those of undisclosed agency and deemed (which means non-existent *de facto*) trusts.
>
> England does not stand alone in this matter; the real need to preserve, and possibly improve, the clause at this time stems also from the views already expressed by courts in Australia, Canada and the United States.

It may be that this approach offers a more rational solution to the problem than that outlined by Lord Wilberforce, which compresses the facts into a contractual mould in order to preserve the common law principle of privity in a situation in which it would appear that it is being rejected. Be that as it may, I leave open for another day consideration of the Carver proposal, and I

À cet égard, la treizième édition de Carver, *Carriage by Sea* (1982), est intéressante; on y trouve un point de vue différent sur la question de la responsabilité des manutentionnaires et autres mandataires du transporteur. Le savant auteur rejette la thèse selon laquelle la notion d'une conception du *jus tertii* n'existe pas en *common law* et il cite une ancienne jurisprudence qui appuie son application. Essentiellement, on y exprime le point de vue qu'il n'y a rien de mal en principe ou en jurisprudence à appliquer clairement le principe du *jus tertii*. Il n'y a rien de répréhensible, soutient-on, dans un contrat d'affrètement, à mettre à exécution la volonté des parties. L'essentiel de l'argument du savant auteur se retrouve à la p. 262 du volume 1, où il affirme au paragraphe 410:

> [TRADUCTION] **Importance de la clause Himalaya**
>
> Ce sera un jour heureux lorsque la clause *Himalaya* et l'*Eurymedon* auront fait leur temps. La clause *Himalaya* s'est révélée une digue des plus efficace pour stopper la marée qui menaçait de renverser la barrière érigée pour arrêter les incursions contre cette soupape de sûreté que sont les fortunes de mer pour les armateurs. Mais les exceptions que constituent les fortunes de mer peuvent être mieux sauvegardées par des moyens plus simples et plus rationnels quand il devient évident pour tous que le principe fondamental du *jus tertii* s'applique à tout. C'est manifestement le principe de protection existant qu'il faut appliquer maintenant pour assurer que la volonté des parties à un contrat d'affrètement peut être protégée simplement en stipulant expressément dans le connaissement ce qu'est cette volonté.
>
> Une clause fourre-tout, du genre *Himalaya*, pourrait être conçue, mais il n'est plus nécessaire de s'engager dans des concepts bizarres, qui varieront d'un pays à l'autre, tels que le mandat secret et les fiducies présumées (c'est-à-dire non existantes *de facto*).
>
> L'Angleterre n'est pas seule à cet égard; le besoin réel de préserver, et peut-être d'améliorer, la clause actuellement découle aussi des points de vue déjà exprimés par les tribunaux en Australie, au Canada et aux États-Unis.

Il se peut que ce point de vue offre une solution plus rationnelle au problème que celle énoncée par lord Wilberforce, qui fait violence aux faits pour les faire entrer dans le moule contractuel afin de préserver le principe de *common law* des liens contractuels dans une situation où il semblerait rejeté. Quoi qu'il en soit, je reporte l'étude de la proposition Carver à une autre occasion; je

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would follow the approach of Lord Wilberforce expressed in the case of *The "Eurymedon"*. [Emphasis added.]

McIntyre J. went on to find that the clause in question applied to the stevedoring company and that they were protected from liability.

Several points about *ITO—International Terminal Operators*, *supra*, warrant mention. First, unlike *Canadian General Electric*, *supra*, and *Greenwood Shopping Plaza*, *supra*, this case involved third party beneficiaries. The bill of lading expressly extended the benefit of a limitation of liability on third parties such as stevedores, which is the essence of a "*Himalaya* clause". In this sense, the stevedoring company was not a complete stranger to the contract of carriage but rather a third party beneficiary. While this fact was insufficient in itself to allow the third party to rely on the clause as a means of defence, it demonstrates that *ITO—International Terminal Operators* was concerned with a different aspect of the doctrine of privity from the two earlier decisions; the aspect which is involved in the case at bar.

Second, the majority of this Court in *ITO—International Terminal Operators* in recognizing the "*Himalaya* clause" took into consideration factors such as: commercial reality, the need for a definite establishment of risks in order to secure the respective needs for insurance, the situation in other jurisdictions, the need to promote uniformity and certainty in this area of law, and the true intention of the parties.

Third, and perhaps most importantly, while McIntyre J. opted for a recognition of the "*Himalaya* clause" within the current framework of the doctrine of privity and the traditional exception of agency, he nonetheless left open "for another day" the consideration of whether an approach simply recognizing a *jus tertii* would be a more rational solution to the problem faced by third party beneficiaries. Although his comments in this respect

préfère le point de vue exprimé par lord Wilberforce dans l'affaire «*Eurymedon*». [Je souligne.]

Le juge McIntyre a ensuite conclu que la clause en question s'appliquait à la compagnie de manutention et que celle-ci était exonérée de toute responsabilité.

Plusieurs précisions s'imposent concernant l'affaire *ITO—International Terminal Operators*, précitée. Premièrement, contrairement aux affaires *Canadian General Electric* et *Greenwood Shopping Plaza*, précitées, cette affaire met en cause des tiers bénéficiaires. Le connaissement étendait expressément la limitation de la responsabilité à des tiers comme les manutentionnaires, ce qui constitue l'essence même d'une «clause *Himalaya*». En ce sens, la compagnie de manutention n'était pas parfaitement étrangère au contrat de transport, mais constituait plutôt un tiers bénéficiaire. Bien que ce fait soit insuffisant en soi pour permettre au tiers d'invoquer la clause comme moyen de défense, il montre que l'arrêt *ITO—International Terminal Operators* portait sur un aspect du principe du lien contractuel différent de celui dont il était question dans les deux arrêts précédents, et c'est de cet aspect dont il est question en l'espèce.

Deuxièmement, en reconnaissant la «clause *Himalaya*», notre Cour, à la majorité, a pris en considération des facteurs comme la réalité commerciale, la nécessité d'une détermination précise des risques afin d'établir les besoins de chacune des parties en matière d'assurance, la situation dans d'autres ressorts, la nécessité de favoriser l'uniformité et la certitude dans ce domaine du droit et l'intention véritable des parties.

Troisièmement, et ce qui est peut-être le plus important, même si le juge McIntyre a choisi de reconnaître la «clause *Himalaya*» dans le cadre actuel du principe du lien contractuel et de l'exception traditionnelle du mandat, il a néanmoins reporté «à une autre occasion» l'étude de la question de savoir si la simple reconnaissance des droits des tiers apporterait une solution plus rationnelle au problème auquel font face les tiers bénéfi-

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were made in a context different from that in the case at bar, I see nothing in the "Carver proposal" nor in the reasons of the majority in *ITO—International Terminal Operators* which would prevent this Court from accepting McIntyre J.'s invitation, albeit in a different factual setting.

It appears from the foregoing that the three decisions of this Court relied upon by the appellant do not completely and clearly dispose of the issue under consideration. Put another way, there is nothing in any of them which precludes this Court from adopting the approach I shall set out in the following part of these reasons.

(4) The Doctrine of Privity and the Present Appeal

None of the traditional exceptions to privity is applicable in the case at bar. As noted by the appellant, there is no evidence to support a finding of agency or trust, and these matters were not fully argued before the courts below. While the respondents rely to a certain extent on the approach taken by Lambert J.A. in the Court of Appeal, I must say that I have much difficulty in supporting a conclusion that the approach described in *The Eurymedon*, *supra*, and *ITO—International Terminal Operators*, *supra*, is applicable to the facts of this case. Rather than artificially extending recognized exceptions beyond their accepted limits, I prefer approaching this matter on the basis that privity of contract would otherwise apply so as to preclude the respondents from obtaining the benefit of the limitation of liability clause. The questions I now need to address are whether this doctrine should be relaxed in the circumstances of this case and, if so, on what basis.

(a) *Should the Doctrine of Privity be Relaxed?*

Without doubt, major reforms to the rule denying third parties the right to enforce contractual

ciaires. Bien que ses observations à cet égard aient été formulées dans un contexte différent de celui dont nous sommes saisis, je ne vois rien dans la «proposition Carver», non plus que dans les motifs de la majorité dans *ITO—International Terminal Operators*, qui empêcherait notre Cour de se rendre à l'invitation du juge McIntyre, même si les faits en cause sont différents.

Il ressort de ce qui précède que les trois arrêts de notre Cour invoqués par l'appelante ne règlent pas complètement et clairement la question en litige. En d'autres termes, rien dans ces arrêts n'empêche notre Cour d'adopter le point de vue que je vais énoncer dans la partie suivante des présents motifs.

4) Le principe du lien contractuel et le présent pourvoi

Aucune des exceptions traditionnelles au principe du lien contractuel ne s'applique en l'espèce. Comme l'a souligné l'appelante, aucun élément de preuve ne permet de conclure à l'existence d'un mandat ou d'une fiducie, et ces questions n'ont pas été pleinement débattues devant les tribunaux d'instance inférieure. Bien que les intimés s'en remettent, jusqu'à un certain point, à l'approche adoptée par le juge Lambert de la Cour d'appel, je dois dire que j'ai beaucoup de mal à conclure que l'approche décrite dans les affaires *Eurymedon* et *ITO—International Terminal Operators*, précitées, peut s'appliquer aux faits de la présence affaire. Au lieu d'étendre artificiellement l'application des exceptions reconnues au-delà de leurs limites acceptées, je préfère aborder la question en tenant pour acquis que le principe du lien contractuel s'appliquerait par ailleurs de manière à empêcher les intimés de bénéficier de la clause de limitation de la responsabilité. Il m'incombe dès lors de déterminer si ce principe devrait être assoupli dans les circonstances de la présente espèce et, le cas échéant, de quelle manière.

a) *Le principe du lien contractuel devrait-il être assoupli?*

Il ne fait aucun doute que c'est au législateur qu'il incombe de procéder à des réformes majeures

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provisions made for their benefit must come from the legislature. Although I have strong reservations about the rigid retention of a doctrine that has undergone systematic and substantial attack, 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: see, for two recent examples, *Watkins v. Olafson*, [1989] 2 S.C.R. 750, at pp. 760-61, and *R. v. Salituro*, [1991] 3 S.C.R. 654, at pp. 665-70.

McLachlin J.'s comments in *Watkins v. Olafson*, at pp. 760-61, speaking for the Court, are worth repeating:

> This branch of the case, viewed thus, raises starkly the question of the limits on the power of the judiciary to change the law. Generally speaking, the judiciary is bound to apply the rules of law found in the legislation and in the precedents. Over time, the law in any given area may change; but 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.
>
> There are sound reasons supporting this judicial reluctance to dramatically recast established rules of law. 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

de la règle qui nie aux tiers le droit de faire exécuter des dispositions contractuelles stipulées à leur profit. Bien que j'aie de sérieuses réserves quant à l'opportunité d'appliquer strictement un principe qui a fait l'objet de critiques à la fois systématiques et vigoureuses, j'estime que le principe du lien contractuel est un principe établi du droit des contrats et qu'il n'y a pas lieu de l'écarter à la légère. Le seul fait d'abolir le principe du lien contractuel ou de l'ignorer, sans plus, représenterait une modification majeure de la common law, dont les ramifications seraient à la fois complexes et incertaines. Dans le passé, notre Cour a montré qu'elle n'était pas disposée à sanctionner des modifications de cette envergure apportées par des membres de la magistrature: pour deux exemples récents, voir *Watkins c. Olafson*, [1989] 2 R.C.S. 750, aux pp. 760 et 761, et *R. c. Salituro*, [1991] 3 R.C.S. 654, aux pp. 665 à 670.

Il vaut la peine de reprendre les observations que le juge McLachlin a formulées au nom de notre Cour dans *Watkins c. Olafson* (aux pp. 760 et 761):

> Cette partie du pourvoi, vue dans cette perspective, pose carrément la question des limites du pouvoir des tribunaux de modifier le droit. En général, le pouvoir judiciaire est tenu d'appliquer les règles de droit formulées dans les textes législatifs et la jurisprudence. Avec le temps, le droit relatif à un domaine donné peut changer, mais cela ne se fait que lentement et progressivement, et dépend largement du mécanisme d'application d'un principe existant à des circonstances nouvelles. Bien que certains juges puissent être plus innovateurs que d'autres, les tribunaux judiciaires ont généralement refusé de modifier sensiblement et profondément des règles reconnues jusque-là pour les appliquer au cas qui leur était soumis.
>
> Il y a de solides raisons qui justifient ces réticences du pouvoir judiciaire à modifier radicalement des règles de droit établies. Une cour de justice n'est peut-être pas l'organisme le mieux placé pour déterminer les lacunes du droit actuel et encore moins les problèmes que pourraient susciter les modifications qu'elle pourrait apporter. La cour de justice est saisie d'un cas particulier; les changements importants du droit doivent se fonder sur une perception plus générale de la façon dont la règle s'appliquera à la grande majorité des cas. De plus, une cour de justice peut ne pas être en mesure d'évaluer

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.

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

This Court has also recognized, however, that in appropriate circumstances courts have not only the power but the duty to make incremental changes to the common law to see that it reflects the emerging needs and values of our society: *R. v. Salituro*, at pp. 669-70. It is my view that the present appeal is an appropriate situation for making such an incremental change to the doctrine of privity of contract in order to allow the respondents to benefit from the limitation of liability clause.

As we have seen earlier, the doctrine of privity has come under serious attack for its refusal to recognize the right of a third party beneficiary to enforce contractual provisions made for his or her benefit. Law reformers, commentators and judges have pointed out the gaps that sometimes exist between contract theory on the one hand, and commercial reality and justice on the other. We have also seen that many jurisdictions around the world, including Quebec and the United States, have chosen from an early point (as early as the doctrine became "settled" in the English common law) to recognize third party beneficiary rights in certain circumstances. As noted by the appellant, the com-

pleinement les questions économiques et de principe qui sous-tendent le choix qu'on lui demande de faire. Les modifications substantielles du droit comportent souvent la formulation de règles et de procédures subsidiaires nécessaires à leur mise en œuvre, ce qui devrait plutôt se faire par voie de consultation entre les tribunaux et les praticiens que par décision judiciaire. Enfin, et c'est peut-être là le plus important, il existe un principe établi depuis longtemps selon lequel, dans une démocratie constitutionnelle, il appartient à l'assemblée législative, qui est le corps élu du gouvernement, d'assumer la responsabilité principale pour la réforme du droit.

Ce sont des considérations comme celles-là qui permettent de soutenir que les réformes majeures du droit doivent plutôt relever de l'assemblée législative. Lorsqu'il s'agit de procéder à une extension mineure de l'application de règles existantes de manière à répondre aux exigences d'une situation nouvelle et lorsque les conséquences de la modification sont faciles à évaluer, les juges peuvent et doivent modifier les règles existantes. Mais quand il s'agit d'une réforme majeure ayant des ramifications complexes, les tribunaux doivent faire preuve de beaucoup de prudence.

Cependant, notre Cour a également reconnu que, dans des circonstances appropriées, les tribunaux ont non seulement le pouvoir, mais également l'obligation, de modifier progressivement la common law afin qu'elle réponde aux besoins et aux valeurs qui se font jour dans notre société: *R. c. Salituro*, aux pp. 669 et 670. J'estime qu'il convient en l'espèce d'effectuer une telle modification progressive du principe du lien contractuel afin de permettre aux intimés de bénéficier de la clause de limitation de la responsabilité.

Comme nous l'avons vu antérieurement, le principe du lien contractuel a fait l'objet d'attaques virulentes parce qu'il ne reconnaît pas à un tiers bénéficiaire le droit de faire exécuter des dispositions contractuelles stipulées à son profit. Des réformateurs du droit, des commentateurs et des juges ont souligné les écarts qui existent parfois entre la théorie des contrats, d'une part, et la réalité commerciale et la justice, d'autre part. Nous avons également vu que bien des ressorts dans le monde, dont le Québec et les États-Unis, ont tôt fait (aussitôt que le principe est devenu «établi» en common law anglaise) de reconnaître les droits des tiers bénéficiaires dans certaines circonstances. Comme

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mon law recognizes certain exceptions to the doctrine, such as agency and trust, which enable courts, in appropriate circumstances, to arrive at results which conform with the true intentions of the contracting parties and commercial reality. However, as many have observed, the availability of these exceptions does not always correspond with their need. Accordingly, this Court should not be precluded from developing the common law so as to recognize a further exception to privity of contract merely on the ground that some exceptions already exist.

While these comments may not, in themselves, justify doing away with the doctrine of privity, they nonetheless give a certain context to the principles that this Court is now dealing with. This context clearly supports in my view some type of reform or relaxation to the law relating to third party beneficiaries. Again, I reiterate that any substantial amendment to the doctrine of privity is a matter properly left with the legislature. But this does not mean that courts should shut their eyes to criticisms when faced with an opportunity, as in the case at bar, to make a very specific incremental change to the common law.

At this point, it is useful to recall briefly the salient facts with which this Court is seized. The appellant entered into a contract with Kuehne & Nagel for certain services, namely, the storing of its transformer. When the contract was signed, the appellant knew that it contained a clause limiting the liability of the "warehouseman" to $40. It also knew, or can be assumed to have known, that Kuehne & Nagel employed many individuals and that these employees would be directly involved in the storing of the transformer. The appellant chose not to obtain additional insurance from Kuehne & Nagel and instead arranged for its own all-risk coverage. When the damages to the transformer occurred, the respondents, two of Kuehne & Nagel's employees, were acting in the course of

l'a fait remarquer l'appelante, la common law reconnaît certaines exceptions à l'application du principe, telles celles du mandat ou de la fiducie, qui permettent aux tribunaux, dans les circonstances appropriées, d'atteindre des résultats conformes aux intentions véritables des parties contractantes et à la réalité commerciale. Toutefois, comme plusieurs l'ont fait remarquer, la possibilité de recourir à ces exceptions ne satisfait pas toujours à leurs besoins. En conséquence, notre Cour ne devrait pas être empêchée de faire évoluer la common law de manière à reconnaître une autre exception au principe du lien contractuel, pour le simple motif que certaines exceptions existent déjà.

Même s'il se peut qu'elles ne justifient pas en soi l'abolition du principe du lien contractuel, ces observations permettent néanmoins de situer dans un certain contexte les principes dont notre Cour est maintenant saisie. Selon moi, ce contexte justifie nettement un certain type de réforme ou d'assouplissement du droit applicable aux tiers bénéficiaires. Je répète de nouveau que c'est au législateur qu'il incombe d'apporter des modifications substantielles au principe du lien contractuel. Mais cela ne signifie pas que les tribunaux devraient faire fi des critiques lorsque l'occasion leur est donnée, comme dans la présente affaire, d'apporter une modification progressive très précise à la common law.

Il importe, à cette étape-ci, de rappeler brièvement les faits saillants dont notre Cour est saisie. L'appelante a conclu avec Kuehne & Nagel un contrat visant la prestation de certains services, savoir l'entreposage de son transformateur. Lorsqu'elle a signé le contrat, l'appelante savait qu'il renfermait une clause limitant à 40 $ la responsabilité de l'«entreposeur». Elle savait également, ou on peut supposer qu'elle savait, que Kuehne & Nagel retenait les services de nombreuses personnes et que ces employés participeraient directement à l'entreposage du transformateur. L'appelante a choisi de ne pas souscrire une assurance supplémentaire auprès de Kuehne & Nagel, mais elle s'est organisée pour souscrire sa propre assurance tous risques. Lorsque le transformateur a été

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their employment and were performing services directly related to the contract of storage. The appellant is now seeking to recover the full amount of damages from these employees since it can only obtain $40 from the employer. As a defence to such a claim, the respondents are attempting to obtain the benefit of the limitation of liability clause.

There are few principled reasons for upholding the doctrine of privity in the circumstances of this case. Maintaining the alleged *status quo* by itself is an unhelpful consideration since I am considering whether or not a relaxation, or change, to the law should be made. Similarly, most of the traditional reasons or justifications behind the doctrine are of little application in cases such as this one, when a third party beneficiary is relying on a contractual provision as a defence in an action brought by one of the contracting parties. There are no concerns about double recovery or floodgates of litigation brought by third party beneficiaries. The fact that a contract is a very personal affair, affecting only the parties to it, is simply a restatement of the doctrine of privity rather than a reason for its maintenance. Nor is there any concern about "reciprocity", that is, there is no concern that it would be unjust to allow a party to sue on a contract when he or she cannot be sued on it.

Moreover, recognizing a right for a third party beneficiary to rely on a limitation of liability clause should have relatively little impact on the rights of contracting parties to rescind or vary their contracts, in comparison with the recognition of a third party right to sue on a contract. In the end, the most that can be said against the extension of exceptions to the doctrine of privity in this case is that the respondent employees are mere donees and have provided no consideration for the contractual limitation of liability.

endommagé, les intimés, deux employés de Kuehne & Nagel, agissaient dans l'exercice de leurs fonctions et fournissaient des services directement liés au contrat d'entreposage. L'appelante demande aujourd'hui le paiement par ces employés du montant intégral des dommages puisqu'elle ne peut obtenir que 40 $ de leur employeur. Comme moyen de défense, les intimés tentent d'invoquer la clause de limitation de la responsabilité.

Peu de raisons fondées sur des principes justifient le maintien du principe du lien contractuel dans les circonstances de la présente affaire. Le maintien du prétendu statu quo n'est en soi d'aucun secours puisque j'examine s'il y a lieu d'assouplir ou de modifier le droit. De même, la plupart des raisons et des justifications traditionnelles qui sous-tendent le principe ne s'appliquent guère dans le cas où, comme en l'espèce, un tiers bénéficiaire invoque une disposition contractuelle comme moyen de défense à l'action intentée par l'une des parties contractantes. Il n'y a aucune crainte de double indemnisation ou d'une avalanche de poursuites intentées par des tiers bénéficiaires. Le fait qu'un contrat soit une affaire très personnelle qui ne touche que ceux qui y sont parties, n'est qu'un nouvel énoncé du principe du lien contractuel plutôt qu'une raison de le maintenir. Il n'y a aucune crainte relative à la «réciprocité», en ce sens qu'on ne s'inquiète pas du fait qu'il serait injuste de permettre à une partie d'engager des poursuites fondées sur un contrat alors qu'elle ne peut être poursuivie en vertu de celui-ci.

De plus, le fait de reconnaître aux tiers bénéficiaires le droit d'invoquer une clause de limitation de la responsabilité devrait avoir relativement peu d'effet sur les droits des parties contractantes de résilier ou modifier leurs contrats, comparativement au fait de reconnaître aux tiers le droit d'engager des poursuites fondées sur un contrat. En fin de compte, tout ce que l'on peut faire valoir à l'encontre de la création d'une nouvelle exception au principe du lien contractuel en l'espèce, c'est que les employés intimés sont de simples donataires et qu'ils n'ont fourni aucune contrepartie en échange de la limitation contractuelle de la responsabilité.

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The doctrine of privity fails to appreciate the special considerations which arise from the relationships of employer-employee and employer-customer. There is clearly an identity of interest between the employer and his or her employees as far as the performance of the employer's contractual obligations is concerned. When a person contracts with an employer for certain services, there can be little doubt in most cases that employees will have the prime responsibilities related to the performance of the obligations which arise under the contract. This was the case in the present appeal, clearly to the knowledge of the appellant. While such a similarity or closeness might not be present when an employer performs his or her obligations through someone who is not an employee, it is virtually always present when employees are involved. Of course, I am in no way suggesting that employees are a party to their employer's contracts in the traditional sense so that they can bring an action on the contract or be sued for breach of contract. However, when an employer and a customer enter into a contract for services and include a clause limiting the liability of the employer for damages arising from what will normally be conduct contemplated by the contracting parties to be performed by the employer's employees, and in fact so performed, there is simply no valid reason for denying the benefit of the clause to employees who perform the contractual obligations. The nature and scope of the limitation of liability clause in such a case coincides essentially with the nature and scope of the contractual obligations performed by the third party beneficiaries (employees).

Le principe du lien contractuel ne tient pas compte des conséquences particulières qui découlent des relations employeur-employé et employeur-client. L'employeur et l'employé partagent manifestement les mêmes intérêts lorsqu'il s'agit d'exécuter les obligations contractuelles de l'employeur. Lorsqu'une personne conclut, avec un employeur, un contrat visant la prestation de certains services, il ne fait presque aucun doute, dans la plupart des cas, que des employés se verront confier les principales tâches liées à l'exécution des obligations qui découlent du contrat. Tel était le cas dans la présente affaire et, de toute évidence, l'appelante le savait. Bien qu'il se puisse qu'une telle similitude ou ressemblance ne soit pas présente lorsque l'employeur s'acquitte de ses obligations par l'entremise de quelqu'un qui n'est pas son employé, pareil élément est presque toujours présent lorsque des employés sont en cause. Il va de soi que je ne laisse nullement entendre que l'employé est une partie aux contrats de son employeur au sens traditionnel, de manière à pouvoir engager des poursuites fondées sur ces contrats ou être poursuivi pour leur inexécution. Toutefois, lorsqu'un employeur et un client concluent un contrat de prestation de services et insèrent une clause limitant la responsabilité de l'employeur relativement aux dommages imputables aux actes qui, dans l'esprit des parties contractantes et dans les faits, sont normalement accomplis par les employés de l'employeur, il n'existe tout simplement aucun motif valable de refuser le bénéfice de la clause aux employés qui exécutent les obligations contractuelles. En pareil cas, la nature et la portée de la clause de limitation de la responsabilité correspondent, pour l'essentiel, à la nature et à la portée des obligations contractuelles exécutées par les tiers bénéficiaires (les employés).

Upholding a strict application of the doctrine of privity in the circumstances of this case would also have the effect of allowing the appellant to circumvent or escape the limitation of liability clause to which it had expressly consented. This Court warned against such a practice in *Central Trust Co. v. Rafuse*, [1986] 2 S.C.R. 147. There, Le Dain

Appliquer strictement le principe du lien contractuel dans les circonstances de la présente affaire aurait également pour effet de permettre à l'appelante de contourner ou d'éluder la clause de limitation de la responsabilité à laquelle elle a expressément consenti. Dans *Central Trust Co. c. Rafuse*, [1986] 2 R.C.S. 147, notre Cour a mis en

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J. in speaking for the Court made the following statement of principle (at p. 206):

> A concurrent or alternative liability in tort will not be admitted if its effect would be to permit the plaintiff to circumvent or escape a contractual exclusion or limitation of liability for the act or omission that would constitute the tort. Subject to this qualification, where concurrent liability in tort and contract exists the plaintiff has the right to assert the cause of action that appears to be most advantageous to him in respect of any particular legal consequence.

I appreciate that this Court was dealing with a somewhat different factual situation in *Central Trust* since it was addressing the general question of concurrent or alternative liabilities in tort and contract as between two parties to a contract. It was not concerned specifically with the right of a contracting party to bring an action in tort against the employees of the other party, at the same time as suing that other party in contract and tort. However, the concern expressed by Le Dain J., that is, the fundamental unilateral alteration of one's contract, remains entirely applicable to the case at bar. Let me explain.

In making the above "qualification" to concurrent or alternative liability, Le Dain J. was largely influenced by the majority judgment of Pigeon J. in *J. Nunes Diamonds Ltd. v. Dominion Electric Protection Co.*, [1972] S.C.R. 769. In this respect, I think it would be useful to reproduce the passages from *Central Trust*, *supra*, which reveal what Le Dain J. had in mind when he spoke of circumventing or escaping one's contractual limitation of liability. He reviewed *Nunes Diamonds* in the following manner (at pp. 162-63):

> The trial court and the Court of Appeal were of the opinion that there had not been misrepresentation for which D.E.P. was liable. The majority of this Court appear also to have been of this view but, assuming that there had been a misrepresentation, they held that there

garde contre cette pratique. Dans cet arrêt, le juge Le Dain a formulé, au nom de la Cour, l'énoncé de principe suivant (à la p. 206):

> Une responsabilité délictuelle concurrente ou alternative ne sera pas admise si elle a pour effet de permettre au demandeur de contourner ou d'éluder une clause contractuelle d'exonération ou de limitation de responsabilité pour l'acte ou l'omission qui constitue le délit civil. Sous réserve de cette restriction, chaque fois qu'il existe simultanément une responsabilité délictuelle et une responsabilité résultant d'un contrat, il est loisible au demandeur de se prévaloir de la cause d'action qui lui paraît la plus avantageuse à l'égard d'une conséquence juridique donnée.

Je me rends bien compte que, dans *Central Trust*, notre Cour était saisie d'une situation factuelle quelque peu différente puisqu'elle examinait la question générale des responsabilités concomitantes (concurrentes) ou alternatives, en matière délictuelle et contractuelle, des deux parties à un contrat. Elle n'avait pas à se prononcer précisément sur le droit d'une partie contractante d'intenter une action en responsabilité délictuelle contre les employés de l'autre partie au contrat, tout en intentant contre cette dernière une action fondée sur le contrat et la responsabilité délictuelle. Cependant, la crainte exprimée par le juge Le Dain, savoir qu'il y ait modification unilatérale et fondamentale d'un contrat, demeure tout à fait pertinente en l'espèce, et voici pourquoi.

En assujettissant la responsabilité concomitante ou alternative à la «restriction» susmentionnée, le juge Le Dain s'est inspiré largement de l'opinion majoritaire du juge Pigeon dans *J. Nunes Diamonds Ltd. c. Dominion Electric Protection Co.*, [1972] R.C.S. 769. J'estime qu'il serait utile, à cet égard, de reproduire les passages de l'arrêt *Central Trust*, précité, qui révèlent ce que le juge Le Dain entendait par le fait de contourner ou d'éluder une limitation contractuelle de la responsabilité. Il a analysé ainsi l'arrêt *Nunes Diamonds* (aux pp. 162 et 163):

> La cour de première instance et la Cour d'appel ont conclu à l'absence de déclarations inexactes entraînant la responsabilité de D.E.P. Cette Cour à la majorité semble avoir partagé cet avis, mais a conclu que, même à supposer qu'il y ait eu déclarations inexactes, il ne pouvait

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could not be liability in tort for it because of the existence of the contract. Pigeon J., with whom Martland and Judson JJ. concurred, said the following at pp. 777-78:

> Furthermore, the basis of tort liability considered in *Hedley Byrne* is inapplicable to any case where the relationship between the parties is governed by a contract, unless the negligence relied on can properly be considered as "an independent tort" unconnected with the performance of that contract, as expressed in *Elder, Dempster & Co. Ltd. v. Peterson, Zochonis & Co., Ltd.*, [[1924] A.C. 522], at p. 548. This is specially important in the present case on account of the provisions of the contract with respect to the nature of the obligations assumed and the practical exclusion of responsibility for failure to perform them.

It appears to have been assumed by the majority, as had been held by the trial judge, that the clause in the contract limiting liability in the case of loss to $50 did not cover negligence and also that the clause respecting representations did not apply to representations made after the contract was entered into. Pigeon J. said that if D.E.P. were to be liable in tort, despite the limitation of liability in the contract, it would effect a fundamental alteration of the contract.

Le Dain J. went on to examine the House of Lords decision of *Elder, Dempster*, *supra*, in order to elucidate what Pigeon J. meant by an "independent tort unconnected with the performance of [the] contract". This decision is of particular interest in the case at bar because of the similarity of legal issues involved therein, namely, the reliance by a third party on a contractual limitation of liability. Of course, I recognize that *Elder, Dempster* may be interpreted in many different ways and that the House of Lords has later expressed disapproval with at least one of these interpretations (i.e. vicarious immunity): *Midland Silicones*, *supra*. However, in clarifying the comments made by Pigeon J. in *Nunes Diamonds*, this Court chose to adopt one particular meaning of *Elder, Dempster* in *Central Trust* (at p. 164) which is very helpful in understanding the concern expressed by Le Dain J.:

> What [*Elder, Dempster*] decided in essence was that the contractual exclusion of liability for bad stowage in the

y avoir de responsabilité délictuelle en raison de l'existence du contrat. Le juge Pigeon, à l'avis duquel ont souscrit les juges Martland et Judson, affirme aux pp. 777 et 778:

> Le critère de responsabilité délictuelle étudié dans l'affaire *Hedley Byrne* ne peut pas s'appliquer lorsque les relations entre les parties sont régies par un contrat, à moins qu'il soit possible de considérer que la négligence imputée constitue un délit civil indépendant n'ayant aucun rapport avec l'exécution du contrat, comme on l'a dit dans la cause *Elder, Dempster & Co. Ltd. v. Paterson, Zochonis & Co. Ltd.* ([1924] A.C. 522), p. 548. En l'espèce, c'est là un point particulièrement important, à cause des dispositions contractuelles relatives à la nature des obligations assumées et l'exclusion virtuelle de toute responsabilité en cas de défaut de les remplir.

La Cour à la majorité semble avoir tenu pour acquis, à l'instar du juge de première instance, que la clause du contrat qui limitait la responsabilité en cas de perte à la somme de 50 $ ne s'appliquait pas à la négligence et aussi que la clause relative aux déclarations ne visait pas celles faites après la signature du contrat. Le juge Pigeon a affirmé que si, malgré la limitation de responsabilité prévue dans le contrat, D.E.P. devait avoir une responsabilité délictuelle, cela apporterait une modification fondamentale au contrat.

Puis, le juge Le Dain a examiné l'arrêt de la Chambre des lords *Elder, Dempster*, précité, afin d'établir ce que le juge Pigeon entendait par «délit civil indépendant sans rapport avec l'exécution du contrat». Cette décision revêt une importance particulière en l'espèce vu la ressemblance des questions juridiques en cause, soit le fait qu'un tiers invoque une limitation contractuelle de la responsabilité. Je concède, bien sûr, que l'arrêt *Elder, Dempster* peut s'interpréter de différentes manières et que la Chambre des lords a, par la suite, désapprouvé expressément au moins une de ces interprétations (soit l'immunité dérivée): *Midland Silicones*, précité. Toutefois, en clarifiant les observations du juge Pigeon dans *Nunes Diamonds*, notre Cour a opté, dans *Central Trust*, pour une interprétation d'*Elder, Dempster* qui facilite grandement la compréhension de la crainte exprimée par le juge Le Dain (à la p. 164):

> L'arrêt [*Elder, Dempster*] établissait essentiellement que, lorsque l'acte ou l'omission reprochés étaient reliés

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bill of lading could not be circumvented by reliance on a liability in tort where the act or omission complained of was one connected with the performance of the contract. This appears from the speech of Viscount Finlay, cited by Pigeon J. in *Nunes Diamonds*, where, referring to the contention that the shipowners had a liability in tort that was unaffected by the exclusion of liability in the bill of lading [because they were not privy to the contract], he said at p. 548:

> This contention seems to me to overlook the fact that the act complained of was done in the course of the stowage under the bill of lading, and that the bill of lading provided that the owners are not to be liable for bad stowage. If the act complained of had been an independent tort unconnected with the performance of the contract evidenced by the bill of lading, the case would have been different. But when the act is done in the course of rendering the very services provided for in the bill of lading, the limitation on liability therein contained must attach, whatever the form of the action and whether owner or charterer be sued. It would be absurd that the owner of the goods could get rid of the protective clauses of the bill of lading, in respect of all stowage, by suing the owner of the ship in tort.

In a similar fashion, it would be absurd in the circumstances of this case to let the appellant go around the limitation of liability clause by suing the respondent employees in tort. The appellant consented to limit the "warehouseman's" liability to $40 for anything that would happen during the performance of the contract. When the loss occurred, the respondents were acting in the course of their employment and performing the very services, albeit negligently, for which the appellant had contracted with Kuehne & Nagel. The appellant cannot obtain more than $40 from Kuehne & Nagel, whether the action is based in contract or in tort, because of the limitation of liability clause. However, resorting to exactly the same actions, it is trying to obtain the full amount from the individuals ("warehousemen") who were directly responsible for the storing of its goods in accordance with the contract. As stated earlier, there is an identity of interest between the respondents and Kuehne & Nagel as far as performance of the lat-

à l'exécution du contrat, on ne pouvait, au moyen d'une allégation de responsabilité délictuelle, contourner l'exclusion contractuelle de responsabilité pour arrimage défectueux prévue par le connaissement. C'est ce qui ressort des motifs du vicomte Finlay, cités par le juge Pigeon dans l'arrêt *Nunes Diamonds*. Abordant l'argument selon lequel la propriétaire du navire assumait une responsabilité délictuelle que n'écartait pas l'exclusion de responsabilité stipulée par le connaissement, le vicomte Finlay affirme à la p. 548:

> [TRADUCTION] Cet argument me semble faire abstraction du fait que l'acte dont on se plaint a été accompli au cours de l'arrimage effectué en vertu du connaissement et que, selon ce connaissement, la propriétaire n'assume aucune responsabilité pour un arrimage défectueux. Si la faute dont on se plaint avait constitué un délit indépendant, sans lien avec l'exécution du contrat constaté par le connaissement, l'affaire aurait été différente. Mais, lorsque la faute intervient dans le cours des services mêmes qui sont rendus dans l'exécution du connaissement, la limitation de responsabilité qu'il contient doit jouer, quelle que soit la forme que prend l'action et que la poursuite soit engagée contre le propriétaire ou contre l'affréteur. Il serait absurde que le propriétaire des marchandises puisse contourner les clauses protectrices du connaissement relatives à tous les arrimages en poursuivant le propriétaire du navire en responsabilité délictuelle.

De même, il serait absurde, dans les circonstances de l'espèce, de permettre à l'appelante de contourner une clause de limitation de la responsabilité en engageant contre les employés intimés des poursuites fondées sur la responsabilité délictuelle. L'appelante a consenti à ce que la responsabilité de l'«entreposeur» soit limitée à 40 $ à l'égard de tout événement qui se produirait pendant l'exécution du contrat. Lorsque la perte est survenue, les intimés agissaient dans l'exercice de leurs fonctions et exécutaient, quoique négligemment, les services mêmes qui étaient visés par le contrat que l'appelante avait conclu avec Kuehne & Nagel. Qu'elle engage des poursuites fondées sur le contrat ou sur la responsabilité délictuelle, l'appelante ne peut obtenir davantage que 40 $ de Kuehne & Nagel, en raison de la clause de limitation de la responsabilité. Or, elle tente d'obtenir, en invoquant exactement les mêmes actes, une indemnisation complète de la part des personnes (les «entreposeurs») qui étaient directement chargées de l'entreposage de

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ter's contractual obligations is concerned. When these facts are taken into account, and it is recalled that the appellant knew the role to be played by employees pursuant to the contract, it is clear to me that this Court is witnessing an attempt in effect to "circumvent or escape a contractual exclusion or limitation of liability for the act or omission that would constitute the tort". In my view, we should not sanction such an endeavour in the name of privity of contract.

ses marchandises aux termes du contrat. Tel que mentionné précédemment, les intérêts des intimés et ceux de Kuehne & Nagel se confondent en ce qui a trait à l'exécution des obligations contractuelles de celle-ci. Compte tenu de ces circonstances et, je le rappelle, du fait que l'appelante connaissait le rôle joué par les employés conformément au contrat, il me semble évident que notre Cour assiste en fait à une tentative «de contourner ou d'éluder une clause contractuelle d'exonération ou de limitation de la responsabilité pour l'acte ou l'omission qui constitue le délit civil». J'estime que nous ne devrions pas sanctionner pareille tentative en invoquant le principe du lien contractuel.

Finally, there are sound policy reasons why the doctrine of privity should be relaxed in the circumstances of this case. A clause such as one in a contract of storage limiting the liability of a "warehouseman" to $40 in the absence of a declaration by the owner of the goods of their value and the payment of an additional insurance fee makes perfect commercial sense. It enables the contracting parties to allocate the risk of damage to the goods and to procure insurance accordingly. If the owner declares the value of the goods, which he or she alone knows, and pays the additional premium, the bargain will have placed the entire risk on the shoulders of the "warehouseman". On the other hand, if the owner refuses the offer of additional coverage, the bargain will have placed only a limited risk on the "warehouseman" and the owner will be left with the burden of procuring private insurance if he or she decides to diminish its own risk. In either scenario, the parties to the contract agree to a certain allocation and then proceed, based on this agreement, to make additional insurance arrangements if required. It stretches commercial credulity to suggest that a customer, acting prudently, will not obtain insurance because he or she is looking to the employees for recovery when generally little or nothing is known about the financial capacity and professional skills of the

Enfin, il existe de solides raisons d'ordre public qui justifient l'assouplissement du principe du lien contractuel dans les circonstances de la présente affaire. Une clause comme celle qui, dans un contrat d'entreposage, limite la responsabilité de l'«entreposeur» à 40 $ est, en l'absence d'une déclaration par le propriétaire des marchandises de la valeur de ces marchandises et à défaut du paiement d'une assurance supplémentaire, parfaitement logique sur le plan commercial. Elle permet aux parties contractantes de répartir le risque d'endommagement des marchandises et de s'assurer en conséquence. Lorsque le propriétaire déclare la valeur des marchandises, que lui seul connaît, et qu'il paie la prime supplémentaire, le risque est entièrement assumé par l'«entreposeur» aux termes de l'entente. Par contre, si le propriétaire refuse l'offre de protection supplémentaire, l'«entreposeur» n'assume qu'un risque limité en vertu de l'entente, tandis que le propriétaire est tenu de s'assurer lui-même s'il souhaite diminuer son propre risque. Dans l'un et l'autre cas, les parties contractantes s'entendent sur une certaine répartition puis, compte tenu de cette entente, ils prennent, au besoin, des arrangements supplémentaires en matière d'assurance. Il est exagérément naïf sur le plan commercial de laisser entendre qu'un client prudent ne contracterait pas d'assurance parce qu'il compterait sur les employés pour l'indemniser, alors qu'on dispose généralement de très peu de renseignements, voire aucun, sur la capacité financière et les compétences professionnelles des

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employees involved. That does not make sense in the modern world.

In addition, employees such as the respondents do not reasonably expect to be subject to unlimited liability for damages that occur in the performance of the contract when said contract specifically limits the liability of the "warehouseman" to a fixed amount. According to modern commercial practice, an employer such as Kuehne & Nagel performs its contractual obligations with a party such as the appellant through its employees. As far as the contractual obligations are concerned, there is an identity of interest between the employer and the employees. It simply does not make commercial sense to hold that the term "warehouseman" was not intended to cover the respondent employees and as a result to deny them the benefit of the limitation of liability clause for a loss which occurred during the performance of the very services contracted for. Holding the employees liable in these circumstances could lead to serious injustice especially when one considers that the financial position of the affected employees could vary considerable such that, for example, more well off employees would be sued and left to look for contribution from their less well off colleagues. Such a result also creates uncertainty and requires excessive expenditures on insurance in that it defeats the allocations of risk specifically made by the contracting parties and the reasonable expectations of everyone involved, including the employees. When parties enter into commercial agreements and decide that one of them and its employees will benefit from limited liability, or when these parties choose language such as "warehouseman" which implies that employees will also benefit from a protection, the doctrine of privity should not stand in the way of commercial reality and justice.

For all the above reasons, I conclude that it is entirely appropriate in the circumstances of this case to call for a relaxation of the doctrine of privity.

employés en cause. Cela n'a aucun sens dans notre monde contemporain.

De plus, des employés comme les intimés ne s'attendent pas raisonnablement à assumer une responsabilité illimitée pour les dommages causés dans l'exécution du contrat lorsque celui-ci limite expressément à un montant déterminé la responsabilité de l'«entreposeur». Selon la pratique commerciale contemporaine, un employeur comme Kuehne & Nagel s'acquitte de ses obligations contractuelles envers une partie comme l'appelante par l'entremise de ses employés. L'employeur et ses employés partagent les mêmes intérêts en ce qui concerne les obligations contractuelles. Il est tout simplement illogique, sur le plan commercial, de conclure que le mot «entreposeur» n'était pas destiné à viser les employés intimés, de manière à leur refuser le bénéfice de la clause de limitation de la responsabilité à l'égard d'une perte survenue pendant l'exécution des services mêmes que vise le contrat. Conclure à la responsabilité des employés dans ces circonstances pourrait engendrer une grave injustice particulièrement si on considère que la situation financière des employés touchés pourrait varier considérablement, de sorte que, par exemple, les employés mieux nantis seraient poursuivis et en seraient réduits à chercher une contribution de la part de leurs collègues moins nantis. Pareil résultat crée aussi de l'incertitude et nécessite des frais d'assurance excessifs dans la mesure où il contrecarre la répartition des risques expressément prévue par les parties contractantes, ainsi que les attentes raisonnables de tous les intéressés, y compris les employés. Lorsque des parties concluent des contrats commerciaux et qu'elles décident que l'une d'elles et ses employés auront une responsabilité limitée, ou lorsque ces parties décident d'utiliser un terme comme «entreposeur» qui implique que les employés jouiront également d'une protection, le principe du lien contractuel ne devrait pas faire obstacle à la réalité commerciale et à la justice.

Pour tous les motifs qui précèdent, j'estime qu'il est tout à fait approprié, dans les circonstances de l'espèce, de demander l'assouplissement du principe du lien contractuel.

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(b) *How Should the Doctrine of Privity be Relaxed?*

Regardless of the desirability of making a particular change to the law, I have already noted that complex changes with uncertain ramifications should be left to the legislature. Our power and duty as a court to adapt and develop the common law must only be exercised generally in an incremental fashion. This is particularly important when, as here, changes to substantive law are concerned, as opposed to changes to procedural law. The respondents submit that this Court should relax the doctrine of privity so as to permit non-contracting employees to take the benefit of any immunities or limitations of liability granted to their employer. They offer three requirements for the application of this new exception, namely: (1) there is a contractual limitation of liability between an employer and another party; (2) the loss occurs during the employer's performance of its contractual obligations to that party; and (3) the employees are acting in the course of their employment when the loss occurs.

In my opinion, not only does the respondents' submission go beyond what is required to dispose of the present appeal, but it also does not represent an incremental change to the law. The main problem I have is with their first requirement. As we have seen earlier, the criticisms and statutory inroads into the doctrine of privity of contract have mostly, if not exclusively, occurred with respect to third party beneficiaries. That is, with respect to third parties to whom contracting parties have extended, either expressly or impliedly, some form of benefit arising under the contract. However, this is not the thrust of the respondents' submission. In essence, what they are requesting is the recognition of a third party right, or *jus tertii*, for complete strangers to their employer's contracts, without any regard whatsoever to the intention of the contracting parties. While this may be an appropriate

b) *De quelle manière le principe du lien contractuel devrait-il être assoupli?*

Quelle que soit l'opportunité d'apporter une modification particulière au droit applicable, j'ai déjà mentionné que c'est au législateur qu'il incombe d'apporter des modifications complexes ayant des ramifications incertaines. En général, ce n'est que progressivement qu'il nous faut exercer le pouvoir et accomplir le devoir que nous avons, comme cour de justice, d'adapter et de faire évoluer la common law. Cela est particulièrement important lorsque, comme en l'espèce, il est question de modifications du droit positif, et non du droit en matière de procédure. Les intimés soutiennent que notre Cour devrait assouplir le principe du lien contractuel de manière à permettre aux employés non contractants de bénéficier de toute exonération ou limitation de la responsabilité accordée à leur employeur. Ils proposent trois conditions d'application de cette nouvelle exception: 1) il doit y avoir une limitation contractuelle de la responsabilité entre un employeur et une autre partie, 2) la perte doit survenir pendant l'exécution des obligations contractuelles qu'a l'employeur envers cette partie et 3) les employés doivent agir dans l'exercice de leurs fonctions au moment où la perte survient.

J'estime que l'argument des intimés va non seulement au-delà de ce qui est nécessaire pour statuer sur le présent pourvoi, mais également qu'il ne représente pas une modification progressive du droit applicable. La principale difficulté que j'éprouve concerne la première condition. Comme nous l'avons déjà vu, les critiques et les incursions législatives dont a fait l'objet le principe du lien contractuel ont essentiellement, voire exclusivement, porté sur les tiers bénéficiaires, c.-à-d. les tiers auxquels les parties contractantes ont conféré, expressément ou implicitement, une certaine forme d'avantage découlant du contrat. Toutefois, tel n'est pas le sens de l'argument des intimés. Ce qu'ils demandent essentiellement c'est la reconnaissance du droit d'un tiers, ou *jus tertii*, en faveur de parties parfaitement étrangères aux contrats de leur employeur, sans tenir compte d'au-

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step for the legislature, it is not the type of incremental change that this Court should endorse.

In my opinion, a threshold requirement for employees to obtain the benefit of their employer's contractual limitation of liability clause is the express or implied stipulation by the contracting parties that the benefit of the clause will also be shared by said employees. Without such a stipulation, it is my view that the employees are in a no better situation than this Court held those employees involved in *Greenwood Shopping Plaza*, *supra*, to be in, and should not therefore be able to rely on the clause as a means of defence. This Court found that the employees were strangers to the contract, as I discussed above. As for the other requirements proposed by the respondents, I agree with their substance although I would express them in a different manner.

In the end, the narrow question before this Court is: in what circumstances should employees be entitled to benefit from a limitation of liability clause found in a contract between their employer and the plaintiff (customer)? Keeping in mind the comments made earlier and the circumstances of this appeal, I am of the view that employees may obtain such a benefit if the following requirements are satisfied:

1) The limitation of liability clause must, either expressly or impliedly, extend its benefit to the employees (or employee) seeking to rely on it; and

2) the employees (or employee) seeking the benefit of the limitation of liability clause must have been acting in the course of their employment and must have been performing the very services provided for in the contract between their employer and the plaintiff (customer) when the loss occurred.

Although these requirements, if satisfied, permit a departure from the strict application of the doctrine

cune manière de l'intention des parties contractantes. Bien qu'il puisse s'agir d'une mesure appropriée pour le législateur, ce n'est pas le genre de modification progressive que notre Cour devrait approuver.

Selon moi, une condition préliminaire pour que les employés bénéficient de la clause contractuelle de limitation de la responsabilité de leur employeur est que les parties contractantes aient stipulé expressément ou implicitement que la clause s'appliquera également aux employés. Je suis d'avis qu'en l'absence d'une telle stipulation, la situation des employés n'est pas meilleure que celle dans laquelle notre Cour a conclu que se trouvaient les employés en cause dans *Greenwood Shopping Plaza*, précité, de sorte qu'ils ne devraient pas pouvoir invoquer la clause comme moyen de défense. Comme nous l'avons vu, notre Cour a conclu que les employés étaient étrangers au contrat. Quant aux autres conditions proposées par les intimés, je suis d'accord avec leur contenu quoique je les aurais formulées différemment.

En fin de compte, la question restreinte dont est saisie notre Cour est la suivante: dans quelles circonstances les employés devraient-ils avoir le droit de bénéficier d'une clause de limitation de la responsabilité figurant dans un contrat liant leur employeur et le demandeur (le client)? Compte tenu des observations formulées précédemment et des circonstances du présent pourvoi, je suis d'avis que les employés pourront bénéficier d'une telle clause si les conditions suivantes sont remplies:

1) La clause de limitation de la responsabilité doit expressément ou implicitement s'appliquer aux employés (ou à l'employé) qui cherchent à l'invoquer;

2) Les employés (ou l'employé) qui invoquent la clause de limitation de la responsabilité devaient agir dans l'exercice de leurs fonctions et exécuter les services mêmes que visait le contrat intervenu entre leur employeur et le demandeur (le client) au moment où la perte est survenue.

Même si, une fois remplies, ces conditions permettent de déroger à l'application stricte du principe

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of privity of contract, they represent an incremental change to the common law. I say "incremental change" for a number of reasons.

First and foremost, this new exception to privity is dependent on the intention of the contracting parties. An employer and his or her customer may choose the appropriate language when drafting their contacts so as to extend, expressly or impliedly, the benefit of any limitation of liability to employees. It is their intention as stipulated in the contract which will determine whether the first requirement is met. In this connection, I agree with the view that the intention to extend the benefit of a limitation of liability clause to employees may be express or <u>implied</u> in all the circumstances: see e.g. *Mayfair Fabrics v. Henley*, 244 A.2d 344 (N.J. 1968); *Employers Casualty Co. v. Wainwright*, 473 P.2d 181 (Colo. Ct. App. 1970) (*cert.* denied).

Second, taken as a whole, this new exception involves very similar benchmarks to the recognized agency exception, applied in *The Eurymedon* and by this Court in *ITO—International Terminal Operators*, *supra*. As discussed in the latter decision, the four requirements for the agency exception were inspired from the following passage of Lord Reid's judgment in *Midland Silicones*, *supra* (at p. 474):

> I can see a possibility of success of the agency argument if (first) the bill of lading makes it clear that the stevedore is intended to be protected by the provisions in it which limit liability, (secondly) the bill of lading makes it clear that the carrier, in addition to contracting for these provisions on his own behalf, is also contracting as agent for the stevedore that these provisions should apply to the stevedore, (thirdly) the carrier has authority from the stevedore to do that, or perhaps later ratification by the stevedore would suffice, and (fourthly) that any difficulties about consideration moving from the stevedore were overcome.

The first requirement of both exceptions is virtually identical. The second and third requirements of the agency exception are supplied by the identity of interest between an employer and his or her

du lien contractuel, elles représentent une modification progressive de la common law. Je parle de «modification progressive» pour un certain nombre de motifs.

D'abord et avant tout, cette nouvelle exception au principe du lien contractuel repose sur l'intention des parties contractantes. Un employeur et son client peuvent, au moment de rédiger leurs contrats, choisir des mots appropriés pour faire bénéficier expressément ou implicitement les employés de toute limitation de responsabilité. C'est leur intention exprimée dans le contrat qui déterminera si la première condition est remplie. À cet égard, je conviens que l'intention de faire bénéficier les employés d'une clause de limitation de la responsabilité peut être expresse ou <u>implicite</u> dans tous les cas: voir, par exemple, *Mayfair Fabrics c. Henley*, 244 A.2d 344 (N.J. 1968), *Employers Casualty Co. c. Wainwright*, 473 P.2d 181 (Colo. Ct. App. 1970) (*cert.* refusé).

Deuxièmement, vue dans son ensemble, cette nouvelle exception comporte des points de repère très semblables à ceux de l'exception reconnue du mandat qui a été appliquée dans l'affaire *Eurymedon* et, par notre Cour, dans l'arrêt *ITO—International Terminal Operators*, précité. Tel que mentionné dans ce dernier arrêt, les quatre conditions applicables à l'exception du mandat s'inspirent de l'extrait suivant du jugement de lord Reid dans *Midland Silicones*, précité (à la p. 474):

> [TRADUCTION] Selon moi, l'argument du mandat a une chance de succès si (1) le connaissement énonce clairement que ses dispositions limitant la responsabilité visent à protéger l'acconier, (2) si le connaissement énonce clairement que le transporteur, en plus de convenir par contrat que ces dispositions s'appliqueront à lui-même, convient aussi à titre de mandataire de l'acconier qu'elles s'appliqueront à l'acconier, (3) si le transporteur a l'autorisation de l'acconier d'agir ainsi (ou peut-être qu'une ratification ultérieure de l'acconier suffira), et (4) si toutes les difficultés concernant la contrepartie provenant de l'acconier sont surmontées.

La première condition applicable à chacune des deux exceptions est presque identique. Les deuxième et troisième conditions de l'exception du mandat découlent du fait que l'employeur et ses

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employees as far as the performance of contractual obligations is concerned; this is implicit in the recognition of this new exception. As for the fourth requirement of agency, while this new exception makes no specific mention of consideration moving from the employees to the customer, the second requirement of the new exception embraces the same elements which were adopted by courts to recognize consideration moving from stevedores in cases involving "*Himalaya* clauses".

Third, it must be remembered that I am proposing a very specific and limited exception to privity in the case at bar; viz. permitting employees who qualify as third party beneficiaries to use their employer's limitation of liability clauses as "shields" in actions brought against them, when the damage they have caused was done in the course of their employment and while they were carrying out the very services for which the plaintiff (customer) had contracted with their employer. In sum, I am recognizing a limited *jus tertii*.

In closing on this point, I wish to add the obvious comment that nothing in the above reasons should be taken as affecting in any way recognized exceptions to privity of contract such as trust and agency. In other words, even if the above requirements are not satisfied, an employee may still establish the existence of a trust or agency so as to obtain a benefit which the contracting parties intended him or her to have, notwithstanding lack of privity.

(c) *Application of the New Exception*

The only question in the case at bar is whether the respondents are third party beneficiaries with respect to the limitation of liability clause so as to come within the first requirement of the test I set forth above. Based on uncontested findings of fact, the respondents were acting in the course of their

employés partagent les mêmes intérêts en ce qui concerne l'exécution des obligations contractuelles, ce qui est implicite dans la reconnaissance de cette nouvelle exception. Quant à la quatrième condition de l'exception du mandat, même si cette nouvelle exception ne prévoit pas expressément qu'une contrepartie est fournie au client par les employés, la deuxième condition de la nouvelle exception englobe les mêmes éléments que ceux retenus par les tribunaux pour reconnaître qu'une contrepartie provenait des manutentionnaires dans des affaires où il était question de «clauses *Himalaya*».

Troisièmement, il faut se rappeler que je propose, en l'espèce, une exception très précise et limitée au principe du lien contractuel, savoir permettre aux employés qui ont les qualités requises pour être des tiers bénéficiaires d'utiliser les clauses de limitation de la responsabilité de leur employeur comme moyens de défense dans des poursuites engagées contre eux, lorsque les dommages qu'ils ont causés l'ont été dans l'exercice de leurs fonctions et pendant qu'ils fournissaient les services mêmes que vise le contrat intervenu entre le demandeur (le client) et leur employeur. En somme, je reconnais un droit des tiers limité.

Pour conclure sur ce point, je tiens à préciser que les motifs qui précèdent ne doivent évidemment pas être considérés comme modifiant de quelque manière les exceptions reconnues au principe du lien contractuel, comme la fiducie et le mandat. En d'autres termes, même si les conditions susmentionnées ne sont pas remplies, un employé peut encore établir l'existence d'une fiducie ou d'un mandat de manière à bénéficier d'un avantage que les parties contractantes entendaient lui conférer, malgré l'absence d'un lien contractuel.

c) *Application de la nouvelle exception*

La seule question qui se pose ici est de savoir si les intimés sont des tiers bénéficiaires relativement à la clause de limitation de la responsabilité, de manière à remplir la première condition du test susmentionné. Selon les conclusions de fait non contestées, les intimés agissaient dans l'exercice

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employment when they caused the transformer to topple over. Moreover, at that time they were performing the very services provided for in the contract between Kuehne & Nagel and the appellant, namely, the storage and upkeep of the transformer.

For convenience, I reproduce again the limitation of liability clause:

> LIABILITY - Sec. 11(*a*) The responsibility of a warehouseman in the absence of written provisions is the reasonable care and diligence required by the law.
>
> (*b*) The warehouseman's liability on any one package is limited to $40 unless the holder has declared in writing a valuation in excess of $40 and paid the additional charge specified to cover warehouse liability.

Does the language chosen indicate that the benefit of the clause is specifically restricted to Kuehne & Nagel? I think not. On the contrary, when all of the relevant circumstances are considered, it is my view that the parties must be taken as having intended that the benefit of this clause would also extend to Kuehne & Nagel's employees.

It is clear that the parties did not choose express language in order to extend the benefit of the clause to employees. For example, there is no mention of words such as "servants" or "employees" in s. 11(*b*) of the contract. As such, it cannot be said that the respondents are express third party beneficiaries with respect to the limitation of liability clause. However, this does not preclude a finding that they are <u>implied</u> third party beneficiaries. In view of the identity of interest between an employer and his or her employees with respect to the performance of the former's contractual obligations and the policy considerations discussed above, it is surely open to a court, in appropriate circumstances, to conclude that a limitation of liability clause in a commercial contract between an employer and his or her customer impliedly extends its benefit to employees.

de leurs fonctions lorsqu'ils ont fait basculer le transformateur. De plus, ils exécutaient alors les services mêmes que prévoit le contrat intervenu entre Kuehne & Nagel et l'appelante, savoir les services d'entreposage et d'entretien du transformateur.

Pour des motifs de commodité, je reproduis de nouveau la clause de limitation de la responsabilité:

> [TRADUCTION] RESPONSABILITÉ - Al. 11*a*) En l'absence de dispositions écrites, l'entreposeur est tenu de faire preuve de la prudence et de la diligence raisonnables que requiert la loi.
>
> *b*) La responsabilité de l'entreposeur à l'égard d'un colis donné est limitée à 40 $, à moins que l'entreposítaire n'ait déclaré par écrit que la valeur de l'objet en cause est supérieure à 40 $ et qu'il n'ait acquitté les frais supplémentaires spécifiés pour qu'il y ait responsabilité accrue de l'entreposeur.

Peut-on déduire du texte de la clause qu'elle s'applique au seul bénéfice de Kuehne & Nagel? Je ne le crois pas. Au contraire, compte tenu de l'ensemble des circonstances pertinentes, j'estime qu'il faut considérer que les parties ont voulu que cette clause s'applique également aux employés de Kuehne & Nagel.

Il est clair que les parties n'ont pas choisi de prévoir expressément l'application de la clause aux employés. Par exemple, on ne trouve pas à l'al. 11*b*) du contrat des termes comme «préposés» ou «employés». De ce fait, on ne saurait dire que les intimés sont expressément des tiers bénéficiaires de la clause de limitation de la responsabilité. Cela n'empêche toutefois pas de conclure qu'ils sont <u>implicitement</u> des tiers bénéficiaires. Compte tenu du fait que l'employeur et les employés partagent les mêmes intérêts lorsqu'il s'agit d'exécuter les obligations contractuelles de l'employeur, et vu les considérations de principe analysées précédemment, il est sûrement loisible à une cour, dans des circonstances appropriées, de conclure qu'une clause de limitation de la responsabilité figurant dans un contrat commercial intervenu entre un employeur et son client s'applique tacitement aux employés.

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In the case at bar, the parties have not chosen language which inevitably leads to the conclusion that the respondents were not to benefit from s. 11(*b*) of the contract of storage. The term "warehouseman" as used in s. 11(*b*) is not defined in the contract and the definition provided in the *Warehouse Receipt Act*, s. 1, is of no use in determining whether it includes employees for the purpose of the contractual limitation of liability. While it is true that s. 10(*e*) of the contract uses the term "warehouse employee", this by itself does not preclude an interpretation of "warehouseman" in s. 11(*b*) of the same contract as implicitly including employees for the purposes of the limitation of liability clause. Such a conclusion does not offend the words chosen by the parties.

When all the circumstances of this case are taken into account, including the nature of the relationship between employees and their employer, the identity of interest with respect to contractual obligations, the fact that the appellant knew that employees would be involved in performing the contractual obligations, and the absence of a clear indication in the contract to the contrary, the term "warehouseman" in s. 11(*b*) of the contract must be interpreted as meaning "warehousemen". As such, the respondents are not complete strangers to the limitation of liability clause. Rather, they are unexpressed or implicit third party beneficiaries with respect to this clause. Accordingly, the first requirement of this new exception to the doctrine of privity is also met.

C. *Conclusion*

The respondents owed a duty of care to the appellant in their handling of its transformer. According to the uncontested findings of the trial judge, they breached this duty causing damages in the amount of $33,955.41. While neither trust nor agency is applicable, the respondents are entitled to benefit directly from the limitation of liability clause in the contract between their employer and the appellant. This is so because they are third

En l'espèce, les parties n'ont pas choisi des mots qui amènent inévitablement à conclure que les intimés ne devaient pas bénéficier de l'application de l'al. 11*b*) du contrat d'entreposage. Le mot [TRADUCTION] «entreposeur» utilisé à l'al. 11*b*) n'est pas défini dans le contrat et la définition qu'en donne l'art. 1 de la *Warehouse Receipt Act* ne permet pas de déterminer si ce mot inclut les employés aux fins de la clause contractuelle de limitation de la responsabilité. Même s'il est vrai qu'on trouve à l'al. 10*e*) du contrat, l'expression [TRADUCTION] «employé d'entrepôt», cela n'empêche pas en soi d'interpréter le mot [TRADUCTION] «entreposeur» utilisé à l'al. 11*b*) du même contrat comme incluant implicitement les employés aux fins de la clause de limitation de la responsabilité. Pareille conclusion n'est pas contraire aux mots choisis par les parties.

Compte tenu de toutes les circonstances de la présente espèce, y compris la nature de la relation qui existe entre les employés et leur employeur, le fait que les mêmes intérêts soient partagés relativement aux obligations contractuelles, le fait que l'appelante savait que des employés participeraient à l'exécution des obligations contractuelles et l'absence, dans le contrat, d'une disposition non équivoque à l'effet contraire, le mot [TRADUCTION] «entreposeur» employé à l'al. 11*b*) du contrat doit être interprété comme signifiant «des entreposeurs». En ce sens, les intimés ne sont pas parfaitement étrangers à la clause de limitation de la responsabilité. Ce sont plutôt, à l'égard de cette clause, des tiers bénéficiaires implicites. En conséquence, la première condition de cette nouvelle exception au principe du lien contractuel est également remplie.

C. *Conclusion*

Les intimés avaient une obligation de diligence envers l'appelante lorsqu'ils ont manipulé son transformateur. Selon les conclusions de fait non contestées du juge de première instance, ils ont manqué à cette obligation et causé des dommages s'élevant à 33 955,41$. Bien qu'aucune fiducie ou aucun mandat ne soit applicable, les intimés ont le droit de bénéficier directement de la clause de limitation de la responsabilité que renferme le con-

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party beneficiaries with respect to that clause and because they were acting in the course of their employment and performing the very services contracted for by the appellant when the damages occurred. I acknowledge that this, in effect, relaxes the doctrine of privity and creates a limited *jus tertii*. However, when viewed in its proper context, it merely represents an incremental change to the law, necessary to see that the common law develops in a manner that is consistent with modern notions of commercial reality and justice.

trat intervenu entre leur employeur et l'appelante. Il en est ainsi parce que ce sont des tiers bénéficiaires relativement à cette clause et parce qu'ils agissaient dans l'exercice de leurs fonctions et fournissaient les services mêmes pour lesquels l'appelante avait conclu un contrat, lorsque les dommages ont été causés. Je reconnais que cette conclusion a pour effet d'assouplir le principe du lien contractuel et de conférer aux tiers un droit limité. Toutefois, si on la situe dans son contexte approprié, elle représente simplement une modification progressive du droit applicable, qui est nécessaire pour que la common law évolue d'une manière conforme aux notions contemporaines de la réalité commerciale et de la justice.

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V. Disposition

For the foregoing reasons, I would dismiss the appeal and cross-appeal, both with costs.

V. Dispositif

Pour les motifs qui précèdent, je suis d'avis de rejeter le pourvoi principal et le pourvoi incident, avec dépens dans les deux cas.

The following are the reasons delivered by

Version française des motifs rendus par

MCLACHLIN J.—I agree with Justice Iacobucci that the appeal should be dismissed. However, I arrive at the conclusion that the liability of the defendant employees is limited to the $40 maximum stipulated in their employer's contract by somewhat different reasoning.

LE JUGE MCLACHLIN—Je souscris à l'opinion du juge Iacobucci qu'il convient de rejeter le pourvoi. Toutefois, c'est par un raisonnement quelque peu différent que j'arrive à la conclusion que la responsabilité des employés défendeurs se limite au montant maximal de 40 $ stipulé dans le contrat de leur employeur.

