

TRANSPORTATION NOTES

Legal Decisions and Developments Affecting the
Transportation Industry in Canada

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Liability for Latent Defect

On November 22nd the Supreme Court of Canada released an important decision which may have particular impact on participants in the aeronautics industry, although the underlying dispute arose in the very different context of manufacturing of newsprint. The case affirms that the law of the province of Québec, which province is of course a very significant source of Canadian aeronautical products, is indeed significantly different from that of the common law provinces with respect to the liability of a manufacturer. The particular issue addressed by the Court is the right of a manufacturer to contract out of liability for latent defects.

Combustion Engineering Canada ("C.E."), which is now a part of the ABB group and Alstrom Canada, manufactured a recovery boiler for Domtar, a Canadian paper company, in the period between 1985 and 1987. The boiler, designed to recover a toxic product of the pulping process, was a massive piece of equipment which included three superheaters. Within these heaters were some 75 miles of tubing held together by approximately 48,000 tie welds. The problem which led to the litigation was the adequacy of the tie welds used by C.E.

The welds in question are described as "H-style tie

welds". C.E. began using these in 1977, having noted some problems associated with the "A-style" welds it used previously. In introducing the new welds, C.E. did not do a stress analysis. In the early 1980's, and certainly before the contract between C.E. and Domtar, C.E. came into possession of information which cast doubt on the performance of the "H-style" welds and furthermore was aware of a superior hinge-pin system of attachment.

In the discussions between C.E. and Domtar, Domtar asked whether hinge-pin attachments could be used instead of tie welds. C.E. confirmed this was a possibility and that the use of hinge-pins would add \$500,000 to the purchase price. The matter was not pursued further.

The boiler was put into service in September, 1987 and problems began to become apparent 18 months later. In the course of an inspection a number of leaks and cracks were discovered in the tubing. Repairs were made and the boiler was returned to service some 2 weeks later. However, Domtar was apparently of the view that it could not rely upon the boiler in its present condition and demanded that C.E. make more thorough repairs. C.E. refused and Domtar decided to replace the boiler entirely. It did so and com-

menced legal action against C.E.

The main issues which occupied the attention of the courts were: Was there a design defect? If so, which of the contracting parties knew of the defect and which should be taken to know of it? In any event, what is the relevance of such knowledge (or imputed knowledge)? In the event there was a defect, was C.E. entitled to avoid any responsibility by a contractual term purporting to exclude its liability?

The trial judge would have cut the discussion short with a finding that there was no defect at all (although he also found C.E. was in breach of a duty to inform) and this could have been an end to the discussion. However, the Court of Appeal for Québec found it was able to replace the judge's finding on this issue with its own. In both the Court of Appeal and the Supreme Court, the matter proceeded on the basis of a finding that there was indeed a defect.

The Court conducted its analysis on the basis that the rights of the parties would be determined by the Civil Code of Lower Canada (the predecessor of the current Civil Code of Québec) which stipulates that a seller is obliged to provide a warranty against certain latent defects. C.E. attempted to avoid the consequences of

this statute by the proposition that the warranty against latent defects should not be absolute but should require a consideration of the expertise of the seller and buyer. A buyer with expertise should not be able to hold a seller to a strict warranty in the face of a contract which appears to exclude liability. While the Court agreed that expertise is an important consideration, the consequences of expertise differ as between the seller and buyer. A manufacturer will be presumed to have the highest level of expertise and knowledge with respect to his products and will, subject to other conditions discussed below, be required to make good any damage resulting from a defective product. Now, the first condition is that the defect be "latent" and the expertise of the buyer is relevant to this question. If the buyer detected the defect at the time of sale (or if he should have detected it), the defect is not latent and the statutory warranty is not applicable.

Assuming the buyer does not know, and is not deemed to know, of the defect, the next issue to be addressed is the nature of the loss of use which results from the defect. The loss must be sufficiently serious. This does not

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considered an owner of the car.

