Product Liability:

reflections on legal aspects of the policy issues

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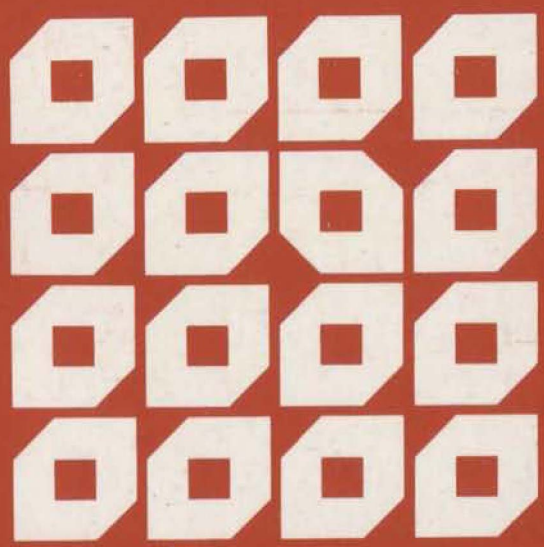
edited by
Jonathan J. Guss



Consommation et Corporations Canada
Consumer and Corporate Affairs Canada

en francais — La responsabilité du fait des produits - réflexions sur l'aspect juridique des questions fondamentales

disponible à — Service des communications
Consommation et Corporations Canada
Ottawa (Ontario)
K1A 0C9

PRODUCT LIABILITY:
Reflections on Legal Aspects of the Policy Issues

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Consumer Research and Evaluation Branch
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February 1979

Cat. No. RG23-54/1980/E
ISBN 0-662-10944-9

FOREWORD

This is a volume of informal background papers on product liability prepared for the federal government. The principles of product liability are the legal and practical commercial rules that determine the apportionment of loss caused by a product in the marketplace, whether the damage is purely economic or physical as well. Although the rules apply to all transactions, for our purposes the focus will be on transactions involving consumer products, including both goods and services. The essays in this volume were prepared to provide an informal introduction to the legal framework for economists working in the field and to ensure that all the essential legal policy issues are raised and sufficiently explored in future research in the field.

Professor Schwartz was invited to provide an introduction to the law using a factual example in order to avoid unnecessary abstraction and to provide an explication of the law easily accessible to non-lawyers. His paper also provides a broad comparison with the state of the law in jurisdictions in the United States. His paper has been updated to March 1979, when the Saskatchewan, New Brunswick and Quebec Acts had been enacted but the latter two had not yet been proclaimed in force.

Professors Romero and Ziegel were invited to raise policy issues that should be addressed in future research. Each provides an introduction to the law in order that the policy considerations will be seen in the context of his understanding of the subject. Although Professor Ziegel's second paper and Professor Romero's paper take account of the recent Saskatchewan legislation, they predate the developments in New Brunswick and Quebec.

Hence, the reader will find three separate introductions to the law of product liability which underline the scope and diversity of the field. Since the papers have been written over a two-year period - a period in which the law has started to undergo swift changes - some of the assertions will not be entirely up-to-date. For this we apologize to the authors, whose work was current when originally prepared, and to the readers who will, to a certain extent, have to refer to the recent provincial efforts in Saskatchewan, New Brunswick, and Québec, if not elsewhere, by the time this volume is distributed.

Jonathan Guss,
Consumer Research and
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General Editor

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INTRODUCTION

by Jonathan J. Guss

I. Focus of the Report

Manufacturers and government, as well as consumers, often complain about the poor quality of the products which they purchase and use. Defects in quality result in loss either from underutilization or from physical injury. The rules of product liability are the legal and commercial standards that determine the apportionment of that loss among those in the chain of distribution from designer to manufacturer to ultimate user.

The focus of the papers in this volume is on the subset of legal product liability rules. There is, of course, a fair degree of overlap between the legal and the practical commercial rules. Indeed, they are a direct reflection of one another.

However, practicalities of the marketplace do not always allow the legal rules to work to their full effect. It is simplest to explain this by way of example. If you buy a pop-up toaster which fails to pop the toast, you might very well assert your rights under the express warranty or if there is no express warranty, under the warranty implied by statute law. You will demand that the warrantor repair your toaster or exchange it for one that does pop. Even if you do not know the law and have not read the warranty, you will assume that you have a right to a new toaster and that the retailer or manufacturer will recognize that right as a rule of the marketplace or a good marketing practice regardless of the law.

The ordinary consumer, however, will probably not claim for the 25 pieces of toast burned before he returned the toaster. He may have a right to recover such losses from the retailer, but it simply is not worth the trouble to argue about it. The ordinary consumer might also fail to recover costs of paint needed to repair the carbon-stained underside of his kitchen cupboard. He could seek recovery of that loss, but the profit-maximizing retailer may reckon that the consumer will not go to the expense of taking him to court, a process which is likely to be more costly than repairing the carbon stains. Thus, the practical realities of the marketplace (in this case, the

transactions costs of asserting rights) sometimes undermine the protection afforded by the rules of law.

Many consumers do not even have the fundamental information that recourse may be available to them for this class of damage. Lack of such information may be the most persistent and difficult problem to resolve. In this sense, there is a divergence between the rules of law and the commercial rules of the marketplace. Since many consumers do not know the rules and since the transactions cost of enforcing the familiar legal rules is high, a considerable portion of loss is never recovered. It is difficult to estimate the magnitude of such losses. While the papers which follow do not deal with the commercial rules of the marketplace, it is important to note that any streamlining of the legal rules and any measures to make legal rules less expensive to apply and enforce will likely increase the overlap between the legal and commercial rules.

II. Objective of the Product Liability Research Program

The objective of research in this area, therefore, is to determine whether the market is failing to provide equitable compensation to persons who suffer losses as a result of defective products or failing to provide a sufficient level of deterrence to the production of defective products. Government intervention, at whatever level, should be directed at those two goals: deterrence and equitable compensation. A likely side effect of achieving these goals would be a general upgrading of product quality.

It is impossible to remove all defective products from the marketplace. Even if it were technically possible, it would not be economically desirable.

While a general improvement in the quality of goods would be expected, the discussion in Section V of this introduction on the economics of product liability indicates that the optimal level of defective production is indeterminate at present.

III. Role of the Federal-Provincial Task Force

At a meeting in July 1977, provincial ministers of consumer affairs and the federal government established a Task Force on Legislative Programs to work where appropriate toward harmonization of laws in the consumer affairs area. Product liability is a high priority area for the Task Force.

Legal scholars and economists have identified weaknesses in the current case law and legislated position with respect to rules of product liability. Governments have been urged to intervene and three provinces have already done so. The objective of the Task Force is to have all the provinces move on a common front in a way that will take account of the economic and commercial factors most likely to be significantly affected by changes in the rules. In any event, action in this area does not appear to be coming quickly and any move toward actual uniformity would take long-term planning.

If the same or similar measures are adopted in each province, both consumers and businesses will benefit. Manufacturers and large retailers will be subject to the same rules throughout the country and will not have to develop special warranties for each province. Consumers who purchase goods produced in another province will be assured of the same protection that covers the goods of an in-province manufacturer and will seldom be forced to use the courts of another province to pursue redress from a supplier in that province.

The federal role in the Task Force is threefold: to provide a centralized economic research function; to ensure a rational relationship between provincial warranty laws and federal law on such related subjects as hazardous products and packaging and labelling; and to determine with the provinces whether or not there is a need for federal legislation in the warranties/product liability area to cover goods in the flow of inter-provincial trade.

While some provinces are fairly well endowed in the consumer affairs field, others lack the resources to do the research necessary to develop a consumer product warranties law. It was agreed by the Task Force that it would be a positive accomplishment if all provinces were working from the same research base. A

good deal of legal research has been done by the provinces which have such legislation -- New Brunswick, Saskatchewan and Québec -- and by other provinces that have proposed it or may be planning it, for instance, Ontario. Thus, it was agreed that the primary focus of federal research would be the economic problems surrounding product liability rules.

Earlier economic studies of the product liability field identified the availability of information about products -- their characteristics, failings and performance -- as a key element in consumer satisfaction. Federal activity in the information field, such as the Packaging and Labelling Act, renders this subject of particular importance to the federal government. The Federal Food and Drug, Hazardous Products and Motor Vehicle Safety legislation is also relevant to this area. The Saskatchewan legislation refers specifically to such standards and establishes that failure to comply with mandatory standards "constitutes prima facie evidence that the consumer product is not of acceptable quality..." and therefore the remedies provided by the Saskatchewan Act are available to the consumer. The New Brunswick legislation provides an implied warranty that the product complies with all mandatory federal and provincial standards related to health, safety or quality. Thus, the federal government can, albeit indirectly, affect the degree of protection offered under provincial legislation.

Provincial measures in this area do include or will include provisions which cover problems caused by goods in the flow of interprovincial trade. It is possible that, in the long run, courts may judge that the provinces do not have this constitutional authority. That is, they may not have the jurisdictional competence to subject the out-of-province supplier to their jurisdiction and to the rules applicable in their jurisdiction for his production activity that took place out-of-province. Although such a problem is unlikely, if it arises and cannot be overcome by appropriate procedural and conflict of law rules, then a federal intervention might be approprite.

Finally, it should be emphasized that the goals of the Task Force are modest, and the move to uniformity or a "common front" is not expected to be rapid.

IV. Definitional Problems

In order to get work done in an orderly fashion in this field, it is important to categorize or to have working definitions of the following terms: 1) types of loss, 2) defective products, 3) strict liability, 4) warranty, 5) liability to whom, and 6) internalization. In an effort to be non-legalistic but to channel the discussion of the Task Force along comprehensive lines, the following working definitions have been recommended (though by no means adopted).

1. There are three broad categories of loss or damage: physical injury, pure economic loss, and consequential economic loss.

   a) Physical injury includes personal injury and injury to the product or to other property.

   b) Pure economic loss means the difference between the actual value of a product and the expected value of the product: for instance, the difference between the value of a skill saw which cuts a 45° angle and one which should but does not, or the difference between a toaster with an operating toast popper and one with a defective toast popper.

   c) There are two types of consequential economic loss:

      - consequential to physical injury means loss causally connected with the physical injury: for instance, the loss of earning power due to an injury to a wage earner or to damaged machinery;

      - consequential to pure economic loss means loss of earnings due to a defect when the defect has not caused any physical damage: for instance, the cost of painting a house a second time after painting it once with defective paint, or lost earnings due to a defective automobile.

2. The word "defective" includes a product that has an actual value less than the expected value (measured, perhaps, by objective criteria). "Defect" also includes a failure to meet a quality standard set by the manufacturer, as well as any other weakness that results in breakdown even if the product meets the manufacturer's quality standard.

3. "Strict liability" means liability without fault - without proof of fault on the part of the supplier, whether retailer or manufacturer. In any case, a person suffering loss must prove a) a defect, and b) that the loss was caused by the defect.

   In certain circumstances, the person suffering loss must also prove that someone in the chain of distribution failed to exercise reasonable care in the manufacture and packaging of the product. Where there is strict liability, there is no need to prove the latter step - that someone was negligent and failed to exercise reasonable care.

   Where liability is not strict, there are nevertheless presumptions (that a supplier ought to have known there was a defect or that the supplier must have been responsible for the defect) which establish a kind of strict liability.

   In jurisdictions where there is a rule of strict liability, defendant manufacturers do escape liability by proving there was no defect or no causation. Hence, as discussed in this paper and others, a step from the present state of the common law in Canada to strict liability is a very small step indeed.

4. A warranty, in origin was a statement by one person upon which he intended another person to rely. Despite its origin in tort law, it is at present related exclusively to contract.

   A warranty in contract creates a form of strict liability, but only between the purchaser and the seller. Provided that the loss was caused by a defect in the goods, the seller is liable (even if he did not know of the defect and was not responsible for its presence).

It is important to consider the following categories of warranties: a) implied warranties, b) statutorily implied warranties, c) express written warranties, d) express advertising warranties, e) express oral warranties, f) additional or extended written warranties or service contracts whether or not at an additional price.

5. "Who can complain?" has become a difficult problem at common law. There are at least five types of injured party to consider: a) the purchaser, b) the second-hand purchaser, c) the user or donee, d) the bystander, and e) the second-hand purchaser who has the goods for resale.

6. The concept of "externalities", costs of the production process which are not borne by the producer, has a fair degree of significance in the product liability field for a variety of reasons. Economists argue that manufacturers ought to internalize the externalities.

   The person who has to bear the costs is the person who internalizes them and thus has the greatest incentive to avoid them. For instance, if an uninsured manufacturer bears the loss caused by his defective goods, he will try to avoid those defects in the future at least to a limited extent.

V. Economic Considerations: In Brief

There is agreement in the economic and legal literature, as well as among practitioners, that the market is failing in various ways and that the present legal system has anomalies and is not providing adequate remedies for these market failings. However, it would be difficult to determine whether government intervention will be justified on the basis of benefit/cost considerations until specific proposals can be considered. For the same reason, the measure of cost-effectiveness of given types of intervention must await a research paper in preparation which is intended to provide an economic framework for measuring various types of proposed intervention.

Market forces are such that there are inevitably products in the market that are defective, and a revision of the liability rules is not likely to change this. The expense of improving design and quality control to the absolute goal of a defect-free market would be prohibitive and sets a loose upper limit to defect-free production. The market also provides a rough lower limit in the sense that a producer whose goods are known to be defective will not have sufficient sales to stay in business. The rules of the market combined with existing legal rules determine in a loose manner the level of defective products and the levels of the losses caused and losses recovered as a result of those defects.

There has been considerable discussion about the cost effects of changes in the rules of liability. It appears that a change in liability rules will not necessarily introduce new costs but may simply shift existing costs. Indeed, a change may reduce overall costs.

In the economic analysis of product liability, factors of social justice are considered in the context of distribution of costs (and in the legal analysis, in the context of "apportionment" of loss). There are policy considerations, however, that are not adequately dealt with in a market analysis. Certain products, for instance, are sufficiently dangerous when defective that government may have a duty to intervene and set standards. Most readers are familiar with this argument and the regulations that have resulted.

Information has an essential role in ensuring that purchasers find safe products which satisfy their expectations. Certain information about products is readily available to producers or to government but there are no market forces that will elicit it. (On the contrary, there are forces that tend toward secretiveness.) Again, government intervention may draw out "low-cost" information that will yield a good return to consumers.

Nevertheless, programs adopted to achieve such policy goals as safety and disclosure should be subjected to an analysis of their effects on economic efficiency and distribution of wealth.

In the product liability context, economic considerations - efficiency and equitable distribution - are focused on two goals: fair compensation for victims of defects and the deterrence of defective production. There should be no objection to the idea that every rule devised to serve as a liability guideline in the market for products should serve at least one of those two goals.

It would be economically optimal and desirable to have the total of (a) the costs of avoiding the defects and (b) the costs caused by the defects approach a minimum. This will only happen if the person who controls the number and type of defects is also faced with the cost of compensating for the loss. In this way the internalization, for example, by the manufacturer, of the costs of compensation will act as a deterrent to the production of defective goods to the point that the costs of avoiding the defects begin to counterbalance the costs of compensating for the losses caused by the defects. Internalization will serve as an incentive to the production of safe products. By the same token, the internalization by an injured person of losses caused by his own misuse of a product will act as a deterrent to negligent use of products.

VI. This Volume

In this volume, we provide an introduction to the subject and we attempt to raise the myriad issues that face the policy maker in trying to find the fine line between over-regulation and permitting market failure. While many issues have been raised, certain have not. For instance, the broad question of whether product liability has become a discrete area of law onto itself or is a mere overlap of contract and tort law is not addressed. Such a consideration would require a thorough inquiry into the history of product liability law, not appropriate to this volume. (The interested reader may wish to see Products Liability by S.M. Waddams (Carswells, 1974) for an historical analysis.)

In addition, little consideration has been given to the role of the inventor, patent holder, designer or trademark owner, any of whom could be named as a third party or a defendant in a product liability suit. Rather, emphasis has been placed on issues concerning the seller, the manufacturer (whether or not

either owns the trade name), and the consumer as these actors have been and are expected to remain the parties ordinarily liable for the supply of defective products or the misuse of sound ones. The civil liability of other parties (such as the designer) will be related to the importance of their role in the choice of product materials, in the production process, and in the marketing of the product. The more deeply they become involved in actually placing the product in the flow of commerce the closer their role is to the manufacturer's or seller's, and the closer they will come in a given case to being the subject of the classic rules of civil liability that affect sellers and manufacturers in their day-to-day operations.

Finally, it should be noted that, although this introduction reviews the federal role in the Federal-Provincial Task Force on Legislative Programs, the papers in the volume were prepared prior to any deliberations of that Task Force on product liability. This introduction and these papers do not reflect the views of the provincial or federal government.

THE ALLOCATION OF LOSS AND RESPONSIBILITY UNDER THE PRESENT LAW IN CANADA

by Saul Schwartz
February 21, 1978

I. Introduction

Product liability is a short-hand way of referring to the allocation of responsibility for loss or injury resulting from defective products. As a general topic it raises in encapsulated form certain basic questions of social and economic policy, social justice and an efficient use of resources. These questions concern (a) who should bear principal liability; (b) for what products and for what losses; (c) to whom; and (d) to what extent. As a purely legal notion, product liability is the legal doctrine which provides the answers to these questions.

If product liability has been the subject of extensive study in recent years, in Canada and elsewhere, it is largely because the answers which the law currently provides are unsatisfactory.

In Canada, only one province, Saskatchewan, has legislation in force attempting to deal with the problems in a comprehensive manner.[1] Elsewhere, there is no law of product liability as such, only certain disparate remedies in contract and tort bolstered, in recent years, by a few consumer statutes of limited effect. It is not surprising, therefore, that the present situation has been subject to much criticism.

However, in order to determine whether, and to what extent, the present law furnishes an adequate response to social and economic needs, the first step must be to ascertain what the law is. Only then can it be evaluated. The object of this paper is to provide for that purpose, a brief non-technical summary of the existing federal and provincial law governing product liability.

No account will be taken here of various means to control the manufacture of dangerous products

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1. Since this paper was written, two other provinces, New Brunswick and Quebec have enacted statutes to deal with problems of product liability but these have not yet been proclaimed in force. [Ed.]

by federal legislation, such as the Hazardous Products Act, R.S.C. 1970, c. H-3, or the Motor Vehicle Safety Act, R.S.C. 1970, c. 26 (1st Supp.). These controls are important since they can prevent some dangerously defective goods from entering the marketplace or enable those which slip through to be removed immediately. They presently affect only a limited range of products, mainly food, drugs, cosmetics, cars, safety helmets. There are many other unregulated defective (even dangerously defective) products on the market. However, pre-market screening can offer an important safeguard for the consumer.

Similarly, no account is taken of the transactional costs of enforcing the rights a consumer may have against a supplier or a manufacturer. If the expense or delay in obtaining redress effectively prevents enforcement, the rights themselves are not of much value. This question, like that of false advertising, and the effect of criminal and quasi-criminal penalties to deter the creation of false expectations about the performance characteristics of a product will be examined elsewhere separately and in an economic context.

The focus here is narrower: to determine how the existing law allocates loss and responsibility for defective products among the manufacturer, the retailer and the consumer. The law will be reviewed against the background of a leading American decision, Henningsen v. Bloomfield Motors Inc. 32 N.J. 358, 171 A 2d 69 (N.J. Supreme Court 1960) which illustrates in dramatic form the principal issues in this area. The facts have been modified and the issues simplified in order to focus on the main problems as they were treated by the Court.

Henningsen v. Bloomfield Motors (modified)

Claus Henningsen bought a Plymouth automobile from the defendant, an authorized dealer, to give to his wife as a Mother's Day gift. The contract between the parties contained the following clauses:

> 7. It is expressly agreed that there are no warranties, express or implied, made by either the dealer or the manufacturer on the motor vehicle, chassis, or parts furnished hereunder except as follows:
>
> 'The dealer or manufacturer warrants each new motor vehicle (including original equipment placed thereon by the manufacturer except tires), chassis or parts manufactured by it to be free from defects in material or workmanship under normal use and service. Its obligation under this warranty being limited to making good at its factory any part or parts thereof which shall, within ninety (90) days after delivery of such vehicle to original purchaser or before such vehicle has been driven 4,000 miles, whichever event shall first occur, be returned to it with transportation charges prepaid and which its examination shall disclose to its satisfaction to have been thus defective; this warranty being expressly in lieu of all other warranties expressed or implied, and all other obligations or liabilities on its part, and it neither assumes nor authorizes any other person to assume for it any other liability in connection with the sale of its vehicles.' [Emphasis added.]