Iacobucci J., as I understand his reasons, founds the liability of the defendants in tort. He concludes that the defendant employees owed the plaintiff a duty of care and that they breached that duty in dropping the plaintiff's transformer. He then finds that the limitation in the contract between the plaintiff and a third party (the employer) is a bar to full recovery in tort. He simply asserts this, without much discussion of how, as a matter of doctrine, defendants in a tort action can raise, as a defence to a tort claim, a contract to which they are not parties. I believe the question of how, in terms of legal principle, a term of a contract can serve as

Selon mon interprétation de ses motifs, le juge Iacobucci a conclu que les défendeurs ont une responsabilité délictuelle. À son avis, les employés défendeurs avaient envers la demanderesse une obligation de diligence à laquelle ils ont manqué lorsqu'ils ont laissé tomber son transformateur. Il a ensuite jugé que la limitation stipulée au contrat conclu entre la demanderesse et un tiers (l'employeur) fait obstacle à une pleine indemnisation en matière délictuelle. C'est ce qu'il affirme simplement, sans trop analyser comment, du point de vue doctrinal, les défendeurs dans une action délictuelle peuvent invoquer en défense un contrat auquel ils ne sont pas parties. J'estime qu'il est important, aux fins du présent pourvoi et d'autres cas qui pourront se présenter, de savoir comment, sur le plan des principes juridiques, une condition

a defence to a claim in tort is important for this and future cases. Hence these reasons.

I have also had the advantage of reading my colleague Justice La Forest's reasons. While I confess to great admiration for the scholarship and good sense they display, my concerns about the magnitude of the change they would introduce to the Canadian law of tort and the difficult questions they raise prevent me from agreeing with them. Later in these reasons, I will briefly address some of these concerns.

In the court below, Lambert J.A conducted an analysis in contract, and found an independent contract between the plaintiff and the employees. A limitation of liability clause was seen by Lambert J.A. to be a logically necessary term to that contract. Meanwhile, Southin J.A. found the employees liable in trespass. With respect, Lambert J.A.'s approach suffers from many difficulties, chief among which is that of uncertainty as to the terms that a court will find to be applied between the employees and the plaintiff in any given case. I am also in respectful disagreement with Southin J.A.'s approach, as an action in trespass is most likely inappropriate in law where a bailor who came into possession of goods with the consent of the plaintiff damages the goods negligently (and not intentionally).

The analysis in this case, as I see it, must start from the self-evident proposition that tort and contract constitute separate legal regimes. The plaintiff's action against the employees in this case is necessarily in tort, since there was no contract between it and the employees. The defendants, however, seek to rely on the terms of the contract between the plaintiff and their employer as a defence. The question is whether they can do this, and if so, on what basis.

d'un contrat peut offrir un moyen de défense à une action fondée sur la responsabilité délictuelle. D'où les présents motifs.

J'ai également eu l'avantage de lire les motifs de mon collègue le juge La Forest. Malgré ma grande admiration à l'égard du savoir et du bon sens qui s'en dégagent, mes craintes à l'égard de l'amplitude du changement qu'ils introduiraient dans le droit canadien de la responsabilité délictuelle et les questions épineuses qu'ils soulèvent m'empêchent d'y souscrire. Plus loin dans les présents motifs, je traiterai brièvement de certaines de ces craintes.

Le juge Lambert de la Cour d'appel a effectué une analyse contractuelle et conclu à l'existence d'un contrat indépendant entre la demanderesse et les employés. Il a considéré qu'une clause de limitation de la responsabilité était une condition logiquement nécessaire de ce contrat. Pour sa part, le juge Southin a conclu que les employés étaient responsables d'atteinte à la possession mobilière. En toute déférence, la méthode adoptée par le juge Lambert présente de nombreuses lacunes, dont la principale est l'incertitude quant aux conditions qu'un tribunal jugera applicables aux employés et au demandeur dans un cas donné. Je suis également en désaccord avec la méthode du juge Southin pour le motif qu'en droit l'action fondée sur l'atteinte à la possession mobilière ne convient vraisemblablement pas lorsque le déposant qui est entré en possession des marchandises avec le consentement du demandeur les endommage par négligence (et non intentionnellement).

À mon avis, l'analyse en l'espèce doit se fonder sur la prémisse évidente en soi selon laquelle le droit de la responsabilité délictuelle et celui des contrats constituent des régimes distincts. En l'espèce, l'action intentée par la demanderesse contre les employés est nécessairement fondée sur la responsabilité délictuelle puisqu'aucun contrat ne la liait aux employés. Toutefois, les défendeurs tentent d'invoquer en défense les conditions du contrat intervenu entre la demanderesse et leur employeur. Il s'agit de savoir s'ils peuvent agir ainsi et, dans l'affirmative, pour quel motif?

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Several theories for permitting an employee sued in tort to rely on a term of limitation in his employer's contract have been suggested. The most salient is the assertion that the plaintiff voluntarily accepted the risk of damage over the amount specified in the limitation clause. On this theory, the plaintiff, having agreed to the limitation of liability vis-à-vis the employer, must be taken to have done so with respect to the employer's employees.

The concept of voluntary assumption of the risk is known in tort law by the maxim *volenti non fit injuria*. Scholars have characterized it in two different ways: first, as a negation or limitation of the duty of care, and second, as a waiver of an existing cause of action (i.e. a bar to recovery): *Clerk & Lindsell on Torts* (16th ed. 1989), at pp. 112-13; J. G. Fleming, *The Law of Torts* (7th ed. 1987), at p. 265; *Salmond and Heuston on the Law of Torts* (19th ed. 1987), at pp. 557-58; A. M. Linden, *Canadian Tort Law* (4th ed. 1988), at pp. 448-49. The negation or limitation of duty of care approach looks at all the circumstances, including the contract, to determine what was the common law duty between the parties. The waiver approach assumes a standard duty of care, but says that the plaintiff's right to sue for breach of that duty has been removed.

In the court below, McEachern C.J.B.C., Wallace J.A. and Hinkson J.A. took the first approach. My colleague Iacobucci J., as I understand his reasons, takes the second. He says it is unnecessary to take the "tort" approach. He determines breach on the usual standard of care without consideration of the particular circumstances or the contract. He then proceeds to consider whether the limitation of

On a avancé plusieurs théories selon lesquelles l'employé poursuivi en matière délictuelle peut invoquer une clause de limitation figurant dans le contrat de son employeur. Celle qui ressort le plus veut que la demanderesse ait volontairement accepté le risque du dommage excédant le montant stipulé dans la clause de limitation. Selon cette théorie, il faut considérer que l'acceptation par la demanderesse de la limitation de la responsabilité de l'employeur vaut également pour les employés de ce dernier.

La notion de l'acceptation volontaire du risque est exprimée en droit de la responsabilité délictuelle par la maxime *volenti non fit injuria*. Selon les auteurs, elle comporte deux aspects différents: d'une part, elle supprime ou limite l'obligation de diligence et, d'autre part, elle constitue une renonciation à un droit d'action existant (et empêche ainsi l'indemnisation): *Clerk & Lindsell on Torts* (16e éd. 1989), aux pp. 112 et 113; J. G. Fleming, *The Law of Torts* (7e éd. 1987), à la p. 265; *Salmond and Heuston on the Law of Torts* (19e éd. 1987), aux pp. 557 et 558; A. M. Linden, *La responsabilité civile délictuelle* (4e éd. 1988), aux pp. 545 à 547. Le point de vue selon lequel il y a suppression ou limitation de l'obligation de diligence tient compte de toutes les circonstances, dont le contrat, pour déterminer la nature de l'obligation des parties en common law. D'après le point de vue selon lequel il y a renonciation, on suppose qu'il existe une obligation de diligence normale, mais on dit que le droit du demandeur de poursuivre pour manquement à cette obligation a été retiré.

En cour d'appel, le juge en chef McEachern de la Colombie-Britannique et les juges Wallace et Hinkson ont adopté le premier point de vue. Selon mon interprétation de ses motifs, mon collègue le juge Iacobucci adopte le second. Il affirme qu'il n'est pas nécessaire d'adopter la méthode fondée sur la «responsabilité délictuelle». Il détermine le manquement selon la norme habituelle de diligence sans tenir compte des circonstances particulières ou du contrat. Il se demande ensuite si la limitation de responsabilité stipulée au contrat conclu entre la demanderesse et l'employeur peut être

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liability in the plaintiff-employer contract provides a defence, and finds it does.

The first problem in Iacobucci J.'s approach is whether the defendants, who were not parties to the contract, can rely on the contract at all. In the past, the doctrine of privity of contract has said no. Iacobucci J. says this should no longer be a bar; I agree.

But there is a second problem. This arises from the fact that the contract term, even if it can be raised as a defence by the employees, does not by its content provide the employees with a defence. The contract exempts only the "warehouseman". The term "warehouseman" is not defined in the contract. But in my respectful view, upon a reading of the contract as a whole, the only reasonable interpretation is that the term "warehouseman" refers to the employer and does not include the employees.

One way of overcoming this difficulty would be through the doctrine of implied terms. It might be argued that where a customer and employer contract for a limitation of liability in circumstances where they know that the work will be done by the employer's employees, it is an implied term of that contract that the plaintiff accepts the risk of the employees' negligence as well, with the consequence that the employees may raise the defence of *volenti* against the plaintiff.

The supposition of an implied term to exempt the employees from liability on this case runs up against the problem that there is nothing to suggest that the parties intended the word "warehouseman", which defines whose liability is exempted, to include the employees. With all respect to Iacobucci J.'s apparent finding to the contrary, the conclusion that the parties intended "warehouseman" to include employees is of doubtful validity, given the absence of evidence on the matter and the fact that elsewhere in the contract "warehouseman" can only be read as not extending to employees.

invoquée comme moyen de défense, ce à quoi il répond par l'affirmative.

La première difficulté que soulève le point de vue adopté par le juge Iacobucci est de savoir si les défendeurs, qui n'étaient pas parties au contrat, peuvent l'invoquer. Autrefois, la réponse était négative en vertu du principe du lien contractuel. Selon le juge Iacobucci, cela ne devrait plus constituer un empêchement; je suis d'accord.

Il existe toutefois une deuxième difficulté. Elle découle du fait que la condition du contrat, même si elle peut être invoquée en défense par les employés, n'offre pas, de par son contenu, un moyen de défense à ces derniers. Le contrat n'exonère que l'«entreposeur». Ce terme n'y est pas défini. Cependant, j'estime que la lecture du contrat dans son ensemble ne permet qu'une seule interprétation raisonnable, c'est-à-dire que le terme «entreposeur» désigne l'employeur et non les employés.

La théorie des conditions implicites constituerait un moyen de surmonter cette difficulté. On pourrait prétendre que lorsqu'un client et un employeur prévoient par contrat une limitation de responsabilité et qu'ils savent tous deux que le travail sera accompli par les employés de l'employeur, il y a alors dans ce contrat une condition implicite selon laquelle le demandeur accepte également le risque de négligence des employés, permettant ainsi à ces derniers d'opposer la défense de *volenti* au demandeur.

La supposition qu'il existe une condition implicite de manière à exonérer les employés de toute responsabilité en l'espèce se heurte au fait que rien ne laisse croire que les parties ont voulu que le terme «entreposeur», qui définit ceux dont la responsabilité est exclue, vise également les employés. En toute déférence pour la conclusion apparemment contraire du juge Iacobucci, il est douteux que les parties aient voulu que le terme «entreposeur» vise également les employés, étant donné l'absence de preuve à ce sujet et le fait qu'ailleurs dans le contrat, on ne peut que comprendre que le terme «entreposeur» ne vise pas les employés.

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However, presumed intention of the parties is only one of the grounds on which an implied term may be founded. As G. H. Treitel states in *The Law of Contract* (8th ed. 1991) at p. 185:

Implied terms may be divided into three groups. The first consists of terms implied in fact, that is, terms which were not expressly set out in the contract, but which the parties must have intended to include. The second consists of terms implied in law, that is, terms imported by operation of law, although the parties may not have intended to include them. The third consists of terms implied by custom.

See also Le Dain J. in *Canadian Pacific Hotels Ltd. v. Bank of Montreal*, [1987] 1 S.C.R. 711, and my concurring reasons in *Machtinger v. HOJ Industries Ltd.*, [1992] 1 S.C.R. 986. In short, the court, where appropriate, may as a matter of policy imply a term in a particular type of contract, even where it is clear the parties did not intend it.

This would seem to me to afford a sufficient foundation for Iacobucci J.'s conclusion that the contract exemption should afford a defence to the employees. It might be argued that as a matter of policy the courts should imply a term in warehousing contracts that "warehouseman" includes the employees of the warehouse for purposes of contractual limitations of liability. This in turn would permit the conclusion that the plaintiff, by entering into such a contract, waived its right to sue the employees for damage beyond $40. This approach does, however, raise the difficult question of whether the court should, as a matter of policy, imply the term contended for.

But voluntary assumption of the risk can be grounded on a broader basis than waiver based on the contract's exclusion clause, as the three judges of the court below who dealt with the matter in tort concluded. Quite apart from the particular contract term, it can be argued that the concatenation of cir-

Toutefois, l'intention présumée des parties ne constitue qu'un seul des moyens de soutenir l'existence d'une condition implicite. Comme le dit G. H. Treitel dans *The Law of Contract* (8e éd. 1991), à la p. 185:

[TRADUCTION] Les conditions implicites peuvent se diviser en trois catégories. La première renferme les conditions implicites en fait, soit celles qui n'ont pas été expressément stipulées au contrat, mais que les parties ont dû avoir l'intention d'inclure. La deuxième catégorie regroupe les conditions implicites en droit, c'est-à-dire les conditions qui découlent de l'application du droit, bien que les parties n'aient peut-être pas eu l'intention de les inclure. Les conditions implicites en vertu de la coutume forment la troisième catégorie.

Voir également les motifs du juge Le Dain dans *Société hôtelière Canadien Pacifique Ltée c. Banque de Montréal*, [1987] 1 R.C.S. 711, et mes motifs concordants dans l'arrêt *Machtinger c. HOJ Industries Ltd.*, [1992] 1 R.C.S. 986. Bref, lorsque cela est indiqué, le tribunal peut, en principe, supposer l'existence d'une condition dans une forme particulière de contrat, même si de toute évidence les parties n'ont pas voulu l'y inclure.

Cela me semble fournir une justification suffisante à la conclusion du juge Iacobucci que les employés devraient pouvoir invoquer comme moyen de défense l'exonération prévue au contrat. On pourrait prétendre qu'en principe, les tribunaux devrait supposer l'existence, dans les contrats d'entreposage, d'une condition prévoyant que le terme «entreposeur» vise les employés de l'entrepôt pour les fins des limitations contractuelles de responsabilité. On pourrait alors conclure que la demanderesse, en concluant un tel contrat, a renoncé à son droit de poursuivre les employés pour les dommages excédant 40 $. Ce point de vue soulève toutefois la question épineuse de savoir si le tribunal devrait, en principe, supposer l'existence de la prétendue condition.

Cependant, comme l'ont conclu les trois juges de la Cour d'appel qui ont abordé la question sous l'angle de la responsabilité délictuelle, l'acceptation volontaire du risque peut se fonder sur un motif plus général que la renonciation découlant de la clause d'exonération du contrat. Tout à fait indé-

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cumstances giving rise to the tort duty, of which the contract with its exemption of liability is one, are such that they limit the duty of care the employees owed to the plaintiff. As Wallace J.A. put it (quoting Purchas L.J. in *Pacific Associates Inc. v. Baxter*, [1990] 1 Q.B. 993 (C.A.), at p. 1011), the question of whether there are circumstances qualifying or negating the duty of care "can only be answered in the context of the factual matrix including especially the contractual structure against which such duty is said to arise."

The law of tort has long recognized that circumstances may negate or limit the duty of care in tort. Indeed, as noted earlier in these reasons, this is one of the fundamental theories by which scholars have explained the defence of voluntary assumption of the risk. Waivers and exemption clauses, whether contractual or not, have long been accepted as having this effect on the duty in tort. As Fleming, *supra*, at p. 265 (dealing with the complete negation of any duty of care), puts it:

> The basic idea is that the plaintiff, by agreeing to assume the risk himself, absolves the defendant from all responsibility for it. The latter's duty of care is thus suspended.

Canadian courts, including this one, have applied this principle in determining liability and damages in tort. In *Car and General Insurance Corp. v. Seymour*, [1956] S.C.R. 322, Kellock J., after discussing the duty of care that is ordinarily owed by the operator of an automobile to a passenger, stated (at p. 331):

> A finding of *volenti* involves the consequence that no such duty existed, the onus of establishing which lay upon the defendant.

pendamment de la condition du contrat en cause, on peut soutenir que les circonstances qui donnent naissance à l'obligation en matière délictuelle, dont fait partie le contrat prévoyant l'exonération de responsabilité, sont de nature à limiter l'obligation de diligence des employés envers la demanderesse. Comme l'a dit le juge Wallace (citant le lord juge Purchas dans l'arrêt *Pacific Associates Inc. c. Baxter*, [1990] 1 Q.B. 993 (C.A.), à la p. 1011), la question de savoir s'il existe des circonstances qui atténuent ou suppriment l'obligation de diligence [TRADUCTION] «peut être tranchée uniquement en fonction du cadre factuel et, en particulier, de la structure contractuelle dans laquelle on allègue que cette obligation prend naissance.»

Le droit de la responsabilité délictuelle reconnaît depuis longtemps que les circonstances peuvent supprimer ou limiter l'obligation de diligence en matière délictuelle. En fait, comme je l'ai déjà souligné dans les présents motifs, il s'agit de l'une des théories fondamentales auxquelles les auteurs ont eu recours pour expliquer le moyen de défense fondé sur l'acceptation volontaire du risque. On reconnaît depuis longtemps que les renonciations et les clauses d'exonération, qu'elles soient contractuelles ou non, ont un tel effet sur l'obligation en matière délictuelle. Comme Fleming, *op. cit.*, le dit à la p. 265 (où il traite de la suppression totale de toute obligation de diligence):

> [TRADUCTION] L'idée fondamentale est que le demandeur qui accepte d'assumer le risque lui-même dégage le défendeur de toute responsabilité à l'égard de ce risque. L'obligation de diligence de ce dernier est donc suspendue.

Les tribunaux canadiens, dont notre Cour, ont appliqué ce principe pour déterminer la responsabilité et les dommages-intérêts en matière délictuelle. Dans l'arrêt *Car and General Insurance Corp. c. Seymour*, [1956] R.C.S. 322, après avoir analysé l'obligation de diligence que le conducteur d'une automobile a normalement envers un passager, le juge Kellock affirme (à la p. 331):

> [TRADUCTION] La conclusion qu'il y a acceptation volontaire du risque a comme conséquence que cette obligation n'existait pas, et c'est au défendeur qu'il incombe de l'établir.

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See also *Crocker v. Sundance Northwest Resorts Ltd.*, [1988] 1 S.C.R. 1186, at p. 1203.

McEachern C.J.B.C., Hinkson J.A. and Wallace J.A. in the Court of Appeal below, after a careful review of the circumstances giving rise to the duty of care owed by the employees to the plaintiff in this case, concluded that it was limited to damage under $40. It would serve no purpose to repeat the considerations that led them to this conclusion, which have been ably summarized by Iacobucci J. Suffice it to say that I think they were right. (I add only the caveat that unlike one commentator (W. J. Swadling, "Privity, Tort and Contract: Exempting the Careless Employee" (1991), 4 *Journal of Contract Law* 208, at pp. 218-19), I do not read Hinkson J.A. as holding that reliance by the plaintiff is essential to recovery in all such cases, nor Wallace J.A. as saying that the only requirement for liability is what is "just and reasonable.")

In England, the courts have rejected the doctrine of "vicarious immunity" which holds as a matter of principle that "an employee who performs acts under a contract made between his employer and a third party is entitled to the same immunities that the contract confers on his employer" (Swadling, *supra*, at p. 223). However, more recent decisions have opened the door to an analysis based on modification of the duty of care similar to that adopted in the Court of Appeal below. In *Junior Books Ltd. v. Veitchi Co.*, [1983] 1 A.C. 520 (H.L.), Lord Roskill, in addressing the question as to "what the position would be in a case where there was a relevant exclusion clause in the main contract", stated (at p. 546):

> ... that question does not arise for decision in the instant appeal, but in principle I would venture the view that such a clause according to the manner in which it was worded might in some circumstances limit the duty of care just as in the *Hedley Byrne* case the plaintiffs were ultimately defeated by the defendants' disclaimer of responsibility. [Emphasis added.]

Voir également *Crocker c. Sundance Northwest Resorts Ltd.*, [1988] 1 R.C.S. 1186, à la p. 1203.

Après avoir revu minutieusement les circonstances donnant naissance à l'obligation de diligence des employés envers la demanderesse en l'espèce, le juge en chef McEachern et les juges Hinkson et Wallace de la Cour d'appel ont conclu qu'elle était limitée aux dommages inférieurs à 40 $. Il ne servirait à rien de répéter les considérations qui les ont amenés à conclure ainsi et que le juge Iacobucci a résumées adroitement. Il suffit de dire qu'à mon avis, ils avaient raison. (J'ajouterai comme seule réserve que, contrairement à un commentateur (W. J. Swadling, «Privity, Tort and Contract: Exempting the Careless Employee» (1991), 4 *Journal of Contract Law* 208, aux pp. 218 et 219), je ne considère pas que le juge Hinkson a conclu que la confiance de la demanderesse est une condition essentielle de l'indemnisation dans tous ces cas, ni que le juge Wallace a affirmé que la seule exigence pour qu'il y ait responsabilité est ce qui est «juste et raisonnable».)

En Angleterre, les tribunaux ont rejeté la règle de l'«immunité dérivée» selon laquelle, en principe, [TRADUCTION] «un employé qui accomplit des actes aux termes d'un contrat intervenu entre son employeur et un tiers a droit aux mêmes immunités que celles que le contrat confère à son employeur» (Swadling, *loc. cit.*, à la p. 223). Toutefois, des décisions plus récentes ont ouvert la voie à une analyse fondée sur une modification de l'obligation de diligence semblable à celle adoptée par la Cour d'appel en l'espèce. Dans l'arrêt *Junior Books Ltd. c. Veitchi Co.*, [1983] 1 A.C. 520 (H.L.), lord Roskill, se demandant [TRADUCTION] «ce qui se produirait s'il y avait une clause d'exonération pertinente dans le contrat principal», a répondu (à la p. 546):

> [TRADUCTION] ... cette question n'a pas à être tranchée en l'espèce, mais, en principe, je me permettrais d'observer que pareille clause, telle que formulée, pourrait dans certaines circonstances limiter l'obligation de diligence, tout comme dans l'arrêt *Hedley Byrne* les demandeurs ont été déboutés en raison de la dénégation de responsabilité des défendeurs. [Je souligne.]

The principles of tort set out in *Anns v. Merton London Borough Council*, [1978] A.C. 728, and repeatedly applied by this Court permit, and indeed require, the court to take into account all relevant circumstances in assessing the duty of care which a particular defendant owes to a particular plaintiff. The existence of a limitation on liability, whether contractual or otherwise, may affect the ambit of that duty of care. In this case, the majority of the Court of Appeal, applying these principles, concluded that the duty of care of the defendants was limited to damage under $40, the plaintiff having accepted all risk of damage over that amount. I would affirm that conclusion.

Les principes du droit de la responsabilité délictuelle qui ont été énoncés dans l'arrêt *Anns c. Merton London Borough Council*, [1978] A.C. 728, et que notre Cour a appliqués à maintes reprises, permettent, et en fait exigent, que le tribunal tienne compte de toutes les circonstances pertinentes dans l'évaluation de l'obligation de diligence qu'un défendeur a envers un demandeur. L'existence d'une limitation de responsabilité, qu'elle soit contractuelle ou autre, peut modifier l'étendue de cette obligation. En l'espèce, la Cour d'appel à la majorité a conclu, après avoir appliqué ces principes, que l'obligation de diligence des défendeurs était limitée aux dommages inférieurs à 40 $, la demanderesse ayant accepté tous les risques de dommage excédant cette somme. Je confirmerais cette conclusion.

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I have outlined how the notion of voluntary assumption of the risk, whether on the basis of a contractual waiver via the doctrine of implied terms, or on an analysis based on the scope of the duty of care, permits the conclusion that the defendant employees are not liable to the plaintiff. It remains to consider briefly the conclusion of my colleague La Forest J. that on the matrix of facts relevant to this case, no duty of care whatsoever lies on the employees, that duty lying exclusively on the employer. My concern is whether it is appropriate for this Court to take such a step at this time.

J'ai souligné comment la notion d'acceptation volontaire du risque, que ce soit en vertu d'une renonciation contractuelle par l'entremise de la théorie des conditions implicites ou en vertu d'une analyse fondée sur l'étendue de l'obligation de diligence, permet de conclure que les employés défendeurs ne sont pas responsables envers la demanderesse. Il reste à examiner brièvement la conclusion de mon collègue le juge La Forest selon laquelle, compte tenu de l'ensemble des faits pertinents en l'espèce, aucune obligation de diligence n'incombe aux employés, celle-ci incombant exclusivement à l'employeur. Je me demande s'il convient que notre Cour fasse ce pas à ce moment-ci.

The rule proposed by my colleague La Forest J. would introduce a change in the common law of tort of major significance. It has always been accepted that a plaintiff has the right to sue the person who was negligent, regardless of whether the employee was working for someone else or not. The employer becomes liable only by the doctrine of vicarious liability, absent independent negligence on its part. The reasons of my colleague would reverse the scheme; the employer, regardless of whether it was itself negligent, would be primarily liable for the negligence of its employees. Only in exceptional cases, as where there is specific reliance on the employee or special

La règle proposée par mon collègue le juge La Forest apporterait un changement capital dans la common law relative à la responsabilité délictuelle. On a toujours reconnu le droit du demandeur de poursuivre une personne négligente, peu importe que l'employé travaille pour quelqu'un d'autre ou non. En l'absence de négligence indépendante de sa part, l'employeur n'engage sa responsabilité qu'en vertu du principe de la responsabilité du fait d'autrui. Les motifs de mon collègue inverseraient la situation; l'employeur, peu importe qu'il ait été lui-même négligent ou non, serait essentiellement responsable de la négligence de ses employés. Le droit de poursuivre directe-

"safety concerns", would there be a right to sue the employee directly.

ment l'employé ne serait accordé que dans des circonstances exceptionnelles comme dans le cas où il y a une confiance précise en l'employé ou encore des «questions de sécurité» particulières.

Such a change would have great impact on the substantive and procedural rights of plaintiffs. On the substantive front, elimination of the current right to recover against a negligent employee would deprive a plaintiff of the possibility of alternative recovery in cases where, for example, the employer has insufficient insurance and no realizable assets (frequently the case with smaller corporate employers). On the procedural front, the rights to discovery and use in evidence of the testimony of the person who was actually negligent might be lost. These are but two important consequences that come to mind.

Un tel changement aurait des répercussions énormes sur les droits des demandeurs sur les plans du fond et de la procédure. Sur le plan du fond, l'élimination du droit actuel de se faire indemniser par un employé négligent priverait le demandeur de la possibilité d'obtenir une indemnité subsidiaire dans le cas où, par exemple, l'employeur n'est pas suffisamment assuré et n'a aucun actif réalisable (ce qui est fréquemment le cas pour les propriétaires d'entreprises moins importantes). Sur le plan de la procédure, le droit à l'interrogatoire préalable et le droit à l'utilisation en preuve du témoignage de la personne qui a effectivement été négligente risquent d'être perdus. Ce ne sont là que deux conséquences importantes qui viennent à l'esprit.

Not only is the proposed change in the law one of great significance; it would introduce collateral questions the answers to which are not immediately apparent, at least to me. How does one define specific reliance on employees or special safety concerns? Once established, do they justify holding employees liable for property damage and economic loss as well as for personal injury damages? Should an employer sued in such a case have a right over against the employee? My concern is not that questions such as these cannot be satisfactorily resolved, but that their resolution would involve the courts in a long and difficult process of law-making in an area where the legislative process might be better suited than the courts to setting the rules. In the meantime employees, employers and the insurance industry would find it difficult to accurately assess and provide for the risk of liability. These considerations suggest to me that however attractive the idea posited by my colleague may seem, the better course is to leave it to the legislatures of Canada to consider the full implications of the proposed change, decide whether on balance it is desirable, and if they think

Non seulement le changement proposé au droit est capital, mais il susciterait des questions accessoires dont les réponses ne sont pas évidentes, du moins pas à mes yeux. Comment définit-on la confiance précise en des employés ou les questions de sécurité particulières? Une fois établies, justifient-elles de tenir les employés responsables de dommages matériels et d'une perte économique, de même que de lésions corporelles? L'employeur poursuivi dans un tel cas devrait-il pouvoir se retourner contre l'employé? Je ne crains pas que de telles questions ne puissent être tranchées d'une manière satisfaisante; je crains plutôt que leur solution n'entraîne les tribunaux dans un long et pénible processus d'élaboration du droit dans un domaine où le processus législatif est peut-être mieux adapté que les tribunaux pour établir des règles. En attendant, les employés, les employeurs et le secteur de l'assurance trouveraient difficile d'évaluer avec précision et de prévoir le risque de responsabilité. Ces considérations me portent à croire que si attrayante que puisse sembler l'idée avancée par mon collègue, la meilleure solution est de laisser aux assemblées législatives du Canada le soin d'examiner toutes les répercussions du changement proposé et de décider si, tout bien consi-

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it is, impose appropriate exceptions, terms and conditions.

As I stated in *Watkins v. Olafson*, [1989] 2 S.C.R. 750, at p. 761:

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

Conclusion

I would dismiss the appeal and cross-appeal with costs.

Appeal and cross-appeal dismissed with costs, LA FOREST J. *dissenting on the cross-appeal.*

Solicitors for the appellant: Lindsay, Kenney, Vancouver.

Solicitors for the respondents: Harper, Grey, Easton & Company, Vancouver.

Solicitors for the intervener: Stevenson, Norman, Vancouver.

déré, il est souhaitable d'imposer les exceptions et les conditions appropriées.

Comme je l'ai indiqué dans l'arrêt *Watkins c. Olafson*, [1989] 2 R.C.S. 750, à la p. 761:

... les réformes majeures du droit doivent plutôt relever de l'assemblée législative. Lorsqu'il s'agit de procéder à une extension mineure de l'application de règles existantes de manière à répondre aux exigences d'une situation nouvelle et lorsque les conséquences de la modification sont faciles à évaluer, les juges peuvent et doivent modifier les règles existantes. Mais quand il s'agit d'une réforme majeure ayant des ramifications complexes, les tribunaux doivent faire preuve de beaucoup de prudence.

Conclusion

Je suis d'avis de rejeter le pourvoi principal et le pourvoi incident avec dépens.

Pourvoi principal et pourvoi incident rejetés avec dépens, le juge LA FOREST *est dissident dans le pourvoi incident.*

Procureurs de l'appelante: Lindsay, Kenney, Vancouver.

Procureurs des intimés: Harper, Grey, Easton & Company, Vancouver.

Procureurs de l'intervenant: Stevenson, Norman, Vancouver.

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TAB 9

1999 CanLII 654 (SCC)

Fraser River Pile & Dredge Ltd. *Appellant*

v.

Can-Dive Services Ltd. *Respondent*

INDEXED AS: FRASER RIVER PILE & DREDGE LTD. v. CAN-DIVE SERVICES LTD.

File No.: 26415.

1999: February 25; 1999: September 10.

Present: Gonthier, Cory, McLachlin, Iacobucci, Major, Bastarache and Binnie JJ.

ON APPEAL FROM THE COURT OF APPEAL FOR BRITISH COLUMBIA

Contracts — Privity of Contract — Insurance policy — Doctrine of principled exception to privity of contract — Insurance policy including waiver of subrogation — Coverage extending to charterers — Charterer negligent in sinking of barge — Barge owner recovering for loss and agreeing to sue charterer — Whether charterer can rely on waiver of subrogation clause to defend against subrogated action initiated by barge owner's insurers on basis of principled exception to the privity of contract doctrine.

A barge owned by the appellant sank while chartered to the respondent. The appellant's insurance policy included clauses waiving subrogation and extending coverage to affiliated companies and charterers. The insurers paid the appellant the fixed amount stipulated in the policy for the loss of the barge. The appellant made a further agreement with the insurers to pursue a negligence action against the respondent and to waive any right to the waiver of subrogation clause. The negligence action against the respondent was allowed at trial, and dismissed on appeal. At issue here is whether a third-party beneficiary can rely on a waiver of subrogation clause to defend against a subrogated action on the basis of a principled exception to the privity of contract doctrine.

Fraser River Pile & Dredge Ltd. *Appelante*

c.

Can-Dive Services Ltd. *Intimée*

RÉPERTORIÉ: FRASER RIVER PILE & DREDGE LTD. c. CAN-DIVE SERVICES LTD.

N° du greffe: 26415.

1999: 25 février; 1999: 10 septembre.

Présents: Les juges Gonthier, Cory, McLachlin, Iacobucci, Major, Bastarache et Binnie.

EN APPEL DE LA COUR D'APPEL DE LA COLOMBIE-BRITANNIQUE

Contrats — Lien contractuel — Police d'assurance — Théorie de l'exception fondée sur des principes à la règle du lien contractuel — Police d'assurance comportant une clause de renonciation à la subrogation — Assurance protégeant les affréteurs — Négligence de la part de l'affréteur dans le naufrage d'une barge — Propriétaire de la barge indemnisé de la perte subie et acceptant de poursuivre l'affréteur — L'affréteur peut-il invoquer une clause de renonciation à la subrogation pour se défendre contre une action subrogatoire intentée par les assureurs du propriétaire de la barge en vertu d'une exception fondée sur des principes à la règle du lien contractuel?

Une barge appartenant à l'appelante a coulé alors qu'elle était affrétée à l'intimée. La police d'assurance de l'appelante comportait des clauses de renonciation à la subrogation et protégeait les sociétés affiliées et les affréteurs. Les assureurs ont versé à l'appelante le montant forfaitaire prévu par la police pour la perte de la barge. L'appelante a conclu une autre entente avec les assureurs en vue d'intenter une action fondée sur la négligence contre l'intimée et de renoncer à tout droit susceptible de découler de la clause de renonciation à la subrogation. L'action pour négligence contre l'intimée a été accueillie en première instance, mais rejetée en appel. Il s'agit en l'espèce de savoir si un tiers bénéficiaire peut invoquer une clause de renonciation à la subrogation pour se défendre contre une action subrogatoire intentée en vertu d'une exception fondée sur des principes à la règle du lien contractuel.

Held: The appeal should be dismissed.

As a general rule the doctrine of privity provides that a contract can neither confer rights nor impose obligations on third parties. Consequently, a third-party beneficiary would normally be precluded from relying on the terms of the insurance policy between the barge owner and its insurers. Given the circumstances of this appeal, however, a principled exception to the privity doctrine applies. A new exception is dependent upon the intention of the contracting parties. This intention is determined on the basis of two critical and cumulative factors: (a) the parties to the contract must intend to extend the benefit to the third party seeking to rely on the contractual provision; and (b) the activities performed by the third party seeking to rely on the contractual provision must be the very activities contemplated as coming within the scope of the contract in general, or the provision in particular, as determined by reference to the intentions of the parties.

The first condition for the requisite intention was met, given that the waiver of subrogation clause expressly referred to a class of intended beneficiaries whose membership included the respondent. That clause was not conditional on the appellant's initiative in favour of any particular third-party beneficiary and can be enforced by the respondent acting independently. The appellant's agreement with the insurers to pursue legal action against the respondent did not effectively delete the third-party benefit from the contract. The parties' freedom of contract was not restricted because the agreement between the appellant and the insurers was concluded after the respondent's inchoate right crystallized into an actual benefit. At that point, the respondent became a party to the initial contract for the limited purpose of relying on the waiver of subrogation clause, and the appellant and the insurers cannot unilaterally revoke the respondent's crystallized rights. The second requirement for relaxing the doctrine of privity was also met. The relevant activities arose in the context of the very activity anticipated in the policy pursuant to the waiver of subrogation clause. That clause was not contained in an unrelated contract that did not pertain to the charter contract.

Sound policy reasons exist for relaxing the doctrine of privity in these circumstances. Such an exception establishes a default rule that closely corresponds to commercial reality. When sophisticated commercial parties enter into a contract of insurance which expressly

Arrêt: Le pourvoi est rejeté.

En règle générale, la règle du lien contractuel prévoit qu'un contrat ne peut ni conférer des droits ni imposer des obligations à des tiers. Par conséquent, un tiers bénéficiaire serait normalement dans l'impossibilité d'invoquer les stipulations de la police d'assurance en vigueur entre le propriétaire de la barge et ses assureurs. Toutefois, une exception fondée sur des principes à la règle du lien contractuel s'applique dans les circonstances du présent pourvoi. Une nouvelle exception est subordonnée à l'intention des parties contractantes. Cette intention peut être établie en fonction de deux facteurs cruciaux et cumulatifs: a) les parties au contrat doivent avoir l'intention d'accorder le bénéfice au tiers qui cherche à invoquer la disposition contractuelle, et b) les activités exercées par le tiers qui cherche à invoquer la disposition contractuelle doivent être les activités mêmes qu'est censé viser le contrat en général, ou la disposition en particulier, compte tenu des intentions des parties.

La première condition relative à l'intention requise a été remplie, puisque la clause de renonciation à la subrogation mentionnait expressément une catégorie de bénéficiaires visés qui comprenait l'intimée. L'application de cette clause ne dépendait pas de l'adoption par l'appelante d'une mesure en faveur d'un tiers bénéficiaire en particulier, de sorte que l'intimée peut la faire exécuter de façon indépendante. L'entente dans laquelle l'appelante a convenu avec les assureurs d'intenter une action contre l'intimée n'a pas eu pour effet de supprimer du contrat l'avantage conféré à des tiers. La liberté contractuelle des parties n'a fait l'objet d'aucune restriction puisque l'entente entre l'appelante et les assureurs est survenue après que le droit virtuel de l'intimée se fut cristallisé en un avantage réel. À ce moment, l'intimée est devenue une partie au contrat initial dans le but limité d'invoquer la clause de renonciation à la subrogation, et l'appelante et les assureurs ne peuvent pas supprimer unilatéralement les droits cristallisés de l'intimée. La deuxième condition applicable à l'assouplissement de la règle du lien contractuel a également été remplie. Les activités pertinentes s'inscrivaient dans le contexte de l'activité même prévue par la police selon la clause de renonciation à la subrogation. Cette clause ne figurait pas dans un contrat n'ayant rien à voir avec le contrat d'affrètement.

Il existe des raisons de principe valables en faveur de l'assouplissement de la règle du lien contractuel dans les présentes circonstances. Une telle exception crée une règle par défaut qui correspond étroitement à la réalité commerciale. Lorsque des parties commerciales averties

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extends the benefit of a waiver of subrogation clause to an ascertainable class of third-party beneficiaries, any conditions purporting to limit the extent of the benefit must be clearly expressed. Relaxing the doctrine of privity here would not introduce significant change to the law which would be better left to the legislature. The factors supporting the incremental nature of the exception were present. The appellant's concerns regarding the potential for double recovery were unfounded as the respondent cannot rely on any provision in the policy to establish a separate claim.

concluent un contrat d'assurance qui étend expressément l'application d'une clause de renonciation à la subrogation à une catégorie vérifiable de tiers bénéficiaires, toute condition censée limiter l'étendue de cette application doit être clairement exprimée. L'assouplissement de la règle du lien contractuel en l'espèce n'entraînerait pas une modification importante du droit, qu'il vaudrait mieux laisser au législateur le soin d'apporter. Les facteurs étayant la nature progressive de l'exception étaient présents. Les préoccupations de l'appelante concernant le risque de double indemnisation étaient dénuées de fondement puisque l'intimée ne peut invoquer aucune disposition de la police pour établir la validité d'une réclamation distincte.

Cases Cited

Applied: *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*, [1992] 3 S.C.R. 299; **disapproved:** *Vandepitte v. Preferred Accident Insurance Corp. of New York*, [1933] A.C. 70; **considered:** *Commonwealth Construction Co. v. Imperial Oil Ltd.*, [1978] 1 S.C.R. 317; **referred to:** *Scott v. Wawanesa Mutual Insurance Co.*, [1989] 1 S.C.R. 1445; *Thomas & Co. v. Brown* (1899), 4 Com. Cas. 186; *Watkins v. Olafson*, [1989] 2 S.C.R. 750; *R. v. Salituro*, [1991] 3 S.C.R. 654.

Jurisprudence

Arrêt appliqué: *London Drugs Ltd. c. Kuehne & Nagel International Ltd.*, [1992] 3 R.C.S. 299; **arrêt critiqué:** *Vandepitte c. Preferred Accident Insurance Corp. of New York*, [1933] A.C. 70; **arrêt examiné:** *Commonwealth Construction Co. c. Imperial Oil Ltd.*, [1978] 1 R.C.S. 317; **arrêts mentionnés:** *Scott c. Wawanesa Mutual Insurance Co.*, [1989] 1 R.C.S. 1445; *Thomas & Co. c. Brown* (1899), 4 Com. Cas. 186; *Watkins c. Olafson*, [1989] 2 R.C.S. 750; *R. c. Salituro*, [1991] 3 R.C.S. 654.

APPEAL from a judgment of the British Columbia Court of Appeal (1997), 39 B.C.L.R. (3d) 187, 98 B.C.A.C. 138, 161 W.A.C. 138, 47 C.C.L.I. (2d) 111, [1998] 3 W.W.R. 177, [1997] B.C.J. No. 2355 (QL), allowing an appeal from a judgment of Warren J. (1995), 9 B.C.L.R. (3d) 260, 33 C.C.L.I. (2d) 9, [1995] 9 W.W.R. 376, [1995] B.C.J. No. 1611 (QL). Appeal dismissed.

POURVOI contre un arrêt de la Cour d'appel de la Colombie-Britannique (1997), 39 B.C.L.R. (3d) 187, 98 B.C.A.C. 138, 161 W.A.C. 138, 47 C.C.L.I. (2d) 111, [1998] 3 W.W.R. 177, [1997] B.C.J. No. 2355 (QL), qui a accueilli l'appel d'une décision du juge Warren (1995), 9 B.C.L.R. (3d) 260, 33 C.C.L.I. (2d) 9, [1995] 9 W.W.R. 376, [1995] B.C.J. No. 1611 (QL). Pourvoi rejeté.

David F. McEwen, for the appellant.

D. Barry Kirkham, Q.C., and *Gregory J. Tucker*, for the respondent.

David F. McEwen, pour l'appelante.

D. Barry Kirkham, c.r., et *Gregory J. Tucker*, pour l'intimée.

The judgment of the Court was delivered by

Version française du jugement de la Cour rendu par

1 IACOBUCCI J. — This appeal concerns the application of the doctrine of privity of contract to a waiver of subrogation clause in a contract of insurance.

LE JUGE IACOBUCCI — Le présent pourvoi concerne l'application du principe ou de la règle du lien contractuel à une clause de renonciation à la subrogation contenue dans un contrat d'assurance.

I. Facts

This action arose subsequent to the sinking of the derrick barge "Sceptre Squamish", owned by the appellant, Fraser River Pile & Dredge Ltd. ("Fraser River") and, at the time of loss, under charter to the respondent, Can-Dive Services Ltd. ("Can-Dive"). Can-Dive was held liable at trial for damages in the amount of $949,503. In appealing the trial decision, Can-Dive does not dispute that the loss resulted from its negligence, but contends that it cannot be held liable in what is in effect a subrogated action by the underwriters of Fraser River's insurance policy.

Fraser River carries on business as a provider of dredging, pile-driving and related services. It owns approximately 50 vessels which it uses for these purposes. Occasionally, Fraser River charters vessels for which it has no immediate use to others. In 1990, Can-Dive undertook work as a sub-contractor on a natural gas pipeline under construction between Vancouver Island and the mainland of British Columbia. In order to carry out the work required, Can-Dive contracted with Fraser River to charter the "Sceptre Squamish", and arranged for Fraser River's personnel to operate the crane and winches on board. The charter contract also included a flat scow. Can-Dive assumed full responsibility for towing the barge to and from the work site, and for maintaining the safety and condition of the barge. The "Sceptre Squamish" was towed to the work site on October 30, 1990, where it remained until sinking in stormy weather on the night of November 16, 1990.

At all material times during the charter of the "Sceptre Squamish" and its subsequent loss, Fraser River was insured under a Hull Subscription Policy (the "policy"), dated June 28, 1990. Following the loss of the vessel and its equipment, Fraser River recovered from the insurers the sum of $1,128,365.57, being the fixed amount stipulated in the policy to cover such loss. On June 4, 1991, Fraser River and the insurers entered into a further

I. Les faits

2 La présente action fait suite au naufrage de la barge-grue «Sceptre Squamish» dont l'appelante, Fraser River Pile & Dredge Ltd. («Fraser River»), était propriétaire et dont l'intimée, Can-Dive Services Ltd. («Can-Dive»), était l'affréteur au moment du sinistre. En première instance, Can-Dive a été condamnée à verser la somme de 949 503 $ à titre de dommages-intérêts. En interjetant appel contre la décision de première instance, Can-Dive ne conteste pas que le sinistre a résulté de sa négligence, mais elle fait valoir qu'elle ne saurait être tenue responsable dans ce qui est, en réalité, une action subrogatoire intentée par les assureurs de Fraser River.

3 Fraser River est un fournisseur de services de dragage et de battage de pieux, et de services connexes. Elle possède une cinquantaine de navires qu'elle utilise à ces fins. Elle frète parfois des navires dont elle n'a pas besoin dans l'immédiat. En 1990, Can-Dive a entrepris des travaux de sous-traitance sur un gazoduc en construction entre l'île de Vancouver et la partie continentale de la Colombie-Britannique. Pour exécuter les travaux requis, Can-Dive a passé avec Fraser River un contrat d'affrètement du «Sceptre Squamish» et s'est arrangée pour que le personnel de Fraser River fasse fonctionner la grue et les treuils qui se trouvaient sur le navire. Le contrat d'affrètement visait également une péniche à fond plat. Can-Dive assumait l'entière responsabilité du remorquage de la barge pour l'amener au chantier et pour l'en ramener, ainsi que de la sécurité et du maintien en bon état de celle-ci. Le «Sceptre Squamish» a été remorqué jusqu'au chantier le 30 octobre 1990 et il y est demeuré jusqu'à son naufrage lors d'une tempête pendant la nuit du 16 novembre 1990.

4 Au cours de l'affrètement du «Sceptre Squamish» et au moment du sinistre qui est survenu, Fraser River était, en tout temps pertinent, titulaire d'une police de coassurance sur corps de navire (la «police») datée du 28 juin 1990. À la suite de la perte du navire et de son équipement, les assureurs ont versé à Fraser River la somme de 1 128 365,57 $, qui représentait le montant forfaitaire prévu par la police en cas de sinistre

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agreement, setting out their joint intention to pursue a legal action against Can-Dive in negligence for the sinking of the "Sceptre Squamish". The preamble of the agreement included the following terms:

> C) The Underwriters have agreed to pay the claims (the claims) of F.R.P.D. for the loss of the barge and crane and the Underwriters wish to proceed with legal action against Can-Dive Services Ltd. and possibly others to recover part or all of their payments;
>
> D) F.R.P.D. has agreed to waive any right it may have pursuant to the waiver of subrogation clause in the aforesaid policy with respect to Can-Dive Services Ltd. . . .

5 Fraser River subsequently commenced this action in June 1991 to recover damages for its losses arising from the sinking of the derrick barge. Can-Dive not only denied that it was negligent, but argued as well that the action was a subrogated action conducted by and for the sole benefit of the insurers, i.e., that as Fraser River had received payment from the insurers in the amount specified in the policy (which exceeded the actual value of the loss by a little over $300,000), the claim was wholly subrogated, notwithstanding that it was initiated by Fraser River. Accordingly, the insurers were precluded from proceeding against Can-Dive on the basis that the company was included within the category of "Additional Insureds" as defined in the terms of the policy as follows:

GENERAL CONDITIONS

1. ADDITIONAL INSUREDS CLAUSE

> It is agreed that this policy also covers the Insured, associated and affiliated companies of the Insured, be they owners, subsidiaries or interrelated companies and as bareboat charterers and/or charterers and/or sub-charterers and/or operators and/or in whatever capacity and shall so continue to cover notwithstanding any provisions of this Policy with respect to change of ownership or management. Provided, however, that in the event of any claim being made by

semblable. Le 4 juin 1991, Fraser River et les assureurs ont conclu une autre entente dans laquelle ils exprimaient leur intention commune d'intenter une action fondée sur la négligence contre Can-Dive pour le naufrage du «Sceptre Squamish». Le préambule de cette entente se lisait notamment ainsi:

[TRADUCTION]

> C) Les assureurs ont accepté de payer les réclamations (les réclamations) de F.R.P.D. pour la perte de la barge et de la grue, et ils souhaitent intenter une action contre Can-Dive Services Ltd. et possiblement contre d'autres personnes ou entités dans le but de recouvrer la totalité ou une partie des sommes qu'ils ont versées;
>
> D) F.R.P.D. a accepté de renoncer à tout droit que peut lui conférer, relativement à Can-Dive Services Ltd., la clause de renonciation à la subrogation contenue dans la police susmentionnée . . .

Fraser River a par la suite intenté, en juin 1991, la présente action en dommages-intérêts pour ses pertes résultant du naufrage de la barge-grue. Non seulement Can-Dive a-t-elle nié avoir fait preuve de négligence, mais encore elle a fait valoir que l'action en cause était une action subrogatoire intentée par les assureurs exclusivement à leur profit, en ce sens que, puisque les assureurs avaient versé à Fraser River le montant prévu par la police (qui excédait d'un peu plus de 300 000 $ le montant réel de la perte subie), l'action était entièrement subrogatoire malgré le fait qu'elle avait été intentée par Fraser River. Par conséquent, les assureurs étaient dans l'impossibilité de poursuivre Can-Dive pour le motif que cette compagnie était incluse dans la catégorie des [TRADUCTION] «autres assurés», qui est ainsi définie dans la police:

[TRADUCTION]

CONDITIONS GÉNÉRALES

1. CLAUSE DES AUTRES ASSURÉS

> Il est entendu que la présente police protège également l'assuré et ses sociétés apparentées, peu importe qu'il s'agisse de propriétaires, de filiales ou de sociétés étroitement liées, en tant qu'affréteurs en coque nue, affréteurs, sous-affréteurs, exploitants ou à quelque titre que ce soit, et continue de les protéger malgré toute disposition de la présente police concernant un transfert de propriétaire ou un changement au sein de la direction. Toutefois, si une réclamation est

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associated, affiliated, subsidiary or interrelated companies under this clause, it shall not be entitled to recover in respect of any liability to which it would be subject if it were the owner, nor to a greater extent than an owner would be entitled in such event to recover.

. . .

Notwithstanding anything contained in the Additional Insureds Clause above, it is hereby understood and agreed that permission is hereby granted for these vessels to be chartered and the charterer to be considered an Additional Insured hereunder.

. . .

Trustee Clause

It is understood and agreed that the Named Insured who obtained this Policy did so on his own behalf and as agent for the others insured hereby including those referred to by general description.

In the alternative, Can-Dive claimed that, assuming it was not included in the policy under the category of "Additional Insureds", the insurers had nonetheless expressly waived any right of subrogation it may have held against the defendant, pursuant to the waiver of subrogation clause which read as follows:

17. SUBROGATION AND WAIVER OF SUBROGATION CLAUSE

In the event of any payment under this Policy, the Insurers shall be subrogated to all the Insured's rights of recovery therefor, and the Insured shall execute all papers required and shall do everything that may be necessary to secure such rights, but it is agreed that the Insurers waive any right of subrogation against:

. . .

(b) any charterer(s) and/or operator(s) and/or lessee(s) and/or mortgagee(s). . . .

présentée par des sociétés apparentées, des filiales ou des sociétés étroitement liées au sens de la présente clause, l'auteur de la réclamation n'a ni le droit d'être indemnisé à l'égard d'une responsabilité à laquelle il serait exposé s'il était le propriétaire, ni le droit de toucher une indemnité supérieure à celle à laquelle un propriétaire aurait droit dans un tel cas.

. . .

Nonobstant le contenu de la clause des autres assurés ci-dessus, il est par les présentes entendu et convenu qu'il est permis d'affréter ces navires et que l'affréteur est considéré comme un autre assuré au sens des présentes.

. . .

Clause de fiducie

Il est entendu et convenu que la présente police est contractée par l'assuré en son nom personnel et en sa qualité de mandataire des autres assurés qui, en vertu des présentes, comprennent ceux visés par la description générale.

6 À titre subsidiaire, Can-Dive a prétendu qu'à supposer qu'elle ne soit pas incluse dans la catégorie des «autres assurés» de la police, il n'en demeure pas moins que les assureurs ont expressément renoncé à tout droit de subrogation qu'ils auraient pu opposer à la défenderesse, selon la clause de renonciation à la subrogation qui était ainsi libellée:

[TRADUCTION]

17. CLAUSE DE SUBROGATION ET DE RENONCIATION À LA SUBROGATION

En cas de paiement effectué en vertu de la présente police, les assureurs seront subrogés dans tous les droits de recouvrement de l'assuré à cet égard, et l'assuré signera tous les documents requis et fera toute chose qui pourra être nécessaire pour garantir ces droits, mais il est convenu que les assureurs renoncent à tout droit de subrogation contre:

. . .

b) un ou des affréteurs, exploitants, preneurs à bail ou créanciers hypothécaires. . .

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II. Judgments Below

A. *Supreme Court of British Columbia* (1995), 9 B.C.L.R. (3d) 260

Warren J.

7 Having found that Fraser River's loss was owing to Can-Dive's negligence, Warren J. nonetheless agreed with Can-Dive that the action amounted to a subrogated claim, and went on to consider Can-Dive's defences based on the provisions of the policy. Can-Dive raised three defences: (a) that in agreeing to charter the "Sceptre Squamish" to Can-Dive, Fraser River agreed as well to extend its own insurance coverage under the policy to cover Can-Dive for the duration of the charter agreement; (b) that it came within the class of "Additional Insureds" as specified in the terms of the policy, thereby precluding the insurers from proceeding in a subrogated action against their own insured; and (c) that the insurers expressly waived a right of subrogation against Can-Dive as a "charterer" pursuant to a waiver of subrogation clause contained in the policy.

8 As to Can-Dive's claim that insurance coverage under Fraser River's policy was a term of the charter agreement, Warren J. held that there was insufficient clear and cogent evidence to enable him to conclude on a balance of probabilities that Fraser River agreed to extend its own insurance to cover any risk of loss by Can-Dive during the charter period. Warren J. also rejected Can-Dive's claim that the insurers were precluded from bringing a subrogated action against the company on the basis that Can-Dive, as a "charterer", came within the contractual definition of "Additional Insureds". Warren J. noted that, for this argument to succeed, Can-Dive would have to rely on a contractual term in the policy, and therefore must first overcome the doctrine of privity of contract which generally

II. Les décisions des tribunaux d'instance inférieure

A. *Cour suprême de la Colombie-Britannique* (1995), 9 B.C.L.R. (3d) 260

Le juge Warren

Après avoir conclu que la perte subie par Fraser River était imputable à la négligence de Can-Dive, le juge Warren a néanmoins convenu avec Can-Dive que l'action équivalait à une action subrogatoire et il a ensuite examiné les moyens de défense, fondés sur les dispositions de la police, qui étaient invoqués par Can-Dive. Cette dernière invoquait trois moyens de défense: a) en acceptant de fréter le «Sceptre Squamish» à Can-Dive, Fraser River avait également accepté d'accorder à Can-Dive, pendant la durée du contrat d'affrètement, la protection dont elle bénéficiait en vertu de sa propre police d'assurance, b) Can-Dive relevait de la catégorie des «autres assurés» mentionnée dans la police, ce qui empêchait les assureurs d'intenter une action subrogatoire contre leur propre assuré, et c) les assureurs avaient expressément renoncé à tout droit de subrogation contre Can-Dive en sa qualité d'«affréteur», conformément à la clause de renonciation à la subrogation contenue dans la police.

En ce qui concerne l'argument de Can-Dive selon lequel la protection conférée par la police d'assurance de Fraser River était une condition du contrat d'affrètement, le juge Warren a décidé qu'il n'existait pas suffisamment d'éléments de preuve clairs et convaincants pour qu'il puisse conclure, selon la prépondérance des probabilités, que Fraser River avait accepté d'étendre sa propre assurance à tout risque de perte par Can-Dive durant la période d'affrètement. Le juge Warren a également rejeté l'argument de Can-Dive selon lequel les assureurs étaient dans l'impossibilité d'intenter une action subrogatoire contre elle pour le motif que Can-Dive, en tant qu'«affréteur», relevait de la définition contractuelle des «autres assurés». Le juge Warren a fait remarquer que, pour que cet argument soit retenu, Can-Dive devrait invoquer une stipulation de la police et donc commencer par surmonter la règle du lien contractuel qui prévoit

provides that a stranger to a contract may neither enforce nor rely on its terms.

généralement qu'un étranger à un contrat ne peut ni faire exécuter ce contrat ni en invoquer les clauses.

9 Warren J. next considered Can-Dive's submission that, notwithstanding its status as a third party to the contract, the insurers were bound by the waiver of subrogation clause contained therein as the doctrine of privity of contract does not apply in circumstances where a third-party beneficiary relies on the waiver to defend against an action initiated by the insurers. Having reviewed the existing jurisprudence purporting to deal with privity of contract in this context, and relying in particular on the decision of the Privy Council in *Vandepitte v. Preferred Accident Insurance Corp. of New York*, [1933] A.C. 70, Warren J. concluded that the doctrine was still applicable except to the extent it was incrementally abrogated through the creation of specific judicial exceptions, or more substantively, through legislative reform, as has generally been the case with automobile insurance legislation. He held that the Court's decision in *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*, [1992] 3 S.C.R. 299, was controlling on this issue; a waiver of subrogation clause, as with any other contractual provision, is subject to the doctrine of privity unless a traditional exception applies, or sufficient reason exists to relax the doctrine in the given circumstances. Warren J. held that relaxing the doctrine of privity of contract in the present circumstances would alter the doctrine in excess of the incremental changes contemplated by the reasoning in *London Drugs*.

Le juge Warren a ensuite examiné l'argument de Can-Dive voulant que, malgré qu'elle fût un tiers au contrat, les assureurs étaient liés par la clause de renonciation à la subrogation contenue dans le contrat puisque la règle du lien contractuel ne s'applique pas lorsqu'un tiers bénéficiaire invoque la renonciation pour se défendre contre une action intentée par les assureurs. Après avoir examiné la jurisprudence censée porter sur la règle du lien contractuel dans ce contexte et après avoir invoqué notamment l'arrêt du Conseil privé *Vandepitte c. Preferred Accident Insurance Corp. of New York*, [1933] A.C. 70, le juge Warren a conclu que cette règle était toujours applicable, sauf dans la mesure où elle avait été progressivement abrogée par la création d'exceptions judiciaires précises ou, plus fondamentalement, par voie de réforme législative, comme c'est généralement le cas dans le domaine de l'assurance automobile. Il a jugé que l'arrêt de notre Cour *London Drugs Ltd. c. Kuehne & Nagel International Ltd.*, [1992] 3 R.C.S. 299, était déterminant à cet égard; la clause de renonciation à la subrogation, à l'instar de toute autre disposition contractuelle, est assujettie à la règle du lien contractuel, sauf si une exception traditionnelle s'applique ou s'il existe un motif suffisant de l'assouplir dans certaines circonstances. Le juge Warren a décidé que, dans les présentes circonstances, assouplir la règle du lien contractuel excéderait les modifications progressives envisagées par le raisonnement de l'arrêt *London Drugs*.

10 Finally, Warren J. considered whether Can-Dive could avail itself of the principles of either trust or agency established in the case law as potential exceptions to the doctrine of privity of contract. He quickly dismissed the application of trust principles, concluding that the policy did not reveal any intention that Fraser River was acting as trustee on Can-Dive's behalf in contracting for insurance coverage. As to the agency exception, Warren J. first noted that Fraser River, as the purported agent for Can-Dive, must have intended to act on behalf of Can-Dive as the principal or as a member of an

Enfin, le juge Warren a examiné la question de savoir si Can-Dive pouvait invoquer les principes de la fiducie ou du mandat, que la jurisprudence reconnaît comme des exceptions possibles à la règle du lien contractuel. Il a vite rejeté l'application des principes de la fiducie en concluant que la police ne révélait l'existence d'aucune intention que Fraser River agisse comme fiduciaire de Can-Dive en souscrivant l'assurance en question. Quant à l'exception du mandat, le juge Warren a d'abord mentionné que, à titre de mandataire apparent de Can-Dive, Fraser River devait avoir eu l'intention

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ascertainable class of principals. As he was of the opinion that the case could be decided on other grounds, Warren J. was prepared to assume for the purposes of argument that the requisite intention was present.

d'agir au nom de Can-Dive, en sa qualité de mandant ou de membre d'une catégorie vérifiable de mandants. Comme il était d'avis que l'affaire pouvait être tranchée en fonction d'autres moyens, le juge Warren était disposé à présumer, pour les fins du débat, l'existence de l'intention requise.

11 The more significant obstacle in applying principles of agency, however, was the requirement of ratification. Warren J. held that to gain the benefit of the policy, Can-Dive as principal would have to ratify the actions taken by Fraser River in acting on its behalf to arrange for the policy to cover Can-Dive as within the class of "Additional Insureds". Subsequent ratification involves three initial requirements: (a) the purported agent must have represented to the third party that he or she was acting on behalf of the purported principal; (b) the purported principal must have been competent at the time the act was done; and (c) the purported principal must be legally capable of completing the act at the time of ratification. Warren J. concluded that the three initial requirements were met in these circumstances. The first criterion was satisfied by the inclusion of the "Trustee Clause", indicating to the insurers that Fraser River may be acting as agent on behalf of certain unnamed parties who might later ratify the act and become "Additional Insureds" under the policy. Both the second and third criteria were satisfied by the status of Fraser River and Can-Dive as capable, juridical persons at all material times.

Toutefois, l'obstacle plus important à l'application des principes du mandat était l'exigence de ratification. Le juge Warren a conclu que pour bénéficier de la police, Can-Dive, en sa qualité de mandant, devrait ratifier les mesures prises en son nom par Fraser River pour que la police protège Can-Dive en tant que membre de la catégorie des «autres assurés». Pour qu'il y ait ratification subséquente, trois conditions initiales doivent être remplies: a) le mandataire apparent doit avoir déclaré au tiers qu'il agissait au nom du mandant apparent, b) le mandant apparent devait avoir la capacité d'agir au moment où l'acte a été accompli, et c) le mandant apparent doit avoir la capacité juridique d'accomplir l'acte au moment de la ratification. Le juge Warren a conclu que ces trois conditions initiales étaient remplies dans les circonstances. La première condition était remplie par l'inclusion de la «Clause de fiducie», qui indiquait aux assureurs que Fraser River pourrait agir comme mandataire de certaines parties non désignées nommément qui pourraient ultérieurement ratifier l'acte et devenir d'«autres assurés» au sens de la police. Les deuxième et troisième conditions étaient remplies du fait que Fraser River et Can-Dive étaient des personnes morales dotées de la capacité d'agir pendant toute la période pertinente.

12 Assuming that these initial hurdles were overcome, there still remained, however, as a final requirement an actual act of ratification, whether express or by implication. Warren J. concluded that Can-Dive's only act of ratification was amending its Statement of Defence upon learning of the existence of the policy and its potential scope of coverage. While Warren J. did not find that Can-Dive was precluded from ratifying its inclusion as an "Additional Insureds" under the terms of the policy subsequent to the time at which the loss occurred, he held that the opportunity for ratification was extinguished when Fraser River

Cependant, à supposer que tous ces obstacles initiaux aient été surmontés, il restait à accomplir comme dernière condition un acte véritable de ratification expresse ou implicite. Le juge Warren a décidé que le seul acte de ratification de Can-Dive avait consisté à modifier sa défense en apprenant l'existence de la police et l'étendue possible de la protection qu'elle offrait. Sans avoir conclu que Can-Dive ne pouvait pas, après le sinistre, ratifier son inclusion dans la catégorie des «autres assurés» au sens de la police, le juge Warren a décidé que la possibilité d'une ratification s'était dissipée lorsque Fraser River et les assureurs

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and the insurers entered into an agreement in June 1991 to pursue a claim against Can-Dive for damages. The effect of this agreement was to change the terms of the policy, given that an action against Can-Dive would have been fundamentally incompatible with the existing scope of the "Additional Insureds" clause. Accordingly, no effective ratification of the policy could have occurred subsequent to this date.

avaient convenu, dans l'entente de juin 1991, d'intenter une action en dommages-intérêts contre Can-Dive. Cette entente avait eu pour effet de modifier les stipulations de la police, étant donné qu'une action contre Can-Dive aurait été fondamentalement incompatible avec la portée existante de la clause des «autres assurés». Par conséquent, aucune ratification valide de la police n'aurait été possible après cette date.

13

Also fatal to Can-Dive's claim was Warren J.'s finding that, even assuming that the requirements of ratification had been met, no consideration flowed from Can-Dive to the insurers; the mere act of chartering Fraser River's vessel was insufficient to amount to consideration for the purposes of concluding that agency principles applied to deem Can-Dive a legal party to the contract between Fraser River and the insurers. In the result, Fraser River's action in negligence was allowed.

L'argument de Can-Dive a également reçu un coup fatal en raison de la conclusion du juge Warren que, même à supposer que les conditions d'une ratification aient été remplies, Can-Dive n'avait fourni aucune contrepartie aux assureurs; le simple affrètement du navire de Fraser River était insuffisant pour constituer une contrepartie qui permettrait de considérer que Can-Dive était, en application des principes du mandat, légalement partie au contrat intervenu entre Fraser River et les assureurs. En définitive, le juge Warren a fait droit à l'action pour négligence intentée par Fraser River.

B. *Court of Appeal for British Columbia* (1997), 39 B.C.L.R. (3d) 187

B. *Cour d'appel de la Colombie-Britannique* (1997), 39 B.C.L.R. (3d) 187

Esson, Huddart and Proudfoot JJ.A.

Les juges Esson, Huddart et Proudfoot

14

Esson J.A., writing for the court, agreed that the claim was wholly subrogated, noting that Fraser River had already received from the insurers the amount fixed in the policy, a sum which exceeded Fraser River's actual losses by over $300,000. He rejected Can-Dive's submission, however, that the trial judge was in error in finding that Fraser River did not covenant to insure Can-Dive as a term of the charter agreement. Instead, Esson J.A. chose to decide the appeal on the basis of the waiver of subrogation clause contained in the policy and the principles of the doctrine of privity of contract.

