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TRANSPORTATION NOTES

Legal Decisions and Developments Affecting the Transportation Industry in Canada

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Air India Justified in Drawing upon Letter of Credit

Wesley Richards was the sole shareholder of Ceylinco Investments Ltd., which operated as Chalais Travel & Tours ("Chalais"). Chalais became an accredited IATA travel agency in April 2002 when it executed the IATA Passenger Sales Agency Agreement (the "PSAA"). It continued to hold this designation until May 2008.

Although the PSAA authorized Chalais to issue passenger tickets on all of the IATA member airlines, Chalais' business was almost exclusively limited to providing services to persons traveling to India — meaning that most of the tickets sold by Chalais were for Air India flights (and connector airlines).

Unfortunately, the relationship did not end well. Rather, it concluded with a dispute over 62 Air India tickets with a value of approximately CAD$118,000 (the "Disputed Tickets").

Before explaining the circumstances of the case, one must explore the paper ticketing process and the workings of the IATA accredited agent/IATA member airline relationship.

During much of the time that Chalais was operating, the industry was still reliant, to a certain extent, on paper tickets. In the paper ticketing regime, accredited travel agents are authorized to issue tickets on airline ticket stock, which is to be imprinted with a plate provided by IATA. All of the Disputed Tickets in this case were of the paper stock variety.

It is also important to understand that IATA accredited agents do not pay the airline directly for tickets purchased by their clients. Rather, they pay for them through IATA's Bank Settlement Plan ("BSP").

Here's how the process works: a client requests a particular booking from a travel agent. The travel agent collects payment from the client and reserves the ticket through one of the Global Distribution Services ("GDS"), such as Sabre. Once the reservation is confirmed, the travel agent then reports the sale of the ticket through a Daily Activity Report to the BSP. Once a week, the agent pays a lump sum through the BSP for the cost of all of the tickets booked in the previous week on flights offered by the IATA member airlines. The BSP then distributes the collected funds to the appropriate airlines. The whole process is intricately designed and there are detailed procedures to be followed by agents, as set out in the PSAA and the IATA Agent's Handbook (the "Handbook").

In order to protect itself from possible abuses by unscrupulous travel agents, Air India requires its agents to designate it as the beneficiary of an irrevocable standby letter of credit (the "LOC"). In November 2007, Chalais entered into an agreement with Air India which required it to provide such a LOC in the amount of CAD$100,000 (the "Net Fares Agreement"). Most of the Disputed Tickets in the matter at hand were purchased before the execution of the Net Fares Agreement.

Towards the end of Chalais' days as a viable travel agency, it stopped responding to Air India's requests for payment for the Disputed Tickets. As a result, Air India drew upon the LOC provided pursuant to the Net Fares Agreement, leaving an outstanding balance of approximately CAD$18,000.

Chalais disputed Air India's claim that it was in arrears for 62 tickets — claiming that it had remitted payment for all but seven tickets. Moreover, Chalais claimed that it had no agreement with Air India when the Disputed Tickets were issued so Air India was not entitled to draw upon the LOC. In addition, Chalais argued that, in accordance with the Handbook, the time had expired for Air India to make a claim for the Disputed Tickets.

Chalais therefore sued Air India for the amount paid pursuant to the LOC. Mr. Richards (the sole shareholder of Chalais) also made a claim in the same action alleging that he had suffered consequential losses as a result of Air India's drawing upon the LOC. Air India counterclaimed for the remaining CAD$18,000.

The Court first had to determine the nature of the relationship between Chalais and Air India when the Disputed Tickets were issued.

In doing so, Justice Butler considered the evidence of Mr. Richards, who testified that there was no agreement between Chalais and Air India until the execution of the Net Fares Agreement in 2007.

Justice Butler was not favourably impressed by Mr. Richards' evidence. The Court took note of the fact that he could not possibly have had this understanding given his very extensive travel agency experience and his training as an accountant.

In any event, it was clear on the evidence at trial that, prior to November 2007, in addition to being bound by the PSAA, Chalais had a relationship with Air India as a consolidator and, after it lost that status in 2006, it had provided an interim letter of credit to Air India before executing the Net Fares Agreement.

In any event, and of primary importance, was the fact that the PSAA provided at clause 7.2 that:

> [A]ll monies collected by the Agent for transportation and ancillary services sold

Inside This Issue

Doctrine of "Inevitable Accident" Applied in Marine Case

The case of *Wolverine Motor Works Shipyard LLC v. Canadian Naval Memorial Trust* examines the doctrine of "inevitable accident" in the context of a claim for negligence where a ship struck another ship berthed alongside of it during a hurricane, causing it to sink.

