BANKS AND BANKING—BANK ACT, R.S.C. 1985, C. B-1, SECTION 178—LIMITATION OF CIVIL RIGHTS ACT, R.S.S. 1978, C. L-16, SS. 19, 27, AS AMENDED—MUST A BANK COMPLY WITH PROVINCIAL LEGISLATION WHEN ENFORCING A BANK ACT SECURITY: *Bank of Montreal* v. *Hall.*

Bradley Crawford*

Introduction

It is, perhaps, a measure of the uncertainty of the times that a judgment of the Supreme Court may be warmly welcomed precisely because it appears to do nothing more than to confirm established principles. In its long-awaited judgment in *Bank of Montreal* v. *Hall*[1] the Supreme Court of Canada re-affirmed some basic principles of constitutional law that affect the business of banking and the scope of the exclusive federal legislative competence over it.[2] In doing so, the court explained its judgment in *Canadian Pioneer Management Ltd.* v. *Labour Relations Board of Saskatchewan*,[3] and added a helpful clarification to its previous pronouncements on the proper test for when federal and provincial statutes "conflict" in such a way as to require a court to apply the doctrine of federal paramountcy. Unfortunately, the judgment also appears to suggest an alternative line of reasoning that could raise new analytical difficulties in the future. Even if such difficulties do not arise, a review of the conflicting case law on related topics appears to confirm the need for legislative reform.

The facts were simple. Hall, a farmer in Saskatchewan, had given the Bank of Montreal security pursuant to section 178 of the Bank Act[4] on a piece of swathing equipment. Upon default by Hall, the bank seized the swather and, presumably, sold it. The bank's action was to enforce a real property mortgage, also given by Hall. It was only in that action that Hall alleged that the bank had acted illegally in seizing the swather without complying with the provisions of the Limitation of Civil Rights

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[1] [1990] 1 S.C.R. 121, (1990), 65 D.L.R. (4th) 361. Judgment was delivered on 1 February, 1990. The Saskatchewan Court of Appeal's decision from which the appeal was taken was delivered on 27 February, 1987, 46 D.L.R. (4th) 523.

[2] Constitution Act, 1867, s. 91(15).

[3] [1980] 1 S.C.R. 433, (1980) 107 D.L.R. (3d) 1 *("Canadian Pioneer Management").*

[4] Now R.S.C. 1985, c. B-1.

Act of Saskatchewan.[5] It was also alleged that as the swather had been additional security for the mortgage loan, the bank's illegal seizure released Hall from all liability on the mortgage in accordance with the provisions of the Limitation of Civil Rights Act.

Saskatchewan Queen's Bench and Court of Appeal

The trial judge, Matheson J.,[6] noted that no question had been raised concerning the validity of the bank's security on the swather. In instructing the sheriff to seize the equipment, the bank had purported to act in accordance with subsection 178(3) of the Bank Act which states that the bank,

> ... has full power, right and authority, through its officers, employees or agents, in the case of (a) non-payment of any of the loans or advances for which the security was given ... to take possession of or seize the property covered by the security....

But Hall's defence invoked the Limitation of Civil Rights Act which provided for a mandatory procedure, potentially including judicial review, before lawful seizure of collateral, upon the sanction of releasing the debtor from all liability under the agreement by which the security had been given.[7] Hall's counsel pointed out that amendments to the Limitation of Civil Rights Act in 1979-80[8] had removed certain references to "chattel mortgages" (which, it was admitted would not catch a bank's section 178 security) and substituted references to "security agreements" and "security interests" (which, it was alleged, did bring section 178 security within the scope of the Limitation of Civil Rights Act). Matheson J. thought that the change had been made only to ensure consistency of terms with the Personal Property Security Act of the province, enacted at the same session[9] and had not been intended to apply to section 178 security at all. Nevertheless, he speculated that:[10]

> It is entirely possible, in view of the development of competing financial and commercial institutions who are subject to provincial consumer protection legislation, that it could be concluded that the invasion by Parliament into the field of property and civil rights, under the guise of enacting legislation relating to the business of banking, is not justified.

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[5] R.S.S. 1978, c. L-16 (the "LCR Act").

[6] (1985), 46 Sask. R. 182, 6 P.P.S.A.C. 61 (Sask. Q.B.).

[7] The statutory scheme appears to operate as follows: s. 21 of the LCR Act requires the secured party to serve a statutory form of notice on the debtor advising of its intention to repossess. Section 23 permits a debtor who receives such a notice, to apply to the Court of Queen's Bench for a hearing. If no application is made for a hearing, the creditor may take possession. If a notice of hearing is served, the creditor may not take possession without leave of the court. Section 27 provides that if a creditor acts in contravention of the foregoing, the debtor is released from all liability and may recover his property and any sums paid by him.

[8] Limitation of Civil Rights Amendment Act, S.S. 1979-80, c. 29, s. 19.

[9] S.S. 1979-80, c. P-6.1.

[10] *Supra*, footnote 6, at pp. 185 (Sask. R.), 64 (P.P.S.A.C.).

Matheson J. also noted that the Limitation of Civil Rights Act "limits, but does not negate" the rights of banks.[11] However, he concluded that the constitutional law issues had not been properly raised before him and, assuming that section 178 was valid, he concluded that it authorized the bank to act without complying with the Limitation of Civil Rights Act.

On Hall's appeal to the Court of Appeal,[12] the constitutional issues were more fully argued, and divided the court. The majority, Sherstobitoff J.A. (Vancise J.A. concurring), thought that Matheson J. had erred in attributing a modest, "housekeeping" intent to the Saskatchewan Legislature in amending the Limitation of Civil Rights Act to provide for its application to security interests. The majority acknowledged the strength of the principle in *Tennant* v. *Union Bank of Canada*[13] which they paraphrased as stating that:[14]

> ... the power of Parliament with respect to banks and banking conferred by subsection 91(15) [of the Constitution Act, 1867] ... extends to every transaction within the legitimate business of the banker, notwithstanding that the exercise of such power interferes with property and civil rights in the province....

However, they thought that the principle had been modified in subsequent cases[15] involving provincial laws governing priorities between banks holding Bank Act security and other creditors. In particular, they noted[16] that the Supreme Court of Canada had stated in *Royal Bank of Canada* v. *Workmen's Compensation Board of Nova Scotia*[17] that banks, although authorized by the Bank Act to take security on property,

> ... cannot expect to hold such property free and clear of those burdens ... that are of general application throughout the particular Province in which the bank is doing business.

The majority thought that the Limitation of Civil Rights Act did not impair the status of banks to carry on their business in Saskatchewan and was not "aimed at any impairment of bank securities, though its operation

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[11] *Ibid.*

[12] (1987), 36 D.L.R. (4th) 523, [1987] 3 W.W.R. 525 (Sask. C.A.).

[13] [1894] A.C. 31 (P.C.).

[14] *Supra*, footnote 12, at pp. 534 (D.L.R.), 537 (W.W.R.).

[15] Citing *Royal Bank of Canada* v. *Workmen's Compensation Board of Nova Scotia*, [1936] S.C.R. 560, [1936] 4 D.L.R. 9; *Canada Trust Company* v. *Cenex Ltd.* (1982), 131 D.L.R. (3d) 479, [1982] 2 W.W.R. 361 (Sask. C.A.); *Attorney-General of Ontario* v. *Barfried Enterprises Ltd.*, [1963] S.C.R. 570, (1963), 42 D.L.R. (2d) 137; *Montcalm Construction Inc.* v. *Minimum Wage Commission*, [1979] 1 S.C.R. 754, (1978), 93 D.L.R. (3d) 641.

[16] *Supra*, footnote 12, at pp. 535 (D.L.R.), 538 (W.W.R.).

[17] *Supra*, footnote 15, at pp. 569 (S.C.R.), 17 (D.L.R.).

may incidentally, in certain cases, have that effect".[18] The procedure for giving notice and enabling the debtor to require a judicial hearing:[19]

> ... may have the effect of delaying the taking of possession by the creditor. It does not affect the amount of the indebtedness or liability for payment ... except in cases of non-compliance ... it requires the bank to follow certain procedures before realizing upon its security, and nothing more.

Finding that the Bank Act contained no indication that "it intended to brook no other legislation" and that there was, therefore, no conflict between the federal and provincial enactments within the test for federal paramountcy laid down in *Multiple Access Ltd.* v. *McCutcheon*,[20] the majority concluded that the Limitation of Civil Rights Act bound the bank and discharged Hall when the bank failed to comply with its procedure prior to seizure of the equipment.

Wakeling J.A. was left in dissent in asserting the proposition that the Limitation of Civil Rights Act "intends that the unqualified right of seizure granted to the bank [by subsection 178(3) of the Bank Act] is to be restricted".[21] That, he thought, was a conflict within the *Multiple Access* test.

Although nothing on the record now appears to form a solid basis for concern, the fact is that many banking lawyers felt a high degree of anxiety at the time of the *Hall* appeal. There appeared to be danger signals everywhere that the courts were siding with the provincial legislatures to erode the reliability and value of the banks' traditional security under the Bank Act. The Ontario Court of Appeal had shocked the industry in 1980 with its decision in *Rogerson Lumber Co.* v. *Four Seasons Chalet Ltd.*[22] Until that decision, no one had considered it possible that a bank that had complied in every respect with the requirements of the Bank Act to take section 178 security could lose in a priority fight against an unperfected purchase money security interest of which it had no prior knowledge and which had not even been properly documented at the time that the bank took possession of the collateral. In those circumstances, the statement by Arnup J.A. in *Rogerson* that the "P.P.S.A. [Personal Property Security Act] cannot prejudicially affect the Bank's interest,

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[18] *Supra*, footnote 12, at pp. 535 (D.L.R.), 538 (W.W.R.), evidently referring here to *John Deere Plow Co. Ltd.* v. *Wharton*, [1915] A.C. 330, (1914), 18 D.L.R. 353 (P.C.); *Great West Saddlery Co. Ltd.* v. *The King*, [1921] A.C. 91, (1921), 58 D.L.R. 1 (P.C.).

[19] *Ibid.*, at pp. 535-536 (D.L.R.), 538-539 (W.W.R.).

[20] [1982] 2 S.C.R. 161, (1982), 138 D.L.R. (3d) 1 ("*Multiple Access*"). The test may be stated as follows: "Paramountcy applies only where there is actual conflict in operation, as where one enactment says 'yes', the other 'no' ... compliance with one is defiance of the other."

[21] *Supra*, footnote 12, at pp. 528 (D.L.R.), 531 (W.W.R.).

[22] (1980), 113 D.L.R. (3d) 671, 29 O.R. (2d) 193 (Ont. C.A.) ("*Rogerson*").

acquired pursuant to a federal statute"[23] seemed no more than lip service to the old concept of the paramountcy of federal banking law.

No longer trusting exclusively to federal law, the banks had begun to register financing statements with respect to their section 178 charges under provincial personal property security statutes. Since there was some doubt whether a section 178 charge properly qualified as a security interest under provincial law, some banks had even begun to require duplicate security documentation in order to comply with both the Bank Act and the provincial legislation. Of course, the legal costs of such duplication of effort were driving up the banks' overheads and the cost of credit to their customers, thus threatening the banks' competitiveness as well. Another cost was paid in conceptual clarity and certainty as commentators wrestled with the difficulties of analysis the practices created.[24]

At the same time, on the public law front, the Supreme Court had given the impression in *Canadian Pioneer Management* that it was inclined to narrow the scope of the concept of the business of banking in constitutional interpretation. In that case,[25] Beetz J. had commented that Lord Watson's speech in *Tennant* v. *Union Bank* could no longer be read literally. That appeared to mean that the Supreme Court was beginning to think that *banking* might no longer embrace every transaction within the legitimate business of a banker. An increasing number of lower court decisions[26] were giving priority to various statutory liens created under provincial legislation on a variety of theories including timing of the creation of the competing interests, and traditional principles of statutory interpretation.[27] The news from the court was not all bad—for example, dual documentation and dual registration were at least effective to protect the banks' interests[28]—but the industry felt besieged.

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[23] *Ibid.*, at pp. 677 (D.L.R.), 199 (O.R.).

[24] B. Crawford, Crawford and Falconbridge, Banking and Bills of Exchange (8th ed., 1986), pp. 435-455; J.S. Ziegel, Interaction of Personal Property Security Legislation and Security Interests Under the *Bank Act* (1986-87), 12 C.B.L.J. 73, at p. 80; R.C.C. Cuming and R.J. Wood, Compatibility of Federal and Provincial Property Security Law (1986), 65 Can. Bar Rev. 267; R.C.C. Cuming, The Relationship between Personal Property Security Acts and Section 178 of the Bank Act: Federal Paramountcy and Provincial Legislative Policy (1988), 14 C.B.L.J. 315.

[25] *Supra*, footnote 3, at pp. 468 (S.C.R.), 26 (D.L.R.).

[26] See *Armstrong* v. *Coopers & Lybrand Ltd.* (1987), 42 D.L.R. (4th) 189 (Ont. C.A.); *Royal Bank of Canada* v. *Canadian Aero-Marine Industries Inc.* (1989), 67 Alta. L.R. (2d) 172 (Alta. Q.B.); *Re Woodley and Edwards; Woodley (Sabre Logging)* v. *Drew Sawmills Ltd.* (1983), 47 B.C.L.R. 227 (B.C.S.C.).

[27] Apparently based on *Royal Bank of Canada* v. *Workmen's Compensation Board of Nova Scotia*, *supra*, footnote 15. See Crawford and Falconbridge, *op. cit.*, footnote 24, pp. 26-29.

[28] See *Re Birch Hills Credit Union Ltd. and Canadian Imperial Bank of Commerce* (1988), 52 D.L.R. (4th) 113 (Sask. C.A.); *Re Bank of Montreal and Pulsar Ventures Inc.* (1987), 42 D.L.R. (4th) 385, 67 C.B.R. (N.S.) 12; *Royal Bank of Canada* v. *Kreiser* (1986), 34 B.L.R. 73 (Sask. Q.B.).

Supreme Court of Canada

Up until the time that leave to appeal to the Supreme Court of Canada was granted, *Bank of Montreal* v. *Hall* was a private litigation. But, for the final appeal, all the preparations were duly taken to inform the Attorneys-General[29] and to place all the constitutional points squarely in issue.

Accordingly, the issues before the Supreme Court of Canada were:

1. The validity of the Limitation of Civil Rights Act as an exercise of provincial legislative competence over property and civil rights in the Province;

2. The validity of subsection 178(3) of the Bank Act as an exercise of the exclusive federal legislative competence over matters coming within the class of subjects designated banking in the Constitution Act, 1867;

3. The question of whether the two statutes met and conflicted so as to engage the doctrine of federal paramountcy.

The validity of the Limitation of Civil Rights Act turned out to be a non-issue. It was not attacked and La Forest J., in giving the judgment of the court, expressed the view that "questions of paramountcy apart ... such legislation may fairly be said to come within property and civil rights in the province and [is] thus *intra vires* the provincial legislature".[30]

But consideration of the validity of section 178 led the court to consider at length the proper scope of the federal power over banking, both on authority and on principle. Counsel for Hall had argued that although Parliament could define the banks' security interest and authorize them to lend on the security of it, for Parliament to go further and to legislate with respect to the requirements relating to realization and enforcement of such security interests would trench on the provinces' powers relating to property and civil rights. That argument was rejected after full consideration of both precedent and policy.

The court's conclusion, after a thorough review of the authorities and of the history of section 178 lending, was that section 178 security is not a mere appendage or gloss upon the proper scope of the Bank Act. It is deeply rooted in the federal policy of assisting banks to lend and their customers to borrow under the aegis of a single, national security regime at more reasonable rates of interest than would be possible under the complex and diverse regimes in force in the various provinces. La Forest J. stated:[31]

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[29] Seven gave notice of their intention to be heard: Can., B.C., Sask., Man., Ont., Que. and N.B. In the end only Can., N.B. and Sask. made representations, as did the National Farmers' Union.

[30] *Supra*, footnote 1, at pp. 131 (S.C.R.), 368 (D.L.R.).

[31] *Ibid.*, at pp. 146 (S.C.R.), 379 (D.L.R.).