Le juge Esson, qui a rédigé les motifs de la cour, a convenu que l'action était entièrement subrogatoire puisque Fraser River avait déjà reçu des assureurs le montant fixé dans la police, lequel excédait de plus de 300 000 $ la perte réelle de Fraser River. Il a toutefois rejeté l'argument de Can-Dive selon lequel le juge de première instance avait commis une erreur en concluant que Fraser River n'avait pas convenu, comme condition du contrat d'affrètement, d'assurer Can-Dive. Le juge Esson a plutôt décidé de trancher l'appel en fonction de la règle du lien contractuel et de la clause de renonciation à la subrogation contenue dans la police.

15

Esson J.A. first considered whether Can-Dive, as a stranger to the contract of insurance between Fraser River and the insurers, could rely on the waiver of subrogation clause to defend against the subrogated action. He disagreed with the trial

Le juge Esson s'est d'abord demandé si Can-Dive, en tant qu'étranger au contrat d'assurance intervenu entre Fraser River et les assureurs, pouvait invoquer la clause de renonciation à la subrogation pour se défendre contre l'action

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judge's conclusion on this point, holding instead that *Vandepitte, supra*, had been impliedly overruled by the Supreme Court of Canada on the basis that the precedent had been ignored in cases where it might well have applied: see, for example, *Scott v. Wawanesa Mutual Insurance Co.*, [1989] 1 S.C.R. 1445, where the Court held, without any reference to the doctrine of privity of contract, that the named insured's son came within the class of "Insured" as defined in the homeowner's policy. Esson J.A. also noted that soon after *Vandepitte* had been decided, its potential impact on contracts for automobile insurance was abrogated in every relevant jurisdiction. In his opinion, the decision was not good law, as it had either been overtaken by legislation, as in the case of automobile insurance, or largely ignored in favour of reasoning which better reflected commercial reality.

subrogatoire. Il a exprimé son désaccord avec la conclusion du juge de première instance sur ce point, préférant statuer que l'arrêt *Vandepitte*, précité, avait été implicitement renversé par la Cour suprême du Canada qui ne l'avait pas pris en considération dans des affaires où il aurait bien pu s'appliquer: voir, par exemple, l'arrêt *Scott c. Wawanesa Mutual Insurance Co.*, [1989] 1 R.C.S. 1445, où la Cour a statué, sans mentionner la règle du lien contractuel, que le fils de l'assuré désigné nommément relevait de la catégorie des [TRADUCTION] «Assurés» définie dans la police du propriétaire occupant. Le juge Esson a également fait remarquer que peu après le prononcé de l'arrêt *Vandepitte*, son incidence possible sur les contrats d'assurance automobile avait été supprimée dans chaque ressort pertinent. Selon lui, cet arrêt n'était pas valable en droit soit parce qu'il avait été supplanté par une mesure législative, comme dans le cas de l'assurance automobile, soit parce qu'il avait été largement laissé de côté au profit d'un raisonnement qui reflétait mieux la réalité commerciale.

16 Apart from referring to the implicit overruling of *Vandepitte*, Esson J.A. also concluded that judicial authority supported Can-Dive's submission that "waiver of subrogation" clauses in contracts of insurance constituted an exception to the doctrine of privity of contract in circumstances where the third-party beneficiary is not a party to the policy, but nonetheless falls within the contractual definition of those to whom coverage is extended. In *Commonwealth Construction Co. v. Imperial Oil Ltd.*, [1978] 1 S.C.R. 317, for example, subcontractors who were not parties to a builder's risk policy, but who met the definition of a "Contractor" for the purposes of coverage, were able to overcome the doctrine of privity of contract. In holding that subrogation was not available against the subcontractor, de Grandpré J. relied upon the nature of the relationship amongst the various contractors on a construction site, i.e., that the parties were involved in a joint effort towards a common goal. To give effect to the doctrine of privity of contract would be commercially unreasonable in these circumstances, in that any loss on the construction site caused by one of the parties would

En plus de mentionner le renversement implicite de l'arrêt *Vandepitte*, le juge Esson a également conclu que la jurisprudence étayait l'argument de Can-Dive selon lequel les clauses de «renonciation à la subrogation» contenues dans des contrats d'assurance constituent une exception à la règle du lien contractuel dans le cas où le tiers bénéficiaire n'est pas partie à la police, mais est néanmoins visé par la définition contractuelle des personnes auxquelles la protection est accordée. Par exemple, dans *Commonwealth Construction Co. c. Imperial Oil Ltd.*, [1978] 1 R.C.S. 317, des sous-traitants qui n'étaient pas parties à une assurance des risques de l'entrepreneur de construction, mais qui répondaient à la définition d'«entrepreneur» pour les fins d'application de la protection, ont été en mesure de surmonter la règle du lien contractuel. Pour statuer que la subrogation n'était pas opposable au sous-traitant, le juge de Grandpré s'est fondé sur la nature de la relation entre les divers entrepreneurs sur un chantier de construction: par leurs efforts conjoints, les parties contribuaient à la réalisation d'un objectif commun. Il aurait été commercialement déraisonnable d'appliquer la

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necessarily lead to litigation between the parties, contrary to the interest of the common enterprise. In addition to the builder's risk cases, Esson J.A. also identified an existing exception to the doctrine of privity of contract in insurance law more generally, originating in a line of authority dating back to a decision of Mathew J. in *Thomas & Co. v. Brown* (1899), 4 Com. Cas. 186.

règle du lien contractuel dans ces circonstances puisque toute perte qui aurait pu être causée par l'une des parties sur le chantier de construction aurait forcément donné naissance à un litige entre les parties, contrairement aux intérêts de l'entreprise commune. En plus de la jurisprudence relative aux risques de l'entrepreneur, le juge Esson a également relevé de façon plus générale une exception à la règle du lien contractuel dans le domaine du droit des assurances, laquelle exception avait son origine dans un courant jurisprudentiel remontant à la décision du juge Mathew dans l'affaire *Thomas & Co. c. Brown* (1899), 4 Com. Cas. 186.

17

Esson J.A. next considered whether this established exception, available in circumstances where a purported third-party beneficiary comes within the class of those to whom insurance coverage is extended, has nonetheless been overtaken by the Court's decision in *London Drugs*, *supra*. In other words, the exception in favour of waiver of subrogation clauses remains good law only to the extent that it does not contradict the legal principles or analytical framework set out in *London Drugs*. Esson J.A. held that an exception of this nature was entirely consistent on the basis that, if an insurer were to seek to avoid liability on the same grounds as were relied upon in *Vandepitte*, *supra*, under the more recent *London Drugs* analysis, it would fail. Many of the same considerations relevant to the disposition of *London Drugs* were applicable in the instant case, e.g., the third party or stranger to the contract was seeking to rely on a contractual provision to defend against an action, rather than seeking to enforce the terms of the contract on its own initiative against one of the original parties. Furthermore, it was expressly stated in *London Drugs* that nothing in the reasons should be taken as affecting in any way existing exceptions to the doctrine of privity of contract such as principles of trust or agency. Accordingly, as the jurisprudence in support of an exception to privity in favour of third-party beneficiaries falling within the contractual definition of the insured class for the purposes of the insurance policy had not been overtaken by the Court's decision in *London Drugs*, Esson J.A. concluded that Can-Dive could

Le juge Esson a ensuite examiné la question de savoir si cette exception reconnue, qui peut être invoquée dans le cas où un tiers bénéficiaire apparent relève de la catégorie des personnes auxquelles la protection est accordée, a néanmoins été supplantée par l'arrêt *London Drugs*, précité, de notre Cour. En d'autres termes, l'exception en faveur des clauses de renonciation à la subrogation ne demeure valable en droit que dans la mesure où elle n'est pas incompatible avec les principes juridiques ou le cadre analytique exposés dans l'arrêt *London Drugs*. Le juge Esson a décidé qu'une exception de cette nature était tout à fait compatible du fait que, si un assuré cherchait à échapper à la responsabilité pour des motifs identiques à ceux invoqués dans l'arrêt *Vandepitte*, précité, il n'y parviendrait pas en vertu de l'analyse plus récente faite dans l'arrêt *London Drugs*. Bien des facteurs utiles pour trancher l'affaire *London Drugs* s'appliquaient à la présente affaire: par exemple, le tiers ou l'étranger au contrat cherchait à invoquer une disposition contractuelle pour se défendre contre une action au lieu de chercher de sa propre initiative à opposer les clauses contractuelles à l'une des parties initiales au contrat. En outre, il était expressément mentionné dans *London Drugs* que les motifs prononcés dans cette affaire ne devraient pas être interprétés comme touchant de quelque manière les exceptions existantes à la règle du lien contractuel, comme les principes de la fiducie ou du mandat. Par conséquent, étant donné que l'arrêt *London Drugs* de notre Cour n'avait pas supplanté la jurisprudence étayant l'existence d'une

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rely on the waiver of subrogation clause in the policy.

18 Esson J.A. was also of the view that Can-Dive could succeed on the basis of the agency exception. He found that the trial judge erred in failing to find a clear act of ratification by Can-Dive. Specifically, he did not agree with the trial judge's conclusion that Can-Dive's amendment to the pleadings in February 1994 could not amount to ratification on the basis that Fraser River and its insurers, by virtue of their agreement in June 1991 to proceed against Can-Dive, had effectively revised the terms of the policy so as to delete the provision granting third-party rights to Can-Dive. Esson J.A. held that while parties to a contract may subsequently delete provisions in favour of third-party beneficiaries, contractual terms providing protection against loss to third parties cannot be varied to the detriment of the third party after the occurrence of the very loss contemplated in the policy.

19 Accordingly, Esson J.A. allowed the appeal and dismissed the action against Can-Dive.

III. Issues

20 As noted above, this appeal concerns the question of whether a third-party beneficiary can rely on a waiver of subrogation clause contained in a contract of insurance to defend against a subrogated action initiated by the insurer. In the context of this appeal, this question raises the following issues:

a. Is Can-Dive, as a third-party beneficiary under the insurance policy pursuant to the waiver of subrogation clause, entitled to rely on that clause to defend against the insurer's subro-

exception à la règle du lien contractuel en faveur de tiers bénéficiaires visés par la définition contractuelle de la catégorie des assurés pour les fins de la police d'assurance, le juge Esson a conclu que Can-Dive pouvait invoquer la clause de renonciation à la subrogation contenue dans la police.

Le juge Esson était également d'avis que Can-Dive pourrait avoir gain de cause en invoquant l'exception du mandat. Il a statué que le juge de première instance avait commis une erreur en ne concluant pas à l'existence d'un acte clair de ratification de la part de Can-Dive. Plus particulièrement, il ne partageait pas la conclusion du juge de première instance que la modification des actes de procédure de Can-Dive en février 1994 ne pouvait constituer une ratification parce que, en raison de l'entente dans laquelle ils avaient convenu, en juin 1991, de poursuivre Can-Dive, Fraser River et ses assureurs avaient en réalité modifié les stipulations de la police de manière à supprimer la disposition accordant les droits d'un tiers à Can-Dive. Le juge Esson a conclu que, bien que les parties à un contrat puissent subséquemment supprimer des dispositions en faveur de tiers bénéficiaires, les clauses contractuelles qui protègent les tiers en cas de sinistre ne peuvent pas être modifiées au détriment de ces tiers une fois survenu le sinistre même prévu par la police.

Par conséquent, le juge Esson a accueilli l'appel et rejeté l'action intentée contre Can-Dive.

III. Les questions en litige

Comme nous l'avons vu, le présent pourvoi concerne la question de savoir si un tiers bénéficiaire peut invoquer la clause de renonciation à la subrogation contenue dans un contrat d'assurance pour se défendre contre une action subrogatoire intentée par l'assureur. Dans le contexte du présent pourvoi, cette question soulève les questions suivantes:

a. En tant que tiers bénéficiaire au sens de la clause de renonciation à la subrogation contenue dans la police d'assurance, Can-Dive a-t-elle le droit d'invoquer cette clause pour se défendre contre l'action subrogatoire intentée par l'assureur, compte tenu de l'exception

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gated action on the basis of the agency exception to the doctrine of privity of contract?

b. Is Can-Dive, as a third-party beneficiary under the insurance policy pursuant to the waiver of subrogation clause, entitled to rely on that clause to defend against the insurer's subrogated action on the basis of the principled exception to the privity of contract doctrine established by the Court's decision in *London Drugs*?

fondée sur le mandat à la règle du lien contractuel?

b. En tant que tiers bénéficiaire au sens de la clause de renonciation à la subrogation contenue dans la police d'assurance, Can-Dive a-t-elle le droit d'invoquer cette clause pour se défendre contre l'action subrogatoire intentée par l'assureur, compte tenu de l'exception fondée sur des principes à la règle du lien contractuel, que notre Cour a établie dans l'arrêt *London Drugs*?

IV. Analysis

A. *Is Can-Dive, as a third-party beneficiary under the insurance policy pursuant to the waiver of subrogation clause, entitled to rely on that clause to defend against the insurer's subrogated action on the basis of the agency exception to the doctrine of privity of contract?*

IV. Analyse

A. *En tant que tiers bénéficiaire au sens de la clause de renonciation à la subrogation contenue dans la police d'assurance, Can-Dive a-t-elle le droit d'invoquer cette clause pour se défendre contre l'action subrogatoire intentée par l'assureur, compte tenu de l'exception fondée sur le mandat à la règle du lien contractuel?*

21 The entirety of the dispute between the parties concerns the legal effect to be given to the waiver of subrogation contained in Clause 17 of the appellant Fraser River's contract of insurance, which reads as follows:

17. SUBROGATION AND WAIVER OF SUBROGATION CLAUSE

In the event of any payment under this Policy, the Insurers shall be subrogated to all the Insured's rights of recovery therefor, and the Insured shall execute all papers required and shall do everything that may be necessary to secure such rights, but it is agreed that the Insurers waive any right of subrogation against:

. . .

(b) any charterer(s) and/or operator(s) and/or lessee(s) and/or mortgagee(s). . . .

Le différend qui oppose les parties porte entièrement sur l'effet juridique qui doit être donné à la renonciation à la subrogation contenue dans la clause 17 du contrat d'assurance de l'appelante Fraser River, dont voici le libellé:

[TRADUCTION]

17. CLAUSE DE SUBROGATION ET DE RENONCIATION À LA SUBROGATION

En cas de paiement effectué en vertu de la présente police, les assureurs seront subrogés dans tous les droits de recouvrement de l'assuré à cet égard, et l'assuré signera tous les documents requis et fera toute chose qui pourra être nécessaire pour garantir ces droits, mais il est convenu que les assureurs renoncent à tout droit de subrogation contre:

. . .

b) un ou des affréteurs, exploitants, preneurs à bail ou créanciers hypothécaires. . .

22 The respondent Can-Dive is seeking to rely on the waiver of subrogation clause contained in the policy to defend against this subrogated action in negligence. As a general rule, however, the doctrine of privity provides that a contract can neither

L'intimée Can-Dive cherche à invoquer la clause de renonciation à la subrogation contenue dans la police pour se défendre contre la présente action subrogatoire fondée sur la négligence. En règle générale, toutefois, la règle du lien contrac-

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confer rights nor impose obligations on third parties. This appeal is concerned only with the former situation, namely, circumstances in which a third party is seeking to obtain a benefit or right established in its favour pursuant to the terms of the contract. The Court is not called on to address the situation in which a contract imposes obligations on a third party, and I stress that nothing in these reasons should be taken as applicable to the law in this area.

23 Although the doctrine of privity would normally be fatal to its case, Can-Dive submits that the principle of agency applies to deem Can-Dive a party to the contract in law, if not in fact, such that privity is no longer a concern. Because of the approach I intend to take to this case, I do not find it necessary to deal with the argument that Can-Dive may rely on the waiver of subrogation clause on this basis. In so stating, I do not wish to be taken as either agreeing or disagreeing with Esson J.A.'s conclusions on this issue. Instead, I prefer to adopt the approach set out in *London Drugs*, *supra*, and consider whether the doctrine of privity should be relaxed in these circumstances.

B. *Is Can-Dive, as a third-party beneficiary under the insurance policy pursuant to the waiver of subrogation clause, entitled to rely on that clause to defend against the insurer's subrogated action on the basis of the principled exception to the privity of contract doctrine established by the Court's decision in London Drugs?*

1. *London Drugs* and a Principled Exception to the Doctrine of Privity of Contract

24 As stated above, Can-Dive's position is that of a third-party beneficiary who normally would be precluded from enforcing or relying on the terms of the policy in effect between Fraser River and its insurers. Accordingly, it is necessary to consider the legal status of the waiver of subrogation clause in light of the Court's decision in *London Drugs*.

tuel prévoit qu'un contrat ne peut ni conférer des droits ni imposer des obligations à des tiers. Le présent pourvoi vise uniquement la première situation, c'est-à-dire celle où un tiers cherche à obtenir un avantage ou un droit établi en sa faveur conformément au contrat. La Cour n'est pas invitée à examiner le cas du contrat qui impose des obligations à un tiers, et je souligne que rien dans les présents motifs ne doit être interprété comme s'appliquant au droit dans ce domaine.

Quoique la règle du lien contractuel lui serait normalement fatale, Can-Dive soutient que le principe du mandat permet de la considérer comme étant une partie au contrat en droit, voire dans les faits, de sorte que le lien contractuel n'est plus un problème. En raison de la façon dont j'entends aborder la présente affaire, je juge inutile d'examiner l'argument selon lequel Can-Dive peut invoquer la clause de renonciation à la subrogation pour ce motif. En affirmant cela, je ne veux pas que l'on croie que j'approuve ou que je rejette les conclusions du juge Esson sur ce point. Je préfère plutôt adopter la méthode énoncée dans l'arrêt *London Drugs*, précité, et examiner s'il y a lieu d'assouplir la règle du lien contractuel dans les circonstances.

B. *En tant que tiers bénéficiaire au sens de la clause de renonciation à la subrogation contenue dans la police d'assurance, Can-Dive a-t-elle le droit d'invoquer cette clause pour se défendre contre l'action subrogatoire intentée par l'assureur, compte tenu de l'exception fondée sur des principes à la règle du lien contractuel, que notre Cour a établie dans l'arrêt London Drugs?*

1. L'arrêt *London Drugs* et l'exception fondée sur des principes à la règle du lien contractuel

Comme nous l'avons vu, la position de Can-Dive est celle d'un tiers bénéficiaire qui serait normalement dans l'impossibilité de faire exécuter ou d'invoquer les stipulations de la police en vigueur entre Fraser River et ses assureurs. Il est donc nécessaire d'examiner le statut juridique de la clause de renonciation à la subrogation compte

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In that case, the Court introduced what was intended as a principled exception to the common law doctrine of privity of contract.

tenu de l'arrêt *London Drugs* de notre Cour. Dans cette affaire, la Cour a énoncé ce qui se voulait une exception fondée sur des principes à la règle de common law du lien contractuel.

25 At issue was the status of a limitation of liability clause in the standard form contract between the appellant and the respondent for storage of the appellant's transformer. The clause limited a "warehouseman's" liability on any one package to $40. While in storage, a transformer was damaged owing to negligence on the part of the respondent's employees. The appellant sued both the warehouse company and its employees, and the trial judge found the employees personally liable for the full amount of the damages. On appeal, the majority allowed the employees to rely on the limitation of liability clause in the employer's contract with the appellant, notwithstanding that the employees were not parties to this contract. The majority of the Court upheld the result on appeal, concluding that in circumstances where the traditional exceptions to privity of contract such as agency or trust do not apply, courts may nonetheless undertake the appropriate analysis, bounded by both common sense and commercial reality, in order to determine whether the doctrine of privity with respect to third-party beneficiaries should be relaxed in the given circumstances.

Le débat portait sur le statut d'une clause de limitation de responsabilité contenue dans le contrat type que l'appelante et l'intimée avaient conclu relativement à l'entreposage du transformateur de l'appelante. La clause limitait la responsabilité de [TRADUCTION] «l'entreposeur» à 40 $ par colis. Pendant l'entreposage, le transformateur a été endommagé à cause de la négligence des employés de l'intimée. L'appelante a poursuivi à la fois la compagnie d'entreposage et ses employés, et le juge de première instance a tenu les employés personnellement responsables du montant intégral des dommages. En appel, les juges majoritaires ont permis aux employés d'invoquer la clause de limitation de responsabilité contenue dans le contrat liant leur employeur à l'appelante, même si ceux-ci n'étaient pas parties au contrat. Les juges majoritaires de notre Cour ont confirmé la décision de la Cour d'appel en concluant que, lorsque les exceptions traditionnelles à la règle du lien contractuel comme le mandat ou la fiducie ne s'appliquent pas, les tribunaux peuvent néanmoins procéder à l'analyse voulue, en s'appuyant sur le bon sens et la réalité commerciale, pour décider si, dans les circonstances, il y a lieu d'assouplir la règle du lien contractuel en ce qui concerne les tiers bénéficiaires.

26 The Court devoted a great deal of attention to the judicial history and application of the doctrine of privity of contract as it relates to third-party beneficiaries, noting the extent of judicial discontent, legislative override, and a significant body of academic criticism. While acknowledging that privity of contract is an established doctrine of contract law, the Court concluded, at p. 423, that the concerns expressed regarding the application of the doctrine to third-party beneficiaries indicated that the time for judicial consideration in this particular context had arrived:

La Cour s'est longuement attardée à l'historique des procédures judiciaires et à l'application de la règle du lien contractuel en ce qui concerne les tiers bénéficiaires, soulignant l'ampleur du mécontentement de la magistrature, les dérogations législatives et les nombreuses critiques formulées par des auteurs de doctrine. Tout en reconnaissant que la règle du lien contractuel est un principe reconnu du droit des contrats, la Cour a conclu, à la p. 423, que les craintes exprimées au sujet de l'application de ce principe à des tiers bénéficiaires indiquaient que le temps était venu de procéder à un examen judiciaire dans ce contexte particulier:

These comments and others reveal many concerns about the doctrine of privity as it relates to third party

Il ressort de ces commentaires, notamment, que le principe du lien contractuel soulève de nombreuses

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beneficiaries. For our purposes, I think it sufficient to make the following observations. Many have noted that an application of the doctrine so as to prevent a third party from relying on a limitation of liability clause which was intended to benefit him or her frustrates sound commercial practice and justice. It does not respect allocations and assumptions of risk made by the parties to the contract and it ignores the practical realities of insurance coverage. In essence, it permits one party to make a unilateral modification to the contract by circumventing its provisions and the express or implied intention of the parties. In addition, it is inconsistent with the reasonable expectations of all the parties to the transaction, including the third party beneficiary who is made to support the entire burden of liability. The doctrine has also been criticized for creating uncertainty in the law. While most commentators welcome, at least in principle, the various judicial exceptions to privity of contract, concerns about the predictability of their use have been raised. Moreover, it is said, in cases where the recognized exceptions do not appear to apply, the underlying concerns of commercial reality and justice still militate for the recognition of a third party beneficiary right.

préoccupations dans la mesure où il concerne des tiers bénéficiaires. Aux fins du présent pourvoi, je crois qu'il suffit de formuler les observations suivantes. Bien des personnes ont souligné que l'application du principe aux fins d'empêcher un tiers d'invoquer une clause de limitation de la responsabilité qui était destinée à lui profiter est contraire à la pratique commerciale et à la justice. Elle ne respecte pas la répartition et l'acceptation des risques par les parties au contrat et elle fait fi des réalités pratiques de la garantie d'assurance. Elle permet essentiellement à une partie de modifier unilatéralement le contrat en contournant ses dispositions et l'intention expresse ou implicite des parties. En outre, elle est incompatible avec les attentes raisonnables de chacune des parties à l'opération, y compris le tiers bénéficiaire qui doit alors assumer l'entière responsabilité. On a également reproché au principe de rendre le droit incertain. Bien que la plupart des commentateurs soient favorables, du moins en principe, aux diverses exceptions reconnues par les tribunaux à l'égard du principe du lien contractuel, on s'est interrogé sur la prévisibilité de leur utilisation. De plus, on affirme que, dans les cas où les exceptions reconnues ne semblent pas s'appliquer, les intérêts sous-jacents de la réalité commerciale et de la justice militent encore en faveur de la reconnaissance d'un droit aux tiers bénéficiaires.

27 The respondent employees in *London Drugs* were unable to rely on existing principles of trust or agency. Rather than adapting these established principles to accommodate yet another *ad hoc* exception to the doctrine of privity, it was decided to adopt a more direct approach as a matter of principle. The Court held that, in circumstances where the traditional exceptions do not apply, the relevant functional inquiry is whether the doctrine should be relaxed in the given circumstances.

Les employés intimés dans *London Drugs* n'étaient pas en mesure d'invoquer les principes existants de la fiducie ou du mandat. Au lieu d'adapter ces principes reconnus de manière à tenir compte d'une autre exception particulière à la règle du lien contractuel, il a été décidé d'adopter une méthode plus directe pour des raisons de principe. La Cour a statué que, lorsque les exceptions traditionnelles ne s'appliquent pas, la question pratique pertinente est de savoir s'il y a lieu d'assouplir la règle dans les circonstances en cause.

28 In order to distinguish mere strangers to a contract from those in the position of third-party beneficiaries, the Court first established a threshold requirement whereby the parties to the contract must have intended the relevant provision to confer a benefit on the third party. In other words, an employer and its customer may agree to extend, either expressly or by implication, the benefit of any limitation of liability clause to the employees. In the circumstances of *London Drugs*, the customer had full knowledge that the storage services contemplated by the contract would be provided

Pour établir une distinction entre de simples étrangers à un contrat et des tiers bénéficiaires, la Cour a d'abord fixé la condition préliminaire selon laquelle les parties au contrat doivent avoir voulu que la disposition pertinente confère un avantage au tiers. En d'autres termes, un employeur et son client peuvent convenir d'étendre expressément ou implicitement aux employés l'application d'une clause de limitation de responsabilité. Dans l'affaire *London Drugs*, le client savait parfaitement que les services d'entreposage prévus au contrat seraient fournis non seulement par l'employeur,

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not only by the employer, but by the employees as well. In the absence of any clear indication to the contrary, the Court held that the necessary intention to include coverage for the employees was implied in the terms of the agreement. The employees, therefore, as third-party beneficiaries, could seek to rely on the limitation clause to avoid liability for the loss to the customer's property.

mais aussi par les employés. En l'absence d'indications contraires manifestes, la Cour a conclu que l'intention nécessaire d'inclure la protection des employés ressortait implicitement du texte de l'entente. Les employés pouvaient donc, en tant que tiers bénéficiaires, chercher à invoquer la clause de limitation de responsabilité en vue d'échapper à toute responsabilité pour la perte du bien du client.

29

The Court further held, however, that the intention to extend the benefit of a contractual provision to the actions of a third-party beneficiary was irrelevant unless the actions in question came within the scope of agreement between the initial parties. Accordingly, the second aspect of the functional inquiry was whether the employees were acting in the course of their employment when the loss occurred, and whether in so acting they were performing the very services specified in the contract between their employer and its customer. Based on uncontested findings of fact, it was clear that the damage to the customer's transformer occurred when the employees were acting in the course of their employment to provide the very storage services specified in the contract.

La Cour a toutefois ajouté que l'intention d'étendre l'application d'une disposition contractuelle aux actes d'un tiers bénéficiaire n'était pertinente que si les actes en question étaient visés par l'entente intervenue entre les parties initiales. Par conséquent, le deuxième aspect de la question pratique était de savoir si les employés agissaient dans l'exercice de leurs fonctions au moment où la perte est survenue et si, ce faisant, ils fournissaient les services mêmes qui étaient mentionnés dans le contrat intervenu entre leur employeur et son client. Selon des conclusions de fait non contestées, il était clair que, au moment où le transformateur du client a été endommagé, les employés agissaient dans l'exercice de leurs fonctions consistant à fournir les services mêmes d'entreposage prévus au contrat.

30

Taking all of these circumstances into account, the Court interpreted the term "warehouseman" in the limitation of liability clause to include coverage for the employees, thereby absolving them of any liability in excess of $40 for the loss that occurred. The Court concluded that the departure from the traditional doctrine of privity was well within its jurisdiction representing, as it did, an incremental change to the common law rather than a wholesale abdication of existing principles. Given that the exception was dependent on the intention stipulated in the contract, relaxing the doctrine of privity in the given circumstances did not frustrate the expectations of the parties.

Compte tenu de toutes ces circonstances, la Cour a considéré que le terme «entreposeur» utilisé dans la clause de limitation de responsabilité incluait les employés aux fins de l'application de cette clause, ce qui avait pour effet de limiter à 40 $ leur responsabilité pour la perte survenue. La Cour a conclu que cette dérogation à la règle traditionnelle du lien contractuel relevait bel et bien de sa compétence, puisqu'elle représentait une modification progressive de la common law et non pas un rejet systématique de principes existants. Comme cette exception était subordonnée à l'intention stipulée au contrat, l'assouplissement de la règle du lien contractuel dans les circonstances en cause ne déjouait pas les attentes des parties.

2. Application of the Principled Exception to the Circumstances of this Appeal

2. Application de l'exception fondée sur des principes aux circonstances du présent pourvoi

31

As a preliminary matter, I note that it was not our intention in *London Drugs*, *supra*, to limit

Tout d'abord, je souligne que, dans l'arrêt *London Drugs*, précité, la Cour n'avait pas l'inten-

application of the principled approach to situations involving only an employer-employee relationship. That the discussion focussed on the nature of this relationship simply reflects the prudent jurisprudential principle that a case should not be decided beyond the scope of its immediate facts.

tion de limiter l'application de la méthode fondée sur des principes aux cas où il n'est question que d'une relation employeur-employé. Le fait que l'analyse a porté sur la nature de cette relation traduit simplement le principe jurisprudentiel prudent qui veut qu'une affaire soit décidée strictement en fonction de son contexte factuel immédiat.

32 In terms of extending the principled approach to establishing a new exception to the doctrine of privity of contract relevant to the circumstances of the appeal, regard must be had to the emphasis in *London Drugs* that a new exception first and foremost must be dependent upon the intention of the contracting parties. Accordingly, extrapolating from the specific requirements as set out in *London Drugs*, the determination in general terms is made on the basis of two critical and cumulative factors: (a) Did the parties to the contract intend to extend the benefit in question to the third party seeking to rely on the contractual provision? and (b) Are the activities performed by the third party seeking to rely on the contractual provision the very activities contemplated as coming within the scope of the contract in general, or the provision in particular, again as determined by reference to the intentions of the parties?

Pour ce qui est d'élargir la méthode fondée sur des principes de manière à créer une nouvelle exception à la règle du lien contractuel qui s'applique aux circonstances du pourvoi, il faut tenir compte de l'accent mis, dans *London Drugs*, sur le fait qu'une nouvelle exception doit d'abord et avant tout être subordonnée à l'intention des parties contractantes. Par conséquent, si on extrapole à partir des exigences particulières énoncées dans l'arrêt *London Drugs*, la décision générale repose sur deux facteurs cruciaux et cumulatifs: a) les parties au contrat avaient-elles l'intention d'accorder le bénéfice en question au tiers qui cherche à invoquer la disposition contractuelle? et b) les activités exercées par le tiers qui cherche à invoquer la disposition contractuelle sont-elles les activités mêmes qu'est censé viser le contrat en général, ou la disposition en particulier, là encore compte tenu des intentions des parties?

(a) *Intentions of the Parties*

a) *Les intentions des parties*

33 As to the first inquiry, Can-Dive has a very compelling case in favour of relaxing the doctrine of privity in these circumstances, given the express reference in the waiver of subrogation clause to "charterer(s)", a class of intended third-party beneficiaries that, on a plain reading of the contract, includes Can-Dive within the scope of the term. Indeed, there is no dispute between the parties as to the meaning of the term within the waiver of subrogation clause; disagreement exists only as to whether the clause has legal effect. Accordingly, there can be no question that the parties intended to extend the benefit in question to a class of third-party beneficiaries whose membership includes Can-Dive. Given the lack of ambiguity on the face of the provision, there is no need to resort to extrinsic evidence for the purposes of determining otherwise. If the parties did not intend the waiver of subrogation clause to be extended to third-party

En ce qui concerne la première question, Can-Dive dispose d'un argument très convaincant en faveur de l'assouplissement de la règle du lien contractuel dans les circonstances de la présente affaire, en raison de la mention expresse des «affréteurs» dans la clause de renonciation à la subrogation, lesquels représentent une catégorie de tiers bénéficiaires visés qui, selon le sens clair du contrat, comprend Can-Dive. En fait, les parties ne contestent pas le sens de ce terme dans la clause de renonciation à la subrogation; il y a désaccord uniquement sur la question de savoir si cette clause a un effet juridique. Il est donc indubitable que les parties avaient l'intention d'accorder le bénéfice en question à une catégorie de tiers bénéficiaires comprenant Can-Dive. Comme cette disposition est sans équivoque à première vue, il n'est pas nécessaire de recourir à une preuve extrinsèque pour statuer autrement. Si les parties n'avaient pas

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beneficiaries, they need not have included such language in their agreement.

eu l'intention d'étendre à des tiers bénéficiaires l'application de la clause de renonciation à la subrogation, elles n'auraient pas eu à inclure ces mots dans leur entente.

In essence, Fraser River's argument in terms of the intention of the parties is not that the scope of the waiver of subrogation clause does not extend to third parties such as Can-Dive, but that the provision can only be enforced by Fraser River on Can-Dive's behalf, and not by Can-Dive acting independently. A plain reading of the provision, however, does not support this conclusion. There is no language in the clause indicating that the waiver of subrogation is intended to be conditional upon Fraser River's initiative in favour of any particular third-party beneficiary. It appears to me that Fraser River has conflated arguments concerning the intentions of the parties in drafting the provision and the legal effect to be given to the provision. In no uncertain terms, the waiver of subrogation clause indicates that the insurers are precluded from proceeding with an action against third-party beneficiaries coming within the class of "charterer(s)", and the relevant inquiry is whether to give effect to these intentions by enforcing the contractual term, notwithstanding the doctrine of privity of contract.

34 En ce qui concerne l'intention des parties, Fraser River fait valoir essentiellement non pas que la clause de renonciation à la subrogation est inapplicable à des tiers comme Can-Dive, mais plutôt que c'est Fraser River au nom de Can-Dive, et non pas Can-Dive de façon indépendante, qui peut la faire exécuter. Toutefois, le sens clair de la disposition n'étaye pas cette conclusion. Le libellé de cette clause n'indique pas que la renonciation à la subrogation est censée dépendre de l'adoption par Fraser River d'une mesure en faveur d'un tiers bénéficiaire en particulier. Il me semble que Fraser River a confondu les arguments touchant les intentions des parties lorsqu'elles ont rédigé la disposition en cause et l'effet juridique qu'il faut lui donner. La clause de renonciation à la subrogation précise en termes non équivoques que les assureurs sont dans l'impossibilité d'intenter une action contre des tiers bénéficiaires qui relèvent de la catégorie des «affréteurs», et la question pertinente est de savoir s'il faut réaliser ces intentions en faisant exécuter la disposition contractuelle, en dépit de la règle du lien contractuel.

In my opinion, the case in favour of relaxing the doctrine of privity is even stronger in the circumstances of this appeal than was the case in *London Drugs*, *supra*, wherein the parties did not expressly extend the benefit of a limitation of liability clause covering a "warehouseman" to employees. Instead, it was necessary to support an implicit extension of the benefit on the basis of the relationship between the employers and its employees, that is to say, the identity of interest between the employer and its employees in terms of performing the contractual obligations. In contrast, given the express reference to "charterer(s)" in the waiver of subrogation clause in the policy, there is no need to look for any additional factors to justify characterizing

35 À mon avis, les arguments en faveur de l'assouplissement de la règle du lien contractuel sont, dans les circonstances du présent pourvoi, encore plus solides qu'ils ne l'étaient dans l'affaire *London Drugs*, précitée, où les parties n'avaient pas expressément étendu aux employés l'application d'une clause de limitation de la responsabilité visant un «entreposeur». Dans cette affaire, il a plutôt fallu, pour justifier l'application implicite de cette clause, s'appuyer sur la relation entre l'employeur et ses employés, c'est-à-dire la communauté d'intérêts de l'employeur et de ses employés sur le plan de l'exécution des obligations contractuelles. Par contre, vu la mention expresse du terme «affréteurs» dans la clause de renonciation à la subrogation contenue dans la police, il n'est pas nécessaire en l'espèce de chercher d'autres facteurs pour justifier la qualification de Can-Dive de

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Can-Dive as a third-party beneficiary rather than a mere stranger to the contract.

tiers bénéficiaire au lieu de simple étranger au contrat.

36 Having concluded that the parties intended to extend the benefit of the waiver of subrogation clause to third parties such as Can-Dive, it is necessary to address Fraser River's argument that its agreement with the insurers to pursue legal action against Can-Dive nonetheless effectively deleted the third-party benefit from the contract. A significant concern with relaxing the doctrine of privity is the potential restrictions on freedom of contract which could result if the interests of a third-party beneficiary must be taken into account by the parties to the initial agreement before any adjustment to the contract could occur. It is important to note, however, that the agreement in question was concluded subsequent to the point at which what might be termed Can-Dive's inchoate right under the contract crystallized into an actual benefit in the form of a defence against an action in negligence by Fraser River's insurers. Having contracted in favour of Can-Dive as within the class of potential third-party beneficiaries, Fraser River and the insurers cannot revoke unilaterally Can-Dive's rights once they have developed into an actual benefit. At the point at which Can-Dive's rights crystallized, it became for all intents and purposes a party to the initial contract for the limited purposes of relying on the waiver of subrogation clause. Any subsequent alteration of the waiver provision is subject to further negotiation and agreement among all of the parties involved, including Can-Dive.

Ayant conclu que les parties avaient l'intention d'étendre à des tiers comme Can-Dive l'application de la clause de renonciation à la subrogation, il faut examiner l'argument de Fraser River voulant que l'entente dans laquelle elle a convenu avec les assureurs d'intenter une action contre Can-Dive ait néanmoins effectivement supprimé du contrat l'avantage conféré à des tiers. Une crainte importante que suscite l'assouplissement de la règle du lien contractuel est qu'il pourrait éventuellement résulter des restrictions à la liberté contractuelle si les parties à l'entente initiale devaient tenir compte des intérêts d'un tiers bénéficiaire avant de remanier le contrat. Toutefois, il importe de souligner que l'entente en question a été conclue après le moment auquel ce qu'on pourrait appeler le droit virtuel conféré à Can-Dive par le contrat s'est cristallisé en un avantage réel sous la forme d'un moyen de défense opposable dans une action pour négligence intentée par les assureurs de Fraser River. Puisqu'ils ont contracté en faveur de Can-Dive en tant que membre de la catégorie des tiers bénéficiaires éventuels, Fraser River et les assureurs ne peuvent pas supprimer unilatéralement les droits de Can-Dive une fois qu'ils se sont cristallisés sous la forme d'un avantage réel. Au moment où les droits de Can-Dive se sont cristallisés, celle-ci est devenue à tous égards une partie au contrat initial dans le but limité d'invoquer la clause de renonciation à la subrogation. Toute modification subséquente de la clause de renonciation doit faire l'objet de nouvelles négociations et d'un accord entre toutes les parties intéressées, y compris Can-Dive.

37 I am mindful, however, that the principle of freedom of contract must not be dismissed lightly. Accordingly, nothing in these reasons concerning the ability of the initial parties to amend contractual provisions subsequently should be taken as applying other than to the limited situation of a third-party's seeking to rely on a benefit conferred by the contract to defend against an action initiated by one of the parties, and only then in circumstances where the inchoate contractual right has

Toutefois, je suis conscient que le principe de la liberté contractuelle ne doit pas être écarté à la légère. Par conséquent, en ce qui concerne la capacité des parties initiales de modifier ultérieurement les dispositions contractuelles, rien dans les présents motifs ne doit être interprété comme s'appliquant à d'autres situations que celle du tiers qui cherche à invoquer un avantage conféré par le contrat pour se défendre contre une action intentée par l'une des parties, et ce, uniquement lorsque le droit

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crystallized prior to any purported amendment. Within this narrow exception, however, the doctrine of privity presents no obstacle to contractual rights conferred on third-party beneficiaries.

contractuel virtuel s'est cristallisé avant toute prétendue modification. Dans le cadre de cette exception restreinte, la règle du lien contractuel ne fait toutefois pas obstacle à l'exercice de droits contractuels conférés à des tiers bénéficiaires.

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(b) *Third-Party Beneficiary is Performing the Activities Contemplated in the Contract*

b) *Le tiers bénéficiaire exerce les activités prévues au contrat*

38

As to the second requirement that the intended third-party beneficiary must rely on a contractual provision in connection with the very activities contemplated by the contract in general, or by the relevant clause in particular, Fraser River has argued that a significant distinction exists between the situation in *London Drugs*, *supra*, and the circumstances of the present appeal. In *London Drugs*, the relationship between the contracting parties and the third-party beneficiary involved a single contract for the provision of services, whereas in the present circumstances, such a "contractual nexus", to use Fraser River's phrase, does not exist. In other words, the waiver of subrogation clause upon which Can-Dive seeks to rely is contained in an unrelated contract that does not pertain to the charter contract in effect between Fraser River and Can-Dive.

En ce qui concerne la deuxième condition, à savoir que le tiers bénéficiaire visé doit invoquer une disposition contractuelle relativement aux activités mêmes prévues au contrat en général, ou dans la clause pertinente en particulier, Fraser River a fait valoir qu'il y a une distinction importante entre la situation qui existait dans l'affaire *London Drugs*, précitée, et les circonstances du présent pourvoi. Dans *London Drugs*, la relation entre les parties contractantes et le tiers bénéficiaire était régie par un seul contrat de louage de services, tandis que, dans le présent pourvoi, il n'existe pas de tel [TRADUCTION] «lien contractuel», pour reprendre l'expression utilisée par Fraser River. En d'autres termes, la clause de renonciation à la subrogation que Can-Dive cherche à invoquer figure dans un contrat qui n'a rien à voir avec le contrat d'affrètement intervenu entre Fraser River et Can-Dive.

39

With respect, I do not find this argument compelling, given that a similar contractual relationship could be said to exist in *London Drugs*, in terms of the service contract between the parties and a contract of employment which presumably existed between the employer and employees. At issue is whether the purported third-party beneficiary is involved in the very activity contemplated by the contract containing the provision upon which he or she seeks to rely. In this case, the relevant activities arose in the context of the relationship of Can-Dive to Fraser River as a charterer, the very activity anticipated in the policy pursuant to the waiver of subrogation clause. Accordingly, I conclude that the second requirement for relaxing the doctrine of privity has been met.

En toute déférence, je ne juge pas cet argument convaincant puisqu'on pourrait affirmer qu'il existait une relation contractuelle similaire dans l'affaire *London Drugs*, vu le contrat de louage de services conclu par les parties et le contrat de travail qui liait vraisemblablement l'employeur et les employés. Il s'agit de savoir si le prétendu tiers bénéficiaire participe à l'activité même que prévoit le contrat contenant la disposition qu'il cherche à invoquer. Dans la présente affaire, les activités pertinentes s'inscrivaient dans le contexte de la relation entre Fraser River et Can-Dive en sa qualité d'affréteur, soit l'activité même prévue par la police selon la clause de renonciation à la subrogation. Je conclus donc que la deuxième condition applicable à l'assouplissement de la règle du lien contractuel est remplie.

(c) *Policy Reasons in Favour of an Exception in These Circumstances*

c) *Raisons de principe en faveur d'une exception dans les circonstances de la présente affaire*

40 Having found that Can-Dive has satisfied both of the cumulative threshold requirements for the purposes of introducing a new, principled exception to the doctrine of privity of contract as it applies to third-party beneficiaries, I nonetheless wish to add that there are also sound policy reasons for relaxing the doctrine in these circumstances. In this respect, it is time to put to rest the unreasonable application of the doctrine of privity to contracts of insurance established by the Privy Council in *Vandepitte, supra*, a decision characterized since its inception by both legislatures and the judiciary as out of touch with commercial reality. As Esson J.A. noted, the decision in *Vandepitte* received little attention outside the field of automobile insurance, where it had been promptly overruled by legislative amendment in British Columbia and other provinces. In addition, Esson J.A. was correct in holding that *Vandepitte* has been impliedly overruled in the course of decisions by the Court, given that in cases where the rule of privity might have been applied, the decision was ignored: *Scott, supra*. Of particular interest is the Court's decision in *Commonwealth Construction Co., supra*. The case concerned a general contractor's "builder's risk" policy that purported to extend coverage to subcontractors who were not parties to the original contract. In holding that subrogation was not available against the subcontractors, de Grandpré J., writing for the Court, made the following comments regarding the "Additional Insureds" and "Trustee" clauses, at p. 324:

> While these conditions may have been inserted to avoid the pitfalls that were the lot of the unnamed insured in *Vandepitte v. Preferred Accident Insurance Corpn. of New York* [citations omitted], a precaution that in my view was not needed, they without doubt cover additional ground.

Bien que j'aie conclu que Can-Dive a rempli les deux conditions préliminaires cumulatives aux fins de l'adoption d'une nouvelle exception fondée sur des principes à la règle du lien contractuel applicable aux tiers bénéficiaires, je tiens néanmoins à ajouter qu'il existe également des raisons de principe valables en faveur de l'assouplissement de cette règle dans les présentes circonstances. À cet égard, il est temps de mettre fin à l'application déraisonnable de la règle du lien contractuel aux contrats d'assurance que le Conseil privé a établie dans l'arrêt *Vandepitte*, précité, que les législatures et les juges considèrent, depuis le début, comme coupé de la réalité commerciale. Comme le juge Esson l'a souligné, on s'est peu attardé à l'arrêt *Vandepitte* en dehors du domaine de l'assurance automobile, où il a vite été renversé par voie de modification législative en Colombie-Britannique et dans d'autres provinces. De plus, le juge Esson a statué à bon droit que l'arrêt *Vandepitte* a été renversé implicitement dans des arrêts de la Cour, étant donné qu'elle n'en a pas tenu compte dans des affaires où la règle du lien contractuel aurait peut-être pu s'appliquer: *Scott*, précité. L'arrêt *Commonwealth Construction Co.*, précité, de notre Cour est particulièrement intéressant. Il y était question d'une assurance des «risques de l'entrepreneur de construction» qui avait été souscrite par un entrepreneur général et qui était censée s'appliquer à des sous-traitants qui n'étaient pas des parties au contrat initial. En statuant que la subrogation n'était pas opposable aux sous-traitants, le juge de Grandpré, qui a rédigé les motifs de la Cour, a fait les remarques suivantes concernant les clauses intitulées [TRADUCTION] «Autres assurés» et «fiducie», à la p. 324:

> Ces conditions peuvent avoir été introduites pour éviter les pièges dont ont été victimes les assurés non nommés dans *Vandepitte v. Preferred Accident Insurance Corpn. of New York* [renvois omis], précaution superflue à mon avis, mais elles ont indubitablement une portée additionnelle.

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When considered in light of the Court's discussion of the necessary interdependence of various contractors involved in a common construction enterprise, the comment reflects the Court's acknowledgment that the rule of privity set out in *Vandepitte* was inconsistent with commercial reality. In a similar fashion, Fraser River in the course of this appeal has been unable to provide any commercial reason for failing to enforce a bargain entered into by sophisticated commercial actors. In the absence of any indication to the contrary, I must conclude that relaxing the doctrine of privity in these circumstances establishes a default rule that most closely corresponds to commercial reality as is evidenced by the inclusion of the waiver of subrogation clause within the contract itself.

41 À la lumière de l'analyse par la Cour de l'interdépendance nécessaire des divers entrepreneurs qui participent à une entreprise de construction commune, ces remarques reflètent la reconnaissance par la Cour du fait que la règle du lien contractuel énoncée dans l'arrêt *Vandepitte* était incompatible avec la réalité commerciale. D'une façon similaire, Fraser River a été incapable, dans le cadre du présent pourvoi, de fournir quelque raison commerciale que ce soit de ne pas faire exécuter un marché conclu par des acteurs commerciaux avertis. En l'absence d'indication contraire, force m'est de conclure que l'assouplissement de la règle du lien contractuel dans ces circonstances crée une règle par défaut qui correspond très étroitement à la réalité commerciale, comme l'atteste l'inclusion de la clause de renonciation à la subrogation dans le contrat même.

A plain reading of the waiver of subrogation clause indicates that the benefit accruing in favour of third parties is not subject to any qualifying language or limiting conditions. When sophisticated commercial parties enter into a contract of insurance which expressly extends the benefit of a waiver of subrogation clause to an ascertainable class of third-party beneficiary, any conditions purporting to limit the extent of the benefit or the terms under which the benefit is to be available must be clearly expressed. The rationale for this requirement is that the obligation to contract for exceptional terms most logically rests with those parties whose intentions do not accord with what I assume to be standard commercial practice. Otherwise, notwithstanding the doctrine of privity of contract, courts will enforce the bargain agreed to by the parties and will not undertake to rewrite the terms of the agreement.

42 D'après le sens clair de la clause de renonciation à la subrogation, l'avantage conféré à des tiers bénéficiaires n'est assujetti à aucune restriction ni à aucune condition limitative. Lorsque des parties commerciales averties concluent un contrat d'assurance qui étend expressément l'application d'une clause de renonciation à la subrogation à une catégorie vérifiable de tiers bénéficiaires, toute condition censée limiter l'étendue de cette application ou ses modalités doit être clairement exprimée. La raison d'être de cette exigence est que l'obligation d'inclure des clauses exceptionnelles dans un contrat incombe très logiquement aux parties dont les intentions sont incompatibles avec ce que je présume être la pratique commerciale normale. Sinon, malgré la règle du lien contractuel, les tribunaux feront exécuter le marché conclu par les parties et n'entreprendront pas de récrire les modalités de l'entente.

Fraser River has also argued that to relax the doctrine of privity of contract in the circumstances of this appeal would be to introduce a significant change to the law that is better left to the legislature. As was noted in *London Drugs*, *supra*, privity of contract is an established doctrine of contract law, and should not be lightly discarded through the process of judicial decree. Wholesale abolition of the doctrine would result in complex repercus-

43 Fraser River a également soutenu que l'assouplissement de la règle du lien contractuel dans les circonstances du présent pourvoi entraînerait une modification importante du droit, qu'il vaut mieux laisser au législateur le soin d'apporter. Tel que souligné dans l'arrêt *London Drugs*, précité, la règle du lien contractuel est un principe reconnu du droit des contrats, et ne devrait pas être écartée à la légère par voie de décision judiciaire. L'abolition

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sions that exceed the ability of the courts to anticipate and address. It is by now a well-established principle that courts will not undertake judicial reform of this magnitude, recognizing instead that the legislature is better placed to appreciate and accommodate the economic and policy issues involved in introducing sweeping legal reforms.

pure et simple de cette règle aurait des répercussions complexes que les tribunaux sont incapables de prévoir et d'examiner. Il existe un principe maintenant bien établi selon lequel les tribunaux n'entreprendront pas une réforme judiciaire de cette envergure, préférant reconnaître que le législateur est mieux placé pour évaluer et prendre en considération les questions économiques et de principe que soulève l'adoption de changements juridiques profonds.

44 That being said, the corollary principle is equally compelling, which is that in appropriate circumstances, courts must not abdicate their judicial duty to decide on incremental changes to the common law necessary to address emerging needs and values in society: *Watkins v. Olafson*, [1989] 2 S.C.R. 750, at pp. 760-61, and *R. v. Salituro*, [1991] 3 S.C.R. 654, at pp. 665-70. In this case, I do not accept Fraser River's submission that permitting third-party beneficiaries to rely on a waiver of subrogation clause represents other than an incremental development. To the contrary, the factors present in *London Drugs*, in support of the incremental nature of the exception, are present as well in the circumstances of this appeal. As in *London Drugs*, a third-party beneficiary is seeking to rely on a contractual provision in order to defend against an action initiated by one of the contracting parties. Fraser River's concerns regarding the potential for double recovery are unfounded, as relaxing the doctrine to the extent contemplated by these reasons does not permit Can-Dive to rely on any provision in the policy to establish a separate claim. In addition, the exception is dependent upon the express intentions of the parties, evident in the language of the waiver of subrogation clause, to extend the benefit of the provision to certain named classes of third-party beneficiaries.

Cela dit, le principe corollaire est tout aussi convaincant: dans les circonstances appropriées, les tribunaux ne doivent pas renoncer à leur devoir de décider d'apporter à la common law les modifications progressives nécessaires pour qu'elle reflète l'évolution des besoins et des valeurs dans la société: *Watkins c. Olafson*, [1989] 2 R.C.S. 750, aux pp. 760 et 761, et *R. c. Salituro*, [1991] 3 R.C.S. 654, aux pp. 665 à 670. En l'espèce, je n'accepte pas l'argument de Fraser River que permettre à des tiers bénéficiaires d'invoquer une clause de renonciation à la subrogation représente autre chose qu'un changement progressif. Au contraire, les facteurs qui, dans l'arrêt *London Drugs* étayaient la nature progressive de l'exception sont également présents dans le présent pourvoi. Comme c'était le cas dans *London Drugs*, un tiers bénéficiaire cherche à invoquer une disposition contractuelle pour se défendre contre une action intentée par l'une des parties contractantes. Les préoccupations de Fraser River concernant le risque de double indemnisation sont dénuées de fondement car l'assouplissement de la règle dans la mesure envisagée par les présents motifs ne permet pas à Can-Dive d'invoquer une disposition de la police pour établir la validité d'une réclamation distincte. De plus, cette exception est subordonnée à l'intention expresse des parties, qui ressort du libellé de la clause de renonciation à la subrogation, d'étendre l'application de la disposition à certaines catégories désignées de tiers bénéficiaires.

V. Conclusion and Disposition

V. Conclusion et dispositif

45 I conclude that the circumstances of this appeal nonetheless meet the requirements established in *London Drugs* for a third-party beneficiary to rely on the terms of a contract to defend against a claim

Je conclus que les circonstances du présent pourvoi satisfont néanmoins aux conditions prescrites dans l'arrêt *London Drugs* pour qu'un tiers bénéficiaire puisse invoquer les clauses d'un con-

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initiated by one of the parties to the contract. As a third-party beneficiary to the policy, Can-Dive is entitled to rely on the waiver of subrogation clause whereby the insurers expressly waived any right of subrogation against Can-Dive as a "charterer" of a vessel included within the policy's coverage.

trat dans le but de se défendre contre une action intentée par l'une des parties contractantes. En tant que tiers bénéficiaire de la police, Can-Dive a le droit d'invoquer la clause de renonciation à la subrogation dans laquelle les assureurs ont expressément renoncé à tout droit de subrogation contre Can-Dive en tant qu'«affréteur» d'un navire visé par la police.

Accordingly, I would dismiss the appeal with costs.

46 Par conséquent, je suis d'avis de rejeter le pourvoi avec dépens.

Appeal dismissed with costs.

Pourvoi rejeté avec dépens.

Solicitors for the appellant: McEwen, Schmitt & Co., Vancouver.

Procureurs de l'appelante: McEwen, Schmitt & Co., Vancouver.

Solicitors for the respondent: Owen, Bird, Vancouver.

Procureurs de l'intimée: Owen, Bird, Vancouver.

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TAB 10

Court of Queen's Bench of Alberta

Citation: Liu v Calgary Chinatown Development Foundation, 2017 ABQB 149

Date: 20170303
Docket: 1401 13225
Registry: Calgary

2017 ABQB 149 (CanLII)

Between:

Kwan Ying Liu, Thoai Phong Lam, Yin Ping Tam
Yuk Chun Chung, Tak Hing Tang and Pik Han Law

Appellants

\- and -

Calgary Chinatown Development Foundation

Respondent

Reasons for Judgment
of the
Honourable Mr. Justice A.D. Macleod

Appeal from the Decision by Master K.R. Laycock
Dated the 07th day of July, 2015

[1] The six Appellants are tenants of a condominium development in Chinatown, a vibrant part of downtown Calgary. They are central to an ongoing dispute between the Bowside Manor Tenants' Advocacy Group ("TAG") and the Respondent, the Calgary Chinatown Development Foundation ("CCDF"). The dispute centers on the residential leases held by the six Appellants and the rent they are being charged by CCDF. This dispute was originally brought before the Residential Tenancy Dispute Resolution Service ("RTDRS") in the fall of 2014 but was then

referred by it to the Alberta Court of Queen's Bench in December of that year. The dispute was ultimately heard by Master Laycock in June 2015. The Master dismissed the application with costs and his judgment is appealed.

[2] Essentially, TAG seeks this Court's assistance in enforcing, on behalf of the six Appellant tenants, an agreement between CCDF and the Canada Mortgage and Housing Corporation ("CMHC") which was made pursuant to the *National Housing Act*, RSC 1985, c N-11. CCDF, the landlord, resists on various grounds including that the tenants are not privy to the contract between it and CMHC and the claims are barred by the *Limitations Act*, RSA 2000, c L-12.

[3] The standard of review in this appeal is one of correctness: *Bahcheli v Yorkton Securities Inc*, 2012 ABCA 166.

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Background

[4] CCDF is a non-profit Alberta Society incorporated on May 6, 1976 and involved in the planning and construction of the residential and commercial development known as Bowside Manor in Calgary, Alberta. There are residential tenancies in the building, a few commercial tenancy units, and an underground parkade. Construction of the building was completed in the late 1970's and CCDF has operated and managed the building since it opened. The board of CCDF is made up of volunteers from the Calgary chinese community. The building sits on three parcels of land, two of which are leased to CCDF and the third is owned by CCDF.

[5] The financing of the building was accomplished in large part by a CMHC mortgage.

[6] CCDF received a subsidy from CMHC so that CCDF could offer, in some residential units, below-market rent geared to the income of the tenants. In addition to the mortgage document, CCDF entered into an Operating Agreement with CMHC dated March 12, 1979, which included the following terms:

> 2. Rental/Occupancy
>
> ...
>
> (2) Accommodation in the project shall be leased at rental rates according to the income of the tenant, as set forth in Schedule "A" attached up to the maximum rent. Where fully serviced accommodation is not provided the rent is to be reduced by an amount approved by the Corporation which represents the cost of services not provided as set forth in clause 1(11) above.
>
> ...
>
> (5) The Borrower shall obtain evidence of the income of the lessees at the time of initial occupancy and annually thereafter and adjust the amount of rent to be paid by the lessee in accordance with the change in income. Individual leases will make provision for this requirement. Verification by the auditor shall be provided in his report to the effect that a rent-to-income ratio has been applied, that income reviews and confirmation of incomes have been undertaken and necessary rent adjustments have been made.

(6) The amount of rent to be paid by the lessee shall not be increased more frequently than annually. However, the amount of rent paid may be reduced at any time upon receipt of concrete evidence that the income of the lessee has decreased since the last annual income review. The lease rent shall be reinstated when the income of the lessee increases to its original amount. Individual leases will make provision for this requirement. The actual policy regarding the above shall be determined by the non-profit corporation/cooperative association with the concurrence of the Corporation.

3. Leasing of House Unit

...

(3) Each lease will make provisions for the annual verification of income and rent to be charged according to the rent-to-income scale.

4. Federal Assistance

...

(4) Should the federal assistance paid in any fiscal year exceed the actual assistance required as established by the Corporation upon receipt of the Annual Project Data Report and financial statements of the Borrower, the excess will be refunded within thirty days of the Corporation by the Borrower subject to the provisions of paragraphs (6) and (7) of this clause.

...

(8) The borrower is required to submit an audited statement of final capital costs within six months of the interest adjustment date of the loan. Any necessary adjustments to the level of federal assistance will be made upon receipt of this audited statement.

...

7. Care Facilities

(1) The federal assistance will be restricted to the shelter component only of accommodation with care facilities.

(2) The Borrower shall provide adequate evidence that provincial or other per diem rates or grants will be available for the operating costs of the non-shelter components and that together with the federal assistance the project as a whole will operate on a break even basis.

...

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10. Annual Review

(1) Three months following the end of the borrower's fiscal year the borrower shall submit to the Corporation a Project Data Report- Schedule "E" attached supported by audited financial statements and a project budget for the next fiscal year, as appropriate. Where applicable, the audited financial statements are to separate the revenue and expenses for the shelter and non-shelter components of the project.

(2) The Corporation shall review and adjust, if necessary, the economic rents annually on the basis of the data provided in (1) above.

(3) Where applicable, the annual project data report will only reflect data related to the shelter component of the project.

...

12. Books, Accounts and Audit

(1) The Borrower shall maintain books, records and accounts in a form satisfactory to the Corporation, and shall permit the Corporation to inspect such books, records and accounts by a representative of the Corporation at any time.

(2) For the purpose of verifying revenue or expenditures and of obtaining statistical or other information on the operation of the project, the Borrower will permit the Corporation to have access to the project and to its books and records.

(3) The Borrower will for statistical purposes, supply such information as is required by the Corporation.

(4) The duties of the borrower's auditor will include:

a) Preparations of a statement of profit and loss including details of all revenue and expenses;

b) Preparation of the balance sheet;

c) A statement indicating whether or not verification of the incomes of the occupants and the rent calculations as required by Clause 2(5) have been undertaken. This assessment by the auditor may be undertaken on a test basis.

d) Preparations of the Annual Project Data Report.

e) Auditor's statement.

...

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18. Default

The Corporation shall have the rights, in the event of the Borrower failing to maintain the low rental character of the project or otherwise committing a breach of this agreement, to declare the unpaid principal of any CMHC direct loan mortgage on the project due and payable forthwith or to discontinue all federal assistance on all NHA Loans or to avail itself of any recourse reserved in any CMHC direct loan mortgage document as though the text of this undertaking was reproduced in full therein which rights are in addition to any other rights to restrain any breach of or to enforce this agreement.

[7] All six of the Appellants are long term tenants who signed a residential lease in the 1990's and the first years of 2000. None of the six residential tenancy agreements before me contain clauses reflecting the substance of sections 3(3), 2(5), and 2(6) of the Operating Agreement despite the agreement that those clauses be inserted in the residential tenancy agreements. There was no explanation as to the omission and CMHC appears not to have raised it, notwithstanding that CMHC monitored the operation and the record is replete with evidence that CMHC adopted a supervisory role under the terms of the Operating Agreement.

[8] It would appear that CMHC was regularly consulted on matters of rent and CCDF provided annual reports and other financial statements, which included reports of the landlord's compliance with the terms of the Operating Agreement. While the record perhaps does not contain each and every report, communication, or financial statement submitted to CMHC by CCDF, there are many examples and it seems that CCDF was performing the reporting function as required by the Operating Agreement to the satisfaction of CMHC.

[9] In August 2007, CMHC and CCDF entered into an agreement to adjust the maximum federal assistance and in 2009 the parties entered into a Contribution Agreement under which CCDF received approximately $250,000 and which included terms requiring it to remain a non-profit society and to provide subsidized housing for a period of ten years from that time. The final payment on the CMHC mortgage was made in May of 2015 and under its terms the Operating Agreement came to an end.

[10] A number of issues were raised by the Appellants, three of which attracted the most concern:

a. Minimum Rent

[11] This term does not appear in the Operating Agreement but "minimum rent" is clearly a factor which is used to calculate the rent payable in the subsidized units remaining in Bowside Manor, of which there are 34.

[12] CMHC and CCDF were both concerned with the financial viability of the project. This is referred to in the Operating Agreement itself and in subsequent correspondence. For example, in a letter dated November 24, 1994 to CCDF, CMHC supports CCDF's proposal to increase the rent-to-income ratio from 25% to 28-30%. Ultimately CCDF chose 30%. With respect to the minimum rents which were then in place, while CMHC acknowledged that there was no provision in the Operating Agreement for CMHC approval of minimum rents, CCDF was

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directed to administer minimum rents at their own discretion "in order to maintain financial viability of the project."

[13] From that time on there is evidence of discussions between CMHC and CCDF about minimum rents and the concept appeared to become an accepted factor for use in calculating rents for subsidized units. CMHC and CCDF were not, however, always in agreement as to the amount to be used as a minimum rent.

[14] The position of the Appellants is that the use of minimum rents was contrary to the Operating Agreement or, alternatively, the minimum rent set by CCDF was too high.

b. Electricity

[15] The Appellants claim that they are being charged too much for electricity and that under the Operating Agreement they should be responsible only for their pro-rata share of the cost of electricity for the residential portion of the building.

c. The Reserve

[16] The Appellants claim that CCDF is maintaining a reserve which is too high, resulting in higher rental charges.

The Role of CMHC

[17] During the course of argument I inquired about CMHC and their position in respect to this action. I was told by counsel that CMHC preferred not to be involved and the parties had not taken any steps to name it as a party. One would normally expect all parties to the contract to be before the Court to enable it to fully adjudicate the issues in question while being satisfied that no injustice is done either to the parties or to others who are interested in the subject matter: *Alberta Treasury Branches v Ghermezian*, 2000 ABCA 228 at para 15.

[18] CMHC's mandate was judicially considered in *Canada Mortgage and Housing Corp v Iness* (2004), 70 OR (3d) 148 (CA) at paras 5-8, leave to appeal to SCC refused, [2004] SCCA No 167:

> CMHC is a federal Crown corporation that is constituted as an agent of Her Majesty in Right of Canada pursuant to s. 5(1) of the *Canada Mortgage and Housing Corporation Act*, R.S.C. 1985, c. C-7; s. 4 of the *National Housing Act*, R.S.C. 1985, c. N-11; and Part I of Schedule III and Part X of the *Financial Administration Act*, R.S.C. 1985, c. F-11.
>
> The purposes of the *National Housing Act*, which are set out in s. 3, include: "to promote housing affordability and choice" and "to protect the availability of adequate funding for housing at low cost".
>
> In furtherance of those purposes, Parliament authorized CMHC to make loans and contributions and to attach terms and conditions thereto. The relevant provisions of the *National Housing Act* are as follows:
>
>> 95(1) [CMHC] may make loans and contributions to assist with the payment of the capital and operating costs of housing projects, and may forgive amounts owing on those loans.

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> (2) [CMHC] may determine the terms and conditions on which it makes a loan or contribution or forgives an amount under subsection (1), including, without limiting the generality of the foregoing,
>
> > (a) conditions with respect to the operation or occupancy of a housing project.

In the exercise of the authority conferred upon it under the *National Housing Act*, CMHC enters into operating agreements with housing co-operatives to which it provides funding.

[19] I have also had the benefit of the diligent work that Kelvin Kwok did (as part of TAG) in obtaining many of CMHC's documents under the *Access to Information Act*, RSC 1985, c A-1. This, together with CCDF's affidavits, has resulted in there being before me much of the correspondence involving CMHC and CCDF, as well as between CMHC and TAG. They include the following:

1. The letter of November 24, 1994 from CMHC to CCDF directing CCDF to administer minimum rents at their own discretion "in order to maintain financial viability of the project."

2. As early as September 19, 1983, CMHC wrote to CCDF noting the significant decline from current year's figures due to the deterioration of the rental market in Calgary. CMHC advises CCDF as follows:

   > Before adjusting your current rents downward you should first of all assess the impact it would have on the viability of the project. We suggest if current rents can be maintained without having a detrimental effect on the marketability of the units then you should not adjust them. If, on the other hand you are experiencing some difficulty in marketing the units at current levels then perhaps some adjustment should be implemented, the amount of which would be left to your discretion.