Ten days after the car had been delivered and with only 468 miles on the odometer, the steering mechanism failed, it ran into a wall and Mrs. Henningsen was severely injured. The car was too badly damaged to determine why the steering mechanism failed, whether it was due to a defective part, improper assembly or some other cause.

Both husband and wife sued the seller and the manufacturer, Chrysler, alleging breach of warranty and negligence. Their claims for breach of implied warranty were successful against both defendants. Mrs. Henningsen received damages for personal injuries. Mr. Henningsen recovered damages for consequential losses including damages to the car (which was a total wreck), medical expenses and loss of consortium. Their claims based on negligence were unsuccessful.

How would they have fared had the defective automobile been exported and sold in Canada?[2]

For convenience the question may be divided into

I. Liability of the Dealer

A. To the purchaser
B. To the injured third party

II. Liability of the Manufacturer

A. To the purchaser
B. To the injured third party

II. Liability of the Dealer

A. To the purchaser

The Court held that although the defect could not be pinpointed, the seller had committed a breach of contract. More specifically, the seller was in breach of the implied warranty of merchantability. Furthermore, the attempted elimination of basic contractual obligations violated public policy and was therefore void. The vendor was therefore liable in damages for breach of contract to the purchaser, Henningsen.

Two questions to be considered are:

1. What are the implied warranties in a contract of sale in Canada?

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2. No account is taken here of the possible effect of various provincial no-fault insurance schemes since the object of this paper is to outline general principles and these schemes had, until recently, only a limited impact on basic principles of liability. However, this has now changed so far as actions for personal injuries sustained in Quebec are concerned. The new Quebec Automobile Insurance Act, S.Q. 1977, c. 38 (proclaimed in force March 1, 1978) imposes a scale of compensation, payable from a central fund, and extinguishes the cause of action for personal injuries. It should be noted that certain general principles stated in the text have been superseded in Quebec in respect of defective automobiles but continue to apply to non-vehicular products.

2. to what extent can they be qualified or excluded?

1. Common Law Provinces

(i) The implied warranties in a contract of sale

All nine provinces have enacted, with minor variations the English Sale of Goods Act, 1893. All therefore contain, as a minimum, implied warranties as to:

Title
Description
Merchantability
Fitness for Purpose

The implied warranties in effect impose upon the seller a strict obligation to ensure that the goods meet certain minimum standards. Breach of an implied warranty will, in all cases, entitle the purchaser to recover damages and sometimes to reject the goods and obtain a refund. They may of course be supplemented by express warranties made by the seller at the time of sale by advertising and together comprise the legal expectations of the consumers about its performance, quality or other attributes.

There is no prescribed content for implied warranties and although there is abundant case law interpreting the Sale of Goods Acts, it may be difficult to predict whether a particular defect amounts to a breach of warranty. For example, to be "unmerchantable", the defect must have existed at the time of sale. If not, the product may have shown a want of durability, but is "durability" implicit in "merchantability" and if so to what extent? Furthermore, although the purchaser is entitled, in principle, to rescind the contract for "unmerchantability", he may in practice have to settle for damages owing to the vagaries of the sale of goods legislation.

For these reasons, some provinces have clarified and amplified the warranties implied into consumer contracts. The definition of "consumer" is not uniform, but in general means a transaction where the article is bought by an individual for his own use and consumption.

Thus in Nova Scotia "durability" is specifically implied into consumer contracts of sale. The Manitoba Act makes it clear that "goods" for the purpose of merchantability include used goods.

However, the major innovations are contained in the Saskatchewan Consumer Products Warranties Act 1977 which has replaced the warranty of merchantability by a new warranty of "acceptable quality". This warranty applies to new and used goods except with respect to defects which the seller has specifically drawn to the consumer's attention beforehand or, if the consumer happens to examine the goods, those defects which he ought to have noticed himself.

It has also added a warranty of durability and, for products requiring maintenance, a new warranty that spare parts and service facilities will be available for a reasonable time after purchase.

Another important feature is the section specifying the various rights of the aggrieved buyer. The provisions set out in detail, for example, the conditions in which the buyer can reject the product ("breach of substantial character" or an "unremediable breach") and when the seller shall have an opportunity to repair the product.

However, this is the only Act to do so.[3]

(ii) The exclusion of implied warranties

Implied warranties may be supplemented by express warranties made at the time of purchase. They may also be modified, or eliminated, which is the situation in the Henningsen case. In place of all the implied warranties the seller has only an express 90-day warranty. Every provincial Sale of Goods Act contains a provision enabling the parties to contract out of any of its provisions. However, it is unlikely that the exclusion clause in Henningsen would protect the vendor any more than it did in New Jersey.

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3. New Brunswick enacted in 1978 the Consumer Product Warranty and Liability Act, S.N.B. 1978, c. 18, embodying many of the reforms proposed in the Third Report of the Law Reform Project (N.B. 1976) but it has not yet been proclaimed in force.

Five provinces[4] have enacted legislation to prevent the exclusion of implied warranties in consumer transactions which would render clause 7 in Henningsen null and void.

See British Columbia: Sale of Goods Act, R.S.B.C. 1960, c. 344, (as amended) s. 2.A.
Manitoba: Consumer Protection Act, S.S.M. 1970, c. C200, ss. 58, 96.
Nova Scotia: Consumer Protection Act, R.S.N.S. 1967, c. 53, (as amended) s. 20C.
Ontario: Consumer Protection Act, R.S.O. 1970, c. 82, (as amended) s. 44a.
Saskatchewan: Consumer Products Warranties Act, 1977 ss. 1976-77, c. 15, ss. 7, 11.

The Saskatchewan Act goes further than the others. Any attempt to exclude or modify the statutory warranties is made an offence under the Act. This is an important advance upon the equivalent provisions elsewhere. To declare an exclusion clause null and void is not thereby to prevent its use. The added sanction will serve to prevent the consumer from being misled about his rights. On the other hand, it does allow the retailer to exclude statutory warranties in sales of used goods.

In the four[5] provinces which have enacted unfair trade practices legislation it might be possible to establish that the exclusion clause was an "unfair act or practice" because of its form, or an "unconscionable act or practice" because it was "excessively one-sided in favour of someone other than the consumer". In either event, the purchaser could claim damages and, except in Alberta, the exclusion clause could constitute an offence punishable by fine or imprisonment.

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4. See also, New Brunswick: Consumer Product Warranty and Liability Act, S.N.B. 1978, c. 18, s. 24. (not proclaimed)

5. Newfoundland has also enacted a Trade Practices Act, S.N. 1978, c. 10, but the Act has not yet been proclaimed in force.

Alberta: Unfair Trade Practices Act, S.A. 1975, c. 33, ss. 4, 11.
British Columbia: Trade Practices Act, S.B.C. 1974, c. 96, ss. 2, 20.
Ontario: Business Practices Act, 1974, S.O. 1974, c. 131, ss. 2, 4.
Prince Edward Island: Business Practices Act, S.P.E.I. 1977, c. 31, ss. 3, 5.

However, these statutes have not yet been used in this way and their impact on the common law is still undetermined.

The purchaser would also be protected in those provinces where he would have to rely upon the common law, namely New Brunswick and Newfoundland. In that event, his right to recover damages notwithstanding the exclusion clause would depend on his willingness to sue and the readiness of the courts to apply the doctrine of fundamental breach. The case law indicates that the doctrine is applied very often in consumer contracts as a rule of law disentitling the vendor from protection by the clause. In addition, the courts have demonstrated a growing willingness to intervene where standard form contracts containing harsh terms are imposed in conditions of gross inequality of bargaining power.

If Claus Henningsen had sued Bloomfield Motors in Canada, he would have recovered damages for breach of the implied warranty of merchantability and recovered damages for property damage and other consequential losses, awarded him in New Jersey.

Nevertheless, there is reason for concern about the lack of uniformity in the legislation concerning particularly the meaning of "consumer" sale. The small businessman is always excluded, yet he cannot choose his terms any more than the salaried consumer. In addition, the law goes no further than to impose very basic warranties. Despite recommendations by various law reform commissions, the only province to provide for the possibility of imposing additional warranties based on an industry standard for a particular product (e.g., automobiles) is Saskatchewan. The relevant provisions have not yet been proclaimed.

2. Quebec[6]

The starting point in civil law for determining the liability of the seller to the purchaser is also the law of contract and the warranties implied by law into a contract of sale in the Civil Code.

(i) The Implied Warranties

As Article 1506 makes clear, there are basically two implied warranties:

(i) title
(ii) latent defects

The latter is particularly important in the context of defective products. A latent defect is one which existed at the time of sale, was unknown to the purchaser (Art. 1522), was of such a nature as to affect the enjoyment of the product and had it been known to the purchaser, he would not have bought the product, at least not at the same price. There is a considerable body of jurisprudence dealing with the question of whether a defect was "latent" or "apparent" and when it was discoverable by the purchaser. It seems clear that a layman buying a new car from an automobile dealer would have little to worry about. He would not be expected to make any mechanical inspection before purchase.

In general, where a purchaser can prove that there was a latent defect in a product at the time of sale and where he acts with reasonable diligence, he can obtain a refund of the price plus expenses -- unless the dealer has excluded the implied warranties in the contract of sale.

(ii) Exclusion of implied warranties

Article 1524 allows the vendor to exclude the implied warranties but he can only do so if he does not "know" of the latent defect. To disclaim with knowledge is tantamount to fraud. Knowledge may be actual or presumed, but it is well established that where (but only where) the vendor "specializes" in

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6. This discussion must be read in the light of the new Consumer Protection Act S.Q. 1978, c. 9. [Ed.]

selling the product in question, he will be conclusively fixed with knowledge of the defect. Thus, Bloomfield Motors would not be allowed to deny knowledge of the defect and regardless of the exemption clause, Article 1527 would apply. The purchaser in Quebec could rescind the contract if he acted with reasonable diligence (Art. 1530) and, in this case, would be liable to "pay all damages suffered by the buyer" (Art. 1527) because he knew or was deemed to know of the latent defect.

There may be difficulties in proving that the product contained a latent defect at the time of sale, particularly in cases like Henningsen where the product was destroyed. Although in recent years the courts have shown a willingness to raise a presumption of fact in such cases, the onus is still on the buyer to prove that the cause of the crash was a latent defect.[7]

B. To the injured third party

The New Jersey Supreme Court had no difficulty in holding that the warranty of merchantability was also owed to Mrs. Henningsen:

> It is our opinion that an implied warranty of merchantability chargeable to ... a dealer extends to the purchaser of the car, members of his family, and to other persons occupying it or using it with his consent.

Mrs. Henningsen was therefore able to recover from the dealer damages for her personal injuries caused by a defective product.

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7. The new Consumer Protection Act S.Q. 1978, c. 9, will effect important changes in this area when it is proclaimed. The warranties implied in the contract will be expanded to include a list which is comparable to that in the new Saskatchewan Act. No account is taken here of these important proposals or those of the Civil Law Revision Office. [Ed.]

The situation in Canada is rather different.

1. Common Law Provinces

It is a basic rule of Anglo-Canadian law that contractual rights and duties arise only between contracting parties. No one but the parties to a contract may sue or be sued in respect of it.

If a man takes his wife out to dinner and they both suffer food poisoning, the right to sue the restauranteur for breach of contract (the implied warranties) will turn on who paid the bill. In our case, the person who paid the bill was Mr. Henningsen. If his wife, the donee, sought to recover damages for personal injuries from the dealer for breach of contract, she would encounter the barrier of privity and her action would fail. However, as the New Brunswick Law Reform Commission (Third Report) succinctly stated:

> To say that only the parties to a contract have rights under the contract is not, of course, to say that only parties to contracts have rights. The law of tort imposes certain responsibilities on the seller of goods even in the absence of a contract. There are certain important differences between contract and tort, with regard to the obligations imposed and the interests protected. While contract imposes strict liability, tort imposes only negligent liability. (p. 135)

Unlike contract, responsibility (and hence damages) may be apportioned between the parties on the basis of their respective degrees of fault. Thus, the dealer is liable in contract to Henningsen for breach of the implied warranty of merchantability regardless of whether the defect was due to his fault or could not have been discovered using even the utmost care. But the dealer will be liable to Mrs. Henningsen only if he proved to have been culpably negligent, i.e., in breach of his duty to take reasonable care to prevent the defective product from causing injury. This duty is owed to anyone who may foreseeably be injured.

As the law presently stands in Canada, it is unlikely that Mrs. Henningsen would succeed in tort. The cause of the steering failure was never ascertained. The dealer would not be liable in negligence unless it could be proved that the defect was discoverable by such examnation as a reasonable automobile dealer would be expected to undertake, as it was known, or ought to have been known, to the dealer. No higher standard of care is owed. (See J. Fleming, Law of Torts, 512, (5th ed. 1977).)

Several provincial reports have recommended the elimination of the privity doctrine in consumer transactions and the extension of the benefits of the implied warranties to the consumer to produce the same result as in Henningsen. So far, however, only one province has enacted legislation to implement such proposals.

The Saskatchewan Consumer Products Warranties Act, 1977 provides in section 4 that:

> persons who derive their property or interest in a product from or through the consumer, whether by purchase, gift, operation of law or otherwise shall ... be deemed to be given by the retail seller or manufacturer, the same statutory warranties as the consumer ...

The retail seller would, under this section, be liable to Mrs. Henningsen, the subsequent owner, for breach of the statutory warranty of "acceptable quality". Since damages are recoverable for all losses which are reasonably foreseeable as a result of the breach (section 20), she could recover from the retailer damages for personal injuries.

The Saskatchewan Act goes further. Section 5 extends the statutory warranties imposed on the retailer to certain users of the defective product:

> A person who may reasonably be expected to use, consume or be affected by a consumer product and who suffers personal injury as a result of a breach, by a retail seller or a manufacturer or a statutory warranty ...

The important limitation is that the user can recover only if he has suffered personal injuries which were reasonably foreseeable as a result of the breach.

In no other common law province is the retailer liable to the donee or user for loss or injury resulting from a defective product.[8]

2. Quebec

So far as the law of contract is concerned the situation is not very different from that in the common law provinces. The implied warranty against latent defects in Article 1527 of the Civil Code applies, like all other provisions in the Section on Sales, only as between vendor and purchaser. The third party, donee, has no right of action in contract against the retailer who has breached Article 1527.

The donee or user could sue the dealer in delict under Article 1053: "Every person ... is responsible for damage caused by his fault to another, whether by positive act, imprudence, neglect or want of skill." The product was not merely defective but dangerously defective. However, in order to recover damages under Article 1053, the donee would have to prove "fault" by the dealer, i.e., failure to exercise reasonable care (to act as a bon père de famille). The duty of care imposed on the dealer in delict is no greater than that imposed in common law negligence. An action in delict under Article 1053 in these circumstances would produce the same result as an action in negligence: no liability.

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8. See also the unproclaimed New Brunswick Consumer Product Warranty and Liability Act, S.N.B. 1978, c. 18, s. 23.

III. Liability of the Manufacturer

A. To the purchaser

Liability for defective products is, in contract, imposed on the vendor. At one time this may have corresponded with the proper source of responsibility for the defect but it is clear that such an assumption is no longer valid today. In the modern marketplace, the retailer is often no more than a conduit for reselling pre-packaged goods. As the Ontario Law Reform Commission stated in its Report on Consumer Warranties and Guarantees in the Sale of Goods (1972):

> It is the manufacturer who endows the goods with their characteristics and it is he who determines the type of materials and components that shall be used and who establishes the quality control mechanism. It is he who determines what express warranties shall be given to the consumer and who is responsible for the availability of spare parts and the adequacy of servicing facilities. Almost all the consumer's knowledge about the goods is derived from the labels or markings attached to the goods or [sic] the sales literature that accompanies them -- and these too originate from the manufacturer. (p. 65).

If liability to compensate for losses caused by defective products should be imposed primarily on the one responsible for creating the defect, the appropriate person to bear the loss is the manufacturer rather than the retailer. Responsibility may be shifted to the manufacturer if the retailer sues for indemnification based on breach of the warranty of merchantability, or any other term in their contract of sale. However, the extent to which this cumbersome device is available will depend on the terms of the contract. There may exist between them the same disparity of bargaining power and imposed terms as between dealer and purchaser, but as a "commercial" contract the terms are not subject to legislative controls or the same likelihood of judicial intervention -- at least in the common law provinces. In Quebec the implied warranties will apply. Apart

from the moral question of placing responsibility on those who are blameworthy, there is also the practical aspect of deterrence. As Chief Justice Laskin said in a recent case, manufacturers

> will be more likely to safeguard the members of the public to whom their products are marketed if they must stand behind them as safe products to consume or to use. They are better able to insure against such risks, and the cost of insurance, as a business expense, can be spread with less pain among the buying public than would be the case if an injured consumer or user was saddled with the entire loss that befalls him.9

Another important practical reason for providing the consumer with a right of recourse against the manufacturer is the possibility that the retailer lacks the means to satisfy the claim. The probability of this is greatly increased if the breach of contract is due to a defect in design for the retailer may be faced with many similar claims. Unless the manufacturer is an available defendant, the purchaser may have no redress at all, at least in contract.

1. Common law provinces

The purchaser may have a remedy in contract or tort against the manufacturer. The remedy in contract is rather tenuous and will be dealt with first.

The fact that the manufacturer created the defect in the product which amounts to a breach of the implied warranty of merchantability in the contract between purchaser and dealer does not give the purchaser any recourse in contract against the manufacturer. The manufacturer was not a party to the sale and the doctrine of privity would bar any such claim.

In order to recover damages from the manufacturer, the purchaser would first have to establish that a contract existed between them. If he could get

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9. Rivtow Marine Ltd. v. Washington Iron Works, [1973] 40 D.L.R. (3d) 530, 551 (Laskin C.J.C.)

over this obstacle, he would then have to prove that the manufacturer had warranted that the product was of merchantable quality. It should be noted at this point that the statutory warranties of merchantability, fitness for purpose, etc., in the Sale of Goods Acts apply only to the contract of sale, i.e., the contract between purchaser and retailer.

Whether a contractual link can be established between manufacturer and purchaser depends on finding a collateral contract, that is, finding whether the purchase was made in reliance on a promise by the manufacturer that the product would conform to certain standards. For example, if the purchaser had seen an advertisement declaring a product to be "durable and sound" and on the strength of that bought the product from a dealer only to discover that it was fragile and defective, he could sue the manufacturer for breach of an express warranty in their collateral contract. However, easy as such contracts are to conceive of in abstract it is difficult to prove the elements of prior knowledge and reliance and there are few reported cases where the rules of privity were successfully circumvented in this way.10

If the purchaser is able to prove he had suffered loss or damage as a result of relying on false advertisement, it could make a difference to his rights. In the first place, if the advertising were in breach of Part V of the Combines Investigation Act, R.S.C. 1970, c. C-23, as recently amended, he might try to recover damages under section 31.1. That section has not yet been tested and its effects are controversial. Alternatively, false advertising would also constitute an "unfair or deceptive act, representation or practice" and it might also have a remedy in damages against the manufacturer under the unfair trades practices legislation in British Columbia (Trade Practices Act, S.B.C. 1974, c. 96 as amended, ss. 1, 2, 20) and Alberta (Unfair Trade Practices Act, S.A. 1975, c. 33, ss. 1(b), 4, 11.).

In Henningsen, the New Jersey Supreme Court held that the purchaser and manufacturer had concluded a collateral contract, consisting of an offer by the

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10. Trueman v. Maritime Auto & Trailer Sales Ltd., 19 N.B.R. (2d) 8 (N.B.C.A. 1977)

manufacturer (extended through the dealer) of its "New Car Warranty" in consideration for the purchase by Henningsen of a Plymouth car from the dealer. The collateral contract was of little use to the purchaser because the terms of the express warranty promised no protection against defects of merchantability. Even if such a warranty were to be implied -- and as already noted none would be implied in Canada -- the term of the express warranty would have excluded it.

The legislative restrictions on excluding conditions in consumer contracts apply, with the exception of Saskatchewan, to contracts governed by the Sale of Goods Act.

Alternatively, the purchaser could sue in tort and prove that the manufacturer had been negligent. (The general conditions were mentioned earlier in the context of Mrs. Henningsen's action against the dealer.) There are, however, two major obstacles. The first relates to proof of negligence where, as here, the cause of the damages is unknown. The standard of care depends on the degree of risk created by the product. But only in cases involving food, drink and certain inherently dangerous chattels -- such as explosives, but not automobiles -- does the standard of care approach strict liability. In other cases proof of fault is needed. It must be shown that an injury was caused by a defect in the product, and that the product was defective when it left the manufacturer. This can be difficult where, as in this case, the product was destroyed. Although the courts have demonstrated a growing willingness to attribute fault to the manufacturer where the cause of the defect is unknown and to require the manufacturer, in effect to "disprove" negligence, it is premature to conclude that the era of strict product liability has arrived in Canada.

