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Knowles v. Anchorage Holdings Co. Ltd. (1964), 46 W.W.R. 173, 43 D.L.R. (2d) 300

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KNOWLES V. ANCHORAGE HOLDINGS CO. LTD. (1964), 46 W.W.R. 173, 43 D.L.R. (2d) 300—CONTRACT—SALE OF GOODS—EXCLUSION OF CONDITIONS AND WARRANTIES—BREACH OF FUNDAMENTAL TERM—RIGHT TO DAMAGES DESPITE EXEMPTION CLAUSE.—In *Knowles v. Anchorage Holdings Co. Ltd.*,[1] the Supreme Court of B.C. was faced with the problem of interpreting the effectiveness of an exemption clause in a Sale of Goods contract where a diesel boat engine supplied by the seller was so defective that, in effect, the seller supplied something different from that which was contracted for. The Court had also to consider the effect of a provision in the contract of sale that the buyer was relying on his own judgment. The term was designed to preclude the implied conditions as to quality or fitness of s. 20(a) of the British Columbia *Sale of Goods Act*.[2] The buyer used the engine for six of the fourteen months during which he retained it prior to bringing the action.

Verchere J. held that the seller (the defendant) supplied something so different from that contracted for that it amounted to a breach of a fundamental term of the contract of sale which rendered the exempting clause ineffective. The learned judge also held that s. 20(a) of the *Sale of Goods Act*[3] did not apply as the complaint of the buyer was not as to the sufficiency or adequacy of the engine but rather that it did not function as an engine should. The buyer was entitled to claim damages although he had not repudiated the contract or lost the right to terminate despite the fact that the buyer used the engine for six months.

The facts of the case are as follows. In July, 1962, the plaintiff visited the president of the defendant company regarding the purchase of an engine for his boat. It was the defendant company's business, *inter alia,* to sell engines. On July 18, 1962, the plaintiff ordered a 3M Cerlist Diesel complete with certain fittings for a total price of $3,045.57. The learned judge found[4] as a fact that the defendant knew of the purpose for which the plaintiff required the engine (to salvage and tow logs) and that the plaintiff relied on the seller's skill and judgment.

Knowles received the engine by August 15, 1962. Immediately trouble developed and he was forced to return the engine to the company several times for repairs. In addition, new parts had to be installed. In October, 1962, Knowles removed the engine from his boat and gave it to the company for additional repairs. He did not use the engine again until June, 1963. When he then used the engine he found that its performance remained unsatisfactory. Lubricating oil was somehow allowed to enter the combustion chamber, and resulted in the burning of excessive amounts of oil. This necessitated

1 (1964), 46 W.W.R. 173, 43 D.L.R. (2d) 300.
2 R.S.B.C. 1960, c. 344, s. 20(a); a parallel provision in Ontario is found in the Sale of Goods Act, R.S.O. 1960, c. 358, s. 15(1).
3 *Ibid.*
4 (1964), 43 D.L.R. (2d) 300 at 301.

the frequent addition of extra oil and proper oil pressure could not be maintained. Due to improper combustion the engine would not operate under load at a speed high enough to permit it to use its rated horsepower. The engine did not work properly despite the expenditure by the seller of between $800-$900. The learned judge found[5] that the defendant had ample time to remedy the defects and that the defects remained. Thereupon the buyer sought damages.

In dealing with the effect of the exemption clause upon s. 20 of the *Sale of Goods Act*[6] the learned judge referred to the Canadian case of *Hayes Mfg. Co. v. Perdue & Cope*[7] as authority for the proposition that a clause in a contract expressly excluding all conditions and warranties not therein set forth does not entitle the vendor to supply something different from that which was bargained for. Thereupon the learned judge introduces the concept of fundamental breach by quoting *Crossley Vaines on Personal Property*,[8]

> . . . this freedom of contract preserved by the Act is subject to the so-called doctrine of fundamental breach, namely that an exempting clause may nowadays be held governed by the overriding proviso that it only avails to exempt a party when he is carrying out his contract: not when he goes outside its four corners by breaking a fundamental term.