> ... the creation of this security interest was predicated on the pressing need to provide, on a nation-wide basis, for a uniform security mechanism so as to facilitate access to capital by producers of primary resources and manufacturers. Such a security interest, precisely because it freed borrower and lender from the obligation to defer to a variety of provincial lending regimes, facilitated the ability of banks to realize upon their collateral. This, in turn, translated into important benefits for the borrower: lending became less complicated and more affordable.

Having satisfied himself of the fundamental importance of section 178 to Parliamentary policy of ensuring that the banks remain an effective source of credit for Canadian business, the learned judge then proceeded to draw the logical conclusion:[32]

> It follows that ... the provisions [of section 178] by which the bank ... effectively acquires legal title to the secured property ... are integral to and inseparable from the legislative scheme. To sunder from the *Bank Act* the legislative provisions defining realization, and, as a consequence, to purport to oblige the banks to contend with all the idiosyncrasies and variables of the various provincial schemes ... would ... be tantamount to defeating the specific purpose of Parliament in creating the *Bank Act* security interest.

If the enforcement of that policy incidentally curtails the application of some provincial law, well, that was recognized as permissible as early as *Tennant* v. *Union Bank of Canada*. In fact, "the issue [in *Hall*], in the final analysis, is really the same as that addressed ... in *Tennant* v. *Union Bank of Canada* ... and the same result must follow".[33]

If the industry had been looking for reassurance that Parliament's control over traditional banking was not being weakened, the court's return to the principles of *Tennant* v. *Union Bank of Canada*, which had stood for ninety-five years, must have been very reassuring. The apparently threatening observations in *Canadian Pioneer Management* on the narrowing of the scope of the concept of banking are now explained as merely a precautionary rein on any overly enthusiastic federal initiatives to extend Parliament's control over non-banks simply because they perform some banking functions as a part of their provincially-regulated businesses. The bothersome tax lien cases are explained in terms that make it clear that they are not a threat to the federal power:[34]

> There is no logical nexus between the conclusion that a bank is to be treated as an ordinary taxpayer in respect of property to which it holds title by virtue of the operation of a federally defined security interest, and the conclusion that legislation defining that security interest is *ultra vires* to the extent that it interferes with or modifies provincial law.

All the apprehensions of the industry should be dispelled by statements such as:[35]

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[32] *Ibid.*, at pp. 147 (S.C.R.), 380 (D.L.R.).

[33] *Ibid.*

[34] *Ibid.*, at pp. 147-148 (S.C.R.), 380 (D.L.R.).

[35] *Ibid.*, at pp. 150 (S.C.R.), 382-383 (D.L.R.).

> . . . I take it to be beyond dispute that the federal banking power empowers Parliament to create an innovative form of financing and to define, in a comprehensive and exclusive manner, the rights and obligations of borrower and lender pursuant to that interest.

However, the reference by La Forest J. to the exclusivity of federal power in that last quotation raised, of course, the third question as to the potential scope of application of the Limitation of Civil Rights Act which the court's judgment had also previously validated. Were the two legislative schemes capable of co-existing as the Court of Appeal had thought? Was there "actual conflict in operation" as required by *Multiple Access*? Did the federal law say "yes" and the provincial law "no", or did the latter merely say "maybe"?

It is difficult to say precisely what the court decided on this issue. The judgment requires interpretation. It may be that the court decided only that there was a proper foundation for the application of the federal paramountcy rule, and in doing so, provided a helpful new perspective on that test. Alternatively, it may be that the court decided something radically different—that there was no scope for the application of provincial law in the field of security for banks' advances, because the field is completely occupied by the Bank Act, which comprises a complete code of the applicable law on the subject.

The reason that the difficulty of interpretation arises is that La Forest J. appears at first to address the paramountcy issue squarely (although somewhat cursorily) and to dispose of the case in favour of the bank upon that basis. Admittedly, there was no pressing need for a full-scale review of the paramountcy issue. A cursory review of the jurisprudence would have sufficed. The "actual conflict in operation" test, which had found its fullest expression in *Multiple Access* with respect to duplicative federal and provincial measures, had been serving the courts' purposes well in recent years. The Supreme Court itself had applied that test without apparent difficulty in *Deloitte Haskins & Sells Ltd.* v. *Workers' Compensation Board*[36] and *Lamb* v. *Lamb*.[37] Even the same panel of the Saskatchewan Court of Appeal which had decided *Hall* had (in the three-year interval between their judgment and the Supreme Court's decision) "correctly" applied the *Multiple Access* test in a second case[38] that raised a conflict between the Provincial Exemptions Act[39] and the provisions of the Bank Act defining section 178 security. A straightforward application of the same test by the Supreme Court of Canada in *Hall* would not have raised any eyebrows or any new questions.

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[36] [1985] 1 S.C.R. 785, (1985), 19 D.L.R. (4th) 577.

[37] [1985] 1 S.C.R. 851, (1985), 20 D.L.R. (4th) 1.

[38] *Re LeBlanc and Bank of Montreal* (1988), 54 D.L.R. (4th) 89, [1989] 1 W.W.R. 49 (Sask. C.A.).

[39] R.S.S. 1978, c. E-14, s. 2(1), para. 9.

On one reading of the judgment, that is exactly what occurred. La Forest J. returned to *Multiple Access* (noting, but not apparently attaching any significance to the fact that it dealt with duplication of federal and provincial provisions, rather than with conflicting or supplementary ones—a distinction that some commentators had begun to think significant).[40] He then quoted Professor Lederman's view that such duplicative legislation represents the "ultimate in harmony"[41] and the dictum of Dickson J. that in such cases, the application of provincial law "does not displace the legislative purpose of Parliament".[42] La Forest J. describes these principles as reducing the problem of federal paramountcy to the question:[43]

> ... whether there is an "actual conflict in operation" ... in the sense that the legislative purpose of Parliament stands to be displaced in the event that the ... bank is required to defer to the provincial legislation in order to realize on its [s. 178] security.

This appears to be a new perspective on the test of *Multiple Access* v. *McCutcheon* rather than a new test in its own right, because the court proceeds to consider whether there is a conflict in the sense established in that case. An examination of the notification procedure of the Limitation of Civil Rights Act and its provision for judicial review, and a comparison of it with the immediate right of seizure granted by subsection 178(3) of the Bank Act satisfied La Forest J. that there was a conflict in the classic sense:[44]

> There could be no clearer instance of a case where compliance with the federal statute necessarily entails defiance of its provincial counterpart. The necessary corollary ... is that to require the bank to defer to the provincial legislation is to displace the legislative intent of Parliament.

The contrary view of the majority in the Saskatchewan Court of Appeal, to the effect that the Limitation of Civil Rights Act imposed only the possibility of delay for the bank, is expressly disapproved:[45]

> I do not think it is open to a provincial legislature to qualify in this way a right given and defined in a federal statute....

If the judgment had stopped there it would be very clear what the court had decided. Section 178 security would prevail over conflicting or qualifying provisions of provincial law wherever necessary in order to

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[40] See P.W. Hogg, Constitutional Law of Canada (2d ed., 1985), pp. 353-367; E. Colvin, Comment: *Multiple Access Ltd.* v. *McCutcheon* (1983), 17 U.B.C.L. Rev. 347; H.S. Fairley, Developments in Constitutional Law; The 1984-85 Term (1986), 8 S.C.L.R. 53, at pp. 106-108; W.R. Lederman, The Concurrent Operation of Federal and Provincial Laws in Canada (1963), 9 McGill L.J. 185.

[41] *Supra*, footnote 1, at pp. 151 (S.C.R.), 383 (D.L.R.).

[42] *Ibid.*, quoting Dickson J. in *Multiple Access Ltd.* v. *McCutcheon*, *supra*, footnote 20, at pp. 190 (S.C.R.), 23 (D.L.R.).

[43] *Ibid.*, at pp. 151-152 (S.C.R.), 383-384 (D.L.R.).

[44] *Ibid.*, at pp. 153 (S.C.R.), 384 (D.L.R.).

[45] *Ibid.*, at pp. 153 (S.C.R.), 385 (D.L.R.).

avoid frustrating Parliament's purpose. For example, the decision of the Ontario Court of Appeal in *Rogerson*[46] would appear to be vulnerable on such an approach. Would it frustrate Parliament's purpose in creating section 178 security to have it utterly defeated, upon a subtle interpretation of provincial personal property security law, by an unwritten, unregistered security interest in favour of an unpaid vendor of which the bank had no knowledge? Arguably so, especially as subsection 179(1) of the Bank Act contains an express rule that appears to subordinate the claims of unpaid vendors unless the bank took its interest with knowledge of them.[47]

Unfortunately, the court did not stop there. In an even more cursory discussion than that dealing with paramountcy, La Forest J. goes on to add what appears to be a second ground (and possibly even the primary ground) for the court's decision. He states that he has dealt with the case in terms of paramountcy only in order "to meet the arguments put forward by counsel".[48] He thinks that the issue can be answered "more directly":[49]

> ... this is simply a case where Parliament, under its power to regulate banking, has enacted *a complete code* that at once defines and provides for realization of a security interest. There is no room left for the operation of the provincial legislation ... [which is, therefore,] inapplicable to the extent that it trenches on valid federal banking legislation.

That is a troubling passage which, if it expresses the real *ratio decidendi* of the judgment, seems capable of raising many difficult new issues. Is it to be understood as a new test for federal paramountcy? If it is, it will require very careful application if it is to avoid the difficulties of analysis that led to the abandonment of the now discredited "negative implication" theory.[50] According to that theory, first propounded by Cartwright and Locke JJ. in dissent in *O'Grady* v. *Sparling*,[51] a statute might "say not only what kinds or degrees of [conduct] shall be punishable, but also what kinds or degrees shall not". In other words, the federal statute might be paramount even though there is no real "conflict" with provincial law

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[46] *Supra*, footnote 22.

[47] In *Rogerson*, Houlden J.A., *ibid.*, at pp. 682 (D.L.R.), 204 (O.R.), dismissed the issues presented by the reference to unpaid vendors in ss. 179(1) with the summary pronouncement that "[i]n my opinion the word 'vendor' should not be interpreted to include a person who sells goods to a purchaser pursuant to a conditional sales contract". With respect, that opinion is obviously not supported by precedent or any established principle. See the authorities to the contrary in Crawford and Falconbridge, *op. cit.*, footnote 24, pp. 425-426. *Cf.*, also the very different situation in *J.I. Case Credit Corp.* v. *C.I.B.C.* (1985), 60 C.B.R. (N.S.) 235 (Sask. Q.B.) in which the bank quite properly lost because it took its s. 178 security knowing of the prior PPSA registration.

[48] *Supra*, footnote 1, at pp. 155 (S.C.R.), 386 (D.L.R.).

[49] *Ibid.* (Emphasis added).

[50] See Hogg, *op. cit.*, footnote 40, p. 361: "The negative implication test no longer has any place in Canadian constitutional law."

[51] [1960] S.C.R. 804, (1960), 25 D.L.R. (2d) 145.

imposing a more lenient duty. A "complete code" analysis would seem to suggest a similar approach. If there may be degrees of completeness, how "complete" must a federal legislative code be in order to displace valid provincial legislation that does not actually conflict in the *Multiple Access* sense? What are the identifying criteria or characteristics by which such "complete codes" may be recognized? The judgment gives no guidance on this, and without some assistance, the lower courts may be expected to experience considerable difficulty.

Ominously, Sherstobitoff J.A. in the Saskatchewan Court of Appeal professed to find "nothing in the ... [Bank Act] to indicate that Parliament intended to brook no other legislation".[52] In other words, the Bank Act did not appear to him to be a complete code. Nor has it struck the academic writers as such.[53] That is almost invariably the case with federal legislation. Nowhere in the Bank Act does Parliament state that compliance with it shall satisfy any provision in any otherwise applicable provincial law. An exceptional instance of such a statement does occur with respect to registration of security interests against railways in section 90 of the Railway Act.[54] If the second ground of decision offered by La Forest J. in *Hall* is to prevail, we might expect to see more of such provisions in future. Until their advent, however, there would be difficulty in continuing to apply cases such as *Armstrong* v. *Coopers & Lybrand Ltd.*,[55] *Royal Bank of Canada* v. *Canadian-Aero Marine Industries Inc.*[56] and *Re Woodley & Edwards*.[57] All of those judgments depended upon a judicial finding that there is no clear expression of federal intention in the Bank Act that section 178 security interests be given priority over provincially created interests such as liens for wages and the like.[58]

Of course it is true that in technical terms there is a clear distinction between the *validity* of a security interest and the relative *priority* it has against competing interests. It is also true that the *Hall* decision did not address the issue of the relative priority of section 178 security. But section 179 does: "priority over all rights subsequently acquired in, on or in respect

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[52] *Supra*, footnote 12, per Sherstobitoff J.A., at pp. 537 (D.L.R.), 540 (W.W.R.).

[53] See commentaries by Ziegel, *loc. cit.*, footnote 24; Cuming and Wood, *loc. cit.*, footnote 24.

[54] R.S.C. 1985, c. R-3, s. 90. "Any instrument evidencing the lease, sale, conditional sale, mortgage or bailment of rolling stock ... may be deposited in the office of the Registrar General of Canada ... and no instrument so deposited need be otherwise deposited, registered or filed under any [other] law ... and ... is valid against all persons."

[55] *Supra*, footnote 26.

[56] *Ibid.*

[57] *Ibid.*

[58] There would be no such problem with cases such as *Royal Bank of Canada* v. *Erdman* (1985), 61 C.B.R. (N.S.) 257 (Sask. Q.B.), however, since it relied upon a sound economic interest analysis.

of such property, and also over the claim of any unpaid vendor . . .". If sections 178 and 179 are a complete code of the law defining and providing for the realization of banks' security interests under federal law, is it not reasonable to deduce that the priority provisions of those sections of the Bank Act are also a part of that code? Judgments based upon a perception that the Bank Act contains no evident intention by Parliament to give any particular priority to section 178 security would appear to be undermined by the *Hall* decision's recognition of at least some of the Bank Act security provisions as a complete code. There is already some recognition of that in the Alberta Court of Appeal's judgment in *Canadian Imperial Bank of Commerce* v. *Klymchuk*,[59] to which I refer below.[60]

There are other problems with a characterization of the Bank Act's sections 178-179 provisions as a complete code. Would that mean, for example, that the sections should no longer be understood to rest upon the underlying provincial law of contract or concepts of property to give them content and implementation? What would be the relation between security taken pursuant to the federal code and charges taken by other secured creditors (including other banks) in accordance with provincial chattel security law? The problems of beginning again to attempt the rationalization of provincial lien and deemed trust legislation with a federal code of section 178 security would be considerable and daunting. The problems of attempting to conduct all financing by means of section 178 security would be equally daunting. The relations between section 178 and the Personal Property Security Act security require much more subtle and sensitive elaboration than a simple declaration by the court that the former constitute a complete code to which provincial law may not apply at all.

All of the historical and jurisprudential review by La Forest J. supports the view that his "complete code" reference was not intended to create a new test of paramountcy. If the learned judge was satisfied that sections 178 and 179 of the Bank Act constituted a complete code on the topic of the definition of the bank's federal security interest and the conditions of its realization, nothing that preceded his statement of that conclusion appears to justify or even to support it. The impressive feature of the rest of the judgment is how La Forest J. integrates his analysis of the Bank Act in the resolution of the paramountcy issue. There is much more than mere verbal formulation in this; it is an approach that requires the court to identify and protect the federal legislative purposes. La Forest J.'s review in *Hall* demonstrates clearly that section 178 security was designed to fulfil clear policy objectives: the creation of a uniform national security device and realization procedures. It could not fulfil those functions if

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[59] (1990), 70 D.L.R. (4th) 340, [1990] 5 W.W.R. 24 (Alta. C.A.) ("*Klymchuk*").

[60] *Infra*, at footnote 63.

provincial legislation might validly add conditions to those in the Bank Act. "To allow this would be to set at naught the very purpose behind the creation of the section 178 security interest."[61] With respect, I find that reasoning very attractive and a considerable advance on the old tests for federal paramountcy.