In 1972, Professor Linden (now Mr. Justice Linden) wrote:

> It is time for the Canadian law of product liability to relieve the injured consumers from the onerous burden of proving fault, and so require manufacturers to stand behind their defective products, whether they were negligently produced or not ... If the courts do not act soon, we can expect the legislatures to fill the vacuum. (Linden, Canadian Tort Law 425 (1972).)

The same passage is to be found in the latest edition of this standard text published in 1977.

The second obstacle relates to the loss claimed by Henningsen. His principal claim is for "direct loss", or damage to the product itself and while such damage is recoverable for breach of contract, it is not clear that such damage is recoverable in tort where the basis for recovery is negligence in the manufacture of a defective product.

It seems appropriate at this stage to compare the approach taken by the New Jersey Supreme Court. The Court stated:

> where the commodities sold are such that if defectively manufactured they will be dangerous to life or limb, then society's interests can only be protected by eliminating the requirement of privity between the maker and his dealers and the reasonably expected ultimate consumer. In that way the burden of losses consequent upon use of defective articles is borne by those who are in a position to either control the danger or make an equitable distribution of the losses when they so occur... We see no rational doctrinal basis for differentiating between a fly in a bottle of beverage and a defective automobile.

There was, the court held, an implied warranty of merchantability which ran with the goods from the manufacturer to ultimate consumer.

> [W]e hold that under modern marketing conditions, when a manufacturer puts a new automobile in the stream of trade and promotes its purchase by the public, an implied warranty that it is reasonably suitable for use as such accompanies it into the hands of the ultimate consumer.

Chrysler, by its express warranty, had specifically excluded any implied warranties. The court held otherwise:

> [W]e are of the opinion that Chrysler's attempted disclaimer of an implied warranty of merchantability and of the obligations arising therefrom is so inimical to the public good as to compel an adjudication of its invalidity.

Thus the American court developed, via the law of implied warranties, a doctrine of strict liability imposed on the manufacturer of defective products.

Several reports have advocated the enactment in Canada of a similar doctrine of strict product liability based on implied warranties running with the goods.

So far, only one province, Saskatchewan, has acted on these recommendations.

By section 13 of the Consumer Products Warranties Act 1977, manufacturers are "deemed" to give statutory warranties. Section 14 abolishes the rule of vertical privity and is combined with sections 4 and 5 to permit the purchaser, donee or user to sue the manufacturer directly for breach of statutory warranties. For this purpose "manufacturers" can include importers and distributors of imported products, processors, assemblers of goods, etc.

Other provisions (not yet in force) deal with difficult problems of attributing liability for express warranties where, for example, they consist of advertising or labels attached by the manufacturer before they reach the retailer (section 10).

It is possible that in practice the reach of the provisions imposing liability on manufacturers may be shorter than intended. As the New Brunswick Law Reform Commission (Third Report) pointed out, difficult questions of a constitutional and procedural nature arise when an attempt is made to impose liability on extra-provincial suppliers (pp. 175-195). An Ontario manufacturer who sells defective products in Ontario to a Saskatchewan retailer may be beyond the jurisdictional reach of Saskatchewan legislation. (It is assumed that he has no office in Saskatchewan.) Yet, according to section 33(2) he may be "indirectly

market[ing] consumer products in Saskatchewan". Service of process and enforcement of judgements obtained against extra-provincial suppliers are additional problems.

The New Brunswick report recommended a tort law approach since that was considered to offer a more secure basis for imposing liability for acts which were mainly extra-provincial. Product liability would be made a tort of strict liability allowing the purchaser or user to sue either the retailer or manufacturer for damages for economic loss or for personal injuries.[11]

However, it is doubtful whether the jurisdictional and procedural problems can be solved by one province acting alone.

2. Quebec

As noted earlier, the implied warranty against latent defects in Article 1522 of the Civil Code applies only between vendor and purchaser. In principle the same barrier of privity operates between manufacturer and purchaser in Quebec as in the common law provinces.

While that is the case in principle, there have been a few decisions in recent years which have ignored the rules of privity to hold the manufacturer strictly liable to the purchaser for latent defects causing damage or loss. These cases have usually concerned defective automobiles[12] although they are not confined to such products.[13] Having been accepted

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11. Adopted in s. 27 of the unproclaimed New Brunswick Consumer Product Warranty and Liability Act, S.N.B. 1978, c. 18, at least in respect to products that are not merely defective but dangerously defective. [Ed.]

12. Lazanek v. Ford Motor Co., [1977] R.L. 262; Gougeon v. Peugeot Can. Ltée., [1973] C.A. 824; Building Products of Can. v. Sauvé Constr., [1976] C.A. 420

13. Lavoie v. C.R.S. Caravane Ltée., [1976] C.S. 611.

by the Quebec Court of Appeal,[14] one route to imposing strict liability upon the manufacturers has now been opened.

The established means for suing the manufacturer where there is no privity is in delict, and the development towards strict liability under Article 1053 of the Civil Code match, but go no further than, those in common law for the tort of negligence. For food, drink and commodities, a presumption of fault (under Article 1238) is cast upon the manufacturer. In practice, the standards of care in this limited area approach strict liability.[15]

In other cases, the duty imposed on manufacturers by Article 1053 is in principle "a duty to take reasonable care that the products he manufactures and issues to the public are free from defects which are likely to cause harm to life, or property of the ultimate user, with whom he stands in no contractual relationship".[16] The duty of care has in fact been equated with that demanded in common law jurisdictions.[17] However, the law in this area is in a state of flux: the courts seem intent on developing a doctrine of strict product liability as the Civil Code Revision Office has recommended.[18] But they still have some way to go.[19]

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14. And by the Supreme Court: See now Gen. Motors Products of Canada Ltd. v. Kravitz (S.C.C. Jan. 23, 1979). In the new but unproclaimed Consumer Protection Act, S.Q. 1978, c. 9, the purchaser will have direct recourse against the manufacturer who will be strictly liable for breach of any of the listed warranties implied into the contract of sale (See Title III, Chapter I).

15. Cohen v. Coca Cola, 62 D.L.R. (2d) 285 (S.C.C. 1967).

16. Masoud v. Modern Motor Sales Ltd., [1951] R.L. 193.

17. Cie F.X. Drolet v. London & Lancashire Guarantee Accident Co., [1943] Que. K.B. 511, aff'd [1946] S.C.R. 82.

18. Report on Obligations, Art. 103.

19. The legal position may be clearer now that the Supreme Court has handed down its decision in G.M. Products of Canada Ltd. v. Kravitz.

B. Liability to injured third party

1. Common law provinces

At common law, an action against the manufacturer in contract would have foundered for the same reason as an action against the dealer: absence of privity. In view of the state of the law of tort (mentioned above), an action in negligence would also be unlikely to succeed -- although if it did, Mrs. Henningsen could recover damages for her personal injuries.

It seems likely, therefore, that in the absence of legislation, a donee or user would have no remedy at common law.

The situation should be contrasted with the result in Henningsen v. Bloomfield Motors and later American developments. In Henningsen, the New Jersey court held that the implied warranty of merchantability ran from manufacturer to ultimate user. Mrs. Henningsen was therefore able to recover damages for personal injuries. Later American cases have shifted the basis of liability from implied warranties in contract to strict liability in tort.[20] The remedies of injured consumers, it was thought, should not depend on the intricacies of the law of sales -- but they do in the common law provinces, and on a very inadequate law.

2. Quebec

As discussed in the context of the dealer's liability to the injured user, Mrs. Henningsen would have little chance of recovering damages in Quebec.[21] There is clearly no contractual link between the manufacturer and the user -- and the line of jurisprudence extending liability for breach of implied warranties to the manufacturer so far affects only the purchaser. Mrs. Henningsen could sue the manufacturer in delict under Article 1053 C.C. As already noted, there is no doctrine of strict liability for defective products although if, as it would appear,

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20. Restatement Second on Torts, Section 402A.

21. But see new Automobile Insurance Act, S.Q. 1977, c. 38, ss. 3, 4.

the vehicle was dangerously defective the degree of proof required to render the manufacturer liable in delict would not be very high. Mrs. Henningsen's chances of success would depend on proof that her injuries were due to a defect in the car and that the defect was present when the car left the manufacturer's hands.

IV. Conclusion

As the preceding analysis shows, the law in Canada apportions liability for losses resulting from defective products rather differently than in the United States.

A. In the common law provinces

With the exception of Saskatchewan,[22]

1. The seller is strictly liable in contract only to the purchaser and his obligations may be varied or waived if the transaction is not a consumer transaction.

2. The seller is not liable without proof of fault to the injured third party.

3. The manufacturer is not liable without proof of fault either to the purchaser or the injured third party. There is no general doctrine of strict product liability: liability is "strict" only in cases involving food, drink, cosmetics and a limited category of "inherently dangerous chattels".

In Saskatchewan[22], recent legislation has imposed strict liability on the retailer and the manufacturer for loss caused by defective products. This strict liability extends to the purchaser, donee and user of the product. The Act is new, parts of it are unproclaimed and it remains to be seen how effectively it has dealt with the difficult procedural and jurisdictional problems in imposing liability on extra-provincial suppliers.

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22. And New Brunswick when it is eventually proclaimed. [Ed.]

B. Quebec[23]

1. The seller is strictly liable in contract only to the purchaser.

2. The seller is not liable to third parties without proof of "fault" under Article 1053 C.C.

3. The manufacturer may be strictly liable to the purchaser for personal injuries and economic loss under a flourishing but controversial line of jurisprudence.

4. The manufacturer is not liable without some proof of fault to the injured party.

C. General

With the exception of Saskatchewan[24], the present law governing liability for defective products in Canada embodies most of the substantive criticisms made by the English and Scottish Law Commissions in a recent report about their own applicable law.

1. In the absence of proof of fault on the part of the manufacturer, only a person standing in a contractual relationship with the supplier of goods has a right and remedy. Where the injured person was not the buyer, he must bear the loss himself.

2. In the absence of proof of fault on the part of the manufacturer, a person standing in a contractual relationship with the supplier has rights and remedies only against him - usually a retailer. Thus liability will often fall not on the manufacturer - who may commonly be regarded by members of the public and others as being

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23. This conclusion will change when the new Quebec Consumer Protection Act, S.Q. 1978, c. 9, is proclaimed. [Ed.]

24. And upon proclamation of the new legislation in New Brunswick and Quebec. [Ed.]

responsible for the quality and safety of the product - but upon a retailer, who from a practical point of view is seldom nowadays regarded as being so responsible.

3. In a number of situations including that envisaged in the preceding paragraph, it may be necessary for each party in the chain of distribution to claim against his immediate supplier for breach of contract, and in consequence the existing law may multiply litigation.

4. A person who claims against a producer in tort or delict has to establish first that his injury was caused by a defect in the product, and second that the defect existed in the product when it left the hands of the producer. The latter burden, in particular, he may be unable to discharge.

5. A person who claims against a producer in tort or delict has a third task, that of establishing that the defect was there because of fault on the part of the producer. Experience shows that if the claimant in tort or delict surmounts the two earlier hurdles he may often be able to surmount the third, because he is aided by the doctrine of res ipsa loquitur or its practical equivalents. He is, however, at a disadvantage in relation to access to the relevant evidence and scientific expertise, and this may be a real barrier to the initiation of an action on his part. (Law Comm. No. 82, 1977 para. 29)

The detailed policy guidelines formulated by the Law Commissions might be very helpful in determining the reforms to the law of product liability in Canada.

1. The loss should lie primarily on the person who created the risk: we are convinced that, particularly when a product is mass-produced, this solution makes sense as a matter of economics. If 10,000 products are manufactured in the same run and one of them, being defective, causes an accident, the easiest way of spreading the loss fairly is to place it on the manufacturer, who can recover the cost of insuring against the risk in the price that he charges for his product.

2. Liability should be imposed on those in the chain of manufacture and distribution who are in the best position to exercise control over the quality and safety of the product: this gives a producer an incentive to improve the safety standard of the product and to reduce the risk of further accidents. A product may be handled by many persons on its way to the buying public, some of whom control its quality, others of whom, such as wholesalers and distributors, usually do not. The person best able to control the quality of the product is, almost invariably, the producer and it is to him that the liability ought accordingly to be channelled. So far as practicable, however, this should be done in a way which will not inhibit technical innovation or progressive industrial development. The possible incidence of spurious claims should also be taken into account.

3. It is desirable that the risk of injury by defective products should be borne by those who can most conveniently insure against it. In the existing state of the law most producers insure against their liability in tort or delict or in contract. First party insurance in respect of personal injury is comparatively rare and comprehensive cover is expensive. The producer is likely to be in the best position to insure against the risk. By putting on the producer the

risk of injury caused by a defect in his product and by taking it away from the person injured one would be adding, no doubt, to the insurance premium otherwise payable by the producer, to an extent which, it must be conceded, is speculative until claims experience is acquired: but we believe that it would be a cheaper and administratively more convenient way of providing compensation for the person injured than to leave individuals to arrange their own first party insurances.

4. Public expectations should be taken into account in determining where the loss should lie. It is in the main the producer rather than the retailer whose name is linked in the public mind with the product, and our impression is that when the product turns out to have a defect which causes an accident public expectation is that the producer should provide redress. Public expectations in the safety and performance of products may be raised by advertising and promotional material emanating from the producer.

5. It is desirable to remove difficulties of a procedural or evidentiary character which impede rather than assist the course of justice ... actions in tort or delict against manufacturers of defective products often pose such difficulties, because the circumstances under which the product has been designed, made and tested may be exclusively within the knowledge of the manufacturer.

6. The policy of the law should be to discourage unnecessary litigation: it is not our function in this report to examine this problem in detail but we are persuaded that the competency of a direct action by the injured person against the person ultimately responsible for causing the injury can only serve to keep litigation to a minimum.

7. It would not be in the public interest to discourage first party insurance in the circumstances in which it is at present usual and appropriate. There are some kinds of risk for which first party insurance is normal, the most significant being the risk of damage to property. The discussion that follows relates only to claims arising out of personal injury and death ... we reject the suggestion that strict liability for defective products should extend to property damage or other heads of damage, such as pure economic loss.

8. The number of persons in the chain of manufacture and distribution who should be liable to third parties should not exceed the number needed to ensure that adequate rights and remedies are available to injured persons. Otherwise costs, and with them the price to the ultimate consumer, are likely to increase. Many different persons and organizations may be involved in the production and distribution of a single product. In some legal systems, notably the State of California, the risk of an accident caused by a defect in a product is put on every member in the "producing and marketing enterprise" including retailers, wholesalers, distributors, those who supply goods on hire and even financing institutions who provide the loan capital for manufacturing companies. If each and every member is liable and has to arrange his own insurance cover, the extra administrative costs and the extra litigation costs mean an increase in the ultimate price to the public of the product ... On the other hand special considerations apply where the defective product has been manufactured abroad.

9. As a matter of general importance, the laws ... should not put such heavy additional liabilities on ... producers as (i) to place them at an undue competitive disadvantage in the international market or (ii) to inhibit technical innovation or research or (iii) to cause reputable manufacturers to cease production altogether. (Law Comm. No. 82, 1977 Para. 38)

EXCERPTS FROM A MEMORANDUM ON RESOLUTION OF CONSUMER PRODUCT WARRANTIES PROBLEMS*

by Jacob S. Ziegel
March 1977

I. Nature and Scope of Warranty Problems

Potential initiatives to resolve outstanding product liability issues cannot be determined without some understanding of the dimensions of warranty problems. The following list represents the main categories of problems:

1. Inadequate information prior to purchase. Lack of reliable information about the character and capability of a product is a pervasive problem that affects the quality of many consumer decisions in the modern marketplace. The consumer's ability to make informed judgements is further complicated because of the growing complexity of most durable products, the exaggerated expectations created by modern forms of advertising, and the non-informational nature of such advertising.

2. Misleading information about nature of product and its performance characteristics. This is a familiar phenomenon, not peculiar to product or warranty advertising, and of course it has been the object of federal (and, more recently, provincial) concern over a substantial period of time.

3. Confusing warranty disclosure and nomenclature. There is no rule of Canadian law, whether in Quebec or in the common law provinces, which requires a manufacturer or retailer to volunteer express warranties. In fact manufacturers' warranties have been common for many years -- but frequently as competitive devices rather than as genuine symbols of reassurance to the consumer. So the adage has taken root that "warranties do not mean what they say and do not mean what they mean".

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*This is an excerpt from a longer study prepared by Professor Ziegel. It serves as an excellent introduction, however, to his second piece in this volume, on "Major Policy Issues". Hence, we have reproduced it here. [Ed.]

4. Uncertainties about consumer's warranty rights. Even before the introduction of the provincial Sale of Goods Acts, the common law implied important warranties of quality and fitness in favour of the buyer. However, these were hedged about by difficult and anomalous rules and not always readily adaptable in the consumer context. Nor was it clear to what extent they applied to used goods or in self-service stores, and to what extent they embraced a requirement of durability. The sales rules in the Quebec Civil Code suffer from similar or other shortcomings.

   Even more serious is the basic rule, common to both systems, that only the seller is deemed to warrant the fitness of his goods; hence, in the absence of a manufacturer's express warranty and other forms of collateral representations, the consumer has no right of recourse against the manufacturer for defective goods not giving rise to personal injuries or damages to other property. His warranty rights are restricted to the retailer although in the modern market-context the typical retailer is little more than a conduit pipe for the transmission of goods from the manufacturer to the ultimate consumer.

5. Use of disclaimer clauses. To add to the consumer's plight, the provincial Sale of Goods Acts all provide that the seller may vary or exclude the statutory warranties implied in the buyer's favour.[1] Sellers have freely availed themselves of this provision and it is a rare written agreement of purchase and sale that does not contain some type of disclaimer clause.

6. Non-observance of warranty obligations. Even when the seller's or manufacturer's warranty obligations are reasonably clear, there is no guarantee that they will be honoured. The retailer may lose interest in the goods once

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1. See the solutions to this problem recently adopted by three provinces, noted in Professor Schwartz's paper, above, in addition to the four provinces mentioned below at page 35. [Ed.]

they have been sold, or the hopeless consumer may be caught in the intricacies of manufacturer-retailer relations, inadequate or non-existent servicing facilities, disputes about the existence or cause of the defect in the malfunctioning product, and restrictions in the terms of the warranty that may deprive it of most of its value.

7. Lack of suitable remedial mechanisms. It is a truism that rights conferred by law are only as strong as the remedies available to enforce them. In theory the consumer who is unable to obtain voluntary redress of his grievance has a right to bring action in a court of law. In practice, most consumers are very reluctant to litigate because of the expense, the delays involved in most types of court proceedings, the unpredictability of the outcome, and the lack of familiarity with the courts and judicial procedures. Hence there arises the need to develop new redress settlement mechanisms, either on a voluntary basis (through industry or government sponsored programs of mediation) or statutorily through the establishment of new types of tribunals, the conferment of new powers on public officials, or legal aid and other devices designed to make private law litigation more attractive to the average consumer.

8. Used goods. The sale of used goods, especially used motor vehicles, raises problems of its own which require particularized treatment, both legislatively and administratively.

II. Existing Disposition of Problems

A. Provincially

The primary source of provincial jurisdiction is section 92[13] of the BNA Act, the property and civil rights clause, and, until recently, it was assumed to be broad enough to permit the provinces to legislate across the full spectrum of warranty problems as outlined above. A doubt has arisen as a result of the recent decision of the Supreme Court of Canada in Interprovincial Co-operatives v. Queen (1975) 53 D.L.R., (3d) 321. Some colleagues of the author have interpreted the decision as potentially restricting the

power of the provinces to regulate the activities of manufacturers and other distributors of consumer products where the manufacturer has no business establishment within the province and there is no privity of contract between the manufacturer and the ultimate purchaser of his product. If this interpretation is correct, it would have very important constitutional implications and would greatly strengthen the case for a strong federal role in the warranties area. However, I believe Interprovincial Co-operatives can be distinguished on its facts and for the purposes of the ensuing discussion it is assumed that the provinces do at least have concurrent jurisdiction to regulate the sale incidents of products that are sold in the territory of the enacting province.

Existing provincial legislation differs substantially in its scope and subject matter, but any balanced catalogue of provincial initiatives should include the following items:

1. Sale of Goods Acts. All the common law provinces have copied, more or less verbatim, the British Sale of Goods Act 1893. The Act contains strong implied warranties of description, merchantability and fitness in favour of the buyer and a powerful set of remedies. Nevertheless, as explained in the report of the Ontario Law Reform Commission of 1972 on Consumer Product Warranties and Guarantees, the Act has proved increasingly inadequate to meet the needs of consumer purchasers in the 1970s. Among the more important weaknesses in the Act are the following:

   - The Act does not apply to manufacturers unless the manufacturer is in direct privity with the retail buyer. In practice he rarely is.