3. CMHC was receiving, reviewing and approving audited financial statements, annual project data reports and other materials. For example, there is a letter from Ms. O'Neil at CMHC to CCDF acknowledging receipt of audited financial statements, annual project data reports and other related materials for CCDF's fiscal year ended December 31, 2010. She goes on to say "that CMHC has now completed their review and are pleased to advise that the information is accepted as submitted. A summary of our review is attached." There is a similar letter from CMHC to CCDF dated July 19, 2013 and July 28, 2014.

4. There is a letter from CMHC to CCDF dated September 27, 2013 (originally sent in May 2012) advising CCDF of recent changes at CMHC. As a result of the March 2012 federal budget, CMHC had undertaken a review of its operations and government funded programs. As a result, the supervision of many of the projects, including Bowside Manor, was going to be less hands on.

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5. On September 2, 2014, CMHC wrote to counsel for CCDF about the ongoing dispute between CCDF and TAG. The letter includes the following:

> In this regard, the differences of opinion in relation to operational and administrative matters are as between the tenants and its board of directors. In certain circumstances, operational matters may raise compliance issues under the Operating Agreement, but at this time and based on a review of information provided to date, CMHC has not raised concerns regarding the administration of Bowside Manor.

6. With respect to the reserve, in 2013 CCDF commissioned a Capital Replacement Funds Study from Read Jones Christoffersen Ltd. This was reviewed by CMHC who replied on April 10, 2014 approving the Capital Replacement Plan. The letter did require adjustments and provided directions for follow up; but it clearly indicates an active monitoring function on the part of CMHC.

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[20] In the fall of 2013, the board of CCDF determined it necessary to increase rents and advised CMHC. There are a series of emails and correspondence indicating that Ms. O'Neil at CMHC thought that the minimum rents being charged were above the industry standard of $300 and recommended that they use the industry standard of $300 as a minimum rent. While CMHC's recommendation was communicated to the tenants, it would appear that this recommendation was, to the knowledge of CMHC, never implemented.

[21] According to the affidavit of Kelvin Kwok, a number of concerns were raised by TAG directly with CMHC. Mr. Kwok had been thorough in his requests under the federal access to information legislation and had marshalled some arguments in favour of lower rent. This culminated in a meeting between TAG and CMHC on June 16, 2016 in Calgary. During this meeting, according to the notes that Mr. Kwok attached as part of Exhibit "K" to his Affidavit, a number of issues were discussed between representatives of TAG and representatives of CMHC including:

(a) Why certain provisions of the Operating Agreement, which were required to be in the residential tenancies agreements, were not in those agreements?
(b) Did CMHC allow CCDF to charge a minimum rent greater than 30% of a tenant's household income while retaining huge operating surpluses in the last decade?
(c) Why did CCDF charge so much for domestic electricity?
(d) Why does CMHC allow CCDF to transfer the amount of money it does to its replacement reserve fund?
(e) A number of questions were asked about the rent charged to commercial tenants contrary to the Operating Agreement.

[22] In other words, the discussion covered all of the issues that have been raised in connection with this action. In each case, CMHC responded that it felt that CCDF had acted appropriately and CMHC had no concerns that it was not acting in compliance with the Operating Agreement. Moreover, CMHC felt that the tenants of Bowside Manor had received at least as much benefit in terms of subsidized rent as CCDF had received in government assistance.

[23] Obviously, TAG disagreed with the positions taken by CMHC and they have pursed this action.

[24] The question as to which position should be preferred as to between the Appellants and CMHC is a question for this Court's consideration only if it finds that terms of the Operating Agreement are:

(a) implied into each of the residential tenancy agreements, or
(b) found to be enforceable by the Appellants.

Implying Terms

[25] The Appellants argue that this Court should imply the terms which were left out of the residential tenancy agreements because the Operating Agreement mandates their inclusion in those agreements. However, the residential tenancy agreements stand on their own. They are workable and there is no compelling reason to imply terms to give them commercial efficacy: *Benfield Corporate Risk Canada Limited v Beaufort International Insurance Inc*, 2013 ABCA 200.

Enforcing Operating Agreement by the Appellants

[26] It is strongly argued that this Court should permit the Appellants to enforce the Operating Agreement such that the rent-to-income ratio applies rather than the minimum rents. They also argued before me that CCDF's reserve fund is too large which has resulted in a lesser subsidy to which the Appellants are entitled. Finally, they argue that the electricity charges are nearly double what they should be under the Operating Agreement.

[27] There has long been a judicial debate in this country as to when the doctrine privity of contract can be ignored and when benefits negotiated between A and B for the benefit of C, can be directly enforced by C. The two leading cases in this country are *Fraser River Pile & Dredge Ltd v Can-Dive Services Ltd*, [1999] 3 SCR 108 and *London Drugs Ltd v Kuehne & Nagel International Ltd*, [1992] 3 SCR 299.

[28] The Supreme Court has held that third party beneficiaries may enforce benefits conferred upon them in a contract to which they are not a party if:

(a) the parties to the contract intended to extend the benefit in question to the third parties seeking to rely on the contractual provision; and
(b) the activity performed by the third parties seeking to rely on the provision is the very activity contemplated as coming within the scope of the contract in general, or the provisions in particular, as determined by reference to the intention of the parties.

On its face, the two-prongs of the test are met here.

[29] Courts have imposed limits on the application of the exception. One of those is that it not be used as a sword; it may only be used as a shield. That reasoning is rather awkward here because while on one hand the Appellants are the aggressors in the litigation, on the other hand what they seek to do is to prevent CCDF from charging higher rent.

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[30] However, the appellate courts in our country are reluctant to disregard the doctrine of privity and they have made it clear that the exception should only be applied to avoid injustice: *London Drugs* at 446.

[31] The Appellants argue that this is a clear case where the benefits were intended to extend to the tenants who were renting subsidized accommodation in Bowside Manor. While that may be so, argues CCDF, the Operating Agreement does not provide for enforcement by the tenants and the remedy for failing to comply with the agreement is exercisable only by the parties to it.

[32] At first blush, the Appellants have a strong argument that they should receive the benefit which was negotiated for them by CMHC. But upon a close examination of the facts of this case, the application of the doctrine of privity does not result in an injustice. I say this for the following reasons:

1. The Operating Agreement contemplates separate enforceable residential tenancy agreements which were indeed entered into. There is no evidence before me that the Appellants relied on the terms of the Operating Agreement prior to entering into their individual residential tenancy agreements. The Appellants did, however, rely on CMHC to perform its duty to monitor CCDF's activities and ensure that CCDF was offering subsidized housing.

2. CMHC has a large number of projects across the country and actively monitors them. If individual tenants could enforce those agreements it would be inimical to CMHC's adopting uniform policies of management across the country. It is clear that CMHC established policies for overseeing these projects and to allow the tenants to litigate these issues would be counterproductive.

3. The policies adopted by CMHC sometimes affected the interpretation of the Operating Agreements. A good example is the concept of minimum rent. While that concept does not appear in the Operating Agreement, CMHC had an overriding concern about the financial viability of their subsidized housing projects. There was the introduction of the minimum rent and the acceptance of that idea by CMHC who ultimately determined that CCDF should administer minimum rents at their own discretion in order to maintain the financial viability of the project. Accordingly, even if I were inclined to accede to the Appellants' arguments, I could do nothing other than to enforce the Operating Agreement as CMHC interprets it. The record before me, however, makes it clear that CMHC does not consider CCDF to be in noncompliance with the Operating Agreement. In my view, this is fatal to the Appellants' case. Given the dynamic relationship between CMHC and its borrower, it cannot be said that the Appellants were ever the beneficiary of a contractual right that had crystalized into a defined benefit to the tenants. Much was left to the discretion of CCDF. CMHC clearly wanted to preserve flexibility in the management of these projects, to among other things, preserve their financial viability.

[33] Accordingly, it is my view that this is not a case where the doctrine of privity should be ignored and the Appellants cannot, in my view, enforce the terms of the Operating Agreement against CCDF. It is unnecessary for me to consider the limitation issues.

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[34] In conclusion, I agree with the result reached by the Master and the appeal is therefore dismissed.

[35] As to costs CCDF wanted to defer that question until after my decision. The Master granted enhanced costs against the tenants. I will hear the parties on costs but I feel compelled to say that I did not consider the arguments made by the tenants to be unmeritorious. Counsel for the Appellants has provided his services *pro bono* which is very much to his credit. It is my view that the Courts should be accessible to arguments such as the ones that have been put forward on behalf of the tenants. If counsel cannot agree on costs they may address me by correspondence.

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Heard on the 8th day of November 2016 and 20th day of January, 2017.
Dated at the City of Calgary, Alberta this 3rd day of March, 2017.

A.D. Macleod
J.C.Q.B.A.

Appearances:

Mr. David Khan
for the Appellants

Mr. Jeffrey L. Smith, Q.C.
Mr. Richard E. Harrison
for the Respondent

TAB 11

Court of Queen's Bench of Alberta

Citation: 541788 Alberta Ltd v Bourgeois & Company Ltd, 2017 ABQB 363

Date: 20170605
Docket: 1303 09072
Registry: Edmonton

2017 ABQB 363 (CanLII)

Between:

541788 Alberta Ltd. and Irv Williams

Plaintiffs

- and -

Bourgeois & Company Ltd.

Defendant

Reasons for Judgment
of the
Honourable Mr. Justice K.P. Feehan

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[1] 541788 Alberta Ltd. ("541") and Irv Williams ("Williams") bring an action in breach of contract and negligence against Bourgeois & Company Ltd. ("Bourgeois & Co") arising out of an appraisal of the market value of real estate consisting of 11.36 acres in the Elsinore subdivision in the expanding boundaries of north Edmonton.

[2] The issue before this Court on summary trial is determination of liability; damages, if necessary, deferred by agreement of counsel.

I. Brief Outline of the Facts

[3] The lands in question were part of lands originally owned by the Horricks family as part of a quarter section of farm land. In 1977, the Horricks family sold this quarter section, excluding the 11.36 acre homestead area, to a developer. The zoning of the remaining 11.36

acres was AG (agricultural), but the Neighbourhood Structure Plan indicated the most probable zoning to be RFI (single-family lots).

[4] A plan of subdivision of the quarter section, excluding the 11.36 acre lands in question, was registered on September 29, 1988 (Record, pp 124-125). This plan of subdivision left undeveloped remnant parcels immediately outside the north, west, and the north boundary of the southeast portion, of the 11.36 acre lands in question. The two northerly remnant parcels are approximately triangular in shape immediately on the northern boundary and are owned by Canterra Castlebrook General Partner Inc ("Canterra"). The narrow "shovel-shaped" strip at the southeast of the 11.36 acre lands in question is also owned by Canterra. Concept Realty Ltd ("Concept") owned the two long narrow remnant parcels, divided by a proposed roadway, on the western boundary of the 11.36 acre lands in question (Record, pp 6-7 and 127).

[5] More specifically, the first northern approximately triangular remnant land comprises Lots A, B and C in Block 69, Plan 8822276; the second northern approximately triangular remnant parcel is Lot D in Block 69, Plan 8822276; the southeast shovel-shaped remnant is Lot A of Block 67, Plan 8822276; and the westerly two remnant parcels are found in NE5-54-24-W4 (Record, pp 127-145).

[6] The Concept remnant parcel to the north of the proposed roadway, described on the plan of subdivision as Elsinore Place, was later purchased by the Plaintiffs and became incorporated in the Stage 1 development of the 11.36 acres. The three Canterra remnant parcels remain extant.

[7] In September or October, 2011, Irv Williams contacted members of the Horricks family to determine whether they were willing to sell the remaining 11.36 acres that had been the family homestead. The Horricks family members indicated they were agreeable to sell those lands and the purchase price would be based upon a fair market evaluation independently determined by a duly qualified real estate appraiser (Record, p 151).

[8] In early November, 2011, there was a telephone conversation between Williams and Guy Bourgeois ("Bourgeois") in which there was apparently a 10 minute discussion about a retainer to perform this independent appraisal of the 11.36 acres. No notes were made of that telephone conversation by either party and recollections of the detail of that conversation are vague and unhelpful (Record, pp 156 and 273-274).

[9] The contract into which the parties entered, such as it was, is constituted by an exchange of emails on November 9, 2011 (Record, pp 44-46). The first email is from Bourgeois, at a personal email address, guyb@bourgeois.ab.ca, although it is signed "Guy J. Bourgeois AACI, P.App, CRP", to irvwill@shaw.ca, addressed to "Mr. Irv Williams". It was "intended to provide...a quotation of fees and timing to complete an appraisal estimating the market value of the lands above mentioned": "11.36 acres potential development land Edmonton". Analysis of the terms of the contract is set out in detail below.

[10] The return email of November 9, 2011 is from Williams Chrysler, signed by Williams, at the email address irvwill@shaw.ca, addressed to Bourgeois, with respect to the appraisal of the 11.36 acres and merely confirms: "Great, that is what I want. Go ahead, thanks" (Record, pp 44 and 174).

[11] On November 21, 2011, Bourgeois attended at the 11.36 acres to conduct a visual inspection.

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[12] On November 29, 2011, Bourgeois & Co provided two documents to Williams: a Letter of Transmittal (Record, pp 49-51) and an Appraisal Report (Record, pp 52-111). Utilizing a land residual cost of development approach and assuming development of 58 single-family lots, the recommended market value for the land only was $3,557,000. Analysis of the terms of the Letter of Transmittal and Appraisal Report are also set out below.

[13] Based upon the Letter of Transmittal and Appraisal Report, on July 25, 2012 a fee simple real estate purchase contract was entered into by 541, a solely owned corporation of Williams (Record, pp 113-119). Williams signed on behalf of 541 (Record, pp 112-119).

[14] The purchase price was $3,800,000 plus GST with a deposit of $600,000, allocated as $1,575,000 for buildings and $2,225,000 for land (Record, pp 113-114). This contract was not subject to conditions, including with respect to re-zoning or subdivision (Record, p 159). The completion day was set for January 15, 2014.

[15] In November, 2012, both Plaintiffs retained Kit Leitch ("Leitch"), a professional engineer and development consultant, to make an application to the City of Edmonton for re-zoning and subdivision approval for the 11.36 acre parcel (Record, p 1). They provided him with a copy of the Appraisal Report at the time.

[16] In or about January, 2013, Leitch spoke with the president of Canterra who indicated that the purchase price for all remnant lots owned by Canterra would be between $1,000,000 and $1,500,000, despite the fact that the assessed value of the remnant lots was minimal (for example, the assessed value of Lot A in Block 67 was $500; Record, p 129).

[17] In February, 2013, Leitch submitted an initial proposal on behalf of the Plaintiffs to re-zone the 11.36 acre parcel from agricultural to 53 single-family lots and 70-75 low to medium-density condominium units (Record, pp 1 and 162). He was advised by City Planners that subdivision of the 11.36 acre parcel would have to account for the remnant lots outside the boundaries of this parcel.

[18] In June or July, 2013, Leitch revised the application on behalf of the Plaintiffs to propose re-zoning to single-family lots and duplexes. The City of Edmonton would not approve re-zoning without the Plaintiffs either acquiring the remnant parcels, or in the case of Lot D, providing roadway access within the 11.36 acre parcel (Record, p 2).

[19] The transfer of land from the Horricks family to 541 was registered on January 14, 2014 subject only to a zoning regulation encumbrance placed by the Minister of National Defence (Record, pp 121-122).

[20] On June 12, 2014, the City of Edmonton conditionally approved a Stage 1 subdivision of 12 lots in the southwest corner of the 11.36 acres (Record, pp 3-6). The Plaintiffs have proposed future development of Stages 2 and 3 for 41 and 40 lots respectively, but the City refused to re-zone some portions of the 11.36 acre parcel until Lot D, Block 69 and Lot A, Block 67, Plan 8822276, comprising portions of the two northern triangular remnants, have been acquired from Canterra. Counsel advised that more recently the City had agreed to allow a green space right-of-way to be provided to Lot D, Block 69, rather than requiring either purchase or roadway access.

[21] There was no evidence in this matter as to whether the Plaintiffs sought a formal relaxation from the Planning Officer or Subdivision Authority of these obligations, and if such relaxations had not been granted, whether they had appealed those decisions to the Subdivision and Development Appeal Board. Consideration as to whether those steps would have been a

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more practical solution, or would have constituted mitigation of any potential damages suffered by the Plaintiffs, is therefore not before the Court on this question of liability.

II. The Contract

[22] On the face of the exchange of emails of November 9, 2011, the contractual parties appear to be Bourgeois or Guy Bourgeois AACI, P.App, CRP, and Williams or Williams Chrysler. At this time there is no mention of the Plaintiff 541 or the Defendant Bourgeois & Co.

[23] The lands are agreed to contain 11.36 acres, legally described as "Lot 1, Blk 1, Plan 7821490...located in the vicinity of 174 avenue and 99 street in north Edmonton".

[24] There is no dispute as to the value of the contract: $4,200 plus GST.

[25] The subject matter of the email exchange of November 9, 2011 was said to be to "assist...in estimating an appropriate purchase price" for the 11.36 acres to allow those acres to be subdivided for residential purposes, and to that end to require an investigation of the "issues and costs that may be incurred in the course of acquiring and developing these lands". The land residual cost of development approach to be used would include the costs to produce those lots and make them available to the public. The issue as to whether the "costs, effort and risk are viable" were to be left to Williams or Williams Chrysler (Record, pp 44-46).

[26] The email indicates that the lands in question had remained in their original state while the development had proceeded all around them and that it is "clear that the highest and best use of the subject lands is to be subdivided in a fashion that is consistent with surrounding properties".

[27] The email sets out how the appraisal would be conducted:

> Our appraisal will investigate the issues and costs that may be incurred in the course of acquiring and developing these lands.
>
> We intend on using a cost of development technique that shows the potential revenue from the sale of lots on these 11.36 acres over time.
>
> This approach also estimates the costs to produce those lots and make them available to the public.
>
> The net present value of the revenue, less costs, will show the price that can be paid for this parcel based on the assumptions that we make on your behalf.
>
> From that information you should be able to determine if the costs, effort and risk are viable from your perspective.

[28] Additionally, the email indicates an estimated time to complete the appraisal of "about 4 weeks" upon receiving authorization and a fee of $4,200 plus GST (Record, pp 44-46; 174-176).

[29] In summary, while the subject lands of the contract and consideration are not in issue, the identification of the parties to the contract and whether the contractual services to be rendered included identification of and the cost implications associated with having to address the remnant parcels, are in dispute.

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III. The Letter of Transmittal

[30] The Letter of Transmittal indicates that the attached Appraisal Report contains "all of the information and analysis leading to an opinion of 'market value' of a vacant parcel of development land located in the Elsinore neighbourhood of north Edmonton" (Record, p 49). The property was said to contain 11.36 acres with a "highest and best use...for redevelopment to a residential subdivision". The purpose of the appraisal was to provide an estimate of "market value" of the "fee simple interest" in the property. The report was "prepared for the exclusive use of Mr. Irv Williams" and not intended for any others, specifically stating: "No other may use this report for any purpose without prior written approval from the authors" (Record, p 50).

[31] Conversely, but confusingly, the Appraisal Report indicates that the opinions expressed are those of Bourgeois only, not those necessarily of Bourgeois & Co (Record, pp 56 and 90), but the Affidavit sworn by Leitch indicated that Bourgeois advised him he had not personally prepared the report (Record, p 2). Although this statement is on its face hearsay, it is admissible as an admission against interest (see *Hearsay in Civil Litigation*, Renke W, JCQBA, Legal Education Society of Alberta, *Civil Advocacy Series: Evidence*, May 2 and 4, 2017, paras 51-53; ***R v SGT***, 2010 SCC 20 at para 20, ***R v Couture***, 2007 SCC 28 at para 75).

[32] The Letter of Transmittal reflects the inspection of the 11.36 acres on November 21, 2011, and consultation with developers and the City of Edmonton Planning and Development Team to discuss issues associated with the development of the property. It indicated that the valuator used both a direct comparison approach (gathering sales of comparable development land) and a "land residual (cost of development technique)" approach, assuming 58 lots could be developed and marketed at prices consistent with the market (forecasting sales of lots over a defined period, deducting costs of development and discounting net results). It indicated that the direct comparison approach supported a value of between $180,000 and $330,000 per acre and the land residual cost of development approach supported a total value of $3,557,000, equating to $313,116 per acre.

[33] Important assumptions in the land residual cost of development approach were set out in the Letter of Transmittal:

(a) the 11.36 acres will be developed with 58 RF1 single-family lots;

(b) construction will start in March 2012 and be completed within eight months;

(c) an absorption period of 24 months is anticipated for the sale of these lots starting in June 2012;

(d) average price will be $180,000 for standard lots and $215,000 for pie-shaped lots;

(e) development costs will be consistent with the intended development;

(f) typical developer's profit will be 25% of all costs;

(g) discounting of residual revenue stream will be 8.5%.

[34] Taking all of the assumptions into account, the Letter of Transmittal anticipated total sales revenue for 58 single-family lots of $10,860,000, total cost to produce those lots of $5,284,789, and expected developer's profit of $1,321,197 (Record, pp 49-51).

IV. The Appraisal Report

[35] The Appraisal Report is set out at pp 52-111 of the Record. Like the Letter of Transmittal, it provides that it may not "be used for any other purpose other than that of the applicant, without the previous written consent of the appraiser" (Record, p 57).

[36] It indicates that the date of valuation was to be as at November 21, 2011, the highest and best use of the land was subdivision and development into approximately 58 single-family lots, and the purpose of the appraisal was to provide an estimate of market value of the fee simple interest in these 11.36 acres "to assist in the purchase and financing of the property" (Record, p 57).

[37] The scope of appraisal was to be in accordance with the Canadian Uniform Standards of Professional Appraisal Practice, utilizing both the direct comparison approach and land residual cost of development approach, deducting in the latter all costs from gross revenues in the appropriate time frame and then discounting results in valuation of the property (Record, p 58).

[38] Based upon a competitive and open market, a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming price is not affected by any undue stimulus, estimated market value was $3,557,000 (Record, p 59).

[39] The appraisal included examination of the Elsinore Area Structure Plan and Neighbourhood Structure Plan, and reflects conversations with City of Edmonton personnel (Record, pp 66-67), including advice as to offsite levies and downstream drainage infrastructure (Record, p 68). The Appraisal Report indicates confidence "that the future use of the subject lands will be consistent with that approved in the NSP" (Record, p 75) and that "about 58 lots can be developed on the subject parcel" (Record, p 77).

[40] There is no specific mention in either the Letter of Transmittal or the Appraisal of the remnant parcels, but a review of the area outline on the aerial photographs, included only to assist the reader in visualizing the property (Record, p 57), appears to include at least some of the remnant lands within the 11.36 acres (Record, pp 52 and 72). The copy of the included registered plan for the 11.36 acres (Record, p 73) also does not indicate any of the remnant parcels, but the lot diagram includes some or all of the remnant parcels (Record, p 77).

[41] Discussion of the direct comparison approach says that the 11.36 acres of land is "imminently developable" and that "all approvals to the NSP stage are complete" (Record, p 79). The land residual cost of development analysis estimated all costs required to produce and sell the lots, based on current market cost information (Record, p 82).

[42] The land residual cost of development analysis makes significant assumptions about the number and size of lots, the sale prices of those lots, absorption period of 2.5 lots per month for 24 months with paid up sales starting June, 2012 and total sellout by May, 2014, demolition costs of the existing farm buildings, offsite levies and downstream drainage costs, taxes during construction, servicing costs over an eight month construction period starting March, 2012 and ending October, 2012, interim financing charges ending December, 2013, marketing costs,

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developer's profit, and discount rate over a 27 month development and sales period (Record, pp 84-85).

[43] The assumptions and final result as set out in the Letter of Transmittal are repeated in the Appraisal (Record, pp 88-89) signed by Guy J. Bourgeois, AACI, P.App., C.R.P., but on stationary bearing the title "Bourgeois & Company".

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V. The Parties to the Contract

[44] 541 and Williams plead breach of contract by Bourgeois & Co, alleging that the Defendant failed to take appropriate and reasonable steps when conducting the appraisal by failing to take into account the existence of the remnant parcels (Statement of Claim, paras 8, 9 and 13), that the Plaintiffs acquiring those parcels was essential to the most profitable development of the subject land, and accordingly the costs of acquiring those additional lands was material to a determination of the appraised market value of the lands (Statement of Claim, para 14). On the other hand, Bourgeois & Co says there is no privity of contract between 541 and Bourgeois & Co; it was 541, not Williams, that entered into the contract with the Horricks family, and if any damages were suffered, it was 541 that suffered those damages (Statement of Defence, paras 9 and 15). In the alternative, Bourgeois & Co say that the Appraisal Report met all of the terms, requirements and objectives of the contract (Statement of Defence, paras 11, 12 and 15).

[45] What is clear from the documentation is that the contract of November 9, 2011 was between Williams personally and either Bourgeois or Guy J. Bourgeois, AACI, P.App, CRP. I find that in any event, Bourgeois was acting on behalf of and in his capacity as an employee of Bourgeois & Co, particularly since the Appraisal Report was on Bourgeois & Co stationary, and Bourgeois, reported that he did not personally draft the Appraisal Report.

[46] It is also clear on the face of the contract that Williams' closely held corporation, 541, is not a party to the contract. 541 was the sole purchaser of the 11.36 acres in question (Record, pp 113-119). However, the parties seeking development approval from the City of Edmonton are both 541 and Williams (Affidavit of Kit Leitch, Record, pp 1-2, paras 1, 2, 3, 4, 7 and 8). There is no requirement that because 541 purchased the 11.36 acres, only it could apply for a development permit, change in land use designation or subdivision (see *Municipal Government Act*, RSA 2000, c M-26, Division 5: Land Use, ss 639-642).

[47] *Edmonton Zoning Bylaw* no. 12800, provides in s 13.2(1)(c) that development applicants only require "confirmation of the owner's authorization to apply for the Development Permit", and in s 24.2 that an applicant for re-zoning need only set out an "interest in the property". Likewise, the *Subdivision and Development Regulations*, AR 43/2002, provide in s 4 that "the owner of a parcel of land, or a person authorized by the owner of a parcel of land, may apply for subdivision of that parcel of land...". Williams could make the development applications referenced by Leitch, in his own right, and apparently did. If the City of Edmonton has refused such development applications, damages, if any, are suffered not only by 541 but by Williams in his own right. There is no privity of contract issue with respect to Williams.

[48] If I am mistaken in that regard, I examine below the law with respect to privity of contract.

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VI. Privity of Contract

[49] The concept of privity of contract is well established: "only a person who is a party to a contract can sue on it", and to be able to enforce a contract, "consideration must have been given by [the person claiming the benefit of the contract] to the promisor" (***Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd*** [1915] AC 847 at 853 (HL).

[50] The strict application of the doctrine of privity of contract has been severely criticized: "The justifications offered for the privity doctrine...are quite unconvincing" (see McCamus, JD, *The Law of Contracts* (2d), 2012, at 307). It is said that the doctrine is a product of "circular reasoning" and "inconsistent with consideration theory" (at 307). Third party beneficiaries of a contract can enforce their promises in American law (Eisenberg, MA, *Third Party Beneficiaries* (1992), Colum. L. Rev. 1358) and New Brunswick (*Law Reform Act*, SNB 1993, c L-1.2, s 4). It has also been recognized that elsewhere in common law Canada: "the general rule has survived, though...its force has been significantly undermined by a growing list of exceptions to the rule" (McCamus at 308).

[51] There have generally been recognized four traditional exceptions to the doctrine of privity of contract: agency, trust, collateral contract and equitable assignment of contract.

[52] In the law of agency, where a principal authorizes an agent to enter into contracts on the principal's behalf, the principal has a direct contractual relationship with the third party (Fridman, GHL, *Canadian Agency Law* (2d), 2012). However, the application of an agency analysis rests on a "finding of a genuine intention to create a relationship of agency" (McCamus at 312). There was no evidence in this case that these parties had such a genuine intention as at November 9, 2011.

[53] The same problem arises with respect to a trust analysis, whereby the right to enforce the contractual obligation, a *chose in action*, as a matter of trust, will only apply where it is clear that the parties actually intended to create a trust relationship. See ***Re Schebsman*** [1944] Ch 83 (CA) and ***Fournier Van & Storage Ltd. v. Fournier*** [1973] 3 OR 741 (HCJ). Again, there was no evidence in this case that a clear intention to create a trust existed on November 9, 2011.

[54] Similar concerns exist with respect to the exceptions of collateral contract and equitable assignment of contract. The Plaintiffs did not adduce evidence to support the assertion that the parties had agreed, expressly or impliedly, that Williams could enter into a collateral contract within the contemplation of the parties, or equitably assign the benefit of Williams' contract with Bourgeois or Bourgeois & Co to 541. The inference of an intended collateral contract or equitable assignment of contract would be artificial, and furthermore, any implied term must be founded on an objective basis having regard to "the specific parties and specific contractual context" (***Energy Fundamentals Group Inc v Veresen Inc***, 2015 ONCA 514 at paras 36-38).

[55] In addition to these traditional exceptions to the doctrine of privity of contract, the Supreme Court of Canada fashioned a "principled exception" in ***London Drugs Ltd v Kuehne & Nagel International Ltd***, [1992] 3 SCR 299, [1992] SCJ 84, and ***Fraser River Pile & Dredge Ltd v Can-Dive Services Ltd***, [1999] 3 SCR 108.

[56] In ***London Drugs***, a contract was entered into between a corporation and a customer. It contained a limitation of liability cause which restricted the liability of the corporation to forty dollars. An action was initiated by the customer against the employees of the corporation who relied upon the limiting contractual provision as a defence. It was argued by the customer that

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the employees could not take advantage of the limitation of liability clause in the contract, as they were not parties to the contract. The Supreme Court of Canada said with respect to the doctrine of privity at 246:

> The doctrine of privity fails to appreciate the special considerations which arise from the relationships of employer-employee and employer-customer. There is clearly an identity of interest between the employer and his or her employees as far as the performance of the employer's contractual obligations is concerned. When a person contracts with an employer for certain services, there can be little doubt in most cases that employees will have the prime responsibilities related to the performance of the obligations which arise under the contract. This was the case in the present appeal, clearly to the knowledge of the appellant. While such a similarity or closeness might not be present when an employer performs his or her obligations through someone who is not an employee, it is virtually always present when employees are involved. Of course, I am in no way suggesting that employees are a party to their employer's contracts in the traditional sense so that they can bring an action on the contract or be sued for breach of contract. However, when an employer and a customer enter into a contract for services and include a clause limiting the liability of the employer for damages arising from what will normally be conduct contemplated by the contracting parties to be performed by the employer's employees, and in fact so performed, there is simply no valid reason for denying the benefit of the clause to employees who perform the contractual obligations. The nature and scope of the limitation of liability clause in such a case coincides essentially with the nature and scope of the contractual obligations performed by the third party beneficiaries (employees).

[57] The Supreme Court of Canada extended this logic in ***Fraser River***, where an owner chartered vessels to a third party charterer, insured by the owner under a hull subscription policy. The policy, a contract between the owner and the insurer, contained a waiver of subrogation clause which stated that the insurers waived any right of subrogation. The vessel being towed by the charterer sank, the owner recovered from the insurers and then pursued a subrogated action against the charterer in negligence. The charterer relied upon the waiver of subrogation clause in the policy between the owner and insurer, even though it was not a party to that contract.

[58] The Court said that ***London Drugs*** had created "a principled exception to the common law doctrine of privity of contract" (para 24), and went on to "note that it was not [its] intention in *London Drugs, supra*, to limit application of the principled approach to situations involving only an employer-employee relationship" (para 31). It said at para 32:

> In terms of extending the principled approach to establishing a new exception to the doctrine of privity of contract relevant to the circumstances of the appeal, regard must be had to the emphasis in *London Drugs* that a new exception first and foremost must be dependent upon the intention of the contracting parties. Accordingly, extrapolating from the specific requirements as set out in *London Drugs*, the determination in general terms is made on the basis of two critical and cumulative factors: (a) Did the parties to the contract intend to extend the benefit in question to the third party seeking to rely on the contractual provision; and (b) Are the activities performed by the third party seeking to rely on the contractual provision the very activities contemplated as coming within the scope of the

contract in general, or the provision in particular, again as determined by reference to the intentions of the parties?

[59] More recently, the Ontario Court of Appeal addressed the relaxation of the doctrine of privity of contract as a "sword" rather than a "shield" as had been the situation in the ***London Drugs*** and ***Fraser River*** cases. In ***Brown v Belleville (City)***, 2013 ONCA 148, the municipality had agreed with a local farmer to maintain and repair part of a storm sewer drainage system. The first farmer sold the land to a second farmer who later sold it to the Browns, the current plaintiffs. The Browns requested that the municipality honour its contractual obligation to the first farmer and the municipality defended on the basis that it had no privity of contract with the plaintiff. The Court of Appeal firstly found there was an enurement clause in the original contract which clearly demonstrated it was within the contemplation of the parties that there would be subsequent owners of the property entitled to take advantage of the contractual provisions. However, in *obiter*, the Court addressed the privity of contract issue at para 79:

> It is important to note at the outset that the doctrine of privity of contract is of considerably diminished force in Canada as a continuing principle of contract law. It has been subject to a wealth of repeated academic and judicial criticism, leading to frequent calls for law reform in Canada and elsewhere....Several of the leading cases cited by the parties on this appeal afford abundant evidence of the relaxation of the ambit of the doctrine in particular cases. Thus, while the doctrine survives in Canada, it persists only in weakened form.

[60] On the other hand, Alberta authorities have tended to apply the principled exception to privity only when the third party beneficiary uses the contractual term to defend an action, not when advancing a claim (see ***375069 Alberta Ltd v 400411 Alberta Ltd***, 2000 ABQB 29 at para 43; ***Parwinn Developments Ltd v 375069 Alberta Ltd***, 2000 ABQB 31 at para 33).

[61] The issues here, therefore, are whether under the circumstances Williams and Bourgeois or Bourgeois & Co intended to extend the benefit of their contract to 541, whether the activities performed by 541, purchase of the 11.36 acres in question and the development applications referenced above, were the very activities contemplated as coming within the scope of the contract, and whether 541 should be entitled to rely upon the principled exception to privity of contract in the context of an action for breach of contract, as opposed to a defence to such an action.

[62] Clearly, the activities performed by 541 were the very activities contemplated by the contract between Williams and Bourgeois or Bourgeois & Co: the purchase of the 11.36 acres with a view to "be subdivided in a fashion that is consistent with surrounding properties" so as to allow "acquiring and developing these lands" (Record, p 45).

[63] I am invited by Williams to take judicial notice (Supplementary Brief of the Plaintiffs, paras 25-27; and Supplementary Brief of the Plaintiff on Judicial Notice) that virtually all land acquisitions for the purpose of application for commercial development permits, change in land use designation and subdivision in Edmonton occur through bodies corporate, rather than by individuals. The Supreme Court of Canada said in ***R v Find***, 2001 SCC 32, at para 48:

> ...a court may properly take judicial notice of facts that are either: (1) so notorious or generally accepted as not to be the subject of debate among reasonable persons; or (2) capable of immediate and accurate demonstration by resort to readily

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> accessible sources of indisputable accuracy: *R v* Potts (1982), 1982 CanLII 1751 (ONCA), 66 CCC (2d) 219 (Ont. C.A.); J. Sopinka, S. N. Lederman and A. W. Bryant, The Law of Evidence in Canada (2nd ed. 1999), at p 1055.

(See also CED Evidence XVII.1, *Judicial Notice*, s 1038; *Judicial Notice: Dispensing with Proof*, Graesser, R, JCQBA, Legal Education Society of Alberta, *Civil Advocacy Series: Evidence*, May 2 and 4, 2017; ***R v Meadowbrook Management Ltd***, 2001 ABPC 245 at para 13, quoting from ***Canada Post Corp v Smith*** (1994), 118 DLR (4th) 454 (Ont Ct Gen Div); ***R v Spence***, (2005) 3 SCR 458 at paras 53-57 and 60-62; and Sopinka, Lederman & Bryant, *The Law of Evidence in Canada*, 4th, 2014, at 1322).

[64] The Supreme Court of Canada said in ***Southcott Estates Inc v Toronto Catholic District School Board***, 2012 SCC 51, at para 1: "Real estate developers frequently create single-purpose corporations for the sole purpose of purchasing and developing properties for profit."

[65] A review of the matters before the City of Edmonton Planning Officer, Subdivision Authority, and the Subdivision and Development Appeal Board bears that out. It would not have been a surprise to any of Williams, Bourgeois or Bourgeois & Co that Williams would use his closely held corporation for the purposes of purchase and development. I therefore take judicial notice of that practice.

[66] Finally, I conclude that the law has evolved with respect to the principled exception to the doctrine of privity of contract since the Alberta decisions noted above which would limit the use of that exception to matters of defence, rather than advancing a claim, and in that regard, I would adopt the position of the Ontario Court of Appeal in ***Brown***.

[67] As a result, had I determined it was necessary to determine the privity of contract issue to dispose of this matter, I would have found that 541, although not a party to the contract between Williams and Bourgeois or Bourgeois & Co, is entitled to rely upon that contract as a third party beneficiary in advancing its claim in this matter.

VII. The Breach of Contract

[68] The email contract of November 9, 2011 was to estimate an appropriate purchase price for the 11.36 acres so that it could be developed to "[its] highest and best use"; that is, to be "subdivided in a fashion that is consistent with surrounding properties" (Record, pp 44-45). The contract indicated that Bourgeois or Bourgeois & Co would investigate the issues and costs that may be incurred "in the course of acquiring and developing these lands". To that end, Bourgeois or Bourgeois & Co utilized a "cost of development technique" that would show the "revenue from the sale of lots" on these lands. The contract also indicated that it would estimate the cost to "produce those lots and make them available to the public" (Record, p 45).

[69] Those words in the email contract of November 9, 2011 make it clear that what Bourgeois or Bourgeois & Co were contracted to do was to provide an appraisal estimating the appropriate purchase price of these lands so that residential development could occur on the land. This process would, without doubt, require the issuance of a development permit, re-zoning of the lands from AG to perhaps RF1, and subdivision. No one could have understood otherwise.

[70] The Letter of Transmittal confirms this. It refers to the 11.36 acres as "development land" (Record, p 49) and contemplated "redevelopment to a residential subdivision" (Record, p 50), reports on consultation with developers and the City of Edmonton Planning and Development

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Team "associated with the development of this property" (Record, p 50), and assumes that 58 lots "could be developed and marketed" (Record, p 50). It reports using a "cost of development technique", deducts the costs of development, and assumes that the land will be "developed with 58 RFI single-family lots" (Record, p 50). It provides that Bourgeois or Bourgeois & Co have "excellent information regarding development costs" and have applied that information "consistent with the intended development", allows for a "developer's profit" and provides an estimate clearly contemplating such development (Record, pp 50-51).

[71] The Appraisal Report advises that the highest and best use of the land is subdivision and development into approximately 58 single-family lots and describes the property type as "Development Land" (Record, p 55). It indicates that these lands are completely surrounded "in its entirety with single-family homes, medium density projects and retail typical of an established residential subdivision" (Record, p 64), and confirms that these lands are "intended for residential single-family lots" (Record, p 66).

[72] Throughout, the Appraisal Report contemplates purchase of this property for the purpose of development application, re-zoning, subdivision and construction of single-family lots, condominiums or duplexes (Record, pp 66, 68, 70, 75, 77, 79, 82-85, and 87-88). Bourgeois or Bourgeois & Co clearly contemplated that their function was to "estimate all costs required to produce and sell the lots" (Record, p 82).

[73] I find that the contract was clearly a contract to determine all costs that could reasonably be expected to be incurred in purchasing, developing, re-zoning, subdividing and selling single-family lots on the 11.36 acres. In fulfilling this duty, Bourgeois or Bourgeois & Co clearly knew that they had to arrive at a cost that took into account and considered the lands and development surrounding this parcel (Record, pp 49, 50, 55, 64, 67, 68, 77 and 88), and to do so Bourgeois or Bourgeois & Co would be required to consult with developers and in particular, with the City of Edmonton Planning and Development Team to "discuss the issues associated with the development of this property" (Record, p 50, 67, 68 and 79). The Appraisal Report also included Edmonton Zoning Bylaw extracts (Record, pp 92-93).

[74] The only substantial contractual issue is whether Bourgeois or Bourgeois & Co was reasonably required to identify and "flag" the remnant parcels as being an issue that would need to be known and evaluated by Williams to determine whether the "costs, effort and risk are viable" (Record, pp 44-46).

[75] Bourgeois & Co has argued that there are significant reasons why the Appraisal Report could not be relied upon by 541 or Williams, but none of those reasons are material as to whether or not the remnant parcels should have been identified as a potential impediment to development, re-zoning and subdivision. Those non-material arguments were:

i. The Appraisal Report was said to be only valid as at November 21, 2011, but the steps taken with regard to this property were significantly delayed after that date:

   (a) The real estate purchase contract between 541 and the Horricks was not signed until July 25, 2012;

   (b) Leitch was not retained until November, 2012;

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(c) The issue of the remnant lots was not determined until January, 2013;

(d) The development applications and re-zoning proposals were not made until February, 2013, and June or July, 2013; and

(e) the Transfer of Land from the Horricks to 541 was not registered until January 14, 2014;

ii. Williams or 541 did not purchase the land from the Horricks at the amount set out in the Letter of Transmittal or Appraisal Report: $3,557,000 (Record, p 51). Instead, the purchase price was $3,800,000 plus GST, allocated as $1,575,000 for buildings and $2,225,000 for land (Record, pp 113-114); and

iii. The Letter of Transmittal and Appraisal Report contemplated the development of the lands for 58 single-family lots, whereas the applications to the City of Edmonton were firstly for 53 single-family lots and 70-75 low-medium density condominium units (Record, pp 1 and 162), and later for single-family lots and duplexes (Record, p 2).

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[76] I find it was essential to the completion of the contract between the parties that Bourgeois or Bourgeois & Co should have at least identified the existence of the remnant lots and flagged them for consideration by Williams. Some or all of the remnant lots are wholly or partially identified either within or immediately outside the 11.36 acres in the subject site-aerial view (Record, p 72), and the development land sketch (Record, p 77) of the Appraisal Report, but on the other hand, are not identified nor acknowledged in the written text of the Letter of Transmittal or Appraisal Report, nor on the diagrams or plans of the property at pp 67, 68 or 73 of the Record.

[77] The Plaintiffs have established a breach of contract.

VIII. The Tort of Negligence

[78] In addition to the pleadings alleging breach of contract, 541 and Williams plead negligence on the part of Bourgeois & Co, as set out in paragraphs 15 and 16 of the Statement of Claim, which negligence was denied in the Statement of Defence at paragraphs 8, 13, 14 and 15.

[79] McCamus, *supra*, says that the breach of a party's contractual duty to another may also constitute a tort imposing compensable injuries upon a third party to the contract, and is thus another device for avoiding the third party beneficiary rule (p 315). McCamus also indicates that in some cases the tort duty owed to the third party appears to arise directly from the breach of contract (p 315). I find, as I did with the consideration of breach of contract, that 541 was reasonably within the contemplation of the parties, so as to create a duty of care in Bourgeois and Bourgeois & Co.

[80] There was no claim advanced, such as is standard with respect to land valuation and appraisals, in negligent misstatement pursuant to the principle in ***Hedley Byrne & Co v Heller & Partners Ltd***, [1964] AC 465 (HL). In ***Hedley Byrne***, the duty of care in making a representation was said to arise out of a relationship between the parties that was as close to contract as possible or "equivalent to contract". Because I have found a contract between Williams and Bourgeois or Bourgeois & Co, and, if necessary, the ability of 541 to rely upon that contract as a third party

beneficiary, it is not necessary to engage in a detailed analysis of the duty of care in negligent misrepresentation aside from contract.

[81] As a result, this Court is left to examine the issue of negligence on a traditional analysis: duty of care, standard of care, breach of the standard of care, causation and damages.

[82] Each of the parties provided expert standard of care evidence from real estate appraisers licensed through the Real Estate Council of Alberta. The Plaintiffs' expert, Ivan Weleschuk ("Weleschuk"), is a Designated Appraiser – Commercial with the Canadian National Association of Real Estate Appraisers, which association requires members to follow the Uniform Standards of Professional Appraisal Practice, the American appraisal standards. The Defendants' expert was John Farmer ("Farmer"), an accredited appraiser with the Appraisal Institute of Canada, which created the Canadian Uniform Standards of Professional Appraisal Practice ("Standards") (Record, pp 317-395).

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[83] The relevant provisions of the Standards include:

> 6.2 **Rules**
> In the report [see 7.1] the Appraiser must:
>
> ...
>
> > 6.2.9 identify the location and characteristics of the property and the interest appraised; [see 7.10]
>
> 7.10 **Characteristics of the Property** [see 6.2.9, 12.21]
>
> 10.1 Relevant to the purpose and intended use of the report, strengths and weaknesses must be analyzed and included in the report:
>
> ...
>
> > 7.10.1.vi. Consideration of known detrimental conditions [see 12.22]
>
> ....
>
> 12.21 Characteristics of the Property [see 6.2.9]
>
> > 12.21.1 ...Any unusual aspect and any contrasts between the subject property and adjoining uses should be highlighted....
>
> ...
>
> 12.22 Detrimental Conditions [see 7.10.1.vi]
>
> > 12.22.1 When qualified specialists have documented the existence of detrimental conditions and estimated the costs of remediation or compliance, an appraiser may be in a condition to develop an opinion of "as is" value and should be aware of, understand and correctly employ those recognized methods and techniques necessary to produce a credible appraisal.

[84] Both experts provided opinions based upon the Standards (Record, pp 317-395).

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[85] The Plaintiffs' expert, Weleschuk, criticized Bourgeois and Bourgeois & Co for relying on a dated Neighbourhood Structure Plan approved in September, 1985, well before any development had occurred within this area of Edmonton. He said on cross-examination on affidavit, in explaining his concern that Bourgeois and Bourgeois & Co ignored the subsequent development of the area:

> ...there is no mention in the appraisal report of what the surrounding development is as far as lot sizes, land uses, and whether those – that surrounding development – would impact what he could do...how the surrounding area might impact his – subject property. (Record, pp 435-436)

[86] Weleschuk indicated that Bourgeois and Bourgeois & Co undertook to investigate the issues and costs that might be incurred in the course of developing the lands in question. He said that in doing so, it was important to identify the location and characteristics of the property (Standards, s 6.2.9), and in his opinion it was an:

> ...obvious characteristic of the Subject Lands...that the undeveloped parcel is surrounded by existing residential subdivisions and undeveloped or remnant lands or parcels [which] may impact the density and number of lots, the cost of development and the timing of development. (Record, p 311)

[87] Weleschuk was of the opinion that Bourgeois and Bourgeois & Co was required:

> ...at a minimum, to clearly set out in his appraisal report as a Limiting Condition either that he ignored any issues that may arise as a result of such remnant parcels or that such remnant parcels may adversely impact the developmental area, the size and number of lots, the cost of development and the timing of development. (Record, p 311)

[88] Weleschuk opined that a "more site specific analysis should have identified the potential impact the remnant parcels would have..." (Record, p 312).

[89] The Defendants' expert, Farmer, opined that Bourgeois "furnished his client with a report compliant with the professional standards required of him at that time". He said that it was "at all times outside the scope of work to consider the acquisition of additional lands, as these would be irrelevant to the specific vendor, and the purpose of the appraisal report" (Record, p 481).

[90] Farmer's analysis was based upon his interpretation of the contract as limited to assisting Williams "in estimating an appropriate purchase price on these lands" (Record, pp 486 and 489). I have found that the contract was broader than that and included consideration of the development and marketing of a subdivision including at least single-family lots consistent with the surrounding development, contemplating development application, re-zoning, subdivision and the development of the single-family lots.

[91] Farmer admits that the Neighbourhood Structure Plan included in the Appraisal Report "does not match the outline of the actual parcel...[which] encircles approximately 62 Lots so it is not clear which Lots the appraiser believed were included in the stated 58 Lots used in the preparation of the analysis" (Record, p 493). This difference may be explained by the inclusion or exclusion of the remnant parcels in the various diagrams or plans of the property, as indicated above (see Record, pp 67, 68, 72, 73 and 77).

[92] Farmer said:

> If the scope of work had required the appraiser to consider additional analysis, information pertaining to preliminary subdivision plans, estimated costs for servicing or any other approvals would likely have been provided by the Plaintiffs. (Record, p 487)

[93] Farmer points out that there was no such clear direction from the client so that the appraiser had to make "efforts to devise a valuation by making estimates and using assumptions" in Bourgeois' land residual analysis cost of development technique, and said that the "weakness of this approach is that the final indication of value will change if any one of these assumptions is altered. The more assumptions made, the weaker the value outcome:.." (Record, p 499). Additionally, he says: "There is, however, a general lack of support for the assumptions made in the report, with reliance based upon the appraisers' experience of appraisal and market conditions" (Record, p 501).

[94] In conclusion, Farmer indicated that it was his opinion "that the analyses, opinions and conclusions in the [Bourgeois] report under review are appropriate and reasonable" (Record, p 503), but again, that conclusion was based upon his limited view of the scope of the contract "to consider the value of a specific parcel of land, to assist in the acquisition of this parcel by their client from a specific vendor" (Record, p 503).

[95] Subsequently, Farmer was asked to answer two specific questions:

1. Considering the scope of his retainer and the evidence given in this action, did the cost of development [land residual] approach require Mr. Bourgeois to consider the remnant parcels in the course of his appraisal and either address them or specifically state that he ignored them in his Appraisal Report?

2. Considering the scope of Mr. Bourgeois' retainer and the evidence given in this action, were the remnant parcels "known detrimental conditions" as that phrase is used in the CUSPAP Standards?

[96] In answer to the first question, Farmer was of the opinion that the cost of development land residual approach did not require Bourgeois to consider the remnant parcels in the course of his appraisal nor to either address them or specifically state that he ignored them in the report. However, that conclusion was qualified by earlier statements that "this appraisal technique (based only in part on the cost of development [land residual] approach) is only used to arrive at a value estimate. It is not a feasibility analysis for development purposes" and "the only actual information that the appraiser had to rely on was a Neighbourhood Structure Plan (NSP), which is in itself, only a concept design for the location of predicting the preferred future type of land uses envisioned by the Plan" (Record, p 866). This conclusion is therefore again limited by Farmer's interpretation of a more restricted contract than I have determined above.

[97] In answer to the second question, Farmer was of the opinion that the remnant parcels could not be considered a "known detrimental condition" under the framework of the Standards which he said "appeared to relate to conditions on the land being appraised [as opposed to adjacent lands]" (Record, p 868).

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[98] Bourgeois and Bourgeois & Co submitted that the Standards differentiate between an appraisal report and a feasibility analysis; and their retainer was to do the former and not the latter. They said that an appraisal report sets out a formal opinion of value on a specific parcel (Record, p 320) while a feasibility analysis encompasses "the cost-benefit relationship of an economic endeavour" (Record, p 322).

[99] The relevant provisions are ss 11.10 and 12.47 of the Standards:

> 11.10 **Feasibility Analysis** [see 12.47]
>
> 11.10.1 In developing a feasibility analysis, a consultant must:
>
> 11.10.1.i. prepare a complete market analysis;
>
> 11.10.1.ii. apply the results of the market analysis to alternative courses of action to achieve the client's objective;
>
> 11.10.1.iii. consider and analyze the probable costs of each alternative;
>
> 11.10.1.iv. consider and analyze the probability of altering any constraints to each alternative;
>
> 11.10.1.v. consider and analyze the probable outcome of each alternative.
>
> ...
>
> 12.47 **Feasibility Analysis** [see 11.10]
>
> 12.47.1 The consultant should compare the following criteria from the client's project to the results of the market analysis:
>
> - The project budget (all construction costs, fees, carrying costs, and ongoing property operating expenses);
>
> - The time sequence of activities (planning, construction and marketing);
>
> - The type and cost of financing obtainable;
>
> - Cash flow forecasts over the development and/or holding period; and
>
> - Yield expectations.
>
> The consultant should have enough data to estimate whether the project will develop according to the expectations of the client and is economically feasible in accordance with the client's explicitly defined financial objectives.

[100] It is clear that the report prepared by Bourgeois or Bourgeois & Co was entitled "Appraisal Report". It is also clear that the contract did not contemplate a full feasibility analysis as defined in the Standards. However, I have found that the terms of the contract between the parties required more than a simple valuation of the lands in question for purchase, but contemplated purchase, development application, re-zoning, subdivision and sale of at least single-family units, and the identification of factors that would have a significant effect on the cost to do so. The contract, as I have determined it to be, falls somewhere between the narrow

scope of an appraisal report contemplated by Farmer, but less than a full feasibility analysis as defined in the Standards.

[101] Comparing the reports of Weleschuk and Farmer, I prefer and accept the Weleschuk opinion, given the scope of the contract between Williams and Bourgeois or Bourgeois & Co that I have determined above. The opinion of Farmer is founded upon a narrower scope of contract, which I do not accept and do not find.

[102] Having accepted the report of Weleschuk, and based upon the conclusions I have reached with respect to the contract issues above, I find that Bourgeois or Bourgeois & Co had a duty of care in preparing their Appraisal Report to Williams and 541, that the established standard of care would have been to identify and flag the existence of the remnant parcels so that Williams and 541 could determine whether the "costs, effort and risk [of the purchase and development of the 11.36 acres] are viable" (Record, pp 44-46) and that in failing to do so, Bourgeois and Bourgeois & Co failed to live up to that standard of care expected of a reasonably competent, equally situated appraiser.

[103] In the present case, any loss that may be suffered by Williams or 541 is a pure economic loss. Discussion as to whether pure economic loss is recoverable in the current circumstances under the analysis in ***Anns v Merton London Borough Council***, [1978] A.C. 728, and ***Nielsen v Kamloops (City)***, [1984] 10 DLR (4th) 641 (SCC), and the following cases, is best left for future discussion on damages, specifically reserved from the issue of liability before this Court.

IX. Conclusion

[104] In conclusion, I find that Williams entered into a contract with Bourgeois or Bourgeois & Co to determine all of the costs that could reasonably be expected to be incurred in purchasing, developing, re-zoning, subdividing and selling single-family lots on the 11.36 acres in question in this litigation. I find that 541 was not a party to this contract but there was nothing preventing 541 from purchasing the lands in question and having Williams, or each of them jointly, make the necessary applications for development approval, re-zoning and subdivision, such that if any damages were incurred, which is not the subject of the matter currently before me, they would have been incurred each of by Williams and 541, and are claimable through Williams as a party to the contract.

[105] If I am wrong in this conclusion, I find that the "principled exception" to the doctrine of privity of contract exists such that 541, as a reasonably contemplated third party beneficiary, is able to take advantage of the contract between Williams and Bourgeois or Bourgeois & Co.

[106] Additionally, I find that on a negligence analysis, Bourgeois and Bourgeois & Co had a duty to both Williams and 541 to identify and flag the existence of the remnant parcels for Williams and 541 in the Appraisal Report; that was the expected standard of care, and they failed to meet that expected standard of care.

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[107] I leave the issues of causation and damages to a further consideration.

Heard on the 31st day of March, 2017.
Dated at the City of Edmonton, Alberta this 5th day of June, 2017.

K.P. Feehan
J.C.Q.B.A.

Appearances:

James K. McFadyen, Q.C.
Parlee McLaws LLP
for the Plaintiffs

Donald J. McGarvey, Q.C.
McLennan Ross LLP
for the Defendant

2017 ABQB 363 (CanLII)

TAB 12

Parwinn Developments Ltd. v. 375069 Alberta Ltd., 2000 ABQB 31

Date: 20000126
Action No. 9903 02337

IN THE COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL DISTRICT OF EDMONTON

BETWEEN:

PARWINN DEVELOPMENTS LTD. AND PERRY NYGREN

Plaintiffs

- and -

375069 ALBERTA LTD.

Defendant

AND BETWEEN:

375069 ALBERTA LTD.

Plaintiff by Counterclaim
(Defendant)

- and -

PARWINN DEVELOPMENTS LTD. and PERRY NYGREN

Defendants by Counterclaim
(Plaintiffs)

REASONS FOR JUDGMENT
of the
HONOURABLE MR. JUSTICE J. L. LEWIS

2000 ABQB 31 (CanLII)

APPEARANCES:

W. MURRAY SMITH
for the Plaintiffs
(Defendants by Counterclaim)

BARRY D. YOUNG, Q.C.
for the Defendant
(Plaintiff by Counterclaim)

2000 ABQB 31 (CanLII)

[1] The plaintiffs seek judgment against the defendant for an unpaid real estate commission of $127,800.00, plus interest under the *Judgment Interest Act*, S.A. 1984, c. J-0.5, as well as any applicable goods and services tax and costs on a solicitor and his own client basis. The defendant denies the claim and counterclaims for a declaration that if a real estate commission is payable, the payment of the real estate commission would constitute a forfeiture and the plaintiff by counterclaim is entitled to relief against such a forfeiture.

ISSUES

[2] Plaintiffs' counsel's position is that the issues before the court are:

(1) What weight should be given to the evidence of John Ryan?

(2) Is there privity of contract between the plaintiff real estate agent and the defendant vendor such as to sustain an action for commission and, if not, alternatively, can this matter be brought within a principled exception to the doctrine of privity of contract? and

(3) Should the removal of the conditions precedent be enforced as the triggering event for the payment of the commission as provided for in paragraph 16 of the offer to purchase and agreement for sale ("the agreement")?

[3] Counsel for the defendant defines its position on the issues before the court as follows:

(1) The plaintiffs are under a misunderstanding that the case turns on deceit or fraud;

(2) Can the plaintiffs sue successfully for recovery of a commission on the basis of the agreement to which neither of the plaintiffs is a party;

(3) If the Court finds for some reason that there is privity between the plaintiff Nygren and the defendant, then the defendant asks the court to allow an amendment to the statement of defence and counterclaim to plead unilateral mistake and allow the remedy of rectification to be applied to the facts so that clause 16 of the agreement conforms to what Mr. Ryan understood it to be;

(4) If the Court finds that there is privity of contract between the plaintiffs and the defendant and that the plaintiffs cannot sue successfully on the agreement, then is there some other agreement that exists between the plaintiffs and the defendant? (Such agreement has not been pled by the plaintiffs. At the opening of trial, counsel for the defendant asked what agreement was being sued on by the plaintiffs. Plaintiffs' counsel stated that it was only the agreement); and

(5) What effect does this Honourable Court's decision in the first trial (***400411 Alberta Ltd.* v. *375069 Alberta Ltd.***) have on the instant case?

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FACTS

[4] The plaintiff, Mr. Nygren ("Nygren"), has been a licensed real estate broker in Calgary since the summer of 1986. In early 1989, after being associated with two real estate firms, he incorporated his own real estate company, the plaintiff, Parwinn Developments Ltd. ("Parwinn"). According to the plaintiffs, Nygren is the sole shareholder of Parwinn.

[5] In early 1989, Nygren contacted Mr. Ryan ("Ryan") of Coopers & Lybrand, chartered accountants, in Edmonton regarding a condominium property in Calgary, known as the Forest Lawn property. The Forest Lawn property was owned by Ryan's company, 386361 Alberta Ltd. ("386361"). Nygren's purpose in contacting Ryan was to determine if he was interested in selling the property, which Mr. Ryan was.

[6] Ryan has had many years of experience as a chartered accountant, trustee in bankruptcy and receiver manager with Coopers & Lybrand. He has had a vast experience in selling and marketing hundreds of properties throughout Canada and has dealt with realtors for upwards of 20 years.

[7] Nygren testified that he was working in conjunction with Mr. Pat Vuong ("Vuong") of Remax Real Estate North of Calgary. Vuong indicated to Nygren that he might have a buyer for the Forest Lawn property and, according to Nygren, he and Vuong made an agreement to split the commission on any sale.

[8] Vuong obtained an offer for the purchase of the Forest Lawn property. Nygren and Vuong brought the offer, dated May 1, 1989, to Ryan in Edmonton. On May 3, 1989, Ryan accepted the offer on behalf of the owner and vendor of the property, 386361.

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[9] The form of offer used in the Forest Law property sale was obtained from Ryan's lawyer, Mr. Romanko of Bryan & Company. This form of offer was used in the Forest Lawn property sale by filling in the blanks, with respect to the sale price, the deposit, when the balance of the purchase price was payable, the date the conditions precedent had to be concluded and the closing date of the sale. The commission clause in the form of offer provides:

> 16. COMMISSION
>
> The parties acknowledge that a real estate commission of Three (3%) percent of the gross sale price of the subject Property is payable to the Agent and, such shall be the responsibility of and shall be fully paid by the Vendor.

[10] In the form of offer for the Forest Lawn property, Remax Real Estate North is shown as the agent for the vendor, 386361. There was no listing agreement signed by Ryan, on behalf of 386361, with either of the plaintiffs, nor with Vuong or Remax Real Estate North. The Forest Lawn property sale closed, but I have no evidence as to whether a real estate commission was paid and if so to whom and the amount. However, I assume a commission was paid in view of the further attempted sale arranged by Nygren and Vuong with another of Ryan's companies.

[11] In any event, Nygren determined from Ryan that he had other properties held by other numbered companies that he would be interested in selling. A package of information on the other properties was obtained by Nygren from Ryan.

[12] Ryan indicated he would be prepared to entertain offers on two properties in Edmonton consisting of 208 townhouse units in total and referred to as the Townhouse and Wellington projects. These two townhouse properties are legally described as Lots 1, 2, 3, 4, 5 and 7 in Block 75, Plan 1837KS. Both properties were limited dividend projects, being controlled by C.M.H.C. through an agreement attached to its first mortgage on each of the properties. The purpose of the limited dividend projects is to provide low-cost housing for low income families.

[13] Vuong found a purchaser for the Townhouse and Wellington properties. This offer was set out in a form of offer to purchase and agreement of sale (the "purchase contract") prepared by Nygren. Nygren prepared this purchase contract using the form of purchase contract he had received from Romanko for the Forest Lawn property sale.

[14] The first draft of this purchase contract was directed to Remax Real Estate North, as agent for the vendor 386361. 386361 was the owner of the Forest Lawn property, but not the owner of the Townhouse or Wellington properties. Another numbered company of Ryan's, 375069 Alberta Ltd. ("375069"), was the owner of the latter properties. Therefore, another purchase contract was prepared and addressed to Remax Real Estate North, as agent for 375069, the vendor and owner. The purchase price remained the same in this revised purchase

contract, but the deposit was increased as Ryan had requested, that is, the deposit payable on the removal of the conditions set forth in the purchase contract was increased from a total of $75,000.00 to a total of $200,000.00 (This deposit amount includes both the initial deposit and the subsequent deposit). This purchase contract was accepted by Ryan on behalf 375069 after it was faxed to him and the original couriered to him.

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[15] Besides changing the sale price, deposit, closing date for the conditions precedent to be removed, and the date of closing of the sale, from the form of purchase contract used in the Forest Lawn property sale, Nygren also changed the commission clause in paragraph 16 to read as follows:

> 16. COMMISSION
>
> The parties acknowledge that a real estate commission of Three (3%) percent of the gross sale price of the subject Property is payable to the Agent and, such shall be the responsibility of and shall be fully paid by the Vendor. The real estate commission shall be deemed to have been earned upon removal of the Conditions Precedent and the Deposit monies shall apply firstly to the to [sic] pay the real estate commission and the parties authorize the Agent to deduct from the Deposit the real estate commission payable. The Vendor hereby irrevocably assigns out of the proceeds of the sale any unpaid balance of the real estate commission and the Vendor directs its solicitors to pay the same to the Agent upon completion of the sale. The Vendor hereby notifies both the Purchaser and its solicitor of this assignment.

[16] Nygren did not tell Ryan of this change to the commission clause in the purchase contract. According to Ryan, he asked Nygren if there were any changes in the purchase contract outside of the price, conditions, deposit and closing date and Nygren said there were no other changes. As with the Forest Lawn property sale, Ryan did not, on behalf of the owner, enter into a listing agreement with any real estate agent with respect to the Townhouse and Wellington properties. Ryan testified, and I accept his evidence, his general practice in 99 percent of the cases when he is selling property, is to never give a listing and to pay commission only upon completion. He testified that his unwavering practice is that no commission is paid until the deal is satisfactorily completed.

[17] The purchase contract on the Wellington and Townhouse projects is dated August 9, 1989. This purchase contract was accepted on August 15, 1989. The closing date was September 20, 1989, with the conditions precedent having to be waived by the purchasers by 12 o'clock noon on September 10, 1989. The date by which the conditions precedent had to be waived, as well as the closing date, were extended a number of times. Finally, on December 29, 1989, the conditions precedent were waived or removed by the purchaser and a closing date was agreed on of February 1, 1990. This closing date was subsequently extended to April 1, 1990. The sale never closed.

[18] Neither of the plaintiffs nor Remax Real Estate North nor Vuong are signatories to this purchase contract. 400411 Alberta Ltd. is the purchaser in this purchase contract.

[19] On January 22, 1990, Nygren on behalf of Nygren Real Estate Agencies, wrote a letter to Coopers & Lybrand, to the attention of Ryan, which Ryan acknowledged and approved on behalf of 375069. The letter states:

> Re: Sale of Townhouse Development Ltd.
> 13135 - 131 Street, Edmonton, Alberta
>
> ---
>
> This letter will re-affirm that upon closing of the sale of the above mentioned property to 400411 Alberta Ltd., the Vendor will pay a real estate commission of 3% of the gross sale price in accordance with paragraph 16 of the Offer to Purchase and Agreement of Sale.
>
> The Commission shall be payable to NYGREN REAL ESTATE AGENCIES and Nygren Real Estate Agencies shall be responsible to pay its sub-agent, REMAX REAL ESTATE NORTH, the selling portion of the commissions payable.
>
> Thankyou [sic] for your continued support and it is always a pleasure to do business with you.
>
> Yours truly,
>
> NYGREN REAL ESTATE AGENCIES
>
> Perry F. Nygren
> Real Estate Agent
> Land Agent
> 100, 209 19 STREET N.W.
> CALGARY, ALBERTA T2N 2H9
> Ph: 403-560-1607
>
> ACKNOWLEDGED AND APPROVED
> 375069 ALBERTA LTD.
>
> PER: ______________________
> John M. Ryan

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[20] According to Ryan, the reason for this letter is that when he found out that Nygren had changed clause 16 of the purchase contract to read that the commission was payable on the conditions being waived, he was livid with Nygren and phoned him and demanded a change in the purchase contract to reflect that the commission was payable on the closing of the sale and not on the conditions precedent being removed or waived. Nygren could not recall exactly what the circumstances were that gave rise to his writing the above letter, or that Ryan was upset with him. I accept Ryan's evidence on this issue.

[21] Nygren acknowledged that in most real estate transactions, he gets paid his real estate commission after the sale is concluded and the monies have been paid. He also testified that he sometimes gets paid his real estate commission after the conditions are removed, but this is totally dependent on the agreement made for the payment of commission.

