Addendum

[1] In the space available, I[1] address five questions in relation to the privity doctrine.

1 Is the Privity Doctrine Still a Legal Problem in Canada After the SCC Decision in *Fraser River*?[2] No

[2] In *Canadian Contractual Interpretation Law*,[3] Geoff Hall states:

> The *Fraser River Pile* test fits neatly with the law of contractual interpretation generally. It is focused on accurately giving meaning to the parties' intentions. To do so, it relies on the text of the contract and the context in which the contract arose, in particular, a reading of the contract as a whole. The result is an outcome which is much more consistent with the law of contractual interpretation than was the former rule precluding third party beneficiaries from enforcing their rights, a rule which often lead to results inconsistent with the parties' intentions…
>
> Subsequent application of *Fraser River Pile* has been quite straightforward.[4]

[3] In *Canadian Contract Law*,[5] John Swan states:

> For most of the readily imaginable cases, the third party beneficiary rule will cause no problems; the parties' expectations will be met; there will be no examples of unjust enrichment and any procedural problems should be amenable to solutions consistent with the general law.

[4] In *The Law of Contracts*,[6] Professor John McCamus states:

> The second issue is whether the principled exception could apply to a case such as *Beswick v. Beswick,* where the third-party beneficiary as

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[1] This addendum was prepared by Wayne Gray, a partner of McMillan LLP, Toronto and a member of the Uniform Law Conference of Canada ("ULCC") Working Group. While I agree with the bottom line conclusion of the Report that the privity rule should not be reformed by statute, it was thought useful to elucidate my reasons, which differ from those set out in the attached report of the rest of the Working Group (the "Report").

[2] Unless otherwise stated, all references to cases and texts may be found in the bibliography attached to the Report.

[3] Geoff R. Hall, *Canadian Contractual Interpretation Law,* (Markham, LexisNexis, 2007) ("Hall"), p. 122.

[4] I hasten to add that, in the ensuing passage, Hall observes that, despite his general conclusion, there have been inconsistencies in the subsequent application of *Fraser River*.

[5] See Report for the full citation to Swan's text ("Swan"), p. 175. Note that Swan devotes a 52-page chapter to the privity rule.

[6] See Report for the full citation to the McCamus text ("McCamus"), p. 315-316.

> plaintiff brings a claim to enforce the promise, or whether its application is restricted to cases like *London Drugs* and *Fraser River*, where the third-party beneficiary, as defendant, relies on a provision as a protection against a claim brought by the promissor…[T]here are two considerations that weigh in favour of the view that the principled exception could apply in both types of cases. [Footnotes omitted.]

[5] There is nothing in *Fraser River* that would limit its application to situations where a third-party beneficiary ("TPB") is seeking to use a contractual provision as a shield to defend herself against a claim rather than as a sword to advance a claim. *Fenrich, Vandewal, Higgins Estate, Parlette* and *Cheong* are each examples of cases in which the courts have recognized that the principled exception may be used as a sword as well as a shield. *RDA Film Distribution* contains a contrary statement. However, this statement is *obiter* and incorrectly purports to apply both *London Drugs* and *Fraser River* in saying that the principled exception is to be used as a shield, not a sword, even though, in *Fraser River*, the Supreme Court ("SCC") said no such thing and sought to broaden any narrow interpretation that might be given to the principled exception it first enunciated in *London Drugs*.

[6] While the privity doctrine has been abolished by legislation in several other common law jurisdictions, these are jurisdictions where, unlike common law Canada, there was no pre-existing principled exception. Thus, statements that support a legislative solution to the privity problem that either pre-date *Fraser River* (1999) or relate to the privity doctrine outside of common law Canada could be misleading.