   - The definition of express warranty, as traditionally applied by the Anglo-Canadian courts, is too narrow and leaves uncertain the extent to which a seller is contractually bound by advertising and other types of representations inducing the purchase of his goods.

- The implied warranties fail to deal with such important questions as the durability of the goods and the availability of spare parts and reasonable repair facilities where the goods are of a type which require regular servicing or repair.

- The Acts do not confer a right to reject non-conforming goods in respect of latent defects of a serious character which only emerge after the initial period of inspection following delivery of the goods has expired.

- Most importantly, as previously mentioned the Act permits the seller to exclude or vary any of the provisions of the Act, including the implied warranties. In practice, sellers avail themselves of this right with unfailing regularity and either exclude all warranties or substitute in their place warranties of much lesser value. Title V of Book II of the Civil Code of Quebec contains special rules concerning the sale of movables and immovables. These are derived from French law and are based on Roman law concepts. Like the common law Sale of Goods Acts, the Quebec Code also implies important warranties in the buyer's favour (garanties legales) but these too can frequently be excluded and suffer from other important shortcomings.

2. Agricultural Machinery Legislation. Historically, legislation of this type appears to have been the earliest attempt in Canada to introduce a separate statutory scheme to protect buyers of a particular type of goods which have attracted repeated complaints. Agricultural machinery legislation was first introduced in the Prairie Provinces during the First World War[2] and still obtains (with numerous subsequent revisions and modifications) in Alberta, Saskatchewan and Manitoba. Similar

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2. Warranties Report, supra n. 1, pp. 66-67 Stat. Sask.

legislation was also subsequently adopted in Prince Edward Island. The Saskatchewan Act[3] is probably the most comprehensive of the four.[4] It provides for licensing of dealers and distributors; it creates strong statutory warranties of fitness in favour of the buyer which cannot be excluded; and it sets forth a detailed procedure with respect to the farmer's rights relating to machinery delivered in a defective condition. The statutory warranties include warranties of durability and oblige the seller to maintain a reasonable supply of spare parts. The warranties bind the manufacturer as well as the retail dealer. A distinctive feature of the Saskatchewan legislation is the establishment of an Agricultural Implements Board which is empowered to investigate complaints and, in appropriate cases, pay compensation to an aggrieved party from a fund specially established for this purpose. Earlier Saskatchewan Acts also contained provisions for the testing and evaluation of agricultural implements and repair parts. The Prairie Provinces have since established a Prairie Agricultural Machinery Institute to assume these and other functions.

3. Consumer Protection Acts. This legislation, like the initiatives mentioned hereafter, is of post-war origin. All the provinces, including Quebec, now have this type of act (though not necessarily appearing under this name). Initially the legislation was designed to deal with door-to-door selling abuses, to introduce truth-in-lending requirements in consumer credit transactions, and to regulate other aspects of consumer credit. Subsequent amendments

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3. Saskatchewan Agricultural Implements Act 1968, Stat. Sask. 1968, c. 1, as am.

4. For a general overview of the Prairie and P.E.I. legislation, see Ontario Report, supra n. 1, pp. 98-99.

in many of the provinces have embraced several aspects of product warranties. The British Columbia, Manitoba, Nova Scotia and Ontario Acts now nullify disclaimer clauses. The Manitoba Act also contains some reasonably significant updating of the implied warranties in the Sale of Goods Act.

4. Motor Vehicles Licensing Statutes. The Ontario Motor Vehicle Dealers Act[5] is the best known species of this genus. Although not directly concerned with warranties, it gives the Registrar of Motor Vehicle Dealers an important handle with which to mediate warranty disputes and to improve dealers' conduct. The Registrar, for example, has used his moral suasion to introduce fairer and more intelligible standard form contracts. He has lent his authority to the adoption of a more meaningful rustproofing warranty, and his intervention has led to the cancellation or suspension of licensing for odometer tampering as well as other forms of fraud and reprehensible conduct.

5. Used Car Safety Legislation. Ontario again pioneered in seeking to prevent dealers and private sellers from foisting unsafe vehicles on unsuspecting buyers. Since 1968 the Ontario Highway Traffic Act has prohibited the transfer of ownership of a vehicle unless it was accompanied by a certificate of mechanical fitness, now re-named safety standards certificate. The old title was a misnomer since the certificate was, and is, only concerned with the safety of the vehicle.[6] Nevertheless, it has had a beneficial spill-over effect in generally improving the quality of used vehicles offered for public and private sale.

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5. R.S.O. 1970, c. 475, as am.

6. Stat. Ont. 1973, c. 167, s. 8, am. R.S.O. 1970, c. 202, s. 58. See further Ontario Report, supra n. 1.

6. Trade Practices Acts. These belong to the most recent round of consumer protection legislation and are modelled along the lines of the American Uniform Consumer Sales Practices Act, though with strong individual variations. The British Columbia and Ontario Acts were both introduced in 1974, that of Alberta a year later.[7] Saskatchewan has announced its intention to adopt a trade practices act in the near future and Quebec's Bill 7, unveiled in 1976 and likely to be re-introduced by the Levesque government, also contains important trade practices provisions. The goal of trade practices legislation is to suppress unfair or deceptive acts or practices, not to guarantee the quality of goods or to impose new warranty obligations. Nevertheless, the concepts enshrined in the legislation are sufficiently broad to reach a substantial number of objectionable practices associated with product warranties, and have been so used by the Federal Trade Commission in issuing trade practices regulations pursuant to its comparable powers under the Federal Trade Commissions Act.

7. Consumer Product Warranties Legislation. Proposals for legislation dealing specifically with consumer product warranty problems have only recently attracted consideration at the provincial level. Once again Ontario seized the initiative. The Ontario Law Reform Commission report of 1972 analysed the provincial problems in the light of the then available data and offered a comprehensive blueprint for dealing systematically with all the major issues. Its proposals included:

   - a liberalized definition of warranty and abolition of the parol evidence rule in consumer transactions.

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7. Prince Edward Island and Newfoundland now have similar legislation. [Ed.]

- abolition of the distinction between warranties and conditions.

- clarification and extension of the statutory warranties.

- abolition of vertical and horizontal privity rules.

- extension of the statutory warranties to manufacturers.

- prohibition of disclaimer and limitation-of-remedy clauses.

- a revised scheme of remedies for warranty breaches fairer to both seller and buyer.

- establishment of mediational and arbitral machinery for the extra-currial settlement of warranty disputes.

The Ontario Government issued a Green Paper in 1973[8] indicating its initial reaction to the report and inviting public comment on the OLRC recommendations and the questions raised in the Green Paper. The Ministry of Consumer and Commercial Relations also held public hearings across the province but, for the most part, these were poorly attended and not very productive. After a substantial delay the Ontario Government published in 1976 Bill 110, the Consumer Products Warranties Act 1976. The Bill was given first reading and allowed to die on the order paper. It was not carefully drafted. It purported to give effect to many of the substantive recommendations in the OLRC report (and indeed went beyond them in one or two instances). However, the draftsmen apparently misunderstood the remedy recommendations and they chose also to ignore the vital recommendations for the settlement of warranty disputes. It is understood that a revised Bill 110 may be introduced in due course though not during the current session of the Ontario legislature.

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8. Green Paper on Consumer Product Warranties in Ontario, Aug. 1973.

At least two other provinces, British Columbia and Saskatchewan, have also evinced interest in the adoption of a consumer product warranties act. The British Columbia Department of Consumer Services, as it was then called, initiated a legislative project in 1975 but abandoned it after the election of a new provincial government in December 1976. Saskatchewan published its Proposal for a Consumer Products Warranties Bill in the spring of 1975. On the whole, this followed faithfully the OLRC recommendations and indeed went beyond them in at least one important respect. The Proposal was subsequently revised and was expected to be given legislative form at the 1976 or 1977 session of the Saskatchewan legislature. At the time of writing (March 1977) this transformation has not yet occurred.9

Uniform warranty legislation has appeared on the agenda of several interprovincial meetings of government officials. A meeting of officials was held in Toronto in October 1976 to determine whether agreement could be reached on the contents of a uniform act. My information is that the officials were not able to reach a consensus and, having regard to the wide differences between Bill 110 and the Saskatcheawn Proposal, quick agreement was hardly to be expected.

Conclusion

The foregoing survey has focussed on legislative and normative standards rather than informal programmes for the adjustment of warranty problems such as may be in force on a voluntary level within the broader framework of consumer complaint handling activities at the provincial level. Suffice it to say, on the basis of available information and my own experience, the ability of most provincial agencies to intervene successfully in the resolution of warranty disputes is somewhat limited both by the paucity of resources and the absence of supporting legislation.

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9. At the time of publication the Saskatchewan legislation had been enacted (S.S. 1976-77, Chapter 15), New Brunswick had enacted the Consumer Product Warranty and Liability Act, (S.N.B. 1978, c. 18) and Quebec had enacted a revised Consumer Protection Act including product liability provisions (S.Q. 1978, c. 9) although the latter two are not yet in force at March, 1979. [Ed.]

Subject to this caveat, the following conclusions appear to be warranted. First, taken as a group, the provinces already have a substantial body of experience in related areas of consumer concern to use as a precedent for coming to grips with warranty problems. Secondly, so far no province has adopted a comprehensive programme of warranty protection and the prospects for the near future of uniform legislation of a high standard are at best uncertain. Thirdly, even those provinces which have shown active interest in the adoption of new legislation have focused little attention on the importance of supplying the consumer with better pre-purchasing information and developing consumer product testing facilities. Finally, no province appears so far to have developed a capability of dealing effectively with national manufacturers or importers of durable products or succeeded in establishing effective, expeditious, and suitable dispute settlement mechanisms. This is the problem par excellence in the motor vehicle field. These gaps suggest fruitful areas for federal intervention but before pursuing this theme it will be convenient to review briefly developments in the U.S. and some other common law jurisdictions.

B. Developments in other jurisdictions

1. United Kingdom and Australia

Both the U.K. and Australia have a growing volume of legislation dealing with express and implied warranties in the sale of goods, but neither to the best of my knowledge has so far enacted a consumer product warranties law which even remotely matches the recommendations in the OLRC Report or the provisions in the Saskatchewan Proposals.

As previously remarked, basic sales law in the U.K. is governed by the Sale of Goods Act 1893. Sections 12-15 of the Act deal with implied warranties. These provisions were amended by the Supply of Goods (Implied Terms) Act 1973 which implemented the recommendations of an earlier report by the English and Scottish Law Commissions. The 1973 amendments do not affect common law privity doctrines (save in one respect not relevant in the present context) with the result that manufacturers are still not deemed to give implied warranties to the ultimate consumer of their goods unless the consumer purchases the product directly from the manufacturer. Again, the 1973 amendments do not regulate the form, content or

implementation of express performance warranties. The amendments do, however, contain a feature which mirrors parallel legislation in the Canadian provinces insofar as they avoid any term in the contract of sale purporting to exclude the implied warranties and conditions in section 13-15 of the parent Act. In non-consumer sales such disclaimer clauses will in the future be unenforceable "to the extent that it is shown that it would not be fair or reasonable to allow reliance on the terms".

The Trade Descriptions Act 1968 is the British counterpart of sections 36-37 of the Canadian Combines Investigation Act though the British Act differs significantly from the Canadian provisions in content and form. The British Fair Trading Act, 1973 combines elements of anti-trust law (which supersede the earlier Restrictive Practices Acts) with modest provisions directed against the suppression of unfair practices deemed inimical to the consumer's welfare. See Parts II and III of the Act. Though apparently similar in intent to the American Federal Trade Commission Act and the provincial trade practices legislation in Canada, the British provisions are much more timid and contribute no new insights to this aspect of consumer protection. It is not therefore necessary to pursue them.

So far as Australia is concerned, it is necessary to distinguish between developments at the state level and initiatives by the central government. All the states have apparently adopted the British Sale of Goods Act 1893. A uniform hire-purchase act which was, and perhaps still is, in force in most of the states throughout the 1960s also contained implied warranty provisions applicable to consumer instalment sales which could not be excluded. Anti-disclaimer clause provisions directed against consumer sales generally have now been enacted in at least two states, New South Wales and South Australia.[10] The New South Wales provisions contain a novel feature. The doctrine of privity of contract has been modified to the extent that the court is given power to add a manufacturer or importer as a party where it appears that the goods were defective when delivered. Warranty

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10. N.S.W., Commercial Transactions (Misc. Provisions) Act, 1974, s. 7; S.A., Consumer Transactions Act, 1972, ss. 8-15.

legislation restricted to the sale of new and used motor vehicles has also been adopted in a substantial number of states. Here too New South Wales appears to have introduced a modest innovation. Its Motor Dealers Act, 1974 provides that the dealer's obligation is deemed to enure in favour of the owner of a motor vehicle whether or not he was the original purchaser of the vehicle.

Of particular interest is the South Australian Manufacturers' Warranties Act 1974, which appears to have been influenced by the OLRC recommendations. The Act implies warranties of merchantability and availability of spare parts which run direct from the manufacturer to the consumer purchaser and permit the consumer to sue the manufacturer directly for damages for breach of express and statutory warranties. The Act also permits the Governor in Council to make regulations with respect to the form of express warranties. None appear to have been adopted so far. I have no information about the practical impact of the Act.

Intervention by the central government in the warranties area is of very recent origin and is found in Division 2 of Part V of the Commonwealth Trade Practices Act, 1974.[11] Its contents follow closely the provisions of the British Supply of Goods (Implied Terms) Act 1973 but, unlike the British Act, the Commonwealth provisions only apply to corporate suppliers. This restriction apparently owes its origin to Section 51(xx) of the Commonwealth of Australia Act which confers jurisdiction on the central government to enact laws with respect to foreign corporations and trading or financial corporations formed within the limits of the Commonwealth.[12]

From the Canadian constitutional perspective, it is important to note that the authority of the Australian government is not restricted to contracts by corporations engaged in interstate commerce and no such restriction appears in the Trade Practices Act.

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11. This Act has recently been amended to extend certain warranties back to the manufacturer, Trade Practices Amendment Act 1978 (Assented to 6 December 1978, Australia). [Ed.]

12. See Tapperell et al., Trade Practices and Consumer Protection (1974), para. 106 et seq.

2. United States

The American position is complex and it is not possible to do justice to its intricacies in the time at my disposal even were I competent to do so. I shall therefore restrict myself to a description of some of its more salient features.

As in Canada, both the federal and state governments enjoy jurisdiction in this branch of consumer law, that of the state governments being based on their general "police" power while the federal jurisdiction is primarily derived from the "commerce" clause of the U.S. Constitution. State common law generally followed the implied warranty concepts developed by the English courts in the nineteenth century until superseded by state legislation. The most important of these was the Uniform Sales Act which was drafted in 1906 by the Conference of Commissioners for Uniform State Legislation, and subsequently adopted in a majority of the states. Its implied warranty provisions substantially copied[13] the provisions in the British Sale of Goods Act. In 1949 the Uniform Sales Act was superseded by Article 2, the sales article, of the Uniform Commercial Code. The Code, in its original or revised form, has been adopted by all the states with the exception of Louisiana, and by the District of Columbia.

Article 2 modifies the warranty provisions in the Uniform Sales Act in the following respects:

- it authorizes a court to refuse to enforce all or any of the terms of a contract of sale if the court finds them to be unconscionable (UCC 2-302).

- it deems prima facie unconscionable attempts by a seller to exclude liability for consequential damages for injury to the person in consumer goods (UCC 2-719).

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13. Except in one important respect. The dichotomy between warranties and conditions, an important feature of Anglo-Canadian law, was not adopted in the American Act.

- it extends the seller's express and implied warranties to any person who may reasonably be expected to use, consume or be affected by the goods and who is injured by breach of the warranties. Liability for injury to the person of an individual cannot be excluded or limited (UCC 2-318).

As will be seen, UCC 2-318 breaches the walls of privity in the case of defective goods liable to cause personal injuries and therefore foreshadowed the movement towards strict liability which gained rapid momentum in the 1960s. At first the courts used the concept of a warranty running with the goods to rationalize the basis of the manufacturer's liability to the consumer.[14] The reasoning was rejected by the Supreme Court of California in Greenman v. Yuba Power Products[15] as artificial and contrived and the manufacturer's liability was put on a tort basis of strict liability for defective goods. This is the theory that has been preferred by most subsequent state courts. What remains unclear is whether tort liability attaches to defective goods involving the consumer in economic loss and not resulting in any personal injury or physical damage to property. In Santor v. A. & M. Karagheusian Inc.[16], the Supreme Court of New Jersey held that no distinction should be drawn between the different types of injury to the consumer but this approach was rejected as too draconian by the Supreme Court of California in Seeley v. White Motor Company.[17] It was the opinion of the California court that economic losses should continue to be governed by the warranty principles in Article 2 of the Uniform Commercial Code and this is the view that appears to have prevailed in the majority of subsequent state decisions. Apart from UCC 2-318, the Code's warranty provisions only apply between the immediate parties to a contract for sale. It follows that in

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14. See Henningsen v. Bloomfield Motors (1960) 161 A. 2d 69 (N.J.)

15. (1963) 377 p. 2d 897.

16. (1965) 207 A. 2d 305.

17. (1965) 403 p. 2d 145.

American law, as in Canadian law,[18] the consumer cannot sue the manufacturer for breach of implied warranties only causing him economic loss, though he will be entitled to hold the manufacturer accountable for breach of an express warranty if the warranty was intended to reach the consumer and was relied upon by him.[19] In the latter case it is not necessary for the consumer to show that there was a direct contractual nexus between him and the manufacturer.

Though the retention of privity doctrines might have been expected to attract adverse reactions in the case of consumer goods, only California appears so far to have adopted legislation reversing the traditional rules.[20] The Song-Beverly Act, enacted in 1970 and amended since,[21] regulates both express and implied warranties applicable to the sale of consumer goods. A manufacturer of consumer goods sold in the state is bound to the consumer by implied warranties of merchantability and fitness (s. 1792. & 1792.1), which can only be excluded in the case of a sale "as is" or "with all faults" and where the disclaimer complies with the statutory notice requirements (s. 1792.3).

Manufacturers and retailers remain free, of course, to offer express warranties but an express warranty may not limit, modify or disclaim the implied warranties provided for in the Act (s. 1793). The language of an express warranty must be "in readily understood language" and, if the warrantor elects to maintain service and repair facilities within the state, provide details of these facilities (s. 1793.1). If the warrantor maintains such repair facilities then, unless the buyer agrees otherwise, the

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18. Except in provinces such as Saskatchewan that have extended the statutory implied warranty to the consumer-manufacturer relationship. [Ed.]

19. Ontario Warranties Report, supra n. 1, p. 67.

20. A handful of states have adopted amendments to Article 2 of the UCC or independent laws barring exclusion of implied warranties in consumer sales transactions.

21. Cal. Stat. 1970, c. 1333, p. 2478, am. 1971, c. 1523, p. 3001.

malfunctioning product must be serviced or repaired within 30 days of their return (s. 1793.2). If the warrantor maintains no repair facilities within the state, the buyer is entitled to return the non-conforming goods either to the retailer from whom he purchased them or to any retail seller within the state who sells like goods of the same manufacturer (s. 1793.3). A retailer who discharges the manufacturer's warranty obligations is entitled to be reimbursed by the manufacturer for the services provided by him (s. 1793.5).

So far as I have been able to ascertain, the Song-Beverly Act has had negligible impact. One reason may be that the Act provides no public machinery for its enforcement -- an aggrieved consumer is entitled to recover treble damages for willful breach of a warrantor's obligations (s. 1794.) but presumably this is not a sufficient inducement to consumers to police the Act themselves. Another serious defect is the omission of any structure for the expeditious settlement of disputes. In my opinion, the California Act is not well drafted and is only of limited precedential value for the formulation of statutory solutions in Canada.

In terms of precedents, the Magnuson-Moss Warranty - Federal Trade Commission Improvement Act,[22] adopted by Congress in January 1975, is of substantially greater interest, although it suffers from its own self-imposed limitations. The Act marks the culmination of almost ten years of efforts by Senator Magnuson and other members of Congress to respond to consumer warranty complaints[23] but it remains to be seen how far the Act will be successful in resolving them.

The Magnuson-Moss Act is essentially a disclosure statute. It does not require a supplier to provide a warranty if he chooses not to, nor does it determine the scope of express warranties except as to terminology. A supplier remains free to make it as generous or as limited as he sees fit. The Act's sponsors obviously felt that competition, not Congress, should determine warranty standards and that easier

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22. P.L. 93-637, 15 U.S.C. 2301.