[22] The first demand Nygren made on Ryan for payment of his commission was in a letter dated November 30, 1990. This was followed by a further letter from Nygren to Ryan on December 3, 1990 seeking payment of his real estate commission.

[23] The real estate commission has not been paid and thus the reason for this action, which was commenced with the issuance of a statement of claim on August 4, 1993 in the Judicial District of Calgary. This action was transferred to the Judicial District of Edmonton for trial, which followed immediately after the trial of the action commenced by the vendors against the purchasers, in which the purchasers seek, amongst other remedies, specific performance of the purchase contract or the return of their deposit monies of some $200,000.00. The vendor seeks amongst other remedies, an order of forfeiture of the deposit monies.

ISSUES OR QUESTIONS TO BE DECIDED

1. Is there a contract between the plaintiffs and the defendant to pay a real estate commission?

[24] Clearly in the purchase contract signed by the vendor, Remax Real Estate North is the agent for the vendor and the company to whom the real estate commission is payable under clause 16. A number of the cases counsel provided to me refer to this type of an agreement as a commission agreement, as opposed to a listing agreement. There was no listing agreement entered into in this case by the defendant vendor with anyone. The commission agreement in the purchase contract was made by the defendant vendor with Remax Real Estate North, not with the plaintiffs. Therefore, if clause 16, the commission agreement, could be enforced it could only be done by Remax Real Estate North.

[25] The plaintiffs argue that if they were not a party to the commission clause, Remax was its sub-agent and that the plaintiffs can benefit from the clause based on this agency relationship. I have no evidence whatsoever before me as to what, if any, arrangement was in

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place between Vuong or Remax and Nygren or his company. As a result, the defendant's argument is that Nygren was not consistent in his characterization of his relationship with Remax and is of no significance.

[26] Nygren stated at trial that he had an agreement with Vuong or Remax to share the commission. If this is the case, and I have no evidence before me to find that it is, Nygren's cause of action is against Remax not the defendants. The plaintiffs cannot use an alleged commission agreement between themselves and Remax as the basis for a claim against the defendants.

[27] If there had been an agreement between Nygren or Parwinn and the defendant vendor to pay a commission on the conditions precedent being waived or removed, I agree with counsel for the defendant vendor that the plaintiffs who drafted the contract, in particular clause 16, should have this clause construed *contra preferentum,* that is, against them: ***Alex Duff Realty Ltd.* v. *Eaglecrest Hldgs. Ltd,*** [1935] 5 W.W.R. 61 (C.A.). Clause 16 is ambiguous, because it says that the commission is deemed to be earned on the conditions precedent being removed, but it does not say when the commission would be payable. Therefore, even if the plaintiffs could rely on the clause, I find that it would not assist their claim.

[28] Second, if there had been an agreement between Nygren or Parwinn and the defendant vendor to pay commission, this Agreement was varied by virtue of the letter of January 22, 1990 from Nygren to the vendor, making the commission payable on the closing of the sale. Consequently, the agent was not entitled to a commission unless and until the sale was completed.

[29] How can the plaintiffs amend an agreement that they are not a party to? The case does not have to be decided on this point, as it is my finding that the plaintiffs have no cause of action, not being parties to the purchase contract.

2. Does an exception to the doctrine of privity of contract apply?

[30] Counsel for the plaintiffs argued at some length, particularly in his written brief, that the concept of privity of contract is evolving to the point where, he argues, his clients should have the benefit of the commission agreement in clause 16 of the purchase contract.

[31] The most recent case in which the doctrine of privity of contract was "extended" is a decision of the Supreme Court of Canada in ***Fraser River Pile & Dredge Ltd.* v. *Can-Dive Services Ltd.,*** [1999] S.C.J. No. 48. The decision of the Supreme Court of Canada is summed up in the headnote to the case as follows:

> As a general rule the doctrine of privity provides that a contract can neither confer rights nor impose obligations on third parties. Consequently,, a third-party beneficiary would normally be precluded from relying on the terms of the

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insurance policy between the barge owner and its insurers. Given the circumstances of this appeal, however, a principled exception to the privity doctrine applies. A new exception is dependent upon the intention of the contracting parties. This intention is determined on the basis of two critical and cumulative factors:

(a) The parties to the contract must intend to extend the benefit to the third party seeking to rely on the contractual provision; and

(b) The activities performed by the third party seeking to rely on the contractual provision must be the very activities contemplated as coming within the scope of the contract in general, or the provision in particular, as determined by reference to the intentions of the parties.

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[32] Clearly in this case, the plaintiffs are not the type of third-party beneficiaries contemplated by this Supreme Court of Canada decision, nor can it be said that the activities contemplated come within the scope of the contract in general as determined by reference to the intention of the parties. The defendant vendor intended to pay a commission if the sale was concluded. That commission would be payable to Remax under the terms of the purchase contract. Whatever arrangement Remax had with the plaintiffs would dictate what the plaintiffs receive, but I have no evidence, as I said, of this arrangement. I have no evidence that the parties to the purchase contract intended to extend the benefit of clause 16 to the plaintiffs.

[33] In ***Fraser River Pile**, supra,* the Supreme Court of Canada indicated that they were making a principled and incremental exception to the doctrine of privity in the particular circumstances of that case. The Court stated that the exception reflected commercial reality and did not introduce significant change to the law. The circumstances of the instant case are distinct from those in ***Fraser River Pile**, supra,* and to accept the plaintiffs' submission would introduce significant change to the basic tenets of contract law. Moreover, as defendant's counsel points out, the exception to the privity of contract concept in ***Fraser River Pile**, supra,* provides that the exception can be used as a shield, even though the party may not be privy to the contract. But, it cannot be used as a sword as the plaintiffs are attempting to argue in this case. I agree.

[34] Therefore, I am satisfied that there is no privity of contract between the defendant vendor and the plaintiffs and the exception in ***Fraser River Pile**, supra,* does not apply. Thus, the plaintiffs' claim fails on this basis.

3. Is there fraud, deceit or mistake?

[35] Plaintiffs' counsel argues that his clients have been ambushed by the defendant in its allegation of fraud or illegality committed by Nygren. This position has been denied by defendant's counsel. In any event, if such defence of fraud or illegality was raised by the defendant, it was not pleaded. Thus, the defendant has not complied with Rule 104 of the

Alberta *Rules of Court* (the "*Rules*") requiring the defendant to plead the material facts on which he relies for his defence. As well, Rule 109 of the *Rules* expressly mandates against ambush defences. See our Appeal Court's decision in ***McMurray Homes Ltd.* v. *New Town of Ft. McMurray***, [1976] 5 W.W.R. 442 and Master Funduk's decisions in ***Caskey* v. *Guardian Insurance Company of Canada***, [1994] 148 A.R. 251 and ***Edmonton Savings and Credit Union Ltd.* v. *124968 Construction Company Ltd. and Werenka***, [1985] 61 A.R. 296. In this case, as defendant's counsel points out, the defendant is not relying on deceit or illegality, nor has it been plead.

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[36] Defendant's counsel argues that if there is a valid contract found between the plaintiffs and the defendant to pay a real estate commission, that the defendant made a mistake in signing the purchase contract providing for the commission to be payable on the conditions precedent being removed, rather than on the conclusion of the sale. Again, this is not plead by the defendant, but counsel has requested that if a valid contract is found between the parties to pay a real estate commission that he be granted leave to amend his statement of defence to plead mistake. In view of my findings and decision, such application is not necessary.

[37] Moreover, in view of my findings, the decision in the first trial (***400411 Alberta Ltd.* v. *375069 Alberta Ltd.***) has no impact on the instant case.

[38] Plaintiffs' counsel has provided me with a number of other cases than those which I have mentioned in this judgment, but pretty well all of these involve the interpretation of a specific agreement, whether it be a listing agreement or some other type of agreement made between the real estate salesman and the vendor. One exception is the case of ***Northwestern Securities of Victoria Ltd.* v. *White*** (1962), 35 D.L.R. (2d) 666, in which the British Columbia Court of Appeal found that a real estate agent could not sue on an agreement when it was not made with him. There was a commission clause in the agreement for purchase and sale between the purchaser and vendor which the real estate agent sued on. In ***Northwestern Securities***, *supra*, as in our case, the real estate agent never signed the agreement for purchase and sale. Therefore, the real estate agent was not a party to the purchase and sale agreement and had no cause of action arising from it. The headnote to this case sums it up as follows:

> Lack of privity as a defence to an action on a contract is a question of law that need not be pleaded.
>
> Thus, where a real estate agent sued for commission as payable under a written contract (rather than for remuneration for services in effecting a sale of the vendor's property) and the contract relied on was an agreement of purchase and sale between the purchaser and vendor, and the undertaking to pay commission was part of the acceptance but there was no agreement with the real estate agent who was mentioned only as agent of the vendor and who signed only in respect of an acknowledgement of money paid to him on behalf of the vendor, *held*, on appeal, the real estate agent could not sue on the agreement when it was not made with him.

[39] Therefore, I find that the plaintiffs' action against the defendant fails for the reasons I have enumerated, and is dismissed, with costs to the defendant on double the appropriate column relative to the claim, no limiting rule to apply. I find there are no exceptional or contractual bases on which to award solicitor and client, or solicitor and his client costs.

HEARD on the 5th day of October, 1999.
DATED at Edmonton, Alberta this 26th day of January, 2000.

J.C.Q.B.A.

2000 ABQB 31 (CanLII)

TAB 13

COURT OF APPEAL FOR ONTARIO

CITATION: Brown v. Belleville (City), 2013 ONCA 148
DATE: 20130312
DOCKET: C55618

2013 ONCA 148 (CanLII)

Cronk, Armstrong and Epstein JJ.A.

BETWEEN

Graeme Brown and Monica Brown

Plaintiff (Respondents)

and

The Corporation of the City of Belleville

Defendant (Appellant)

R. Benjamin Mills, for the appellant

Robert J. Reynolds, for the respondent

Heard: December 7, 2012

On appeal from the judgment of Justice Gary W. Tranmer of the Superior Court of Justice, dated May 15, 2012, with reasons reported at 2012 ONSC 2554.

Cronk J.A.:

[1] This appeal concerns the enforcement of an agreement entered into in 1953 between a municipality and a local farmer. Under the agreement, the municipality agreed to perpetually maintain and repair that part of a storm sewer drainage system that it had constructed on and near the farmer's lands. About six years after it entered into the agreement, and in breach of its covenants under

it, the municipality ceased all maintenance and repair work on the drainage system.

[2] After the farmer's death in 1966, the affected lands were sold by his heirs to third parties. When the third parties sought in 1980 to hold the municipality to its obligations under the agreement, the municipality unilaterally repudiated the agreement.

2013 ONCA 148 (CanLII)

[3] As a result of a corporate amalgamation carried out in the late 1990s, the appellant, the Corporation of the City of Belleville (the "City"), stepped into the shoes of the original municipality under the agreement.

[4] In 2003, the lands were again sold, this time to the respondents, Graeme and Monica Brown. Within months of their acquisition of the lands, the Browns requested the City to honour its maintenance and repair obligations under the agreement. The City refused and, in mid-December 2004, again unilaterally repudiated the agreement.

[5] The Browns eventually sued the City for specific performance of the agreement or, in the alternative, damages for its breach. The City defended the action, asserting that the agreement was unenforceable, on numerous grounds.

[6] After the exchange of pleadings, the parties stated a Special Case under Rule 22 of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194, seeking the court's opinion on 14 questions concerning the agreement. The parties

ultimately agreed on the proper determination of six of the questions posed for the court's consideration and the motion judge's answers to those questions proceeded on consent. The motion judge granted various declarations of right in favour of the Browns in relation to the remaining eight questions.

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[7] The City appeals to this court in respect of three issues. Contrary to the motion judge's rulings, the City argues that: (1) the Browns' claims concerning the agreement are statute-barred; (2) the Browns have no standing to enforce the agreement since they have no privity of contract with the City; and (3) the agreement is contrary to public policy and, hence, unenforceable.

[8] For the reasons that follow, I would dismiss the appeal.

I. Facts

[9] The background facts are set out in the Special Case and are undisputed. As relevant to the issues on appeal, the agreed facts are as follows.

(1) The Agreement

[10] The Browns are the owners of approximately 230 acres of farmland in the City (formerly in the Township of Thurlow ("Thurlow")). Their property forms part of lands that were owned in the 1950s by Roy W. Sills.

[11] In 1953, Thurlow constructed a storm sewer drainage system along the frontage of Mr. Sills's lands and those of his neighbours, and on one of several lots owned by Mr. Sills. In order to maintain and repair the drainage system, as

needed, the municipality required continuing access to Mr. Sills's lands. Accordingly, on April 27, 1953, Thurlow entered into a written agreement with Mr. Sills (the "Agreement"), whereby Mr. Sills agreed to provide the necessary access on an indefinite basis in exchange for Thurlow's covenants that:

> (1) it would maintain the storm sewer in good working condition "at all times"; and
>
> (2) it would make good "any and all damage caused the Owner either by virtue of the original construction of the said sewer interfering now or in the future with the Owner's use and enjoyment of his land in any way or as a result of lack of repair or of acts done at any time by the Corporation in maintaining and repairing the said sewer".

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[12] The Agreement identifies Mr. Sills as the "Owner" of the affected lands and Thurlow as the "Corporation". The recitals to the Agreement state that Mr. Sills had or would receive "material benefits from the construction of the ... sewer" and that he paid the sum of $200 to Thurlow in consideration for these benefits.

[13] The Agreement also contains an 'enurement clause'. It reads: "THIS INDENTURE Shall [*sic*] inure to the benefit of and be binding upon the parties hereto and their respective heirs, administrators, successors and assigns."

[14] The Agreement was never registered on title to the affected lands.

[15] Mr. Sills died on June 26, 1966. By deed dated August 11, 1973, his heirs sold the property now owned by the Browns to John and Wendy Pleizier. No

express assignment of the Agreement in favour of the Pleiziers formed part of this transaction.

[16] The drainage system functioned satisfactorily for some years. However, when Thurlow ceased maintaining it after 1959, the system gradually began to deteriorate. As a result, over time, the Pleiziers and other affected landowners became unable to effectively drain their lands.

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(2) Thurlow's 1980 Repudiation of the Agreement

[17] In the fall of 1980, the Pleiziers brought the Agreement to Thurlow's attention. On December 10, 1980, Thurlow's solicitors wrote to the Pleiziers, indicating that Thurlow was "no longer bound" by the Agreement and that Thurlow was "not prepared to take any action with respect to the repair or maintenance of the ditch".

[18] The parties agree that the Pleiziers took no action to enforce the Agreement or to otherwise pursue it with Thurlow. Indeed, there is no evidence that the Pleiziers responded in any way to the December 1980 letter from Thurlow's solicitors.

[19] Thurlow and the City of Belleville amalgamated in 1998. The City acknowledges that as a result of the amalgamation, by operation of law, it is bound by Thurlow's obligations under the Agreement. The City also accepts that those obligations are perpetual.

(3) The City's Subsequent Repudiations of the Agreement

[20] The Browns purchased their property from the Pleiziers on August 27, 2003. As with the Pleiziers' acquisition in 1973, no express assignment of the Agreement formed part of this transaction.

[21] The Browns were unaware of the existence of the drainage system and the Agreement when they agreed to buy their property from the Pleiziers. However, the Browns were provided with a copy of the Agreement around the time of the closing of the sale transaction.

[22] On September 20, 2004, the Browns requested that the City "meet its obligations under the Agreement". By letter dated December 15, 2004 to the Browns, the solicitors for the City responded: "[D]ue to the considerable lapse of time of approximately 45 years, it is Council's position that they are not bound by the Agreement and are not prepared to take any action in constructing or maintaining the drainage works."

[23] There is no evidence in the Special Case regarding what, if anything, transpired between the City and the Browns concerning the Agreement for about the next five and one-half years. The agreed facts merely stipulate that after the City's December 2004 letter, "further discussions went nowhere", and that this litigation followed.

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[24] Correspondence cited in the Special Case includes a letter to the Browns dated August 3, 2010, in which the City's solicitors mentioned a meeting among the parties and their solicitors held on May 31, 2010. In the same letter, the City's lawyers reiterated: "[I]t is the City's position that it bears no responsibility to the present landowners under the 1953 Agreement and accordingly the City is not prepared to take any action in constructing or maintaining the drainage works."

(4) The Special Case

[25] On July 20, 2011, the Browns sued the City for specific performance of the Agreement or, in the alternative, for damages for its breach. The City defended the action, asserting, on numerous grounds, that it is not bound by the Agreement and that the Agreement is unenforceable as against it. Shortly thereafter, the parties agreed to submit a Special Case to the Superior Court of Justice for determination of a variety of their respective rights and obligations in relation to the Agreement.

[26] Fourteen questions were posed by the parties for the opinion of the court on the Special Case. The City conceded that six of the questions should be answered in favour of the Browns and the motion judge issued declarations of right in the Browns' favour, on consent, in respect of those questions. After

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argument, he also granted declarations of right in favour of the Browns concerning the remaining questions on the Special Case.

II. Issues

[27] On this appeal, the City challenges the motion judge's rulings on three issues. It contends that the motion judge erred by holding that:

> (1) there is no statutory limitation period that acts to bar an action by the Browns;
>
> (2) the Browns, as "successors of the Agreement", are entitled to enforce the Agreement without an express assignment; and
>
> (3) the Agreement is not void as against public policy as fettering the City's discretion with respect to future uses of public roads and road allowances.

III. Analysis

(1) The Limitation Period Arguments

[28] The City's principal limitation period argument, set out in its factum, concerns Thurlow's unilateral 1980 repudiation of the Agreement. The City submits that the Pleiziers "accepted" this repudiation by reason of their inaction in the face of Thurlow's repudiation. As a result, the City says, the applicable six-year limitation period under the *Limitations Act*, R.S.O. 1980 c. 240 (the "1980 Act") began to run in December 1980 and expired in 1986.

[29] During oral argument, the City expanded its limitation period argument to include a second, alternative submission regarding the Browns. It maintained

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that even if the Pleiziers did not accept Thurlow's 1980 repudiation of the Agreement, the Browns accepted the City's subsequent repudiation of it when they failed to respond to the City's notice, in its solicitors' letter of December 15, 2004, of its position that the Agreement did not bind it and that it was not prepared to take any action regarding the drainage system.

[30] Based on the admitted 2004 repudiation and its alleged acceptance by the Browns, the City argues that if the applicable limitation period did not expire in 1986, it must be taken to have expired either in 2010 under the *Limitations Act*, R.S.O. 1990, c. L.15 (the "1990 Act") (a six-year limitation period) or in 2006 under the *Limitations Act, 2002*, S.O., 2002, c. 24, Sch. B. (the "Current Act") (a two-year limitation period). Under either scenario, the City asserts, the lawsuit commenced by the Browns in July 2011 is statute-barred.

[31] In essence, therefore, the City contends that some limitation period must apply to the Agreement and that, on the agreed facts, it expired either in 1986, 2006 or 2010 by reason of the acceptance of the municipality's repudiations of the Agreement by the Pleiziers and/or the Browns.

[32] The motion judge disagreed. Question 13 on the Special Case stated:

> Whether or not a statutory limitation period acts to bar an action by the Plaintiff [*sic*] (or its predecessors in title) and to what extent it should apply if at all (performance of the contract and/or consequential damages).

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The motion judge answered this question this way: "[T]here is no statutory limitation period that acts to bar an action by the Plaintiffs." He granted declaratory relief in the same terms.

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[33] For the reasons that follow, I see no error by the motion judge on this issue.

(a) City's Pleading and Questions on the Special Case

[34] I begin with the City's pleading and the questions posed on the Special Case. In its statement of defence, the City alleged that the Browns' claims were statute-barred under the Current Act. It did not invoke either the 1980 or the 1990 Acts or plead the expiry of a limitation period in 1986 or 2010. Rather, it claimed that the applicable limitation period was that provided for under the Current Act, which would have expired in 2006, two years after the City's 2004 repudiation of the Agreement.

[35] It is true that the City alleged in its pleading that "Thurlow and later Belleville had maintained that the Agreement was at an end and that they were no longer obliged to perform any work stipulated in the Agreement." However, this allegation was pleaded in connection with a claim by the City that any losses suffered by the Browns were avoidable. It was not advanced in relation to an acceptance of repudiation claim. In other words, the termination of the Agreement was pleaded in connection with the City's claim that the Browns had

failed to mitigate their damages. The City did not plead the acceptance by the Browns or the Pleiziers of a repudiatory breach or an anticipatory repudiation of the Agreement.

[36] Nor did the agreed questions on the Special Case expressly refer to any repudiation of the Agreement by Thurlow and, later, by the City, or to any acceptance by the Pleiziers or the Browns of such a repudiaton. Indeed, before the motion judge, the City agreed to affirmative answers to the following questions:

> Question No. 1:
>
> 1. Did the Agreement of April 27, 1953, properly interpreted, impose a perpetual obligation on the Township of Thurlow to maintain the drainage system it has installed in good working condition at all times and to make good any and all damage caused to the property owner whoever that may be from time to time as a result of lack of repair or of acts done at any time by the corporation in maintaining and repairing the system.
>
> Question No. 2:
>
> 2. Whether as a result of the amalgamation of the Township of Thurlow and the Defendant City in 1998, the Defendant City is bound by the contractual obligations of the former Township which are found to have been created by the Agreement.

[37] The motion judge answered these questions in the manner agreed by the parties, and granted declaratory relief accordingly, in the language of the questions as posed.

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[38] In his reasons on the Special Case, the motion judge observed, at para. 71, that the parties' agreement regarding the answers to these two questions "would appear to defeat or bar any limitation period defence".

[39] I agree that the consent responses to Question Nos. 1 and 2 on the Special Case significantly undercut the City's limitation period arguments. By consenting to these answers, the City acknowledged that it was bound by Thurlow's obligations under the Agreement (Question No. 2) and that the Agreement imposed "*a perpetual obligation*" "to maintain the drainage system...in good working condition *at all times*" and "to make good any and all damage caused to the property owner *whoever that may be from time to time*" as a result of the City's conduct (Question No. 1) (emphasis added). This is not the language of a finite or terminable obligation.

[40] That said, the motion judge's reasons confirm that all the City's limitation period arguments were live issues during argument of the Special Case. It appears that, before the motion judge, the City acknowledged that it is bound by Thurlow's obligations under the Agreement, and that those obligations are perpetual, but it nevertheless maintained its position that the Agreement is unenforceable on several grounds. These grounds included the claim that Thurlow and the City had repudiated the Agreement and that the Pleiziers and/or the Browns had elected to terminate the Agreement in the face of those repudiations. This had the effect, the City says, of bringing the parties' future

obligations under the Agreement to an end, thereby triggering the commencement of a limitation period in respect of the municipality's breach of the Agreement.

[41] As I read the record, there was no dispute before the motion judge as to whether a repudiation or repudiations of the Agreement had occurred. Nor is the fact of these repudiations challenged on appeal. The critical issue, therefore, is whether the repudiations were accepted or adopted by the relevant property owners: the Pleiziers and, later, the Browns. In these circumstances, I will first address the governing principles regarding the consequences of a repudiatory breach or anticipatory repudiation of contract.

(b) Governing Principles

[42] A repudiatory breach or an anticipatory repudiation of contract does not, in itself, terminate or discharge a contract. In *Guarantee Co. of North America v. Gordon Capital Corp.*, [1999] 3 S.C.R. 423, at para. 40, the Supreme Court explained:

> Contrary to rescission, which allows the rescinding party to treat the contract as if it were void *ab initio*, the effect of a repudiation depends on the election made by the non-repudiating party. If that party treats the contract as still being in full force and effect, the contract "remains in being for the future on both sides. Each [party] has a right to sue for damages for *past or future breaches*" (emphasis in original): *Cheshire, Fifoot & Furmston's Law of Contract* (12th ed. 1991), by M.P. Furmston at p. 541. If, however, the non-repudiating party accepts the

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> repudiation, the contract is terminated, and the parties are discharged from future obligations. Rights and obligations that have already matured are not extinguished. Furmston, *supra*, at pp. 543-44.

See also *Canada Egg Products, Ltd. v. Canadian Doughnut Co. Ltd.*, [1955] S.C.R. 398, at pp. 406-7; *Place Concorde East Limited Partnership v. Shelter Corp. of Canada Ltd.*, [2006] O.J. No. 1964 (C.A.), 270 D.L.R. (4th) 181, at para. 49.

[43] In his leading textbook, *The Law of Contracts* (Toronto: Irwin Law Inc., 2005), John D. McCamus refers to the election right of the innocent party on repudiation as an option to disaffirm or affirm the contract. Disaffirmation of the contract, in this sense, constitutes an election to terminate the contract in the face of the non-innocent party's repudiation of the contract. In the applicable authorities, it is frequently said that an election to disaffirm the contract is an 'acceptance'[1] or 'adoption' of the repudiation. On this view, an election to affirm the repudiated contract constitutes rejection or denial of the repudiation and a decision to treat the contract as subsisting and on-going.

[44] Professor McCamus puts it this way, at p. 654:

> [I]n the context of a repudiatory breach of an agreement, the victim of the breach is entitled either to affirm or disaffirm the agreement and, in either event,

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[1] Professor McCamus, at p. 658, queries the appropriateness of this term, suggesting that it can be misleading. He emphasizes that the right of the innocent party on repudiation is to elect to terminate (disaffirm) or affirm the contract.

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> pursue remedies for breach of contract. Similarly, in the context of anticipatory repudiation, the effect of the repudiation is to confer an option upon the innocent party either to disaffirm or affirm the contract. Thus, although the innocent party is entitled to disaffirm the agreement immediately and sue, that party may prefer to affirm the agreement and encourage or insist upon performance by the repudiating party or, more passively, simply wait and see whether the repudiating party does in fact eventually refuse to perform his or her contractual obligations when they fall due. [Citations omitted.]

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[45] It appears to be settled law in Canada that where the innocent party to a repudiatory breach or an anticipatory repudiation wishes to be discharged from the contract, the election to disaffirm the contract must be clearly and unequivocally communicated to the repudiating party within a reasonable time. Communication of the election to disaffirm or terminate the contract may be accomplished directly, by either oral or written words, or may be inferred from the conduct of the innocent party in the particular circumstances of the case: McCamus, at pp. 659-61.

[46] In *American National Red Cross v. Geddes Bros.* (1920), 61 S.C.R. 143, rev'g 47 O.L.R. 163 (S.C. (A.D.)), the Supreme Court of Canada addressed the means by which the adoption of a repudiation may be effectively communicated. Sir Louis Davies said, at p. 145:

> The question then, it seems to me, in every such case must be whether under the proved facts adoption of one party to a contract of its repudiation by the other party may be inferred from the proved facts, or whether an

> actual notice of acceptance or adoption must be given by the party receiving notice of the repudiation to the party repudiating.
>
> It seems to me from reading the authorities that such an actual notice of acceptance or adoption is not necessary but that adoption may be reasonably inferred from all the circumstances as proved.

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[47] In *American National*, Davies C.J. concluded, at p. 147, that a direct communication to the repudiating party of the election to disaffirm the repudiated contract is not essential "where facts proved allow of a fair inference of acceptance of renunciation [repudiation in this context] being drawn". This view was endorsed by a majority of the Supreme Court in *Kamlee Construction Ltd. v. Town of Oakville* (1960), 26 D.L.R. (2d) 166, at 182.

[48] More recently, in *White v. E.B.F. Manufacturing Ltd.*, 2005 NSCA 167, 239 N.S.R. (2d) 270, at para. 91, Saunders J.A. of the Nova Scotia Court of Appeal accepted the following description of what constitutes 'acceptance' of repudiation, set out in Chitty on Contracts, 28th ed. (London: Sweet & Maxwell, 1999), Vol. I, at p. 25-012:

> Where there is an anticipatory breach, or the breach of an executory contract, and the innocent party wishes to treat himself as discharged, he must "accept the repudiation." It is usually done by communicating the decision to terminate [to] the party in default although it may be sufficient to lead evidence of an "unequivocal overt act which is inconsistent with the subsistence of the contract ... without any concurrent manifestation of intent directed to the other party" ... *Acceptance of a*

> *repudiation must be clear and unequivocal and mere inactivity or acquiescence will generally not be regarded as acceptance for this purpose. But there may be circumstances in which a continuing failure to perform will be sufficiently unequivocal to constitute acceptance of a repudiation. It all depends on "the particular contractual relationship and the particular circumstances of the case."* [Emphasis added.]

(c) The 1980 Repudiation

[49] In this case, the City argues that Thurlow's repudiation of the Agreement was "accepted" by the Pleiziers when they failed to take any steps to enforce the Agreement from the date of repudiation (1980) to the date of the sale of the property to the Browns (2003). Both the passage of time and the sale transaction, the City submits, are inconsistent with the notion that Thurlow continued to be bound to perform the Agreement. I would not give effect to this argument.

[50] The motion judge found that the Pleiziers' conduct "can be viewed as no more than inactivity." The agreed facts on the Special Case lend strong support to this finding. Those facts include the stipulation that when informed by letter dated December 10, 1980, of Thurlow's position that it was "no longer bound by the provisions of the [Agreement]", the Pleiziers "took no action to enforce the Agreement or otherwise pursue the issue of the Agreement with [Thurlow]". The parties also agreed: "There is in fact no evidence that Mr. and Mrs. Pleizier responded in any way to [Thurlow's] letter."

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[51] I agree with the motion judge that the Pleiziers' silence or inaction in the face of Thurlow's repudiation of the Agreement falls short of satisfying the requirement of clear and unequivocal communication to the repudiating party of the adoption of a repudiatory breach or anticipatory repudiation of contract.

[52] As Saunders J.A. of the Nova Scotia Court of Appeal noted in *White*, at para. 91, citing Chitty on Contracts at p. 25-012, "mere inactivity or acquiescence will generally not be regarded as acceptance" of a repudiation. While there are circumstances where some overt act by the innocent party, viewed in the context of all the parties' dealings, may constitute an acknowledgement or affirmation that the repudiated contract has been terminated, there is simply no evidence in this case of such an overt act by the Pleiziers. Unlike some of the authorities relied on by the City, this is not a case where the innocent party, after repudiation, fails to honour the terms of the contract. There is no evidence that the Pleiziers did not comply with the Agreement or stand ready to perform under it.

[53] I underscore that an act of repudiation, in itself, does not terminate the repudiated contract. Rather, as I have indicated, the innocent party must elect to disaffirm or affirm the contract. Where disaffirmation is intended, this election must be clearly and unequivocally communicated to the repudiating party on a timely basis.

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[54] Thus, contrary to the City's submission, Thurlow's December 1980 letter to the Pleiziers did not terminate the Agreement. Absent an election by the Pleiziers to disaffirm the Agreement and thereby adopt or accept Thurlow's repudiation of it, the Agreement continued in full force and effect. In my opinion, the fact that the municipality did not seek access to the affected lands to carry out maintenance or repair activities does not mean that such access was unavailable.

[55] Moreover, as the motion judge held, the burden to establish the acceptance of the repudiation of a contract is on the party asserting acceptance: see for example, *Ginter v. Chapman* (1967), 60 W.W.R. 385 (B.C.C.A.), at para. 17, aff'd [1968] S.C.R. 560. On the agreed record, the motion judge found, as a fact, that the City failed to discharge this burden. I see no palpable and overriding error in this key finding. Indeed, in my view, it is firmly supported by the record.

[56] The City relies on *Ginter* and *Picavet v. Salem Developments Ltd.*, [2000] O.J. No. 2806 (S.C.) for the proposition that, in some circumstances, the parties to a repudiated contract will be seen to have mutually abandoned it notwithstanding that the innocent party to the repudiation might have failed to clearly communicate a disaffirmation of the contract. I would not accept this argument in this case.

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[57] First, none of the questions on the Special Case addressed the issue of abandonment. Similarly, there were no agreed facts on the Special Case that bear on the issue of abandonment save, arguably, for those relied upon by the City to support its acceptance of repudiation argument. Further, the City acknowledged before this court that a claim of abandonment, *per se*, was neither argued before the motion judge nor pleaded in the manner now asserted by the City.

[58] An allegation of abandonment cannot be evaluated in a factual vacuum. A finding of abandonment must be based on an assessment of the full circumstances of the innocent party's conduct in the aftermath of the other party's repudiation of the contract at issue. This critical assessment was not and cannot be properly undertaken on this record. This is dispositive of the City's ability to raise an abandonment claim on this appeal.

[59] Moreover, and in any event, I do not regard the cases relied upon by the City in support of its abandonment claim as being on all fours with the facts of this case. In *Picavet*, the post-repudiation conduct of the victim of the repudiation was inconsistent with the continuation of the contract at issue: the victim failed to perform any of his post-repudiation obligations under the contract. This conduct strongly supported the conclusion that the victim had accepted and treated the contract as at an end. It was in this context that the court held, at para. 72, that both parties had "walked away from the agreement and abandoned it".

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[60] In this case, however, there is no evidence that the Pleiziers, after Thurlow's repudiation, conducted themselves in a manner inconsistent with their obligation under the Agreement to provide Thurlow with access to their lands. This was the landowner's only obligation under the Agreement. I will return to this issue later in these reasons.

[61] *Ginter* is also factually distinguishable from this case. In *Ginter*, the non-repudiating parties sought damages for breach of contract against the repudiating party on the basis that they had disaffirmed the relevant contract when it was repudiated. However, no election to accept or adopt the repudiation was in fact communicated to the repudiating party within a reasonable time. Instead, the victims of the repudiation twice sought to extend the time for their election to disaffirm and attempted to negotiate a new agreement. It was only when these negotiations failed, that they claimed to have disaffirmed the repudiated contract.

[62] Again, that is not this case. Here, the Pleiziers did not seek to disaffirm the Agreement by clear and unequivocal communication to Thurlow, nor did they take legal action to recover damages or other relief based on Thurlow's repudiation. Indeed, as essentially agreed by the parties, they took no steps to terminate the Agreement after Thurlow's repudiation. Nor is there any evidence that they otherwise acted in a manner inconsistent with the continuation of the Agreement.

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[63] Notwithstanding the City's acknowledgment on the Special Case that the Agreement imposes perpetual obligations, the City argues that a commercially reasonable interpretation of the Agreement requires that it be construed as including an implied term that it could be terminated on notice. As I understood the City's submission, it essentially contends that even if Thurlow's repudiation of the Agreement was not accepted or adopted by the Pleiziers, the City's obligations cannot be viewed as enforceable indefinitely.

[64] While the courts no longer presume that an indefinite term contract is perpetual, the specific terms of the contract as well as the relationship between the parties and the surrounding circumstances may dictate enforcement of an indefinite term contract on a perpetual basis: *1397868 Ontario Ltd. v. Nordic Gaming Corp. (c.o.b. Fort Erie Race Track)*, 2010 ONCA 101, 258 O.A.C. 173, at paras. 13-14. Thus, when the term of a contract is indefinite and there is no provision for termination on reasonable notice, a court may treat the contract as perpetual in nature or the court may imply a provision of unilateral termination on reasonable notice.

[65] In this case, by reason of its consent to the answer to Question No. 1 on the Special Case, the City explicitly conceded that the Agreement imposes perpetual obligations on the City. The suggestion that the Agreement contains, by implication, a termination on notice term is inconsistent with that concession.

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In my view, it is also inconsistent with the intentions of the parties as reflected in the express provisions of the Agreement.

[66] The courts are loathe to imply a term in a contract that is inconsistent with the express terms of the contract: see *G. Ford Homes Ltd. v. Draft Masonry (York) Co. Ltd.* (1983), 43 O.R. (2d) 401 (C.A.), at p. 403; *ter Neuzen v. Korn*, [1995] 3 S.C.R. 674, at pp. 712-13. This is especially so where, as here, there is no basis on which to reasonably conclude that the parties would have agreed to such a term had it been raised at the time the contract was originally entered into. In this case, the precise purpose of the Agreement – securing indefinite access to Mr. Sills's property – and the specified nature of the obligations created under the Agreement – perpetual maintenance and repair of the drainage system – tell strongly against the implication of such a term.

[67] Accordingly, I conclude that the City's limitation period argument concerning the 1980 repudiation of the Agreement fails.

(d) The 2004 Repudiation

[68] I will also briefly address the City's contention that its 2004 repudiation of the Agreement triggered the running of a limitation period that expired either in 2010, under the 1990 Act, or in 2006, under the Current Act. As I have already indicated, this claim was not advanced directly by the City in its factum and only brief mention of it was made by the City in oral argument.

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[69] Like the limitation period argument mounted in respect of Thurlow's 1980 repudiation of the Agreement, the City's limitation period argument in respect of the 2004 repudiation rests on the contention that the innocent parties to the repudiation (the Browns), by their conduct, adopted or affirmed that repudiation, thereby terminating the Agreement. There is no evidentiary foundation for this assertion.

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[70] The motion judge rejected the City's claim that the Browns had accepted the City's 2004 repudiation of the Agreement. He stated, at paras. 81 and 83:

> The facts as to the conduct of the [Browns] are less clear [than the facts regarding the Pleiziers' conduct] ... What occurred between the December 15, 2004 letter and the August 3, 2010 letter is not a matter of record. Clearly, there were ongoing discussions that the City saw fit to end in its August 3, 2010 letter.
>
> ...
>
> On the record before me, I cannot find that the letter of December 15, 2004 started the time of a limitation defence to begin to run. For example, *bona fide* settlement discussions can suspend the commencement of a limitation period and its running in certain circumstances. The onus is on the [City] to prove the date that the limitation began.

[71] I agree with the motion judge's assessment of the state of the record and his conclusion. On the agreed facts, it is clear that the Browns did not directly accept the City's repudiation of the Agreement. And there is virtually a complete paucity of evidence and agreed facts regarding what, if anything, transpired

between the Browns and the City concerning the Agreement from the date of the 2004 repudiation until August 2010. The agreed facts merely stipulate that, after the City's December 2004 letter, "further discussions went nowhere" and litigation followed.

[72] Given this significant evidentiary gap, I agree with the motion judge that the City failed to discharge its onus to prove facts regarding conduct by the Browns from which it could reasonably be inferred that they elected to disaffirm the Agreement in the face of the City's repudiatory breach.

(2) The Browns' Standing to Sue

[73] The common law doctrine of privity of contract, an established principle of contract law, stands for the proposition that "no one but the parties to a contract can be bound by it or entitled under it": *Greenwood Shopping Plaza Ltd. v. Neil J. Buchanan Ltd.*, [1980] 2 S.C.R. 228, at para. 9. See also *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*, [1992] 3 S.C.R. 299, at p. 416; *Dunlop Pneumatic Tyre Co. Ltd. v. Selfridge & Co.*, [1915] A.C. 847 (H.L.), at p. 853. In this case, it is common ground that the Browns have no privity of contract with the City in respect of the Agreement. They are not signatories to the Agreement and no explicit assignment or transfer of the Agreement was made in their favour.

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[74] Relying on this lack of privity, the City argues that the Browns have no standing to enforce the Agreement because none of the recognized exceptions to the privity of contract doctrine applies on the facts of this case. The City submits that: (1) its covenants under the Agreement are positive covenants which, by operation of law, cannot run with the land; (2) because the Agreement was not assigned or transferred to the Browns, there is no equitable basis on which the Browns are entitled to enforce it; and (3) in the alternative, even if an equitable basis exists for recognition of an assignment or transfer of the Agreement to the Browns, it is defeated by the application of the doctrine of laches.

[75] In response, the Browns rely on what they describe as three exceptions or qualifications to the privity of contract doctrine, any one of which, they maintain, affords them standing to enforce the Agreement. In his factum, counsel for the Browns identified these three "exceptions" or qualifications in this fashion: (1) the enurement clause of the Agreement, under which the benefit of the Agreement flowed to the Browns; (2) the benefit of the City's covenants in the Agreement runs with the lands to the benefit the Browns, as Mr. Sills's successors in title; and (3) the 'principled exception' to the privity rule established by the Supreme Court in *London Drugs*.

[76] The motion judge ruled that the first two suggested exceptions or qualifications apply on the facts of this case. He held that the Browns are

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successors of Mr. Sills and that the benefit of the Agreement flowed to them under the express terms of the Agreement. He also held that the benefit of the City's covenants under the Agreement run with the land and are enforceable against the City, as the original covenantor under the Agreement. Given these holdings, the motion judge found it unnecessary to address the Browns' argument that the principled exception to the privity doctrine also applies.

[77] In the result, the motion judge granted declarations that the Browns are "successors of the Agreement" and, thus, they are entitled to enforce it without an express assignment (Question No. 3 on the Special Case); the City does not have a valid defence to the Browns' claims on the basis that they are trying to enforce "a positive covenant in regard to their land" (Question No. 8 on the Special Case); and, the Browns' claim for damages for breach of the Agreement is not defeated by the doctrine of laches (Question No. 14 on the Special Case).

[78] For reasons that differ in some respects from those of the motion judge, I am of the view that he was correct in concluding, in effect, that the Browns have standing to enforce the Agreement.

[79] It is important to note at the outset that the doctrine of privity of contract is of considerably diminished force in Canada as a continuing principle of contract law. It has been subject to a wealth of repeated academic and judicial criticism, leading to frequent calls for law reform in Canada and elsewhere. See for

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example, *London Drugs*, at pp. 418-26; *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*, [1999] 3 S.C.R. 108, at para. 26; McCamus, at pp. 296-301. Indeed, several Commonwealth jurisdictions have abrogated the privity doctrine entirely, or in specific contexts, by statute. In other instances, the reach of the doctrine has been "significantly undermined by a growing list of exceptions to the rule": McCamus, at p. 299. See also Angela Swan and Jakub Adamski, *Canadian Contract Law*, 3rd ed. (Markham: LexisNexus Canada Inc., 2012) at p. 229. Several of the leading cases cited by the parties on this appeal afford abundant evidence of the relaxation of the ambit of the doctrine in particular cases. Thus, while the doctrine survives in Canada, it persists only in weakened form.

(a) The Enurement Clause

[80] The analysis of the City's standing challenge must begin with consideration of the intentions of the parties at the time the Agreement was entered into, as reflected in the provisions of the Agreement. The Browns rely, especially, on the enurement clause in the Agreement, which they characterize as an "exception" or qualification to the privity of contract doctrine. While I view the use of the term "exception" in this context as misconceived – the enurement clause does not fall within or constitute, by itself, a recognized exception to the privity rule, such as trust or agency – I do accept that the language of the provision is critical in this

case. For convenience, I again set out the terms of the enurement clause, as agreed between Thurlow and Mr. Sills:

> THIS INDENTURE Shall [sic] inure to the benefit of and be binding upon the parties hereto and their respective heirs, administrators, successors and assigns.

[81] The motion judge held, at para. 30, that the words of the enurement clause "clearly demonstrate that it was in the contemplation of the parties that there would be subsequent owners of Mr. Sills' [sic] property". He found, as a fact, that the Browns are successors of Mr. Sills, as contemplated under the enurement clause. I agree. Moreover, I did not understand the City to challenge these findings on appeal. To the contrary, counsel for the City candidly conceded during oral argument that the Browns are successors in interest to Mr. Sills. This was a proper concession.

[82] The motion judge did not comment further on the effect of these findings in relation to the privity rule, saying merely, at para. 31: "Therefore, I find that the [Browns] fit within this exception to the privity of contract rule as successors."

[83] The question therefore arises as to what legal consequences flow from the language employed by the parties in the enurement clause. As I have already said, I do not think this type of contractual provision can properly be termed an "exception" to the doctrine of privity of contract on the current state of the law.

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[84] That said, the broad and unqualified language of the enurement clause constitutes an express stipulation by the contracting parties that they intended the benefit of the Agreement to be shared by future owners of Mr. Sills's lands, as his successors or assigns or by way of inheritance. The language of the enurement clause unequivocally confirms that the contracting parties intended and agreed that the benefit of the Agreement would extend to an aggregation or class of persons that includes successor landowners of Mr. Sills. On the admitted findings of the motion judge, the Browns are Mr. Sills's successors. In this sense, the Browns are not strangers or 'third parties' to the Agreement. Rather, they step into Mr. Sills's shoes and have standing to enforce the Agreement as against the City as if they were the original covenantee(s) to the Agreement: see Angela Swan and Jakub Adamski, *Canadian Contract Law*, at p. 169 and, generally, at pp. 163-226.

[85] In these circumstances, given the intention of the contracting parties stipulated in the Agreement under the enurement clause, I conclude that 'relaxing' the doctrine of privity in this case does not frustrate the reasonable expectations of the parties at the time the Agreement was formed. To the contrary, it gives effect to them.

[86] This conclusion is fortified by the agreed answers to Questions Nos. 1 and 2 on the Special Case, quoted earlier in these reasons. As I have said, by those answers, the City agreed that the Agreement imposes: "a *perpetual* obligation"

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on it to maintain the drainage system "*at all times*" and to make good damage caused "*to the property owner whoever that may be from time to time*" as a result of lack of repair or acts done "*at any time*" by the City "in maintaining and repairing the system" (emphasis added). As the motion judge aptly observed, at para. 23, the wording of these answers "appears clearly to favour a determination of [the privity of contract] issue in favour of the [Browns]".

[87] I agree. On the language of the enurement clause and the agreed proper interpretation of the Agreement as a whole, the City and Mr. Sills clearly understood that the continuing access sought by the City to the affected lands could only be provided by the property owner "whoever that may be from time to time". In consideration for such continuing access, the City undertook to maintain and repair the drainage system, indefinitely, for the benefit of the property owner.

[88] It is also important to emphasize that the City itself is not a stranger to the Agreement, against whom it is sought to enforce contractual covenants. The City acknowledged on the Special Case that, as a result of the 1998 amalgamation of Thurlow and the City of Belleville, the City stands in Thurlow's shoes and is bound by Thurlow's contractual obligations created under the Agreement. Thus, as a matter of law, the City, in effect, is the original covenantor under the Agreement.

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[89] The City relies strongly on the decision of the Supreme Court in *Greenwood* in support of its privity-based attack on the enforceability of the Agreement. I agree that *Greenwood* is the principal obstacle to the Browns' standing claim. However, for several reasons, I do not think that *Greenwood* and its progeny bar the Browns' action against the City.

[90] In *Greenwood*, the employees of a corporate tenant of a shopping centre, while acting in the course of their employment, negligently caused a fire that destroyed part of the centre. The question arose whether the provisions of the lease that required the landlord to insure the premises protected the tenant's employees from liability. The Supreme Court held that the employees, who were strangers to the lease and, hence, had no privity of contract with the landlord, could not claim the benefit and protection of the insurance provisions. As this court said in *Tony and Jim's Holdings Ltd. v. Silva* (1999), 43 O.R. (3d) 633, at para. 15, in so holding, the Supreme Court in *Greenwood* essentially refused to relax the application of the privity rule beyond the then-recognized exceptions of trust or agency. On the limited evidence before it, the Supreme Court concluded that neither exception was made out.

[91] In my opinion, although not explicitly overruled, *Greenwood* has been overtaken by the subsequent decisions of the Supreme Court in *London Drugs* and *Fraser River*, which established the principled exception to the doctrine of privity of contract.

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[92] I will return to the facts and significance to this case of *London Drugs* and *Fraser River* later in these reasons. At this point, however, I note that *London Drugs* involved the question whether third-party beneficiaries to a contract could invoke the protection of a limited liability clause agreed upon by the original contracting parties. In addressing this question, Iacobucci J., writing for a majority of the Supreme Court, considered and distinguished *Greenwood* on several grounds. As relevant here, he noted, at p. 431, that unlike the facts in *London Drugs*, (1) *Greenwood* involved a lease rather than a contract for services; (2) there was little, if any, evidence to support a finding that the parties to the contract at issue in *Greenwood* intended to confer a benefit on the parties who sought the protection of the limited liability clause; and (3) in *Greenwood*, the parties seeking to obtain benefits under the contract were viewed as complete strangers and not third-party beneficiaries. In light of these distinguishing features, Iacobucci J. concluded, at p. 431, that *Greenwood* is of limited use in a determination of third-party beneficiary rights. This conclusion, and the distinguishing aspects of *Greenwood* identified by Iacobucci J. in *London Drugs*, apply equally to this case.

[93] Indeed, in my view, this case is even more distinct from *Greenwood* than the factors identified in *London Drugs* suggest. *Greenwood* did not involve the consideration of an enurement clause or the rights of persons who stood in the shoes of the original contracting parties. In contrast, this case involves the right

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of successors to an original covenantee – who were expressly intended by the original contracting parties to share in the benefit of their bargain – to rely on and enforce the benefit of perpetual contractual covenants given by the original covenantor. As I have said, by reason of the enurement clause in the Agreement, Mr. Sills's successors effectively assume the position of first parties to the Agreement by stepping into his shoes, as the original covenantee. In this capacity, the Browns simply seek to require the City to make good on the promises it saw fit to make under the Agreement.

[94] On these particular facts, the strict application of the doctrine of privity would ignore the nature, stated purpose and express terms of the Agreement and allow the City, as the original covenantor, to escape the covenants to which, as a matter of law, it must be seen to have expressly consented. In these circumstances, I conclude that the strict application of the doctrine of privity should not stand in the way of justice: *London Drugs*, at p. 446.

(b) The Principled Exception to the Privity Rule

[95] Given my conclusion that the Browns have standing to enforce the Agreement by operation of the enurement clause, it is not technically necessary to consider the other arguments advanced by the City in support of its privity of contract objection to the enforceability of the Agreement. Were it necessary to do so, however, I would also rest the rejection of this objection on the principled

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exception to the privity rule established in *London Drugs*, as amplified and applied in *Fraser River*. The principled exception may be explained by brief reference to *London Drugs* and *Fraser River*.

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[96] In *London Drugs*, the Supreme Court was concerned with whether a contractual limitation of liability clause in favour of a warehouseman applied to protect the warehouseman's employees from liability in a lawsuit brought against them and their employer by a customer whose goods were damaged through the employees' negligence while the goods were in storage at the employer's warehouse. A majority of the Supreme Court held, at pp. 414 and 452, that the concept of "warehouseman" under the contract between the employer and the customer must be taken to implicitly cover the warehouseman's employees. As the employees were thus third-party beneficiaries to the limitation of liability clause set out in the relevant storage contract between their employer and the customer, and as they were performing the precise services contracted for by the customer, the employees could benefit from the clause notwithstanding that they were not signatories to the contract.

[97] As this court stated in *Madison Developments Ltd. v. Plan Electric Co.* (1997), 36 O.R. (3d) 80, at para. 30, leave to appeal to S.C.C. refused, [1997] S.C.C.A. No. 659, the Supreme Court in *London Drugs* not only distinguished and declined to follow *Greenwood*, it also applied new reasoning to create an

incremental change in the law of privity and set forth a test for the application of this change.

[98] More specifically, the majority of the Supreme Court held in *London Drugs*, at p. 448, that while none of the traditionally-recognized exceptions to the privity of contract doctrine applied to assist the employees, the privity rule should be relaxed where the following requirements were satisfied:

> 1. the limitation of liability clause must, either expressly or impliedly, extend its benefits to the employees (or employee) seeking to rely on it; and
>
> 2. the employees (or employee) seeking the benefit of the limitation of liability clause must have been acting in the course of their employment and must have been performing the very services provided for in the contract between their employer and the plaintiff (customer) when the loss occurred.

[99] The principled exception to the privity rule introduced in *London Drugs* was again considered and applied, this time unanimously, by the Supreme Court in *Fraser River*. In that case, at paras. 28-29 and 32, the court clarified that satisfaction of the first branch of the *London Drugs* test is a threshold requirement: to invoke the exception, there must be a showing that the contracting parties intended to extend the benefit in question to the third party seeking to rely on the contractual provision. Further, under the second branch of the test, the intention to extend the benefit of the contractual provision to the actions of a third-party beneficiary is irrelevant unless the actions of the third

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party come within the scope of the contract in general, or the provision in particular, between the initial contracting parties.

[100] The Supreme Court emphasized in *Fraser River*, at para. 32, as did the majority of the court in *London Drugs*, at p. 449, that the extension of the principled approach to create a new exception to the doctrine of privity of contract, "first and foremost must be dependent upon the intention of the contracting parties". Finally, the application of the principled approach is not confined to situations involving only employer-employee relationships or limited liability: see *Fraser River*, at para. 31; *Madison*, at para. 30.

[101] I am satisfied that the first branch of the test for the application of the principled exception to the privity rule is met in this case. There can be no question that under the terms of the Agreement, the original contracting parties intended to extend the benefit of the City's covenants under the Agreement to an ascertainable group or class of persons that includes the Browns. Thus, there is a compelling argument in favour of relaxing the doctrine of privity in this case, given the inclusion of an enurement clause that expressly refers to "successors" of Mr. Sills, like the Browns. On this aspect of the facts, this case is closer to *Fraser River* than to *London Drugs*.

[102] Not without some hesitation, I am also persuaded that the second branch of the principled exception test is satisfied. The Agreement required that Mr. Sills

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provide access to his lands for the purpose of the maintenance and repair of the drainage system that Thurlow had installed. This was the activity of the convenantee for which the parties bargained. There is no evidence nor any agreed facts in the Special Case indicating that Mr. Sills, or the Browns as his successors in interest, failed to perform or stand ready to perform this obligation under the Agreement by denying or impeding the City's access to their lands for the purposes envisaged by the Agreement.

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[103] I appreciate that the last repair work on the drainage system appears to have been carried out in 1959, more than 50 years ago. But nothing on the Special Case indicates that any of Mr. Sills, the Pleiziers or the Browns ever denied access to their property or would have done so if such access had been sought by the municipality.

[104] The City submits that it was incumbent on the Browns and their predecessors in title to call on the City for the maintenance or repair of the drainage system and that their failure to do so further signals that they elected to disaffirm the contract.

[105] I disagree. This assertion is wholly unsupported by the language of the Agreement. Moreover, on the evidence, both the Pleiziers and the Browns did draw the City's attention to its obligations under the Agreement to maintain and repair the drainage system. The City (and Thurlow) responded to the requests

that it honour its obligations with unilateral repudiations of the Agreement. In these circumstances, I do not think that it is open to the City to now assert that the landowners were obliged, yet failed, to seek to hold the City to its obligations.

[106] For the same reasons, I would reject the City's claim that the Browns' entitlement to enforce the Agreement is defeated by laches. This equitable defence is of limited application in the case of a claim for enforcement of the benefit of a contract. These claims, as here, relate to the alleged contractual entitlement to specific performance or damages. They are, therefore, founded in law rather than equity.

[107] In this case, we are concerned with the City's continuing breach of its obligations under the Agreement following its unilateral repudiations of the Agreement. I see no dispositive effect of delay by the Browns on the liability of the City in these circumstances.

[108] Further, and importantly, there is no evidence that the Pleiziers' or the Browns' conduct resulted in prejudice to the City. The City's bald claim of prejudice is based solely on the historical nature of the Agreement – no particulars of actual prejudice to the City were proven or agreed upon by the parties.

[109] In sum, no agreed facts or other evidence on this record suggests that any of Mr. Sills, the Pleiziers or the Browns resiled from or failed to perform the

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Agreement. To paraphrase the language of *Fraser River*, at para. 39, the provision by them of access to their property was the "very activity" contemplated by and required of them under the Agreement containing the provision upon which they seek to rely.

[110] I recognize that *London Drugs* and *Fraser River* were cases where the third-party beneficiaries sought to rely, by way of defence, on the benefit of the contractual provisions at issue to resist claims brought against them – they were not seeking to enforce the affirmative benefit of the relevant contractual provisions.

[111] Nonetheless, it is my view that the Browns' status as the successors of the original covenantee under the Agreement affords them the right to seek to enforce the original covenantor's contractual obligations, as against the original covenantor. In effect, for the purpose of enforcement of the Agreement, the Browns are Mr. Sills and the City is Thurlow. Further, insofar as the performance of the City's obligations under the Agreement are concerned, there is a clear identity of interest between Mr. Sills and the Browns. As Mr. Sills's successors, the Browns stood ready to comply with the activity required of them under the Agreement – the provision of access to their lands. In all these circumstances, the application of the principled exception to the privity rule advances the interests of justice.

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(3) The Agreement is not Void on Public Policy Grounds

[112] The City raises two public policy-based arguments as further impediments to the enforcement of the Agreement by the Browns. It argues that the Agreement is unenforceable as against it because a perpetual contract that admits of no right of termination offends public policy and is unconscionable. Further, the City says, the enforcement of perpetual obligations of the kind created under the Agreement offends public policy because it fetters the City's discretion regarding the future use of public roads and road allowances. In my opinion, these arguments cannot succeed on this record.

[113] With respect to the first argument, Question No. 4 on the Special Case reads: "Whether or not the Agreement, if properly interpreted as imposing a perpetual obligation, is invalid as contrary to public policy because it does impose a perpetual obligation". In respect of this question, the motion judge ruled: "[T]he Agreement, which imposes a perpetual obligation upon the City, is not invalid as contrary to public policy because it does impose a perpetual obligation."

[114] Although the City raised Question No. 4 in its Notice of Appeal, it did not challenge the motion judge's ruling on this issue or otherwise mention the matter in its factum. Instead, the City sought to advance this claim during oral argument. The procedural unfairness to the Browns arising from this tactic is

manifest. In the circumstances, in my view, the City is precluded from attempting to raise this issue on appeal. To conclude otherwise would offend basic fairness.

[115] The City's second public-policy based argument fails for lack of evidentiary support. As the Browns submit, there is simply no evidence or agreed facts to support the City's assertion that its discretion regarding the future use of public roads and road allowances will be fettered or impeded if it is held to its obligations under the Agreement.

[116] I would reject this ground of appeal.

IV. Concluding Comments

[117] I conclude with these comments. The disposition of this appeal on the basis that I propose does not deprive the City of any recourse. As acknowledged by the Browns during oral argument, it is open to the City to pursue those defences to enforcement of the Agreement pleaded by it in its statement of defence that were not dealt with on the Special Case, *e.g.* the City's claim that the Agreement was frustrated. Further, on a properly amended pleading, there is nothing to prevent the City from pursuing, if so advised, its claim that Mr. Sills's successors in title abandoned the Agreement. These matters were not dealt with on the Special Case and formed no permissible part of the issues raised before this court. Of course, the adjudication of the Browns' entitlement to the specific remedies sought by them also remains for another day.

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V. Disposition

[118] For the reasons given, I would dismiss the appeal. If the parties are unable to agree on the costs of this appeal, the Browns may submit their brief written costs submission to the Registrar of this court, within 15 days from the date of the release of these reasons. The City shall submit its brief responding submissions on costs to the Registrar, within 15 days thereafter.

Released: "EAC" March 12, 2013

"E.A. Cronk J.A."
"I agree Robert P. Armstrong J.A."
"I agree Gloria Epstein J.A."

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TAB 14

Postponement of claims of silent partners

139 Where a lender advances money to a borrower engaged or about to engage in trade or business under a contract with the borrower that the lender shall receive a rate of interest varying with the profits or shall receive a share of the profits arising from carrying on the trade or business, and the borrower subsequently becomes bankrupt, the lender of the money is not entitled to recover anything in respect of the loan until the claims of all other creditors of the borrower have been satisfied.

R.S., c. B-3, s. 110.

Postponement of wage claims of officers and directors

140 Where a corporation becomes bankrupt, no officer or director thereof is entitled to have his claim preferred as provided by section 136 in respect of wages, salary, commission or compensation for work done or services rendered to the corporation in any capacity.

R.S., c. B-3, s. 111.

Postponement of equity claims

140.1 A creditor is not entitled to a dividend in respect of an equity claim until all claims that are not equity claims have been satisfied.

2005, c. 47, s. 90; 2007, c. 36, s. 49.

Claims generally payable rateably

141 Subject to this Act, all claims proved in a bankruptcy shall be paid rateably.

R.S., c. B-3, s. 112.

Partners and separate properties

142 (1) Where partners become bankrupt, their joint property shall be applicable in the first instance in payment of their joint debts, and the separate property of each partner shall be applicable in the first instance in payment of his separate debts.

Surplus of separate properties

(2) Where there is a surplus of the separate properties of the partners, it shall be dealt with as part of the joint property.

Surplus of joint properties

(3) Where there is a surplus of the joint property of the partners, it shall be dealt with as part of the respective

Renvoi des réclamations d'un bailleur de fonds

139 Lorsqu'un prêteur avance de l'argent à un emprunteur, engagé ou sur le point de s'engager dans un commerce ou une entreprise, aux termes d'un contrat, passé avec l'emprunteur, en vertu duquel le prêteur doit recevoir un taux d'intérêt variant selon les profits ou recevoir une partie des profits provenant de la conduite du commerce ou de l'entreprise, et que subséquemment l'emprunteur devient failli, le prêteur n'a droit à aucun recouvrement du chef d'un pareil prêt jusqu'à ce que les réclamations de tous les autres créanciers de l'emprunteur aient été acquittées.

S.R., ch. B-3, art. 110.

Renvoi des réclamations pour gages des dirigeants et administrateurs

140 Dans le cas où une personne morale devient en faillite, aucun dirigeant ou administrateur de celle-ci n'a droit à la priorité de réclamation prévue par l'article 136 à l'égard de tout salaire, traitement, commission ou rémunération pour travail exécuté ou services rendus à cette personne morale à quelque titre que ce soit.

S.R., ch. B-3, art. 111.

Réclamations relatives à des capitaux propres

140.1 Le créancier qui a une réclamation relative à des capitaux propres n'a pas droit à un dividende à cet égard avant que toutes les réclamations qui ne sont pas des réclamations relatives à des capitaux propres aient été satisfaites.

2005, ch. 47, art. 90; 2007, ch. 36, art. 49.

Réclamations généralement payables au prorata

141 Sous réserve des autres dispositions de la présente loi, toutes les réclamations établies dans la faillite sont acquittées au prorata.

S.R., ch. B-3, art. 112.

Associés et biens distincts

142 (1) Dans le cas où des associés deviennent en faillite, leurs biens communs sont applicables en premier lieu au paiement de leurs dettes communes, et les biens distincts de chaque associé sont applicables en premier lieu au paiement de ses dettes distinctes.

Surplus des biens distincts

(2) Lorsqu'il existe un surplus des biens distincts, il en est disposé comme partie des biens communs.

Surplus des biens communs

(3) Lorsqu'il existe un surplus des biens communs, il en est disposé comme partie des biens distincts respectifs en

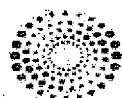
TAB 15

PRINCIPLES OF CORPORATE INSOLVENCY LAW

by

Roy Goode

SWEET & MAXWELL



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Chapter 8

The Proof, Valuation and Ranking of Claims in Winding Up

Introduction

In Chapter 6 we defined and described the assets of the company available for distribution to its creditors. The present chapter looks at the liabilities side of the company's balance sheet and discusses the treatment of claims in the winding up and the order of distribution of assets among the competing creditors.[1] **8–01**

1. THE PARI PASSU PRINCIPLE OF DISTRIBUTION

The principle stated

The most fundamental principle of insolvency law is that of *pari passu* distribution, all creditors participating in the common pool in proportion to the size of their admitted claims. In the case of voluntary winding up, this principle is expressed in the Insolvency Act itself: **8–02**

> "Subject to the provisions of this Act as to preferential payments, the company's property in a voluntary winding up shall on the winding up be applied in satisfaction of the company's liabilities *pari passu* . . ."[2]

[1] The phrase "distribution of assets" does not mean distribution in specie, but is the conventional shorthand for distribution by way of dividend of the net proceeds resulting from dispositions of the assets by the liquidator.

[2] Insolvency Act 1986 s.107.

In the case of compulsory winding up, the principle is found in the Insolvency Rules: "Debts other than preferential debts rank equally between themselves in the winding up."[3]

A similar principle applies in administration,[4] although its application is more limited. It is this principle of rateable distribution which marks off the rights of creditors in a winding up from their pre-liquidation entitlements. Prior to winding up,[5] each creditor is free to pursue whatever enforcement measures are open to him. Where self-help (for example, by repossession of goods, realisation of security or exercise of a right of set-off) is not available, the creditor must have recourse to legal process and, if the debtor company fails to satisfy a judgment voluntarily, enforce the judgment by execution against the company's assets or income. The rule here, in the absence of an insolvency proceeding, is that the race goes to the swiftest. The creditor initiating the earliest execution has first bite at the cherry and whatever is left is available for the next in line. A creditor who leaves it too late finds he has a *brutum fulmen*—there is a judgment in his favour, but no assets against which to enforce it. Liquidation puts an end to the race. The principle first come, first served, gives way to that of orderly realisation of assets by the liquidator for the benefit of all unsecured creditors and distribution of the net proceeds *pari passu*. The *pari passu* principle is all-pervasive. It is based on the notion that losses caused by liquidation should be borne by unsecured creditors equally. Its broad effect is to strike down all agreements, payments and transfers which have as their object and result the unfair preference of a particular creditor by removal from the estate on winding up of an asset that would otherwise have been available for the general body of creditors.[6]

The statutory principle of *pari passu* distribution is buttressed by more specific statutory rules on preferences by which pre-liquidation payments and transfers made in the run-up to winding up may be avoided.[7] These have a different temporal factor. The *pari passu* principle, like the anti-deprivation rule,[8] has no backward reach. It does not affect transactions completed prior to the commencement of liquidation or administration.[9] In the absence of a statutory provision to the contrary, a person is entitled to discharge his liabilities in any order he pleases.[10] By contrast, the statutory provisions on preferences are designed to unravel payments and transfers

[3] Insolvency Rules 1986 r.4.181(1).

[4] Insolvency Rules 1986 r.2.69. See below, para.11–85.

[5] Or administration. See Ch.11.

[6] It is true that the approach would be the same whatever the distribution rule. But as pointed out earlier (above, para.3–07) the reference to the *pari passu* principle in this context is simply shorthand to describe what is in fact the central rule of distribution.

[7] See below, Ch.13.

[8] See above, para.7–18.

[9] *Re Smith, Knight & Co Ex p. Ashbury* (1968) L.R. 5 Eq. 228.

[10] *Re Sarflux Ltd* [1979] Ch. 592, per Oliver J. at 602.

already made to a creditor in the twilight period *prior* to liquidation or administration at a time when the company is already insolvent or will become so as the result of payment or transfer in question. Moreover, recoveries by the liquidator under the statutory provisions will not necessarily fall to be distributed *pro rata* among the general body of creditors; they simply add to the pool of assets available for distribution, with liquidation expenses and preferential claims coming ahead of those of ordinary unsecured creditors.

As we have seen,[11] the *pari passu* principle is to be distinguished from the anti-deprivation rule discussed in Chapter 7. The latter is aimed at contractual provisions which have the effect of reducing the company's net asset value upon its liquidation or administration by a transfer to a party who is not a creditor. By contrast, a payment or transfer to a creditor upon winding up or administration has no effect on the company's net asset value, because its effect is pro tanto to reduce the company's liability to the creditor. The objection to such a payment or transfer is thus a different one, namely that it disturbs the statutory scheme of distribution and thereby gives an unfair advantage to the creditor to whom the payment or transfer is made. We have noted earlier that because the two rules share certain characteristics,[12] many of the cases cited as decisions on the *pari passu* principle are in fact decisions on the anti-deprivation rule. Examples are provided by cases on limited and determinable interests, pre-emption provisions in articles of association and provisions forfeiting building materials to the employer on the builder's liquidation.