The Nova Scotia Superior Court held that this was an inevitable accident and that the plaintiff failed to prove negligence. Importantly, the Court explained, the standard that applies to preparations made on a ship for heavy weather is that of reasonable skill and diligence, not perfection. Moreover, the Court underlined, it is highly preferable to tender expert evidence in such cases.

The plaintiff, Wolverine Motor Works Shipyard LLC, was the owner of all shares in "the Larinda", a US-flagged motor and sailing vessel.

The defendant, the Canadian Naval Memorial Trust ("the Trust") was the owner of "the Sackville", a steel-hulled corvette, maintained as a World War II memorial. The HMCS Sackville served with the Royal Canadian Navy during World War II, primarily as a convoy escort across the Atlantic and then as a utility vessel into the early 1980s. Subsequently, the Sackville was restored to her wartime configuration, and maintained as a museum ship in Halifax during the summer months.

The Larinda was a replica Boston Schooner, built by her captain, and was in Halifax at the time in question for the purpose of participating in "Tall Ships" events. At the time in question, the vessels were moored at parallel wharves, with only a "camber" of water separating them. The Sackville was "considerably larger and heavier" than the Larinda.

The focus of the evidence was the preparation undertaken for the anticipated arrival of Hurricane Juan on September 29, 2003. Commander Wendell Brown ("Cdr. Brown"), a retired Canadian naval officer, was primarily in charge of the measures taken to secure the Sackville.

The main issue was the arrangement of the lines by which the Sackville was secured, a number of which broke loose in the hurricane, resulting in the collision with the Larinda. Cdr. Brown testified that the lines were set up for the "worst weather that might be expected", with sufficient length to account for the anticipated rise and fall in the tide.

The Sackville was secured by a total of eight lines. Cdr. Brown testified that these were of greater strength than would normally be provided for a ship the size of the Sackville.

Cdr. Brown testified that he and another officer in charge of the Sackville's maintenance made a number of visits several days before the hurricane to check the lines and to ensure that they would have enough slack to deal with the expected tide and surge. There were also lines connected from the Larinda directly to the Sackville, which were also checked.

Cdr. Brown also testified that they kept abreast of weather reports. He testified that preparations would always be made for a worse storm than predicted – for instance, if the storm called for winds of 50 knots, the lines would be prepared such that they wouldn't break at 51 knots. Cdr. Brown testified that the weather report predicted a storm of about 75 knots.

On the night of the storm, both officers came to check on the ship while the weather progressively worsened. They monitored the tide and walked the jetty, observing the Sackville's lines. Crew members from another ship were also in the area and indeed offered additional lines to Cdr. Brown. Cdr. Brown declined to use more lines.

Later that night, Cdr. Brown returned in this "floater suit". He testified that around midnight, the storm intensified and he could not see through the wall of water that had built up, but that the Sackville's mast appeared to be steady. At around 1 am, as the winds died down, Cdr. Brown could see the Sackville's bow moving away from the jetty, presumably as the lines broke. He requested a tug to move the Sackville back to the jetty, and this tug arrived almost an hour later. At that point, the Sackville's bow was against Larinda's port quarter. It was determined after the fact that lines one, three and four had broken, while line two had "paid out". The Larinda was taking on water, and eventually sank.

Subsequent analysis of the weather revealed that the hurricane had struck in a way that put the Sackville closer to the eye of the storm, where winds rapidly change direction, than initially anticipated and that winds exceeded 100 knots.

The defendant commissioned a report by London Offshore Consultants ("LOC") which concluded that the failure of the lines was due to the sudden increase in speed and the change in direction of the wind as the eye of the hurricane hit, as well as the motion of the sea.

The LOC report suggested the lines failed in a "catastrophic manner" and not as a result of chafing. The LOC report also concluded that adequate preparations were made for the weather as it was expected.

The issue for the Court to consider was whether the defendant was liable in negligence or whether it could avail itself of the doctrine of "inevitable accident." This doctrine pertains to a situation where events occur which would not have been capable of being prevented by ordinary skill and diligence.

The Court held that a defendant does have an onus, if it is relying on this doctrine, to show that there is no evidence against it of lack of diligence and further, to show that it has exercised due diligence in the circumstances. The Court found expert evidence particularly important in this respect.

In this case, the Court found that: the personnel in charge of Sackville were experienced and had monitored the ship in the "days and hours" before the hurricane; that there was no duty to put out additional moorings on the Sackville because there was no evidence that the existing moorings would be inadequate for the weather as anticipated; and that the severity of the weather and the "combined forces of wind, tide, surge and waves" could not have been anticipated.

The Court was concerned that the plaintiff had brought no contrary expert evidence to show that the defendant had lacked in skill and diligence.