23. Ontario Report, supra n. 1, pp. 92-95.

comparability would encourage manufacturers to offer superior warranties. Again, with two exceptions, the Act does not affect state law governing applicable implied warranties. Bearing in mind these important restrictions, the following is a summary of the principal provisions of the Act:[24]

1. Section 102, which applies to warranties of consumer products priced at $5.00 or more, provides for disclosure of the terms and conditions of a written warranty. This section empowers the Federal Trade Commission to promulgate regulations requiring inclusion of certain information in a written warranty. Such rules may require, inter alia, inclusion of any of the following items: a clear identification of the name and address of the warrantor, the identity of the parties to whom the warranty is extended, the products or parts covered, what the warrantor may be expected to do in the event of a defect, malfunction or non-conformity with the written warranty, the procedure a consumer should follow to secure warranty performance, information regarding the availability of any informal dispute settlement procedure the warrantor may provide, a description of the legal remedies available to the consumer, and the time when the warrantor will perform any obligations under the warranty.

2. Section 102 also requires the FTC to prescribe rules requiring the terms of any written warranty to be made available to prospective consumers prior to the sale of the product.

3. Section 103 requires the written warranty on a product sold to a consumer for more than $10.00 to be conspicuously designated as a "full (statement of duration) warranty" or "limited warranty". The "full" designation is reserved for those warranties which meet the federal minimum

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24. The summary is based on an internal TFC staff memorandum of 10 June 1975.

standards for a warranty set forth in section 104 of the Act. Under these standards, a warrantor must remedy the product within a reasonable time and without charge in the case of a defect, malfunction or failure to conform with the written warranty. In addition, the "full" warrantor may not disclaim or modify any implied warranty of durability arising under state law. The "full" warrantor may exclude or limit consequential damages for breach of express or implied warranties if it is done conspicuously on the face of the warranty.

4. If the warrantor fails to remedy the defect or malfunction after a reasonable number of attempts, the warrantor must give the consumer the choice of a refund or a replacement of the product or part without any charge. A full warranty imposes only the requirement of notification upon consumers as a condition of securing remedy, unless the warrantor can justify in a rule-making proceeding or other forum that another duty is reasonable. The Commission is empowered to specify the requirements of this section by a rule, including the determination of what constitutes a reasonable number of attempts to repair the product under different circumstances.

5. Section 106 provides that the Commission may prescribe by rule the manner in which terms of service contracts are disclosed to consumers.

6. Section 107 permits the designation of representatives but provides that such a designation will not relieve the warrantor of his direct responsibilities to the consumer or make the representative a co-warrantor.

7. Section 108 prohibits disclaimer of any implied warranty when there is a written warranty or when the warrantor enters into a service contract applicable to the product within 90 days of the sale. The only modification of an implied warranty

permitted under these circumstances is the limitation of the duration of the implied warranty to the length of a written ("limited") warranty of reasonable duration, as long as the limitation is conscionable and is clearly and conspicuously disclosed on the face of the warranty.

8. Section 110(d)(1) creates a private right of action including, in very restrictive circumstances, the right to bring a class action, for damages and other legal and equitable relief in any court or competent jurisdiction in any state or the District of Columbia or in an appropriate U.S. District Court if the prescribed jurisdictional requirements are met.

9. Section 110 encourages warrantors to establish informal dispute settlement procedures to resolve consumer complaints without litigation. The Commission must prescribe rules establishing minimum standards for such procedures which a warrantor may incorporate into the terms of a written warranty. If a warrantor establishes such a procedure in accordance with the Commission's rules, the warrantor may require that a consumer first resort to the procedure before pursuing any legal remedy created by the Act.

10. The Act does not invalidate or restrict any right or remedy available to consumers under state law or other federal law [section 111(b)(1)], except as otherwise provided.

11. Section 111(e) provides that a state requirement which relates to written warranty labelling disclosure or performance thereunder and which is within the scope of sections 102, 103 or 104 of the Act (but not identical to the provisions under these sections) will not apply to written warranties which are in compliance with the federal Act unless the Commission determines otherwise.

12. A state may apply for exemption from the provisions of the Magnuson-Moss Act and, in considering such application, the Commission must consider, inter alia, whether the state legislation affords greater protection to consumers than the requirements of the Federal Act and does not unduly burden interstate commerce.[25]

The Federal Trade Commission, as the public agency responsible for the administration and enforcement of the Magnuson-Moss Act, has so far adopted trade regulation rules involving the following subjects:

Part 701 -- disclosure of written terms and conditions of consumer product warranties.
Part 702 -- pre-sale availability of written warranty terms.
Part 703 -- informal dispute settlement mechanisms.

(See C.F.R., December 31, 1978, pp. 60168 et seq.). Parts 701 and 702 became effective December 31, 1976. Part 703 became effective July 4, 1976.

The Commission has also given notice of proposed rules covering (a) disclosure and other regulations concerning the sale of used motor vehicles (41 C.F.R. 1089, January 6, 1976), and (b) calculation of depreciation for refunds under full warranties on consumer products (16 C.F.R., Part 704, June 1, 1976). My information is that, because of lack of response from industry, the second proposal may not be proceeded with.

It is too early to judge the practical impact of the Act or its success in promoting greater warranty competition, improved warranty standards, and more scrupulous observance by warrantors of their warranty obligations. The Act's sponsors may have proceeded on an unduly optimistic view of the importance which consumers attach to warranty provisions as a factor in purchasing decisions. On the other hand, the compulsory classification of warranties, coupled with the Commission's prestige and enforcement powers, may

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25. California appears so far to be the only state which has applied for exemption. See FTC News Summary, 16 July 1976.

increase manufacturers' sensitivity and awareness of their warranty responsibilities and suppress some of the more obvious abuses which have occurred in the past. These are at least modest starts in the right direction. A serious shortcoming of Magnuson-Moss is that it provides no machinery for the informal settlement of warranty disputes, particularly since, as pointed out in my earlier memorandum, suppliers have shown little disposition to establish their own industry-sponsored machinery.

As noted, Magnuson-Moss does not impose minimum quality standards, but a description of the evolving U.S. position would be incomplete without a reference to several federal Acts which (albeit largely for other reasons) do regulate this area. The Food and Drugs Act is too well known to require further elaboration; the National Traffic and Motor Vehicles Safety Act is equally familiar and served as a model for the Canadian Motor Vehicles Safety Act. The Consumer Product Safety Act is the American counterpart of our Hazardous Products Act. All these Acts, and others less well known, are primarily concerned with product safety.

In addition to the NTMVSA, the Motor Vehicle Information and Cost Savings Act (P.L. 92-510), adopted by Congress in 1972, is consciously directed towards improving the quality of motor vehicles and providing the purchaser with more information about performance characteristics. Title I of the Law requires the Secretary of Transportation to set properly loss reduction standards with the object of producing automobiles that are more resistant to damage or less expensive to repair if damaged. Title II requires the Secretary to undertake a study of the methods for determining the susceptibility of passenger motor vehicles to damage, their repair costs, and their degree of occupant protection. When these data have been assembled the Secretary is expected to develop procedures to communicate it to consumers.

Finally, reference should be made to a Consumer Product Testing Act Bill (s. 643, 94th Cong., 1st Sess.) introduced in the Senate in 1975 by Senators Magnuson and Moss. The purpose of the bill was to establish reliable and uniform protocols for quality and performance testing of consumer products and to require meaningful dissemination of the results of such tests to consumers. The bill was not enacted but is indicative of continuing American concern about the quality and reliability of pre-purchasing information available to consumers and could serve as another useful precedent for Canadian action.

MEMORANDUM: MAJOR POLICY ISSUES IN PRODUCER LIABILITY FOR DEFECTIVE GOODS

by Jacob S. Ziegel
November 29, 1977

I. Introduction

This memorandum has been prepared at the request of the Department of Consumer and Corporate Affairs with a view to assisting economists in the preparation of studies on the economic foundations of product liability. As the title of the memorandum indicates, the mandate is to outline the major policy issues and not to suggest definitive answers or to provide a blueprint for possible legislation, federal or provincial. A discussion in depth, even if limited to the major policy issues, would require more time than that available and these remarks therefore should simply be regarded as signposts for future lines of enquiry. Also, this paper intentionally avoids any attempt to describe, except incidentally, the complex judicial and legislative position that now governs this branch of the law in Canada and the important developments that have been occurring in other jurisdictions. Needless to say, they provide a rich storehouse of experience and approaches in considering responses to unresolved problems.

Finally, a caveat is in order about the scope of this memorandum. The instructions were not clear whether to confine it to the liability of manufacturers and producers and exclude other participants in the distributive chain, notably retailers. It is important to include retailers so as to provide a balanced picture, and that has been done. Specifically the instructions were to consider the tortious as well as warranty liability of producers for defects causing injury to persons or damage to other property. The reader should appreciate that the author believes he is not an expert in this specialized area of the law. Finally, functionally, and to a substantial extent conceptually, harmful products have traditionally been regarded as requiring a separate approach from defective products resulting only in economic loss. The distinction is sound and of fundamental importance and that view has been adopted in the discussion which follows.

II. Liability for Economic Loss

A. Why should the law hold the producer liable for defective products causing economic loss and what interests should it seek to protect?

These questions are of pervasive importance and provide the key to many of the more detailed questions that follow. The traditional and rather meaningless answer is that the producer/seller has breached his express or implied promises to deliver defect-free goods. A more reasoned reply is that by injecting the goods into the marketplace and inviting their purchase the participants in the distributive chain trigger behavioural responses which cannot be disappointed without undermining confidence in the marketplace. More specifically, according to a widely accepted analysis of contract philosophy, the law seeks to protect the buyer's expectation, reliance and restitutionary interests engendered by a contract of purchase and sale.

Is this too idealized a view of the marketplace? Does it take sufficiently into account the financial and technical constraints under which most goods are produced? If so, what formulas will more fairly represent the interests of buyers and sellers?

B. Conceptual basis of liability

Should the producer's liability rest in contract, in tort or both, or should it be of a hybrid nature? The problem has attracted an increasing amount of attention during the past decade, particularly in the United States. While there is no unanimity, the weight of opinion favours a contractual or, more accurately, a sales law (warranty) approach. For a recent discussion of the issues, see Morrow v. New Moon Homes Inc., (1976) 548 P. 2d 279, Alaska S. Ct., and the literature cited in n.6.

This memorandum supports a sales law approach. The basic issue is whether the producer's liability is imposed ab extra by non-excludable legal norms or whether liability is deemed to arise because of breach of a consensual bargain between the parties. Obviously, the less scope is seen for genuine bargaining the stronger the case for a tortious approach. However, even in these types of cases the distinction remains important in defining the range of persons protected

against economic losses, the types of losses, and the nature of the remedies.

C. Assuming a sales law-warranty approach, what types of warranty?

In common with other legal systems, Canadian provincial law has long accepted the distinction between express and implied warranties. Both continue to raise important policy issues:

1. Express Warranties

a) How should it be defined: in terms of the Chandelor v. Lopus test, the Uniform Sales Act test, or the test in UCC 2-313? To what extent should privity between the parties be relevant? If a reliance test is adopted, must the consumer show awareness of, and reliance on, the representation before the purchase? How much allowance should be made for puffing? In answering these questions I believe the better approach is to ignore artificial distinctions and to adopt a common sense, functional approach. Hence, I would favour a presumption of reliance where the representation is made to the public and could normally be expected to induce reliance conduct.

b) Verbal warranties. To what extent should the seller be liable for the unauthorized representations of his salesmen? Sellers argue that to hold them responsible for such representations is to introduce an imponderable element into their cost accounting as well as to encourage the fabrication of evidence which cannot be readily verified. While admitting the potential for abuses and possible hardship to the seller, I believe the equities favour the consumer buyer who reasonably relies on the salesman's representations.

2. Implied Warranties

a) General considerations. It has been the theory of our law for more than a century that the buyer's reliance not only arises from express representations but is also implied from the nature of the goods, the nature of the transaction, and the status of the parties. Sellers might feel that this tilts the balance too heavily in the buyer's favour -- that the law has taken too one-sided a view of the transaction and that a more competitive marketplace would develop if consumers were forced to bargain for improved express warranties instead of relying on implied warranties. The almost universal use of disclaimer clauses reflects this line of reasoning. Canadian law, judicial and legislative, has strongly resisted it by its concept of an irreducible core of implied obligations. (Apart from consumer sales legislation and the jurisprudence, see now also the Ontario New Home Warranties Act and the British Defective Premises Act 1974, for comparable developments in the real estate field.) It is unrealistic to expect the average consumer buyer to bargain effectively for warranty protection and it is too late to attempt to reverse the clock. See also infra, section VII.

b) Types of Implied Warranties. Present law recognizes implied warranties of title and quiet possession, description, merchantability and fitness, and correspondence with sample in a sale by sample. Technical questions arise under each of these heads. This discussion is confined to two that are particularly controversial:

i) Strict Liability. Should the seller be held responsible for breach of a warranty even though he was excusably ignorant of the defect and

could not have discovered it by the use of reasonable care and skill? The question arises most frequently in the case of defective products causing physical harm (see e.g., Kendall v. Lillico and the Ashington Piggeries case), but not exclusively so (see e.g., Beale v. Taylor, Microbeads v. Vinhurst Road Marketings Ltd.). By the use of the fiction of implied absolute promises the law early deflected attention from the relevance of negligence, which seems ironical in view of the slow evolution of a general negligence doctrine in the tortious area. Is the law correct in its approach? Should absolute liability depend on the nature of the interest sought to be protected, and should fault remain a relevant consideration in determining the seller's liability for consequential losses and in assessing the admissibility of disclaimer clauses?

ii) Durability. Viewed through the buyer's eyes, durability merely represents his expectation of a stream of benefits over a reasonable period of time. Whether existing law supports this concept is a moot point. The Ontario Law Reform Commission (OLRC) report on Consumer Warranties and Guarantees felt the buyer's expectations were reasonable and should be explicitly recognized; they now have been in the Saskatchewan Consumer Product Warranties Act. The Canadian Manufacturers Association (CMA) strongly objected to the OLRC recommendation on several grounds, the most important of which are the uncertainty and cost of a test of "reasonable" durability. Granting the legitimacy of these concerns, is the only alternative to allow producers an unfettered discretion to determine the duration of express and implied warranties of quality? If so, how much substance will remain to the obligations of merchantability and fitness?

A possible compromise might be to adopt the CMA's suggestion of minimum periods of durability but this presupposes agreement on acceptable minimum periods and the willingness of manufacturers to release data on the life expectancy of major types of consumer goods and the frequency and types of warranty claims.

3. Types of Goods

a) Durable and soft goods. Most litigation in the warranties sphere involves durable goods. However, general sales law draws no distinction between different categories of new goods on the footing that the character of the buyer's interest deserving of protection does not differ. Is this a sound approach? Can the remedial provisions of a modern consumer sales law be applied indifferently to soft and hard goods and to goods for internal consumption as well as goods for use?

b) Used goods. These remain a troublesome area. The better reasoned decisions hold that the implied warranties also apply here although there is much difficulty in determining the requisite degree of merchantability and fitness. Cf. Bartlett v. Sydney Marcus Ltd. with Crowther v. Shannon Motor Co. From the dealer's point of view, there is the added complication that any damages he may be forced to pay cannot readily be recovered from the manufacturer. Do these difficulties argue in favour of restoring the principle of caveat emptor to this category of goods? Is the better alternative a prophylactic regime of inspection to prevent unsafe goods being sold (cf. provincial certification requirements in the case of used vehicles) and a mandatory system of disclosure of known defects as adopted in Australia and New Zealand?

D. What types of sellers should be subject to implied warranties?

Should they be confined to manufacturers and producers? Should they also include retailers and any other merchant-seller who forms part of the distributive chain? An economist might argue that only the manufacturer/producer should be held responsible since he controls the quality of the goods, sets the price pattern, and ultimately determines the buyer's expectations. On pragmatic grounds, I believe it important that the retailer should continue to be held equally accountable. In most cases the hardship will be more apparent than real since the retailer will be entitled to be indemnified by the wholesaler or manufacturer from whom he acquired the goods.

It should be clear in any event that notions of privity should not govern the range of affected sellers. Even manufacturers do not seriously argue otherwise. But abolishing privity concepts must be a two-way exchange: if the manufacturer is to be held liable to the ultimate buyer, the buyer must also be bound by valid disclaimers accompanying the goods or otherwise introduced by the manufacturer at the time of original sale.

E. Beneficiaries of warranties -- abolishing horizontal privity

This problem has attracted most attention in the personal injury area, but may also be of considerable importance (i) where goods are bought for another's use, e.g., by way of a gift, or (ii) where the retail buyer may reasonably be expected to dispose of the goods before they have exhausted their economic usefulness.

Assuming the reasonableness of extending the merchant-seller's obligations in favour of transferees other than the original consumer buyer, what restrictions should he be able to place on the transferability of his warranty obligations? Should he have an unfettered discretion? Should it depend on the nature or the value of the product? Should he be entitled to charge a reasonable fee as a condition of his acceptance of the transfer? The reluctance of the motor vehicle industry and other types of manufacturers to recognize the free transferability of warranty rights suggests that they involve added costs for the manufacturer. Do the available data support this inference?

F. Remedies for breach of warranty

Existing sales law principles are generally very favourable to the buyer. If he acts promptly he may reject the defective goods and also sue for reliance and expectation as well as incidental damages. The recoverable damages cover consequential as well as direct losses. Does this strike a fair balance? From the seller's point of view there are several objections, viz.

a) An unrestricted right to reject leaves the seller with used goods which he cannot resell without substantial loss. This argues in favour of the seller's right to cure the defect if it can be done without significant prejudice and inconvenience to the buyer (cf. UCC 2-508, and the recommendations in the OLRC report);

b) Consequential damage claims greatly increase the scope of the seller's liability, are difficult to cost in advance, and are not included in current liability insurance policies; and

c) Even liability for incidental damages, e.g., cost of returning goods for repair, may add disproportionately to the cost of warranty claims and may be difficult to estimate accurately.

Do these factors, and others which have not been listed, justify the limited warranty coverage which is preferred by most suppliers of durable goods? Do the hard data (a carefully kept industry secret) support their apprehensions or are they based on theoretical rather than actual experience? Do consequential damages present a significant problem in consumer claims? If claims for consequential damages are not admitted, will this impose an unfair burden on the individual consumer? What will be the practical result of obliging suppliers to pay for the cost of returning defective goods? Will it favour large national corporations with well established networks and discourage new entrepreneurs with limited resources?

G. Supplier's right to exclude or restrict statutory warranty liabilities

This issue pervades all the other questions previously raised and colours the answer to them. Obviously, if warranties can be excluded, in whole or in part, suppliers will be much less concerned about their statutory content. The same is true of the remedies for breach.

There are two basic conflicting approaches. The first, reflected in the existing Sale of Goods Acts, permits the seller to vary or exclude his statutory and contractual obligations. This is the free market or consensual approach. The other, heavily consumer oriented, approach generally negates the exclusion of the statutory warranties on the ground that an attempt to do so must be inherently unconscionable. The latter philosophy is reflected in section 44a of the Ontario Consumer Protection Act and similar legislation in the other provinces, in the OLRC report and in the Saskatchewan CPW Act, and in numerous judicial decisions invalidating disclaimer clauses.

How realistic is the free market approach? Can the average consumer ever make an informed choice to waive protection of the statutory warranties? How much disclosure would be necessary, by whom, and at what point? And at what cost? Does a mandatory regime of statutory warranties discourage warranty competition? Does it force a consumer to pay for warranty protection whether or not he needs or wants it? Should the law strive for minimum warranty protection and leave more extended protection -- time-wise or quality-wise -- to competition? How would the irreducible core be determined. Would an unconscionability test with a presumption of unconscionability in the consumer's favour be preferable to a uniformly applied warranty standard? Is it realistic to expect consumers to litigate unconscionability?

Finally, in assessing the value of the alternative approaches what lessons can be learned from the Prairie Agricultural Machinery Acts, the Magnuson-Moss Consumer Product Warranty Act, and the disclaimer provisions in the provincial Sale of Goods Acts?

H. Administration and policing of statutory warranty regimes.

Widespread experience shows that a mere listing of statutory warranty obligations is not enough -- that such legislation requires stronger teeth to be effective. The alternatives are between greater inducement for private enforcement, the usual panoply of administrative and other public law sanctions, or a combination of both. No less important are readily accessible and cheap facilities for adjusting individual warranty disputes. What of the mediational and arbitral provisions in the Ontario New Homes Warranty Act? Can the major industries be persuaded to establish their own mediational or arbitral machinery or do they lack sufficient common interest?