It was then necessary to determine whether the engine delivered was in fact the thing contracted for. After repeating the difficulties to which the plaintiff was subjected as a result of the defective engine, the learned judge quoted Lord Dunedin's remarks in *W. & S. Pollock & Co. v. Macrae*:[9]

> Now, when there is such a congeries of defects as to destroy the workable character of the machine, I think this amounts to a total breach of contract, and that each defect cannot be taken by itself separately so as to apply the provisions of the conditions of guarantee and make it impossible to claim damages.

This proposition was verified by quoting words to the same effect from the judgment of Holroyd Pearce, L.J. in *Yeoman Credit Ltd. v. Apps*.[10] *Charterhouse Credit Co. v. Tolly*[11] was referred to as authority for the proposition that there could be a breach of a fundamental term although the condition could have been made good at considerable expense. The learned judge then concluded that there was a breach of a fundamental term to provide an engine of workable character.

The defendant's submission that the plaintiff's expressed reliance on his own judgment precluded any of the implied terms of s. 20 of the *Sale of Goods Act*[12] from arising was dismissed thus:

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5 *Id.* at 302.
6 *Supra*, footnote 2.
7 [1931] 2 D.L.R. 610, 43 B.C.R. 545.
8 Crossley Vaines, *Personal Property*, 3rd ed., 1962, pp. 295, 296.
9 [1922] S.C.(H.L.) 192 at 200.
10 [1961] 2 All E.R. 281 at 289.
11 [1963] 2 All E.R. 432.
12 *Supra*, footnote 2.

> The answer lies in my opinion in the lack of any inconsistency between the plaintiff's reliance on the defendant's skill or judgment to provide an engine that would meet the fundamental obligation of an engine of workable character and his reliance on his own judgment that a properly performing engine of the capacity supplied would be suitable for his purpose.[13]

The plaintiff's "acceptance" of the engine and any subsequent denial of his rights to claim damages was dismissed on the basis of Donovan, L.J.'s remarks in *Charterhouse Credit Co. v. Tolly*[14] to the effect that it was significant that the House of Lords, in deciding cases[15] similar to the one at bar, never considered the "acceptance" by a buyer a valid reason for denying the buyer damages where the seller was in breach of a fundamental term of the contract. *Massey-Harris Co. v. Skelding*[16] was cited as authority for awarding damages in the case of a breach of contract where otherwise it would be too late for the buyer to claim rescission. In that case the Supreme Court of Canada[17] held that damages would be the amount of the full purchase price.

The *Knowles* case represents in part the adoption in Canada of the doctrine of breach of fundamental term as expounded by the English courts in recent years. This doctrine has developed from a dictum of Devlin J. in *Smeaton Hanscomb & Co. Ltd. v. Sassoon I. Setty*[18] where that learned justice defined a fundamental obligation as "something fundamental to the whole contract, so that if it is not complied with, the performance becomes totally different from that which the contract contemplates."

This is not a new doctrine, but has been in existance for many years.[19] This use of the doctrine as a weapon against exemption clauses is, however, of fairly recent vintage. As Cheshire and Fifoot state:

> . . . in comparatively recent years it has been generalized so as to counter the undue rise of exemption clauses in any type of contract.[20]

As far back as 1834, Lord Abinger said:

> If you contract to sell peas you cannot oblige a party to take beans. If the description of the article tendered is different in any respect it is not the article bargained for and the other party is not obliged to take it.[21]

One could go back as far as 1812[22] and find that where the description in a lease did not correspond to the actual condition of the land, the lease was void.