The Court found that, while expert evidence would not be necessary in every case, in the circumstances of this case the plaintiff was asking the court to conclude that there was negligence simply because the accident happened and this was not reasonable. The Court found that, even if it were prepared to find a *prima facie* case, the defendants had successfully shown that they had exercised adequate skill and diligence in the circumstances.

The law would not expect a defendant to always get everything right.

Wolverine Motor Works Shipyard LLC v. Canadian Naval Memorial Trust, 2001 NSSC 208

End of the Line

The favoured word in the recent jurisdiction is "impairs". So, for the doctrine to apply, the court must identify a core legislative competency or an essential part of a federal undertaking which would be impaired or seriously affected if a provincial enactment were allowed to stand.

The operation of a major international airport clearly falls within the federal power over aeronautics and is likewise a federal undertaking. The lease, as would be expected, is very restrictive in what it permits the Authority to do and this will be significant. The Authority covenants that it will use the airport lands for purposes compatible with the operation of an international airport. It further agrees to keep the premises free of encumbrances. This was significant because there is precedent to allow the creation of encumbrances of leasehold interests on federal lands. However, in the main case which was cited by the province in support of its position, the lessor of the lands was engaged in operations which were within the province's regulatory authority. Here, the Authority is engaged in the operation of an international airport and that has been repeatedly affirmed to be an area of core federal competence.

The outcome of the case would then depend upon whether allowing liens to be filed against the leasehold interest would affect a core or vital aspect of this federal undertaking and, if so, whether the effect would be sufficiently severe to justify rendering the provincial enactment ineffective.

The following factors were particularly important in the Court's view. First, the subject of the contracts was the expansion of essential parts of the airport: taxiways and passenger concourses. Second, the mandate of the Authority was to operate an international airport and any impairment of its ability to construct essential infrastructure would have a very severe impact on that mandate. Lastly, allowing the filing of liens could affect the Authority's ability to obtain financing and thus impair its ability to fulfill its mandate.

For these reasons, the provincial legislation was found to be ineffective and the exclusive nature of Parliament's jurisdiction over all aeronautical matters was once again affirmed.

Attorney General of British Columbia v. Vancouver International Airport Authority, 2011 CanLII 52133

Air India Letter of Credit *(cont'd)*

> under this Agreement, including applicable remuneration which the Agent is entitled to claim thereunder, are property of the Carrier and must be held by the Agent in trust for the Carrier or on behalf of the Carrier until satisfactorily accounted for to the Carrier and settlement made.

Having considered this provision in the PSAA, the Court found that the relationship between Chalais and Air India was one of trustee/ beneficiary. This finding is supported by the Supreme Court of Canada's decision in *Air Canada v. M&L Travel Ltd.* [1993] 3 SCR 787.

The Court then turned to Chalais' argument that Air India was too late in seeking the trust funds. In this regard, Chalais argued that the PSAA and the Handbook required that Chalais retain accounting records for only two years — and since two years had passed by the time Air India complained about the missing funds, Chalais was justified in having destroyed the relevant records and therefore it was not fair that it be called upon to defend itself at this late stage. On this point, Justice Butler held that the PSAA merely sets out the time that the records are to be retained — and does not relieve Chalais of its obligation to account as trustee for the monies received for the benefit of Air India.

"Given the worldwide nature of airline traffic and the fact that agents and airlines do not directly deal with each other for payment and issuance of tickets, the system is subject to abuse. It is possible for an agent to receive payment for a ticket from a customer, issue the ticket and book a reservation, but fail to report the sale or remit payment to the airlines through the BSP."

Chalais also argued that, pursuant to s. 2.1 of IATA Resolution 850m, it was too late for Air India to claim the monies through an Agency Debit Memo through the BSP because the amounts weren't sought within nine months of travel. The Court did not accept this argument because this provision merely limits the ability to make a claim for the funds through the BSP. In fact, the very same section of Resolution 850m explicitly permits an air carrier to pursue the funds directly from the travel agency after nine months following the date of travel.

The Court then considered whether Chalais did, in fact, fail to pay for the Disputed Tickets. In short, it held that Chalais did fail to do so. In coming to this decision, it noted that Chalais and Mr. Richards failed to account for the trust funds with "the level of skill and prudence which would be expected of a reasonable business person managing his or her own affairs." Instead, it found that Mr. Richards, who acted as Chalais' accountant, "took a remarkably relaxed attitude to his duties", noting that Mr. Richards' evidence was that "if less than the proper amount for the weekly remittance had been debited from [Chalais'] account, no one would have checked."

Further, the Court found that by failing to cooperate with Air India when it requested an audit in 2008, Chalais had breached its duties set out in the Handbook — leading to the inference that the failure to permit the audit confirmed that the tickets were issued without payment to Air India.