III. Defective Products Causing Personal Injury or Physical Damage to Other Property (Tortious Liability)

Under existing Canadian law the producer's liability for defective products causing personal injury or damage to other property may rest in tort or in contract. Contractual liability will usually arise out of breach of an express or implied warranty and will usually only enure for the benefit of the buyer who has suffered the injury. This type of claim will also be subject to the usual privity restrictions.

Claim in tort will be based on the producer's failure to exercise the requisite degree of care and skill in the manufacture of the product and will therefore require proof of negligence. On the other hand, such claims will not be circumscribed by rules of privity and any injured party is entitled to bring a claim if he can satisfy the test of foreseeability.

Until recently, dissatisfaction with the common law rules was primarily of American origin and led in the United States to the adoption of concepts of strict liability, though the route by which this result was achieved differed among the states. The issue is also attracting increasing attention in England and has been the subject of a recent report by the English Law Commission. The Ontario Law Reform Commission has also commissioned a study and is expected to offer some recommendations in 1979. On the assumption that some changes in the existing rules are desirable, the following questions have been selected as illustrating

the interaction between rules governing claims for economic losses and claims for personal injuries and physical damages and, equally important, the factors that distinguish the two types of claim and the rules governing them.

A. To what extent should claims for personal injury and physical damages be treated on the same footing as claims for economic losses?

As previously indicated (supra, s. II), preponderant American opinion is that such claims should be treated differently. I share this view on the ground that the interests sought to be protected are quite different. Claims for economic losses are designed to protect the buyer's reliance, expectation and restitutionary interests. Liability for harmful products, on the other hand, is concerned with allocating the risk arising from the manufacture and distribution of such goods and the persons best able to absorb and protect themselves against such losses. Contractual theories of liability appear to be largely relevant in this context.

B. Should liability for harmful products be regulated by the same legislation as that governing economic losses?

There is some precedent for doing so (see e.g., UCC 2-318 and the recent Saskatchewan Consumer Products Warranties Act) but it may be politically inexpedient and conceptually confusing.

C. Should claims for harmful products be governed exclusively by tort law?

Under existing rules an injured buyer can sound his claim in tort (for negligence) or in contract (for breach of warranty). His remedies are cumulative and he is not put to his election. Though it may seem odd that the buyer should be in a stronger position than the non-buyer I believe the distinction can be justified. For example, the buyer may have bargained for particular types of goods or have received an express assurance that they will serve his particular purposes. There is justification therefore for continuing to allow him to invoke his warranty remedies.

D. Should there be strict liability for harmful products?

This is the question that has provoked the liveliest controversy. It has frequently been observed that it is anomalous that a buyer, by following the warranty route, should be able to impose strict liability whereas a non-buyer, who is injured by the same product, should be remitted to a claim in negligence. While the anomaly is a real one it does not, I think, prove that strict liability should obtain in all cases. Rather, it turns on the answer to such questions as who is in a better position to absorb the loss, the availability of insurance, the impact of strict liability on small manufacturers, the danger of frivolous or inflated claims, and alternative schemes of protecting injured parties, e.g., a comprehensive Personal Injury Act along the lines of the New Zealand model and financed by a modest increase in sales tax or other form of public revenue.

E. Who should be protected by the new tort regime?

There is some division on this question among American authorities. The Restatement of Torts - 2d, s. 402A, extends protection to users of the defective product but excludes innocent bystanders. Increasingly, however, the distinction is seen to be an untenable one and bystanders and other non-users have been allowed to sue. I believe this is to be the better view and the one that is consistent with the test applied in negligence cases under the rule in Donoghue v. Stevenson.

F. What types of injuries should be covered?

Here too there is a difference of opinion. Some would confine strict liability to personal injuries while others would include physical damage suffered by other property. The recent report of the English Law Commission supports the narrower alternative; on the other hand, many American decisions now favour the broader approach. If physical damage claims are to be entertained then there arises a further question whether it should embrace all forms of physical damages or be confined to those suffered by non-business persons.

I do not think these questions can be answered in the abstract. They should be determined by the same types of empirical considerations as govern the adoption of the principle of strict liability for personal injuries. At the political level strict liability for personal injuries is likely to be more acceptable than strict liability for physical damages and this may strengthen the case for an incremental rather than revolutionary approach to this branch of the law.

SOME THOUGHTS ON LOSSES CAUSED BY DEFECTIVE CONSUMER PRODUCTS

by Louis Romero
February 1978

I. Introduction

Any legal system closely affects the organization of economic activity and the distribution of the benefits and burdens generated by that activity.

Examples of Canadian statutes that affect organization of economic activity are the federal and provincial legislation regulating companies and securities, which facilitate the accumulation of capital. Labour relations legislation and sales law facilitate the acquisition of labour power and raw materials which are combined to manufacture new products. Examples of laws that affect the distribution of benefits and burdens generated by economic activity are contracts and sales law which facilitate the voluntary exchange not only of goods and services but also of risks and losses.

Quite frequently the Canadian legal system facilitates the operation of the market so that the distribution of benefits and burdens is determined by the economic actors. For example, automobile manufacturers and their dealers negotiate franchise or distribution contracts and enter into legally binding agreements that set methods for the acquisition and sale of automobiles as well as the organization of and compensation for the manufacturers' warranty schemes. Likewise, when an insurance company sells a sickness and accident policy to a Canadian consumer or when a manufacturer promises consumers to replace or repair defective parts, the legal system is facilitating the voluntary exchange of risks by sanctioning and enforcing these undertakings.

At times the Canadian legal system, rather than facilitating voluntary exchanges, takes positive steps to affect the initial allocation of benefits and losses. When a judge finds that a manufacturer was negligent and orders him to pay damages to a consumer, when a province requires all car owners to have third party liability insurance, or when the federal government requires automobile manufacturers to incorporate some safety features into their cars, they are forcing a shift in costs, risks or losses between economic actors.

It seems to me that a study of product or producer liability should be undertaken against the background outlined above. In other words, to put the study in its proper perspective the following factors should be recognized as significantly affecting the subject under discussion:

1. Economic activity generates not only goods and services but also losses and burdens, such as those arising from the manufacture of defective products.

2. Those losses and burdens are often distributed or absorbed through the operation of the market mechanism. Some losses are absorbed voluntarily by the participants, as for example those covered by the manufacturers' warranty scheme. Other losses are passed to participants who do not wish to absorb them but who lack the economic strength to shift them to somebody else. To use a legal maxim, in many cases "the loss lies where it falls".

3. The Canadian legal system is intimately involved in the allocation of risks and the shifting of losses. It facilitates the voluntary exchange of risks but it also takes positive steps to force a shift of risks and losses. On the basis of this observation, I would suggest that we have and we have always had a law of product liability in Canada.

4. For the reasons outlined above, other countries with which Canada trades and competes have a law of product liability affecting the cost of their products and allocating or distributing the risks of industrial production.

5. The law of negligence or warranty forces an initial shift of risks and losses, but these will not necessarily be absorbed by the parties to which they are shifted. These parties may have sufficient strength to pass the losses to one or more economic actors. Therefore our legal system affects but does not necessarily determine the distribution of the costs of risks and losses generated by the mass production and distribution of consumer goods.

6. In addition to the laws of negligence and warranty, a great number of statutes and government programs affect the allocation of risks in our society. We can think of federal and provincial statutes setting standards for dangerous products or activities, the different provincial schemes dealing with automobile insurance and workmen's compensation, health insurance and hospital insurance plans and the provisions of the Canada Pension Plan dealing with disability and life insurance. All of these statutes affect the distribution of losses caused by defective products in our society.

7. The shifting of losses from users to manufacturers and distributors of consumer products by our legal system could have a deterrent effect discouraging the production or marketing of defective products. However, given the fact that the losses initially shifted by the legal system can often be shifted again or distributed among a certain class, and that manufacturers and distributors of consumer products are subject to many other pressures, the impact of the legal system as an incentive to the reduction of the total number of defective products may be minimal. The effectiveness of private law as a deterrent may vary from industry to industry, but I think it is naive to assume, as many legal writers do, that the shift to manufacturers of the losses arising from the use of defective consumer products will automatically act as a deterrent in the manufacture of those products.

II. Initial Shift of Consumer Losses Through Private Law

Under this heading I will outline the legal categories which are presently used by Canadian courts when they compensate Canadian consumers for losses caused by defective products. This section will provide a basis for my discussion later in this paper of possible changes in our private law.

A. Introduction

In most court cases involving defective consumer products a consumer acting as a plaintiff will request an award of damages to compensate him for a loss he has suffered. The consumer will argue that the loss was caused by the behaviour of the defendant and that the behaviour of the defendant amounted to a breach of a pre-existing legal duty owed by the defendant to the plaintiff. A successful consumer action for losses arising from the purchase or use of a defective consumer product will, therefore, involve all the following elements:

1. Damages granted to compensate a consumer for his losses

   An award of damages is the most common type of legal remedy requested in consumer actions, but not the only available one. In some cases a consumer will request rescission of a contract and return of the purchase price.

   As an award of damages is an order of the court addressed to the defendant to pay money to the plaintiff, the plaintiff will have to prove and quantify in dollar terms the losses he has suffered because of his purchase or use of the defective product.

2. The breach of duty by the defendant caused the plaintiff's loss

   If the consumer's loss was due to his own misuse or lack of proper maintenance of the product, his legal action will fail as the plaintiff's loss is not attributable to the defendant's breach.

3. The defendant was in breach of a duty he owed to the plaintiff

   The consumer will have to prove a breach of duty by the defendant. This can be done by proving that the product sold by a retailer fell below the standard of quality required in the circumstances of the sale by the Sale of Goods Act. Another way could be proving that the behaviour of the defendant in manufacturing the product fell below the

standard of care to be expected of a reasonable manufacturer in the defendant's circumstances, i.e., by proving that the defendant was negligent.

Later in this paper I will discuss the manner in which the courts give specific content to these general standards.

4. The defendant owed a duty to the plaintiff

The defendant may be subject to a duty imposed upon him by the law of contracts or by the law of torts.

A duty may arise out of a contract between the plaintiff and the defendant either because the parties actually promised something or because the legal system implies terms into the contract, for example, the implied terms that the goods be of acceptable quality or that they be fit for their ordinary purpose.

A defendant may also be liable for breach of a duty imposed upon him by the law of torts. The most important duty in this area of the law is the duty to take such degree of care as is reasonable to expect from the defendant in the circumstances, so as to avoid causing loss to the ultimate user. Breach of this duty amounts to negligence.

B. Consumer losses

Discussions of product liability issues are often carried at a rather high level of abstraction. General statements on this subject are often vague and ambiguous as they could apply to many different types of losses. For example, the desirability of shifting the loss, the method of doing so and the practical problems encountered in dealing with a case of serious personal injury will vary considerably from a case involving minor out-of-pocket expenses. Therefore, for purposes of clarification, under this heading I will outline and illustrate the different types of losses which a consumer may suffer as a consequence of the purchase or use of a defective product.

1. Death or personal injuries

Obviously these are the most serious type of losses a consumer may suffer. Most legal systems provide for some form of compensation to the victims of accidents caused by a person who was in breach of his or her duty.

Under provincial legislation certain close relatives of a deceased person can sue the manufacturer or retailer of the defective product that caused the person's death. In order to succeed the relatives must prove that the deceased would have succeeded against the defendant had he not died of his injuries. Both in the case of wrongful death and personal injuries the courts will award a lump sum to the plaintiff taking into account his pecuniary and non-pecuniary losses. In the case of personal injuries the pecuniary losses may include hospital, medical and nursing expenses as well as loss of past and future earnings. The non-pecuniary losses may include pain and suffering, loss of limb or disfigurement, loss of amenities of life, loss of life expectancy, etc.

In Canada the provincial authorities that have supplied free medical or hospital services to persons injured by defective products are subrogated to the consumers' rights and they can recover the cost of those services from wrongful defendants.

A related type of loss for which our legal system does not seem to provide an adequate remedy is prenatal injuries caused by defective drugs used by pregnant women. The difficulties encountered in settling the thalidomide claims in England led to the appointment in 1972 of a Royal Commission under the chairmanship of Lord Pearson[1] and to the passage by the British Parliament in 1976 of the Congenital Disabilities (Civil Liability) Act.

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1. Royal Commission on Civil Liability and Compensation for Personal Injury. London: Queen's Printer. Cmnd. 7054, I to III.

2. Physical damage to the consumer product arising from an accident caused by a defect in the consumer product

An example would be damage to the body of a car arising out of an accident caused by a defect in its steering mechanisms.

3. Physical damage to the consumer product caused by a defective part

An example would be the damage to a car engine caused by a defect in the car's lubricating mechanism. Another example would be the destruction by fire of a car caused by defective electrical wiring.

As the examples given above illustrate, a defective part may cause a sudden breakdown of the consumer product or a slow but premature wearing out of other parts. Some U.S. authors draw a sharp distinction between accident and non accident losses and they suggest that a claim for the car fire should be made in tort under the doctrine of strict product liability, while a claim for the premature wearing out should be made under the law of warranty.

4. Damage to other property caused by a defective consumer product

We can think of a defective car colliding with and damaging another car or a house. A camera kept in a car could be damaged in a car accident or in a leaking trunk. Food kept in a defective deep freezer may spoil when the freezer breaks down.

5. Costs of repairing a defective product

A consumer may suffer a loss because he is required to spend extra money in the repairs necessary to remove and replace defective or malfunctioning parts in a consumer product.

6. New expenses incurred because of the breakdown of a consumer product

Examples would be the cost of towing a defective car to a repair shop, the cost of renting a replacement car while the defective car is being repaired, or the extra hotel expenses incurred by a family on holiday when their defective trailer breaks down far away from home.

7. Losses arising from the reduced value of a defective product

This occurs when the consumer pays the price of a new non-defective chattel and receives a defective one. This type of loss may be revealed gradually over a period of time as for example in the case of an expensive carpet that prematurely wears out in streaks. One remedy for this type of loss could be an award of damages equivalent to the difference between the price paid and the actual value of the defective product. Another could be a rescission of the contract whereby the price is returned to the consumer and the product is returned to the supplier, with or without an allowance for the value derived from the use of the defective product. Finally, another remedy would be replacement of the defective product with adjustments for use and installation expenses.

8. Expenses originally incurred in connection with the defective chattel

A consumer may wish, for example, to recover not only the price he paid for defective wall-to-wall carpeting but the expenses incurred in having it installed. Likewise the consumer may wish to be compensated not only for the reduced value of defective paint but for the cost of painting his house with it.

9. Expenditure already incurred and lost because of the breakdown of a defective chattel

A car breakdown may prevent a consumer from attending a theatre performance for which he had bought tickets; pre-paid hotel reservations could be lost for the same reason.

10. Non-pecuniary losses caused by the defective product

Under this heading we could include a consumer's claim for the loss of enjoyment of his holidays which were ruined by a car breakdown far away from home, or a claim of damages to compensate the consumer for the inconvenience, anxiety and mental distress derived from the purchase of what is commonly referred to as "a lemon".

11. Business losses

If we narrow our analysis to products bought for personal, family or household purposes, this type of loss will be excluded from our study. In the United States disclaimer clauses excluding liability for this type of loss have generally been allowed, and a number of leading cases show the court's reluctance to grant damage for loss of business profit even when applying the doctrine of strict product liability.

For the purpose of the present study, I will limit my remarks to losses suffered by consumers in their private capacity. This will exclude not only business losses but, for example, personal injuries suffered by an employee at work and caused by a defective machine. One of the important decisions to be made in the federal study of producer liability is the scope of the study and whether some arbitrary limit like the one discussed above will have to be adopted.

C. Consumer Losses for which the Law of Negligence and Warranty Will Grant Compensation

Generally speaking it can be stated that the law of negligence has been mainly concerned with physical harm, i.e., with compensating plaintiffs for personal injuries and property damage. Once there has been a physical impact or accident a consumer may recover in tort for most of the losses outlined in the previous heading, as long as they are held not to be too remote.

Strange as it may seem, there is still considerable doubt in Anglo-Canadian law as to whether a consumer may sue in negligence for physical damage to the defective product itself. For example, in the Rivtow Marine case (1974) 10 D.L.R. (3d) 530, a majority of the Supreme Court of Canada expressed the opinion that claims for damage to the defective product itself should be based on warranty and not on tort, but there was a strong dissent by Laskin, C.J.

The law of negligence does not provide any remedies to the owners of consumer products when those products turn out to be of inferior quality and fail to meet the consumers' reasonable expectations. In order to obtain compensation for this type of loss, consumers will have to rely on breach of warranty by the seller.

The law of warranty (subject to the doctrine of privity and the enforceability of disclaimer clauses) provides remedies not only for personal injuries and damage to property but also for purely economic losses such as the diminution in value or the cost of repairing or replacing the defective products.

The general reluctance of Canadian courts to grant damages for purely economic loss under the doctrine of negligence has been paralleled under the doctrine of strict liability in the United States. Although there is no unanimity on this point, many American courts have adopted the following statement of Traynor J. in Seely v. White Motors (1965) 45 Cal. Reptr. 17 at 23.

> [The] manufacturer cannot be held liable for the level of performance of his product ... unless he agrees that the product was designed to meet the consumer's demand. A consumer should not be charged at the will of the

> manufacturer with bearing the risk of physical injury when he buys a product on the market. He can, however, be fairly charged with the risk that the product will not match his economic expectations unless the manufacturer agrees that it will.

For the purpose of subsequent discussion, it is important to keep in mind that the great majority of consumer complaints with regard to defective products involve purely economic losses and that only the law of warranties presently will grant a remedy for those losses.

D. Manufacturers' liability

The old English Common Law, operating in a stable agricultural economy, was more concerned with compensating plaintiffs who had suffered accidents than with protecting the activity that caused the accident. During the eighteenth and nineteenth centuries, however, the courts developed new doctrines that showed their solicitude for the people who engaged in certain accident-prone manufacturing activities. In a long line of cases that continued into the earlier part of this century, the courts required proof of the defendant's fault before obliging him to absorb the plaintiff's losses.

This doctrinal change has been explained on the basis of the economic and social philosophy prevalent at the time. English judges thought that the progress of their society depended on freedom of action and of economic activity. Manufacturers' strict liability for losses caused by defective products was seen as a fetter on free enterprise and a brake on industrial growth. Consequently, judges limited the manufacturer's liability for defective products to cases of fault, i.e., to cases where the plaintiff could prove the defendant's undue disregard for the safety of others. It was generally agreed that it was best for society if losses lay where they fell except in exceptional cases where the plaintiff could prove the culpability, blameworthiness or negligence of the defendant.

In order to decide whether a defendant had been negligent and therefore whether he should absorb the plaintiff's loss the courts have used the concept of the reasonable man or, as we call it nowadays, the

reasonable person. Did the defendant take the amount of care that a reasonable person would have taken in the circumstances or did he create an unreasonable risk of physical harm? It is obvious that behind this legal formula the courts were and are making value judgements about the magnitude of the risk to the plaintiff created by the defendant's conduct and the social utility of that conduct. In thousands of decisions on negligence actions where the judges have analysed the unique facts of the cases before them, they have weighed among others the following factors, before deciding whether the plaintiff's loss should be shifted to the defendant:

1. Probability of loss to the plaintiff or predictability of the risk created by the defendant's activity (hereinafter referred to as P).

2. Severity or magnitude of the possible loss to the plaintiff (hereinafter referred to as L).

3. Object or purpose of the defendant's behaviour (hereinafter referred to as O). To what extent is the defendant's conduct or activity justified in terms of social utility?

4. Cost of preventing the risk, both to the defendant and to society (hereinafter referred to as C).

Although most courts do not write their judgements in terms of the four elements indicated above, legal writers have referred to them as useful predictors of court decisions. They have expressed this insight in the following formula:

	P.L.	= O.C.	
if	P.L.	> O.C.	The defendant is held to be liable
if	P.L.	< O.C.	No liability

The above formula is merely a description of the most important elements that go into deciding whether a defendant was negligent. The application of the formula will depend on the weight given to the different factors by the judges who in turn will reflect the values of their society. Therefore the application of the same formula has led to different results at different times in history. For example, the attitude of the judges towards personal injuries and their ideas about the importance of industrial

activity for society has changed considerably over the years; these non-economic factors are not easily measured or evaluated in terms of cost benefit analysis.

Another imperfection of the formula is that it does not reflect adequately the judges' moralistic and individualistic concern with the defendant's conduct which is so characteristic of the law of negligence. Even when the courts refer to some of the above factors they do so from the defendant's point of view: did he foresee or should he have foreseen the likelihood and severity of the plaintiff's loss? Should the defendant have ceased in his activity or should he have carried it on in a different manner in order to prevent the plaintiff's loss?