The pari passu principle is primarily relevant to winding up

8–03 Until recently, it could be said that since the *pari passu* principle is concerned to ensure an equitable distribution of the company's estate among its creditors, its application as a mandatory rule was almost entirely confined to liquidation, for this was the only collective insolvency process which had as its primary objective the distribution of assets among the general body of creditors in accordance with a statutory *pari passu* rule that cannot be excluded by contract.[13] However, there has been a marked trend in recent years to use administration as a liquidation substitute, following upon a change in the Insolvency Rules to enable proofs to be made, rules of set-off applied and assets distributed (with leave of the court in the case of unsecured creditors) under rules substantially similar to those applicable on a winding up. Nevertheless, it remains the case that many distributions are

[11] Above, para.7–03.
[12] See above, para.7–03.
[13] See below, para.8–06.

made pursuant to a company voluntary arrangement under Pt I of the Insolvency Act or a compromise or arrangement under Pt 26 of the Companies Act 2006 and will be governed by the terms of those arrangements, which have to be approved by the requisite majority of creditors, rather than by any a priori rule of distribution. For the same reason, the *pari passu* principle has no necessary application to informal work-outs. No doubt any distribution to ordinary unsecured creditors will normally be expected to follow the order of priorities that would apply in a winding up, but there is no rule of law precluding creditors from approving an arrangement on a different basis.[14] Moreover, in many cases there will be no free assets to distribute among unsecured creditors.

The *pari passu* principle does not in any event apply to administrative receivership, for this is not a true collective insolvency proceeding,[15] and if the receiver, after meeting out of floating charge assets payments to preferential creditors, the costs of preserving and realising the assets, his other expenses and remuneration, the prescribed part to be surrendered for the benefit of unsecured creditors and the claims of his debenture holders, has a surplus, his duty is to pass it to any subsequent secured creditor or, if none, then to the company; he has no general power of distribution. It has also been held that the *pari passu* principle cannot be invoked so as to entitle the holder of a floating charge to share in the prescribed part available to unsecured creditors from assets the subject of the charge, since the general principle must give way to the express terms of s.176A(2) of the Insolvency Act 1986.[16] On the other hand, the *pari passu* principle reinforces the natural construction of s.176A(2) precluding the court from disapplying s.176A(2) in part, for example, by excluding creditors with claims of less than a specified amount.[17]

Where a commercial contract on its true interpretation provides for the distribution of assets to a group of persons as between whom no distinction is to be drawn, the court will imply a requirement to make distributions proportionately,[18] but such an implication is not possible where the document evinces an intention that the distribution should be on some other basis.[19] It is a question in each case of interpreting the contract.[20]

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14 *Re HPJ UK Ltd* [2007] B.C.C. 284, where the judge approved the payment by the administrator of a fixed sum to HM Revenue & Customs, with the approval of the other creditors, in order to remove the delay and expense of ascertaining the exact amount due and to maximise any dividend to the creditors. Similarly, s.4(4) of the Insolvency Act 1986, while precluding approval of a proposed CVA which would affect the enforcement rights of a secured creditor or the priority of a preferential debt, leaves unsecured creditors free to agree on a distribution among themselves otherwise than on a *pari passu* basis. As to the prescribed part, see above, paras 6–38 *et seq*.

15 See para.1–38.

16 *Re Permacell Finesse Ltd* [2008] B.C.C. 208.

17 *Re Courts Plc* [2009] 1 W.L.R. 1499.

18 *Re Golden Key Ltd* [2009] EWCA Civ 636.

19 *Re Golden Key*, above, n. 18.

20 See, e.g. *Re Sigma Finance Corp* [2010] B.C.C. 40; *Re Golden Key*, cited above n.18; and *Re Whistlejacket Capital Ltd* [2008] B.C.C. 826.

The *pari passu* rule: its significance in practice

8–04 I have described the *pari passu* principle of distribution as fundamental and all-pervasive. This, at least, is the theory of insolvency law, although this has not passed unchallenged.[21] In practice, as was pointed out by the Cork Committee many years ago,[22] a rateable distribution among creditors is rarely achieved. There are three main reasons for this.

First, the principle is in general confined to assets of the company and does not affect creditors having rights *in rem*. These include secured creditors, who under the liberal regime allowed by English law can take security for present and future indebtedness over future as well as present assets, including fixed charges over future debts and floating charges over all assets; suppliers of goods under contracts which reserve title until payment, a technique in widespread use; and third parties for whom the company holds assets on trust or who have proprietary tracing rights in equity to assets in the possession or under the control of the company. The effect of these rights *in rem* is substantially to reduce the corpus of assets available for unsecured creditors.

Secondly, the liquidator takes the assets subject to equities affecting them, such as a right to avoid a transaction for misrepresentation or undue influence.

Thirdly, huge chunks of what free assets remain have to be applied to meet claims ranking in priority to those of the ordinary unsecured creditor. These embrace: (i) expenses of the liquidation, which are "pre-preferential" liabilities payable in full (rather than having to be proved) and include the liquidator's expenses and remuneration, which can be substantial; and (ii) various claims of employees.[23] When all of these have been satisfied, the dividend produced by what is left is often pitifully small.[24] The effect is largely to frustrate a primary objective of the insolvency process and to deprive the general body of creditors of any significant interest in the winding up process.[25] Yet the *pari passu* principle retains considerable practical importance, if only in a negative sense, in that it may have the effect of invalidating pre-liquidation transactions by which a creditor of a company hopes to secure an advantage over his competitors in the event of the company going into winding up or administration; and where the principle does have this invalidating effect, it results in an expansion of the assets available for

[21] See above, para.3–07.
[22] "Insolvency Law and Practice", Report of the (Cork) Review Committee (Cmnd. 8558), para.1396.
[23] See below, para.8–20.
[24] Although it may be somewhat enhanced by recoveries in respect of void or voidable transactions (below, Ch.13) and under the provisions requiring a percentage ("the prescribed part") of the net realisations of assets subject to a floating charge to be surrendered for the benefit of unsecured creditors (see Insolvency Act 1986 s.176A and below, para.8–50).
[25] A point I developed more fully in "The Death of Insolvency Law" (1980) 3 Co. Law. 123.

distribution.[26] Moreover, the principle of *pari passu* distribution has been invoked as the foundation for other rules which do not involve agreements at all, such as the hotchpot rule,[27] the rule against double proof[28] and the rule that save in exceptional circumstances a creditor should not be given leave to register a charge by a company out of time when it is in liquidation.[29] It is thus necessary to examine the scope of the principle in some detail.

Debts covered by the *pari passu* principle

8–05 The *pari passu* principle applies only: (i) to provable debts payable to the general body of creditors[30]; and (ii) within each separate class of preferential, ordinary and deferred creditors.[31]

The *pari passu* rule may not be excluded by contract

8–06 A contractual provision purporting to exclude the principle of *pari passu* distribution, whether in bankruptcy or in winding up, is void.

> ". . . a man is not allowed, by stipulation with a creditor, to provide for a different distribution of his effects in the event of bankruptcy from that which the law provides."[32]
>
> ". . . a person cannot make it a part of his contract that, in the event of his bankruptcy, he is then to get some additional advantage which prevents the property being distributed under the bankruptcy laws."[33]

However, as we shall see, the *pari passu* principle, broad though it is, does admit of some exceptions.[34]

[26] See below, paras 8–10 et seq.
[27] See below, paras 15–69 and 16–47.
[28] See below, para 8–45.
[29] See below, para 13–125.
[30] See below, para 8–41.
[31] See below, para 8–53.
[32] *Ex p. Mackay* (1873) 8 Ch. App. 643, per James L.J. at 647.
[33] *Ex p. Mackay*, per Mellish L.J. at 648.
[34] See below, paras 8–17 et seq.

2. IMPACT OF THE PARI PASSU PRINCIPLE[35]

Arrangements which do not offend against the *pari passu* principle

8–07 We shall come to the exceptions to the *pari passu* principle a little later.[36] At this point it is worth noting the various types of arrangement which are not considered to offend against the principle of *pari passu* distribution at all. These include subordination agreements, provisions for acceleration of liability on winding up, pre-emption provisions in articles of association of a company providing for the compulsory transfer at a reasonable price of the shares of any member that goes into liquidation or bankruptcy, and rules of an exchange by which members who hold shares in the exchange by virtue of their membership cannot receive consideration for any transfer and have to surrender the shares on cessation of membership on account of insolvency or for any other reason.

Subordination[37]

8–08 Two creditors may agree between themselves that one of them who would otherwise rank higher than or *pari passu* with the other shall be subordinated to the other. The subordination may be of secured or unsecured debt. Subordination of secured debt results in what was originally the higher-ranking mortgage or charge being demoted to junior status. Subordination of unsecured debt typically means either that the subordinated creditor cannot collect from the debtor until the senior creditor has been paid in full or that the junior creditor will account for any collections to the senior creditor until the latter has received full payment. Subordination may arise either by negotiated agreement or by the terms of a bond or note issue under which the rights of holders are subordinated to holders of other bonds or notes issued by the same issuer or certain tranches of the issue are to rank below other tranches. Subordinated loan notes or bonds are frequently issued by banks as part of a securitisation, attracting a higher rate of interest because of the increased risk.

Although in general creditors are free to agree among themselves that the secured or unsecured claim of one of them shall be subordinated to the

[35] See Michael Bridge, "Collectivity, Management of Estates and the *Pari Passu* Rule in Winding Up" in John Armour and Howard Bennett (eds), *Vulnerable Transactions in Corporate Insolvency* (Oxford: Hart Publishing, 2003), Ch.1.

[36] Below, para.8–17.

[37] See generally Philip R. Wood, *Project Finance, Securitisations and Subordinated Debt*, 2nd edn (London: Sweet & Maxwell, 2007); Eilis Ferran, *Company Law and Corporate Finance* (Oxford: Oxford University Press, 1999), Ch.16; and *Goode on Legal Problems of Credit and Security*, edited by Louise Gullifer, 4th edn (London: Sweet & Maxwell, 2008), paras [5.58]–[5.59].

claims of the others, there was until relatively recently concern that in the event of winding up a subordination agreement might be held void as running counter to the mandatory provisions of the insolvency legislation. This was thought to be a possible consequence of the decision of the House of Lords in *National Westminster Bank Ltd v Halesowen Presswork and Assemblies Ltd*[38] to the effect that rules for the administration of assets in winding up embody not merely private rights which creditors are free to vary or waive, but rules of public policy for the orderly administration of estates. In the *Halesowen* case, it was held that a debtor could not contract out his statutory set-off. There was a fear that, by parity of reasoning, a creditor could not subordinate his claim in winding up to a claim of equal rank, for this would (so it was argued) infringe the *pari passu* rule in much the same way as the IATA clearing house arrangement was held to do by a majority decision of the House of Lords in the *British Eagle* case.[39] Conflicting decisions had been given in other parts of the Commonwealth, some courts holding that a subordination agreement contravened the mandatory rules of insolvency law,[40] while others considered that such an agreement had no effect on other creditors and was unobjectionable.[41]

To deny the validity of subordination in insolvency could have the most serious consequences, particularly in view of the widespread use of subordination agreements and the issue of subordinated debt on the market, coupled with the recognition of the efficacy of such agreements in insolvency in foreign jurisdictions and the fact that in many cases a company could not continue to trade and obtain credit unless some of its creditors, which might include the company's parent, were willing to subordinate their indebtedness. In England, there are now several decisions in favour of the validity of subordination agreements. In the first, *Re Maxwell Communications Corp (No.2)*,[42] Vinelott J., after reviewing all of the relevant authorities, concluded that the principle laid down in *Halesowen* applied only to those rules the infringement of which would give one creditor an advantage denied to other creditors. A subordination agreement would not have this effect.[43] In the second case, *Re SSSL Realisations (2002) Ltd*,[44] Lloyd J. held that the validity of a subordination agreement was not affected by the fact that the subordinated creditor was also in insolvent liquidation.[45] To these considerations, one might add that the Insolvency Rules expressly recognise the right

38 [1972] A.C. 785, Lord Cross of Chelsea dissenting.

39 *British Eagle International Airlines Ltd v Compagnie Nationale Air France* [1975] 2 All E.R. 390.

40 See, e.g. *Re Orion Sound Ltd* (1979) 2 N.Z.L.R. 574.

41 See, e.g. *Horne v Chester & Fein Property Developments Pty Ltd* (1987) 11 A.C.L.R. 485.

42 [1994] 1 B.C.L.C. 1.

43 On the contrary, it could have precisely the opposite effect of benefiting all of the ordinary unsecured creditors, not merely the creditor in whose favour the subordination was agreed.

44 [2005] 1 B.C.L.C. 1, affirmed on other issues [2006] Ch. 610.

45 See also *Re Kaupthing Singer & Friedlander Ltd* [2010] EWHC 316 (Ch), per Blair J. at [10].

of a creditor to assign his right of dividend to another creditor,[46] which would typically occur in cases where the first creditor had agreed to be subordinated to the second. It would therefore be strange if the subordination agreement pursuant to which such an assignment was made were to be held invalid.

Moreover, a contract providing for contractual subordination of a company which later goes into liquidation cannot ordinarily be disclaimed as an unprofitable contract under s.178(3)(a) of the Insolvency Act, even though the subordination may be financially disadvantageous, because the contract does not by reason only of the subordination give rise to prospective liabilities, it does not require performance over a substantial period of time and it does not involve expenditure.[47]

Provisions for acceleration of liability on winding up

8–09 In the case of an executed contract, winding up automatically accelerates the debt,[48] subject to a statutory discount to allow for the acceleration when a dividend distribution comes to be made.[49] But to cover cases where the contract is still executory at the time of winding up, so that the liquidator has the option to adopt it, the other party may seek to provide in the contract for acceleration of the company's liability in the event of its going into liquidation. In this case, the acceleration clause would appear to be of no effect, for if the liquidator were to adopt the contract, he would have to use the company's assets to make payment before the company could receive the benefit against which the payment was to have been made, whilst if he did not adopt it, the other party would be in the position of being able to prove for a supposed debt in respect of which payment had not been earned. This conclusion is reinforced by r.4.92 of the Insolvency Rules, under which a creditor may prove for rent and other payments of a periodical nature only so far as due and unpaid up to the date on which the company went into liquidation.[50]

8–10 The *pari passu* rule has two broad effects. First, it invalidates agreements designed to give one creditor a benefit at the expense of the others when the

[46] Insolvency Rules 1986 r.11.11(1), which requires a liquidator who receives notice of the assignment to pay the dividend to the assignee.

[47] *Re SSSL Realisations Ltd* [2006] Ch. 610, affirming the decision of Lloyd J. [2005] 1 B.C.L.C. 1.

[48] See above, para.3–11.

[49] Insolvency Rules 1986 r.11.13(2). The same is true of administration (r.2.105). However, if the agreement itself provides for acceleration, the whole amount becomes provable without a discount.

[50] If the lease or contract under which the rent or other periodical sum is payable continues in force, so that the company receives the quid pro quo for the payment, the creditor can adjust his proof so as to claim for each further sum as it falls due. See above, para.6–22 and below para.8–41.

company goes into liquidation or administration.[51] Secondly, it provides the underpinning of other rules aimed at securing equality of distribution.

Impact of the *pari passu* principle on contracts

Direct payment clauses in building contracts

8–11 Building contracts commonly provide that in the event of a main contractor's insolvency the employer should be entitled to utilise sums that would otherwise be payable to the main contractor to make direct payment to sub-contractors of sums due to them from the main contractor.[52] Since the majority decision of the House of Lords in *British Eagle International Airlines Ltd v Cie Nationale Air France*,[53] such provisions have come under attack as procuring payment to the sub-contractor out of funds that should have been available to the general body of creditors, thus contravening the principle of *pari passu* distribution.[54] The first question to consider is whether the funds would, indeed, have been available to creditors. It seems clear that where payment to the sub-contractor was to be made from retention funds held for the benefit of the main contractor, there could be no infringement of the *pari passu* rule to the extent that prior to liquidation the main contractor had ceased to have an interest in the retention fund, because it had mortgaged such interest[55] or had agreed to hold it on trust for the sub-contractor.[56] More difficult is the case where the right to payment under the main contract remains vested in the main contractor, but the contract provides that the employer may withhold payment until all sub-contractors have been paid sums that have become payable to them under their sub-contracts and may pay direct to sub-contractors sums owing by the main contractor. Such was the position in *Att Gen v McMillan & Lockwood Ltd*,[57] which produced a division of opinion in the New Zealand Court of Appeal. The majority view was that upon the main contractor going into liquidation the continued application of the provision as to withholding of payment from the contractor and payment to sub-contractors was barred by the *pari passu* rule. The minority view, as expressed by Williamson J., was that the liquidator could not stand in any better position than the company had before it went into winding up and was therefore not entitled to disregard the withholding clause.[58] Williamson J.

[51] The benefit must be in favour of a creditor; if it is in favour of a party who is not a creditor, the rule to be applied is the anti-deprivation rule discussed in Ch.7.
[52] See para.6–17.
[53] [1975] 2 W.L.R. 758. See also paras 6–17 and 9–14.
[54] For a general discussion, see Michael G. Bridge, "Collectivity", cited above n.35, pp.26 et seq.
[55] *Drew & Co v Josolyne* (1887) 18 Q.B.D. 590.
[56] *Re Tout & Finch Ltd* [1954] 1 W.L.R. 178. See further para.6–17.
[57] [1991] 1 N.Z.L.R. 53.
[58] For an English decision to the same effect, see *Re Wilkinson* [1905] 2 K.B. 713.

considered that it was necessary to balance the various public policy considerations, and this led him to the conclusion that it would not be contrary to public policy for the withholding clause to continue to operate after the company had gone into liquidation. This difference of view corresponds precisely to that which featured in *British Eagle*, discussed earlier,[59] the majority decision of the New Zealand Court of Appeal following the majority decision of the House of Lords in *British Eagle*.

It should be noted that if the Minister had made payments to sub-contractors prior to the main contractor's liquidation, these would not have been affected by the *pari passu* rule, which, as noted earlier, has no backward reach and bites only on provisions for payment unimplemented at the commencement of the winding up. However, the mere fact that the Minister's power had become exercisable prior to the winding up was not sufficient; once liquidation supervenes payment cannot be made to one creditor at the expense of others, even if the liability to make the payment was incurred before the commencement of the winding up.

Contractual set-off in favour of a third party

8–12 A contractual provision for set-off of claims by third parties against a debt owed to the company is not valid on the company's liquidation, for set-off is limited to mutual claims and to allow third-party set-off would be to subvert the fundamental principle of *pari passu* distribution of the insolvent company's assets.[60]

Provision for additional security

8–13 It is also a contravention of the *pari passu* principle for the debtor company to undertake to give the creditor additional security in the event of the company's liquidation.[61]

The *pari passu* rule as the principle underlying other rules

8–14 The *pari passu* rule has manifestations which go beyond contractual provisions. It provides the underpinning for other insolvency rules relating to proof of debt. Thus, the rule that claims are to be valued as at the date of commencement of

[59] Above, para.6–17 and below, para.9–14.
[60] *Re Bank of Credit and Commerce International SA* [1998] A.C. 214, per Lord Hoffmann at [5], citing *British Eagle*, cited above n.39.
[61] *Re Thompson Ex p. Williams* (1877) 7 Ch.D. 138.

the winding up is designed to ensure that one is comparing like with like so that the assets are distributed *pari passu*.[62] The hotchpot rule, by which a creditor seeking to prove in the winding up of the company must bring into account any dividend he has received in a foreign liquidation of the company,[63] reflects the principle that the assets of a company in liquidation, after provision for liquidation expenses and preferential debts, are divided *pari passu* among the creditors.[64] Similarly, the rule against double proof, which precludes two parties, for example, a creditor and a surety from proving separately for the same debt, is a particular application of the principle that the debtor's assets are to be applied in payment to its creditors *pari passu*[65].

3. EXCEPTIONS TO THE PARI PASSU PRINCIPLE

8–15 The *pari passu* principle, although of fundamental importance, is not absolute. For reasons of policy, insolvency law provides certain deviations. But before considering these, I should like to mention cases which are often advanced as exceptions to the *pari passu* principle but which in reality involve an entirely different principle.[66]

False exceptions to the *pari passu* principle

8–16 The principle of *pari passu* distribution of assets does not apply to the rights of secured creditors, suppliers of goods under agreements reserving title or creditors for whom the company holds assets on trust.[67] However, this is not because these are exceptions to the rule but because such assets do not belong to the company[68] and thus do not fall to be distributed among creditors on any basis. While liquidation expenses, including liabilities under post-liquidation contracts, enjoy a super-priority,[69] they do not constitute an

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[62] *Re Dynamics Corp of America* [1976] 1 W.L.R. 757, per Oliver L.J. at 764 in a passage cited with approval by the House of Lords in *Wight v Eckhart Marine GmbH* [2004] 1 A.C. 147 at [28].

[63] See below, para.15–69.

[64] *Cleaver v Delta American Reinsurance Co* [2001] 2 A.C. 328, per Lord Scott at [31].

[65] *Barclays Bank v T.O.S.G. Trust Fund Ltd* [1984] A.C. 626, per Oliver L.J. at 637.

[66] See also R.J. Mokal, *Corporate Insolvency Law: Theory and Practice*, pp.96 et seq.

[67] There is said to be one case in which moneys held on trust are subject to a right of set-off, namely where the solvent creditor holds property of the company with authority, still current at the time of winding up, to convert it into money; but this appears not to be a true exception, but rather to turn on an implied agreement that the solvent party is to be a debtor, not a trustee. See below para.9–26.

[68] In the case of assets subject to a security interest, the assets do not belong to the company to the extent of the security interest, but the company does, of course, have an equity of redemption.

[69] See below, para.8–32.

TAB 16

All England Law Reports/2015/Volume 2 /Re Lehman Brothers International (Europe) (in administration) and others - [2015] 2 All ER 111

[2015] 2 All ER 111

Re Lehman Brothers International (Europe) (in administration) and others

[2014] EWHC 704 (Ch)

CHANCERY DIVISION

DAVID RICHARDS J

12-15, 18-20 NOVEMBER 2013, 14 MARCH 2014

Company - Administration - Assets available for creditors - Ranking of claims - Surplus of assets after payment of unsubordinated proved debts - Shareholder who was also subordinated debt-holder submitting claim in company's administration - Whether subordinated debt-holder's claim ranking before or after claims for statutory interest on proved debts - Whether subordinated debt-holder's claim ranking before or after claims of foreign currency creditors - Whether contractual interest provable or statutory interest payable if administration immediately followed by liquidation - Whether shareholders' contribution obligation limited to paying proved debts and liabilities or extending to payment of statutory interest and non-provable liabilities - Whether administrators entitled to refuse to admit proofs of debt under contributory rule or equitable rule preventing distribution of fund to person sharing in fund unless he brought into fund what he owed - Whether liability for future calls could be proved in administration or liquidation of corporate contributory - Insolvency Act 1986, ss 74(1), 189(2) - Insolvency Rules 1986, SI 1986/1925, rr 2.86(1), 2.88, 4.91(1).

The main operating company of the Lehman Brothers group in the United Kingdom and Europe was Lehman Brothers International (Europe) ('LBIE'), an unlimited company incorporated in England, which had two shareholders, LBL and LBHI2, both of which were Lehman group companies. LBHI2 was the immediate holding company of LBIE and held all but one of the shares. LBL held the other share and was a service company for various Lehman companies, including LBIE. In September 2008 the Lehman group collapsed and all three companies were put into administration in England. Separate administrators were appointed for each company. In the administration of LBIE it was anticipated that after payment of all unsubordinated proved debts there would be a significant surplus available to pay other creditors and/or make a distribution to LBHI2 and LBL as members. Both LBHI2 and LBL had ordinary unsecured claims against LBIE, and LBHI2 was also a subordinated loan creditor for $2.225bn (the subordinated loan debt) under subordinated loan agreements under which LBHI2 provided a loan facility to LBIE to enable it to secure its regulatory capital. LBHI2 lodged a claim in the LBIE administration for over £11/4bn in respect of the subordinated loan debt, and while it accepted that its claim ranked behind provable debts it contended that it ranked ahead of all other claims, including unsecured creditors' claims for statutory interest. Under r 2.88(9)[a] of the Insolvency Rules 1986, interest had

[a] Rule 2.88, so far as material, is set out at [18], [113], [114], below

accrued from the date of administration in September 2008 at the statutory rate of 8% or the contractual rate, whichever was the higher. The administrators of the three companies applied for directions as to which, if any, claims were payable out of the surplus before any return could be made to the two members, the order in which claims ranked for payment, and whether LBL and LBHI2 were potentially liable to make contributions under s 74(1) of the Insolvency Act 1986, which imposed on shareholders in a winding up an obligation to contribute an amount sufficient to pay the company's debts and liabilities and the winding-up expenses and to enable adjustment of the contributories' rights among themselves. The issues that arose on the application were: (i) whether LBHI2's claim, as the subordinated debt-holder, ranked before or after claims for statutory interest on proved debts, having regard to r 2.88(7) which stated that 'Any surplus remaining after payment of the debts proved shall, before being applied for any purpose, be applied in paying interest on those debts', and to s 189(2)[b] of the 1986 Act which provided that any surplus remaining in a winding up after the payment of proved debts 'shall, before being applied for any other purpose, be applied in paying interest on those debts'; (ii) whether LBHI2's claim ranked before or after the claims of foreign currency creditors who had suffered loss as a result of their debts being automatically converted under rr 2.86(1) and 4.91(1)[c] into sterling at the date of the commencement of the administration for the purposes of proof of debt; (iii) whether such foreign currency conversion claims were capable of being asserted against LBIE so as to be payable out of available assets; (iv) whether contractual interest was provable or statutory interest was payable for the period of an administration if it was immediately followed by a liquidation; (v) whether, arising out of LBIE's status as an unlimited company, the shareholders' contribution obligation under s 74(1)[d] of the 1986 Act was limited to the amount required to pay proved debts and liabilities in the liquidation or whether it extended to providing funds to pay statutory interest and any non-provable liabilities; (vi) whether the 'contributory rule' (under which a contributory of a company in liquidation could not recover anything in respect of his claim as a creditor until he fully discharged his obligations as a contributory) or the equitable rule in *Cherry v Boultbee* (1839) 4 My & Cr 442, (1839) 41 ER 171 (under which a person entitled to a distribution from a fund, such as an insolvent estate, to which he owed money, was required to contribute what he owed to the fund before he could receive a distribution from it) applied to the administration of LBIE and entitled the administrators to refuse to admit proofs of debt by LBHI2 or LBL or to pay dividends on such proofs, on the grounds that if LBIE went into liquidation LBHI2 and LBL would or might become liable to meet calls under s 74(1) which they would not be able to satisfy because they were insolvent; (vii) whether, and if so when, a liability for future calls could be the subject of proof in the administration or liquidation of a corporate contributory; (viii) what was the effect of set-off in the administration or liquidation of a corporate contributory; and (ix) what was the effect of set-off in the administration or liquidation of LBIE.

Held - (1) The claims of LBHI2 arising under its subordinated loan agreements with LBIE were subordinated not only to provable debts but also to statutory

[b] Section 189, so far as material, is set out at [116], below

[c] Rule 4.9, so far as material, is set out at [93], below

[d] Section 74 is set out at [138], below

interest and unprovable liabilities. The term 'Liabilities' in the subordinated loan agreements was not restricted to provable debts, and the category of non-provable liabilities which were payable if there were sufficient assets available included the claims of creditors which could not, by virtue of the relevant legislation, constitute provable debts but which were just as much liabilities of the borrower as provable liabilities. Rule 2.88(7) of the Insolvency Rules applied to a surplus of assets over proved debts, not a surplus after the discharge of all liabilities; the rule created a right in favour of creditors to have the relevant surplus applied in the payment of statutory interest, and that right fell within the definition of 'Liabilities' in the subordinated loan agreements which were 'payable or owing' by LBIE. Accordingly, the effect of the subordination provisions was that the subordinated debt ranked below statutory interest and any other non-provable debts in the order of

priority of distribution of assets of LBIE (see [23], [62]-[64], [71], [77], [85]-[87], [250], below); *Re Nortel GmbH* [2013] 4 All ER 887 applied; *Re Lines Bros Ltd* [1984] BCLC 215 distinguished.

(2) Creditors of LBIE whose contractual or other claims were denominated in a foreign currency were entitled to claim in the LBIE administration for any currency losses suffered as a result of a decline in the value of sterling against the currency of their claim between the date of the commencement of the LBIE administration and the date of distribution payments made to them, since it would be contrary to principle and justice if the debtor, or the shareholders receiving the surplus, were able to deny foreign currency claimants their full contractual rights. However, currency conversion claims ranked as unprovable liabilities and were only payable after payment in full of all proved debts and statutory interest on those debts (see [104], [110]-[111], [250], below); *Re Dynamics Corp of America (No 2)* [1976] 2 All ER 669 and *Re Lines Bros Ltd (in liq)* [1982] 2 All ER 183 considered.

(3) If the administration of LBIE was immediately followed by a liquidation, unpaid interest in respect of the period of the administration was not provable as a contractual debt in the liquidation nor payable as statutory interest under either r 2.88 of the Insolvency Rules or s 189 of the 1986 Act. However, creditors of LBIE with debts which carried interest by reason of contract, judgment or other reasons unconnected with the administration or liquidation of LBIE were entitled to claim in a subsequent liquidation of LBIE immediately following the administration for interest accrued due during the period of the administration, because it was an unprovable claim payable after payment in full of all proved debts and statutory interest (see [118]-[121], [126]-[127], [250], below); *Re Humber Ironworks and Shipbuilding Co* (1869) LR 4 Ch App 643 applied.

(4) Arising out of LBIE's status as an unlimited company, the obligation of LBHI2 and LBL as LBIE's shareholders to make a contribution under s 74(1) of the 1986 Act to the assets of a company in liquidation 'sufficient for payment of its debts and liabilities' was not restricted to providing for proved debts but extended under s 189(2) to paying statutory interest on those debts and unproved liabilities (see [112], [155], [163]-[164], [175], [178], [250], below).

(5) The contributory rule and the equitable rule in *Cherry v Boultbee* applied only in a liquidation and did not apply in an administration, since there was no statutory mechanism for making calls on contributories in an administration. Accordingly, an administrator was not permitted to refuse to admit a proof of debt by a member or to refuse to pay dividends on such proof on the grounds that if the company went into liquidation the member would or might become

[2015] 2 All ER 111 at 114

liable to calls under s 74(1) which it could not pay. Accordingly, LBHI2 and LBL were not prevented by those rules from lodging claims in the administration of LBIE (see [188]-[189], [193]-[194], [250], below); *Re Kaupthing, Singer and Friedlander Ltd (in administration) (No 3)* [2012] 1 All ER 883 applied; *Cherry v Boultbee* (1839) 4 My & Cr 442 and *Re Overend, Gurney & Co, Grissell's Case* (1866) LR 1 Ch App 528 distinguished.

(6) LBIE, acting by its administrators, was entitled to lodge a proof in a distributing administration or a liquidation of either LBL or LBHI2 in respect of those companies' contingent liabilities under s 74(1) of the Insolvency Act 1986 which would arise if LBIE went into liquidation and calls were made by the liquidator. The valuation of such claims was a matter of estimation under the provisions of the Insolvency Rules (see [195]-[196], [200], [226], [250], below) dicta of Lord Neuberger in *Re Nortel* [2013] 4 All ER 887 at [75]-[77] applied; *Re Pyle Works* (1889) 44 Ch D 534 considered.

(7) In a distributing administration or liquidation of LBL or LBHI2, the claims of those companies as creditors of LBIE would be the subject of mandatory set-off against the claims of LBIE in respect of those companies' contingent liabilities as contributories. Moreover, in the administration of LBIE the contingent liabilities of LBL and LBHI2 as contributories would be the subject of mandatory set-off against the admitted proofs of debt of those companies as creditors of LBIE. (see [228], [242], [249]-[250], below); *Re Duckworth* (1867) LR 2 Ch App 578 considered; *Re Auriferous Properties Ltd (No 1)* [1898] 1 Ch 691 doubted and not followed.

Notes

For the rule in *Cherry v Boultbee*, see 5 *Halsbury's Laws* (5th edn) (2013) para 573, and for powers and functions of administrator; quantifying claims; interest, see 16 *Halsbury's Laws* (5th edn) (2011) para 286.

For the Insolvency Act 1986, ss 74, 189, see 4(2) *Halsbury's Statutes* (4th edn) (2012 reissue) 138, 239.

For the Insolvency Rules 1986, SI 1986/1925, rr 2, 4, see 3 *Halsbury's Statutory Instruments* (2006 reissue) 430, 489.

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Abrahams, Re, Abrahams v Abrahams [1908] 2 Ch 69.

Akerman, Re, Akerman v Akerman [1891] 3 Ch 212, [1891-94] All ER Rep 196.

Anglo-French Co-operative Society, Re, ex p Pelly (1882) 21 Ch D 492, CA.

Auriferous Properties Ltd, Re (No 1) [1898] 1 Ch 691.

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British & Commonwealth Holdings plc, Re (No 3) [1992] BCLC 322, [1992] 1 WLR 672.

British Eagle International Airlines Ltd v Cie Nationale Air France [1975] 2 All ER 390, [1975] 1 WLR 758, HL.

Chartbrook Ltd v Persimmon Homes Ltd [2009] UKHL 38, [2009] 4 All ER 677, [2009] AC 1101, [2009] 3 WLR 267.

Cherry v Boultbee (1838) 2 Keen 319, (1838) 48 ER 651; *affd* (1839) 4 My & Cr 442, (1839) 41 ER 171, LC.

Duckworth, Re (1867) LR 2 Ch App 578, CA.

Dynamics Corp of America, Re (No 2) [1976] 2 All ER 669, [1976] 1 WLR 757.

GEB (a debtor), Re [1903] 2 KB 340, CA.

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General Works Co, Re, Gill's Case (1879) 12 Ch D 755.

Humber Ironworks and Shipbuilding Co, Re, Warrant Finance Co's Case (1869) LR 4 Ch App 643, CA.

International Contract Co, Re, Hughes' Claim (1872) LR 13 Eq 623, V-C.

Kaupthing, Singer and Friedlander Ltd (in administration), Re (No 3) [2011] UKSC 48, [2012] 1 All ER 883, sub nom *Re Kaupthing, Singer and Friedlander Ltd (in administration) (No 2), Mills v HSBC Trustee (CI) Ltd* [2012] 1 AC 804, [2011] 3 WLR 939.

Lines Bros Ltd (in liq), Re [1982] 2 All ER 183, [1983] Ch 1, [1982] 2 WLR 1010, CA.

Lines Bros Ltd, Re [1984] BCLC 215.

Martin's Patent Anchor Co Ltd v Morton (1868) LR 3 QB 306.

Maxwell Communications Corp plc, Re (No 2) [1994] 1 All ER 737, [1993] 1 WLR 1402.

McMahon, Re [1900] 1 Ch 173.

Milan Tramways Co, Re, ex p Theys (1884) 25 Ch D 587, CA.

Miliangos v George Frank (Textiles) Ltd [1975] 3 All ER 801, [1976] AC 443, [1975] 3 WLR 758, HL.

Nortel GmbH (in administration), Re, Re Lehman Brothers International (Europe) (in administration) (Nos 1 and 2) [2013] UKSC 52, [2013] 4 All ER 887, [2014] AC 209, [2013] 3 WLR 504; *rvsg* [2011] EWCA Civ 1124, [2012] 1 All ER 1455, [2012] Bus LR 818; *affg* [2010] EWHC 3010 (Ch), [2011] Bus LR 766.

Overend, Gurney & Co, Re, Grissell's Case (1866) LR 1 Ch App 528, CA.

Paraguassu Steam Tramroad Co, Re, Black & Co's Case (1872) LR 8 Ch App 254, CA.

Pyle Works, Re (1889) 44 Ch D 534, CA.

Revenue and Customs Comrs v Football League Ltd [2012] EWHC 1372 (Ch), [2013] 1 BCLC 285, [2012] Bus LR 1539.

R-R Realisations Ltd, Re [1980] 1 All ER 1019, [1980] 1 WLR 805.

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United Railways of The Havana and Regla Warehouses Ltd, Re [1960] 2 All ER 332, [1961] AC 1007, [1960] 2 WLR 969, HL.

Vaughan, Re, ex p Canwell (1864) 4 De G J & Sm 539, 46 ER 1028.

Washington Diamond Mining Co, Re [1893] 3 Ch 95, CA.

West Coast Gold Fields Ltd, Re, Rowe's Trustee's Claim [1905] 1 Ch 597; *affd* [1906] 1 Ch 1, CA.

West of England and South Wales District Bank, Re, ex p Branwhite (1879) 48 LJ Ch 463, 40 LT 652.

White Star Line Ltd, Re [1938] 1 All ER 607, [1938] 1 Ch 458, CA.

Whitehouse & Co, Re (1878) 9 Ch D 595.

Wight v Eckhardt Marine Gmbh [2003] UKPC 37, [2004] 2 BCLC 539, [2004] 1 AC 147, [2003] 3 WLR 414.

Williams v Harding (1866) LR 1 HL 9, HL.

Application

By an application issued on 14 February 2013 and amended on 27 March 2013, (i) the joint administrators of Lehman Bros International (Europe) ('LBIE'),

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namely Anthony Victor Lomas, Steven Anthony Pearson, Derek Anthony Howell, Paul David Copley and Russell Downs, (ii) the joint administrators of Lehman Bros Ltd ('LBL'), namely Anthony Victor Lomas, Steven Anthony Pearson, Michael John Andrew Jervis, Derek Anthony Howell and Dan Yoram Schwarzmann, and (iii) the joint administrators of LB Holdings Intermediate 2 Ltd ('LBHI2'), namely Anthony Victor Lomas, Steven Anthony Pearson, Derek Anthony Howell, Dan Yoram Schwarzmann and Michael John Andrew Jervis, applied for directions under para 63 of Sch B1 to the Insolvency Act 1986 as to whether LBHI2 and LBL (the members), as the two members of LBIE, were entitled to prove in the administration of LBIE and whether LBIE was entitled to prove in the administrations or in any subsequent liquidations of the members, and if so the ranking of such claims, the extent of any set off and contribution required to be made by the members pursuant to s 74 of the Act, to LBIE's assets for the payment of LBIE's debts and liabilities, the expenses of the winding up and to enable adjustment of the rights of the contributories amongst themselves. Lehman Brothers Holdings Inc ('LBHI'), which was the ultimate parent of the Lehman Bros group, and Lydian Overseas Partners Master Fund Ltd ('Lydian'), which was an unsecured unsubordinated creditor of LBIE, were joined as respondents. The facts are set out in the judgment.

William Trower QC and Daniel Bayfield (instructed by Linklaters LLP) for the joint administrators of LBIE.

David Wolfson QC and Nehali Shah (instructed by DLA Piper UK LLP) for the joint administrators of LBL.

Anthony Trace QC, Louise Hutton and Rosanna Foskett (instructed by Dentons UKMEA LLP) for the joint administrators of LBHI2.

Barry Isaacs QC and Mark Arnold QC (instructed by Weil, Gotshal & Manges) for LBHI.

Antony Zacaroli QC and David Allison (instructed by Allen & Overy LLP) for Lydian.

Judgment was reserved.

14 March 2014. The following judgment was delivered.

DAVID RICHARDS J.

Introduction

[1] This is an application by the joint administrators of three companies in the Lehman Brothers group. The circumstances which give rise to the application are both unexpected and unusual.

[2] The circumstances are unexpected because when the Lehman Brothers group collapsed in September 2008, it was not anticipated that there would be any surplus of assets once the general body of unsecured creditors of any of the principal companies had been paid. The principal trading company within the group in the United Kingdom and Europe was Lehman Brothers International (Europe) ('LBIE') and it is now anticipated that it is likely to have a significant surplus once all unsubordinated proved debts have been paid in full.

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[3] The circumstances are unusual because LBIE is an unlimited company. It has two members, both other companies in the group. Both have ordinary unsecured claims against LBIE and one of them has a very large claim as a subordinated loan creditor. Issues arise as to the potential liability of the members for the liabilities of LBIE, and in particular its subordinated liabilities, and the relationship between their liability, if any, as members and their claims as creditors.

[4] The purpose of the application is to determine the claims which may be made against the surplus before any return to members and the order in which such claims rank for payment, and to resolve the existence and extent of the potential liability of the members. These broadly stated issues involve a number of novel and important questions.

[5] The applicants are the respective joint administrators of LBIE and of its two members, Lehman Brothers Ltd ('LBL') and Lehman Brothers Holdings Intermediate 2 Ltd ('LBHI2'). LBIE and LBL have been in administration since September 2008 and LBHI2 since January 2009.

[6] Lehman Brothers Holdings Inc ('LBHI') and Lydian Overseas Partners Master Fund Ltd ('Lydian') were joined as respondents. LBHI is the ultimate parent of the Lehman Brothers group. On 15 September 2008 it commenced Ch 11 bankruptcy proceedings in the United States Bankruptcy Court for the Southern District of New York, from which it emerged on 6 March 2012. It is an indirect creditor of many companies in the group and the ultimate shareholder of all of them. Its primary interest on this application relates to LBHI2's right to recover subordinated loans made by it to LBIE and issues relating to such subordinated loans. Although there are in some respects important differences between the positions adopted by LBL, LBHI2 and LBHI, they have made common cause on most issues, while in some instances advancing different submissions in support of the same conclusions. For convenience, I will call them 'the other Lehman companies' when referring to them collectively.

[7] Lydian is an unsecured unsubordinated creditor of LBIE and its position is aligned with the submissions which have been advanced on behalf of the administrators of LBIE. They have avoided duplication of submissions and Lydian has

concentrated on issues relating to foreign currency conversion claims.

[8] The parties have agreed a statement of facts and there have been no contested issues of fact. The entire argument has been directed to legal issues.

[9] The parties cooperated to produce an agreed list of issues, divided into 22 questions, some of which are further subdivided. The oral and written submissions of the parties were not primarily directed to each of those questions, but rather were made by reference to a number of principal issues. I have adopted the same course in this judgment and do not attempt to provide answers to each of the questions in the list of issues.

Background

[10] LBIE was incorporated on 10 September 1990 under the Companies Act 1985 as a company limited by shares. On 21 December 1992 it was re-registered as an unlimited company. It appears that this step was taken for US tax reasons. Re-registration of LBIE as an unlimited company enabled it to be treated as a branch of its then parent company for US tax purposes, thereby enabling losses in LBIE to be set off against profits in the parent.

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[11] The share capital of LBIE comprises 6,273,113,999 ordinary shares of $1 each, 2m 5% redeemable Class A preference shares of $1000 each, and 5·1m 5% redeemable Class B shares of £1000 each. All these shares, except for one ordinary share, are held by LBHI2. The two classes of preference shares result from capital restructurings of LBIE in 2006 and 2007, to which I shall refer below. The remaining ordinary share is held by LBL.

[12] The sole function of LBHI2 was to act as the immediate holding company of LBIE.

[13] LBL was the service company for the operations of the group in the UK, Europe and the Middle East, and as regards companies based in the UK, was the principal employer, seconding employees to other companies within the group, maintained the IT systems and was the lessee of many of the group's premises. It became a shareholder in November 1994, holding a single ordinary share denominated in sterling. In May 1997 all the sterling shares were cancelled and replaced by shares denominated in US dollars and LBL has at all times since then been the holder of a single ordinary share of $1. There is no documentary evidence that LBL held the dollar share as nominee for the other shareholder. This judgment does not deal with the relationship between LBL and LBHI2 as members of LBIE, and whether LBL has any right of indemnity against LBHI2.

[14] The administrations of these companies have involved the realisation of their assets to best advantage, rather than the preservation of the companies as going concerns. Paragraph 65 of Sch B1 to the Insolvency Act 1986 ('the 1986 Act') permits the administrator of a company to make distributions to creditors of the company, with the permission of the court where the creditors are neither secured nor preferential. Once an administrator gives notice of an intention to make a distribution, the administration is commonly referred to as a distributing administration. Detailed provisions related to the making of distributions to creditors by administrators are contained in rr 2.68 to 2.105 of the Insolvency Rules 1986 ('the Insolvency Rules'), which for the most part reflect the equivalent provisions in rr 4.73 to 4.99 applicable in a winding up. With the permission of the court, the administrators of LBIE declared and paid a first interim dividend of 25.2p in the £ in November 2012, totalling some £1·611bn.

Ranking of claims

[15] Central to many of the issues arising on this application are the claims which may be made against the available assets of LBIE after payment of all its general unsecured unsubordinated creditors and the ranking of those claims. In *Re Nortel GmbH* [2013] UKSC 52, [2013] 4 All ER 887, [2014] AC 209 Lord Neuberger said (at [39]):

'In a liquidation of a company and in an administration (where there is no question of trying to save the company or its business), the effect of the insolvency legislation ... as interpreted and extended by the courts, is that the order of priority for payment out of the company's assets is, in summary terms, as follows: (1) Fixed charge creditors; (2) Expenses of the insolvency proceedings; (3) Preferential creditors; (4) Floating charge creditors; (5) Unsecured provable debts; (6) Statutory interest; (7) Non-provable liabilities; and (8) Shareholders.'

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The categories relevant to the issues on this application are, principally, statutory interest and non-provable liabilities.

[16] Provable debts rank equally between themselves and are paid in full unless the assets are insufficient to meet them, in which case they abate in equal proportions between themselves: r 2.69. Rules 2.72 to 2.80 provide the machinery for proving debts, including the submission of a proof, its admission or rejection by the administrator and appeals against the administrator's decision. Rule 2.81 provides for the administrator to estimate the value of any debt which, by reason of its being subject to any contingency or for any other reason, does not bear a certain value and provides that he may revise any estimate previously made, if he thinks fit by reference to any change of circumstances or to any information becoming available to him. The amount provable in the administration in such a case is the estimate for the time being. Rule 2.85 provides for set-off. Rule 2.86 provides for the conversion of foreign currency debts into sterling, a rule to which I shall later return. Rule 2.89 provides that a creditor may prove for a debt of which payment was not yet due on the date when the company entered administration, but subject to r 2.105 which adjusts the dividend where payment is not due at the date of the declaration of dividend.

[17] The claims of creditors which are provable as debts in an administration, as well as in a liquidation, are governed by rr 12.3 and 13.12.

[18] The sixth category, statutory interest, in the order of priority set out in Lord Neuberger's judgment, is governed in the case of an administration by r 2.88. Provisions in very similar terms apply in a liquidation and are contained in s 189 of the 1986 Act and in r 4.93. Rule 2.88 was amended with effect from 6 April 2010 so as to apply to administrations commencing on or after that date. LBIE entered administration in September 2008, so that r 2.88, as amended in 2005, applies to it. Rule 2.88(1) in the form applicable to the administration of LBIE provides that where a debt proved in the administration bears interest, the interest is provable as part of the debt except insofar as it is payable in respect of any period after it entered administration or, if the administration was immediately preceded by a winding up, any period after the date of liquidation. Rule 2.88(3) to (4) in the form applicable to LBIE provides for the payment of interest in respect of periods before the relevant date in certain circumstances which are not directly material to the issues on this application. The provisions of r 2.88(7) to (9) for the payment of interest in respect of periods after the relevant date are critical to some of the issues and, in the form applicable to LBIE, are as follows:

'(7) ... any surplus remaining after payment of the debts proved shall, before being applied for any purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the company entered administration.

(8) All interest payable under paragraph (7) ranks equally whether or not the debts on which it is payable rank equally.

(9) The rate of interest payable under paragraph (7) is whichever is the greater of the rate specified under paragraph (6) or the rate applicable to the debt apart from the administration.'

The rate specified under r 2.88(6) is the rate specified in s 17 of the Judgments Act 1838 on the date on which the company entered administration. The rate at the commencement of the administration of LBIE was 8%. It is relevant to

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note that this rate is significantly in excess of market rates since 2008, which explains why unsecured claims against LBIE have been trading at a substantial premium to par since it became apparent that there may be a surplus of assets available after the payment of all unsubordinated proved debts.

[19] The effect of r 2.88 is that contractual interest for periods up to the commencement of the administration is provable but post-administration contractual interest is not. Instead, interest is payable on all proved debts, whether or not they carried any entitlement to interest, from the commencement of administration to the date of payment or payments of the proved debts. It is this latter category of interest which is termed 'statutory interest' and it is payable out of the surplus remaining after payment of the debts proved before such surplus is applied for any purpose.

Non-provable liabilities

[20] The seventh category in the order of priority, non-provable liabilities, requires some explanation and is indeed the subject of some controversy on this application. In *Re Nortel* the issue was whether liabilities arising under contribution notices issued under the Pensions Act 2004 against companies after they had gone into administration ranked as expenses of the administration or provable debts or neither. At first instance ([2010] EWHC 3010 (Ch), [2011] Bus LR 766) and in the Court of Appeal ([2011] EWCA Civ 1124, [2012] 1 All ER 1455, [2012] Bus LR 818) it was held that they ranked as expenses. Reversing these decisions, the Supreme Court held that they were provable debts. The possibility that the liability created by a contribution notice issued in these circumstances could be neither an expense nor a provable debt was explicitly contemplated by the Supreme Court. In those circumstances it would fall within category (7): see *Re Nortel* [2013] 4 All ER 887 at [54] and [115].

[21] Although the clear trend of insolvency legislation since the nineteenth century has been to expand the category of debts which may be the subject of proof, there have until very recently been some well-recognised categories of debt which were not capable of proof in an administration or liquidation. First, claims in tort could not be proved unless the cause of action had accrued by the commencement of the administration or liquidation, until r 13.12 was amended to reverse the effect of the decision in *Re T & N Ltd* [2005] EWHC 2870 (Ch), [2006] 3 All ER 697, [2006] 1 WLR 1728. By virtue of the amendment, such claims may be proved provided that 'all the elements necessary to establish the cause of action exist at [the commencement of the administration or liquidation] except for actionable damage'. Secondly, costs awarded against a company in administration, albeit in proceedings commenced before the administration and in respect of costs incurred prior to the commencement of the administration, were held not to be provable debts in a long line of cases, which were overruled by the Supreme Court in *Re Nortel*.

[22] Mr Isaacs QC, on behalf of LBHI, submitted that following the decision of the Supreme Court in *Re Nortel*, it is no longer possible for any claims to fall within category (7) except as expressly provided by provisions in the legislation. Rule 12.3(2)(b) provides that obligations arising under confiscation orders made under certain legislation relating to criminal offences and any obligation arising from a payment out of the social fund under social security legislation by way of crisis loan or budgeting loan are not provable in an administration or

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liquidation. Mr Isaacs submits that these are the claims to which category (7) is confined, together with any other claims which by future legislation may not be provable.

[23] I do not accept this submission. In the context of the issue under consideration in *Re Nortel*, I feel no doubt that Lord Neuberger intended the category to include such claims of creditors as could not, by virtue of the relevant legislation, constitute provable debts but which would remain as liabilities of the company, payable in the event that there were sufficient assets available for the purpose. Given that the other items in the order of priority achieve their respective rankings by reason of express provisions in the legislation, it appears to me that when Lord Neuberger referred to the legislation 'as interpreted and extended by the courts' he was referring, if not solely then primarily, to 'non-provable liabilities' falling within category (7). The Supreme Court did not decide that there could be no such non-provable

liabilities. On the contrary, Lord Neuberger stated (at [77]) that the mere fact that a company could become under a liability pursuant to a provision in a statute which was in force before the insolvency event could not mean that, where the liability arises after the insolvency event, it falls within r 13.12(1)(b) and is therefore provable. Lord Sumption made the same point (at [130]). Lord Neuberger noted (at [90]) the submission of counsel that the legislature had progressively widened the definition of provable debts and *narrowed* the class of non-provable liabilities and referred (at [93]) to the 'notion that all possible liabilities *within reason* should be provable' (my emphasis).

[24] It may also be noted that certain provable debts are postponed to all other liabilities. Rule 12.3(2A) so provides in respect of certain claims arising by virtue of s 382 of the Financial Services and Markets Act 2000. Section 74(2)(f) of the 1986 Act provides for the postponement of any 'sum due to any member of the company (in his character of a member) by way of dividends, profits or otherwise'. It is common ground that no issue arises under these provisions on this application.

Issues irrespective of LBIE's status as an unlimited company

[25] The issues which arise, irrespective of the status of LBIE as an unlimited company, are:

(i) Does the claim of LBHI2 as the holder of the subordinated loan debt rank ahead of or behind statutory interest?

(ii) Does LBHI2's claim as the subordinated debt-holder rank ahead of or behind the claims, if they exist as a matter of law, of those foreign currency creditors who have suffered a currency loss as a result of conversion of their debts into sterling as at the date of the commencement of the administration for the purposes of proof?

(iii) Are such foreign currency conversion claims capable, as a matter of law, of being asserted against LBIE so as to be payable out of available assets?

(iv) Is contractual interest provable, or statutory interest payable, for the period of an administration if it is immediately followed by a liquidation?

[26] Before addressing these issues directly, I will set out the circumstances in which the subordinated loan debt was created, the regulatory background against which it was created and its material terms.

Subordinated loan debt

[27] LBHI2 was at the date of the commencement of LBIE's administration and continues to be the holder of $2.225bn of subordinated loan debt, in

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respect of which it has lodged a claim in the administration for £1,254,165,598.48. LBHI2 accepts that its claim ranks behind provable debts, but it contends that it ranks ahead of all other claims, including the claims of unsecured creditors for statutory interest.

[28] Prior to a capital restructuring of LBIE in 2006, LBIE had three subordinated loan facilities: a EUR 3bn long term facility, a $4•5bn long term facility and a $8bn short term loan facility. Each of the facilities was provided by its then immediate parent company.

[29] In 2006, in order to utilise LBIE's foreign tax credits for US tax purposes, it was decided to improve its profitability, in part by restructuring its regulatory capital base so as to replace some subordinated debt with share capital and so reduce

its interest payments. LBHI2 was interposed as the immediate holding company of LBIE and $2bn of existing subordinated debt was replaced with $2bn of preference shares issued to LBHI2. The existing subordinated loan facility agreements were cancelled and replaced with similar facility agreements with LBHI2 and $4•7bn of subordinated debt was drawn down by LBIE.

[30] As part of a further restructuring in May 2007, $5•1bn of subordinated debt was converted into $5•1bn of preference shares.

[31] The amount outstanding under the subordinated facilities fluctuated, with both drawdowns and repayments. Drawdowns in the course of 2007 led to a peak balance of $4•775bn, reducing to $2•225bn at the commencement of the administration.

[32] Considerable work has been undertaken to determine whether that balance represents drawings under the long term or short term dollar facilities but no firm conclusion has been reached by the administrators of LBIE and I am not asked to determine that issue. For present purposes at least, it is not significant because the subordination provisions in the agreements are materially the same.

[33] The subordinated loans formed part of LBIE's regulatory capital. Under capital adequacy rules made by regulators, banks and other financial institutions are required to hold capital of a certain amount, which depends in broad terms on the extent of their business and their risk exposures. The purpose of capital adequacy rules is so far as possible to ensure that firms provide financial resources to protect their customers and other stakeholders against failure and enable them to withstand some level of loss.

[34] There is a significant international background to the capital adequacy rules applicable in the UK. Mr Isaacs QC on behalf of LBHI took me carefully through some of its principal elements.

Capital adequacy rules

[35] In July 1988 the Basel Committee on Banking Supervision, comprising representatives of the central banks and supervisory authorities of the Group of Ten countries, published the first Basel Accord, entitled International Convergence of Capital Measurement and Capital Standards ('Basel I'). It was agreed by all its members and endorsed by the central bank governors of the Group of Ten countries. It set out the details of the agreed framework for measuring capital adequacy and the minimum standard to be achieved which the national supervisory authorities represented on the Basel Committee intended to implement in their respective countries. The fundamental objectives, as stated in Basel I, were, first, that the new framework should serve

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to strengthen the soundness and stability of the international banking system and, secondly, that the framework should have a high degree of consistency in its application to banks in different countries. While the framework established by Basel I was mainly directed towards assessing capital in relation to credit risk (the risk of counterparty failure), it emphasised that other risks, such as interest rate risk and investment risk, needed to be taken into account by supervisors in assessing overall capital adequacy.

[36] Basel I addressed subordinated term debt in para 23:

> 'The Committee is agreed that subordinated term debt instruments have significant deficiencies as constituents of capital in view of their fixed maturity and inability to absorb losses except in a liquidation. These deficiencies justify an additional restriction on the amount of such debt capital which is eligible for inclusion within the capital base.'

[37] Effect was given to Basel I within the EC by the Council Directive of 17 April 1989 (89/299/EEC) 'on the own funds of credit institutions'. Article 2.1 provided that the unconsolidated own funds of credit institutions could consist of a number of items, including equity share capital and 'fixed-term cumulative preferential shares and subordinated loan capital as referred to in art 4(3)'. Article 4(3) provided that member states could include fixed-term cumulative preferential shares and subordinated loan capital in own funds--

> 'if binding agreements exist under which, in the event of the bankruptcy or liquidation of the credit institution, they rank after the claims of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled.'

Article 4(3) went on to provide that subordinated loan capital had to fulfil certain further criteria, including that the loans had an original maturity of at least 5 years and were repaid early only if 'the solvency of the credit institution in question [was] not affected'.

[38] Of direct relevance to LBIE was Council Directive of 15 March 1993 (93/6/EEC) 'on the capital adequacy of investment firms and credit institutions', which provided for capital adequacy requirements for investment firms and capital adequacy rules for credit institutions related to market risk. Annex V provided that the own funds of investment firms and credit institutions were defined in accordance with Directive 89/299/EEC, subject to certain modifications.

[39] In June 2006 the Basel Committee on Banking Supervision published a revised Accord ('Basel II'). Paragraph 49(xii) repeated what had been said about subordinated term debt in Basel I, but an additional tier of capital was introduced (tier 3) consisting of short-term subordinated debt for the sole purpose of meeting a proportion of the capital requirements for market risks. The minimum original maturity of such short-term subordinated debt was two years but to be eligible as tier 3 capital, it needed 'if circumstances demand, to be capable of becoming part of a bank's permanent capital and thus be available to absorb losses in the event of insolvency'.

[40] Effect was given to Basel II in the EU by the Directives of 14 June 2006 (2006/48/EC and 2006/49/EC) 'relating to the taking up and pursuit of the business of credit institutions' and 'on the capital adequacy of investment firms and credit institutions'. So far as relevant, the first of these Directives repeated

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the definition of own funds contained in Directive 89/299/EEC and repeated the requirement that subordinated loan capital could be included only if 'binding agreements exist under which, in the event of the bankruptcy or liquidation of the credit institution, they rank after the claims of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled': art 64(3).

[41] The financial regulator for LBIE at all relevant times was the Financial Services Authority (the FSA), which has since been replaced for these purposes by the Prudential Regulation Authority.

[42] On 31 December 2006 the FSA introduced the General Prudential Sourcebook ('GENPRU') which set out the capital adequacy requirements applicable to LBIE from that date until it went into administration. The purpose of these rules, as stated in para 1.2.26, was to ensure that a regulated firm would 'at all times maintain overall financial resources, including capital resources and liquidity resources, which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due'. Based on Basel II and the relevant Directives, three tiers of capital were specified, which a firm was required to identify separately in its regulatory capital reporting to the FSA.

[43] The characteristics of tier 1 capital were that it was able to absorb losses, it was permanent, it ranked for repayment upon winding up, administration or similar procedures after all other debts and liabilities and it had no fixed costs, such as an obligation to pay dividends or interest. The most common example of tier 1 capital is ordinary share capital.

[44] Tier 2 capital was capital which did not meet the requirements of permanency and lack of fixed costs which were required for tier 1 capital. There were two types of tier 2 capital. Upper tier 2 capital was capital which was perpetual but which carried servicing costs which could not be waived at the firm's option. It specifically included cumulative preference shares. Lower tier 2 capital was capital which was either not perpetual or had fixed servicing costs that could not generally be waived or deferred. It was required generally to have an original maturity of at least 5 years and specifically included medium to long-term subordinated debt.

[45] Tier 3 capital was described by GENPRU as forms of capital conforming less well to the characteristics of tier 1 capital. It specifically included subordinated debt of short maturity.

[46] Subordination was a characteristic of all three tiers of capital.

[47] The amount of capital that a firm could designate as tier 2 capital was restricted to a value no greater than 50% of its tier 1 capital, with any excess capital being designated as tier 3 capital. The $2bn of preference shares issued by LBIE in 2006 constituted lower tier 2 capital. Because of the limits on the amount of capital which could be held as tier 2 capital, a substantial amount of the preference shares was classified as tier 3 capital. All the subordinated debt was classified as tier 3 capital.

Subordinated debt agreements

[48] As mentioned above, all the subordinated debt agreements contain essentially the same subordination provision. Each agreement, including in particular the subordination provisions, was based heavily on templates provided by the FSA. There is no evidence to suggest that anyone in the Lehman Brothers group gave any consideration to how these provisions would

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operate in the event of an insolvency of LBIE and indeed the recollection of several witnesses in interviews which have been conducted suggests that it is highly unlikely that any such consideration was given.

[49] Each agreement contains Sch 1, setting out variable terms, and Sch 2, setting out standard terms. Clause 8 of the variable terms provides for the payment of interest on a monthly basis. Clause 9 provides for repayment, with a specified repayment date and provisions for prepayment. The entire clause is expressed to be 'subject always to 4(3) (restrictions on repayment) and 5 (subordination) of the Standard Terms'.

[50] Clause 1(1) of the standard terms contains a number of definitions. 'Financial Resources Requirement' is defined as having the meaning given to it in the FSA Handbook. 'Insolvency' is defined to mean and include liquidation, administration and other similar procedures. 'Liabilities' means 'all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever)'. 'Senior Liabilities' means 'all liabilities except the Subordinated Liabilities and Excluded Liabilities'. 'Subordinated Liabilities' is defined to mean 'all Liabilities to the Lender in respect of each Advance made under this Agreement and all interest payable thereon'. 'Excluded Liabilities' is defined to mean 'Liabilities which are expressed to be, and in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of the Borrower'.

[51] Clause 4 provides for repayment, but 'subject in all respects to the provisions of para 5 (subordination)': cl 4(1). Clause 4(3) contains restrictions on the ability of LBIE to effect early repayment of any loan or to pay interest by reference to its financial resources requirement.

[52] The effect of cl 4(4) to (7) is that the only remedy available to the lender for repayment of any advances or enforcement of the terms of the loan facility agreements is to institute proceedings for the insolvency of LBIE. This is a

standard term of subordinated loan agreements and precludes the lender from obtaining judgment and executing or otherwise enforcing the judgment, thereby avoiding the subordination provisions.

[53] Clause 5 contains the subordination provisions:

'(1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon--

(a) (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 120% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that--

(i) paragraph 4(3) has been complied with; and

(ii) the Borrower could make such payment and still be in compliance with such Financial Resources Requirement; and

(b) the Borrower being "solvent" at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which

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would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be "solvent".

(2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be "solvent" if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding--(a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and (b) the Excluded Liabilities.

(3) Interest will continue to accrue at the rate specified pursuant to paragraph 3 on any payment which does not become payable under this paragraph 5.

(4) For the purposes of sub-paragraph (1)(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FSA, shall in the absence of proven error be treated as accepted by the FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower's solvency or Insolvency.

(5) Subject to the provisions of sub-paragraphs (6), (7) and (8) below, if the Lender shall receive from the Borrower payment of any sum in respect of the Subordinated Liabilities--(a) when any of the terms and conditions referred to in sub-paragraph (1) above is not satisfied, or (b) where such payment is prohibited under paragraph 4(3),

(6) Any sum referred to in sub-paragraph (5) above shall be received by the Lender upon trust to return it to the Borrower.

(7) Any sum so returned shall then be treated for the purposes of the Borrower's obligations hereunder as if it had not been paid by the Borrower and its original payment shall be deemed not to have discharged any of the obligations of the Borrower hereunder.

(8) A request to the Lender for return of any sum referred to in sub-paragraph (5) shall be in writing and shall be made by or on behalf of the Borrower or, as the case may be, its Insolvency Officer.'

[54] Clause 7 contains undertakings by LBHI2 as lender not to take any of the steps specified in cl 7 without the prior written consent of the FSA. These undertakings are designed to prevent any action which might subvert the subordinated status of the liabilities. In particular, in sub-cll (d) and (e), the lender undertook not without the prior written consent of the FSA to–

'(d) attempt to obtain repayment of any of the Subordinated Liabilities otherwise than in accordance with the terms of this Agreement;

(e) take or omit to take any action whereby the subordination of the Subordinated Liabilities or any part of them to the Senior Liabilities might be terminated, impaired or adversely affected.'

Submissions on the subordinated debt agreements

[55] It is the submission of the administrators of LBIE, supported by Lydian and the administrators of LBL, that the subordinated debt ranks after statutory interest and non-provable debts. They rely on what they submit is a straightforward application of the express terms of the subordinated loan facility agreements. Clause 5(1) of the standard terms provides that 'the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities' and provides further (in cl 5(1)(b)) that payment of any amount of the subordinated liabilities is conditional upon 'the Borrower' being

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solvent at the time of, and immediately after, the payment by the borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the borrower could make such payment and still be 'solvent'. Clause 5(2) defines what is meant by the borrower being 'solvent'. It means that LBIE is 'able to pay its liabilities (other than the Subordinated Liabilities)' in full disregarding the obligations and liabilities referred to in sub-paras (a) and (b).

[56] 'Senior Liabilities' means all liabilities except the subordinated liabilities and excluded liabilities. 'Liabilities' are defined to mean 'all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever)'.

[57] The administrators of LBIE submit that the obligation to pay statutory interest is a liability or obligation of LBIE within the meaning of 'Liabilities' in the subordinated debt agreements. It follows, they submit, that the subordinated loan debts rank behind statutory interest as being 'subordinated to the Senior Liabilities'. The only exclusions, whether under the definition of 'Senior Liabilities' or under cl 5(2) are, first, 'obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower' and, secondly, the excluded liabilities (as defined). The obligation to pay interest is, they submit, clearly payable in the insolvency of LBIE and does not therefore fall within the first of those exclusions. 'Excluded Liabilities' are defined as 'liabilities which are expressed to be and, in the opinion of the Insolvency Officer of [LBIE], do, rank junior to the Subordinated Liabilities in any Insolvency of [LBIE]'. They submit that this definition refers most obviously to other subordinated loans or other debts which are expressly, by their terms, subordinated to the subordinated claims arising under the subordinated facility agreements to which LBHI2 was a party. The right to statutory interest is not expressed to rank junior to those subordinated loan debts.

[58] The administrators of LBHI2, and LBHI, seek to meet these submissions in a number of ways in support of their case that the subordinated loan debts rank ahead of statutory interest.