How then to interpret the court's "complete code" statement? I prefer to think that the reference was not intended to state a new principle of statutory interpretation. It does not supersede the careful analysis of the paramountcy issue. It appears to be merely another way of expressing the court's recognition of its duty to implement a competent legislative purpose where that is clearly perceived. It protects the federal provisions not only from dysfunctional interference from provincial legislation, but also from other federal legislation. It is significant that the whole Bank Act was not described as a complete code, nor even the whole of sections 178 and 179. The court's statement was much more precise than that: "Parliament ... has enacted a complete code that at once defines and provides for the realization of a security interest".[62] For now, it is decided only that the Bank Act provisions displace conflicting or qualifying provincial law with respect to the definition and realization of the banks' special security.

There is already some evidence that the courts will take a similar approach to the "complete code" discussion in *Hall*. In *Re Canadian Imperial Bank of Commerce and Klymchuk*[63] the Alberta Court of Appeal was required to resolve a priority conflict between the lien created under section 10 of the federal Prairie Grain Advance Payments Act[55] with a bank's security taken under section 178. Belzil J.A. for the court referred to the decision of the Supreme Court in *Hall* on only the paramountcy issue, and concluded that the bank's ownership of property as a result of receiving section 178 security is absolute, except only as Parliament itself may reduce or modify its rights. He did not read the judgment in *Hall* as protecting banks' section 178 security only on topics on which the Bank Act could be properly described as comprising a complete code. This was made very clear by his criticism of the prior decision in *Re Swaan*.[64] On virtually identical facts, Lander L.J.S.C. had given priority to the lien under the federal Prairie Grain Advance Payments Act on the reasoning (not echoing, but preceding similar reasoning in *Armstrong*, *Canadian-Aero* and *Woodley*,[65]) that the lien took priority because the "Bank Act does not

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[61] *Supra*, footnote 1, at pp. 154 (S.C.R.), 386 (D.L.R.).

[62] *Ibid.*, at pp. 155 (S.C.R.), 386 (D.L.R.).

[63] *Supra*, footnote 59.

[64] (1980), 37 C.B.R. (N.S.) 1 (B.C.S.C.). Belzil J.A. did not criticize expressly, but might with equal justification have criticized the *Armstrong*, *Canadian-Aero* and *Woodley* decisions, *supra*, footnote 26.

[65] *Supra*, footnote 26.

expressly or impliedly affect or derogate from the effect of the Prairie Grain Advance Payments Act".[66] The criticism of that view by Belzil J.A. and the Alberta Court of Appeal, post-*Hall*, could not have been more trenchant:[67]

> This was the wrong test ... it is the *Prairie Grain Advance Payments Act* which could not deprive the bank of its pre-existing property rights unless it specifically so provided.

With its judgment in *Hall*, the Supreme Court has forcibly reminded the lower courts and provincial legislatures that the federal competence over matters relating to banking is exclusive. Provincial legislation that would frustrate Parliament's purposes will not be applied to the extent that it conflicts with some core provision of the Bank Act or seeks to qualify its effect. The definition and realization of section 178 security interests are identified as such "core provisions". It remains to determine what other provisions of the Bank Act are as well.

For example, the historical and policy analysis of the Bank Act security provisions by La Forest J. would also appear to support the proposition that registration by a bank of the required Notice of Intention pursuant to subsection 178(4) is both a necessary and sufficient registration for all purposes. It is certainly arguable that banks ought not to be obliged to comply with provincial chattel security registration requirements. But what is the effect of a bank voluntarily registering a Personal Property Security Act financing statement with reference to its section 178 security? On one view, such a registration ought to be a nullity. The Personal Property Security Acts do not apply to "a lien given by statute"[68] which section 178 security may be since its attributes are legislated. But, of course, section 178 requires the signature and delivery of a document in the statutory form. That is a contract and may be capable of taking legal effect in accordance with the appropriate provincial law. On another view, it is a practical certainty that if applied to the parties' transaction, the Personal Property Security Acts—particularly Part V—would conflict with provisions of the Bank Act or at least purport to qualify or modify them in some material way. The *Hall* decision would appear to preclude that. The question then becomes: should the bank's Personal Property Security Act registration be recognized for some purposes where no such conflict arises—for instance, to fix its relative priority as against a competing Personal Property Security Act security interest—but not for others, on which such conflicts would exist? The Ontario Court of Appeal has very recently attempted to answer that question in *Bank of Nova Scotia* v. *International Harvester Credit Corp.*[69] The issues raised by the court's reasoning are far too complex

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[66] *Supra*, footnote 64, at p. 6.

[67] *Supra*, footnote 59, at pp. 347 (D.L.R.), 222 (W.W.R.).

[68] For example, Personal Property Security Act, 1989, S.O. 1989, c. 16, s. 4(1)(a).

[69] (1990), 74 O.R. (2d) 748 (Ont. C.A.).

and technical to discuss here. The result of the decision was a holding that a bank could not, by making a Personal Property Security Act registration, improve upon the priority it would have had if it had relied only upon the Bank Act security provisions in accordance with which it took security from its customer. That is fair enough, but with the greatest respect to the court, some of the propositions relied upon to reach that result raise many more problems than they resolve. One such problem is whether—in the light of the *Hall* decision—the court was correct to recognize the bank's rights under its section 178 security as a "security interest" within the scope of the Personal Property Security Act in the first place.

It is plain that the task of reconciling section 178 security with Personal Property Security Act security interests and all the other competing interests in an increasingly complex area of law will not be promptly accomplished by traditional common law methods. Bank Act security was designed for simpler times and primary or extractive industries where competing interests were few. Virtually every court and scholar to investigate the issues in the past decade has commented on the need for federal-provincial cooperation and legislative reform to reconcile the Bank Act and the Personal Property Security Acts. I agree. The *Hall* decision does not change any of that, but its reaffirmation of some fundamental principles will be of great assistance to the banks when the negotiations begin.

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TORTS AND CONTRACT—DUTY OF CARE—PRIVITY OF CONTRACT—WHETHER TERMS IN CONTRACT WITH EMPLOYER AFFECT EMPLOYEE'S LIABILITY IN NEGLIGENCE: *London Drugs Ltd.* v. *Kuehne & Nagel International Ltd.*

Joost Blom*

Introduction

The British Columbia Court of Appeal's decision in *London Drugs Ltd.* v. *Kuehne & Nagel International Ltd.*[1] is one of the most thoughtfully innovative cases on private law to come along in Canada for a good while. Its conclusions, if accepted by the Supreme Court of Canada, will have a pivotal effect on the law of negligence as it operates in relation to a transaction governed by contract.

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[1] (1990), 70 D.L.R. (4th) 51, 45 B.C.L.R. (2d) 1 (B.C.C.A.), leave to appeal granted, December 7, 1990 (S.C.C.).

Dennis Brassart and Hank Vanwinkel were employed at a warehouse operated by Kuehne & Nagel International Ltd. On September 22, 1981 they were told to load a transformer weighing 7,500 pounds onto a truck that would take it to new premises being built by London Drugs, the unit's owner. Each end of the transformer's shipping crate was marked, "lift by cables supplied". To anyone who looked at the top of the transformer it was obvious that this referred to a loop of steel cable at each end. There were also warning cards on the crate that directed lifting by cables and prohibited the use of a forklift. Brassart and Vanwinkel did not follow these instructions. They lifted the crate with two forklifts so that the truck would be able to back up between them. The transformer toppled over and fell. It cost London Drugs $33,955.41 to repair.

London Drugs had stored the transformer, as well as other property, under a contract it made with Kuehne & Nagel in 1980. During the negotiations for this contract the representative for Kuehne & Nagel made what McEachern C.J.B.C. called a "brutally frank disclosure ... about the difficulties of establishing liability against a warehouseman", and he emphasized that Kuehne & Nagel's liability would be limited to $40 a pallet.[2] A written note included with Kuehne & Nagel's quote stated that if additional coverage was desired, "all risks" coverage could be purchased at $0.0685 per $100 valuation per month. London Drugs did not include any valuation in its documents for the contract, and its representative explained at trial that London Drugs had obtained all-risk coverage itself. So under the contract the damage to the transformer was not recoverable from Kuehne & Nagel, except to the extent of $40. London Drugs would have to look to its own all-risk insurance, subject to whatever deductible that policy provided for.

London Drugs (presumably meaning in reality its insurer) brought an action against Kuehne & Nagel (presumably meaning in reality Kuehne & Nagel's liability insurer) in tort as well as in contract, hoping the tort claim would provide a way around the contractual limitation clause.[3] The trial judge found the employees had been negligent but he held that the clause was effective to limit Kuehne & Nagel's liability to $40, regardless of whether the claim was in contract or tort.[4] This part of his decision was not appealed.

London Drugs also brought actions in negligence against Brassart and Vanwinkel (hereafter "the defendants"). The reports of the case do not say whether they were insured under Kuehne & Nagel's policy, but it seems reasonable to assume that they were.[5] So the claim against them

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[2] *Ibid.*, at pp. 55 (D.L.R.), 8 (B.C.L.R.).

[3] *Ibid.*, at pp. 112 (D.L.R.), 68 (B.C.L.R.), per Wallace J.A.

[4] [1986] 4 W.W.R. 183, 2 B.C.L.R. (2d) 181 (B.C.S.C.).

[5] Liability insurance policies often do not insure employees of a named insured unless the policy is endorsed to this effect, but such an endorsement is to be expected. I understand

individually was probably meant to give access to this insurance by circumventing the $40 limitation clause in the warehouse contract. On orthodox principles the claim against the two men to recover the whole cost of the repairs was compelling. Since Brassart and Vanwinkel were not parties to the warehousing contract they could not avail themselves of the $40 limitation.[6] On the other hand, they owed a duty of care towards London Drugs under *Donoghue* v. *Stevenson*.[7] The owner of the goods they were handling was someone whom they should have had in contemplation as liable to suffer loss if they failed to take reasonable care. As recently as 1980, in *Greenwood Shopping Plaza Ltd.* v. *Beattie*,[8] the Supreme Court of Canada had upheld the right of a landlord to recover from two employees of a tenant, for the damage caused by a fire that they had negligently started in the leased premises. So far as these men were concerned, it was no defence that by the terms of the lease the landlord had covenanted to insure against fire and so, as between it and the tenant, to bear the full risk of the loss.

At trial, Trainor J. considered two main arguments for the defendants. One was that they were under no duty of care at all in respect of London Drugs' goods because their negligence was in the very course of performing a contract between their employer and London Drugs. Trainor J. held that there was no general rule that exempted them from a duty of care in these circumstances. The cases cited in favour of such a rule were either obsolete[9] or distinguishable.[10] The rule was also inconsistent with the position the Supreme Court of Canada had taken in the *Greenwood* case.[11]

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from one of counsel for the defendants that a judgment against the individual defendants would indeed be within the scope of Kuehne & Nagel's insurance.

[6] Unless the defendants could claim that Kuehne & Nagel had obtained the limitation clause for their benefit as their agent, it would not matter whether the clause expressly referred to the defendants' personal liability. In any case it apparently did not; so far as it is quoted in the report, the clause referred only to "the warehouseman's liability".

[7] [1932] A.C. 562 (H.L. (Sc.)).

[8] [1980] 2 S.C.R. 228, (1980), 111 D.L.R. (3d) 257.

[9] *Elder, Dempster & Co. Ltd.* v. *Paterson, Zochonis & Co. Ltd.*, [1924] A.C. 522 (H.L.), as interpreted by Scrutton L.J. in *Mersey Shipping & Transport Co.* v. *Rea Ltd.* (1925), 21 Ll. L.R. 375, at p. 378 (C.A.), was disapproved in *Scruttons Ltd.* v. *Midland Silicones Ltd.*, [1962] A.C. 446, at pp. 470-471, [1962] 1 All E.R. 1, at pp. 8-9 (H.L.), per Viscount Simonds L.C.

[10] *J. Nunes Diamonds Ltd.* v. *Dominion Electric Protection Co.*, [1972] S.C.R. 769, (1972), 26 D.L.R. (3d) 699, and *Sealand of the Pacific Ltd.* v. *Robert C. McHaffie Ltd.* (1974), 51 D.L.R. (3d) 702, [1974] 6 W.W.R. 724 (B.C.C.A.), held that the defendants in those cases were not liable in tort for negligent statements they had made in the context of an existing contractual relationship. The decisions turned on the lack of a factual basis for finding the "special relationship" on which liability in negligent misstatement depends: Trainor J., *supra*, footnote 4, at pp. 189-191 (W.W.R.), 186-189 (B.C.L.R.).

[11] *Supra*, footnote 8. Trainor J. also relied on *Canadian General Electric Co.* v. *Pickford & Black Ltd.*, [1971] S.C.R. 41, (1970), 14 D.L.R. (3d) 372, which held stevedores liable for damaging cargo, notwithstanding an exemption clause in the contract between the

The alternative argument was that if the defendants were under a duty of care their liability should be limited to $40, on the ground that London Drugs had impliedly consented to extend this limitation of liability to the employees. To permit an action against the defendants for the whole loss would circumvent the risk London Drugs accepted. To this the judge simply answered that the facts did not support it:[12]

> As inviting as this submission would seem to be [as it is] based on reason and good sense in the particular circumstances of a commercial relationship, yet to give effect to it would be to rewrite the contract. That course is not open to me.

The Court of Appeal, sitting unusually as a panel of five, reversed Trainor J.'s decision by a majority of four to one. McEachern C.J.B.C. and Wallace J.A., for separate reasons, held that the defendants were under a tort duty of care towards London Drugs, but that their liability for breach of this duty was limited to $40. Hinkson J.A. thought that since London Drugs had agreed with their employer, Kuehne & Nagel, to bear virtually the whole risk of loss itself, the defendants owed no duty of care to London Drugs at all. The fourth judge in the majority, Lambert J.A., also decided that the defendants' liability was limited to $40 but he did so on contractual rather than tortious grounds. On his view London Drugs had impliedly made a contract with the defendants, through Kuehne & Nagel as their agent, that the defendants' liability would be no greater than Kuehne & Nagel's own. The dissenting judge, Southin J.A., thought that neither the tortious nor the contractual line of reasoning of the majority could be squared with authority or with the facts.

Contract—Lambert J.A.

It may be useful to start with Lambert J.A., as he was the only judge to analyze the defendants' relationship with the plaintiff as contractual. His reasoning was that the warehousing contract included, by necessary implication, a clause similar in effect to a Himalaya clause.[13] This is a clause by which a carrier obtains the shipper's agreement to limit or exclude not only the carrier's own liability for damage to the cargo, but also the liability of any servant or independent contractor that the carrier employs to load, carry or discharge the goods. The key is that the carrier must be stipulating for this contractual benefit as agent for the other parties who are to enjoy it. The Privy Council in *New Zealand Shipping Co.*

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owner and the carrier. Another Supreme Court case, not referred to Trainor J. or the Court of Appeal, was *Cominco Ltd.* v. *Bilton*, [1971] S.C.R. 413, (1970), 15 D.L.R. (3d) 60, which held that the master of a tug owed a duty of care not to damage the barge he was towing. It was immaterial that he was only carrying out a contract that his employer had with the barge owner.

[12] *Supra*, footnote 4, at pp. 192 (W.W.R.), 189 (B.C.L.R.).

[13] Named after the ship in *Adler* v. *Dickson*, [1955] 1 Q.B. 158, [1954] 3 All E.R. 397 (C.A.) (where actually the clause was inapt to protect the company's employees).

v. *A.M. Satterthwaite & Co. Ltd.*,[14] which was followed by the Supreme Court of Canada in *ITO-International Terminal Operators Ltd.* v. *Miida Electronics Inc.*,[15] held that the shipper, by agreeing to the Himalaya clause, offers the protection of the clause to stevedores and others who perform part of the contract of carriage, and that these parties accept the offer and provide consideration to the shipper by their act of performance. The shipper is thus bound by a separate contract not to sue the stevedore for more than the clause allows.