With respect to the interpretation of the exemption provisions under the *Motor Vehicle Act* the trial judge found that, while on the face of it, a lease would not appear to be a “contract of conditional sale” matters were complicated by the fact that, until 1990, a conditional sale included a lease with an option to purchase by virtue of the definition of this term in the *Sale of Goods on Condition Act* (“*SGCA*”). This act was subsequently replaced by the *Personal Property Security Act* (“*PPSA*”), which does not contain a definition of “conditional sale”. The trial judge found that this change in the law did not change the meaning of conditional sale established by the repealed statute. If the legislature had intended to change the meaning of this term, it would have done so explicitly in the *PPSA*. Further, the trial judge held that according to rules of statutory interpretation, the repeal of a statute is not to be taken as making a statement about the previous state of the law. Therefore, the repeal of the *SGCA* could not be taken as an intention to change the meaning of “contract of conditional sale”.

The trial judge also rejected an argument that the arrangement between the parties was a “true lease” rather than a “security lease” based on, inter alia, the fact that the option to purchase was at the fair market price, and that generally, persons who purchased lease vehicles were not the lessees. The trial judge found a number of factors which led to the conclusion that the arrangement was not a true lease: a \$25,000 security down payment was made; for tax purposes TLS treated the lease as a loan transaction; the lessee was required to pay more than “rent” money insofar as he had an obligation to cover any shortfall if the lessor did not receive fair market value when it sold the vehicle. Finally, the trial judge rejected the argument that, notwithstanding the definition of “conditional sale” TLS was a *de facto* owner because it had retained the insurance .

The Court of Appeal disagreed with the trial judge’s conclusions, finding that

TLS was not covered by the conditional sale exception. First, the Court endorsed the trial judge’s conclusion regarding choice of jurisdiction. The court then turned to the interpretation of “conditional sale”. The Court underlined that, according to rules of statutory interpretation, exemptions or exceptions have to be interpreted “in light of their underlying rationale” and should not be used to “undermine the broad purposes of the legislation”. The Court noted that the original purpose of the vicarious liability provisions was to ensure that the victim has as broad a right to recovery as possible. While the advent of compulsory automobile insurance might seem to make this purpose less necessary, this purpose still stands due to the principle of indemnity.

The Court further stated that, while no evidence of legislative debate on the purpose of the exemption in s. 86 had been presented, it was likely that it was meant to apply in situations where a vehicle had been “sold”, meaning that the former owner had parted with possession and control as well as title to the vehicle. The term “sold” would not apply where there was an option to purchase that might never be exercised. Further, although in other portions of the *Motor Vehicle Act* a broader definition of owner could be found that included a lessee, the Court was of the view that the section on vicarious liability had effectively created its own definition of ownership.

The Court also addressed the issue of the repeal of the *Sale of Goods Act*. Unlike the trial judge, the court was not persuaded that the rules of statutory interpretation in British Columbia mandating that a repeal should not be taken as a statement about the law were helpful in this case. In the Court’s opinion, these rules in no way required that judicial interpretations of a repealed act should continue to be applied in a separate statutory context. Rather, the Court was persuaded by the principle that once a statute is repealed it should be deemed to have never existed.

Finally, the Court stated that it did not find helpful the Appellant’s arguments about “*de facto*” ownership by TLS.

The point, the Court said, was the statutory interpretation of that specific provision of the *Motor Vehicle Act* as compared to the legal consequences of the agreement between the parties. In this case, the parties had signed a document that was called a lease, that called for the payment of “rent” for a specified term, and that offered only an option to purchase at the end. Therefore, the legal nature of the agreement was a lease and not a “disguised sale” or a “contract of conditional sale” at common law.

The Court in this case was clearly focused on the particular provisions of the *Motor Vehicles Act* and also gave weight to the purpose underlying these provisions. The Court was not willing to import interpretations of the terms at hand from a repealed statute or even other provisions within the same act. The case represents a victory for the policy of full indemnity to accident victims over questionable statutory interpretation.

Yeung (Guardian ad litem of) v. Au,
2006 BCCA 117

“The purposes of s. 86 are . . . to expand the availability of compensation to injured plaintiffs . . . and to encourage employers and other owners to take care in entrusting their vehicles to others. These objectives are consonant with the objectives of vicarious liability generally.”