2 Is Legislation Needed to Fix What Remains of the Privity Doctrine? No

[7] On a legislative solution for the privity problem, Swan writes:[7]

> The Supreme Court has repeatedly said that more radical reforms of the third party beneficiary rule are not for the courts but for the legislature. This statement is, on its own terms, odd because the rule was entirely the creation of the courts and we even know the cases where it was developed – and the selective use of precedent that lead to the acceptance of the rule in its pure form. Surely what the courts have done (and done comparatively recently) they can undo, particularly when the

[7] Swan, p. 175-176. See also Swan at p. 180 where he reiterates that "there is not much left to the [privity] rule" and *London Drugs* "…and the subsequent cases suggest that wholesale legislative reversal of the rule may no longer be necessary to avoid its worst effects."

> rule they have purported to develop operates so haphazardly and unfairly….
>
> …The Supreme Court has, it has submitted, gone far enough that the role of legislation can be no more than very minor.

[8] McCamus says:[8]

> After the passage of more than thirty years since the decision in *Beswick*, reforming legislation has finally been enacted in the United Kingdom. In Canada, however, it may be legitimately questioned whether it is realistic to expect that the legislatures of the common law provinces will act in unison so as to overrule this anomalous doctrine. No reform or, at best, a patchwork of reform appears to be the more likely consequence of leaving this issue to the legislatures. The path of judicial reform to date, however, has plainly adopted the strategy of carving-out exceptions to the doctrine on a piecemeal basis. [Footnotes omitted.]

[9] It is questionable whether a legislative solution would be faster than further judicial development. The experience in the U.K., Ireland and Australia suggests that legislative reform takes many decades. In 1987, the Ontario Law Reform Commission (the "OLRC") recommended simple reversal of the rule as a bar to enforcement;[9] yet, to date, no action has been taken and the case for reform has gone cold. The experience in Australia shows that uniformity in a federal state is difficult to achieve. Two states and the lone territory have passed two different versions of privity legislation. The remaining four states, including the commercial centre, New South Wales, have passed no such legislation. In Canada, only 1 of 12 common law legislatures has amended the privity rule, and 15 years have elapsed since that took place. We might also question whether a legislative enactment will be a complete codification of the rule or will leave some issues remaining for judicial development or interpretation. Again, there are two prevailing models for reform: simple reform along the lines recommended by the OLRC and enacted in New Brunswick ("NB"), Québec and California; and a detailed enactment along the lines recommended in Ireland and adopted in the U.K.

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[8] McCamus, p. 300-301.

[9] OLRC, *Report on Amendment of the Law of Contract*, (Toronto, Ministry of Attorney General, 1987).

[10] There are a number of further concerns with a legislative solution. First, reforming the privity rule by legislation would require significant legislative effort (x13). The SCC can create a uniform rule for the 12 common law provinces in a single decision. Legislative reform of the privity rule risks the type of balkanization within in the country that Australia has experienced for many years. It also risks the type of ossification that has occurred in jurisdictions such as New Zealand, Queensland, Western Australia and, even closer to home, NB. Once passed, these one-off statutes have tended to collect legislative dust. For example, according to Swan, the NB legislation has been overtaken by judicial developments and the changes made in the common law by those cases offer a preferable solution to the TPB problem than the legislation.[10]

[11] There is also an issue of institutional competency. By their nature, courts develop contract law rules on an incremental, experimental basis. There is much refinement and adjustment as the law develops. On the whole, of course, contract law is dominated by judicial rule-making. Legislative rules are largely made on *a priority* basis and have generally played a secondary role in the development of contract law in common law Canada. Thus, leaving further development of TPB rights to the courts is more consistent with the general approach to contract law development in common law Canada than legislative intervention.

3 If There Must be Legislative Intervention, Should it be General Reversal or a Detailed Set of Rules? Answer, Follow the *American Restatement*, *i.e.* General Reversal of the Privity Rule

[12] On how to reform the privity rule, McCamus says:[11]

> Though it is easy to conclude that the privity doctrine is ripe for further modification, it is perhaps more difficult to identify the optimal model of reform. One possibility would be for the legislatures or the courts to overrule the doctrine by adopting the principle that the absence of privity, *per se*, will not preclude an action by a third-party beneficiary to enforce a promise. The law would thus be allowed to develop on a case-by-case basis. To fashion a rule that would indicate more precisely in what circumstances a third-party beneficiary should be allowed to enforce would be more difficult…Perhaps it would be difficult to improve on the rule set out in the *Restatement on Contracts*, which distils the American experience with granting such relief and provides that a

[10] Swan, p. 178.