The trouble with applying this analysis to the *London Drugs* case was that the warehousing contract had no terms to support a construction that Kuehne & Nagel was acting not only for itself but also as agent for its employees in securing the $40 limitation on liability.[16] Lambert J.A. overcame this by finding that such an intention had necessarily to be implied in order to avoid a "commercial absurdity".[17] The absurdity was that if Brassart and Vanwinkel could be liable to London Drugs for the whole damage, Kuehne & Nagel could be liable under the British Columbia contributory negligence statute[18] to contribute to the damages. This would be so if the company's own fault, together with the negligence of its men, caused the loss. Its vicarious liability might well be "fault" for this purpose,[19] but even if that were not so there could be independent

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[14] [1975] A.C. 154, [1974] 1 All E.R. 1015 (P.C.). See also *Port Jackson Stevedoring Pty. Ltd.* v. *Salmond & Spraggon (Aust.) Pty. Ltd.*, [1981] 1 W.L.R. 138, [1980] 3 All E.R. 257 (P.C.).

[15] [1986] 1 S.C.R. 752, (1986), 28 D.L.R. (4th) 641.

[16] *Supra*, footnote 6. McEachern C.J.B.C. and Wallace J.A. expressly disagreed with Lambert J.A. on the ground that neither the evidence nor the terms of the contract showed the clear commercial intention on which *New Zealand Shipping* and *ITO* were based: *supra*, footnote 1, at pp. 64-65, 124 (D.L.R.), 19, 81 (B.C.L.R.).

[17] *Ibid.*, at pp. 108 (D.L.R.), 64 (B.C.L.R.).

[18] Negligence Act, R.S.B.C. 1979, c. 298, s. 4.

[19] Lambert J.A. cited *Flamant* v. *Knelson* (1971), 21 D.L.R. (3d) 357, [1971] 4 W.W.R. 454 (B.C.S.C.), and *Uhryn* v. *B.C. Telephone Co.* (1973), 42 D.L.R. (3d) 308, [1973] 5 W.W.R. 758 (B.C.S.C.), to support the view that an employer's vicarious liability made it equally at "fault" with its employees for the purposes of the Negligence Act, and that the employees could thus claim contribution from the employer for half the damages. Those cases, however, dealt with quite a different issue. They decided that what is now s. 1, which deals with the apportionment of damages where the plaintiff and the defendant were both at "fault", also defines the liability of a party that is vicariously liable for the defendant's fault. They did not say that that party was itself at "fault", only that the defendant's "fault" should be attributed to it for the purposes of that section. Lambert J.A. also relied on the view of two judges in *Lister* v. *Romford Ice & Cold Storage Co.*, [1957] A.C. 555 (H.L.). Those judges were dealing, not with an employee's right to contribution from the employer, but with the employer's right to contribution from the negligent employee; and they thought the employer had a right to contribution for 100% of its liability: at pp. 579-580, per Viscount Simonds, 584-585, per Lord Morton. Wallace J.A. expressly disagreed with Lambert J.A.'s view that an employer whose liability was only vicarious might be made to contribute to a negligent employee's damages: *supra*, footnote 1, at pp. 122 (D.L.R.), 79 (B.C.L.R.).

fault, as by Kuehne & Nagel's negligent selection or supervision of the employees.[20] If Kuehne & Nagel could possibly be liable for contribution of substantial damages, it would contradict the plain intent fo the $40 limitation clause. The only way of avoiding such an absurdity was to imply a promise by London Drugs that the employees were to have the benefit of the $40 limitation as well.[21] It was true that in the *Greenwood* case[22] the Supreme Court of Canada had refused to find an implied contractual protection for the employees; but Lambert J.A. distinguished *Greenwood* on two grounds. The impact of a right of contribution had not been raised there; and the Supreme Court had expressly refrained from considering an implied contractual link between the plaintiff and the employees because, having no transcript of the trial, it felt that it lacked the evidentiary basis for doing so.[23]

The reasoning of Lambert J.A. is attractive because it avoids (as he emphatically pointed out) doing unorthodox things to the concept of a duty of care in tort. But it has a particularly weak link in the assumption that Brassart and Vanwinkel, if successfully sued by London Drugs, could claim contribution from Kuehne & Nagel, which would strip the latter of the protection of the limitation clause. If the plaintiff suffers harm due to the fault of two parties, D1 and D2, and D2 has a contract with the plaintiff under which its liability is excluded, can D1, if successfully sued, claim contribution from D2, who could not be sued directly? The Supreme Court of Canada clearly said no to this question in *Giffels Associates Ltd.* v. *Eastern Construction Co.*[24] Lambert J.A. distinguished that case because, even if it applied to the British Columbia statute,[25] it only applied if D2 had a complete defence, whereas here Kuehne & Nagel was liable to London Drugs for $40.[26]

This seems a doubtful distinction. It would be anomalous in the extreme if somebody with a complete defence against a plaintiff's $33,000 claim were immune from contribution, whereas somebody with a defence against $32,960 of that claim were fully liable to contribution. The point is, as Laskin C.J.C. said in *Giffels*:[27]

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[20] Lambert J.A. noted that there was no suggestion in this action that Kuehne & Nagel was directly at fault in relation to the damage to the transformer, but such an allegation could still be raised if Brassart and Vanwinkel brought a separate action against Kuehne & Nagel; *supra*, footnote 1, at pp. 102 (D.L.R.), 58 (B.C.L.R.).

[21] Lambert J.A. also thought that a term to the same effect should be implied into the defendants' contracts of employment with Kuehne & Nagel, though it was not necessary to do so in order to reach the result: *ibid.*, at pp. 108-109 (D.L.R.), 65 (B.C.L.R.).

[22] *Supra*, footnote 8.

[23] *Supra*, footnote 1, at pp. 106 (D.L.R.), 62-63 (B.C.L.R.).

[24] [1978] 2 S.C.R. 1346, (1978), 84 D.L.R. (3d) 344.

[25] The difference in wording between s. 1 of the B.C. Negligence Act and s. 2(1) of the Negligence Act, R.S.O. 1970, c. 296, considered in *Giffels*, is slight.

[26] *Supra*, footnote 1, at pp. 102 (D.L.R.), 58 (B.C.L.R.).

[27] *Supra*, footnote 24, at pp. 1355 (S.C.R.), 350 (D.L.R.).

> It is ... open to any contractor (unless precluded by law) to protect itself from liability under its contract by a term thereof, and it does not then lie in the mouth of the other to claim contribution in such a case. The contractor which has so protected itself cannot be said to have contributed to any actionable loss by the plaintiff.

By logical extension, if D2 has protected itself so that it is only liable for $40, it cannot be said to have contributed to any actionable loss by the plaintiff above that amount. D1 has a right to contribution of $40, but no more. Such a result would surely be fairer to D2, as well as more logical, than the position as described by Lambert J.A. In a recent report the Ontario Law Reform Commission said this was the current law.[28]

If this is right the employees' liability does not affect the $40 limit on Kuehne & Nagel's exposure. Lambert J.A.'s "absurd result" disappears, and with it the argument that a Himalaya clause had to be implied. It could still be said that such a clause would make excellent sense, as it would avoid placing the employees in an unfairly exposed position as compared with the employer; but this is not enough for the officious bystander to say that the parties must of course have intended it.[29] Implying it might be a very good thing to do, but it would go beyond the interpretation of a contract. It would really be imputing new contractual rights in a very large class of cases, with a view to cancelling in part the doctrine of privity.[30]

Tort—McEachern C.J.B.C., Wallace and Hinkson JJ.A.

Without a doubt, the tort analyses that were used by the other three majority judges were judicial legislation too, but of a less drastic kind, at least in appearance. Those judges drew new limits for already recognized rights, which somehow looks less radical than to set up brand-new rights. In addition—as the law of negligence keeps on demonstrating—judicial legislation is often easier to achieve in tort. Doctrines in tort, as a rule, are more openly expressive of judicial policy than those in contract, and so they are more amenable to being modified in the name of policy.

The three judges who held for the defendants on tort grounds each analyzed the problem in a significantly different way. Hinkson J.A. found the key in the notion of "proximity" or "neighbourhood" as the foundation of a duty of care. As a series of recent English cases emphasized, this was not simply based on physical proximity. "Rather, it is a legal concept

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[28] Report on Contribution Among Wrongdoers and Contributory Negligence (1988), p. 130.

[29] See Lambert J.A.'s review of the criteria for implying contractual terms, *supra*, footnote 1, at pp. 107 (D.L.R.), 63-64 (B.C.L.R.).

[30] If a Himalaya clause were implied in favour of Kuehne & Nagel's employees in the present case, it would have to be implied in every case where the party that stipulates for an exemption or limitation clause has employees who might also be sued. There were no special facts to take this case out of the general class of such cases.

which takes into consideration all of the circumstances in a particular case."[31] Several cases in commercial settings had stressed the relationship of proximity.[32] Here London Drugs had decided that it would not declare a value of more than $40 for a $40,000 transformer, and would cover the risk by its own insurance. Hinkson J.A. summed up his conclusion this way:[33]

> In the present case, the circumstances do not disclose that there was such a close and direct relationship of proximity between the owner and the employees as to give rise to a duty of care by the employees to the owner. The owner was not relying on the warehouseman and its employees not to damage the transformer. Rather, it accepted the risk of that occurring and took steps to protect itself through its own policy of insurance. When the situation of the employees is viewed against the contractual background existing between the owner and the warehouseman, in my opinion, it shows that the necessary requirement of proximity did not exist. It would be otherwise if the owner had not agreed to bear the risk itself. Further, in those circumstances it would not be just and reasonable to hold that the employees owed a duty of care to the owner.

On this analysis the result was that Brassart and Vanwinkel were not liable at all.

Like Hinkson J.A., Wallace J.A. drew on the recent English case law that explored the complexity of the tort concept of a duty of care. He saw two general approaches in those cases:[34]

> ... (a) the approach delineated by *Anns*[35] that, having found there to be a prima facie duty of care based on proximity and foreseeability, one then considers all the surrounding circumstances concerning the nature of the relationship to ascertain if

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[31] *Supra*, footnote 1, at pp. 80 (D.L.R.), 36 (B.C.L.R.). Hinkson J.A. referred particularly to Lord Keith's "just and reasonable" gloss in *Governors of the Peabody Donation Fund* v. *Sir Lindsay Parkinson & Co. Ltd.*, [1985] A.C. 210, at pp. 240-241, [1984] 3 All E.R. 529, at p. 534 (H.L.); and to the same judge's statement in *Yuen Kun Yeu* v. *A.-G. Hong Kong*, [1988] A.C. 175, at p. 192, [1987] 2 All E.R. 705, at p. 711 (P.C.), that "all the circumstances of the case, not only the foreseeability of harm, [are] appropriate to be taken into account in determining whether a duty of care [arises]." A Canadian case that also emphasized how wide a range of factors had to be taken into account in finding "proximity" or "neighbourhood", is *B.D.C. Ltd.* v. *Hofstrand Farms Ltd.*, [1986] 1 S.C.R. 228, (1986), 26 D.L.R. (4th) 1, quoted by McEachern C.J.B.C., *supra*, footnote 1, at pp. 69-70 (D.L.R.), 24 (B.C.L.R.).

[32] These cases involved tort claims between parties who were not in privity of contract but who were both engaged in the same construction works: *Junior Books Ltd.* v. *Veitchi Co.*, [1983] 1 A.C. 520, [1982] 3 All E.R. 201 (H.L. (Sc.)); *Norwich City Council* v. *Harvey*, [1989] 1 W.L.R. 828, [1989] 1 All E.R. 1180 (C.A.); *Pacific Associates Inc.* v. *Baxter*, [1990] 1 Q.B. 993, [1989] 2 All E.R. 159 (C.A.). The cases dealt in opposite ways with the significance, for a finding of reliance, that the contractual arrangements for the project gave the plaintiff no direct recourse against the defendant. *Junior Books* did not see it as inconsistent with a finding of reliance, whereas the other two saw it as flatly contradicting such a finding.

[33] *Supra*, footnote 1, at pp. 80-81 (D.L.R.), 36 (B.C.L.R.).

[34] *Ibid.*, at pp. 120-121 (D.L.R.), 77 (B.C.L.R.).

[35] *Anns* v. *Merton London Borough Council*, [1978] A.C. 728, [1977] 2 All E.R. 492 (H.L.).

> that prima facie duty is negated or qualified in its scope or effect, or (b) the approach followed in *Pacific Associates* v. *Baxter*[36] and in *Norwich City Council*[37] of considering three essential criteria to the existence of a duty of care in tort in any particular circumstances; namely, proximity, reliance, and whether it is "just and reasonable" to impose such a duty. In my view, it does not make any essential difference which approach is adopted. In either case, the end result is the same, namely, 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.

He did not doubt the existence of the duty of care here, but he held that it was "just and reasonable" that its "scope and consequences" should be qualified by the provisions in the warehousing contract.[38] It was appropriate "that not only are the common law obligations of such a third party construed in the light of the contractual arrangements, but also that appropriate qualifications to such duties are determined in a like manner".[39] This was because of the expectations that the parties would base on those arrangements. They would not infer that London Drugs intended to retain a right to claim against individual employees for the full amount of any loss:[40]

> Furthermore from the point of view of the employees in such an arrangement, they could be expected to appreciate that they would have to indemnify their employer for any damage they negligently caused to goods stored in the warehouse only to the extent to which their employer suffered a loss (in this instance $40 per pallet): *Romford Ice & Cold Storage Co.* v. *Lister*.[41]. . . . The employees would not anticipate, however, that they would be required to indemnify a third party for a loss far in excess of that sustained by their employer.

To the objection that his analysis would mean that employees' duties were "controlled by a variable contractual matrix such that they would never know the duties to which they are subject",[42] Wallace J.A. replied both in principle and on the facts:[43]

> In principle . . . [the question is] not what the tort feasor did know, but what a thoughtful person in his shoes would have known. On the facts of this case, an informed employee would have been aware of the $40 per pallet limitation; all the warehouse receipts issued by Kuehne included the same limitation. Moreover, the evidence shows that similar limitations of liability are of general use in the warehousing industry as a whole. . . . It was a standard condition that forms a constant backdrop for the allocation of duties in the warehousing industry.

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[36] *Supra*, footnote 32.

[37] *Ibid.*

[38] *Supra*, footnote 1, at pp. 122 (D.L.R.), 78 (B.C.L.R.).

[39] *Ibid.*, at pp. 124-125 (D.L.R.), 81 (B.C.L.R.).

[40] *Ibid.*, at pp. 122 (D.L.R.), 79 (B.C.L.R.).

[41] *Supra*, footnote 19.

[42] *Ibid.*, at pp. 123 (D.L.R.), 80 (B.C.L.R.).

[43] *Ibid.*, at pp. 123-124 (D.L.R.), 80 (B.C.L.R.).

Although he reasoned broadly along the same lines as Wallace J.A., McEachern C.J.B.C. kept the recent English cases more at arm's length. He pointed out that the "just and reasonable" gloss on the *Donoghue* v. *Stevenson* principle had not been accepted by the Supreme Court of Canada.[44] The Canadian courts, he said, should try to develop their own jurisprudence.[45] For the present purpose he found the necessary authority in the second part of Lord Wilberforce's two-stage test in *Anns* v. *Merton London Borough Council*[46] for approaching the question of a duty of care. As paraphrased by Wilson J. in *City of Kamloops* v. *Nielsen*[47] the formula was:

> (1) is there a sufficiently close relationship between the parties (the local authority and the person who suffered the damage) so that, in the reasonable contemplation of the authority, carelessness on its part might cause damage to that person? If so,
>
> (2) are there any considerations which ought to negative or limit (a) the scope of the duty and (b) the class of persons to whom it is owed, or (c) *the damages to which a breach of it may give rise*?

He disagreed with Hinkson J.A.'s view that London Drugs had not relied on Brassart and Vanwinkel at all. The fact that it took out its own insurance did not alter the fact that it would have preferred not to have the transformer damaged, and it probably suffered a deductible as well.[48] The clause in the warehousing contract therefore did not negative the existence of a duty of care on the employees. It did, however, modify the consequences of a breach of that duty. McEachern C.J.B.C. put the issue in tort as follows:[49]

> "What is the relationship between the parties as regards the transformer?" To properly answer that question the contract must be considered since it defines what the plaintiff wanted done to the transformer, how it expected it to be managed, and what the plaintiff expected in the event of a breach. Thus the contract is relevant in determining tort rights and duties.
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> The importance of contract in tort analysis is not a new phenomenon. In *Junior Books*,[50] for example, the benefit of the contract between the main contractor and the subcontractor was conferred on the owner in tort. Contract can today result

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[44] *Ibid.*, at pp. 70 (D.L.R.), 24 (B.C.L.R.). Lambert J.A. made the same point, at pp. 92-93, 94 (D.L.R.), 48, 50 (B.C.L.R.).

