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January 25, 2007

SUING THE SELLER: Using Ontario’s *Sale of Goods Act* to Recover Damages caused by Defective Products in a Subrogated Action

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INTRODUCTION

Where a subrogated claim for property damage is caused or contributed to by a faulty or defective product, a common, but often incorrect, assumption is that the plaintiff’s strongest or “best” case will lie against the manufacturer. This may be true in some countries, such as the United States, where a manufacturer can be held strictly liable for all damages caused by its products, without proof of negligence. However, under Canadian law, “strict liability” against a manufacturer does not exist. A plaintiff may not succeed against a manufacturer simply by proving that the manufacturer’s product was defective and that this caused the plaintiff’s loss. In most cases the plaintiff must *also* prove that the manufacturer was somehow negligent, either in the process by which it designed or manufactured the product, or by the fact that it failed to adequately warn the plaintiff of a known hazard associated with the use of the product.

Under Ontario’s *Sale of Goods Act*, however, anyone who sells a defective product, including a manufacturer, may potentially be held responsible to the buyer for all the resulting damage in a subrogated action, regardless of whether they had any knowledge of the defect when they sold the product. In other words, a seller may be found to be strictly liable for damages caused by a defective product when the circumstances surrounding the sale meet certain criteria set out in

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the legislation. As a result, subrogation professionals should always be alert to the circumstances where the *Sale of Goods Act* may give rise to an excellent claim against a seller of a defective product, even where a claim against the manufacturer is difficult to prove.

WHAT IS A “DEFECTIVE” PRODUCT?

In product liability actions, the issue of whether a product is “defective” is a hotly debated matter. Generally speaking, however, a product will be considered defective if it fails to meet the reasonable expectations of a user and causes damage or injury as a result. Nearly every kind of product may suffer from a defect, whether the product is low-tech (such as a beach towel) or high-tech (such as computer hardware). Nearly all product defects can be classified into three groups:

- A. **MANUFACTURING DEFECTS:** These are defects in a product which occur unintentionally during the manufacturing process. An example of a manufacturing defect would be the overheating problem that caused Dell to recall more than four million laptop batteries. During manufacture, tiny shards of metal were left in the battery cells, some of which caused short-circuits, leading to overheating.
- B. **DESIGN DEFECTS:** Even though a product is manufactured exactly as planned, the product may still be considered defective if the way the product is designed makes it inherently dangerous or prone to cause damage. For example, if coiling or folding a power cord during use caused the insulation to melt and expose wires, creating a fire hazard, the power cord could be considered to have a design defect.
- C. **MARKETING DEFECTS:** These defects relate to the manner in which a product is advertised and sold. These defects typically relate to a failure to warn about known hazards or risks surrounding the normal, or even abnormal, use of a potentially dangerous product. An example of a marketing defect might include the failure of a manufacturer to place adequate labels on a can of lacquer floor sealer warning that the vapours are flammable and must be kept away from open flame.

WHAT IS THE SALE OF GOODS ACT?

The *Sale of Goods Act*¹ is the primary law governing the sale of property other than land in Ontario. One of the purposes of this *Act* is to ensure that buyers of goods in Ontario are afforded some protection from defective products. Although a purchaser of a defective product may have a claim against a seller for breach of contract or breach of warranty outside of the *Sale of Goods Act*, the *Act* recognizes that a product should satisfy certain reasonable expectations of a buyer, even when the seller does not state or warrant to the buyer that the product will perform as

¹ R.S.O. 1990, c. S-1 [“*Act*”]

intended. As a result, when a sale meets certain criteria set out in the *Act*, the *Act* implies conditions into the sales contract regarding the quality of a product and the fitness of the product for its intended purpose. If the product fails to live up to the conditions, the seller may be liable to the buyer for all damages suffered as a result.

WHAT ARE THE IMPLIED CONDITIONS AND WHEN DO THEY APPLY?