In the context of product liability this moralistic approach of the courts is reflected in the requirement that the consumer prove not only that a product was defective and caused his loss, but that the defect in the consumer product was due to the manufacturer's negligence. In other words, the consumer will have to adduce sufficient evidence to prove to the satisfaction of the court that the manufacturer's method of production or of quality control fell below the standards to be expected of reasonable manufacturers or, in some cases, those prevailing in the industry. This requirement has imposed a heavy burden on consumers and in fact it often has prevented them from succeeding in negligence actions. The harshness of the doctrine of negligence has been softened both by a legal and a practical development.

The legal development is the doctrine of res ipsa loquitur (the thing speaks for itself) which allows proof of the manufacturer's negligence by the use of circumstantial evidence. As the Latin maxim indicates, in some cases the accident speaks for itself, i.e., it is reasonable for the court to draw an inference that the accident would not have occurred without the manufacturer's negligence. Not every accident would give rise to this inference but if the accident is such that the court decides that the application of the doctrine is warranted, the onus of proof shifts to the manufacturer to show that the accident is as consistent with no negligence as with negligence. If the manufacturer discharges this onus, the burden will still be on the plaintiff to prove the defendant's negligence.

A different practical development that has eased the task of consumers suing manufacturers of defective products has been the recent tendency of the courts to assume the manufacturer's negligence after the consumer proves both that the product was defective when it left the manufacturer and that the defective product caused the consumer's loss. As I say, this is a practical development and not a doctrinal one, but many authors have observed that while the courts pay lip service to the need to prove that the manufacturer's negligence was the cause of the defect they are likely to find negligence with very little evidence, as long as the consumer has proved defect and causation.

E. Retailers' liability

A consumer who suffers a loss because of the purchase or use of a defective product may be able to recover damages from a retailer. In order to do so, the consumer will have to prove that the retailer was in breach of a duty arising either from an express promise or from a term implied into the contract of sale. These "implied terms" were developed by judges in the early part of the nineteenth century in order to protect business buyers from commercial losses -- hence the expression "merchantable quality" which is used in this context. These implied terms were later extended to sales to consumers and were codified in section 14 of the English Sale of Goods Act 1893.

This extension of concepts developed in the context of sales to merchants to the context of sale to consumers illustrates the way in which the common law has often progressed, i.e., through the extension of legal doctrines to analogous fact situations for good practical reasons but without an overall rational plan as to the way the law should be or as to the distribution of losses in society.

The implied quality obligations of the Sale of Goods Act make sellers strictly liable for losses caused by products which are unmerchantable or unfit for purpose. It is important to appreciate the full implication of strict liability in the context of sales law. It basically means that in order to succeed a buyer is not required to prove that the defective quality of the goods is attributable to the retailer's negligence. It is no valid defence for a seller to prove that even if the goods sold were unmerchantable or unfit for purpose he was not at fault and he took all the precautions that could reasonably be expected of him in the circumstances of the particular sale.

The observation made above can be illustrated by the case of Frost v. Aylesbury Dairy Company [1905] 1 K.B. 608 (Eng. C.A.) where the defendants were held liable for the death of the plaintiff's wife who had contracted typhoid fever by drinking contaminated milk sold by the defendant. It was unsuccessfully argued by the defendants that they took all reasonable care but that at the time there was no scientific test to discover that particular type of virus, so that there was no way in which the defect in the goods could have been discovered. The court held that the goods were not of merchantable quality or reasonably fit for purpose and the defendants were strictly liable for supplying goods that were not in compliance with the implied terms.

The fact that business sellers are strictly liable for breach of the implied quality terms should not lead us to assume that they are in the position of insurers or that they are absolutely liable for any quality defects. The test of reasonableness is included in the concepts of merchantability and fitness for purpose so that imperfect or defective goods could in certain circumstances still be merchantable or fit for purpose. The different judicial tests of merchantability are used to determine the quality that reasonable buyers would expect in the circumstances of the sale. Thus, if a used car with considerable mileage is sold at a modest price it will likely be considered merchantable even if soon after the sale it needs a new clutch. A different conclusion will be arrived at if the car was sold as a new car. Therefore, even though in warranty the concept of reasonableness is not applied to the defendant's behaviour as in negligence, it is applied to the required quality of the products.

In addition to the condition of merchantability the Sale of Goods Act implies into sales a condition "that the goods shall be reasonably fit for that purpose". Just as with the condition of merchantability, the Act does not require that the goods be absolutely fit but only reasonably fit. Referring to this point, Lord Peace stated in Kendall v. Lillico [1969] 2 A.C. at p. 115,

> I would expect a tribunal of fact to decide that a car sold in this country [England] was reasonably fit for touring even though it was not well adapted for condition in a heatwave:

> but not, if it could not cope adequately with rain. If, however, it developed some lethal or dangerous trick in very hot weather, I would expect it to be found unfit. In deciding the question of fact the variety of the unsuitability would be weighed against the gravity of its consequences. Again, if food was merely unpalatable or useless on rare occasions, it might well be reasonably suited for food. But, I should certainly not expect it to be held reasonably suitable if even on very rare occasions it killed the consumer.

It is interesting to note that this judge, in the middle of a discussion of sales law refers to two of the factors mentioned above to explain the law of negligence, i.e., the probability and the severity of the loss. This indicates that those factors are taken into consideration in order to decide whether there should be a shift of loss from the plaintiff to the defendant irrespective of the legal categories used to justify the decision. It should be noted, however, that in sales law the formula discussed above is applied to determine the quality of the goods that a consumer is entitled to expect while in negligence law the formula is applied to the defendant's behaviour.

The strict liability of sales law makes it easier for the consumer to recover for claims based on sales than for claims based in negligence. However, an action in contract by a consumer may fail because of the presence of disclaimer clauses in the contract of sale, or because of the doctrine of privity. It is one of the basic premises of contract law that the parties make their own contracts and they may agree to exclude the conditions implied into contracts of sale by the Sale of Goods Act. This assumption makes sense in most contracts between businessmen who have roughly equal bargaining power and a reasonable knowledge of the goods sold and the risks involved in the transaction. These facts are not present in most consumer sales and for this reason a number of Canadian provinces, such as Nova Scotia, Ontario, Manitoba and British Columbia, have made void any disclaimer of the implied terms of the Sale of Goods Act in consumer sales. But even in these provinces consumers can sue for breach of these quality obligations those suppliers who are parties to the contract of sale, i.e., retailers. As most

manufacturers do not sell directly to consumers they do not owe consumers a duty to supply goods that are merchantable and fit for purpose. Likewise, only those consumers who are parties to a contract can sue on it. So if two friends are injured in an accident caused by a new car that was not of merchantable quality, only the buyer of the car can sue the seller for breach of warranty, while the other passenger will have to sue in negligence.

F. Developments in the United States

In the last twenty years, the law of product liability has been subjected to considerable change in the United States. The story of this change has often been told elsewhere, but for present purposes it can be explained as a doctrinal change that combines those aspects of sales and tort law that are most favourable to consumers.

Just as in Canadian sales law, the new doctrine of strict liability of manufacturers of consumer products emphasizes the reasonable quality that consumers are entitled to expect rather than the manufacturers' fault. At the same time it does away with the doctrine of privity and the effectiveness of disclaimer clauses. These recent legal changes have been justified by American courts and commentators on the basis of enterprise liability and the more efficient distribution of losses. I do not propose to analyse in this paper the many reasons given to justify manufacturers' strict liability for defective products, but I would like to make a few comments about them.

In the first place many of the arguments raised by lawyers and economists for the adoption of the new legal doctrines are based on ideal models or on unverified assumptions about the way the American economy really works.

Secondly, even if the full impact of strict liability is unknown, the new legal doctrines are generally considered to be a fairer or more equitable method of spreading the costs associated with the mass production and distribution of consumer goods. The individualistic morality that pervades the law of negligence has been attacked from many angles as not only unjust but inefficient. There seems to be a consensus that the traditional legal doctrines have not been adapted to the many changes in production and

distribution occurring in North America in the last fifty years. There is a growing consensus that negligence and sales law may have been right for the society of nineteenth century United States, but is not adequate for the consumer society that has developed since World War II.

Thirdly, the theories advanced as justification for strict liability have not been carried to their logical extreme. For example, enterprise liability would justify the absorption by the manufacturers of all the accident losses arising from the activity where the product manufacturerd by him is used. However, strict product liability has been limited to "products in defective condition unreasonably dangerous to the consumer or to his property", as stated in section 402A of the Restatement of the Law of Torts, & (Second).

G. Effect of the private law on individual behaviour

So far, I have been talking about tort and contract law as applied by the courts. Even in cases that end up before the courts the final decision may not be reached on the basis of warranty or negligence, because of the law of evidence.

I would estimate that less than one per cent of all the cases involving defective products end up in court. What effect does the law of warranty and negligence have in the settlement of all the other disputes arising from defective consumer products? Strange as it may seem, no empirical studies have dealt with this subject and very few on the impact of other types of law on private behaviour. However, law professors like myself keep on analysing legal concepts and writing case comments without any clear idea about the effect of legal doctrines on consumer dispute resolution.

Probably legal doctrines are a factor among many others which affect the settlement of consumer disputes. The likelihood of a consumer's success in a court action may induce a lawyer or an insurance adjuster to settle a consumer claim. But even in this type of situation substantive law will play a limited role and the participants will also consider other factors such as the available evidence, the probable costs of the litigation, etc.

In less important cases where no professional settlers such as lawyers or adjusters are involved, private law plays an even less important role. This point is illustrated by the findings of the research team that prepared a report on consumer warranties for the Ontario Law Reform Commission in 1971. After referring to the Ontario law that nullified any clauses in sales contracts which purport to exclude the terms implied by the Sale of Goods Act the Commission states at page 60, of its Report on Consumer Warranties:

> It seems clear that the legislation has given sellers no incentive not [sic] to continue using sales agreements with the same objectionable disclaimer clauses as before. Inquiries by the Research Team of the project have shown that this is in fact what is happening, and, further, that many merchants and manufacturers are not even aware of the new statutory provisions. In our opinion, this is an unfortunate state of affairs, and points to a serious lack of knowledge of the existing law among those supplying the consumer goods industry.

If manufacturers and retailers are not aware of statutory provisions which affect their businesses, it is quite likely that consumers who enter into sales contracts less frequently than retailers are also unaware of those provisions. Therefore, consumers will often settle their disputes or give up their claims in complete ignorance of their rights.

In addition to ignorance of the law, other factors which will influence settlements will be consumers' unwillingness to litigate for minor claims because of their ignorance of court procedures, unwillingness or inability to take time off work in order to attend court during the day, etc.

Given the fact that most consumers are ignorant of their rights and settle minor disputes without recourse to experts in consumer law, a number of measures designed to increase consumer information have been considered desirable. One is the federal initiative aimed at encouraging manufacturers to disclose their voluntary warranty schemes which, in fact, extend beyond the periods stated in the warrranty booklets. A second measure is contained in the U.S. Magnuson-Moss

Warranty Act and in the Saskatchewan Consumer Products Warranties Act and is aimed at clarifying the contents of the manufacturers' written warranties. Even if consumers do not rely on the private law, they can read the warranty booklets and make claims on the basis of the manufacturers' promises. A third step aimed at increasing consumer awareness is the requirements in the two Acts mentioned above that the manufacturers' warranties clearly state that they grant legal rights and that consumers may have other rights under state or provincial laws. A final measure is the section contained in the Saskatchewan Act that forbids and punishes the inclusion in consumer contracts of any disclaimer clauses made void by the Act. If void disclaimer clauses continue to be included in consumer contracts consumers will continue to believe in them when they settle their claims.

III. Other Factors Affecting Loss Distribution

A. Introduction

Even if a court decides to shift a loss from a plaintiff to a defendant, it does not necessarily follow that the loss will be absorbed by that defendant. He may in turn succeed in passing the loss to somebody else or to a group of persons that will end up sharing it.

Under this heading I will call attention to some legal issues that are closely connected to the distribution through society of the losses caused by defective products. I lack the knowledge of economics or the empirical data necessary to analyse the distribution of those losses. However, I think they should be considered in a study of product liability.

B. Loss prevention through quality control and safety standards

In the Report of the Task Force on Appliance Warranties and Services the U.S. Secretary of Commerce made the following observation:

> In voicing complaints, consumers do sometimes observe that they would have been willing to pay more for an appliance initially in the interest of avoiding subsequent repair costs and inconveniences. Every designer and manufacturer faces a complex balancing of initial cost and selling price on the one hand and long-term operating and maintenance expense on the other.

The Secretary of Commerce went on to recommend the conduct of a study:

> comparing the cost of adapting the sort of "zero defects" program used in military procurement with the cost to the consumer for appliance maintenance and repairs. The aim of such a study should be to guide both manufacturers and consumers in understanding what constitutes the best cost effectiveness balance both at point of sale and over the lifetime use of the appliance.

These statements bring into focus the fact that many or most of the losses arising from defective products could have been prevented at the manufacturing level.

The legal system is only an awkward and expensive mechanism that shifts and distributes some of the losses caused by defective products but it does not produce any real wealth to society. It gets into motion once a loss has occurred and in societal terms it would be much more beneficial to prevent accidents or breakdowns of consumer products.

Obviously the costs to manufacturers or to society of producing consumer goods with zero defects could be prohibitive in many cases. But it has often been assumed that many or most defects can be detected at the manufacturing level, and that the cost of the increased levels of quality control could be passed to all the buyers of the product. Behind the move to impose strict liability on manufacturers of defective products in the United States, there has been an often unarticulated belief that somehow it was to the manufacturers' advantage to save money in quality design and control and to pass the cost of defective products to the rest of society. This belief has

persisted in spite of the available evidence about the cost to manufacturers of their recall campaigns, their voluntary warranty plans and their advertising campaigns. It is much cheaper to prevent or correct defects at the factory than after the goods have been sold to consumers. It does not make much sense to spend millions of dollars creating an image of quality and reliability and to have an abundance of defective products and disappointed consumers which will detract from that image.

Closely associated with the belief that through the operation of an imperfect market mechanism, manufacturers are passing an unfair amount of costs to consumers, is the idea that imposing strict liability on manufacturers would act as an incentive to encourage them to institute better methods of quality control and that manufacturers are in a better position than other distributors to spread the cost of consumer losses among all the buyers of their products.

C. Defendant Recovers from Somebody Else

If a consumer succeeds in shifting his loss to a retailer, the retailer may in turn recover from his supplier the damages he has to pay to the consumer and the cost of the action. The quality terms implied by the Sale of Goods Act enure to the benefit of both consumer and business buyers. In fact, cases involving defective consumer products have often given rise to a number of actions up the chain of distribution so that the consumer sues the retailer who will sue his wholesaler who will sue the manufacturer who will sue the supplier of the defective part. In this manner, the consumer loss may be shifted several times upwards through the chain of distribution until it has to be absorbed by one of the suppliers, normally the manufacturer, who may or may not have provided in his price calculations for the distribution of this type of loss, either through product liability insurance or through self-insurance.

One of the many reasons advanced for allowing the consumer to sue the manufacturer directly is to avoid the proliferation or circuity of action.

But it does not necessarily follow that in all cases retailers who have to pay damages to consumer buyers will be able to recover from their suppliers. The contract of sale between the retailer and his supplier may contain disclaimer clauses which exclude the warranty obligation of the Sale of Goods Act or the retailer may be too late in suing (normally action may be started within a certain period of time). In addition, the supplier who sold the goods to the retailer may have gone into liquidation or bankruptcy or may be in a foreign country and it may be difficult to sue him or to enforce a judgement against him. If these circumstances are present, the retailer will have to absorb the loss and this has been considered unfair, especially in jurisdictions where the retailer is subject to strict liability to the consumer while the manufacturer is liable to the consumer in negligence. A number of measures have been taken to allow retailers to pass the loss back through the chain of distribution. One is section 2-607(5) of the Uniform Commercial Code. Under this section when a retailer is sued by a consumer buyer the retailer may be able to "vouch over" against the supplier from whom he bought the goods and to claim an indemnity from him. A problem with this section is that it is basically aimed at simplifying procedures and the retailer may still be precluded by the terms of the contract from claiming an indemnity from the party who sold the goods to him.

In England, the Supply of Goods (Implied Terms) Act, 1973 has incorporated into the Sale of Goods Act a provision applicable to disclaimer clauses in business contracts. Section 55(4) states that disclaimer clauses in business contracts shall "not be enforceable to the extent that it is shown that it would not be fair or reasonable to allow reliance on the term". Subsection (5) goes on to specify the circumstances that should be considered in deciding whether reliance on a disclaimer clause is fair or reasonable. I am not aware of any case where English courts have been called to apply this section, but I am sure they will be faced with a very difficult task as they are called to evaluate the fairness of business non-consumer contracts.

A third type of provision allowing retailers to recover the damages to pay consumers because of an action is section 16 of the Saskatchewan Consumer Products Warranties Act which allows retailers to recover from manufacturers any losses the retailer suffers as a result of a consumer suit, if the manufacturer is also in breach of warranty to the consumer

and irrespective of whether the retailer bought the goods directly from the manufacturer.

D. Manufacturers' warranties

Most manufacturers of consumer durable goods have established voluntary schemes whereby they repair or replace defective parts in material or workmanship, free of charge to the consumer, for a limited period after the purchase of the item. These warranty schemes perform the economic function of passing to manufacturers some of the costs associated with defective products.

The cost of these warranty schemes is paid for by consumers in two different ways. Most warranty schemes are given free of charge to consumers, so that the cost of the programs is included in the price of the products. There are two other types of warranty plans which consumers pay for directly. One is optional extended warranties offered by manufacturers or big retailers which may go into effect after the termination of the original "free" warranty. For example, buyers of new automobiles may "buy" extra protection covering certain parts of their car for a period beyond the 12 month/12,000 miles covered by the basic warranty. Likewise, big department stores in Canada offer extra warranty protection to cover washing machines and other consumer durables after the expiry of the initial one-year warranty. A new development in this area is the entry of companies other than manufacturers or retailers into the warranty field. For example, an American company is selling extra warranty protection to Canadian buyers of new automobiles through the dealers. Both the U.S. Magnuson-Moss Warranties Act and the Saskatchewan Consumer Products Warranties Act bring within there scope these additional warranty schemes which are named "service contracts" in both Acts.

E. Different insurance plans

The warranty plans sold by manufacturers and retailers of consumer products as well as by companies specializing in this new field are really insurance plans covering certain of the costs associated with the breakdown or malfunctioning of consumer products. They perform the function of distributing among a certain class of consumers the costs of repairing the consumer products and of replacing certain parts.

A similar function, but with regard to other types of costs, is performed by product liability insurance sold to manufacturers of consumer products, which often cover the manufacturers' liability for personal injuries and damage to other property caused by a defective product. Usually, these policies do not cover damage to the defective product itself as manufacturers often can be self-insured with regard to this risk; likewise, insurance companies selling product liability insurance are not willing to cover liability for consequential losses such as loss of profits by the consumer, extra expenses caused by the breakdown of the product, etc.

Other types of insurance, although not directly aimed at the losses arising from defective products, may in fact perform the function of distributing some of those losses. We can think of first party "sum insurance" where a certain sum of money is paid out to the beneficiaries as in the case of life or sickness and accident insurance. If the death or injuries were caused by defective products the sums paid by this type of insurance will not come from the buyers of the product but from a different group of people, the ones buying that type of insurance. This may amount to an unfair subsidization of the activity that generated the defective product, especially so because in this type of insurance the company is not subrogated to the consumers' right and therefore will not recover from the person responsible for the defective product the sums paid to the victim or his family. This is not the case with loss or indemnity insurance where the company will compensate the consumer for his loss but will try to recover from the person from whom the consumer could have recovered. Of course, even in this type of insurance, if the insurance company compensated the consumer but decides not to pursue its rights against the manufacturer, we will have a group of people (the buyers of insurance) paying a cost associated with the manufacturing activity. Likewise, if the provinces fail to recover the cost of hospital or medical services from the manufacturers of defective products that cause personal injuries the taxpayers in general, including those who do not buy or benefit from the product, will be subsidizing the activity of the industry and the buyers of those products. The same considerations apply to the death and sickness and accident benefits paid under the Canada Pension Plan.

IV. Important Issues to Be Analysed Before any Major Reform of Canadian Product Liability Law

A. Introduction

In the pages above, I have tried to describe some aspects of the complex Canadian system of product liability which shifts and spreads some of the losses caused by defective products. This system is not only affected by legal doctrines such as those of contracts, tort and insurance, but by the practices of the participants such as the policies of manufacturers with regard to their voluntary warranty schemes.