[45] *Ibid.*, at pp. 69 (D.L.R.), 24 (B.C.L.R.).

[46] *Supra*, footnote 35, at pp. 751-752 (A.C.), 498 (All E.R.).

[47] [1984] 2 S.C.R. 2, at pp. 10-11, (1984), 10 D.L.R. (4th) 641, at pp. 662-663, quoted, and italics supplied by McEachern C.J.B.C., *supra*, footnote 1, at pp. 70-71 (D.L.R.), 25 (B.C.L.R.).

[48] *Ibid.*, at pp. 72 (D.L.R.), 26-27 (B.C.L.R.). In support of the existence of reliance on the employees, McEachern C.J.B.C. also referred to the fact that s. 2(4) of the Warehouse Receipt Act, R.S.B.C. 1979, c. 428, prohibits terms or conditions that impair the warehouseman's duty of reasonable care and diligence. See also Lambert J.A., *ibid.*, at pp. 85-88 (D.L.R.), 41-44 (B.C.L.R.).

[49] *Ibid.*, at pp. 71 (D.L.R.), 26 (B.C.L.R.).

[50] *Supra*, footnote 32.

> in the creation of tort law duties towards some parties by inference. Why should contract not on the same reasoning limit tort law duties of a non-party to the contract which relates directly to the subject matter of both the tort and the contract?

Like Wallace J.A., he regarded the expectations based on the contract as a critical factor. He described as "essentially unreasonable" the idea that London Drugs relied on Kuehne & Nagel's contractual obligation with respect to the first $40 of any damage, but relied on the employees without limitation. The evidence did not support such a differentiation, nor would that kind of reliance be foreseeable to a person in the position of the employees.[51] He concluded:[52]

> To put it differently, I think the interaction of contract and tort in this legal and factual setting created an amalgam or matrix of obligations and remedies forming the law of this transaction in which the parties allocated the risk of damage to the transformer in accordance with their expectations based on sound economic considerations. In the words of Wilson J. these are "considerations which ought to ... limit the damages to which a breach of [duty] may give rise".
>
> It is reasonable, in my view, that the plaintiff's remedy for the breach by the employees of their tort duties should not be greater than that which the plaintiff agreed would be imposed upon their employer.

The main difference between the approaches taken by McEachern C.J.B.C. and Wallace J.A. is in the stress they laid on the employees' actual or imputed knowledge of the limitation of liability in the warehousing contract. Wallace J.A. treated it as an important reason why the employees' duty of care towards London Drugs should be qualified. Aside from a passing reference to the employees' expectations,[53] McEachern C.J.B.C. focused on London Drugs and Kuehne & Nagel having "established, with statutory assistance, their own law for this transaction".[54] He seemed to view the owner's expectations as the key. London Drugs had accepted an allocation of risk that could only be given its proper effect by holding that it applied to the employees' liability as well as the employer's. Wallace J.A. saw the question, at least in part, as one of defining the employees' exposure to liability according to the expectations that they themselves could reasonably have had.[55]

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[51] *Supra*, footnote 1, at pp. 72 (D.L.R.), 27 (B.C.L.R.).

[52] *Ibid.*, at pp. 73 (D.L.R.), 27 (B.C.L.R.).

[53] *Supra*, footnote 51 and accompanying text.

[54] *Supra*, footnote 1, at pp. 71 (D.L.R.), 26 (B.C.L.R.). The statute referred to is the Warehouse Receipt Act, *supra*, footnote 48.

[55] "[I]t is patently 'just and reasonable' that parties, who have agreed ... to certain qualified rights and duties, should not have the risks to which they are exposed as a consequence of the relationship created by the contract extended to cover common law obligations of a greater scope than *that which they accepted by agreement.*" *Supra*, footnote 1, at pp. 122 (D.L.R.), 78 (B.C.L.R.) (emphasis added).

The Dissent—Southin J.A.

In her dissenting judgment Southin J.A. did more than invoke the doctrine of privity. She rejected any possibility of modifying the duty of care in tort because, she said, duty of care was a negligence concept whereas the present action could have been pleaded in trespass, being for damage to a bailor's goods caused by the direct act of another. Trespass included negligent acts of commission as well as intentional ones.[56] A servant was liable in trespass as the one who did the act; the master was properly sued in case.[57] Trespass knew no limitation on the servant's liability such as those being put forward in the present action.

Analysis

Two questions have to be asked about the Court of Appeal's decision. First, is the result a just one? It is submitted that there is no doubt whatever on this score. The most succinct statement of the position was actually given by Southin J.A., who said that although she felt found to hold for the plaintiff, the result was morally unjust:[58]

> In so saying, I am not unmindful that one man's notion of justice is another man's notion of injustice. It is plain that this plaintiff declined to declare the goods at greater value than $40 because it insured the goods itself. I do not suppose for a moment that its officers thought, "If our goods are damaged, our insurer will recover the money from the servant of the bailee who damages our goods." What they thought was, "We have insured the goods ourselves and therefore need not spend the money on paying a further premium." As for the plaintiff's insurers I should be very much surprised if when they fixed their rates, they took into account the possibility that if they had to pay the plaintiff, they could recover the loss from the servants of a bailee.
>
> These servants are simply ordinary workmen doing their job. It may be that their employer's insurer is the true defendant but, in many cases, a bailee will have no insurance upon which his servants have a right to claim.

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[56] Canadian law still seems to recognize a substantive distinction, at least for some purposes, between unintentional injuries that could formerly have been pleaded in trespass and those that could only have been pleaded in case (negligence): *Cook* v. *Lewis*, [1951] S.C.R. 830, [1952] 1 D.L.R. 1; *Bell Canada* v. *Bannermount Ltd.* (1973), 35 D.L.R. (3d) 367, [1973] 2 O.R. 811 (Ont. C.A.). In England, unintentional injury is now only actionable if it meets all the requirements of negligence: see *Letang* v. *Cooper*, [1965] 1 Q.B. 232, [1964] 2 All E.R. 929 (C.A.); *Fowler* v. *Lanning*, [1959] 1 Q.B. 426, [1959] 1 All E.R. 290 (Q.B.D.); J.G. Fleming, The Law of Torts (7th ed., 1987), pp. 19-20. Southin J.A. cited (*supra*, footnote 1, at pp. 131 (D.L.R.), 88-89 (B.C.L.R.)) the first edition of Halsbury's Laws of England, vol. 27 (1913), pp. 844-845. Compare the fourth edition, vol. 45 (1985), pp. 635 (para. 1393), 700 (para. 1492). Even if Southin J.A.'s analysis is correct as a matter of history, there is surely too much clanking of mediaeval chains in the result. It would mean that the employees' position might differ depending on whether they ruined the transformer by dropping it (trespass) or leaving it out in the rain (case).

[57] *Supra*, footnote 1, at pp. 132 (D.L.R.), 89 (B.C.L.R.).

[58] *Ibid.*, at pp. 135 (D.L.R.), 93 (B.C.L.R.).

The employer has all the advantages when it comes to dealing with potential liability for a customer's loss. The employer is the one who decides how much to charge the customer for the service, who makes money from providing it, who can negotiate with the customer about limitations on liability, and who can insure in respect of liability. Employees have no say in setting the price for the service, are not paid by the customer, are in no position to negotiate with the customer about their own liability, and are very unlikely (or, as a practical matter, may even be unable) to insure against their personal liability if the employer does not do it for them. Under those circumstances it is manifestly unfair to hold the employer protected from, but the employee exposed to, liability at the suit of a customer who has freely agreed not to claim damages for the loss that occurred.

The second question is whether the majority were right in finding that the common law enabled them to reach the just result. I have already suggested that Lambert J.A.'s contractual analysis is probably fatally undermined if one does not accept his view that the employees' right to contribution from their employer would operate so as to create an absurdity. The different approaches taken by the other three majority judges, all of which hinge on the tort duty of care, each have their vulnerable spots as well, although some more than others.

Probably the line taken by Hinkson J.A. presents the most serious problems. It seems unrealistic to say, as he did,[59] 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 as saying, "Go ahead and be as careless as you want with my property."

A more serious difficulty with Hinkson J.A.'s approach is that it only works if the limitation is practically an exclusion. If Kuehne & Nagel's maximum liability had been fixed at a substantial sum instead of just $40, it would have been impossible to say that the employees owed no duty of care whatever because London Drugs had assumed the whole risk of damage to the transformer. In such a case they presumably would have been in a relationship of proximity to London Drugs because it looked to them and their employer to cover part of the loss. If so, they would have been under a duty of care.

So the other two judges, it is submitted, were on firmer ground in accepting that there was a duty of care, whilst limiting liability for a breach

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[59] *Supra*, footnote 33 and accompanying text.

of it on the ground of the contractual setting in which the breach took place. The problem with this line of thinking, as Lambert J.A. pithily said, is that "there is no such thing as a $40-duty".[60] The law of negligence has got used to the idea that a duty of care may be limited to a *type* of damage. For example, there may be a duty of care with respect to physical damage but no duty of care with respect to "pure" economic loss arising from the same act or omission.[61] But no case before *London Drugs* has found that it is possible, without any contract between the parties, for a breach of duty to make the wrongdoer liable for a portion of the loss limited by monetary *amount*.

Is this conceptually an incoherent idea? Putting it another way, given that it makes sense to talk about a "physical harm duty" (you're liable for that damage) as distinct from an "economic loss duty" (you're not liable for that), does it make sense to talk about a "$40 duty" (you're liable for the first $40 of loss) as distinct from an "excess over $40 duty" (you're not liable for the excess)? The key is, surely, that the law of tort defines the recoverable damage—that is, defines the damage to which a duty of care relates—according to reasons of policy. There are good reasons for treating pure economic loss differently from physical harm to person or property. If there are equally good reasons for treating the loss over $40 differently from the first $40 of loss, it is hard to see any *logical* objection to doing it.

In a case like *London Drugs*, the basic argument for treating the plaintiff's loss over $40 differently from the first $40 is that the plaintiff took the risk of the former loss for its own account. When it made the contract relating to its property, the plaintiff contemplated the possibility that its goods might be damaged, and it entered into the transaction on the footing that it would have no recourse in respect of the loss over $40.[62] In order to get a lower price for the storage, it decided to bear the financial risk that its property might be damaged for more than $40. There is no reason why the law of torts should rescue it, or its insurer, from a financial risk that it voluntarily decided to run. If it had wanted to avoid that risk it should have made a different contract.

There is, in fact, a substantial body of precedent for this kind of "you made your bed, you lie in it" argument against allowing an injured

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[60] *Supra*, footnote 1, at pp. 89 (D.L.R.), 44 (B.C.L.R.).

[61] That was the example Lord Wilberforce gave to explain his reference, in *Anns*, to "considerations which ought ... to reduce or limit ... the damages to which a breach of ... [the duty] may give rise": *supra*, footnote 35, at pp. 752 (A.C.), 498 (All E.R.). See also Lambert J.A., *supra*, footnote 1, at pp. 95 (D.L.R.), 51 (B.C.L.R.).

[62] One might suggest that London Drugs only agreed that it would have no recourse against Kuehne & Nagel, but, as Southin J.A. pointed out, it is far-fetched to suppose that London Drugs or its insurer assumed it would have recourse against the individual employees.

party to claim in tort.[63] It is very often implicit, and sometimes explicit, in the cases dealing with pure economic loss. That is because, in the great majority of cases, the economic loss stems from the fact that the plaintiff entered into a transaction on the terms it did. If the terms had been different there would have been no loss. It is not for the law of negligence, so the argument runs, to come to the aid of a plaintiff that consciously risked its money by choosing to accept those terms. Economic efficiency, as well as simple fairness, argue in favour of letting the loss lie where it falls, since that is where the plaintiff could have expected it to fall.

To take one example, in *Leigh and Sillavan Ltd.* v. *Aliakmon Shipping Ltd.*[64] the plaintiff was a buyer of cargo who bore the risk of damage at sea, but had agreed to a modification of the sale contract that had the effect of leaving title with the sellers. The House of Lords unanimously held that the plaintiff had no claim in tort against the carrier for damage to the cargo. The carrier owed no duty of care to the plaintiff because the plaintiff was not the owner. To the argument that the law of negligence should extend the duty of care to someone in the plaintiff's position, whose financial interest was almost identical to an owner's, the law lords replied that the buyer's risk stemmed from the way the contract had been modified. The buyer could easily have stipulated for terms that would have taken care of the risk. As Lord Brandon said:[65]

> These considerations show, in my opinion, not that there is some lacuna in English law relating to these matters, but only that the buyers, when they agreed to the variation of the original contract of sale, did not take the steps to protect themselves which, if properly advised, they should have done.

In the *Aliakmon* case the plaintiff should have known that it would have no tort remedy if the goods were damaged. It chose to go ahead without protecting its position. *London Drugs* is an example of the converse situation. The plaintiff knew that if the goods were damaged it would usually have a tort remedy for the full amount of the loss, but it chose to do without that protection except for the first $40. In *Aliakmon* the House of Lords saw no reason to find a new duty of care in order to assist a plaintiff who in effect had chosen to run the risk of loss. In *London Drugs* the British Columbia Court of Appeal saw good reason to cut back a normally recognized duty of care in order *not* to assist a plaintiff who had chosen to run the risk of loss. What the Court of Appeal did is novel,[66]

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[63] I have attempted a survey of how the law of tort takes account of the fact that the plaintiff's loss arose out of a planned transaction, in J. Blom, Fictions and Frictions on the Interface Between Tort and Contract, to be published in a collection of papers given at the Paisley Conference on the Law of Negligence, held in Paisley, Scotland, September 28-29, 1990.

[64] [1986] A.C. 785, [1986] 2 All E.R. 145 (H.L.).

[65] *Ibid.*, at pp. 819 (A.C.), 156 (All E.R.).

[66] Novel at least in the context of contractual exemption clauses. As Professor Fleming points out, tort rights are often limited by reference to a non-contractual notice that the defendant assumes no responsibility: *op. cit.*, footnote 56, p. 268.

but it is submitted that it makes excellent sense in policy terms, and is no more playing fast and loose with the concepts of tort law than many well-accepted recent decisions in the law of negligence.[67]

If the case is looked at in this way, it is the reasonable expectations of London Drugs, not Brassart and Vanwinkel, that are crucial to defining the proper scope of tort recovery. It is not so much a matter of what the defendant could expect to be sued for, as of what the plaintiff could expect to be at its own risk. Thus there is room to doubt whether, as Wallace J.A. apparently thought, the defendants' duty of care towards London Drugs would be limited to $40 only if a reasonable employee in their position would have known about the limitation clause in the contract. Moreover, to insist on such imputed knowledge is not very attractive in practical terms. In most cases one could hardly expect the average employee to be familiar with the fine print in customers' contracts. If imputed knowledge of the contractual terms were a criterion, it would mean that employees of lower rank would be more exposed to personal liability than those higher up, because they would be likely to know less about the contract. And, supposing Brassart and Vanwinkel had found out about Kuehne & Nagel's limited liability after the accident, rather than knowing about it before, would they really have thought it any fairer for them to have to pay $33,000 damages when Kuehne & Nagel only had to pay $40?