1) Fitness for a Purpose

The *Sale of Goods Act* creates an implied condition in a sales contract that the products being purchased are “reasonably fit for their purpose”.² Some courts have held that a product is reasonably fit if it meets the “reasonable expectations” of the buyer and the seller of the goods.³ If the buyer is entitled to the protection of this condition and a product is found *not* to be reasonably fit for its purpose, the seller is strictly liable. It does not matter that the seller was unaware of the defect, or that the defect was hidden and could not have been discovered with the utmost skill.

In order to claim the protection of this implied condition in a subrogated action, the *Act* requires the plaintiff to satisfy five criteria:

1. **THE PLAINTIFF IS THE BUYER:** In order for the plaintiff to rely on the protections of the *Act*, the plaintiff must fall within the definition of a “buyer” under the *Act*. Essentially, the buyer is the person who enters into the sales contract with the seller and pays the seller the purchase price for the item. The buyer is not necessarily the person who uses the product. For example, a person who receives a defective product as a gift from a friend cannot sue the seller for damages under the *Act*.
2. **THE PRODUCT’S REQUIRED PURPOSE IS MADE KNOWN TO THE SELLER:** The buyer must have communicated to the seller the purpose for which it required the product. However, courts have held that this purpose can be made known by implication if the buyer requires the product for its normal purpose.
3. **THE BUYER RELIED ON THE SELLER’S SKILL AND JUDGMENT:** The buyer must have relied on a seller’s skill and judgment when purchasing a product. For example, where a buyer has ordered products to satisfy certain specifications and ignores a seller’s suggestions that a different product may be more appropriate, the buyer may not be entitled to rely on the implied warranty of fitness for purpose. Conversely, some Ontario courts have held that if a buyer makes known to a seller the purpose for which

² Section 15 of the Act provides as follows:

s. 15 Subject to this Act and any statute in that behalf, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale, except as follows:

1. Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required so as to show that the buyer relies on the seller’s skill or judgment, and the goods are of a description that it is in the course of the seller’s business to supply (whether the seller is the manufacturer or not), there is an implied condition that the goods will be reasonably fit for such purpose, but in the case of a contract for the sale of a specified article under its patent or other trade name there is no implied condition as to its fitness for any particular purpose.

³ Gregorio v. Intrans-Corp. et al., [1994] O.J. No. 1063 (Ont. C.A.).

goods are being purchased and the seller agrees to sell the item, then it may be presumed that the buyer has relied on a seller's skill and judgment.

4. **IN THE COURSE OF THE SELLER'S BUSINESS TO SUPPLY:** The *Act* requires that a product must be of a description "which it was in the course of the seller's business to supply". The purpose of this requirement is to exclude sales by private persons who are not acting in the course of business. By way of example, the purchase of a used car from an automobile dealer would meet this criteria, whereas the purchase of a used car from a moving company would not, since the used car would not be a product which is in the course of the moving company's business to supply.
5. **THE SALE IS NOT UNDER A PATENT OR TRADE NAME:** The *Act* requires that the sales contract must not have been "for the sale of a specified article under its patent or trade name". This criteria is rarely a barrier to obtaining the protection of this implied condition. Ontario courts have generally interpreted this provision so narrowly that it has no other application where the other requirements set out above are met.

2) Merchantable Quality

In addition to a condition of fitness for purpose, the *Sale of Goods Act* also implies a condition that goods must be of "merchantable quality".⁴ This means that the product must be capable of being sold on the market as well as being reasonably fit for the purpose for which it is sold. In other words, a product is only of merchantable quality if a reasonable person who knew about any hidden defects in the product would nonetheless have accepted the item from the seller.⁵

In order to claim the protection of this implied condition, the *Act* requires the plaintiff to satisfy three criteria:

1. **THE PLAINTIFF IS THE BUYER:** As set out above, in order for the plaintiff to rely on the protections of the *Act* in a subrogated action, the plaintiff must fall within the definition of a "buyer" under the *Act*.
2. **THE PRODUCT MUST BE BOUGHT BY DESCRIPTION:** Under the *Act*, the condition of merchantable quality is only implied when products are purchased by "description", rather than as a request for a specific product. Despite this distinction, practically speaking, nearly every sale made in the ordinary course of business will be found to have an element of description.¹ In fact, some courts have suggested that the only sale that will not be a sale by description is one where there was a defect in the product that would have been visible upon an inspection.
3. **THE SELLER DEALS IN PRODUCTS OF THAT DESCRIPTION:** The product must be bought from a seller who "deals in goods of that description". This is basically the same as the requirement that a product must be "of a description that is in the course of a seller's business to supply", as set out above.

4 Supra, note 1. Section 15, condition 2. provides:

Where goods are bought by description from a seller who deals in goods of that description (whether the seller is the manufacturer or not), there is an implied condition that the goods will be of merchantable quality, but if the buyer has examined the goods, there is no implied condition as regards defects that such examination ought to have revealed.

5 Kendall & Sons v. Lillico & Sons Ltd., [1968] All E.R. 444 (H.L.).

CAN A SELLER CONTRACT OUT OF THE IMPLIED CONDITIONS?

Although the *Sale of Goods Act* permits sellers to contract out of its implied conditions,⁶ Ontario courts have held that a seller must use precise and explicit language in order to do so. A term in a contract that initially appears to immunize the seller from the implied conditions in the *Sale of Goods Act* may not actually be a defence to a subrogated action. For example, consider a sales contract which contains the following clause

THIS EXPRESS WARRANTY IS IN LIEU OF ALL OTHER WARRANTIES, EXPRESS OR IMPLIED, INCLUDING ANY IMPLIED WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE, WHICH ARE HEREBY EXCLUDED.

Although it may appear that the above clause would defeat a subrogated claim against a seller, Ontario courts have held that the exclusion of an “implied warranty”, is not the same thing as the exclusion of an “implied condition” under the *Sale of Goods Act*.⁷ As a result, attempts to limit a seller’s liability in a manner similar to the above clause may not in fact be a bar to an action for breach of an implied condition under the *Act*.⁸ Presumably, a seller would have to state in clear, direct and unambiguous language that it was limiting its liability for breach of the implied conditions under the *Sale of Goods Act*. Additionally, where any ambiguity remains, these clauses should be construed strictly against the parties who drafted them, this usually being the sellers.

CONCLUSION

Anyone who allows a defective product to enter the stream of commerce may potentially be liable for damages caused by that product in a subrogated action. Under Canadian law, however, it is usually necessary to prove not just the *existence* of a defect in a product that caused a loss, but also that its defective design or manufacture was the result of negligence, or that there was a failure to warn potential customers or users of risks associated with the use of the product.

The Ontario *Sale of Goods Act* may provide an alternative ground of recovery for plaintiffs in product liability actions. Where an insurer can show that its insured has purchased a defective product in the ordinary way from a seller of such products, in circumstances where the product was used for its intended purpose, the insurer may have excellent recovery prospects against the seller, regardless of whether there was any fault or negligence on the part of the seller. In any event, the opinion of a lawyer experienced in product liability claims and negligence cases should always be obtained in order to evaluate the recovery potential of a loss which may have been caused or contributed to by a defective product.

⁶ Section 54 of the Act provides as follows:

s. 54 Where any right, duty or liability would arise under a contract of sale by implication of law, it may be negated or varied by express agreement or by the course of dealing between the parties, or by usage, if the usage is such as to bind both parties to the contract.

⁷ Gregorio, *supra* note 3. See also *General Refractories Co. of Canada v. Venturedyne, Ltd.*, [2002] O.J. No. 54 paras. 148-150 (Ont. S.C.J.).

⁸ *Ibid.*



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