[59] Mr Trace QC on behalf of LBHI2 and Mr Isaacs QC on behalf of LBHI submit that the subordinated loan facility agreements must be construed in the context of their regulatory purpose and of the insolvency regime which applies to

LBIE in the event that it goes into administration or liquidation. The latter follows, they submit, from the many references in the agreements to the insolvency of the borrower and the clear contemplation that the subordination provisions should apply in an insolvency. The relevant provisions of the applicable insolvency regime are, for present purposes, the provisions in the Insolvency Rules for the proof of debts and the provisions of r 2.88 as they apply to statutory interest. They submit that 'Liabilities' means all provable and proved liabilities. As it is not in doubt that LBHI2 is entitled to prove for its claim under the subordinated facility agreements, the purpose of the subordinated provisions is to rank the subordinated debt within the general class of provable unsecured claims and to rank the subordinated debt behind the unsubordinated unsecured debts. This construction is consistent with r 2.88(7), providing that 'Any surplus remaining *after payment of the debts proved* shall, before being applied for any purpose, be applied in paying interest on those debts ...' As LBHI2 is entitled to prove and has lodged a proof for its subordinated loan debts, they are 'debts proved' which must be paid before there arises any surplus out of which statutory interest is to be paid. Moreover,

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the language of r 2.88(7) shows that it does not create a liability or obligation in favour of the creditors whose debts have been proved and paid but constitutes only a direction to the administrator as to how he is to apply the surplus in those circumstances. It is a direction, not a liability or obligation 'payable or owing by the Borrower'.

Issues on the subordinated debt agreements: discussion

[60] In approaching the issues of construction of the subordinated facility agreements, it is clearly right to have regard to their regulatory context. It is common ground that they are largely based on templates provided by the FSA and that the subordination and other provisions contained in the standard terms are not tailor-made to LBIE or the particular facilities into which it entered but are generally applicable to all subordinated loans which are relied on by institutions to meet their capital adequacy requirements. Although subordinated loans may rank only as lower tier 2 or even tier 3 capital, they are nonetheless to be treated as part of the capital or own funds of the institution for the purposes of providing protection to those dealing with the institutions and for the purpose of absorbing losses.

[61] I do not accept the submissions made by Mr Isaacs QC that the capital adequacy regime is concerned to protect only particular categories of creditor, including in particular trading counterparties. The requirement contained in the various Directives earlier referred to is that there should exist binding agreements under which in the event of the liquidation of the institution subordinated loan capital is to 'rank after the claims of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled'. There is nothing there to suggest any limit on the categories of creditors to which the loan capital is subordinated. On the contrary the references are to 'all other creditors' and 'all other debts'. Nor do I accept the submission made that the absorption of losses is a purpose of subordinated debt only where the institution is a going concern. Both Basel I (para 23) and Basel II (paras 49(xii) and 49(xiv)) refer expressly to the absorption of losses by subordinated debt in a liquidation.

[62] The wording of the requirements contained in the Directives for binding agreements whereby subordinated loan capital ranks 'after the claims of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled' militates strongly against the suggested restriction of the meaning of 'Liabilities' in the subordinated facility agreements to provable debts. The reference to 'the claims of all other creditors' would suggest that the definition of 'Liabilities' is to be given the widest meaning, which is indeed consistent with the express terms of the definition. The requirement that subordinated loan capital is not to be repaid 'until all other debts outstanding at the time have been settled' is in my judgment equally consistent with the widest possible interpretation. To be consistent with the construction put forward on behalf of LBHI2 and LBHI, the words 'outstanding at the time' would have to refer to the commencement of the liquidation. In my judgment they refer not to that time but to the time when the subordinated loan capital might otherwise be repaid.

[63] All of this is consistent with the concept that subordinated loan capital qualifying as part of the institution's regulatory capital is, as against creditors, to be treated as part of the 'capital' of the institution. It is not of course part of the share capital of the company and it ranks ahead of any share capital in terms of repayment.

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[64] In any event, there seems no reason as a matter of construction, looking only at the terms of the agreements, to restrict 'Liabilities' to provable debts. There is nothing in the definition or in the rest of the agreement which, in my view, suggests that any such restriction is to apply.

[65] Mr Trace and Mr Isaacs submit that the subordination provisions must be read in the context of the English statutory provisions applicable to an insolvency of LBIE. The precise wording of r 2.88(7), and the counterpart provision applicable to a liquidation in s 189(2), is an important part of this submission.

[66] Before looking at the detailed wording of r 2.88(7), it is right to sound a note of caution about too detailed a recourse to UK insolvency legislation. As earlier observed, 'Insolvency' is defined for the purposes of the subordinated loan agreements to include not only insolvency proceedings in the UK but 'the equivalent in any other jurisdiction to which the Borrower may be subject'. The standard terms are intended to apply in the context of insolvency proceedings in any jurisdiction. It is almost certainly the case that formal insolvency proceedings in all jurisdictions likely to be relevant involve a realisation and distribution of assets, on a largely pari passu basis, among creditors and a procedure for establishing the claims to be admitted for the purposes of such distribution.

[67] There can, however, be no such confidence that the precise terms of the insolvency laws of different countries relating to the debts and liabilities which are to be admitted to this process and the date as at which they are to be assessed or valued are the same as those contained in UK legislation. For example, it would not be an irrational insolvency law which provided that the available assets should be distributed amongst creditors proportionately to their claims including interest from the commencement of the insolvency process to the date of payment. Nor would it be an irrational insolvency law which made provision for the payment of foreign currency losses, whether or not on a subordinated basis. An insolvency law could well provide that all claims arising after the commencement of the insolvency process, and not qualifying as expenses, should be the subject of proof or its equivalent, again payable on a subordinated or unsubordinated basis. These considerations support the view that it is not appropriate to construe the subordination provisions in the agreements strictly by reference to the relevant provisions of the UK insolvency legislation.

[68] In any event, I do not consider that the terms of r 2.88(7) and s 189(2) provide the support for which Mr Trace and Mr Isaacs contend. Rule 2.88(7) provides that 'Any surplus remaining *after payment of the debts proved* shall, before being applied for any purpose, be applied in paying interest ...' (my emphasis). The phrase 'the debts proved' must mean all the debts proved, and so Mr Trace submits those debts include LBHI2's proof for its subordinated debt. Accordingly, he submits, it follows that any statutory interest is payable only after the debts proved, including the subordinated claim, have been paid.

[69] The answer to this point lies, in my judgment, as Mr Trower for the administrators of LBIE submits, in the provisions of cl 7(d) and (e). I have earlier quoted these provisions. The expression 'the debts proved' means all of those debts admitted to proof by the administrator, because it is only those debts which will be paid out of the available assets. In my judgment, the lodging of a proof in respect of the subordinated loan debts coupled with an attempt to require the administrator to admit the proof would be both an attempt to obtain repayment of subordinated liabilities otherwise than in

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accordance with the terms of the agreement, within the meaning of cl 7(d), and the taking of action whereby the subordination of those liabilities to the senior liabilities might be impaired or adversely affected, within the meaning of cl 7(e). In my view, an attempt to rely on provisions of the applicable insolvency law to advance the subordinated liabilities above senior liabilities is well within the intended scope of paras (d) and (e) of cl 7.

[70] A further point made by Mr Trace and Mr Isaacs was that the language of r 2.88(7) and s 189(2) sets out a mechanism directing the office-holder how to apply the surplus in his hands, and does not impose any obligation or liability on the company. Accordingly, those provisions do not create a liability falling within the meaning of 'Liabilities' in the subordinated loan agreements. They further submitted in this connection that r 2.88(7) presupposes a surplus and it is impossible for a direction as to the application of a surplus to constitute a debt or liability.

[71] I do not accept this submission. First, the surplus to which r 2.88(7) applies is a surplus of assets over proved debts. It is not and does not purport to be a surplus after the discharge of all liabilities. As to whether r 2.88(7) creates a debt or liability, it is no doubt true to say that it constitutes a direction to the administrator. It does not follow that it does not create a debt or liability of the company for the purposes of the subordination agreement. The assets constituting the surplus to which r 2.88(7) applies are assets of the company in administration, albeit that their beneficial ownership is or may well be in suspense: *Revenue and Customs Comrs v Football League Ltd* [2012] EWHC 1372 (Ch), [2013] 1 BCLC 285, [2012] Bus LR 1539 (at [101]-[102]). The effect of the direction in r 2.88(7) is to create a right in favour of creditors to have the relevant surplus applied in the payment of statutory interest. It does not create a proprietary or equitable interest in the surplus in favour of those creditors. It is in my judgment in no sense a misuse of language to say that it creates a concomitant liability or obligation. The definition of 'Liabilities' includes liabilities and obligations 'payable or owing by the Borrower'. If the rule creates a liability or obligation, it is in my judgment rightly characterised as a right or obligation of the borrower for the purposes of this agreement.

[72] In this connection, reliance was placed on statements made by Mervyn Davies J in *Re Lines Bros Ltd* [1984] BCLC 215. The issue in that case was quite different from the question of construction of the subordinated loan agreements which I am presently considering. The issue was whether the provisions then contained in the Bankruptcy Act 1914 for the payment of interest on debts proved in a bankruptcy were applicable to the winding up of the company in that case, by reason of the provisions of s 317 of the Companies Act 1948 which applied only in 'the winding-up of an insolvent company'. The question was whether the company was for these purposes insolvent in circumstances where there was a surplus of assets over all proved debts. In the light of previous authorities to the same effect, the judge held that the company was not insolvent for the purposes of s 317 once its debts and liabilities as existing at the date of the commencement of the winding up had been paid or met in full: see [1984] BCLC 215 at 225.

[73] In reaching that decision, the judge went further back into the relevant statutory history to s 10 of the Supreme Court of Judicature Act 1875, as judges in previous cases had done. The question was whether post-liquidation interest, statutory or contractual, constituted 'debts and liabilities' for the purposes of that section. The judge concluded that neither statutory nor contractual post-liquidation interest fell within that expression for the purposes

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of s 10. In reaching this conclusion, Mervyn Davies J gave two reasons, the first of which is the passage ([1984] BCLC 215 at 223) on which reliance is placed by Mr Isaacs:

> 'This is not a debt or liability within s 10 for two reasons: (1) the section speaks of "its" debts and liabilities. At no stage can statutory interest be regarded as a debt or liability of the company. A liquidator's obligation under s 33(8) to pay interest out of a surplus is pursuant to a statutory direction to him, being an obligation which is part of the statutory scheme for dealing with a company's assets which comes into operation at the outset of the winding up.'

This is but one of the reasons given by Mervyn Davies J for his overall conclusion and it is not one which featured in the earlier cases, for example the judgment of Pennycuick V-C in *Re Rolls-Royce Co Ltd* [1974] 3 All ER 646, [1974] 1 WLR 1584. More importantly, the context of the decision in *Re Lines Bros Ltd* is so different from the present context that it is not in my judgment of assistance in the construction of the subordination provisions in the subordinated loan agreements.

[74] Mr Trace, but not Mr Isaacs, submitted that if, contrary to his submission, statutory interest fell within the definition of 'Liabilities' in the subordinated debt agreements, it constituted an 'Excluded Liability' and did not therefore rank ahead of the subordinated debt, by reason of cl 5(2)(b) of the agreements. Mr Trace submitted that, given that the definition of 'Excluded Liabilities' is based on the ranking of claims in an insolvency of the borrower, the reference to 'Liabilities which are expressed to ... rank junior to the Senior Liabilities' must mean, or at least include, liabilities which rank junior by operation of express provisions of the applicable insolvency legislation. As r 2.88(7) expressly provides for statutory interest to be payable only after payment of the proved debts, which include the subordinated debts, it follows that statutory interest is expressed to rank junior to the subordinated liabilities.

[75] I do not accept this submission. Statutory interest is not expressed to rank junior to the subordinated liabilities, but only to the debts proved. It seems to me that the obvious purpose of the exclusion of such liabilities is to cater for the situation in which a borrower issues further debt on terms that it is expressed to rank junior to the subordinated liabilities created by these subordinated debt agreements. It is, and was at the date of these agreements, a real possibility that a borrower might wish to issue such debt and the purpose of this provision is simply to ensure that such junior subordination is effective. It is relevant in this context also to bear in mind that different insolvency regimes could well treat interest accruing after the commencement of the insolvency process in different ways, and not necessarily in terms which could even arguably suggest that it was subordinated. The purpose of the template agreements, giving effect as they do to EU Directives, is to provide a uniform system of subordination. No inconsistency with that purpose arises if particular debts are created on express terms that they rank junior to the subordinated liabilities under these agreements.

[76] Mr Isaacs advanced a number of additional arguments in support of the overall submission that the subordinated loan debt ranked ahead of statutory interest. He submitted that the definition of 'Liabilities' could not carry an all-embracing meaning. Applied literally, it would mean that the full amount of

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future debts and the maximum possible amount of contingent debts would have to be paid in an administration or in a liquidation, notwithstanding the provisions of the Insolvency Rules providing for an estimation of the value of contingent debts and a discounting of future debts. Further, he submitted that a broad construction of 'Liabilities' would include the return of any surplus to shareholders, and it was clear that it could not possibly extend that far.

[77] As to these points, it is in my view clear that the payment of the estimated value of contingent debts and the discounted value of future debts in an administration or liquidation is payment of those debts in full. The contractual right of a contingent creditor is not to a payment of the maximum amount which may become payable but is a right to payment if, but only if, the contingency occurs. The rules provide a mechanism for placing a present value on that right. Likewise, the contractual right of a creditor with a future debt is to payment on the due date, but not before it. In order to bring administrations and liquidations to a conclusion as quickly as practicable, future debts are discounted. The creditor receives the full present value of the debt, calculated as provided by the Insolvency Rules. The contractual rights of contingent and future creditors are clearly compromised by the insolvency process but their claims are, for the reasons I have given, properly regarded as paid in full. As to the return of any surplus to shareholders, the obligation on the administrator or liquidator to make such a return is in my view clearly not a liability or obligation payable or owing by the borrower for the purposes of the subordinated debt agreements. None of these points suggests that statutory interest is not to fall within the meaning of 'Liabilities'.

[78] Mr Isaacs submitted that it was significant that the word 'solvent' was used in cl 5(1)(b). Relying on what Lord Hoffmann said in *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] 4 All ER 677, [2009] AC 1101 (at [17]), Mr Isaacs submitted that the use of the word 'solvent' as the defined expression was indicative of its intended meaning. Although the term is defined in cl 5(2), the choice of that term shows that it was not intended to include statutory interest within 'Liabilities' because the obligation to pay statutory interest arises only when the company is solvent and there is a surplus. With respect, I do not think that there is anything in this point. The existence of the surplus out of which statutory interest is payable does not mean that the company is solvent, it means only that the company has been able to pay its proved debts in full. If a company is under an obligation to pay statutory interest to its creditors but has insufficient assets to do so in full, so there is in any event no surplus available for a return to shareholders, it is in no sense a misuse of language to say that the company is not solvent.

[79] If, contrary to his principal submissions, 'Liabilities' do include statutory interest, Mr Isaacs submitted that statutory interest was excluded by reason of cl 5(2)(a). Mr Isaacs submitted that the words 'not payable or capable of being established or determined in the Insolvency of the Borrower' referred to the process of paying proved debts or establishing the status and amount of a debt for the purpose of deciding whether it was capable of proof, and if so, in what amount. This process of construction would have the effect of restricting 'Liabilities' to provable debts, even though its definition was wider. I see no reason to restrict the ordinary meaning of cl 5(2)(a) in the way suggested by Mr Isaacs. Statutory interest is payable in the administration or liquidation of LBIE and is not therefore, in my view, excluded by para (a).

[80] Finally, Mr Trace submitted that if the effect of the subordination provisions was indeed to subordinate the relevant debts to statutory interest

and non-provable debts, such an agreement was not as a matter of law permissible and was therefore void. The agreement would be an impermissible attempt to contract out of the mandatory effect of r 2.88(7) and s 189(2). Mr Isaacs did not support this submission.

[81] It was once widely considered that a purely contractual subordination of a debt intended to take effect in an insolvency was void as being an attempt to contract out of the mandatory requirement for a pari passu distribution among all creditors admitted to proof. The mandatory character of this provision formed a basis of the decision of the House of Lords in *British Eagle International Airlines Ltd v Cie Nationale Air France* [1975] 2 All ER 390, [1975] 1 WLR 758. For this reason, subordination was usually effected by the creation of a trust, whereby the subordinated creditors agreed to hold distributions received by them in respect of their subordinated debts on trust for the other creditors: see, for example, *Re British & Commonwealth Holdings plc (No 3)* [1992] BCLC 322, [1992] 1 WLR 672.

[82] The validity of a purely contractual subordination provision arose for consideration in *Re Maxwell Communications Corp plc (No 2)* [1994] 1 All ER 737, [1993] 1 WLR 1402 (*Re Maxwell*). Vinelott J held that there were no principles of insolvency legislation or public policy which precluded the making of a contract between a company and a creditor whereby, in the event of the company's insolvency, the debt was to be subordinated to the payment of debts owed to other unsecured creditors.

[83] Mr Trace did not question the correctness of Vinelott J's decision. He submitted, however, that it was authority only for the proposition that within the overall class of provable claims it was permissible for one creditor to agree with the company on a purely contractual basis to subordinate its debt to other unsecured debts. He submitted that it did not follow that it was permissible for a creditor with a provable debt to agree to a subordination lower down the order of priority, for example after statutory interest. This would run counter to the express mandatory terms of r 2.88(7) and s 189(2).

[84] I cannot see why, if the mandatory statutory provisions for a pari passu distribution do not prevent a contractual subordination of one debt to other proved debts, r 2.88(7) and s 189(2) should prevent a contractual subordination of a provable debt to a ranking below statutory interest. Since such a subordination could be achieved through the use of a trust, as was done in *Re British & Commonwealth Holdings plc (No 3)* [1992] BCLC 322 at 331, a prohibition of a contractual subordination would 'represent a triumph of form over substance' just as much as Vinelott J thought it did in the circumstances of *Re Maxwell* [1994] 1 All ER 737 at 16. Further, in *Re Maxwell* Vinelott J expressly contemplated that a preferential creditor could agree that his debt would rank equally with the unsecured non-preferential debts, notwithstanding that the payment of preferential debts in priority to the general body of unsecured debts is itself the subject of provisions expressed in mandatory terms: s 175(1) of the 1986 Act (liquidation) (which applies also in an administration: para 65(2) of Sch B1 to the 1986 Act).

[85] My overall conclusion on this issue is, therefore, that the subordinated debt ranks below statutory interest in the order of priority of distribution of assets of LBIE. This conclusion involves no contortions in the construction of the express terms of the subordinated debt agreements and appears to me to be consistent with the regulatory background to the agreements.

[86] The policy behind statutory interest is to compensate creditors for the delay in payment to them of their debts on account of the insolvency process,

even where they had no contractual or other legal right to interest. If it were not for the insolvency process, creditors would be entitled to seek to enforce their debts against the debtor company and its property. If the subordinated debts are,

as it is accepted, subordinated to the principal amounts of such unsecured debts, there is nothing surprising in their subordination to the payment of statutory interest on those debts. It would be a greater cause of surprise if they were not so subordinated. Moreover the contrary view is capable of some significantly inconsistent results. It was accepted by Mr Trace and Mr Isaacs that while a borrower was a going concern, a subordinated debt could not be paid unless the borrower could pay all its debts in full including any contractual or other enforceable interest. Such interest ceases to be payable from the date of the commencement of the insolvency process, and is in effect replaced by the right to the payment of statutory interest out of the surplus remaining after the payment in full of proved debts. The result would be somewhat inconsistent if the subordinated debts did not rank junior to such statutory interest. Unsubordinated creditors with a contractual or other entitlement to interest would find that the subordination provisions worked to their disadvantage once the borrower entered an insolvency process.

[87] All or almost all of the arguments addressed above appear to me to support the conclusion also that the effect of the subordination provisions is to subordinate the relevant debts to rank junior to any non-provable debts, as well as statutory interest. Such liabilities are as much liabilities of the borrower as provable liabilities. Subordinated debt forming part of the regulatory capital of the borrower would, consistently with the requirements of the Directives, rank behind such non-provable liabilities as much as behind provable liabilities. Just as in the case of statutory interest, a contrary conclusion would produce surprising results. If, as was entirely possible, the Supreme Court had held in *Re Nortel* that the liability created by a contribution notice issued after the commencement of an administration or liquidation was neither an expense nor a provable debt, it would have constituted a non-provable debt payable after statutory interest in the order of priority set out in the judgment of Lord Neuberger. If a contribution notice were served before the commencement of an administration or liquidation, it is clear that the subordinated debt would rank junior to the liability so created and could not be paid under the terms of the subordinated debt agreements unless the borrower was able to pay such liability under the contribution notice in full. It is hard to see why the subordination provisions should not have the same effect in the event of the issue of a contribution notice after the commencement of an administration or liquidation.

Currency conversion claims

[88] Until the decision of the House of Lords in *Miliangos v George Frank (Textiles) Ltd* [1975] 3 All ER 801, [1976] AC 443, the established position in English law was that a creditor with a debt contractually payable in a foreign currency could not obtain judgment in an English court in the foreign currency but only a judgment in sterling converted as at the date when payment was due under the contract. The same position applied as regards proofs of debt in a liquidation: see *Re United Railways of The Havana and Regla Warehouses Ltd* [1960] 2 All ER 332, [1961] AC 1007. The power of the English courts to give judgment in a foreign currency established by *Miliangos* quickly led to a reconsideration of the position in a liquidation. The particular difficulty is that

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in order to undertake a pari passu distribution of assets among creditors it is necessary to convert all claims to a single currency. The issue was the date at which such conversion should take place. The question came before Oliver J in *Re Dynamics Corp of America* (*No 2*) [1976] 2 All ER 669, [1976] 1 WLR 757. He held that in a compulsory winding up of an insolvent company, a creditor's claim for a debt in a foreign currency, and any set-off in a foreign currency against such a debt, must be converted into sterling as at the date of the winding-up order.

[89] The question arose again in *Re Lines Bros Ltd (in liq)* [1982] 2 All ER 183, [1983] Ch 1. The Court of Appeal approved the decision of Oliver J in *Re Dynamics Corp* and held that, in the case of a voluntary liquidation, the foreign currency debts should be proved according to their sterling value as at the date of the commencement of the winding up. In that case, there was a surplus of assets available after paying all the proved debts. There was an insufficiency of assets to pay all claims to post-liquidation interest in full and the issue effectively before the court was whether the available surplus should be applied in the payment of interest or, as the foreign currency claimants asserted, in payment of their claims converted as at a date later than the commencement of the winding up. It was held that the foreign currency creditors had no claim to *prove* for more than the sterling equivalent of their debts as at the date of the commencement of the liquidation and that the right of creditors with contractual claims to interest ranked next in the distribution of the available assets.

[90] The foreign currency creditors relied on the injustice, recognised by the House of Lords in *Miliangos*, of the creditor, not the debtor, taking the risk of changes adverse to him in the exchange rate between the contractual currency and sterling. In considering this submission and its application in an insolvent liquidation, Brightman LJ said ([1982] 2 All ER 183 at 191-192, [1983] Ch 1 at 16):

'The policy behind the decision [in *Miliangos*] was that the foreign currency debtor should not be entitled to impose on the foreign currency creditor the risk of a fall in the value of sterling. Justice demands that the risk shall be borne by the debtor, who is the party in default. Hence the justice of the reinterpretation of the law, that the debtor in default is not to be excused from his contractual obligation by payment of anything less than the sterling equivalent of the money contractually due at the date of payment. If this statement of the reasoning behind the *Miliangos* decision is correct, clearly it has no role to play in the distribution of the assets of an insolvent company. The sterling creditors are not in default vis-à-vis the foreign currency creditors. Therefore, there is no obvious reason why the risk of depreciation in the value of sterling pending distribution of the assets should be borne by the sterling creditors. The company is the wrongdoer towards both the sterling creditors and the foreign currency creditors. There is no particular reason, in the field of abstract justice, why the currency risk should be borne by one description of creditor rather than by another description of creditor when they are all directed to rank pari passu. They do not rank pari passu if the sterling creditors are required to underwrite the exchange rate of the pound for the benefit of the foreign currency creditors. The just course, as it seems to me, is to value the

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foreign debt once and for all at an appropriate date, and to keep to that rate of conversion throughout the liquidation until all debts have been paid in full.'

This underlying rationale loses its force once all the proved debts and post-liquidation interest have been paid. If there remains a surplus, any competition lies not with other creditors but with the company as the debtor, or rather the shareholders who stand behind it. In this situation, the claims of justice underpinning the decision in *Miliangos* re-assert themselves.

[91] Because there would be no funds available after the payment of post-liquidation interest on proved debts, the issue whether foreign currency creditors would then have a further claim against the assets of the company in respect of currency losses suffered between the date of liquidation and the date of payment of the dividend in full on their proved claims, did not arise for decision. It was nonetheless a matter which was the subject of argument and Brightman LJ commented on it in a passage which I should set out in full ([1982] 2 All ER 183 at 195, [1983] Ch 1 at 20-21):

'We were much pressed in argument by the bank with the injustice which might arise, on the liquidators' submission, in the case of a wholly solvent company. Take a simple example. A company has English assets of £1m, and has borrowed 100,000 Swiss francs from a Swiss bank in Switzerland repayable on demand under a Swiss contract in the same currency. If the company for some reason declined to repay on demand, judgment could be recovered against it in Swiss Francs in England, and could be executed against the assets in an equivalent sum of sterling converted as at the date when execution is authorised. Suppose, however, that the company goes into voluntary liquidation. Suppose that sterling is devalued by 10% before the liquidator can discharge the debt. The Swiss creditor, it is said, would on the liquidators' argument receive less than his due entitlement in Swiss francs, and the profit on the exchange caused by the company's default would enure for the benefit of the undeserving shareholders. Per contra, if sterling had been revalued upwards, it would (it is said) be open to the liquidator, like any other foreign currency debtor, to discharge the company's obligation in the currency of the contract. So, in the end, the foreign currency creditor will get the worst of both worlds; he will gain nothing if the exchange rate moves against the currency of the contract, and he will lose if it moves in favour of the currency of the contract. This is not a problem with which we are directly concerned, and I wish to guard against expressing any concluded view upon it. But when the problem arises for decision, it may be relevant to observe that the view has been repeatedly expressed in relation to interest that, once the provable debts have been satisfied in full, so that the company has in that sense a surplus of assets, the duty of the liquidator is to discharge the contractual indebtedness of the company in respect of such debts to the extent that the contractual indebtedness exceeds the provable indebtedness. "As soon as it is ascertained that there is a surplus, the creditor whose debt carries interest is remitted to his rights under his contract": see *Re Humber Ironworks and Shipbuilding Co, Warrant Finance Co's Case* (1869) LR 4 Ch App 643 at 647 per Giffard LJ; see also Selwyn LJ to the same effect (at 645). It is on that principle that a creditor may claim post-liquidation interest. He does this on the basis that obligations under the contract are not

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necessarily discharged despite the fact that all provable debts have been paid at 100p in the pound. It may be the duty of the liquidator, in the case of a wholly solvent liquidation, if a foreign currency creditor has been paid less than his full contractual foreign currency debt, to make good the shortfall before he pays anything to the shareholders. I do not say that this is necessarily the solution to the problem posed, but I have not heard any convincing objection to that solution.'

[92] Oliver LJ, who was also a member of the court, said as regards this issue ([1982] 2 All ER 183 at 199, [1983] Ch 1 at 26):

> 'We are not, however, here concerned with a solvent company and the point must be left for decision when it arises. Certainly for my part I do not dissent from the proposition that the answer to the criticism of counsel for the bank may well be found in the way suggested in the judgment of Brightman LJ.'

[93] At this time there was no express provision in the legislation dealing with foreign currency claims. With the reform of insolvency law undertaken in the 1986 Act and the Insolvency Rules, it was clear that some provision would need to be made. Rule 4.91(1) provided:

> 'For the purpose of proving a debt incurred or payable in a currency other than sterling, the amount of the debt shall be converted into sterling at the official exchange rate prevailing on the date when the company went into liquidation [or, if the liquidation was immediately preceded by an administration, on the date that the company entered administration].'

The words in square brackets were added with effect from 1 April 2005 following the introduction in 2003 of the power of administrators to make distributions to creditors. Similar provision was made for administrations in 2003, and amended in 2005, in r 2.86(1):

> 'For the purpose of proving a debt incurred or payable in a currency other than sterling, the amount of the debt shall be converted into sterling at the official exchange rate prevailing on the date when the company entered administration [or, if the administration was immediately preceded by a winding up, on the date that the company went into liquidation].'

[94] In submitting that foreign currency creditors who have suffered an exchange loss as a result of their debt being paid in sterling as at the rate prevailing at the date of the commencement of the liquidation or administration have a non-provable claim for such currency losses, Mr Zacaroli QC lays emphasis on the words included in both rules 'for the purpose of proving a debt'. He submits, supported by Mr Trower, that these words make clear that currency conversion is effected solely for the purposes of proving debts and therefore for the purpose of achieving the pari passu distribution amongst proved debts required by the legislation. It gives effect to the position established by the Court of Appeal in *Re Lines Bros Ltd*. But it does no more than that and it does not suggest or imply that, in circumstances where assets are otherwise available for distribution among shareholders, foreign currency creditors are not entitled to make claims for their exchange losses. They submit that the arguments in favour of allowing such claims,

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acknowledged as valid by Brightman LJ with some support from Oliver LJ, establish the case for allowing such claims. Relying on *Re Humber Ironworks and Shipbuilding Co* (1869) LR 4 Ch App 643 and *Wight v Eckhardt Marine GmbH* [2003] UKPC 37, [2004] 2 BCLC 539, [2004] 1 AC 147 (at [26]-[27]), per Lord Hoffmann, they submit that the process of proof and distribution amongst creditors with admitted proofs does not extinguish the underlying contractual obligation.

[95] In opposing these submissions, Mr Wolfson submitted, first, that there could be no non-provable currency conversion claim because there was no provision for it in the legislation. He at first submitted that r 12.3(2) is an exhaustive statement of non-provable claims, but later accepted that it could not be treated as comprehensive. I have already dealt with this issue and held that there is no legislative or other bar on the making of non-provable claims against a company in liquidation, once all provable claims have been dealt with (subject to the application of the contributory rule and any contractual or other subordination of provable claims).

[96] Secondly, Mr Wolfson drew attention to the position which would exist in the following circumstances. A foreign currency debt is payable on 1 January but is not paid. The company goes into liquidation on 1 March. The debt is converted into sterling at the rate prevailing on 1 March, which is more favourable to the creditor than the rate prevailing on 1 January. When the liquidator later makes a distribution among the creditors with proved claims, on say 1 July,

sterling has depreciated against the contractual currency and the amount that the creditor receives in sterling is then worth less than his foreign currency debt. As it seems to me, the creditor has suffered a loss. He was entitled to be paid in the foreign currency and, when finally he was paid albeit in sterling, he received less than the foreign currency amount to which he was entitled. Accordingly, he has not received his full contractual entitlement.

[97] Mr Wolfson did not dispute that in these circumstances the foreign currency creditor would not have received his full contractual entitlement, but he contrasted that with a situation where sterling appreciates against the relevant foreign currency between 1 March and 1 July, so that the creditor receives in sterling an amount which when converted at the prevailing exchange rate is greater than the amount to which he was contractually entitled. There is no suggestion by anyone that in those circumstances the foreign currency creditor must refund the amount of the excess to the company in liquidation. It followed, Mr Wolfson submitted, that the claim to a non-provable currency conversion loss was in effect a one-way bet.

[98] This leads on to the submission made by Mr Wolfson and other counsel that in a liquidation there are in a number of circumstances winners and losers. The purpose of a liquidation is to achieve a broad justice, and in achieving that some creditors may find themselves in a worse position but equally other creditors may find themselves in a better position than their strict contractual rights. I accept that this is so, and that it is necessary in order to achieve the pari passu distribution of assets amongst creditors with proved claims. But I do not understand why it should prevent those creditors who have not received their contractual entitlement from pressing their claims against the company once the statutory regime for pari passu distributions has run its course. It is no answer to a creditor with a contractual claim which has not been met to say either that, in other circumstances, he might have done better, or that other creditors have in fact done better. As Brightman LJ made clear in *Re Lines*

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Bros Ltd, individual creditors may not achieve their full contractual rights when they are in competition with other creditors, but there is no justice in them not doing so when they are in competition only with the debtor.

[99] Mr Wolfson further took the example of a foreign currency creditor with a contractual payment due in the future and carrying a low contractual rate of interest. His foreign currency claim would be converted for the purposes of proof at the exchange rate prevailing at the date of commencement of the liquidation or administration, and he would then benefit from the statutory 5% discount rate on the amount of his provable debt on which he would receive dividends, which may be a significantly more advantageous discount rate to him than the real market discount rate calculated by reference to the contractual interest rate. Added to that, he would benefit from statutory interest at a rate of 8% on the full amount of his provable debt. I do not doubt that, as in many cases, there may be some difficulties in working out the consequences of allowing particular claims. It may well be that in asserting a non-provable currency conversion claim the creditor in this example might have to give credit for the benefits which he has received under the insolvency regime. The existence of these possible difficulties, and I do not accept that they are any more than that, does not in my judgment provide a sound basis for saying that there can be no currency conversion claims arising out of the contractual rights of creditors.

[100] In addition to supporting the submissions of Mr Wolfson, Mr Isaacs advanced further reasons why in his submission the currency conversion claims could not exist.

[101] First, he submitted that because the foreign currency debt was converted into sterling at the prevailing rate of exchange as at the date of the commencement of the liquidation, any currency conversion claim was by definition contingent as at that date. The contingency is, of course, a movement in the exchange rate adverse to the position of the creditor. Accordingly, Mr Isaacs submitted, if a currency conversion claim exists at all, it is a contingent debt which could be the subject of proof. Mr Isaacs is of course right that any currency conversion claim is, as at the date of the commencement of the liquidation, contingent. It is however clearly not a provable contingent claim. The scheme of the legislation is, as set out in the relevant rules, to convert foreign currency debts into sterling for the purposes of proof as at the date of the commencement of the liquidation. That is the full extent of any provable claim in respect of the foreign currency debt. It cannot in my judgment follow that there can be no claim against the company based on the creditor's contractual rights, capable of being advanced after the payment in full of all provable debts and statutory interest. The point is that the contingent claim which Mr Isaacs identifies is not provable.

[102] Secondly, Mr Isaacs submitted that the availability of a currency conversion claim would render unworkable the provisions for set-off where there is a foreign currency creditor. In an administration the account necessary for set-off is taken between what is due between the company and a creditor as at the date of the notice by the administrator of an intention to make a distribution: r 2.85(3). Rule 2.85(6) applies, so far as concerns set-off involving one or more foreign currency debts, the conversion required by r 2.86(1). Accordingly, the foreign currency debt is converted into sterling at the official exchange rate prevailing on the date when the company went into administration.

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[103] On that basis, Mr Isaacs gave the example of a debt of £100m owed by a creditor to the company. The creditor is owed \$100m by the company which as at the administration date converts into £70m. The effect of the set-off would be to leave the creditor owing £30m to the company. The creditor would be treated as having paid £70m to the company. If changes occur in the exchange rates between the date of the commencement of the administration and the date as at which the set-off is effected, such that the £70m paid by way of set-off would convert to \$90m, the creditor would continue to have an obligation to pay £30m to the company but, if currency conversion claims are permitted, would have a currency conversion claim for \$10m. Mr Isaacs submitted that there would then need to be a second conversion and a second set-off, neither of which is recognised by the rules, thus demonstrating that no such currency conversion claim may lie.

[104] In answer to this, Mr Zacaroli submitted that there would need to be no such second conversion or second set-off. He accepts that there is no set-off of the currency conversion claim and he accepts that set-off is applicable only in relation to provable claims. If the creditor sought to rely on set-off against the currency conversion claim, he would be interfering with the rights of other creditors and with the pari passu distribution of assets. Mr Zacaroli accepts that this is not permitted but submits that that is no reason why a currency conversion claim should not lie as a non-provable claim once all provable debts and statutory interest have been paid. In my judgment Mr Zacaroli provides a complete answer to the submission made by Mr Isaacs.

[105] Mr Isaacs further submitted that the existence of currency conversion claims could create significant difficulties for the office-holder in determining the time at which to make distributions. The precise choice of date of distributions would affect the currency conversion claims, if any, which could be made by different groups of creditors depending on the contractual currency of payment. At the same time, delays in the date of distribution to mitigate the effect of such claims would have the effect of increasing the amount of statutory interest payable. As it seems to me, it is the duty of the office-holder to proceed to make distributions as soon as he reasonably can. If he is otherwise in a position to make a distribution, it could not be right to delay doing so in the hope that it would mitigate the effect of currency conversion claims. In any event, as conversion rates often fluctuate unpredictably, any attempt by an office-holder to time distributions by reference to the currency markets is liable to backfire.

[106] I was referred to reports published by the Law Commission and the Review Committee on Insolvency Law and Practice chaired by Sir Kenneth Cork ('the Cork Report') between 1981 and 1983. In 1981 the Law Commission published its Working Paper No 80, *Private International Law: Foreign Money Liabilities*, in the wake of the *Miliangos* decision. In paras 3.39-3.47 the Law Commission addressed the issue as it affected the liquidation of companies and the bankruptcy of individuals. This followed the decision of Oliver J in *Re Dynamics Corp of America (No 2)* [1976] 2 All ER 669, [1976] 1 WLR 757, but before the decisions at first instance and in the Court of Appeal in *Re Lines Bros Ltd*. The Law Commission endorsed the approach adopted by Oliver J of fixing the date of the winding-up order as the date on which foreign currency debts should be converted into sterling for the purposes of proof. In para 33.46 the Law Commission considered the position in the 'small minority of cases' where the company is found to be solvent. The report identified that this raised a third question, 'whether in such cases foreign currency creditors should be

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compensated from the assets of the company or the bankrupt for adverse exchange fluctuations between the date of the relevant order and the date of actual payment.' This, the Working Paper stated, would involve a second, later, conversion of these debts as at the date of actual payment, or as close thereto as is practicable. The paper expressed a view against a later conversion date where a change in the relative value had been adverse to the creditor in question on the grounds that

'it would involve a discrimination between foreign currency debts depending on whether the exchange rates have moved to the advantage or disadvantage of the creditors'.

[107] The Cork Report was published in 1982. The question of foreign currency liabilities was considered in paras 1306-1309. In para 1308 the report referred to two decisions in which it had been held that conversion should be effected as at the date of the winding up. These were presumably *Re Dynamics Corp of America* and *Re Lines Bros Ltd* at first instance. The Report supported this conclusion and recommended that any future Insolvency Act should expressly provide that the conversion of debts in foreign currencies should be effected as at the date of the commencement of the relevant insolvency proceedings. The Report continued:

> 'Furthermore, we take the same view as the Law Commission (Working Paper No 80) that conversion as at that date should continue to apply, even if the debtor is subsequently found to be solvent. To apply a later conversion date only in the case where the exchange rate has moved to the advantage of the creditor, but (necessarily) not where it had moved against him, would, in our view, be discriminatory and unacceptable.'

Although the judgment of the Court of Appeal in *Re Lines Bros Ltd* was given in February 1982, the Cork Report does not appear to have taken account of it in relation to claims for currency losses. If the Committee had been aware of the views expressed by Brightman LJ on this topic, with some support from Oliver LJ, they would be almost certain to have considered and addressed them.

[108] In the Law Commission's Final Report published in October 1983, reference was made in paras 2.22-2.23 and 3.34-3.37 to the position in a liquidation or bankruptcy. The decision of the Court of Appeal was by then reported and reference was made in para 2.23 to the discussion in that case concerning the position if the company is solvent. The conclusion expressed in para 3.37 was:

> 'The present law relating to the conversion into sterling of foreign currency claims in relation to solvent and insolvent companies and to bankruptcy is satisfactory.'

[109] This conclusion rather neatly leaves the point open. The Report endorses the conversion of foreign currency debts into sterling as at the date of liquidation for the purposes of proof. As the Court of Appeal had left open the question whether creditors could advance currency conversion claims in the event of a surplus of assets after the payment of all proved debts and interest, the effect of the Report is also to leave open that issue.

[110] In any event, I do not consider that these reports take the matter very far. The first two take no account of the discussion in the judgment of Brightman LJ and express concern based on the possibility of discrimination. However, as Brightman LJ makes clear in his judgment in passages which I have earlier cited, the issue of discrimination arises between different creditors, all of

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whom are innocent for these purposes. Once all proved debts and interest on them have been paid, issues of discrimination as between creditors do not arise. The question then, as Brightman LJ observed, is whether the debtor should take the advantage or the benefit of the decline in the value of sterling. In my judgment, it would be contrary to principle and justice that the debtor, or the shareholders receiving the surplus, should be able to deny the foreign currency claimants their full contractual rights. Those contractual rights are compromised by the insolvency regime only for the purpose of achieving justice among creditors through a pari passu distribution.

[111] Accordingly, I hold that currency conversion claims can be advanced as non-provable claims against a company which has paid in full all proved claims and statutory interest on those claims, except only those proved claims which by contract or otherwise are subordinated or which, in a liquidation, are subject to the contributory rule.

Is interest accruing during an administration provable or payable in a subsequent liquidation?

[112] The amount of statutory interest payable on the debts proved in the administration of LBIE is very substantial. LBIE has been in administration since September 2008 and statutory interest has been accruing at the rate of 8% or the contractual rate of interest, whichever is the higher, since then. The administrators of LBIE may take steps to place LBIE into liquidation, particularly with a view to making calls on its members and with a view to invoking the contributory rule, which I deal with later in this judgment. One of the issues which I later consider is whether the members are liable, in a liquidation, to make contributions for the purposes of funding the payment of statutory interest pursuant to their liability under s 74(1) of the 1986 Act. I conclude that they are. It is accordingly an issue of some significance whether statutory interest accruing during the period of the administration is provable or payable in a subsequent liquidation.

[113] Provisions relating to interest as they apply to an administration and to a liquidation are largely the same, except in one important respect. As regards administration, r 2.88(1) provides:

> 'Where a debt proved in the administration bears interest, that interest is provable as part of the debt except insofar as it is payable in respect of any period after the company entered administration or, if the administration was immediately preceded by a winding up, any period after the date that the company went into liquidation.'

This is the version of the rule in force between 1 April 2005 and 5 April 2010 and, by virtue of the transitional arrangements, applies to the administration of LBIE because it commenced during that period. Where, therefore, a debt bears interest before the commencement of the administration by reason of contractual terms, the Judgments Act or otherwise, the interest is provable for the period up to the commencement of the administration or the commencement of an earlier liquidation.

[114] In respect of the period following the commencement of the administration, r 2.88(7) provided during the period 1 April 2005 to 5 April 2010 as follows:

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> 'Any surplus remaining after payment of the debts proved shall, before being applied for any purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the company entered administration.'

This entitlement to statutory interest ranks immediately after the proved debts. The provision for statutory interest in r 2.88 (7) did not completely dovetail with the provision in r 2.88(1) because, if there were an earlier liquidation, interest during the period of that earlier liquidation fell within neither rule. The same was, to an extent, true in respect of some other provisions of r 2.88 which it is not necessary to detail. These inconsistencies were cured by amendments made to r 2.88 with effect from 6 April 2010. The position is now that interest is provable up to the date when the company went into administration or, if earlier, liquidation and statutory interest is payable in respect of the period since the earlier of those two dates.

[115] The provisions applicable to interest in a liquidation are contained in both the 1986 Act and the Insolvency Rules. As regards proving for interest, r 4.93 in the form in force between 1 April 2005 and 5 April 2010 provided:

> 'Where a debt proved in the liquidation bears interest, that interest is provable as part of the debt except insofar as it is payable in respect of any period after the company went into liquidation or, if the liquidation was immediately preceded by an administration, any period after the date that the company entered administration.'

The terms of r 4.93 have been amended consistently with the amendments to r 2.88 but not in a way which has altered their effect.

[116] The provision for statutory interest is contained in s 189 of the 1986 Act, which has not been amended. Section 189 includes the following:

> '(1) In a winding up interest is payable in accordance with this section on any debt proved in the winding up, including so much of any such debt as represents interest on the remainder.
>
> (2) Any surplus remaining after the payment of the debts proved in a winding up shall, before being applied for any other purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the company went into liquidation.'

In the provisions applicable both in an administration and in a liquidation, all such interest ranks equally, whether or not the debts on which it is payable rank equally, and the rate of interest payable is the greater of the rate payable on judgments (8% at all material times) and the rate applicable apart from the administration or winding up (normally the contractual rate).

[117] The provisions are therefore broadly the same. Interest on interest-bearing debts may be proved for any period before the company enters either administration or liquidation, whichever is the earlier. Until the amendments made with effect from 6 April 2010, statutory interest was payable out of any surplus remaining after the payment in full of proved debts from the date that the company entered administration, or from the date that it went into liquidation, but without in either case provision for the period of an earlier liquidation or administration respectively. By reason of the amendments made

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to r 2.88 with effect from 6 April 2010, it is clear that statutory interest is payable out of any surplus with effect from the commencement of an earlier liquidation. No similar amendment was made to s 189.

[118] On the basis of the terms of these provisions, the other Lehman companies submit that where an administration is followed by a liquidation, interest on interest-bearing debts is provable in respect of the period down to the commencement of the administration, but statutory interest is payable out of a surplus only from the date of the liquidation. On this basis, if LBIE were to go into liquidation, creditors would not receive interest in respect of the period from September 2008 when it went into administration until the date it goes into liquidation.

[119] On a straightforward reading of the relevant provisions, this appears to be their effect. It is, however, very difficult indeed to understand what policy could have justified this result. It has always been clear that in the case of either a distributing administration or a liquidation, not preceded by an earlier liquidation or administration (as the case may be), interest is provable on interest-bearing debts for the period up to the commencement of the relevant insolvency proceeding and statutory interest is payable out of the surplus on all debts for the period from the commencement of the relevant insolvency proceeding. There would seem to be no purpose served in a denial of any interest during the period of an immediately preceding administration or liquidation. That there was no policy justifying such denial would appear to be demonstrated by the amendments made to r 2.88 with effect from 6 April 2010 which ensure that in an administration which has been immediately preceded by a liquidation, statutory interest is payable in respect of the period since the commencement of the earlier liquidation.

[120] Mr Trace rose to the challenge of suggesting some policy justifications. First he suggested that it achieved simplicity. Secondly, he suggested that the possibility of a distributing administration being followed by a liquidation was sufficiently unlikely to make it unnecessary to make provision for statutory interest dating back to the start of the earlier administration. He suggested that a distributing administration was seen as an alternative, rather than a precursor, to a liquidation. These do not appear to me to be convincing reasons. Rule 4.73(8) provides that where a winding up is immediately preceded by an administration, a creditor proving in the administration shall be deemed to have proved in the winding up and therefore demonstrates that a move from a distributing administration to a liquidation is contemplated. More importantly, the lack of any provision for interest during the period of a preceding administration applies to all

administrations which are immediately followed by a liquidation, whether or not the administrator has given notice of an intention to make distributions.

[121] It is, I think, significant that changes were made in 2005 and 2010 to the rules, but not to s 189 of the 1986 Act, the only relevant provision to be contained in primary legislation. The rules are made and may be amended by statutory instrument made by the Lord Chancellor with the concurrence of the Secretary of State and, in the case of rules affecting court procedure, with the concurrence of the Lord Chief Justice or a judicial office-holder nominated by him. Any such statutory instrument is subject to annulment in pursuance of a resolution of either House of Parliament. The rules and their amendments are not therefore made by Parliament and may obviously be made very much more easily than amendments to the primary legislation contained in the 1986 Act. Given that there is no rational justification for providing that interest for

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the period of an administration which is immediately followed by a liquidation is neither provable or payable as statutory interest, I can only conclude that either the terms of s 189 were overlooked or, more probably, it was thought that in some way the amendments to the rules avoided the need to amend the primary legislation.

[122] The question is therefore whether the amended rules can be construed in a way which allows interest for the period of the administration to be proved or paid as statutory interest in the later liquidation. Or are their terms such that this conclusion is impossible?

[123] Mr Trower and Mr Zacaroli did not submit that there was any means by which the rules could be construed so as to provide that in the event of a liquidation immediately preceded by an administration, interest on interest-bearing debts could be proved for the period up to the commencement of the liquidation. It is, I think, common ground that in such circumstances interest is not capable of proof for the period of the earlier administration.

[124] Mr Trower submitted that, on a proper construction of r 2.88(7), the right to the payment of statutory interest out of a surplus remaining after the payment of the proved debts survives the conversion of the administration into a liquidation and entitles those who proved their debts in the administration to interest out of such surplus for the period from the commencement of the administration. Any creditor proving for the first time in the liquidation would not be so entitled, nor would it be entitled to prove for interest during the period of the administration.

[125] There are, as I see it, a number of serious difficulties with this submission. First, on a natural reading of 2.88(7) it applies to a surplus in the hands of the administrator rather than in the hands of a subsequent liquidator. Read in its context, it seems to direct the administrator as to the application of the surplus which he holds. Secondly, if it were to bear the meaning for which Mr Trower contends, it could I think apply only to a surplus in the hands of the administrator which he transferred to the liquidator. I do not see how it could apply to a surplus which arises for the first time in the hands of the liquidator. Rule 2.88(7) requires the surplus remaining after the payment of debts proved to be applied in payment of interest on those debts in respect of the periods during which they have been outstanding since the company entered administration 'before being applied for any purpose'. That is impossible to reconcile with the equivalent provision in s 189(2) which requires the surplus remaining in the hands of the liquidator to be applied in paying interest on proved debts in respect of the periods during which they have been outstanding since the company went into liquidation 'before being applied for any other purpose'. Thirdly, if r 2.88(7) is restricted to the surplus in the hands of the administrator, its effect is limited, first, to the amount of that surplus and, secondly, to the creditors who have lodged a proof in the administration. It therefore only goes a limited way to meeting the problem. Fourthly, in any event, it is a construction which provides no assistance in the case of an administration which has not become a distributing administration. It may be thought more likely that it is in such circumstances that a company will go into liquidation following an administration and the absence of any provision which could deal with interest for the period of an administration in such a case is in my view very telling.

[126] I am driven to the conclusion that the effect of the relevant legislation is that, in a case where an administration is immediately followed by a liquidation, interest for the period of the administration is neither provable nor

payable as statutory interest in the liquidation. This result would be avoided only if and to the extent that the administrator was able to pay statutory interest under r 2.88(7) before the company went into liquidation.

[127] In those circumstances, consistently with what I have earlier held as regards non-provable liabilities, I see no reason why creditors whose debts carried interest prior to the administration, whether by way of contract, judgment interest or otherwise, should not in the liquidation be entitled to claim interest at such rate for the period of the administration as a non-provable liability. In my judgment, the reasoning in *Re Humber Ironworks and Shipbuilding Co* (1869) LR 4 Ch App 643 applies and, as Giffard LJ put it, 'the creditor whose debt carries interest is remitted to his rights under his contract' or, as I would add, any other rights to interest which he may enjoy.

LBIE as an unlimited company

[128] The remaining issues arise out of the status of LBIE as an unlimited company.

[129] Modern company law began with the Companies Act 1862, a statute described by Sir Francis Palmer as the 'Magna Carta of co-operative enterprise'. Among the many reforms which the Companies Act 1862 introduced or consolidated was a simple process of registration of companies. It provided for the three types of registered company, which remain today with little amendment. They are companies limited by shares, companies limited by guarantee and unlimited companies.

[130] These three types of registered company are distinguished by the differences in the liabilities of their members. In no case, do the members have any direct liability to creditors of the company. In this respect, they are importantly different from partnerships, unincorporated joint stock companies (usually formed by a deed of settlement), companies incorporated under the Joint Stock Companies Act 1844 (which provided for the registration and incorporation of companies but made the members liable without limit to creditors as if they were partners) and Scottish partnerships, where the partners are secondarily liable to creditors. The liability of members of a registered company, whether limited or unlimited, is exclusively to provide funds to the company or to its liquidator. In the case of companies limited by shares, the liability of a member is limited to the amount unpaid on the shares registered in the name of the member. In the case of a company limited by guarantee, the liability of the member is limited to the amount stated in the memorandum of association of the company. There is no stated limit on the liability of the members of unlimited companies.

[131] It is now very unusual for companies limited by shares to have shares in issue which are not fully paid. Almost invariably, shares are fully paid up on their issue. This was not, however, the case in the second half of the nineteenth century and the first twenty or so years of the twentieth century. There are many reported cases dealing with the issues that arise when calls are made on shares, whether by the directors while the company is a going concern or by the liquidator in a winding up. The last of these cases to which I have been referred was decided in 1917. The only subsequent cases giving any consideration to these issues are *Re White Star Line Ltd* [1938] 1 All ER 607, [1938] 1 Ch 458, and *Re Kaupthing, Singer and Friedlander Ltd* (*in administration*) (*No 3*) [2011] UKSC 48, [2012] 1 All ER 883, [2012] 1 AC 804 (*Re Kaupthing*), in which Lord Walker considered an important aspect of the liability of members by way of analogy with the issue in that case.

[132] As the limited liability of members, together with a simple process of registration and incorporation, were the principal advantages of the mid-nineteenth century reforms, it is not surprising that there has been only a sparse use of unlimited companies. It appears that their introduction by the Companies Act 1862 was to compensate for the prohibition of partnerships or joint stock companies with more than 20 members or, in the case of banks, 10 members. If members wished to have an association which most closely resembled the old joint stock company, the unlimited company was

introduced for that purpose. There remained in some circles some stigma attached to limited liability and there were a number of businesses, including banks and building societies, which were incorporated as unlimited companies. A number of cases, though far fewer than those concerned with limited companies, dealt with issues arising out of the liability of members of unlimited companies. The use of unlimited companies, never great, declined during the nineteenth century. In the twentieth century, their principal advantage was an exemption from ad valorem stamp duty, and later capital duty, payable on the issue of new capital by a company. For this reason, their principal use for many years was as estate or investment companies, where estates or other property were transferred to companies in exchange for shares issued to or owned for the benefit of the families owning them. For the same reason, they were sometimes used in complex corporate restructurings and transactions. As appears from the facts of the present case, unlimited companies have found a place in corporate planning for US tax purposes.

[133] An unlimited company may, but is not required to, have a share capital. At the date of the appointment of the administrators, the issued share capital of LBIE was $13,273,114,000 divided into 6,273,114,000 ordinary shares of $1 each, 2m class A preference shares of $1000 each and 5•1m class B shares of $1000 each. LBHI2 is the registered holder of all the shares except for one ordinary share registered in the name of LBL. All the shares were fully paid up at the date of the appointment of the administrators.

[134] The liability of members arises in two distinct ways, which it is important to differentiate. First, the holders of shares, whether in a limited or unlimited company, are liable to pay up their shares either in accordance with the terms of issue or when made the subject of calls by the company. It is the liability to meet calls for unpaid capital which has a bearing on the issues in this case. The provisions governing calls are contained in the articles of association of the company and apply to calls made by the company before it goes into liquidation.

[135] By way of example, the last version of Table A articles applying to companies limited by shares (contained in the Schedule to the Companies (Tables A to F) Regulations 1985, SI 1985/805), reflecting or repeating provisions contained in earlier versions of Table A, provided in reg 12 that subject to the terms of allotment, directors were empowered to make calls upon the members in respect of any moneys unpaid on their shares, whether in respect of nominal value or premium, and each member was, subject to receiving at least 14 days' notice, required to pay to the company as required by the notice the amount called on his shares. Regulations 13 to 22 contained further provisions relating to calls and to the remedies in respect of a failure to pay calls, including the final sanction of forfeiture of the shares. The standard form articles for an unlimited company contained in Table E incorporated by reference the relevant provisions of Table A, as do the articles of LBIE.

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[136] In a winding up of a company, a separate regime applies to both calling up unpaid capital on shares and making other calls on the members of unlimited companies and of companies limited by guarantee. The relevant provisions are now contained in the 1986 Act and the Insolvency Rules (as amended), but it should be noted that before 1986 the relevant provisions were contained in successive Companies Acts and the Winding-up Rules. The relevant provisions, even those contained in the Companies Act 1862, have not changed radically over the years. All the authorities to which I shall refer are dealing with provisions contained in the Companies Acts but I shall endeavour to indicate also their counterpart in the present legislation. The provisions applicable to the making of calls in a liquidation replace the provisions in the articles of companies for making calls on shares.

[137] For convenience, in this judgment, I shall refer to the liabilities of members arising before a liquidation as contractual and those arising in a liquidation as statutory. Being statutory, it is not possible to contract out of the latter provisions.

Liability of members in a liquidation

[138] Section 74 of the 1986 Act sets out the liability of present and past members in a liquidation. It provides:

'(1) When a company is wound up, every present and past member is liable to contribute to its assets to any amount sufficient for payment of its debts and liabilities, and the expenses of the winding up, and for the adjustment of the rights of the contributories among themselves.

(2) This is subject as follows—

(a) a past member is not liable to contribute if he has ceased to be a member for one year or more before the commencement of the winding up;

(b) a past member is not liable to contribute in respect of any debt or liability of the company contracted after he ceased to be a member;

(c) a past member is not liable to contribute, unless it appears to the court that the existing members are unable to satisfy the contributions required to be made by them;

(d) in the case of a company limited by shares, no contribution is required from any member exceeding the amount (if any) unpaid on the shares in respect of which he is liable as a present or past member;

(e) nothing in the Companies Acts or this Act invalidates any provision contained in a policy of insurance or other contract whereby the liability of individual members on the policy or contract is restricted, or whereby the funds of the company are alone made liable in respect of the policy or contract;

(f) a sum due to any member of the company (in his character of a member) by way of dividends, profits or otherwise is not deemed to be a debt of the company, payable to that member in a case of competition between himself and any other creditor not a member of the company, but any such sum may be taken into account for the purpose of the final adjustment of the rights of the contributories among themselves.

(3) In the case of a company limited by guarantee, no contribution is required from any member exceeding the amount undertaken to be contributed by him to the company's assets in the event of its being wound up; but if it is a company with a share capital, every member of it is liable

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(in addition to the amount so undertaken to be contributed to the assets), to contribute to the extent of any sums unpaid on shares held by him.'

[139] The scheme of s 74 is, in sub-s (1), to impose a general liability on every present and past member and then in sub-ss (2) and (3) to qualify the liability. The liability of past members is qualified by the terms of sub-s (2)(a), (b) and (c). The limitation on the liability of members of a company limited by shares is provided by sub-s (2)(d), which limits a member's liability to the amount unpaid, if any, on the shares in respect of which the member is liable. The equivalent qualification for members of a company limited by guarantee is provided by sub-s (3). Sub-section (2)(f) is somewhat misplaced. It is not concerned with the liability of members but provides for the postponement of debts due to members in their character as such. The unlimited liability of the members of an unlimited company is achieved by the absence of any qualification in sub-ss (2) or (3) to the general provision in sub-s (1).

[140] Throughout the remaining provisions of the 1986 Act, the term 'contributory' is used to describe those past and present members on whom a liability is placed by s 74, and other persons liable to contribute under s 76; see s 79 for the definition of 'contributory'.

[141] Sections 80-83 contain further provisions in relation to contributories and their liability, two of which are relevant to the issues in this case.

[142] Section 80 provides:

> 'The liability of a contributory creates a debt (in England and Wales in the nature of an ordinary contract debt) accruing due from him at the time when his liability commenced, but payable at the times when calls are made for enforcing the liability.'

The words 'an ordinary contract debt' replaced the words 'a specialty' with effect from 1 October 2009. This is not material to the issues in this case.

[143] Material to this case are the words in s 80, 'accruing due from him at the time when his liability commenced'. It has been held that the liability of a member as a contributory commences for the purposes of this section when he becomes a member: *Re Vaughan, ex p Canwell* (1864) 4 De G J & Sm 539, *Williams v Harding* (1866) LR 1 HL 9 at 29, and see *Buckley on the Companies Acts* (14th edn, 1981) p 507. The liability of a member to pay calls made before a winding up and in a winding up are therefore both created at the same time.

[144] Section 82 deals with the effect of the bankruptcy of a contributory. It provides:

> '(1) The following applies if a contributory becomes bankrupt, either before or after he has been placed on the list of contributories.
>
> (2) His trustee in bankruptcy represents him for all purposes of the winding up, and is a contributory accordingly.
>
> (3) The trustee may be called on to admit to proof against the bankrupt's estate, or otherwise allow to be paid out of the bankrupt's assets in due course of law, any money due from the bankrupt in respect of his liability to contribute to the company's assets.
>
> (4) There may be proved against the bankrupt's estate the estimated value of his liability to future calls as well as calls already made.'

[145] It was submitted by Mr Wolfson that the presence of the provisions permitting proof in sub-ss (3) and (4), without any corresponding provisions

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relating to proof in the administration or liquidation of a corporate contributory, demonstrated that there could be no proof in the latter case in respect of a liability as a contributory. This submission misunderstands the purpose of those sub-sections. Sub-section (2) makes the trustee in bankruptcy the contributory in respect of the shares registered in the name of the bankrupt. Without further provision any claim in respect of calls would therefore lie against the trustee in bankruptcy. Sub-sections (3) and (4) provide that claims in respect of future calls are not to be made against the trustee personally but are to be admitted to proof in the bankrupt's estate. Without those provisions, the bankrupt's estate would have no liability in respect of future calls and therefore no proof in respect of them could be made. In the case of an administration or liquidation of a corporate contributory, the shares remain registered in the name of the company and there is therefore no need for any provision to the effect that proofs in respect of future calls may be made in the administration or liquidation.

[146] Section 148 of the 1986 Act provides that the court shall as soon as may be after the making of a winding-up order settle a list of contributories, unless it appears that it will not be necessary to make calls on or adjust the rights of contributories. By s 150 the court may, either before or after it has ascertained the sufficiency of the company's assets, make calls on all or any of the contributories to the extent of their liability--

'for payment of any money which the court considers necessary to satisfy the company's debts and liabilities, and the expenses of winding up, and for the adjustment of the rights of the contributories among themselves, and make an order for payment of any calls so made.'

Section 154 provides that the court shall adjust the rights of the contributories among themselves and distribute any surplus among the persons entitled to it. Section 160 provides that provision may be made by rules for enabling or requiring the powers and duties of the court in respect of settling the list of contributories and the making of calls to be exercised or performed by the liquidator as an officer of the court and subject to the court's control. Provision is so made in the Insolvency Rules, to which I refer below. As regards a voluntary winding up, s 165(4) provides that a liquidator may exercise the court's powers of settling a list of contributories and making calls.

[147] The provisions in the Insolvency Rules delegating the duties and powers of the court with regard to settling the list of contributories and making calls to the liquidator as an officer of the court, subject to the court's control, are contained in rr 4.195 to 4.201 and 4.202 to 4.205 respectively. None of them calls for special comment for the purposes of the present case.

[148] There are other provisions of the 1986 Act and the Insolvency Rules which are relevant, such as provisions dealing with the proof of debts and set-off, but I shall refer to those provisions when dealing with the particular issues to which they relate.

Issues

[149] The issues which arise in connection with the liability of the contributories of LBIE are:

(i) The extent of the liability arising under s 74 of the 1986 Act.

(ii) The application of the 'contributory rule' and the equitable rule in *Cherry v Boultbee* (1838) 2 Keen 319, (1839) 4 My & Cr 442, (1839) 41 ER 171.

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(iii) Whether and, if so, when can a liability for future calls be the subject of proof in the administration or liquidation of a corporate contributory.

(iv) The effect of set-off in the administration or liquidation of a corporate contributory.

(v) The effect of set-off in the administration or liquidation of the company.

The extent of liability under section 74 of the 1986 Act

[150] The issue is whether the liability to contribute to the assets of a company in liquidation under s 74(1) extends to providing the funds needed to pay statutory interest and any non-provable liabilities or, whether as the other Lehman companies submit, it is limited to the funds required to pay the debts and liabilities proved in the liquidation. On either basis, the liability also extends to the provision of funds for the payment of the expenses of the winding up and for the adjustment of the rights of contributories among themselves.

[151] The issue turns on the proper construction of s 74(1) and of the provisions creating the liability to pay statutory interest - s 189 in the case of a liquidation and r 2.88(7) in the case of an administration. Before coming to the detailed points of drafting on which the case of the contributories is largely based, there are some general points to make.

[152] First, the purpose of a liquidation is to realise to best advantage all the assets of the company and to distribute the proceeds of sale among those entitled to them in the order of priority in which they are entitled to receive them. As the liquidation of a company ends with its dissolution, nothing as a matter of principle should be left unresolved for the future. This is in contrast to individuals, who are discharged from bankruptcy and who can therefore, for example, continue to be liable for such pre-bankruptcy liabilities as the law may prescribe. It is the purpose of a liquidation to pay all the liabilities of the company, including those which are not capable of proof. The payment or compromise of non-provable tort claims in *Re T & N Ltd* [2006] 3 All ER 697 was as much a purpose of the administrations of the T & N companies as the payment of their provable debts. In *Re R-R Realisations Ltd* [1980] 1 All ER 1019, [1980] 1 WLR 805 the final distribution to members was delayed while provision was made for tort claims made by the estates of persons killed in the crash of an aircraft powered by Rolls Royce engines which occurred well into the liquidation. It is clear from the waterfall set out in Lord Neuberger's judgment in *Re Nortel* [2013] 4 All ER 887, [2014] AC 209 that a liquidation, or in that case a distributing administration, has this comprehensive purpose.

[153] Secondly, while acknowledging that of course the extent of any liability is a matter of construction of the relevant statutory provisions, one might suppose that if a member of an unlimited company is to be liable to contribute to the assets of the company for the payment of its debts and liabilities without limit, such liability would extend to all its debts and liabilities, whether or not they were capable of proof. Many unprovable liabilities are, or at least until the decision in *Re Nortel* were, incapable of proof not by virtue of their very nature but by virtue of when the liability arose. Until r 13.12 was amended in 2010, tort claims were provable only if the cause of action was complete by the time of the liquidation. Following the amendment, the cause of action must by then be complete save for the occurrence of actionable damage. Obligations to make payments pursuant to the exercise of discretionary powers, for example orders for costs in litigation or the issue of contribution notices in respect of

pension fund deficits, were before the decision of the Supreme Court in *Re Nortel* provable only if the power had been exercised before the commencement of the liquidation but not otherwise.

[154] The obligation to pay statutory interest in a liquidation is of a different character, because it can arise only in the event of a liquidation. It is worth bearing in mind the position which exists prior to the liquidation. The company, particularly for example a bank, may have many liabilities which carry interest. To the extent that such interest accrued due for payment after the commencement of the liquidation, it was never provable but, under the law as it existed before the 1986 Act, it was payable once all provable debts had been paid: see *Re Humber Ironworks and Shipbuilding Co* (1869) LR 4 Ch App 643. It is difficult to see the policy which would make members of an unlimited company liable to contribute for the purposes of paying the principal amount of such contractual debts but not require them also to provide funds for the payment of contractual interest, all the more so when on any basis they had to do so for contractual interest accruing due before the commencement of the liquidation. It might be thought surprising if the substitution under the insolvency legislation of statutory interest for non-provable contractual interest reduced the liability of members.