In summary, I would argue that the decision in *London Drugs* can be supported in terms of the principles of tort law, and that the best rationale would be, as phrased by McEachern C.J.B.C., that both London Drugs and the defendants were acting in the context of an "amalgam or matrix of obligations and remedies"[68] as part of which London Drugs agreed with Kuehne & Nagel to bear the risk of damage over $40. The duty of care on the defendants was limited in amount because, in view of that assumed risk, it was "reasonable ... that the plaintiff's remedy for the breach by the employees of their tort duties should not be greater than that which the plaintiff agreed would be imposed upon their employer".[69]

It has to be acknowledged that accepting this principle into the law of negligence will affect claims against other defendants besides employees. It will be extremely difficult, for instance, to find any basis for treating independent contractors differently from employees, if the risk of independent contractors' negligence is clearly intended to be included in the limitation or exclusion clause. So, if *London Drugs* is right, and if the suggested ratio for the case is accepted, it is hard to avoid the conclusion

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[67] The *Aliakmon* case itself may or may not be well accepted in Canada. The contrary result was reached, on very similar facts, in *Triangle Steel & Supply Co.* v. *Korean United Lines Inc.* (1985), 32 C.C.L.T. 105 (B.C.S.C.).

[68] *Supra*, footnote 1, at pp. 73 (D.L.R.), 27 (B.C.L.R.).

[69] *Ibid.*

that the shipping cases where stevedores were held not to be protected, like *Scruttons Ltd.* v. *Midland Silicones Ltd.*[70] in the House of Lords, and *Canadian General Electric Co.* v. *Pickford & Black Ltd.*[71] in the Supreme Court of Canada, must now be seen as obsolete. Nor would the elaborate agency analysis in *New Zealand Shipping Co.* v. *A.M. Satterthwaite & Co. Ltd.*[72] and *ITO—International Terminal Operators* v. *Miida Electronics Inc.*[73] be relevant any more. The fact that the cargo owner clearly agreed to bear the risk of the damage caused by the stevedores' negligence would be sufficient to limit the latter's duty of care.[74]

It is this frontal assault on entrenched authority that has led Isaac J., of the Ontario Court, not to follow *London Drugs* in a case on all fours with it, *Muller Martini Canada Inc.* v. *Kuehne & Nagel International Ltd.*[75] He thought that whatever innovations there might be in the concept of a duty of care they had not affected the rule, binding on him, that someone who is not in privity of contract with the owner must owe a duty of care towards the owner in respect of damage to the property. Besides, Isaac J. did not see the result as bad:[76]

> To my mind, there is no net social benefit to be derived by a shift in the *locus* of the risk of harm to the plaintiff from the defendant employees. Any injustice, real or perceived, could be adjusted either by legislation or by appropriate contractual arrangements between the parties concerned.

One may suggest, with respect, that there is a net social benefit to be gained: preventing contracting parties, or their insurers, from bringing tort claims in respect of risks that, with their eyes open, they had agreed to

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[70] *Supra*, footnote 9.

[71] *Supra*, footnote 11. *Greenwood Shopping Plaza Ltd.* v. *Beattie*, *supra*, footnote 8, might be distinguishable on the ground that leave to appeal was granted on a very narrow question (as McEachern C.J.B.C. said, *supra*, footnote 1, at pp. 63 (D.L.R.), 17 (B.C.L.R.)), or on the ground that the Supreme Court felt it had no evidence from which to infer that the landlord intended the clause to extend to the employees: *supra*, footnote 8, at pp. 240-241 (S.C.R.), 265-266 (D.L.R.).

[72] *Supra*, footnote 14.

[73] *Supra*, footnote 15.

[74] This would bring Canadian law into approximately the same position as the law in the United States, which recognizes a doctrine of vicarious immunity. The American law was cited to the Court of Appeal, though with the admission that it did not present a uniform picture (*supra*, footnote 1, at pp. 73 (D.L.R.), 28 (B.C.L.R.)). The American authorities are surprisingly sparse. See *Robert C. Herd & Co. Inc.* v. *Krawill Mach. Corp.*, 359 U.S. 297 (1959), (stevedores immune if party to or express beneficiary of contract of carriage), overruling *A.M. Collins & Co.* v. *Panama Ry. Co.*, 197 F. 2d 893 (5th Cir., 1952), cert. den., 344 U.S. 875 (1952); *Mayfair Fabrics* v. *Henley*, 244 A. 2d 344 (N.J. Super. Ct., 1968) (tenant's employee immune under terms of lease), distinguished in *U.S. Fidelity & Guar. Co.* v. *Friedman*, 540 So. 2d 161 (Fla. Dist. Ct. App., 1989); Restatement (Second) Agency (1958), paras. 343, 345, 347 and Reporter's Note to para. 345; 53 Am. Jur. 2d, Master & Servant (1970), para. 446, p. 464.

[75] (1990), 73 D.L.R. (4th) 315 (Ont. Ct. (Gen. Div.)).

[76] *Ibid.*, at pp. 324-325.

carry themselves.[77] The only argument for allowing such claims (with their attendant cost) is privity of contract, which, at least in this context, has no social value at all, and has already been happily sidestepped, on minimal pretexts, in cases like *New Zealand Shipping* and *ITO*. It is true that all the relevant cases in the House of Lords, Privy Council and Supreme Court of Canada have clearly found a duty of care to exist, but that was simply assumed; all the argument was about privity of contract.

At least since *Donoghue* v. *Stevenson*,[78] once somebody has been shown to have caused damage by negligence, there has been an instinctive tendency to see liability as the normal outcome and non-liability as exceptional. This was given all but formal expression in Lord Wilberforce's two-stage test in *Anns*.[79] It also makes itself felt in the Himalaya clause cases. In *Scruttons* v. *Midland Silicones*[80] Lord Reid asked, in relation to servants or independent contractors who damage property belonging to their employer's customer, "On what ground are they to be better off than if they had damaged the property of some other person?" Liability, in other words, is assumed to be the starting point.

As a result of its encounter with the jungles of pure economic loss, the law of torts has grown more circumspect. Where economic loss is concerned, liability is now clearly seen as the exception rather than the rule. The demolition of *Anns* in England by *Murphy* v. *Brentwood District Council*[81] epitomizes this shift. Tort law has come to pay much closer attention to the nature of the plaintiff's loss, and to insist that good reason be shown for shifting that kind of a loss to the defendant. *London Drugs* is the first important case to look through our newly critical eyes at the duty of care in respect of physical damage, a duty that until now has been taken for granted. It is submitted that the British Columbia Court of Appeal's revision of orthodoxy is an improvement in the law that can be squared with principle, if not with precedent.

One might conceivably push the challenge to orthodoxy one stage further. Suppose that the warehousing contract had left Kuehne & Nagel's liability unlimited. Even then, would it have been right to impose the same unlimited liability on the employees? They would never have been handling $40,000 transformers if it had not been part of their job. The employer is being paid to assume the risk of damage to the transformer,

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[77] At least where the risks are commercial risks. Courts may be less inclined to cut back on the duty of care if the injury is of a more compelling kind, like personal injury. Yet even there the Himalaya clause technique has been held effective to absolve the negligent individual from a duty of care: see *Dyck* v. *Manitoba Snowmobile Assn.* (1982), 136 D.L.R. (3d) 11, 11 Man. R. (2d) 308 (Man. C.A.), aff'd, [1985] 1 S.C.R. 589, (1985), 18 D.L.R. (4th) 635.

[78] *Supra*, footnote 7.

[79] *Supra*, footnote 46 and accompanying text.

[80] *Supra*, footnote 9, at pp. 478 (A.C.), 13 (All E.R.).

[81] [1990] 3 W.L.R. 414, [1990] 2 All E.R. 908 (H.L.).

but except in the most theoretical sense the employees are not. They are selling their labour, not a form of insurance. The risk of doing $40,000 worth of damage is imposed on them, but as employees (and here their position would be different from independent contractors) they are badly placed to arrange things financially to cope with that risk. They can get their employer to include them as insureds under its liability policy, but then suing them is indistinguishable from suing the employer; it is the same insurance.

If one were framing a law of negligence from scratch, a strong case could be made for refusing a plaintiff any cause of action at all against individual employees for damage resulting from a risk that was within the scope of a contract with the employer. If the plaintiff wanted the extra protection (for what it was worth) of the employees' individual liability, it could contract for it with the employees. It is hard to adopt this position now, because without the employee's tort liability there is nothing on which to base the employer's.[82] Here the distinction between physical damage and economic loss (at least when caused by negligent misstatement) is crucial. In cases of negligent misstatement it is possible to find the employer, but not any individual employee, under a duty of care in respect of negligent errors made within the organization. That is because reliance by the plaintiff is the basis of the duty of care, and depending on the facts it may be possible to say that the plaintiff relied exclusively on the employer for the accuracy of the device, not on the individual who actually gave it.[83] But where an employee causes physical harm there is no means of imposing a duty of care exclusively on the employer. The duty of care has to be on the person who does the damage, because the employer's liability (assuming the employer as such did nothing negligent) is only vicarious.

If it were possible to get over this hurdle and devise some kind of "contractor's tort", by which employees' negligence towards their employer's customer or client was treated as the employer's negligence without imposing a duty of care on the individual employee, it might yield the most satisfactory result. The problem of an employee's tort liability, which made itself felt because of privity of contract, would then have been addressed, paradoxically enough, with a kind of privity of tort.

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[82] Since the plaintiff can sue the employer in contract one might say that a tort action is unnecessary. But there may be cases where a tort action would offer some advantage. It would be anomalous if a tort action were not available against, say, a warehouseman whose employees damaged the goods, but were available against a warehouseman who damaged the goods personally.

[83] Compare *Sealand of the Pacific* v. *Robert C. McHaffie Ltd.*, *supra*, footnote 10, with *Northwestern Mutual Ins. Co.* v. *J.T. O'Bryan & Co.* (1974), 51 D.L.R. (3d) 693 (B.C.C.A.) and *B.C. Automobile Assn.* v. *Manufacturers' Life Ins. Co.* (1981), 29 B.C.L.R. 330 (C.A.). See also *Ataya* v. *Mutual of Omaha Ins. Co.* (1988), 34 C.C.L.I. 307 (B.C.S.C.); *Moss* v. *Richardson Greenshields of Canada Ltd.*, [1989] 3 W.W.R. 50 (Man. C.A.); *Leon Kentridge Assocs.* v. *Save Toronto's Official Plan Inc.* (27 March 1990), (Ont. Dist. Ct.) [unrep.].

TORTS—LIABILITY OF PUBLIC AUTHORITIES—
RECOVERY FOR PURE ECONOMIC LOSS:
Murphy v. *Brentwood District Council.*

Graham McLennan*

The liability of public authorities in tort was significantly expanded by the 1977 decision of the House of Lords in *Anns* v. *Merton London Borough Council.*[1] Over the last thirteen years the Supreme Court of Canada has repeatedly adopted the principles and reasons of Lord Wilberforce's speech in *Anns.* Recently, the House of Lords has taken the unusual step of expressly overruling *Anns* in *Murphy* v. *Brentwood District Council.*[2]

In *Anns,* Lord Wilberforce set forth the by now well-known two part test to determine liability in negligence of public authorities as follows:[3]

> First one has to ask whether, as between the alleged wrongdoer and the person who has suffered damage there is a sufficient relationship of proximity or neighbourhood such that, in the reasonable contemplation of the former, carelessness on his part may be likely to cause damage to the latter—in which case a prima facie duty of care arises. Secondly, if the first question is answered affirmatively, it is necessary to consider whether there are any considerations which ought to negative, or reduce or limit the scope of the duty or the class of person to whom it is owed or the damages to which a breach of it may give rise.....

Although the *Anns* decision dealt with the liability of the Merton London Borough Council in negligence for failing to inspect properly a building foundation, Lord Wilberforce's analysis was often used to determine whether a duty of care was owed by a plaintiff to a defendant in negligence actions generally.

The *Anns* decision has been adopted by the Supreme Court of Canada and consequently followed in many Canadian decisions. In *City of Kamloops* v. *Nielsen*[4] the Supreme Court of Canada dealt with a factual situation similar to that in *Anns.* The plaintiff commenced action against the City of Kamloops for costs of repair of a house he purchased. The house had been constructed with faulty foundations, to the knowledge of the City of Kamloops' building inspectors, who issued, but failed to enforce, a stop work order against the builder.

The majority decision in *City of Kamloops* v. *Nielsen* was written by Wilson J., with whom Ritchie J. and Dickson J. concurred. Wilson J. described *Anns* as "[t]he leading English authority favouring the existence of a duty of care owed by the City to the plaintiff".[5] She adopted the

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[1] [1978] A.C. 728, [1977] 2 All E.R. 492 (H.L.).

[2] [1990] 3 W.L.R. 414, [1990] 2 All E.R. 908 (H.L.).

[3] *Supra,* footnote 1, at pp. 751-752 (A.C.), 498 (All E.R.).

[4] [1984] 2 S.C.R. 2, (1984), 10 D.L.R. (4th) 641.

[5] *Ibid.*, at pp. 8 (S.C.R.), 661 (D.L.R.).

Anns decision and concluded there was a private law duty of care owed by the City of Kamloops to Nielsen and, accordingly, granted judgment for the costs of repair.

Wilson J. devoted eight pages of her judgment to the City of Kamloops' argument that even if there was a breach by the city of a private law duty owed to the plaintiff, the plaintiff's action should be dismissed because his loss was purely economic.[6] She rejected this argument and noted that recovery for economic loss was permitted in *Anns*.[7] She concluded:[8]

> I said earlier in commenting upon the floodgates argument in relation to the imposition of a private law duty of care that I was not troubled by the thought that public officials in discharging their duties should incur the same liability as ordinary citizens. It may be that in exposing public authorities to liability for economic loss when under our law as it presently stands a private litigant may not be so exposed, the court would be extending the liability of public authorities beyond that of private litigants. I am not, however, persuaded that this is so.

Wilson J. then stated that developing jurisprudence may in fact establish that private defendants are liable for pure economic loss, notwithstanding the Supreme Court of Canada decision in *Rivtow Marine Ltd.* v. *Washington Ironworks*.[9]

The City of Kamloops also argued that the finding of private law duties owed by public officials ought to be discouraged, because such finding would open the floodgates and create an open season on municipalities. Wilson J. responded to this argument by stating:[10]

> No doubt a similar type of concern was expressed about the vulnerability of manufacturers following the decision in *Donoghue* v. *Stevenson*. While I think this is an argument which cannot be dismissed lightly, I believe that the decision in *Anns* contains its own built-in barriers against the flood.

The barriers referred to by Wilson J. include limits on the duties imposed upon municipalities by their governing legislation and the fact that liability will not arise out of pure policy decisions, following the distinction between "policy" and "operational" decisions set forth in *Anns*.

The Supreme Court of Canada continues to follow *Anns* in actions against public authorities in negligence. In 1989, the court applied it in *Just* v. *The Queen in right of British Columbia*.[11] In *Just* the plaintiff commenced an action in negligence against the Province of British Columbia for the death of his daughter caused by a boulder crashing down upon their car, which was stopped in a line of traffic on a major highway adjacent

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[6] *Ibid.*, at pp. 26-35 (S.C.R.), 674-681 (D.L.R.).

[7] *Ibid.*, at pp. 32 (S.C.R.), 679 (D.L.R.).

[8] *Ibid.*, at pp. 34 (S.C.R.), 680 (D.L.R.).

[9] [1974] S.C.R. 1189, (1973), 40 D.L.R. (3d) 530.

[10] *Supra*, footnote 4, at pp. 25 (S.C.R.), 673-674 (D.L.R.).

[11] [1989] 2 S.C.R. 1228, (1989), 64 D.L.R. (4th) 689.

to a rocky slope. The majority decision was written by Cory J., who stated:[12]

> In cases such as this, where allegations of negligence are brought against a government agency, it is appropriate for courts to consider and apply the test laid down by Lord Wilberforce in *Anns* v. *Merton London Borough Council.*

In applying *Anns*, Cory J. reversed the British Columbia Court of Appeal and characterized the defendants' actions as being a matter of "operations", rather than "policy", and ordered that a new trial be held.[13]

The Supreme Court of Canada, continuing to follow *Anns*, has moved in the direction of expanding the vulnerability of public authorities to tort actions. This trend is discussed in Professor Lewis Klar's recent article on three Supreme Court of Canada decisions, including the *Just* decision.[14]

The House of Lords is clearly moving in the opposite direction. In *Murphy* v. *Brentwood District Council*, the House of Lords expressly examined the question of whether *Anns* was correctly decided. It concluded the case was decided incorrectly and that all decisions following it for the last thirteen years were overruled. The speeches of the law lords in *Murphy* may have an impact on the direction taken by Canadian courts on the issues of liability of public authorities and recovery for pure economic loss in tort actions.