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13 (1964), 43 D.L.R. (2d) 300 at 304 *per* Verchere J..
14 *Supra*, pp. 438, 439 per Donovan L.J..
15 Donovan L.J. referred to *Pollock & Co. v. Macrae, supra,* and *Wallis Son and Wells v. Pratt & Haynes,* [1911] A.C. 394.
16 [1934] 3 D.L.R. 193, [1934] S.C.R. 432.
17 [1934] 3 D.L.R. at 194, [1934] S.C.R. at 435 *per* Duff C.J.C..
18 [1953] 2 All E.R. 1471 at 1473.
19 See Anson, *Law of Contract,* Guest 22 ed., 1964, p. 153.
20 Cheshire and Fifoot, *Law of Contracts,* 6th ed., p. 117.
21 *Chanter v. Hopkins* (1834), 4 M. & W. 399 at 404; see also *Bowes v. Shand,* [1877] 2 A.C. 456 at 480 *per* Lord Blackburn.
22 *Jones v. Edney* (1812), 3 Campb. 284, 170 E.R. 1384.

The cases indicate that Canadian Courts have applied similar reasoning to the type of problem raised in the *Knowles* case. The British Columbia Supreme Court could have arrived at a similar decision without specifically referring to the modern English cases. Cases such as *Hayes Mfg. Co. v. Perdue & Cope*,[23] *Massey-Harris Co. Ltd. v. Skelding*[24] (which were cited in the *Knowles* case) and *Alabastine Co. of Paris Ltd. v. Canada Producer and Gas Engine Co.*[25] indicate that an exemption clause will not permit a seller to provide goods of such inferior quality that the purchaser would, in effect, receive goods of a totally different nature from those which he contracted to buy. In *Cork v. Greavette Boats Ltd.*,[26] a case of a sale of a faulty engine in which the seller sought to rely on an exemption clause, Greene J. after referring to the *Alabastine*[27] case and other English cases, said, ". . . in all these cases there was a *fundamental* failure in the article supplied which went to the substance of the Contract."[28] (Italics mine). It must be remembered, however, that the Canadian cases adopted the principle of breach of fundamental term from the English cases on sale of goods. These English cases in turn adopted their reasoning from sale of land transactions and shipping cases involving deviation from course.[29]

Exculpatory clauses will not avail a seller who has not lived up to his fundamental contractual obligations. The problem is how to distinguish fundamental terms from those that are merely collateral. Montrose has stated that an

> . . . autonomic policy underlines the doctrine of fundamental terms. The parties themselves distinguish between terms which are fundamental, . . . terms which are 'definitive' of the goods and terms which do not have this fundamental quality even though they may operate as conditions or promises.[30]

Melville has referred to conditions and warranties as "desirable or collateral provisions, express or implied".[31] These provisions are subsidiary to the main purpose of the contract. On the other hand there are three fundamental terms.[32] These include the parties to the contract, the price or consideration and the main purpose or core of the contract. This list is not, however, all inclusive. Regard must be had to the intentions of the parties and the circumstances surrounding the making of the contract.

To establish a breach of a fundamental term, which vitiates the operation of the vendor's exculpatory clause, the purchaser must

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23 *Supra*, footnote 7.
24 *Supra*, footnote 16.
25 (1914), 300 L.R. 394.
26 [1940] O.R. 352.
27 *Supra*, footnote 25.
28 *Id.* at 395.
29 See F. M. B. Reynolds, *Warranty, Condition and Fundamental Term*, 79 L.Q.R. 534 at 546 where the deviation theory is criticized. See also Crossley Vaines, *Personal Property*, at 295-296 (cited in the *Knowles* case).
30 J. L. Montrose, *Some Problems about Fundamental Terms*, 1964 C.L.J. at 264.
31 L. W. Melville, *The Core of the Contract*, 19 M.L.R. 26 at 33.
32 *Ibid.*

prove the breach was of a flagrant nature.[33] It has been held[34] that minor breaches collectively considered constitute a fundamental breach of contract. "The inability of a thing to function in the way intended is considered a breach of an *implied* term."[35]

The effectiveness of the *Knowles* case is weakened by the learned judge's failure to state in precise terms the factors which lead to his finding of the fundamental breach. Verchere J. found a fundamental breach of contract when he considered collectively the following factors:

(a) the inconvenience and bother to which the purchaser was subjected as a result of purchasing an engine with what appears to be "incurable" defects,
(b) the defects themselves,
(c) the loss of income attributable to the inefficient working of the engine.