The Court also noted that Air India was able to prove through the testimony of its Regional Finance Manager and through business records that many of the passengers purchasing the Disputed Tickets did indeed travel. This was corroborated through BSP and Chalais records. The Court noted that most of the Disputed Tickets were reported as "void" on the BSP reports — meaning that Chalais made the booking through the GDS, issued a ticket on Air India stock, then voided the ticket (even though the passenger did not actually cancel his reservation), resulting in no payment to Air India through the BSP.

The Court found that both Chalais and Mr. Richards are liable to Air India for the breaches of trust. It held that the practice of issuing tickets and purporting to void them while leaving the reservations in place was dishonest and fraudulent.

It was notable that the finding attached to Mr. Richards in his personal capacity even though he was a "stranger to the trust". In doing so, the Court referred to the Air *Canada v. M&L Travel*, *supra*, noting that he "was the individual who should have instituted systems to ensure that void tickets were handled in accordance with the requirements of the Handbook. … On the basis of his degree of involvement with the business I conclude that he had actual knowledge of the breaches of trust and that his actions facilitated those breaches."

The Court held that Air India had properly drawn upon the LOC and ordered that Chalais and Mr. Richards pay the balance owing of approximately CAD$18,000 plus interest to Air India.

Wesley Richards d.b.a. Chalais Travel & Tours and Ceylinco Investments Ltd. v. Air India Ltd.

End of the Line: Federal Jurisdiction in Aeronautical Matters

The exclusive jurisdiction of the Canadian Parliament over aeronautics was settled in 1951. Since then provincial legislation of various sorts has been enacted which, if allowed to stand, would have circumscribed that jurisdiction significantly.

With few exceptions, Parliament has prevailed. Most recently, at the end of August of this year, the Supreme Court of Canada refused leave to appeal a decision of the Court of Appeal for British Columbia which in turn declined to apply the provisions of a provincial Act that would have permitted the creation of a lien affecting the leasehold interest of the Vancouver International Airport Authority.

By way of background, Canada is a federation and the authority to legislate is divided between a federal Parliament and the Legislatures of the provinces and territories. Our Constitution assigns legislative subject matters to either the federal or the provincial level. By way of example, defence, navigation and shipping and banking are all within the federal legislative powers, while education, property and civil rights and the administration of justice are provincial matters. The Constitution which distributes these powers was originally enacted in 1867 and has never been amended to deal specifically with aeronautics. Therefore there was some early dispute as to how aeronautics should be regulated and the present rule was established in 1951. At that time it was determined that a residual power of Parliament—to enact laws for the "Peace, Order and good Government of Canada"—included aeronautics in the federal sphere.

This however was far from the end of the matter. The interpretation of this scheme for the division of powers has generated some very complicated law with political implications. Most recently, "cooperative federalism" has emerged as the dominant view and Canadian courts generally attempt to accommodate "the ordinary operation of statutes enacted by both levels of government". Nevertheless, provincial legislation has not fared well when its operation can be seen to have a serious effect on the aeronautical legislative power or on an integral part of a federal undertaking of an aeronautical nature. This is the case even if no federal statute comes into direct conflict with the provincial enactment.

The land on which the Vancouver International Airport is built is federal crown land which has been leased to the Authority. This is a common arrangement in Canada. In the case of *Vancouver International Airport Authority v. British Columbia*, the question which arose was whether provincial legislation which made provision for a builders' lien could have any application to the leasehold interest of the Authority. The province, in attempting to justify its legislation, readily agreed that the liens which it purported to create could never authorize the selling of federal land, but argued that the leasehold interest of the Authority should be subject to the legislation which would allow the registration of a charge against the leasehold interest.

The underlying dispute arose as the Authority entered into contracts for airport improvements. The nature of these contracts was of some significance. One was for the expansion of taxiways and the other for expansion of passenger concourses. In the course of the construction several companies that supplied materials and labour registered builders' liens. When the Authority learned of this it asked the Registrar to refuse to accept further builders' liens and the Registrar refused. The Authority sought a remedy in court and was successful at every level. As the Supreme Court of Canada has refused leave to appeal the decision of the Court of Appeal, the dispute is at an end. No liens may be registered or enforced in respect of work done under these contracts.

The constitutional doctrine invoked to support this result is that of "interjurisdictional immunity", a doctrine we have had several occasions to comment on in this newsletter. This doctrine has had an eventful history. It started modestly, expanded significantly by the late 1980's and, within the last 5 years, has been restricted significantly. We believe it may be described accurately as follows: the doctrine applies when a province enacts legislation which affects a core federal legislative competency or an essential part of a federal undertaking. Much of the recent debate has been over the nature of the effect which will trigger the operation of the doctrine. It is clear that it is not enough to point to an effect, however minor. On the other hand, it is not necessary to wait until the provincial legislation has "sterilized" the federal competency.

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