Even though as lawyers, our natural tendency is to think of the remedies that a particular consumer-plaintiff can obtain from one or more possible defendants, it is important to keep in mind that there are many other people involved in the product liability system in addition to plaintiffs and defendants. In fact, the consumer's loss may be shifted back through the chain of distribution and it may be spread among the members of a certain group, such as all the buyers of the product or all the persons insured by a certain insurance company, or all the taxpayers.

In order to be able to discuss and evaluate policy initiatives in the area of product liability, it is necessary to design a comprehensive theoretical framework with which to evaluate the present Canadian system of product liability, as well as any proposal for reform. Hopefully, this will be one of the main achievements of the federal study of producer liability. In my opinion, the framework should clarify and answer, among others, the following questions: which are the possible goals of an ideal system of producer liability, i.e., which policies would we want the system to pursue? How consistent are those goals or policies with one another? Do they conflict so that we can achieve one only at the expense of another? Which solutions or approaches would lead to the achievement of those goals? Which are the costs and side effects of those methods or approaches? Are there any ways of receiving feedback on the effects of those approaches once they are implemented? Are there separate areas of product liability so that we can have a different mix of aims and methods in each area?

For the purpose of discussing what I consider to be some of the issues in the area I need a tentative or elementary framework and I will classify the different problems under two basic headings taken from the law of torts, i.e., deterrence and compensation. These are two of the alleged goals of tort or negligence law, but I will use them in a slightly different sense. I will assume first that one of the goals of a product liability system is to prevent the occurrence of losses. Traditionally, the tort law has been considered to perform an admonitory function by punishing tortfeasors and warning other potential wrongdoers. Under this heading I will classify some measures that could contribute to a reduction of the total number and amount of consumer losses arising from the purchase or use of consumer products. In my opinion most consumers are not interested in obtaining legal remedies and they would prefer not to suffer any loss in the first place. As indicated above, in societal terms, every time a consumer product malfunctions or shows a cosmetic defect, a loss occurs. From then on we may use the legal system as an expensive method of shifting or distributing the loss, but the ideal system would be one that reduces the number of losses to a minimum.

But even an ideal system of product liability will not prevent all losses caused from defective products. This is due to the fact that the avoidance of all defective products would be too expensive for society. In many cases it would bring our system of production and distribution to a standstill.

Since we will continue having some losses, which are the best methods of dealing with those losses? Should the loss be absorbed by the consumer himself, or should he be entitled to compensation for his loss? Who should pay this compensation? A person at fault? The persons that benefit from the activity that caused the loss? Should the loss be collective by spreading it as broadly as possible among the members of a certain group and if so which group?

B. Deterrence: Reduction of the total cost of consumer losses

This reduction of the total cost of consumer losses can be achieved through government action or through private decisions reached by the participants in the production and distribution of consumer products.

1. Government action. A number of statutes and government measures may be seen as methods of decreasing consumer losses. For example, the provisions of the Motor Vehicle Safety Act can be seen as a method aimed at preventing certain consumer losses, i.e., loss of life, limb or property caused by unsafe motor vehicles. This Act is designed to deal only with safety, i.e., with the prevention of some of the more severe types of consumer losses. A number of issues that could be studied in the area are the following: is government activity limited to safety matters because of the costs associated with this type of approach or because of constitutional considerations? What have been the justifications and costs of the federal initiatives with regard to rust-proofing of automobiles? Should the approach of the Motor Vehicle Safety Act be used to prevent other types of consumer losses such as poor quality or the unreasonably short life of other consumer products? Should government intervene with this approach when the loss to each consumer is minor but the total volume to society is major?

   Another issue related to this type of government intervention in economic activity in order to reduce the total cost of consumer losses is the method used to enforce the legislation. Is it enough to impose penalties on the parties that violate the statutes? Could savings in enforcement be achieved by giving consumers a private right of action for breach of a statutory standard? There is some uncertainty as to the constitutional power of the federal government to give consumers a right of action against manufacturers that do not comply with standards set under federal law. Should this uncertainty be cleared by passing legislation on the matter and inviting a constitutional challenge? Should consumers be allowed to recover double or triple damages in this type of action? Could the same goal be achieved by provincial legislation that requires or encourages courts to adopt the

federal standards in tort or warranty actions? Section 34 of the Saskatchewan Consumer Products Warranty Act could be used as a precedent in this regard. It states:

> 34(1) In any action arising under this Act, proof that a consumer product does not comply with mandatory health or safety standards set under an Act of the Parliament of Canada or an Act of the Legislature or with quality standards set by regulations constitutes prima facie evidence that the consumer product is not of acceptable quality or fit for the purpose for which it was bought.

2. Private action: Prevention of losses can be achieved by the free decisions made by the various participants in the marketing of consumer products. Through a number of minor changes in the present product liability system, manufacturers, distributors and consumers could be encouraged or induced to take the necessary steps to reduce the number of consumer losses.

   i. Manufacturers. In my discussion above, I indicated that manufacturers can prevent some consumer losses by increasing quality control at the manufacturing level. We need more knowledge about the factors considered by different manufacturers when they decide the level of quality of their products. How do the costs of their recall campaigns and voluntary warranty scheme compare with the cost of detecting the same defects at the manufacturing stage? What percentage of defects are never repaired under the warranty schemes and the recall campaigns? Is it still cheaper for manufacturers to correct a small percentage of defects at a high cost in the dealers' workshops than to detect

and correct most of the defects at the factory level?

ii. Other participants. Wholesalers and retailers could play a more active role in the reduction of the number of defective products. Big department stores in Canada already perform this function to a limited extent. In the first place their purchasing agents try to avoid acquiring products which in the past have shown mistakes made at the manufacturing stage, for example, clothes improperly sewn, toys improperly glued, etc. Secondly, the advertising department of big department stores often refrain from creating unreasonable expectations in the buyer. For example the 1978 spring and summer catalogue of one of those department stores contains the following statement:

> Our lowest priced AM/FM digital clock radio is offered to compete with other economic units that also have limited range. Recommended for local reception only.

This type of disclosure decreases the number of defective products by reducing the consumers' expectation with regard to the particular item.[2] Wholesalers and importers of consumer products could similarly

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2. The examples given in the text illustrate two different meanings of the expression "defective product". One refers to an article that was manufactured when somebody made a mistake at the production level. Another is a product which was properly manufactured but that somehow does not meet the consumer's reasonable expectations, i.e., the manufacturer has reduced the expected lifetime of the product by an unannounced change in components, or the retailer represents a low-quality product as being a high-quality one.

contribute to the reduction in the number of defective products.

Federal and provincial governments could encourage this type of behaviour by widely publicizing information on consumer products that is presently available, such as recall campaign statistics, government tests, etc. They could also make and publicize new tests of the quality, performance and durability of the different brands of consumer products. An interesting precedent in this area is the testing of different brands of farm machinery done and publicized by the Saskatchewan government.

The legislation which allows consumers to raise against finance companies any defences consumers have against retailers has been justified not only in terms of fairness, but in terms of the policing of retailers that could be exercised by finance companies. The analogous function of discouraging the manufacture of consumer loss-causing products could be performed by wholesalers and retailers.

iii. Consumers. In the area of consumer credit the principle of cost disclosure is now firmly established in the United States and Canada, and there is a consensus that the consumer should get full information on the period of the loan and all the cost components, i.e., not only interest but premiums, bonuses, etc. In the context of sale of goods our present legal system is only concerned with disclosure of the selling price but this is only one element of the cost of a product. The consumer is not given any information about the past or expected lifetime of the product or its frequency of repair record, items which are essential to calculate the real cost of the article being bought. If consumers had better information and were willing to use it, their informed individual choice could

contribute to reduced sales or in the elimination from the market of certain products which cause an undue amount of consumer losses.

Just as in the case of any other measure aimed at improving the present product liability system, we will have to ask whether any measures aimed at improving information are worth their cost. An interesting example is the FTC regulations dealing with disclosure of manufacturers warranties, passed under the Magnuson-Moss Act. Under these regulations retailers in the United States are required to display the different manufacturers' warranties by having the warranty booklets attached to the outside of the goods or by having a special loose-leaf book containing the different warranty booklets so that consumers may study and compare them before they purchase the goods. The FTC regulations have been criticized because they increase the retailer costs while very few consumers take advantage of the available information.

A number of conclusions about consumer behaviour will have to be reached before we can evaluate the cost of availability of information. What percentage of consumers of certain products will evaluate available data on the real cost of the product itself or on the likelihood of other losses? Are consumers psychologically able to evaluate the risks associated with consumer products or will they simply conclude that "it won't happen to me"? Will the consumers compare the long-run costs with the short-run ones? In other areas such as planning for retirement, insuring against third party liability or against paying doctors or hospital bills, society does not seem to trust the freedom and good sense of its citizens. Why should we proceed on a different assumption here?

A closely related issue is whether expenses incurred in increasing the availability of understandable data on consumer products will have to be justified in terms of its effect through the market on the reduction of the total volume of consumer losses, or in terms of the reduction of losses to the consumers who take advantage of the information. If the latter, will the costs of information benefit only a certain segment of society, and is this an undesirable result in terms of distributive justice?

C. Compensation: the shifting and spreading of consumer losses

Two basic issues arise under this heading: Firstly, should consumers be compensated for the losses caused by defective products or should losses lie where they fall? Secondly, assuming that consumers should be compensated by somebody else, who should pay that compensation? The people benefiting from the activity that caused the loss? The widest possible class, i.e., taxpayers?

A very useful empirical study would deal with compensation under the present Canadian product liability system. What percentage of the different losses are compensated at all? Even in the case of those who are compensated, to what extent are they compensated? What expenses do consumers have to incur in order to attain that compensation? How successful are the different methods of risk-spreading in terms of compensation? How do those methods of compensation attain the deterrence goals mentioned above?

The theoretical framework and the empirical knowledge about the Canadian compensation system could be used to evaluate the different proposals that have been made to change the present system, i.e., changes in warranties and law or the adoption of new systems of strict product liability or injury compensation.

At present, compensation of consumer losses in Canada is achieved through the law of sales and tort. In the pages that follow, I will discuss some policy issues in those two areas as well as some new proposals.

1. Warranties

For a number of reasons I think priority should be given to a study of this basis of liability. In the first place, there has been a lot of recent activity in the area, a certain momentum for law reform has been gathered in Canada and any changes which are going to occur are likely going to take place in this area. In the second place, the American history of product liability has shown that changes started in this area acted as a catalyst in the move toward strict product liability law. Changes in

warranty law have performed an educational function for the bench and bar, who after assimilating the new doctrines have seen them as mere steps toward strict liability. Finally, warranty has been the legal doctrine that traditionally has given consumers any remedies for the most frequent type of losses, i.e., for the consumer's unfulfilled economic expectations, the diminished value of the goods or the cost of repairing them. A number of studies could be done in the area of warranty:

a. Analysis and evaluation of the economic assumptions of the Ontario Law Reform Commission's Report on Consumer Warranties and Guarantees in the Sale of Goods. Firstly, is the abolition of the doctrine of privity justified in terms of the different goals of the ideal system of consumer loss compensation? Is it justified in terms of deterrence, risk-spreading, etc.?

Secondly, the Ontario Report recommends the invalidity and prohibition of the use of disclaimer clauses in consumer contracts. Is this recommendation justified in economic terms, i.e., in light of the desired goals of the ideal system of consumer loss compensation?

b. Desirability of using the reasonability test to define the statutory warranties. As I have indicated above, the non-excludable statutory warranties of acceptability, fitness for purpose and durability are defined in terms of reasonability, and a similar kind of reasoning is used to decide whether a defendant was negligent. Is this test too uncertain for consumers, manufacturers and courts? Would any other test be flexible enough to be applied to billions of consumer products? A number of issues arise here:

i. The relationship between the concept of defect on the one hand and acceptability or fitness on the other. The words

"defect" or "defective" denote that a product does not live up to, or falls short of, a certain standard. But that standard is not necessarily the one required by our law. Consumer products may be considered defective and still be of acceptable quality or reasonably fit for a purpose.

Are the present tests of unreasonable quality too much of an incentive? Or do they in fact reflect the reasonable expectations of consumers? Do consumers only complain when the products fall far short of the legal standard or are there many disputes in cases that fall in the penumbra of the concept? Would it be possible to have a clearer quality test, for example "the machine will be in good working order for 3 years or 300 hours of use"? Could the statutory warranties of most "consumer durables" be set clearly by regulation? How would we deal with cosmetic defects? Is it feasible and what would be the cost of adding to consumer durables a device to count the hours of use?

ii. Can the manufacturers calculate the cost of their liability under the new statutory minimum warranty adopted by Saskatchewan? Is this absolutely necessary, given the fact that retailers have been subject to the same type of liability and they seem to have been able to calculate its cost?

iii. Do the courts have adequate conceptual tools to reach a decision on the basis of reasonability? Does the concept help in solving problems such as whether products that cause allergies or a new "miracle" medicine that is "unavoidably unsafe" are of acceptable quality? Do the courts admit evidence relevant to Learned Hand's rule in the Carrol Towing case? Should they?

c. Relationship between the statutory or implied warranties on the one hand and the manufacturers' warranties on the other.

One of the recommendations of the Ontario Report adopted by the Saskatchewan Act is that both retailers and manufacturers should be subject to a minimum core of non-excludable warranties, but that they should be free to give "additional written warranties", as they are named in the Saskatchewan Act. This approach is also adopted in the United States by the Magnuson-Moss Act, with one difference: there, the minimum warranties are given under state law and the additional written warranties are regulated by federal law. The problem with this system of overlapping warranties is that they are not coextensive and this could be quite misleading to consumers. Are consumers going to understand that even if they have no rights under the manufacturers' 12 months/12,000 miles warranties, they still have rights under the statutory core warranty, because the application of the reasonability test to their case leads to the conclusion that their car should be acceptable, fit for purpose and durable for at least 50 months or 50,000 miles?

An attempt to deal with this problem is the regulation passed by the FTC in 1976 requiring warranty booklets of goods sold for $15.00 or more to include the following statement:

> This document gives you legal rights and you may also have other rights that vary from state to state.

Section 17(2) of the Saskatchewan Act requires the inclusion of a statement to the same effect in "additional written warranties".

Two separate issues arise from the present system of overlapping but not coextensive warranties: one is whether this approach is going to be misleading to consumers;

another one is, even if it is not misleading, whether it is desirable in terms of disclosure, i.e., of giving consumers enough information to allow them to calculate the value of the different warranties. Probably the ideal system would be one that would disclose in clear terms the duration of the minimum non-excludable core warranty and then the duration of the manufacturer's "additional written warranty" which would go into force after the expiry of the minimum core warranty. This new system would require both a new way of determining the duration of the core warranty by a method different than the reasonability test, and a change in the mandatory practices of manufacturers.

d. Another type of study could deal with remedies for breach of warranty. Are the present legal remedies divorced from consumers' expectations? In my experience, most consumers are not aware of their right to damages, of the fact that a damage award may considerably surpass the price of the goods, or even of the fact that they have rights against retailers. When a product shows a quality defect, the natural reaction of the average consumer is to take it back to the retailer; in the case of a minor defect, a consumer will be content with having it repaired, while in the case of a major defect, the consumer will generally expect to have the product exchanged for a defect-free one, or to get his money back. Are the recommendations of the Ontario Report or the remedies sections of the Saskatchewan Act realistic in terms of consumer expectations? Should the warranties legislation cover the replacement of defective products?

2. Sales Law

The Ontario Law Reform Commission has undertaken a comprehensive study of the Sale of Goods Act. Some of the recommendations of this study could be of importance for a system of product liability in Canada.

One would be the use of disclaimer clauses in business contracts. We have seen that consumers can recover from retailers who can recover from their sellers and so on up the chain of distribution. If it is decided that manufacturers should bear these losses because of their ability to insure or distribute their cost through prices, it may well be that in fact, because of the presence of disclaimer clauses, the loss will have to be absorbed by a middleman who may not have the ability to spread the loss.

Another important recommendation of the study will be the one dealing with the quantum of damage for breach of the contract of sale. Will damages be granted to compensate buyers for consequential losses such as personal injuries or damage to property caused by defective goods; or will damages be limited to compensate buyers only for the diminution in value of the defective goods, i.e., to restore the price that the buyer has overpaid? Some proponents of strict product liability have suggested that business suppliers should be made liable for consequential losses under the rules of the new strict liability and that sales law should only grant damages for the loss of bargain, up to the price paid for the goods. Is this a desirable proposal in light of the goals of the loss compensation system?

3. Strict product liability

Two types of studies can be made of this area. One is to analyse the different systems of product liability in light of the theoretical framework of ends and means of an ideal system of compensation of consumer losses. This type of study would evaluate the desirability of imposing strict liability for defective products in light of the goals of the ideal system. A second type of study would be of a legal nature and should deal with the relationship of strict product liability to consumer warranties and sales law. It

should deal, among others, with the following issues:

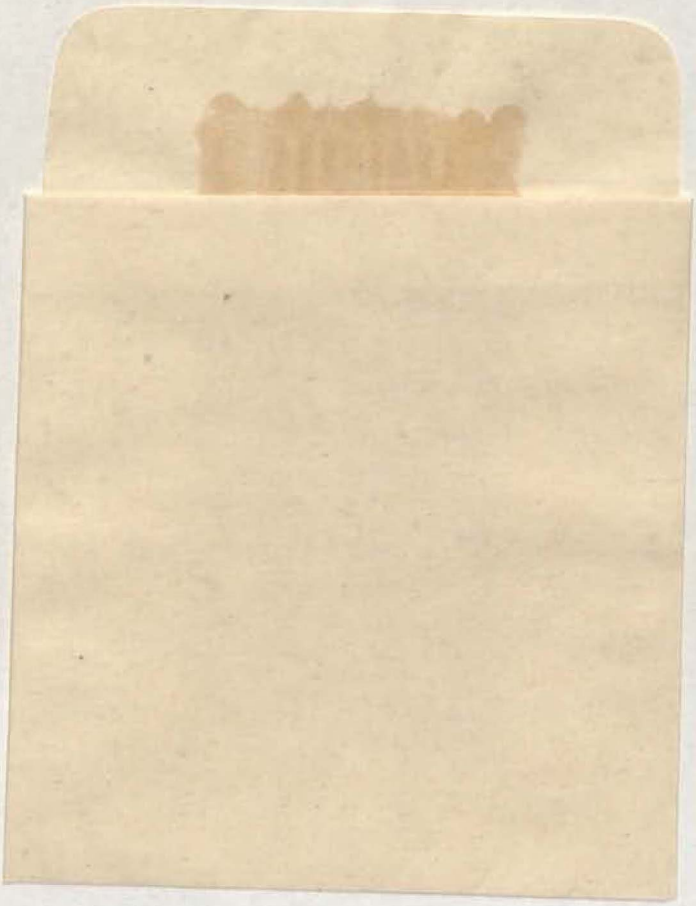
a. Should strict product liability be limited to cases of injury to the person or property, while consumer warranties and sales law are confined to compensate consumers for the diminished values of the goods or the cost of repairing them? To put it another way, would it be desirable in a case of defective products which cause injury to the person or property, to require the plaintiffs to plead warranty in order to recover damages for their unfulfilled economic expectations (the diminished value of the defective goods) and to plead strict product liability in order to recover consequential damages for personal injuries or property damage? Should buyers continue to be entitled to sue on two separate bases of liability? Once the doctrine of strict product liability is established should the consumer warranty and the sales legislation be amended to exclude from their scope damages for losses caused by the use of the defective goods and to limit them to losses caused by the sale of the goods?

b. If the overruling of horizontal privity is considered desirable in order to increase the number of people protected, should it be done through the doctrine of strict product liablity or through the doctrine of warranty? Should the claim of non-buyers be allowed only in cases of accidents but not in cases of purely economic loss?

4. Injury compensation schemes

Although this type of scheme would deal only with a few of the losses caused by consumer products, they are the most severe ones. This type of scheme will cover many types of injuries not caused by defective products, such as those caused by negligent

people with perfect products, while it will not cover most of the losses discussed in this paper, i.e., losses that do not arise out of an accident, such as the mere malfunction or breakdown of a consumer product. Even though this type of scheme does not fit neatly within the scope of the federal study on producer liability, I think an analysis of the subject could throw some light on a number of important issues, such as the deterrence provided by the present system of tort liability, the percentage of injured people that are compensated under it and under the other systems of compensation. It would be of special interest to know the relationship of the New Zealand system to warranty and negligence law and how that system would compare with a new system of warranty and strict liability in achieving the desired goals of an ideal consumer loss compensation system.



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