[155] Turning to the express terms of s 74(1), the liability is to contribute 'to any amount sufficient for payment of its debts and liabilities'. Nowhere in s 74, or in any other provision, is there any express provision that the liability is restricted to amounts sufficient for the payment of *provable* debts and liabilities.

[156] Mr Trower submitted that, while the defined meaning of 'debts' is restricted to provable debts, the defined meaning of 'liabilities' is not so restricted. Rule 12.3 makes provision for 'provable debts':

> '(1) Subject as follows, in administration, winding up and bankruptcy, all claims by creditors are provable as debts against the company or, as the case may be, the bankrupt, whether they are present or future, certain or contingent, ascertained or sounding only in damages.'

Part 13 of the Insolvency Rules (entitled 'Interpretation and Application') contains in r 13.12 definitions of 'debt' and 'liability' for the purposes of a liquidation and administration. 'Debt' is defined in r 13.12(1), a provision which was subject to close scrutiny in *Re Nortel*. It sets out the pre-conditions which must be satisfied for a debt to be the subject of proof. Rule 13.12(2) is concerned with the circumstances in which a liability in tort is 'a debt provable in the winding up'. These provisions, in my view, make good Mr Trower's submission that the word 'debt' is used to mean provable debt.

[157] Rule 13.12(4) defines 'liability':

> 'In any provision of the Act or the Rules about winding up, except insofar as the context otherwise requires, "liabilities" means (subject to paragraph (3) above) a liability to pay money or moneys worth including any liability under an enactment, any liability for breach of trust, any liability in contract, tort or bailment, and any liability arising out of an obligation to make restitution.'

As Mr Trower emphasised, this sub-rule is not linked to the status of a liability as a provable debt. In terms it applies 'in any provision of the Act or the Rules about winding up', which by virtue of sub-r (5) applies also to an administration.

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[158] Section 74 requires members to contribute sums sufficient not only for the payment of the debts and liabilities of the company but also 'for the adjustment of the rights of the contributories among themselves'. Mr Trower relies on this as support for his submission that 'debts and liabilities' are to be given a broad meaning, encompassing all the liabilities of the company, whether provable or not. As the adjustment of the rights of the contributories among themselves lies almost at the bottom of the waterfall, above only a return of capital to members, it suggests that the contributions required from contributories are to be applied in discharge of the liabilities which rank below provable debts but above the adjustment of rights among contributories. Counsel for the other Lehman companies submitted that this did not follow and that there was no difficulty in the liquidator either ring-fencing out of a larger call the amount required for the adjustment of rights among contributories after provable debts had been paid in full, or making a further call specifically for the purpose of the adjustment of the rights of contributories.

[159] There is, however, no provision in the 1986 Act or the Insolvency Rules for any such segregation or separate call. The legislation proceeds on the basis that funds received by the liquidator will be applied in accordance with the order of priority established by the legislation and case-law. If it had been intended that sums from calls after the discharge of provable debts should be held by the liquidator on, in effect, a purpose trust, it is to be expected that the legislation would have made appropriate provision. It is no answer to say that such provision is implicit, because this presupposes the question to be answered, whether the obligation of contributories is limited to making contributions for the payment of provable debts.

[160] Mr Trower derived further support for his submission from the provisions of two other sections in the 1986 Act. First, s 89(1) provides for a statutory declaration of solvency to be made by the directors of a company if its voluntary winding up is to proceed as a members' voluntary winding up, not a creditors' voluntary winding up. The principal difference between the two types of voluntary winding up is that in the former the members have powers of control, while in the latter it is the creditors who have such powers. The declaration requires the directors to state that they have formed the opinion that 'the company will be able to pay its debts in full, together with interest at the official rate' within a period not exceeding 12 months from the commencement of the winding up. Secondly, s 149(3) is more closely linked to the liability under s 74:

> 'In the case of any company, whether limited or unlimited, when all the creditors are paid in full (together with interest at the official rate), any money due on any account whatever to a contributory from the company may be allowed to him by way of set-off against any subsequent call.'

While not decisive, this provision is more consonant with the liability under s 74 extending to statutory interest, rather than excluding it.

[161] The principal submissions on behalf of the other Lehman companies, were first, that r 2.88(7) and s 189(2) which provide for the payment of statutory interest do not create liabilities of the company, and secondly, that the meaning of 'its debts and liabilities' in s 74(1) is restricted to provable debts and liabilities.

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[162] The submission that the right of creditors to receive statutory interest is not a liability of the company in liquidation is substantially the same argument as was made on behalf of LBHI2 and LBHI in respect of the construction of the subordinated loan agreements, a submission which I have earlier rejected. It is, however, necessary to consider this submission in the different context of s 74. The same points are made that s 189(2) is not a provision that creates a liability, but is an instruction or direction to the liquidator as to how to apply a surplus remaining in his hands after payment of the debts proved. The obligation arises only if there is such a surplus. Unless a call is made, there is no such surplus and it is no part of the function of the liquidator to make calls for the purpose of creating the surplus which is the necessary pre-condition to the obligation to pay statutory interest. Reliance is again placed on the decision of Mervyn Davies J in *Re Lines Brothers Ltd* [1984] BCLC 215.

[163] The issue is whether, as a matter of construction of s 74(1), the obligation created by s 189(2) is a liability of the company. I see the linguistic argument for saying that the terms of s 189(2) constitute a direction to the liquidator, rather than creating a liability of the company. I do not, however, accept that the way in which s 189(2) is expressed has the effect, or is intended to have the effect, of excluding statutory interest from the obligations of contributories under s 74. I find it impossible to discern the policy reason for saying that members are liable to contribute assets for the payment of the principal amount of provable debts, but are not liable for the interest on those debts which is payable to compensate the creditors for being kept out of their money until a distribution is made in the liquidation. The justification for statutory interest, even in those cases where the debts do not already carry a right to interest, is that the creditors are prevented by the liquidation regime from obtaining judgment against the company which would then carry interest at judgment rate. If a judgment were obtained before the commencement of the liquidation, interest at the judgment rate is provable down to the commencement of the liquidation. Members are liable to contribute in respect of such interest. There is no plausible policy reason why they should cease to be so liable in respect of interest accruing due after the commencement of the liquidation. The fact that such interest, at the same rate, becomes payable under s 189(2) rather than under the Judgments Act provides no sound reason for distinguishing between them.

[164] There is, moreover, the point which I have already made, that until the introduction of s 189(2) contractual interest was payable in a liquidation but was not provable in competition with other debts. I do not find it plausible that the use of language in s 189(2) was intended to have the effect that what was previously clearly a liability of the company should cease to be so for the purposes of s 74(1). Further, the non-provable liabilities which rank behind statutory interest are, on any footing, liabilities of the company, although not provable debts. If s 74(1) extends to making calls for the payment of non-provable liabilities, ranking behind statutory interest, it makes no sense at all that calls cannot be made in order to fund the payment of statutory interest. The submission that statutory interest is excluded from s 74(1) because of the wording of s 189(2) can make sense only if the meaning of 'its debts and liabilities' is restricted to provable debts.

[165] A further point arising out of the terms of s 189(2) was made on behalf of the other Lehman companies. Payment of statutory interest under that provision is to be made out of 'any surplus remaining after the payment of the

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debts proved in a winding up'. There must be a surplus of assets available for distribution before any statutory interest becomes payable. It was submitted that the surplus would arise only if and to the extent that the liquidator made calls and the contributories had made payments in response to those calls. In my judgment, this submission is misconceived. The assets available to a liquidator to meet the claims of creditors, including statutory interest and non-provable debts, includes the right to make calls. Clearly no distribution can in fact be made except to the extent that, so far as calls are concerned, payments are made in response to those calls. If, on its proper construction, the liability of contributories under s 74

extends to providing funds for the payment of statutory interest and non-provable debts, the liquidator by making calls for that purpose is not creating a surplus, and so causing the obligation to pay statutory interest to arise, but is making calls in response to the requirement to pay statutory interest.

[166] A number of submissions were made in support of the proposition that, on its proper construction, the phrase 'its debts and liabilities' in s 74(1) was restricted to provable debts.

[167] First, no right to statutory interest exists outside a liquidation or administration. All other liabilities, including non-provable liabilities, exist or may exist independently of the liquidation. While true, this does not seem to me to advance the position of the other Lehman companies. Like the obligation to pay statutory interest, the obligation of contributories under s 74(1) arises only in a liquidation. I see no good reason why an obligation to contribute which arises only in a liquidation should not extend to obligations to make payments to creditors which arise only in a liquidation. The submission seeks to put a gloss on s 74(1) which is not present either in the wording of the section or in the definition of 'liabilities'.

[168] Secondly, it was submitted that where the expression 'debts and liabilities' or similar expressions are used elsewhere in the 1986 Act, they do not include statutory interest. In this context, Mr Isaacs gave a number of examples.

[169] The first examples were ss 95(4), 99 and 131(2) which make provision for statements of affairs in a members' voluntary liquidation, a creditors' voluntary liquidation and a compulsory liquidation respectively. The statements of affairs required by ss 95 and 99 must show, amongst other things, 'particulars of the company's assets, debts and liabilities'. The first point to note is that there is no express provision restricting these particulars to provable debts. The requirement is to make a statement as to the affairs of the company, and in principle its affairs will extend to its debts and liabilities which are not provable as well as to those which are provable. Even though not provable, they are liabilities of the company and are payable if there are funds available to do so. Mr Isaacs submitted that statutory interest could not be included in these statements of affairs, for two reasons. First, it would require an assumption that a company which is insolvent would be able to pay its proved debts in full and, secondly, it would require matters to be known which could not possibly be known, such as the amount of the surplus and the length of time before proved debts were paid. I am bound to say that I do not consider that much light will be shed on s 74 by whether or not statutory interest is usually or can be included in these statements of affairs. Having said that, I cannot see that the fact that there may not be funds available to pay any statutory interest means that no provision for it could or should be made. Provision will be made for the full amount of provable debts, and I would

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suggest non-provable liabilities, notwithstanding that there may be insufficient funds to pay all of the former or any of the latter. As to the amount of statutory interest being incapable of calculation, while this is true, it is not impossible to make a provision, just as provisions would need to be made for contingent liabilities. It may further be noted that the requirement imposed by s 95 to prepare a statement of affairs arises 'where the liquidator is of the opinion that the company will be unable to pay its debts in full (together with interest at the official rate)' within the year after the commencement of a members' voluntary winding up. It may be the inability to pay statutory interest in full which triggers the requirement for a statement of affairs.

[170] The second provision relied on was s 123 which deals with the inability of a company to pay its debts for the purposes of the jurisdiction of the court to wind up the company. Mr Isaacs relied in particular on s 123(2) which provides that a company is deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of its assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities. He accepted that future contractual interest might be included for these purposes, but he submitted that it could not include statutory interest. I entirely agree with this proposition. A creditor clearly cannot rely on the inability of the company to pay a liability which arises only in a liquidation for asserting the insolvency of the company for the purposes of obtaining an order to wind up the company. This does not, however, shed light on the extent of the obligation imposed by s 74(1) which itself only arises in the liquidation.

[171] Thirdly, Mr Isaacs relied on s 214(6). Section 214 imposes liability on directors and others for wrongful trading. It applies where a company has gone into insolvent liquidation and the respondent knew or ought to have concluded that there was no reasonable prospect that it would avoid going into insolvent liquidation. Section 214(6) provides that for the purposes of the section a company goes into insolvent liquidation if it does so 'at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of the winding up'. I do not think that this assists Mr Isaacs' submission. First, as Mr Trower submitted, the reference to 'its debts and other liabilities' suggests that it is intended to include non-provable liabilities. In any event, I can see no good reason why non-provable liabilities should not be taken into account for the purposes of applying this sub-section. Further, a company will avoid going into creditors' voluntary winding up, rather than members' voluntary winding up, only if the directors are able to declare that the company will be able to pay its debts in full together with statutory interest.

[172] Fourthly, Mr Isaacs relied on s 272 which sets out the grounds on which a debtor may present his own bankruptcy petition. The only grounds are inability to pay debts and the petition must be accompanied by a statement of the debtor's affairs containing, amongst other things, prescribed particulars of 'his debts and other liabilities'. However, there is no reason to consider that 'other liabilities' is restricted to provable debts. On the contrary, a debtor's inability to pay his debts is as much established when he can show that he is unable to pay his debts, whether provable or unprovable, as well as in those circumstances where he is unable to pay only his provable debts.

[173] Reference to these various statutory provisions does not, in my judgment, establish or suggest that the liability under s 74(1) is restricted to provable debts. In some instances, these sections tend to suggest the contrary.

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[174] Mr Isaacs relied on four provisions as showing that, where it was intended to include statutory interest, express reference was made. The provisions in question are s 89(1), s 149(3), s 215(4) and r 12.3(2A). In none of these provisions, however, is reference made to interest or statutory interest in addition to the phrase 'debts and liabilities'. They are all cases where the reference is either to 'debts' or to what are clearly claims by creditors in respect of provable debts.

[175] Overall, I consider that Mr Trower is correct in his submission that where the legislation refers to 'liabilities' instead of or in addition to 'debts', it does so because a reference only to provable debts would not be appropriate.

[176] Mr Isaacs repeated in this context the submissions he had made in the context of the subordinated loan agreements that the expression 'debts and liabilities' could not be read literally, because of the provisions relating to future debts, contingent liabilities and non-provable liabilities. I reject these submissions for the same reasons as earlier given in relation to the subordinated loan agreements.

[177] As a final submission, assuming his prior submissions were wrong, Mr Isaacs submitted that LBIE could not claim against LBHI2 for statutory interest in respect of any period after the commencement of LBHI2's administration. He submitted that it would be contrary to r 2.88(1) which has the effect that, where a debt proved in an administration bears interest, the interest is not provable as part of the debt in respect of any period after the commencement of the administration. I do not accept this submission. Rule 2.88(1) is concerned with claims for principal plus interest. A claim for a contribution under s 74 is not such a claim but is a single claim for the amount due under s 74. It is nothing to the point that a constituent element of the claim is statutory interest payable in the liquidation of LBIE. Mr Isaacs relied on the decision in *Re International Contract Co, Hughes' Claim* (1872) LR 13 Eq 623. A nominee shareholder lodged a proof in the liquidation of the beneficial owner of the shares for an indemnity against calls on the shares and interest on those calls. The interest had accrued due since the commencement of the winding up of the beneficial owner, and the indemnity was held not to be provable to the extent of such interest by reason of what was then the common law rule that post-liquidation interest was not provable but only payable out of any available surplus. The issue, as Wickens V-C saw it, was whether that rule should be extended to the case before him on the grounds that it was analogous to cases falling within the rule but was not actually one of them. He concluded that the rule should be extended to include this analogous case. Now that the rule is enacted in r 2.88(1), it is the terms of the rule and nothing else which governs the circumstances in which a sum representing interest may be proved. A claim under s 74 is not a claim for interest on a proved debt.

[178] Accordingly, I conclude that members are liable to contribute to the assets for the payment of not only provable debts but also statutory interest and non-provable liabilities.

The contributory rule

[179] A series of cases in the nineteenth century, beginning with *Re Overend, Gurney & Co, Grissell's Case* (1866) LR 1 Ch App 528 (*Grissell's Case*), established the principle that a person could recover nothing as a creditor of a company

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until he had discharged all his liability as a contributory. A classic statement of this principle was given by Buckley J in *Re West Coast Gold Fields Ltd* [1905] 1 Ch 597 at 602:

> 'The right view is that the person liable as contributory must discharge himself in that character before he can set up that, as a creditor, he is entitled to receive anything and a fortiori, as it seems to me, before he can set up that, as a contributory, he is entitled to receive anything.'

His decision was upheld by the Court of Appeal ([1906] 1 Ch 1).

[180] This principle was conveniently referred to in the course of submissions as 'the contributory rule' and I will use the same description in this judgment.

[181] The passage from the judgment of Buckley J was cited by Lord Walker in *Re Kaupthing* [2012] 1 All ER 883 at [20], in his discussion of this principle by way of analogy with the issue arising for decision in that case. Referring further to this principle, Lord Walker said (at [52]):

> 'The situation in this line of authority is that a shareholder is a creditor of an insolvent company, but his shares are not fully paid up, so that he is liable as a contributory. Suppose he has 10,000 £1 shares, 10p paid, and is owed £15,000, but the dividend prospectively payable is only 30p in the pound. If the liquidator calls on him for £9,000 to make his shares fully paid up, he has no right of set-off, and to that extent he is disadvantaged (that is *Re Auriferous Properties Ltd (No 1)* [1898] 1 Ch 691, 67 LJ Ch 367). If he seeks to prove in the liquidation, the liquidator can rely on the equitable rule as it applies in a case of this sort--that is, that he can receive *nothing* until he has paid *everything* that he owes as a contributory. That is *Re Auriferous Properties Ltd (No 2)* [1898] 2 Ch 428. The rule is also very clearly stated by Buckley J in *Re West Coast Gold Fields Ltd* [1905] 1 Ch 597 at 602, 74 LJ Ch 347 at 349 (affirmed [1906] 1 Ch 1, 75 LJ Ch 23 and cited in [20] above). Payment of the call is a condition precedent to the shareholder's participation in any distribution, and again the shareholder is to that extent disadvantaged.'

[182] The issue in *Re Kaupthing* was whether the rule against double proof took priority over and excluded the equitable rule commonly known as the rule in *Cherry v Boultbee*. The Supreme Court held that, just as the principle established in *Grissell's Case* takes priority over the rule in *Cherry v Boultbee*, so too does the rule against double proof. The contributory rule was developed by the courts on the basis of the statutory provisions relating to the liability of contributories. It is a rule dictated by the nature and the purpose of the obligation imposed on contributories by the legislation in a winding up. It may bear some relation to the rule in *Cherry v Boultbee* but, as the decision in *Re Kaupthing* makes clear, it is in important respects distinct from it.

[183] In *Re Kaupthing* [2012] 1 All ER 883 at [8] Lord Walker described the rule in *Cherry v Boultbee* as--

> 'basically a simple technique of netting-off reciprocal monetary obligations, even where there is no room for legal set-off, developed and used by masters in the Court of Chancery giving directions for the administration of the estates of deceased persons.'

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It produces a netting-off effect that is similar to set-off and applies in circumstances where set-off itself is not applicable, because there is not the necessary similarity in claims. The rule applies to net off a person's claim as a beneficiary of an estate against the estate's claim against him as a debtor. Lord Walker (at [13]) cited the statement of the rule by Kekewich J in *Re Akerman* [1891] 3 Ch 212 at 219, [1891-94] All ER Rep 196 at 198:

> 'A person who owes an estate money, that is to say, who is bound to increase the general mass of the estate by a contribution of his own, cannot claim an aliquot share given to him out of that mass without first making the contribution which completes it. Nothing is in truth retained by the representative of the estate; nothing is in strict language set off; but the contributor is paid by holding in his own hand a part of the mass, which, if the mass were completed, he would receive back.'

[184] It is common ground that if LBIE went into liquidation and if the liquidator were to make calls on LBHI2 and LBL, those companies would be unable to make any claim as creditors in the liquidation, whether in respect of unsubordinated or subordinated claims, until they had discharged in full their liability as contributories. The issue in this case is whether the same principle applies before a call is made and, specifically, while a company is in administration but after the administrators have given notice of an intention to make distributions.

[185] Mr Trower submits that the contributory rule is a firmly established rule to protect the position of those entitled as creditors to a distribution out of a company's assets. It prevents a contributory from claiming or proving in competition with them, until such time as he has discharged his obligations to contribute to the full extent of his liability. He points out that a distributing administration, as much as a liquidation, involves a pari passu distribution among creditors and involves the protection of the interests of all creditors, including those whose debts may not be provable. A distributing administration, like a liquidation, may end with the dissolution of the company. In these circumstances, it is, he says, entirely adventitious from the perspective of the members of LBIE that it happens to be in administration, rather than liquidation. It is in administration, rather than liquidation, because the joint administrators consider that it continues to be in the best interests of the estate as a whole that it should remain in administration, and the court has endorsed that view. In these circumstances, he submits that it is very difficult to see any sensible policy reason why the contributory should be able to prove in an administration but not in a liquidation. The mischief which the rule prevents, that of removing from the creditors all or part of the fund which should be available to pay their debts, is present equally in an administration and a liquidation.

[186] Mr Trower submits therefore that the contributory rule applies once an administrator gives notice of an intended distribution. It applies to any member who is subject to a potential liability under s 74 if the company were wound up and who seeks to prove in the administration. If the company is limited by shares and there is unpaid capital on shares, the company in most cases has its contractual right to make calls while still a going concern. An administrator succeeds to the authority of the directors to make such calls. Whether the contributory could in those circumstances set off his liability to pay the calls against any liability of the company to him as a creditor is a

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question which does not arise for decision on this application. The issue on this application arises in circumstances where the liability of the member is exclusively the statutory liability imposed on a member as a contributory in a liquidation.

[187] Mr Trower of course accepts that no call can be made on LBHI2 or LBL while LBIE remains in administration. The power arises only in a liquidation. He submits that the absence of any provision for calls in an administration should not prevent the courts from developing the contributory rule so as to apply in an administration, in order to protect the very interests which it exists to protect in a liquidation. The rule should be developed to meet the changes in insolvency procedures made by the introduction of administrations, and in particular the power to wind up the affairs of the company and to distribute the proceeds of realisations of assets among creditors in an administration.

[188] The fundamental difficulty in applying the contributory rule in an administration is precisely because there is no statutory mechanism for making calls on contributories in an administration. While LBIE remains in administration, there can be no calls and therefore nothing that LBHI2 and LBL as members could do to put themselves in a position where they could prove as creditors in respect of their subordinated and unsubordinated claims. Yet this would be the result of

applying the contributory rule to a company in administration. It is no answer to say, as Mr Trower does, that in this case LBHI2 and LBL would be unable by virtue of their own insolvency to meet any calls. The rule, if it is to apply, must apply equally to solvent and insolvent contributories. If the affairs of LBIE are fully wound up in the course of its distributing administration, culminating in the dissolution of the company without a liquidation, LBHI2 and LBL, even if they were fully solvent, would have no opportunity of participating as creditors in any distribution. It might be that this effect could be mitigated by a retention by the administrators of sufficient funds to pay dividends on the proofs by LBHI2 and LBL as creditors, and to pay such dividends to them as and when it became clear that no liquidation would follow. There is however no legislative mechanism or justification for adopting such a procedure. In my judgment, if it was contemplated or intended that the contributory rule should apply in a distributing administration, either administrators would have been given the same power to make calls as liquidators or provisions of the sort just mentioned would have been spelled out in the legislation.

[189] Mr Zacaroli submitted that the absence of an equivalent provision to s 74 for a company in administration appeared to be the result of an oversight rather than a deliberate policy decision. It is not particularly useful to speculate why no provision has been made for calls in an administration, but I would be surprised if it were an oversight. It may be that it was considered that there were so few companies where calls on members could be called only in a liquidation that it was not thought worthwhile to include the elaborate provisions which apply in a liquidation. The view may have been taken that, for those few cases where this was a live issue, the company could proceed to liquidation, rather than remaining in a distributing administration. This is simply speculation on my part. The important point is that there is no provision for calls to be made by administrators of the sort provided in s 74(1).

[190] There is no case in which the contributory rule has been invoked except in relation to calls already made by the liquidator. If Mr Trower's submissions were well-founded, it would follow that the rule could be relied on

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in the period between the commencement of the liquidation and the making of any call. In *Grissell's Case* (1866) LR 1 Ch App 528 at 534 the issue was whether, in the case of a contributory who was also a creditor, there should be set-off for 'so much of his debt as is equal to the amount of calls which have been made upon, but not paid by, him'. Lord Chelmsford LC, sitting with Knight Bruce LJ and Turner LJ, held that there could be no such set-off. Lord Chelmsford said (at 536):

> 'Taking the Act as a whole, the call is to come into the assets of the company, to be applied with the other assets in payment of debts. To allow a set-off against the call would be contrary to the whole scope of the Act. In support of this view it will be sufficient to refer again to the 133rd section as to the satisfaction of the liabilities of the company *pari passu*. And the argument against the allowance of a set-off, addressed to the Court on behalf of the official liquidators, is extremely strong—that if a debt due from the company to one of its members should happen to be exactly equal to the call made upon him, he would in this way be paid 20 shillings in the pound upon his debt, while the other creditors might, perhaps, receive a small dividend, or even nothing at all.'

Lord Chelmsford added that it necessarily followed that 'the amount of such call must be paid before there can be any right to receive a dividend with the other creditors.'

[191] The shares in *Grissell's Case* had a nominal value of £50 each, on each of which £15 had been paid up before the commencement of the liquidation. The liquidators made a call of £10 per share and this was the call which was in issue. This left £25 uncalled on each share. There was no issue whether payment of a dividend on the contributory's claim as a creditor should be deferred until either a call was made in respect of the uncalled capital or until it became clear that no such call would be made. Lord Chelmsford did however address this issue (at 535):

> 'In the first place, I think that they cannot be required to pay up the full amount remaining unpaid upon their shares. The 75th section of the Act enacts, that the liability of any person to contribute to the assets of a company, in the event of its being wound up, "shall be deemed to create a debt accruing due from such person at the time when his liability commenced, but payable at the time or respective times when calls are made as hereinafter mentioned for enforcing such liability." Until the call is made, there is nothing more than a liability to contribute. This, indeed, creates a debt, but the debt does not accrue due until the call is made. The power to make calls is only to satisfy the debts and liabilities of the company, and the costs, charges, and expenses of winding it up, and for the adjustment of the rights of the contributories amongst themselves. But if the whole of the amount unpaid upon the shares were required to be paid up, more might be raised than would be requisite for these purposes, and it might be that a contributory thus paying in advance might lose all that he had so paid in the event any of his own co-contributories becoming insolvent.'

In the concluding paragraph of his judgment he said (at 536-537):

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'The amount of the call being paid, the member of the company stands exactly on the footing of the other creditors with respect to a dividend upon the debt due to him from the company. The dividend will be of course on the whole debt, and the member of the company will from time to time, when dividends are declared, receive them in like manner when either no call has been made, or, having been made, when he has paid the amount of it.'

[192] It is clear from the judgment of Buckley J in *Re West Coast Gold Fields Ltd* [1905] 1 Ch 597 at 600 that he understood the effect of *Grissell's Case* to be that a contributory could not receive any payment out of the estate as a creditor until he had satisfied 'all his obligations as a shareholder and contributory, by paying into the common fund all sums due from him in respect of calls'.

[193] The position as regards the rule in *Cherry v Boultbee* is the same. It is well-established that the rule does not apply where the debt to the estate is not presently payable, even if it is a future debt that will become payable. It was held in *Re Abrahams* [1908] 2 Ch 69 that a beneficiary who owed a debt payable by instalments to the estate was entitled to receive his share of the residue immediately and that the executors were not entitled to retain it as against the future instalments. Mr Trower placed some reliance on the decision of Swinfen Eady J in *Re Rhodesia Goldfields Ltd* [1910] 1 Ch 239. The decision and reasoning in that case is, however, consistent with *Re Abrahams*. The amount of the debt due from the beneficiary to the fund had not been established or ascertained but there was no dispute that, if an amount was due, it was presently payable. In those circumstances it was held that, pending ascertainment of the amount if any due, the share of the fund for which payment was sought should be retained. The decision in *Re Abrahams* was stated to be correct by Lord Walker in *Re Kaupthing* [2012] 1 All ER 883 (at [45]).

[194] I conclude therefore that neither the contributory rule nor the rule in *Cherry v Boultbee* has any application in an administration of an insolvent company. The administrator is not permitted to refuse to admit a proof of debt by a member or to refuse to pay dividends on such proof on the grounds that, if the company went into liquidation, the member would or might become liable to calls under s 74(1).

Proof in the administration or liquidation of a member in respect of a contingent liability for calls

[195] It is not in dispute that, if a liquidator has made calls in respect of the liability under s 74(1), he may prove for the amount of such calls in the liquidation, administration or bankruptcy of the contributory. The call creates a presently payable debt and there is no reason why it should not form the subject of a proof. Paragraph 8 of Sch 4 to the 1986 Act expressly gives power to a liquidator to prove in the bankruptcy or insolvency of any contributory for any balance against his estate. The issue is whether a proof may be lodged by an administrator of a company in the insolvency of a member in respect of a contingent liability under s 74(1), which is contingent on the company going into liquidation and on calls being made by the liquidator. The administrators of neither LBHI2 nor LBL have yet given notice of an intention to declare dividends, but the issue will become live if the administrators of either or both of those companies give such notices.

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[196] It is, in my judgment, clear that the contingent liability of a member to pay calls which may be made in a future winding up of the company satisfies the general characteristics necessary for a provable debt in the insolvency of the member. I have earlier referred to the authorities which establish that such liability commences with the contract by which he became a member. In the case of a corporate member, there is no difficulty in applying the definition of 'debts' in r 13.12(1) to this liability. It is a 'debt or liability to which the company may become subject after [the date on which the company went into liquidation or prior administration] by reason of any obligation incurred before that date': r 13.12(1)(b). In view of the contractual basis of the obligation, giving rise to the statutory liability, this would be the case even

before the decision of the Supreme Court in *Re Nortel* [2013] 4 All ER 887, [2014] AC 209. There can be no room for doubt on this conclusion, given the very broad meaning given to that provision by the Supreme Court.

[197] In *Re Nortel* [2013] 4 All ER 887, [2014] AC 209 (at [75]) Lord Neuberger said:

> 'Where a liability arises after the insolvency event as a result of a contract entered into by a company, there is no real problem. The contract, insofar as it imposes any actual or contingent liabilities on the company, can fairly be said to impose the incurred obligation. Accordingly, in such a case the question whether the liability falls within para (b) will depend on whether the contract was entered into before or after the insolvency event.'

This paragraph largely, but not completely, covers the present case. The statutory liability commences with the contract of membership but the liability is not imposed by the contract, but by the statute.

[198] Lord Neuberger went on to consider the case of obligations arising other than under a contract. He said (at [76]):

> 'Where the liability arises other than under a contract, the position is not necessarily so straightforward. There can be no doubt but that an arrangement other than a contractual one can give rise to an "obligation" for the purposes of para (b). That seems to follow from r 13.12(4).'

[199] Lord Neuberger specifically considered statutory liabilities (at [77]):

> 'However, the mere fact that a company could become under a liability pursuant to a provision in a statute which was in force before the insolvency event, cannot mean that, where the liability arises after the insolvency event, it falls within r 13.12(1)(b). It would be dangerous to try and suggest a universally applicable formula, given the many different statutory and other liabilities and obligations which could exist. However, I would suggest that, at least normally, in order for a company to have incurred a relevant "obligation" under r 13.12(1)(b), it must have taken, or been subjected to, some step or combination of steps which (a) had some legal effect (such as putting it under some legal duty or into some legal relationship), and which (b) resulted in it being vulnerable to the specific liability in question, such that there would be a real prospect of that liability being incurred. If these two requirements are satisfied, it is also, I think, relevant to consider (c) whether it would be consistent with the regime under which the liability is imposed to conclude that the step or combination of steps gave rise to an obligation under r 13.12(1)(b).'

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[200] There can in my view be no doubt at all that the liability of a member to calls under the statute in a winding up satisfies requirements (a) and (b) set out by Lord Neuberger. The issue is therefore whether the requirement in (c) is satisfied.

[201] Mr Wolfson submitted that for two reasons the administrators of LBIE cannot seek to prove in an administration or liquidation of LBL.

[202] First, Mr Wolfson relied on the provisions of s 82 of the 1986 Act, expressly permitting a proof in respect of future calls in the bankruptcy of an individual debtor. He submitted that the presence of these express provisions and the absence of any equivalent provisions permitting proof in the administration or liquidation of a corporate member showed that proof for a liability to future calls was incapable of proof in the latter. I reject this submission for the reasons already given when earlier discussing this section. The particular incidents of personal bankruptcy made it necessary to introduce these express provisions. Their purpose is not to create a right of proof in a personal bankruptcy which is not present in a corporate insolvency.

[203] Secondly, Mr Wolfson submitted that administrators have no power to prove in respect of a contingent liability for calls. He relied on para 8 of Sch 4 to the 1986 Act to which I have already referred, conferring an express power on a liquidator to prove in the bankruptcy or insolvency of a contributory, and the absence of any equivalent power for an

administrator, as showing that administrators had no such power and as further showing that there was no provable liability until a call was made.

[204] This submission appears to involve two points. The first, more general, point is that only calls which have been made can be the subject of a proof. It follows that even in a liquidation, the liquidator could not lodge a proof in the insolvency of a contributory until a call had been made and then only for the amount of the call. I do not see how this point can be spelt out of the power conferred expressly by para 8 of Sch 4. It cannot, by an implication which is not by any means necessary, displace the effect of r 13.12, as interpreted by the Supreme Court in *Re Nortel*. Support for the proposition that a contingent liability to pay calls is not capable of proof must be found elsewhere.

[205] The second, narrower, point is that an administrator lacks power to submit a proof in the insolvency of a contributory, by reason of the absence of an express power, in contrast to the power expressly conferred on a liquidator. The first point to make here is that, if a contingent liability for calls is a provable debt, it is open to a company which is not in administration or liquidation to prove for such liability. It is true that in many cases the only estimate which could be given of such contingent liability is nil, but there would be cases of companies whose solvency was in doubt where it might be appropriate to put an estimate, even a substantial estimate, on the contingent liability. The company, acting by its directors, would not need express statutory authority to lodge a proof in the insolvency of a member.

[206] If that is right of the company before it is in administration, it must also be right of a company in administration. There can be no sense in a regime which deprives the company of this right just at the moment when it is likely to acquire a substantial value. Even in an administration, the power of the company could be exercised by the directors, if necessary with the consent of the administrator under para 64(1) of Sch B1 to the 1986 Act. In my view, the administrator has the necessary power under para 59(1), as being something which is 'necessary or expedient for the management of the affairs, business and property of the company'. Further, para 20 of Sch 1 to the 1986

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Act confers power on an administrator to 'rank and claim in the bankruptcy, insolvency, sequestration or liquidation of any person indebted to the company'. Mr Wolfson submitted that there was no indebtedness in respect of a call until the call was made, but this simply restates the first proposition that only an actual call can give rise to a provable debt. There can be no doubt that para 20 enables an administrator to claim in the insolvency of any person, which must include a member, for any provable debt, including contingent debts.

[207] Mr Isaacs, supported by Mr Wolfson, submitted that there could be no provable debt before the company went into liquidation because the liability was owed not to the company but to its liquidator. The company therefore had no status as a creditor to submit a proof in respect of calls, whether contingent, future or present. As the creditor was the liquidator, only the liquidator had such status. It was in that sense that para 8 of Sch 4 to the 1986 Act was consistent with there being no provable debt prior to the liquidation of the company.

[208] Mr Isaacs relied on the decision of Sir George Jessel MR in *Re Whitehouse & Co* (1878) 9 Ch D 595. The issue was whether a contributory was entitled to set off a debt due to him from the company against calls made against him both by the company before the commencement of its liquidation and by the liquidator after the commencement of its liquidation. Speaking of the statutory liability to calls made by a liquidator for the purpose of enforcing the liability under s 38 of the Companies Act 1862 (now s 74 of the 1986 Act), Sir George Jessel said (at 599-600):

> That is a new liability; he is to contribute; it is a new contribution. It is a mistake to call that a debt due to the company. It is no such thing. It is not, as has been supposed, in any shape or way a debt due to the company, but it is a liability to contribute to the assets of the company; and when we look further into the Act, it will be seen that it is a liability to contribution to be enforced by the liquidator. It is quite true that a call made before the winding-up--and in the case before me a call was made before the winding-up--is a debt due to the company, but that does not affect this new liability to contribution.'

He had earlier described the section as giving rise to a 'debt due to the liquidator' which could not therefore be the subject of set-off against a debt due from the company.

[209] These observations were disapproved by Cotton LJ and Lindley LJ in *Re Pyle Works* (1889) 44 Ch D 534. The case concerned a mortgage of the uncalled amounts on some partly paid shares and all the present and future property of the company. The issue was whether the mortgages extended to the calls to be made by the liquidator in the winding up of the company, so giving the mortgagees priority over the unsecured creditors. The Court of Appeal, affirming the decision at first instance, held that the calls to be made by the liquidator were subject to the mortgages. As regards *Re Whitehouse & Co*, Cotton LJ said (44 Ch D 534 at 575):

> 'Although the decision of the Master of the Rolls was right, yet in my opinion his observations upon the position of the liquidator, as regards a call made in the winding-up upon a shareholder who is also a creditor of the company and claims a right to set-off his debt against the call, were,

> though unintentionally, erroneous; for he disallowed the set-off in that case, not on the true ground put by the Court of Appeal in *Black & Co's Case (Re Paraguassu Steam Tramroad Co* (1872) LR 8 Ch App 254 at 261-262, 265), but on the ground that a call is something that accrues to the liquidator, and is not a sum which is really due to the company, and that the shareholder's debt is a debt due to him from the company and not from the liquidator.'

The same view was expressed by Lindley LJ (at 585-586).

[210] Mr Isaacs invited me to say that the views of Sir George Jessel should be preferred. Even if it were open to me to do so, I would not prefer his views to those of Cotton LJ and Lindley LJ, which have not subsequently been doubted.

[211] *Re Pyle Works*, like *Re Whitehouse & Co*, was concerned with a call by a liquidator of amounts unpaid on shares in a limited company. They were therefore calls which could have been made by the directors before the company went into liquidation, but were instead made by the liquidator under his statutory powers. This was remarked on by Cotton LJ and Lindley LJ as relevant to the issue whether the uncalled capital could be the subject of a mortgage created by the company prior to its liquidation. There is in this respect a distinction between such calls and calls which can only be made in a winding up. Cotton LJ said (at 574-575):

> 'But it was said that calls which are made after the winding-up has commenced are not to be considered as part of the capital of this company. I cannot agree to that. It was argued that the liability to "contribute to the assets of the company", in the 38th section of the Act, is something entirely different from a call made by the directors before the winding-up, and that a call made after the winding-up has commenced is not to be considered as a call of part of the capital of the company. In my opinion, that view is wrong as regards a case like this. We are considering the case of a call made in the winding-up of a limited company--not of a company limited by guarantee nor of an unlimited company. In the case of an unlimited or of a guarantee company, what can be called for in the winding-up may not be, and I think is not, considered as part of the capital of the company; but in the case of a limited company, although there is a special provision in sect. 38, sub-s. 4 as to what is to be done when there is a winding-up, yet that is merely giving the power to call for that part of the capital of the company which has not been called up.'

A similar distinction was made by Lindley LJ (at 584). He referred to the moneys which are payable only on a winding up as forming 'a statutory fund which only comes into existence when the company is in liquidation'.

[212] I do not consider that this distinction can justify the conclusion that, for the purposes of proof in the insolvency of a member, a distinction should be drawn between a liability under s 74(1) of the 1986 Act to pay uncalled capital on shares and a liability under that section of a member of a company limited by guarantee or of an unlimited company. In all cases, the liability stems from the contract of membership and commences with that contract and, in all cases, it constitutes a liability under the section to contribute to the assets of the company in order to fund the payment of its liabilities.

[213] To say that the company is not a creditor in respect of such a contingent liability under s 74, is to say that although there is a liability, before

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a liquidation, there is no creditor. The consequence would be that the bankruptcy or liquidation of a member could proceed to a conclusion without the possibility of any proof in respect of this liability already undertaken by the member. It would in my view be extraordinary if a liability could be avoided in this way. To suggest, as some counsel did, that this result could be avoided by a company placing itself in liquidation, even though that was both unnecessary and undesirable, does not strike me as an adequate response.

[214] Mr Isaacs relied on Fry J in *Re West of England and South Wales District Bank, ex p Branwhite* (1879) 40 LT 652 at 653:

> 'It appears to me to be clear that the liability to contribute to the assets of the company while it is a going concern, and the liability to contribute to the assets of the company when it is being wound up, are separate and distinct liabilities--the one created in effect by the articles of association of the company and the deed of settlement and its registration under the 16th section of the Act; the other arising only in the event of the company being wound up. Those two liabilities appear to me to be very different in their nature. The one requires payment of the amount of the calls to the company, the other requires payment of the amount of the calls to the liquidator or officer of the court; if a voluntary winding up to the liquidator. In the one case the payment must be made according to the discretion of the directors, and in the other not, but under the direction of the court or the voluntary liquidator. One is for the general purposes of the company, and the other is to meet the special demands of the fund created by the statute.'

In *Re White Star Line Ltd* [1938] 1 All ER 607, [1938] 1 Ch 458 the Court of Appeal said that they could see no flaw in the reasoning in this judgment. While obviously accepting the distinct characters of the two liabilities, this passage does not in my judgment justify a conclusion that prior to the liquidation of a company there can be no proof in the insolvency of a member of the contingent liability to meet calls which can only be made in a liquidation.

[215] Mr Isaacs found it difficult to reconcile his submissions with the authorities that establish that the statutory liability, even for calls which can be made only in a winding up, commence with the contract of membership. He submitted that until there is a winding up, the statutory liability has no existence whatsoever, but once there is a winding up 'it springs back and it originates from the time when the member becomes a member'. He did not accept that there was a statutory liability that existed 'in any meaningful sense' before the commencement of the liquidation. I do not find that a convincing explanation.

[216] Mr Isaacs submitted that, even if conditions (a) and (b) stated in *Re Nortel* [2013] 4 All ER 887 (at [77]) were satisfied, the precondition in (c) would not be satisfied. He submitted that it would not be consistent with the regime under which the liability in s 74(1) is imposed to conclude that an obligation under r 13.12(1)(b) arises, at any rate prior to the commencement of the liquidation of the company and probably not until a call is actually made. Mr Isaacs relied on three grounds for this submission.

[217] First, he relied on the many provisions to the effect that a call can be made and enforced only by a liquidator under the powers of the court delegated to him by the legislation. Unlike the liability arising on the issue of a

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contribution notice which was in issue in *Re Nortel*, the liability in issue in this case can arise only in the liquidation of the company. I have addressed this submission when concluding above that the company can properly be regarded as the creditor for the purposes of proof in the insolvency of a member prior to the liquidation of the company.

[218] Secondly, Mr Isaacs relied on the provisions which exist for the protection of contributories when the liquidator settles a list of contributories and makes calls: see rr 4.196, 4.198, 4.199 and 4.202. These protections are not operable in

circumstances where the company, whether acting by its directors or an administrator, lodges a proof in the insolvency of a member. I am not persuaded by this. It is true that r 4.198 enables a person entered on a list of contributories to object, but the trustee or liquidator or administrator of an insolvent member would be entitled to reject a proof. Likewise, I do not follow why any other objections which could arise in the event of a liquidation could not also be taken in considering a proof of debt. Insofar as the member would be entitled to look to other members to share in the liability in the event of calls made in a liquidation, this can be factored into the estimate of the member's contingent liability for the purposes of proof.

[219] Thirdly, Mr Isaacs submitted that there would be some surprising results if a proof for a contingent liability was possible before the company went into liquidation.

[220] It was said, first, that it could involve the imposition of a greater liability than that provided by s 74, because the administrator of the company would use the proceeds of proof in the payment of the costs and expenses of the administration and the payment of its debts and, if the company were then to go into liquidation, further calls could be made by reference to the amount of the costs of the liquidation and the debts requiring payment. As an administrator is the agent of the company, most if not all expenses of the administration are also liabilities of the company, for which a member with unlimited liability will be liable.

[221] Secondly, a past member has no liability to contribute under s 74 if he ceases to be a member for one year or more before the commencement of the winding up. This, it seems to me, would be one of the factors taken into account in estimating the amount of the liability.

[222] Thirdly, if a company in administration could prove in the insolvency of a member, it should also be able to do so before it goes into administration but, said Mr Isaacs, this is an odd result for a company which is not even in any insolvency regime. This no doubt would mean in many cases that the contingent liability would be estimated to have a value of nil but it does not mean that in principle the liability is incapable of proof.

[223] Fourthly, the member would not be able to take advantage of the rights conferred on it by the legislation in the event of a call in a liquidation, in particular the right to share in any adjustment of the rights as between contributories. Again, this appears to me to be a matter which can be taken account of in estimating the value of the claim, having regard to the amount which the company would be likely to be able to recover from other contributories.

[224] Fifthly, Mr Isaacs relied on the effects of s 82 of the 1986 Act, when read with *Martin's Patent Anchor Co Ltd v Morton* (1868) LR 3 QB 306. In that case, a former bankrupt who had received his discharge but retained partly paid shares sought to rely on s 75 of the Companies Act 1862, the predecessor to s 82(4), to argue that he was released from any liability to pay up the shares because a

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proof could have been lodged in his bankruptcy in respect of future calls. Such a result would, in the words of Blackburn J (at 311) be 'a monstrous injustice'. It was avoided because what is now s 82(4) applies only where the bankruptcy is still pending when the winding up takes place. Mr Isaacs submitted that it would be strange if there were a different result if the member were a company in administration or liquidation. I do not consider that it would be strange if there were different consequences, in view of the very different circumstances of a distributing administration or liquidation of a company, as opposed to the bankruptcy of an individual. It is the fact that an individual may be discharged from bankruptcy, still holding his partly paid shares, which creates a real difference in circumstances. No such possibility exists in relation to an insolvent company in a distributing administration or liquidation.

[225] In any event, s 82 applies only where the company is itself in liquidation. It has no bearing on whether a company which is not in liquidation may prove for a contingent liability in respect of future calls in the administration or liquidation of a corporate member. It was held in *Re McMahon* [1900] 1 Ch 173 that a company, while a going concern, was entitled

to prove in the administration of the insolvent estate of a deceased shareholder for the estimated value of the liability to future calls in respect of the shares registered in the name of the deceased. Accepting that the proof was in respect of a liability in respect of calls which could be made before the company was in liquidation, it nonetheless establishes that there is no restriction on a proof for future calls to those cases where the insolvency of the company and of the contributory are concurrent. It is also worth observing, as did Stirling J in his judgment (at 178), that at the time when s 75 of the Companies Act 1862 was enacted and when *Martin's Patent Anchor Co Ltd v Morton* was decided, the right of proof in a bankruptcy did not generally extend to contingent liabilities. Stirling J regarded s 75 of the Companies Act 1862 as a step by the legislature towards the widening of the circumstances in which contingent liabilities could be proved, rather than as providing an inference that companies, while going concerns, did not enjoy a right of proof within the terms of the later bankruptcy legislation.

[226] I conclude, therefore, that LBIE, acting by its administrators, is entitled to prove in an administration or liquidation of LBL or LBHI2 for their contingent liability arising in a liquidation of LBIE under s 74(1).

Set-off in the administration or liquidation of the members

[227] If, as I have held, the administrators or subsequent liquidators of LBIE are entitled to prove in the administration or subsequent liquidation of LBL and LBHI2, the question arises whether, by reason of the mandatory application of insolvency set-off in the administrations or liquidations of LBL and LBHI2, the claims of those companies against LBIE as creditors should be set off against LBIE's claim against them as contributories.

[228] Free from any authority, I would conclude that mandatory insolvency set-off applied in these circumstances. It is displaced in the liquidation of the company whose liquidator is making the calls because of the contributory rule. As discussed earlier, the contributory rule prevents a contributory from sharing in a distribution of the estate as a creditor until he contributes the amount which he is liable to pay. This flows from the statutory regime applying to the company in liquidation. The contributory rule, as applied to the liquidation of the company whose liquidator is making calls, has no obvious application in

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the administrations or liquidations of the contributories. So far as the other persons interested in the winding up of their estates, the creditors, LBIE is simply another creditor.

[229] This has long been established as the position in the bankruptcy of a contributory. The point arose in *Re Duckworth* (1867) LR 2 Ch App 578. The debtor was the holder of 100 shares in a company and was also a creditor of that company. The company was ordered to be wound up and six months later the debtor executed a deed of assignment to trustees for the benefit of his creditors which was duly registered under the relevant legislation. The liquidator made a call on the shares and applied to the Court of Bankruptcy for an order that the trustees pay the dividend on this claim due under the deed of assignment. Giving a judgment with which Turner LJ agreed, Lord Cairns LJ held that the bankruptcy of the contributory was subject to the bankruptcy statutes. The contributory rule, as laid down in *Grissell's Case* decided only nine months earlier, had no application. *Grissell's Case* would, of course, apply in the liquidation of the company if the debtor's trustees had sought to prove his debt in that liquidation. This decision was taken as correct by the Court of Appeal in *Re GEB (a debtor)* [1903] 2 KB 340 (see, for example, Romer LJ (at 352)) and it has never been doubted. I find it difficult to see why the same reasoning would not apply in the liquidation of a corporate contributory.

[230] However, Wright J held in *Re Auriferous Properties Ltd (No 1)* [1898] 1 Ch 691 (*Re Auriferous (No 1)*) that the liquidator of the company was entitled to prove in the winding up of a corporate contributory for the whole amount due by way of calls on the shares without set-off. The liquidator of the corporate contributory could prove in the winding up of the company for a debt due to the corporate contributory, but could receive no dividends in respect of such proof until the full amount of the calls had been paid. The requirement to pay calls in full before receiving a dividend on the proof in the liquidation of the company was decided by Wright J in *Re Auriferous Properties Ltd (No 2)* [1898] 2 Ch 428, on a straightforward application of *Grissell's Case*. Mr Wolfson submitted that *Re Auriferous (No 1)* was wrongly decided and should not be followed. Mr Trower submitted that it was correctly decided and that it is *Re Duckworth* which is

anomalous. Mr Trower pointed out that *Re Auriferous (No 1)* was cited by Lord Walker in the passage in *Re Kaupthing* [2012] 1 All ER 883 (at [52]) which I have earlier set out.

[231] It is necessary therefore to look with some care at the judgment of Wright J in *Re Auriferous (No 1)*. The facts were that African Gold Properties Ltd (the Gold company) held shares in Auriferous Properties Ltd (the Auriferous company). In January 1896, the Auriferous company became indebted to the Gold company in the sum of £2,775. Two calls were made by the directors of the Auriferous company in January and June 1896, making the Gold company liable in the sum of £1,250. In December 1896 the Auriferous company was wound up by order of the court. In January 1898 the Gold company went into creditors' voluntary winding up. The Gold company lodged a proof for its debt in the winding up of the Auriferous company. Acting by its liquidator, it issued a summons in the winding up of the Auriferous company, raising for decision the question whether the debt owing to it by the Auriferous company could be set off by the calls due by it to the Auriferous company. The summons was subsequently amended by also being entitled in the matter of the winding up of the Gold company.

[232] When reading the report, I was initially puzzled as to whether the issue raised by the liquidator of the Gold company related to the winding up of the

Auriferous company, rather than the winding up of the Gold company. Taking out the summons in the winding up of the Auriferous company suggested that it was this question which was being raised. Although much of the argument of counsel for both parties is at least ambiguous on this, it is clear from the last sentence of the report of the argument of counsel for the Gold company and from the terms of the judgment of Wright J (particularly at 697), that the question did indeed relate to the winding up of the Gold company.

[233] At the start of his judgment, Wright J observed (at 696) that if the Gold company had not been in liquidation it could not have set off its claim for money lent against its liability for the amount of the call. He referred to *Grissell's Case* and continued (at 696):

> 'The ground of the rule is that all contributions from shareholders enforceable in the liquidation are by the Companies Acts made applicable for the payment of the company's creditors pari passu ... and that a person who is a creditor and also a contributory cannot be allowed to do what might amount to paying his own claim in full out of a fund which ought to be distributed rateably ...'

He continued by observing that the amount due in respect of the calls was enforceable by the liquidator of the Auriferous company by a balance order as a contribution to be made in the winding up of the Auriferous company and could not be the subject of set-off. The judgment thus far focused on what would happen in the winding up of the Auriferous company.

[234] Wright J continued (at 696-697) by saying that 'in the present case it happens that the Gold Company is also in liquidation, and the question is, What is the effect of this?' He then summarised the effect of *Re Duckworth*:

> 'If the Gold Company had been a bankrupt individual instead of being a company in liquidation, the liquidator of the Auriferous Company must have enforced his claim in the bankruptcy and according to bankruptcy law, which even before and apart from the Judicature Act would have allowed the set-off ...'

[235] He continued that in the case before him the creditor-contributory was not a bankrupt individual but a company in liquidation and 'therefore, the particular ground on which *Re Duckworth* was decided is not applicable.' He said that it was not therefore the bankruptcy legislation which applied, but the Companies Acts as administered in the Chancery Division. He continued (at 697-698):

> 'And the simple question is whether s. 10 of the Judicature Act, 1875, has introduced into the law of the winding-up of companies the bankruptcy rules as to set-off, so as to allow a set-off against liability for the amount of unpaid calls in the case of a company

constituted with limited liability. It seems to me that this question is decided in effect in the negative by *Gill's Case* (*Re General Works Co* (1879) 12 Ch D 755), which was cited with approval in the Court of Appeal in *In re Washington Diamond Mining Co* ([1893] 3 Ch 95); and that the liquidator of the Auriferous Company is entitled to prove in the winding-up of the Gold Company for the whole amount still due upon the shares, leaving the liquidator of the Gold Company to his right of proof in the winding-up of the Auriferous Company for the money lent. It is true that in *Gill's Case* the

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creditor-contributory was not a company in liquidation, but that circumstance does not prevent it from being in point as a decision that the bankruptcy law of set-off is not imported by the Judicature Act into the law of companies so as to allow a set-off against calls; though for other purposes there may be the same right as in bankruptcy (see in *Ex parte Theys* (*Re Milan Tramways Co, ex p Theys* (1884) 25 Ch D 587)) to a set-off of cross-claims as existing at the time of the bankruptcy. *In re Duckworth* has, therefore, no application.'

[236] As appears from that passage, it was reliance on the decision in *Re General Works Co, Gill's Case* (1879) 12 Ch D 755 which led Wright J to hold that there could be no set-off, not only in the liquidation of the company but also in the liquidation of the corporate contributory. In this way he distinguished the position of an individual contributory in bankruptcy.

[237] In *Gill's Case*, Mr Gill had obtained a judgment for £501 against the General Works Co Ltd before it was wound up by order of the court. Mr Gill was the holder of unpaid shares, on which a call was made by the liquidator giving rise to a liability on his part of £220. Mr Gill claimed the right to set off his debt of £501 against the call and to prove in the winding up for the balance. The liquidator issued a summons to enforce payment of the call which Mr Gill defended on the basis of the right to set-off which he claimed. Bacon V-C decided the case on a straightforward application of *Grissell's Case*. He said (at 757-758):

'The law vests in the liquidator the control of all the assets of the company, and the assets of the company in this case consist of, amongst others, a sum which Mr. Gill undertook to contribute to the assets of the company, whatever might happen. Though he has become a creditor, he must permit the assets to be realized, including the calls on him. Even if he has obtained a judgment against the company, he cannot levy any execution under it so as to get at assets in the hands of the official liquidator ... Mr. Gill is nothing better than a partner in a concern which has become insolvent, and if I were to adopt his contention, the result would be to allow one creditor only to recover 20s. in the pound, while all the other creditors had to be satisfied with little or nothing.'

[238] I do not see how the decision in *Gill's Case* can assist in the conclusion that there is no set-off in the liquidation of a corporate contributory. It was concerned with the winding up of the company, not the corporate contributory. After the passage in his judgment ([1898] 1 Ch 691 at 697-698) which I have cited above, Wright J continued (at 698) that the view which he took 'seems to be consistent with all the decisions on s. 101 of the Act of 1862 since the Judicature Act' and he cited *Re Anglo-French Co-operative Society, ex p Pelly* (1882) 21 Ch D 492 at 509 and *Re Pyle Works* (1889) 44 Ch D 534 per Lindley LJ. Those cases support the application of *Grissell's Case* to the liquidation of the company making the calls. Neither case is concerned with the position as regards set-off in the liquidation of a corporate contributory and I am not aware of any other case before *Re Auriferous* (*No 1*) which dealt with that point.

[239] What is the effect of the citation of *Re Auriferous* (*No 1*) by Lord Walker in *Re Kaupthing* [2012] 1 All ER 883 (at [52])? The first point to note is that Lord Walker was not concerned to examine the position which would apply in

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the liquidation of a corporate contributory. He was concerned with the application of the contributory rule in the liquidation of the company in which the calls were made. At the start of para [52] Lord Walker instanced the case of a shareholder with partly paid shares who is also a creditor of the insolvent company. He cited *Re Auriferous* (*No 1*) as authority for this proposition:

'Suppose he has 10,000 £1 shares, 10p paid, and is owed £15,000, but the dividend prospectively payable is only 30p in the pound. If the liquidator calls on him for £9,000 to make his shares fully paid up, he has no right of set-off, and to that extent he is disadvantaged ...'

He went on to cite *Re Auriferous (No 2)* as authority for the proposition that if the creditor-contributory seeks to prove in the liquidation, the liquidator can rely on the contributory rule so that the creditor-contributory can receive nothing until he has paid everything that he owes as a contributory.

[240] It seems to me clear that Lord Walker is dealing with two closely related but separate issues. The first is the unavailability of set-off, and the second is the requirement for the creditor-contributory to pay everything he owes as a contributory before he can receive anything as a creditor. Both issues relate to the position in the liquidation of the company, not the contributory. The entire first page of the judgment of Wright J in *Re Auriferous (No 1)* supports that first proposition as it applies to the liquidation of the company making the calls. Lord Walker was not concerned with the position in the liquidation of a corporate contributory and there is certainly no indication that any argument was advanced to the Supreme Court as to the position in those circumstances and as to whether *Re Auriferous (No 1)* was correctly decided. I conclude that the citation by Lord Walker of *Re Auriferous (No 1)* does not amount to an endorsement of the actual decision in that case.

[241] My clear view is that *Re Auriferous (No 1)* was wrongly decided. In my judgment, it seeks to apply the principle in *Grissell's Case* to the wrong liquidation and it wrongly seeks to distinguish the position in the bankruptcy of an individual contributory, as held by the Court of Appeal in *Re Duckworth*. I note that the view is taken in *Derham on the Law of Set-off* (4th edn, 2010) that *Re Auriferous (No 1)* is questionable: see paras 8.74 and 11.09 (fn 36). I appreciate of course that the decision is 114 years old, but it is in an area of the law which has lain dormant for all but 20 years of that period. It has never been approved by a higher court nor, so far as I am aware, applied in any other case.

[242] My conclusion is, therefore, that in the administration or liquidation of LBHI2 or LBL set-off will apply between any claim by LBIE for an actual or contingent liability under s 74(1) and those companies' claims against LBIE.

Set-off in the administration of LBIE

[243] If, as I have held, the contributory rule does not apply outside a liquidation and therefore does not apply in the administration of LBIE, the question arises whether insolvency set-off applies in the administration of LBIE between the claims of LBL and LBHI2 admitted to proof and the contingent claim of LBIE to calls which may be made in a subsequent liquidation of LBIE. I have held that such contingent claims exist and may be the subject of proof and set-off in the administrations or liquidations of LBL and LBHI2. As there are therefore cross-claims between LBIE on the one hand and its members on the other, it would follow that the mandatory insolvency set-off applicable in a distributing administration by virtue of r 2.85 would apply.

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[244] The question is therefore whether, given the particular characteristics of a liability to pay calls, there are reasons of principle or policy to displace the application of set-off, just as the contributory rule displaces set-off in a liquidation. Mr Wolfson submits that, as there can be no set-off in a liquidation of an actual liability to pay calls against a debt due to the company to the contributory, it follows that there cannot in an administration be a set-off of the contingent claim in respect of a possible call in a future liquidation against debts due by the company to the member. He submitted that the effect of set-off was to discharge the relevant liabilities to the extent of the set-off, so reducing or eliminating the liability of the member to pay calls in a future liquidation. He submitted that such a reduction or elimination would be contrary to the contributory rule as set out in *Grissell's Case* and subsequent cases, because it would mean that the members received either full payment or a greater payment in respect of their debts than other creditors and that the company was deprived, in a subsequent liquidation, of its right to obtain contributions for the purposes of making distributions among creditors.

[245] These submissions have a number of notable features. First, as Mr Wolfson I think later accepted, the effect of a set-off of a contingent liability is not to discharge the actual liability should the contingency occur. A contingent claim is admitted to proof in an estimated amount. To the extent of that amount, a payment or set-off will discharge the underlying

liability. But if the chances of the contingency occurring subsequently increase or if the contingency in fact occurs, the rules provide for the estimate to be increased, if appropriate to the full amount. Set-off against a contingent claim in respect of future calls may therefore reduce the amount which may be recovered in respect of those calls but it will not eliminate it. Secondly, this takes no account of the particular circumstance in this case that the liability of the members is unlimited. I return to this point below. Thirdly, as Mr Trower submitted, the effect of Mr Wolfson's reliance on the contributory rule was to turn it on its head. The purpose of the contributory rule is to protect creditors, so that contributories must pay the amount due from them to constitute the fund for distribution among creditors before they are entitled to participate in the distribution themselves as creditors. Reliance on this principle to enable a member with a potential liability to pay calls to prove for the full amount of his claim as a creditor in an administration without set-off is a curious application of the rule and a curious way in which to protect the interests of the other creditors.

[246] The only basis on which it might be argued that mandatory set-off in an administration should be displaced would be that the set-off reduced or extinguished the value of the right to make calls in a subsequent liquidation, were it to occur. This is not a result which could follow in the case of an unlimited company. However large the amount of set-off allowed against the member's claim as a creditor in the administration, the member, or his successor in title, would be liable without limit to calls in a subsequent liquidation.

[247] The position as regards a company limited by shares may be more complicated. The liability of the member is limited to the amount unpaid on his shares. Allowing a set-off of a contingent claim in respect of a future call would therefore reduce the amount recoverable on a subsequent call made by a liquidator exercising his statutory powers. There is, however, some unreality about this. The liability of a member to pay up his shares is enforceable by the company under the powers contained in its articles of association before the

[2015] 2 All ER 111 at 175

company goes into liquidation. As I have earlier held, those powers are exercisable directly or indirectly by an administrator, as much as by directors when the company is under their control. The administrator of such a company would therefore be able to call up the amount unpaid on issued shares. Whether a set-off would then be permissible against sums due to the relevant members as creditors is not a matter which I am required to decide on this application. Mr Trower submitted that set-off would not be permissible in those circumstances. If that is right, the concern on which Mr Wolfson based his argument would be met. If, however, set-off were permitted, Mr Wolfson's concerns lack legal foundation. If a set-off is permitted against a present liability to pay calls whether before an administration or in an administration, there can be no obvious objection to permitting a set-off against a contingent liability to pay calls.

[248] Mr Wolfson sought to meet this point by submitting that, in the case of a contributory which goes into administration before the company goes into distributing administration or liquidation, what falls to be brought into account in a set-off is not the full value of the proof against the contributory but rather only the dividend payable in the administration or liquidation of the contributory. LBIE would not therefore be able to claim against LBL for more than the dividend payable in the latter's insolvency on a proof by LBIE in respect of the contingent liability to calls. In support of this submission, Mr Wolfson relied on the authorities cited by Lord Walker in *Re Kaupthing* [2012] 1 All ER 883 (at [15] -[19]) and Lord Walker's analysis of them. Those were all cases involving individuals who were either liable to a fund to which the rule in *Cherry v Boultbee* applied or were contributories in a company. The right to receive no more than the dividend arose where the individual had died or become bankrupt before the relevant fund was constituted by either a will taking effect or a company going into liquidation. In those circumstances, the person entitled to the benefit of a share in the fund or a share in the company was not the individual but his executor or trustee in bankruptcy and the amount due from them was no more than the dividend payable from the estate of the deceased or bankrupt. No such principle can apply where the contributory or member is a company. In those circumstances there is no change in the ownership of the right to participate in the fund or the share in the company. The set-off which is required is a set-off of the full value of the debts between the relevant parties.

[249] I therefore conclude that in the administration of LBIE, insolvency set-off will apply as between the claims of LBL and LBHI2 as creditors and the contingent claim by LBIE in respect of calls in a possible future liquidation of LBIE. It is, of course, only if the value of such contingent claims are estimated at more than nil that any set-off will occur.

Summary of conclusions

[250] My conclusions on the issues dealt with in this judgment are:

(i) The claims of LBHI2 under its subordinated loan agreements with LBIE are subordinated not only to provable debts but also to statutory interest and unprovable liabilities.

(ii) Creditors of LBIE whose contractual or other claims are denominated in a foreign currency are entitled to claim against LBIE for any currency losses suffered by them as a result of a decline in the value of sterling as against the currency of the claim between the date of the commencement of the

[2015] 2 All ER 111 at 176

administration of LBIE and the date or dates of payment or payments of distributions to them in respect of their claims. Such currency conversion claims rank as unprovable liabilities, payable only after the payment in full of all proved debts and statutory interest on those debts.

(iii) If the administration of LBIE is immediately followed by a liquidation, any interest in respect of the period of the administration which has not been paid before the commencement of the liquidation will not be provable as a debt in the liquidation nor will it be payable as statutory interest under either r 2.88 of the Insolvency Rules or s 189 of the 1986 Act.

(iv) Those creditors of LBIE with debts which carry interest by reason of contract, judgment or other reasons unconnected with the administration or liquidation of LBIE will be entitled to claim in a liquidation of LBIE, which immediately follows the administration, for interest which accrued due during the period of the administration, as an unprovable claim against LBIE, payable after the payment in full of all proved debts and statutory interest on such debts.

(v) The obligation of members to contribute under s 74(1) of the 1986 Act extends not only to provide for proved debts but also for statutory interest on those debts and unprovable liabilities.

(vi) The contributory rule (that is, the rule that a contributory of a company in liquidation cannot recover anything in respect of any claims he may have as a creditor until he has fully discharged his obligations as a contributory) applies only in a liquidation. It does not apply in an administration, including the administration of LBIE. The equitable rule in *Cherry v Boultbee* also does not apply.

(vii) LBIE, acting by its administrators, will be entitled to lodge a proof in a distributing administration or a liquidation of either LBL or LBHI2 in respect of those companies' contingent liabilities under s 74(1) of the 1986 Act which may arise if LBIE were to go into liquidation. The valuation of such claims would be a matter of estimation under the provisions of the Insolvency Rules.

(viii) In a distributing administration or liquidation of LBL or LBHI2, the claims of those companies respectively as creditors of LBIE would be the subject of mandatory set-off against the claims of LBIE in respect of those companies' contingent liabilities as contributories. I have reached the conclusion that the decision in *Re Auriferous Properties Ltd (No 1)* [1898] 1 Ch 691 was wrong and should not be followed.

(ix) In the administration of LBIE the contingent liabilities of LBL and LBHI2 as contributories will be the subject of mandatory set-off against the admitted proofs of debt of those companies as creditors of LBIE.

[251] I must end by recording my thanks to counsel and their instructing solicitors for the quality of their written and oral submissions and the diligence of their research into important legal issues of complexity and, in some instances, obscurity. I will invite the parties to agree, if possible, a form of order which gives effect to this judgment.

Order accordingly.

Peter Hutchesson Barrister (NZ).