Forum Selection Upheld Again

The Ontario Court of Appeal recently upheld a forum selection clause and declined jurisdiction over an action started in Ontario. This is one of a number of recent cases which highlight the courts' willingness to hold commercial parties to the terms of their contract. Furthermore, it is particularly instructive respecting the care which should be taken to review each factor in the real and substantial connection test which will determine whether jurisdiction exists before dealing with the alternative of a stay based on the inconvenience of the forum.

The parties entered into a contract in British Columbia relating to website services. The alleged breach of contract occurred in British Columbia and at the time of the contract, the plaintiff resided in that province. The plaintiff then moved to Ontario and initiated the action.

At the motion challenging jurisdiction, the defendant relied upon a clause that stated the agreement would be governed by the laws of British Columbia, that any litigation or arbitration between the parties would take place in British Columbia and that the parties "consent to personal jurisdiction and venue in that province." The defendant relied on the Supreme Court case of *Z.I. Pompey Industrie* which stipulates that parties should be held to such forum selection clauses unless the party resisting the clause is able to show "strong cause" to depart from the terms of the contract. The plaintiff argued that this was a case involving internet breaches where the damages went beyond British Columbia. It noted that the defendant is an international corporation and could easily travel to Ontario to defend the action.

The motions judge refused to uphold the forum selection clause. Although the facts are not set out in great detail in either decision, it is clear that the jurisdiction clause which was at the centre of the debate appeared in an electronic document whereby the plaintiff purported to define the contractual position, probably as part of "click-wrap" procedure. The motions judge concluded there was no evidence to indicate the plaintiff accepted the term or was aware

of the "small print". Furthermore, the motions judge held that Ontario was the convenient forum on the basis that the plaintiff resided in Ontario, held property there and, although the contract may have been breached in British Columbia, the damages flowed to Ontario and other jurisdictions. The judge also accepted the plaintiff's arguments regarding the ease of travel between the two provinces and the limited amount of witnesses. As a result, he concluded that Ontario was the convenient forum.

On appeal, the Court held that the motions judge erred by holding that the forum selection clause was not part of the contract and by failing to apply the real and substantial connection test to determine whether Ontario should assume jurisdiction. The Court held that the only evidence on the record was that the terms of service, including the jurisdiction clause, were part of the contract. The Court then went through all of the factors in the real and substantial connection test to conclude that the claim was not sufficiently connected to Ontario. These factors include: the connection between the forum and the plaintiff's claim; the connection between the forum and the defendant; unfairness to either party in assuming or not assuming jurisdiction; involvement of other parties to the suit; the court's willingness to recognize and enforce an extra-provincial judgment rendered on the same jurisdictional basis; whether the case is inter-provincial or international in nature. The only possible connection to Ontario, being any damages flowing to Ontario where the plaintiff voluntarily moved, was outweighed by the fact that the contract was made, performed and breached in British Columbia.

The present trend in Ontario seems to very firmly favour the recognition and enforcement of jurisdiction clauses, especially in commercial agreements.

Pisu v. Combustion Labs Media Inc.,
2007 ONCA 782,
overturning 2007 CanLII 923 (ON S.C.)

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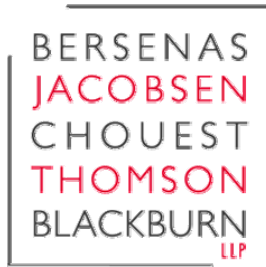
mean that the good must be rendered completely unusable, but the loss must be such as would have affected the purchaser's willingness to buy, had he known of the defect. If such a defect exists at the time of sale and is not known to the buyer, the seller's liability under the statutory warranty is engaged.

The next question is whether the seller can avoid that liability by a contractual exclusion clause. After a lengthy consideration of Québec precedents and French antecedents, the Supreme Court concluded that a manufacturer will rarely be able to rely upon a contractual limitation clause once its liability has been engaged. A manufacturer will be presumed to know of the latent defect. This presumption is rebuttable, but a heavy onus rests upon the manufacturer and it would appear unlikely that a manufacturer will often succeed in rebutting the presumption. By way of contrast, it will be recalled that if the buyer has knowledge of the defect the liability of the seller is not engaged at all. However, there is no presumption that a buyer, even a sophisticated buyer, has the requisite knowledge and the onus of proving that knowledge rests on the seller.