The facts in *Murphy* were similar to those in *Anns* and in *City of Kamloops*. The plaintiff purchased a newly constructed house from a construction company. Serious cracks developed in the house and it was discovered that the foundation, approved by the local council under building regulations and bylaws, was defective. The plaintiff was unable to repair the foundation and sold the defective house for £35,000 less than its market value in sound condition. The trial judge and the Court of Appeal held that they were bound to follow *Anns*, and that the defendant council owed a duty of care to the plaintiff, and judgment was granted.

In the House of Lords concurring speeches were given by Lord Mackay, Lord Keith, Lord Bridge, Lord Oliver and Lord Jauncey. The most comprehensive speeches were delivered by Lord Keith and Lord Oliver.

Lord Keith carefully reviewed the reasoning of Lord Wilberforce in *Anns* and the decision of Lord Denning in *Dutton* v. *Bognor Regis Urban District Council*.[15] In commenting on both those decisions he said:[16]

> It appears that the normal principle concerned was that which emerged from *Donoghue* v. *Stevenson*, as extended to the sphere of statutory functions of public bodies in *Dorset Yacht Co. Ltd.* v. *Home Office.*

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[12] *Ibid.*, at pp. 1235 (S.C.R.), 700-701 (D.L.R.).

[13] *Ibid.*, at pp. 1237-1247 (S.C.R.), 703-710 (D.L.R.).

[14] L.N. Klar, The Supreme Court of Canada: Extending the Tort Liability of Public Authorities (1990), 28 Alta. L. Rev. 648.

[15] [1972] 1 Q.B. 373, [1972] 1 All E.R. 462 (C.A.).

[16] *Supra*, footnote 2, at pp. 425 (W.L.R.), 917 (All E.R.).

However, that principle had been carried too far:[17]

> The jump which is here made [by Lord Denning M.R. in *Dutton*] from liability under the *Donoghue* v. *Stevenson* principle for damage to person or property caused by a latent defect in the carelessly manufactured article to liability for the cost of rectifying a defect in such an article which is ex hypothesi no longer latent is difficult to accept. As Stamp L.J. recognized in the same case [*Dutton*], there is no liability in tort upon a manufacturer towards the purchaser from a retailer of an article which turns out to be useless or valueless through defects due to careless manufacture. The loss is economic.

In *Anns* Lord Wilberforce characterized the damage sustained by the plaintiff as physical damage. Lord Keith disagreed and characterized the loss in *Anns* and the loss sustained by the plaintiff in *Murphy* as purely economic loss.[18] Lord Keith went on to restrict the situations in which one may recover for pure economic loss. He stated:[19]

> The right to recover for pure economic loss, not flowing from physical injury, did not then extend beyond the situation where the loss had been sustained through reliance on negligent misstatements as in *Hedley Byrne* .... Upon analysis, the nature of the duty held by *Anns* to be incumbent upon the local authority went very much further than a duty to take reasonable care to prevent injury to safety or health. The duty held to exist may be formulated as one to take reasonable care to avoid putting a future inhabitant owner of a house in a position in which he is threatened, by reason of a defect in the house, with avoidable physical injury to person or health and is obliged, in order to continue to occupy the house without suffering such injury, to expend money for the purpose of rectifying the defect.

Lord Keith stated that to impose a duty of that nature would have serious implications. He noted, for example, that a similar duty must necessarily be incumbent on the builder of the house, a manufacturer of chattels and defendants in many other situations, which would introduce a principle something in the nature of a transmissible warranty of quality into the law of negligence. Lord Keith stated that:[20]

> In America the courts have developed the view that in the case of chattels damage to the chattel itself resulting from careless manufacture does not give a cause of action in negligence or product liability.

Lord Keith noted that in *Anns* Lord Wilberforce approved of the dissenting judgment of Laskin J. in *Rivtow Marine* v. *Washington Iron-works*.[21] Lord Keith commented:[22]

> For my part, I consider the decision of the majority was correct. The defect in the crane was discovered before it had done any damage, so that there could be no question of application of the *Donoghue* v. *Stevenson* principle. The cost of rectifying the defect was incurred for the purpose of enabling the crane to be profitably

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[17] *Ibid.*, at pp. 426 (W.L.R.), 918 (All E.R.).

[18] *Ibid.*, at pp. 428 (W.L.R.), 919 (All E.R.).

[19] *Ibid.*, at pp. 429 (W.L.R.), 920-921 (All E.R.).

[20] *Ibid.*, at pp. 430 (W.L.R.), 921 (All E.R.).

[21] *Supra*, footnote 9.

[22] *Supra*, footnote 2, at pp. 431 (W.L.R.), 921-922 (All E.R.).

operated. The danger of injury from the defect, once it was known, could have been averted simply by laying up the crane. The loss was purely economic.

The following lengthy passage from Lord Keith captures the essence of all of the Law Lords' speeches in *Murphy* v. *Brentwood District Council*:[23]

> Liability under the *Anns* decision is postulated upon the existence of a present or imminent danger to health or safety. But considering that the loss involved in incurring expenditure to avert the danger is pure economic loss, there would seem to be no logic in confining the remedy to cases where such danger exists. There is likewise no logic in confining it to cases where some damage (perhaps comparatively slight) has been caused to the building, but refusing it where the existence of the danger has come to light in some other way, for example, through a structural survey which happens to have been carried out, or where the danger inherent in some particular component or material has been revealed through failure in some other building. Then there is the question of whether the remedy is available where the defect is rectified, not in order to avert danger to an inhabitant occupier himself, but in order to enable an occupier, who may be a corporation, to continue to occupy the building through its employees without putting those employees at risk.
>
> In my opinion it is clear that *Anns* did not proceed upon any basis of established principle, but introduced a new species of liability governed by a principle indeterminate in character but having the potentiality of covering a wide range of situations, involving chattels as well as real property, in which it had never hitherto been thought that the law of negligence had any proper place. . . .
>
> My Lords, I would hold that *Anns* was wrongly decided as regards the scope of any private law duty of care resting upon local authorities in relation to their function of taking steps to secure compliance with building byelaws or regulations and should be departed from.

Unlike the Supreme Court of Canada, the High Court of Australia has declined to follow *Anns*. Lord Keith appears to approve of the following comment on *Anns* from the judgment of Brennan J. of the High Court of Australia:[24]

> It is preferable, in my view, that the law should develop novel categories of negligence incrementally and by analogy with established categories, rather than by a massive extension of a prima facie duty of care restrained only by indefinable "considerations which ought to be negative, or to reduce or limit the scope of the duty or the class of person to whom it is owed."

It is difficult to predict what impact the decision of *Murphy* will have on the direction of Canadian tort law. Clearly, the liability of public authorities is being restricted by the House of Lords while apparently undergoing expansion by the Supreme Court of Canada.

Lord Keith's comment on pure economic loss in *Murphy* suggests that liability for pure economic loss may be restricted to *Hedley Byrne* cases of negligent misstatements and certain maritime law cases. Wilson J.'s comments on recovery for pure economic loss in the *City of Kamloops*

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[23] *Ibid.*, at pp. 431-433 (W.L.R.), 922-923 (All E.R.).

[24] *Ibid.*, at pp. 422 (W.L.R.), 915 (All E.R.), quoting from *Sutherland Shire Council* v. *Heyman* (1985), 157 C.L.R. 424, at p. 481, 60 A.L.R. 1, at pp. 43-44.

case suggest that the Supreme Court of Canada is prepared to consider recovery for pure economic loss in tort actions generally.

It will be interesting to observe the judicial consideration in Canada of the speeches of the Law Lords in *Murphy* v. *Brentwood District Council* in examining the difficult issues of liability of public authorities and recovery for pure economic loss in tort actions.

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INTERNATIONAL TRADE—CANADA-UNITED STATES—
FREE TRADE AGREEMENT—COUNTERVAILING DUTIES—
METHOD OF CALCULATING SUBSIDIES:
IPSCO Inc. & IPSCO STEEL Inc. v.
The United States & Lone Star Steel Company.

Moira L. McConnell*

Preamble

One of the by-products of the Canada-United States Free Trade Agreement (FTA) is that Canadian and United States lawyers in almost any area of practice must now cultivate, if not intimacy, at least an acquaintance, with each other's legal systems.[1] The inner workings of the United States court and administrative structures have been for most of us a mystery best left on the library shelves or to Washington based specialists. In part this "deference" reflects the notion that the political and legal environment in the United States differs and therefore the institutional consciousness is different (for example, some United States judges are elected, and even when appointed, Canadian law lore imagines them as more "politically" motivated than in Canada). But this state of blithe indifference is changing, and must continue to change, if only because of the increased employment mobility for lawyers and other professionals under the FTA and because of the needs of clients. There is much to be gained both in terms of increased practice and contact with new approaches to issues and, more importantly, new case law. Perhaps one of the more interesting developments from a jurisprudential perspective will be the evolution of this unique brand of "Uni-Can" case law.[2]

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[1] It is fair to say that, despite a common origin, Canadian lawyers, probably for historical reasons of precedent, inevitably look to Britain for most law and rarely, except perhaps in the context of Charter/human rights and damages in tort law, look to American case law. Indeed, for many of us legal research involving United States Law Reports presents further problems in that many law libraries do not carry all report or register series.

[2] Obviously there may be areas of law which will remain entirely discrete, at least so long as we have nation states as presently constructed; however, with increasing mobility of citizens it is entirely likely that this will decrease. This does not mean that the two

Introduction

This comment will examine a decision of the United States Court of Appeals (Federal Circuit) which has a great deal of significance for the difficulty Canada and the United States have encountered in reconciling their two political economic regimes and philosophies under freer trade. One of the more important and largely unresolved issues in international trade under the FTA and under the General Agreement on Tariffs and Trade (GATT) is determining what types of government assistance constitute a trade pattern distorting subsidy which would justify the imposition of a tariff or countervailing duty by a trading partner.[3] On April 3, 1990, in the case of *IPSCO Inc. & IPSCO STEEL Inc.* v. *The United States & Lone Star Steel Company*[4] (*IPSCO* hereafter) a three person panel[5] of the United States Court of Appeals overturned a decision of a judge of the United States Court of International Trade (C.I.T.) which upheld the method of subsidy determination employed by the International Trade Administration of the Department of Commerce.[6] The Court of Appeals essentially ruled that the International Trade Administration, a specialized

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legal environments will completely assimilate (the most common fear is that Canada will be swallowed up), but rather there will be a third combined area which deals specifically with matters involving both countries. I hesitate to use the terms "Ameri-Can" or "Can-Am" since the United States of America does not, alone, constitute "America".

[3] Under the FTA the matter was partially resolved by the two governments agreeing that:

> Article 1902: Retention of Domestic Antidumping Law and Countervailing Duty Law
> 1. Each Party reserves the right to apply its anti-dumping law and countervailing duty law to goods imported from the territory of the other Party.
>
> Article 1906: Duration
>
> The provisions of this Chapter shall be in effect for five years pending the development of a substitute system of rules in both countries for antidumping and countervailing duties as applied to their bilateral trade. If no such system of rules is agreed and implemented at the end of five years, the provisions of this Chapter shall be extended for a further two years. *Failure to agree to implement a new regime at the end of the two year extension shall allow either Party to terminate the Agreement on six months notice.*

(Emphasis added).

[4] 899 F. 2d 1192 USCA (Fed. Circuit), 12 ITRD 1065 (Slip. Op. 89-1486).

[5] The panel was comprised of Newman and Mayer, Circuit Judges and Dumbault, Senior District Court Judge from the Western District of Pennsylvania. The decision of the court was written by Mayer J.

[6] *IPSCO INC. and IPSCO Steel Inc.* v. *United States & Lone Star Steel Co.*, 687 F. Supp. 614 (CIT 1988) and the decision affirming the remand decision of the ITA in 710 F. Supp. 1581 (CIT 1989). IPSCO originally appealed on three grounds relating to methodology: (1) use of company-specific information to determine a country-wide rate of subsidy; (2) use of sales value rather than weight of steel in assessing grants; (3) use of a 15 year amortization period. The ground addressed in this comment, the first of these, was not the basis for remand to the ITA by Restani J. Restani J. ruled on a number of matters arising from the ITA determination, see *Oil Country Tubular Goods from Canada*, 51 Fed. Reg. 15,037 (1986). This comment will focus only on the appeal from Restani J.'s decision on the determination methodology. There was also another complaint brought

administrative body, had misinterpreted the statute which it administered.[7] The case is important from a Canadian perspective, not only because of its direct impact on the subsidy/countervailing duty disputes between Canada and the United States, but also because of its implications for regional development assistance in Canada. The court took the view that:[8]

> There is no evidence that the Canadian government subsidized "the manufacture, production, or exportation of a class or kind of merchandise", 19 U.S.C. #1671 (a) (1988), *only that it attempted to aid a single ailing firm.*

It concluded that the sales of *all* companies, including those receiving *de minimis* or no subsidy, exporting the product to the United States must be taken into account in calculating the subsidy amount against which a Countervailing Duty Order will be made. Exporters which receive a *de minimis* or no subsidy or have a significant difference between their subsidy levels may apply for an exemption from the application of the Order. As stated above the sales must be taken into account in addition to the sales of the subsidized exporters when establishing the margin of subsidy and the resulting country-wide countervailing duty. The rationale for this approach is that it is the *product* that is being countervailed, rather than a specific company. This approach is supported by the fact that under the GATT and the United States domestic law there must also be a determination of material injury to the domestic United States industry before an Order will issue. It can be seen then that calculating the net benefit from a subsidy programme in this way effectively "spreads" the cost/benefit of company (regional development) specific subsidies across Canada between all companies operating in the same export market.

The court's conclusion touches directly on the difficulty that has plagued the subsidy/countervailing duty cases and negotiations between Canada and the United States. It is common knowledge in Canada that financial assistance is often provided to specific companies or areas of Canada to alleviate income disparity or unemployment rather than to provide a subsidy

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at about the same time between the same parties but involving antidumping laws: *Antidumping; Oil Country Tubular Goods from Canada; Final Determination of Sales at Less Than Fair Value*, 51 Fed. Reg. 15,029 (1986). This will not be discussed in this comment.

[7] The statute in question was the Trade Agreements Act 1979, also in 19 U.S.C. subtitle IV (#1671 ff). The idea of deference to specialized bodies interpreting and implementing their particular statute is common to both Canada and United States law, as is the degree to which this principle is disregarded from case to case. For example, the Court of Appeal's recitation has familiar echoes:

> Expert discretion is the lifeblood of the administrative process, but unless we can make the requirements for administrative action strict and demanding, *expertise*, the strength of modern government, can become a monster which rules with no practical limits on its discretion.

Mayer J., quoting from *Motor Vehicle Mut. Mfrs Ass'n* v. *State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, at p. 48 (1983). (Emphasis in the decision of Mayer J.).

[8] *Supra*, footnote 4, at p. 1197. (Emphasis added).

to a particular export product. The plaint of the Canadian taxpayer supporting highly inefficient industries is frequently heard. This type of assistance, whatever its exact form (for example, tax rebates, grants, guarantees, loans), has provided problems for trading partners in that, laudable as the purpose may be, it may be seen as having a distorting effect on international trade competition. It has been observed that:

> As the market penetration of foreign goods has risen over the past ten years, an increasing number of U.S. firms have claimed they are being injured by unfair competition from subsidized foreign imports.[9]

In effect an employment or social policy purpose being effected in Canada may "spill over" and result in unemployment or loss of income in the United States (assuming the degree of trade was ever to become that significant in a particular industry).

Background to the Case

For the purposes of this comment it is unnecessary to do more than outline the highly developed procedures and legislation governing international trade matters in the United States.[10] The procedure in countervailing duty and anti-dumping actions is relatively straightforward and operates within a strict time frame for the determinations. The Trade Agreements Act of 1979 applies only to trade with states which are signatory to the multilateral GATT Subsidies Code.[11] The Department of Commerce, through its agency, the International Trade Administration, is responsible

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[9] R. Diamond, Economic Foundations of Countervailing Duty Law (1989), 29 Virginia Jo. of Int'l Law 767, at p. 767.