[11] McCamus, p. 319-320.

> third-party beneficiary will be able to enforce the promise "if recognition of a right to performance in the beneficiary is appropriate to effectuate the intentions of the parties". [Footnotes omitted.]

4 At What Point Should TPB Rights Affect the Freedom of Contracting Parties to Modify or Terminate Their Contracts? Answer, Not Until the Boat Sinks (*i.e.* TPB Rights Have Crystallized)

[13] Paragraphs 76-79 of the Report discuss the right of the contracting parties to vary or cancel TPB rights. Perhaps the strongest argument in favour of the privity rule is that it creates certainty about how to amend or terminate an existing contract. At least until *Fraser River*, there was no need to obtain the consent of anyone who was not party to the original contract. TPBs could not complain if the parties to the contract amended or terminated their rights. After all, TPB rights do not arise spontaneously. A TPB only acquires rights from the contracting parties. If a TPB wants to have irrevocable rights upon which it can rely, the TPB would have to become party to the contract or obtain an undertaking from at least one of the parties to not agree to a variation or termination without the TPB's consent. In many cases, there is a strong nexus between one of the contacting parties and the TPB (so that the TPB rights are less fragile or vulnerable to cancellation or amendment). TPBs that are related by blood or marriage are examples. Corporate affiliates are another example.

[14] It is no answer to say that contracting parties can include an amending or termination formula in their contract that excludes any need for TPB consent. It often takes years for legal changes to filter down to needed changes to contractual boilerplate used in everyday transactions. More than 16 years after adoption in this country of the *United Nations Convention on Contracts for the International Sale of Goods*, parties may still adopt the Convention more often by inadvertence than advertence. The need to consider expressly excluding TPB rights has not yet become universally recognized by Canadian practitioners or their clients. Likewise, it is impractical to expect parties to apply to court for judicial variation or termination of contracts. Even in the largest transactions, parties will be loathe to do this.

[15] One of the dangers of amending the privity rule to recognize TPB rights is that it may undermine the certainty that has heretofore existed with respect to modifying or terminating contracts. In *Fraser River*, Iacobucci J. developed a crystallization test. In that case, the

chartered barge had sunk and, therefore, the SCC easily held that it was too late for the parties to the insurance contract to cancel the waiver of subrogation clause in favour of the charterparty, Can-Dive. The SCC placed significant value on not undermining the right of original parties to modify the contract and, therefore, formulated a narrow (or late-stage) crystallization test. If the recognition of TPB rights becomes so widespread as to undermine the rights of the original parties to vary or cancel their contract, then abolition of the privity doctrine may be do more harm to the market than good.

5 Is there a Need for Further Consultation? Answer, Take a Good Break

[16] According to the original study paper delivered at the 2007 ULCC annual meeting,[12] an informal survey was conducted of academics and practitioners in Alberta on whether the privity rule should be reformed. In successive years, the ULCC has (or will have) received detailed reports on reform of the privity doctrine. In 2004, the Law Reform Commission of Nova Scotia issued a report on the topic. In 2008, the Law Reform Commission of Ireland did the same. Given the extensive work that has been done recently on the subject in Canada and elsewhere, there seems to be little value in contemplating further consultations at this time. The courts should be given a fair chance to develop TPB rights in a post-*Fraser River* world. Hoisting the subject for a few years rather than spending more time and energy on it would seem to be in order.

[12] M. Lavelle, *Privity of Contract and Third Party Beneficiaries* (Charlottetown: ULCC, 2007).