Thus a manufacturer subject to the law of Québec may be subject to an action for breach of the statutory warranty even in the face of the most clearly written exclusion clause and this without any proof that the sales transaction was unconscionable. By contrast, in the common law world, a manufacturer will generally be entitled to rely upon a clearly worded exclusionary provision unless there is a showing of unconscionability.

On the facts of the present case, the Court found that all the elements were in place to support a finding that C.E. was liable under the warranty and was not able to exclude that liability by contract. The defect was sufficiently serious, it existed at the time of sale and Domtar was not aware of it. C.E. may have had an honest belief in the adequacy of its product, but this was not sufficient to rebut the presumption of knowledge. To do so, it would have been necessary to show that it could not reasonably have obtained knowledge of the defect.

ABB Inc v. Domtar
2007 SCC 50



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“The exemption (to vicarious liability) applies only where a motor vehicle has been ‘sold’ pursuant to a true conditional sale agreement. . . . Other forms of chattel financing do not come within the exemption. . . .”

Court of Appeal overturning the trial judge.

Our transportation law group represents the interests of carriers in litigation of personal injury, property loss and commercial disputes. We also advise on insurance and regulatory issues and represent clients before the courts, agencies, tribunals and authorities with important jurisdiction over transportation undertakings.

These Transportation Notes are intended to provide general information and do not constitute legal advice. Readers should consult legal counsel on matters of interest or concern raised by anything in this publication.

We welcome your comments and suggestions.

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End of the Line

The Supreme Court recently dismissed an application for leave to appeal in *Yeung (Guardian at litem of) v. Au*, 2006 BCCA 117. The case involved the interpretation of an exception to the vicarious liability provision in section 86 of the British Columbia *Motor Vehicles Act*. The provision in question applies to exempt certain parties involved in the “sale” of a motor vehicle from the imposition of vicarious liability. The issue in the case was whether this exemption applied to the lessor of a car involved in an accident, Transportation Lease Systems Inc. (“TLS”). More specifically, the issue addressed was whether the extensive definition of “conditional sale” (which encompasses leases with an option to purchase) contained in the repealed BC *Sale of Goods on Condition Act* continued to apply to the vicarious liability provisions. The British Columbia Court of Appeal, reasoning that the vicarious liability provisions were to be addressed on their own specific wording and preferring a more narrow definition of conditional sale, decided that TLS was not covered by the exception and was therefore vicariously liable for

damages sustained in the accident.

The Plaintiff and Appellant was the passenger of a car driven by the son of the lessee. She was rendered severely disabled as a result of an accident. The driver lost control of the car, swerved into oncoming traffic and was found negligent. Damages in the amount of \$5.8 million were awarded to the Plaintiff. The only outstanding issue, which went before the BC Court of Appeal, was whether the lessor of the car was also liable, along with the lessee and his son. The arrangement between the parties was for a three-year lease with monthly payments and an option to purchase at the expiry of the term. The agreement also required the payment of a \$25,000 refundable deposit by the lessee that could, among other things, be used if the car sustained more than reasonable damage while leased or if the lessor ended up selling the car at less than fair market value. The lessee was requested to obtain insurance in the amount of \$2 million. In addition, the lessor had its own insurance. The car was registered under the *Per-*

sonal Property Security Act with the father of the driver as the debtor. After the accident, TLS signed a salvage release form to the insurer in which it declared itself the registered owner and the sole legal or beneficial owner of the vehicle.

The trial judge first dealt with a jurisdictional argument. There was a clause in the lease that provided that the lease was to be governed by the law of Ontario. If Ontario law should apply TLS would certainly have been vicariously liable. The trial judge dismissed the Ontario jurisdiction argument, holding that in tort, the law of the place where the activity occurred (*lex loci delicti*) applied. In this case, the claim was in tort and TLS was not relying on a contractual defence.

The trial judge went on to find that TLS was covered by the exception and was without liability because the lease constituted a contract of conditional sale. Contrary to the usual principles, the trial judge decided to allow evidence of insurance coverage for TLS because this would go toward determining whether TLS could be

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