It is noted that the learned judge compared the efficiency of the old engine and the income that engine gave the purchaser with the efficiency and income derived from the new engine.

The case law indicates that the court in using its discretion will find a fundamental breach if, from the facts of the case, the defects of the goods seem flagrant. The cost of repairing the goods appears to be irrelevant.

When construing exemption clauses the courts have been bound by such rules of construction as the "Main Purpose" rule which states that a party to a contract cannot exempt himself from a failure to perform the main purpose of the contract and the "Four Corners" rule which provides that any liability for damage sought to be covered by exemption clauses must fall within the four corners of the contract and not outside it. The *ejusdem generis* rule and the *contra preferenteum* rules are also used by the courts in strictly construing the exemption clause, usually in favor of the buyer. It would seem that the doctrine of breach of a fundamental term is merely another way of phrasing the idea contained in the "Main Purpose" and "Four Corners" rules. Where an article supplied is so defective as to be in essence a different article than that contracted for, it would be considered a breach of a fundamental term, as it was here, or alternatively to be a failure to perform the main purpose of the contract, or to fall outside of the four corners of the contract.

The rule may be said to be founded upon some "principle of justice"[36] or upon some grounds of public policy which declares that:

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[33] *Schmidt v. International Harvester Co. of Canada Ltd.* (1962), 38 W.W.R. 180.
[34] *Yeoman Credit Ltd. v. Apps, supra,* footnote 10; *W. & S. Pollock & Co. v. Macrae, supra,* footnote 9.
[35] Melville, *supra,* footnote 31.
[36] Montrose, *op. cit.,* p. 67.

> . . . the intention of the parties is subordinate to higher considerations of justice. The policy is not confined to doctrines such as those of illegality, based on the conduct of the parties entering into the contract but extends to the regulation of the consequences to the parties after they have entered into the contract. This is the heteronomic concept which underlines the doctrine of fundamental breach.[37]

Indeed, "the doctrine of fundamental breach does offer the public a new hope of protection against injustices perpetrated by abuse of contract".[38]

Some learned writers have claimed that fundamental breach must be specially pleaded.[39] It is interesting to note that in the *Knowles* case, fundamental breach was not pleaded by the plaintiff (buyer). The plaintiff sought damages for breach of an implied condition of the *Sale of Goods Act* or alternatively that the engine was not delivered as specified. The defendant-seller sought to rely on the exemption clause and the buyer's admission of reliance upon his (the buyer's) own judgment. Nonetheless, Verchere J. found there was a breach of a fundamental term. It is not clear whether he based his finding upon the plaintiff's alternative claim that the engine was not delivered as specified or whether he employed the "heteronomic" theory of Montrose. It could be argued that the engine was not delivered as specified. This, it is submitted, would be in breach of the *Sale of Goods Act* which provides, *inter alia,* that the seller must deliver goods in accordance with the contract of sale. However, no mention of this section of the *Sale of Goods Act* was to be found in the *Knowles* case. Therefore, we could assume that as a matter of public policy the learned judge would not allow the seller of what the judge found to be defective goods, to rely on the exemption clause in the contract of sale regardless of whether breach of a fundamental term was pleaded or not.

In conclusion, we can agree with Devlin J. who said that a fundamental term is "something less than a condition".[40] It is the very pith and substance of a contract. In analysing the concept of fundamental terms, in earlier years the courts adopted rules of construction to vitiate the harshness of exemption clauses. In modern times, the courts have used the same doctrine, but this time clothed in the image of public policy or rule of law, to achieve the same result. Regardless which method is employed, the consumer is afforded protection.

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[37] *Id.* p. 264.
[38] A. G. Guest, *Fundamental Breach of Contract,* 77 L.Q.R. 118.
[39] See *Hunt & Winterbottom (West of England) Ltd. v. B.R.S. (Parcels) Ltd.,* [1962] 1 All E.R. 111.
[40] *Smeaton Hanscomb & Co. Ltd. v. Sassoon I. Setty, Son & Co.,* [1953] 2 All E.R. 1471 at 1473.