[10] For an interesting and helpful discussion of the political and historical background of these institutions, see A. Rugman and A. Anderson, Administered Protection in America (1987), especially pp. 10-20.

[11] The relevant provision of the Trade Agreements Act provides in s. 701(a) (19 U.S.C. #1671 (a) (1988)):

> If -
>
> (1) the administering authority determines that-
>
> (A) a country under the Agreement, or
>
> (B) a person who is a citizen or national of such a country, or a corporation, association, or other organization organized in such a country,
>
> is providing, directly or indirectly, a subsidy with respect to the manufacture, production, or exportation of a class or kind of merchandise imported, or sold (or likely to be sold) for importation, into the United States, and
>
> (2) the Commission determines that-
>
> (A) an industry in the United States-
>
> (i) is materially injured, or
>
> (ii) is threatened with material injury, or
>
> (B) the establishment of an industry in the United States is materially retarded, by reasons of imports of that merchandise or by reason of sales (or the likelihood of sales) of that merchandise for importation
>
> then there shall be imposed upon such merchandise a countervailing duty, in addition to any other duty imposed, equal to the amount of the net subsidy.

under the Trade Agreements Act for the determination of the existence and amount of subsidies, while another agency, the International Trade Commission, is responsible for determining whether there is a "material injury" to the domestic industry.[12] Only if there is an affirmative conclusion on *both* points does the International Trade Administration issue an Order imposing a countervailing duty on the product equivalent to the "net subsidy" determined by the International Trade Administration. Investigations can be initiated by the Secretary of Commerce or, much more frequently, by petition of the domestic industry. Until the FTA these determinations could be reviewed by the Court of International Trade, but now under the FTA (Chapter 19) the matter goes to a panel comprised of Canadian and American lawyers and trade policy specialists, which reviews the International Trade Administration and International Trade Commission determinations using a prescribed standard of administrative review.[13] Essentially these are the general legal principles that a court of the importing party would otherwise apply when reviewing a determination of the competent investigating authority. In the present case the FTA had not yet entered into force and, consequently, the matter proceeded through the existing United States court/administrative review system. Although this has been superseded by the FTA regime with respect to final determinations, the nature of the review process is substantially similar.[14]

In July 1985 the Lone Star Steel Company and CF & I Steel Corp., producers of oil country tubular goods[15] in the United States, filed a petition

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[12] In the case of states not signatory to the GATT Subsidies Code no material injury need be shown. For a history of the negotiations on the Subsidies Code, see G.R. Winham, International Trade and the Tokyo Round Negotiation (1986).

[13] Under art. 1911 of the FTA the standard of review in the case of Canada is that set out in s. 28 of the Federal Court Act, R.S.C. 1985, c. F-7, and in the case of the United States that set out in the Tariff Act of 1930 (as amended), s. 516A (b)(1)(B) and in one instance, s. 516A (b)(1)(A).

[14] Chapter 19 of the FTA provides, under article 1904, that:

> Article 1904: Review of Final Antidumping and Countervailing Duty Determinations
>
> 1. As provided in this Article, the Parties shall replace judicial review of *final* antidumping and countervailing duty determinations with binational panel review.
>
> . . .
>
> 10. This Agreement shall not affect:
>
> a) the judicial review procedures of either Party, or
>
> b) cases appealed under those procedures,
>
> with respect to determinations *other than final* determinations.
>
> 11. A final determination shall not be reviewed under any judicial review procedures of the importing Party if either Party requests a panel with respect to that determination within the time limits set forth in this Article. Neither Party shall provide in its domestic legislation for an appeal from a panel decision to its domestic courts.

(Emphasis added).

[15] Oil country tubular goods are described in the Court of International Trade decision, *supra*, footnote 6 (1988), at p. 616, as hollow steel products of circular cross section intended for use in drilling for oil and gas.

with the International Trade Administration alleging that Canadian manufacturers and exporters of such goods received, directly and indirectly, subsidies from the relevant provincial and federal governments, and that these threatened to materially injure the United States oil country tubular goods industry. The International Trade Administration conducted an investigation of eleven Canadian exporting firms and sought information from them and the relevant governments as to the benefits received by the companies under the alleged subsidy programs.

Of the eleven companies, eight filed timely requests for an exemption from any Countervailing Duty Order which might issue, on the basis that they were not in receipt of benefits under the identified programs. This was pursuant to an International Trade Administration regulation which provides that:

> 355.38 Any firm which does not benefit from a subsidy alleged or found to have been granted to other firms producing or exporting the merchandise subject to the investigation shall, on timely application therefor, be excluded from a Countervailing Duty Order . . .[16]

This regulation allows firms not benefitting from a subsidy found to have been granted another company to be excluded from the application of the Order.

Of the remaining three companies under investigation, Algoma Steel Corp. reported that it did receive a benefit, but that the amount was below the *de minimis* rate (0.05%) set by the International Trade Administration and was therefore entitled to be treated as though it had received no benefits.[17] One firm did not respond at all and the remaining firm, IPSCO, was found by the International Trade Administration to be in receipt of a subsidy greater than *de minimis* at 0.72 per cent *ad valorem*.[18] After the International Trade Commission found that there was a threat of material

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[16] These regulations regarding countervailing duties were promulgated by the Department of Commerce, 19 C.F.R. #355 FF (1988). Presumably this regulation was passed to set up a procedure for dealing with a discretionary provision of the statute, 19 U.S.C. #1671e(a) (2), which provides for the publication of the countervailing duty order which:

> (2) shall presumptively apply to all merchandise of such class or kind exported from the country investigated, except that if -
>
> (A) the administering authority determines there is a significant differential between companies receiving subsidy benefits, or
>
> (B) a state owned enterprise is involved, the order *may* provide for differing countervailing duties. . . .

(Emphasis added).

[17] Under the regulations, *ibid.*, at #355.8, *de minimis* net subsidies are disregarded:

> For purposes of this part, the Secretary will disregard any aggregate net subsidy that the Secretary determines is less than 0.5% *ad valorem*, or the equivalent specific rate.

As noted by the Court of Appeals this section does not define "aggregate net subsidy" nor does it indicate how it is to be calculated.

[18] *Oil Country Tubular Goods from Canada, supra*, footnote 6 (1986), (51 F. Reg. 15037).

injury to the United States industry, a country wide Countervailing Duty Order was issued in June 1986. Because of the exemptions the Order was effective only against IPSCO and the company that had not responded to the investigation.

The Canadian subsidies in question were provided under an investment tax credit program, a regional development incentive program and a general development agreement. In simple terms, the International Trade Administration calculated the benefit received from the subsidies by determining the amount allocable to the selected review period (in this case, calendar year 1984) and dividing it by each company's total sales during that period. The important point to note is that this determination was made on a company-specific basis; that is, the benefit IPSCO was found to have received was divided by its sales during the review period and not the total export sales of Canadian products.

IPSCO challenged the International Trade Administration's determination in the Court of International Trade, arguing that it had incorrectly determined that the country-wide rate was the rate found for IPSCO when it should have divided the total subsidies provided to *all* the companies by the total sales of *all* the exporting companies to determine the countervailable benefit. According to IPSCO, if it had done so, then, given the amount of subsidy involved, there would have been only a *de minimis* net benefit to IPSCO and no Order would have issued. In other words IPSCO argued that the other companies should have been included in the calculation of net benefit to the *product* and then been excluded from the application of any Order that might have been issued against that product. The obvious benefit to IPSCO from this method of calculation is that its competitors were in receipt of no subsidies but clearly had sales. Thus the denominator was greatly increased in the equation and the subsidy would be reduced correspondingly.

The Court of International Trade Decision

With respect to the argument on the method of calculating the net subsidy, Restani J. essentially adopted a position of deference to the agency which promulgated the regulations. The United States argued that the form in which Regulation 355.38, the regulation allowing for exclusion, was first passed in 1980 reflected the proper understanding of the United States Department of Commerce in that it provided that:[19]

> Ordinarily firms wishing to be considered for exclusion from *any possible affirmative determination* should . . .

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[19] *IPSCO INC. and IPSCO Steeel Inc.* v. *United States and Lone Star Steel, supra,* footnote 6, at p. 619. (Emphasis added in the case citation).

Restani J. accepted the view that this was meant to deal with exclusion from the entire determination process and not just the result, and concluded:[20]

> In this case, ITA's interpretation does not lead to results that are inconsistent with the statute.

There were several other contentious issues in relation to the determination in terms of how the particular subsidy was calculated, for example, the use of a fifteen year depreciation schedule for non recurring grants, but these were points considered by the Court of International Trade and supported by the Federal Circuit Court of Appeals.

The Federal Circuit Court of Appeals' Decision

Mayer J., writing for the Court of Appeals, examined the statute, the regulations and other International Trade Administration determinations where several companies received *de minimis* or no subsidy, and concluded that there was some inconsistency in the International Trade Administration practice as to whether these companies were taken into account in the calculation of the net subsidy. Mayer J. commented:[21]

> It strikes us that there is a hint of ad hoc adjudication at work in this scheme. Whether or not this is sustainable as a general proposition, we believe that the method of calculating the rate applied to Ipsco's exports in this case was unreasonable. Congress created a presumption in favour of country-wide countervailing duty rates. 19 U.S.C. #1671e(a)(2)(1988) (countervailing duty orders "presumptively apply to all merchandise of such kind or class exported from the country investigated"). *It was inconsistent with the concept of a country-wide rate for the ITA to disregard those companies receiving no benefit or a de minimis benefit when it determined the amount of the net subsidy and whether it was more than de minimis. "Unlike the antidumping law, which is directed to company-specific activity, the countervailing duty law is directed at government or government sponsored activity." 53 Fed. Reg. 52306, 52325. The purpose of countervailing duties is to discourage foreign subsidization that results in injury to a United States industry because of unfair competition from cheaper imports.... The country wide countervailing duty rate that applies to imports from the investigated country must bear some relation to the approximate average rate of subsidization of the subject goods....* The [ITA] regulations suggest that the proper procedure is for the ITA to calculate a weighted-average net subsidy by dividing the sum of all the benefits provided in subsidy of the subject goods by the total value of export sales of these goods to the United States.

Consequently the decision of the Court of International Trade was reversed on this point.

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[20] *Ibid.*

[21] *Supra*, footnote 4, at p. 1197. (Emphasis added).

Comments

The approach of the Court of Appeals is both consistent with the GATT and the United States statute and sensible in terms of pinpointing the essential issues in countervailing duty cases. In principle, the United States is not concerned with the way in which foreign governments choose to spend their money, unless this choice has a harmful impact on United States domestic production. Clearly for United States practice to go any further runs the danger of complaints of extraterritoriality.[22] In the case of imported products the issue is the extent to which the product causes or may cause a material injury to domestic interests. In general the imported products are indistinguishable from each other and in this sense the "harm" is hard to allocate on a company-specific basis. Thus, a more sensible result is that adopted by the Court of Appeals because it focuses on the extent to which a product entering the United States has been subsidized overall. The way in which a subsidy is allocated in another country is in this sense completely irrelevant once there is a determination that certain programs provide countervailable subsidies. This approach recognizes that in some cases grants and other forms of subsidization on a company-specific basis are motivated by reasons other than export assistance. This is an approach which may well solve some of the difficulties Canada has been having with the United States in relation to countervailing duties. However there may be some problems internally for Canada arising from this determination. This method of calculation has the effect of spreading more evenly the benefit and risk of cost in the form of countervailing duty across the industry as a whole. In the *IPSCO* case the impact would have been positive to the industry as a whole in that the subsidy received by IPSCO was very close to *de minimis* in any event. The addition of further sales of all exporters and the Algoma *de minimis* subsidy into the calculation would mean only that in all likelihood no Countervailing Duty Order would have been issued.

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[22] As noted by H. Kindred, International Law Chiefly as Interpreted and Applied in Canada (4th ed., 1987), p. 508, defining the phrase "extraterritorial application of natural laws" is problematic, but it is "taken to mean the asserted right of a state to impose its law on conduct engaged in by persons who are not its residents or nationals and which occurs outside of its territory". The chief basis for this assertion of authority has been the rather disputed "effects" doctrine, the most notorious example of which is the U.S. anti-trust legislation. While the use of tariffs/import controls, *etc.*, does not, strictly speaking, constitute an exercise of jurisdiction outside national territory, if one appreciates that the underlying issue is control over activities and policies regulated by other states, then the more powerful trading partner *de facto* will control the behaviour, standards, *etc.*, of nationals who wish to trade with it. In this sense then, the issue is not dissimilar from the difficulties many states have with U.S. anti-trust legislation and its free market aversion to monopolistic behaviour, or, in another context, the control exerted by many states with respect to liner conference shipping and other restrictive trade practices. Essentially the law and policy of the stronger partner is applied throughout the market place.

Another recent case, this time involving a Chapter 19 FTA panel, may illustrate the point. Although it was not referred in the hearings in the case of *Sydney Steel Corporation* v. *United States Department of Commerce, International Trade Organization, and Bethlehem Steel Corporation*[23] (*SYSCO Steel*) the *IPSCO* case would have had important ramifications if it had been argued.[24] In *SYSCO* the International Trade Administration determined SYSCO to be completely uncreditworthy and unequityworthy and assessed a countervailable benefit at 112.34% (on remand reduced to 94.57% *ad valorem*), while the subsidy to Algoma was determined as *de minimis*. At present a country-wide Order has been made on the basis of SYSCO's subsidy. If one applies the *IPSCO* ruling however, then the sales of other exporters such as Algoma, as well as their subsidies, should have been calculated to achieve a net subsidy. Effectively this would spread the effect of the 112.34% (94.57%) subsidy to other producers such as Algoma Steel. In theory Algoma Steel should, under the Regulations, be able to receive an exclusion from the Countervailing Duty Order. However a close reading of the governing legislation indicates that the decision to grant an exclusion is discretionary.[25] This may become crucial in that if, for example, Algoma had not received an exclusion from the Order then it is likely that the reduced countervailing duty would have applied against its exports. Thus the benefits of the regionally-oriented subsidy programs may be spread across Canada and the costs directly and indirectly shared amongst taxpayers and producers nationally.

The implications for interprovincial federal relations are relatively obvious and undoubtedly food for reflection. In addition it certainly will have some effect on intra-industry relations in that, even between themselves, the companies may not be starting from even ground. In addition to operating with minimal assistance,[26] some companies may have to take a chance

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[23] Heard April 1, 1990. Panel decision remanding the case to the ITA was dated 8 June, 1990 (55 Fed. Reg. 25684-01. Can. Gazette, Part I, July 7, pp. 2492-2494). The remand determination by ITA is dated 11 July 1990 (Can. Gazette, Sept. 22, 1990, pp. 3454-3455. Panelists: David Gantz, Robert Pitt, John Richard, Michael Sandler, Gilbert Winham).

[24] An attempt was made by SYSCO *after* the hearing to introduce the *IPSCO* decision but since counsel had not identified a relevant issue nor amended SYSCO's statement of claim and had expressly stated in the hearing that *IPSCO* was not relevant to the case, the application was inappropriate in the circumstances.

[25] The court emphasized the legislative history and wording of the governing statute, *supra*, footnote 15, to show that the country-wide product approach was the proper way to determine countervailing duty. It is notable that the statute uses mandatory language (shall) to refer to the application of the Countervailing Duty Order and permissive language (may) to refer to the availability of exemptions.

[26] The problem is compounded by the increasingly broad definition of "subsidy" under U.S. law, at least as applied by the ITA.

on also paying, albeit indirectly, for other competitor companies in the industry who have been in receipt of financial assistance. Ultimately then the costs will be spread across the industry and Canada as a whole. It is foreseeable that this may well have an impact on federal provincial relations, especially where powerful interest groups are effective at lobbying for changes in the government's approach to fiscal policy matters. Balanced against these "negative" aspects though, is the fact that, in a larger policy sense, this decision operates to the benefit of Canada in that it makes allowance for socio-economic assistance programs which seem now to be almost a mainstay of Canadian political and economic life.

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