THE CANADIAN INDEMNITY COMPANY (DEFENDANT) ..... } APPELLANT;

AND

ANDREWS & GEORGE COMPANY LIMITED (PLAINTIFF) ..... } RESPONDENT.

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*June 9, 10
*Oct. 7

ON APPEAL FROM THE COURT OF APPEAL FOR BRITISH COLUMBIA

Contracts—Insurance—Sale of Goods—Indemnity against liability imposed by law caused by accident arising out of condition in vendor's product after possession passed to another—Defective glue causing damage to vendee's product—Whether defect an accident—Whether liability assumed by agreement or imposed by law—Sale of Goods Act, R.S.B.C., 1948, c. 294, ss. 21, 58.

The respondent sold and delivered a quantity of glue to a lumber company to be used in the manufacture of plywood. Owing to the respondent's ignorance that its testing appliance was out of order, the glue supplied was defective and as a result the lumber company sustained damages, which the respondent paid. It then brought this action against the appellant upon a business liability insurance policy to recover the amount of such damages. Before this Court the only claim advanced was upon Endorsement 10(1) whereby the insurer undertook "To indemnify the Insured against the liability imposed by law upon the Insured for damage to or destruction of property of others caused by accident during the policy period and arising out of the handling or use of or the existence of any condition in merchandise products or containers manufactured, sold, or handled by the Insured after the Insured has relinquished possession of such merchandise products or containers to others and away from the premises owned by, leased to or controlled by the Insured." By Exception A to this endorsement it was provided that the policy should not cover "Damage to or destruction of property where the Insured has assumed liability therefor under the terms of any contract or agreement." Under Endorsement 11(1) the insurer undertook "to pay on behalf of the Insured all sums which the Insured shall be obligated to pay by reason of the liability imposed by law upon the Insured or by written contract for damage to or destruction of property of others of any or every description not hereinafter excepted, resulting solely and directly from an accident due to the operations of the Insured as stated in the said Policy . . . ."

Held: Reversing the judgment of the Court of Appeal for British Columbia and restoring that of the trial judge, that the action should be dismissed.

Per: Kerwin and Estey JJ.: (1) The defective condition of the glue was unsuspected and undesired and therefore there was an "accident" which caused damage to the "property of others"; (2) it was not necessary that such accident should occur "after the Insured had relinquished possession of such merchandise products . . . . to others and away from the premises owned . . . . by the Insured" but it was sufficient if the damage should so arise. So held upon

*PRESENT: Kerwin, Rand, Kellock, Estey and Cartwright JJ.

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the construction of the endorsement but, in any event, being capable of that construction, the endorsement must be construed *contra proferentem;* (3) by s. 21 of the *Sale of Goods Act,* R.S.B.C. 1948, c. 294, there is an implied condition in certain circumstances as to the quality or fitness for any particular purpose of goods supplied under a contract of sale. Within the terms of Exception A to Endorsement 10(1) the respondent assumed liability for the damage under the terms of the contract between it and the lumber company, particularly in view of the fact that Endorsement 11(1) includes both liability imposed by law and that imposed by written contract. The implied condition under the *Sale of Goods Act* is as much a term of the contract as if it had been expressly stated therein; (4) in view of Exception A it is unnecessary to consider whether the rule in *Donoghue* v. *Stevenson* [1932] A.C. 562, and *Grant* v. *Australian Knitting Mills Limited* [1936] A.C. 85, applied between the immediate parties to a contract so as to raise the contention that the lumber company had a cause of action against the respondent as well in tort as in contract.

Per: Rand J.: (1) There was no accident and in any event none occurred after the respondent had parted with possession of the glue; (2) the phrase "liability imposed by law" in Endorsement 10(1) does not include liability arising under contract. This is put beyond controversy by the inclusion in Endorsement 11(1) of liability "imposed by law . . . . or by written contract"; (3) under the rule in *Donoghue* v. *Stevenson* the duty of care by the respondent in the manufacture of the glue extended to the immediate purchaser, the lumber company; but (4) that duty did not arise out of a contract, notwithstanding s. 21 of the *Sale of Goods Act.*

Per: Kellock J.: The damage for which indemnity was given by Endorsement 10(1) was not damage arising after the respondent had relinquished possession of the glue but damage caused by accident so arising, and the respondent failed to show any accident within the meaning of the Endorsement.

Cartwright J. concurred with those parts of the reasons of Kerwin and Rand JJ. which held that any possible liability was excluded by the terms of Exception A to Endorsement 10(1).

APPEAL from the judgment of the British Columbia Court of Appeal (1) reversing the judgment of Farris, Chief Justice of the Supreme Court of British Columbia at the trial (2), dismissing the plaintiff's claim to recover under a policy of insurance against business liability.

D. McK. Brown for the appellant.

J. A. MacInnes Q.C. for the respondent.

(1) (1951) 4 W.W.R. (N.S.) 37; [1952] 1 D.L.R. 180.

(2) [1951] 1 D.L.R. 783.

The judgment of Kerwin and Estey, JJ. was delivered by:—

KERWIN J.:—Among other businesses carried on by the respondent is the making of glue and the sale thereof to lumber companies for use in their manufacture of plywood. One of these lumber companies, Canadian Western Lumber Company, Limited, purchased a quantity of glue from the respondent under an open oral contract. The glue was not fit for the purpose for which it was supplied as it showed defective lamination or adhesion, and the respondent paid the lumber company the sum of $9,159.79 which, as between the parties to this litigation, it is agreed is the amount of the damage sustained by the lumber company. This action to recover that amount from the appellant was based upon the terms of endorsement No. 10 to what is called a comprehensive business liability policy, issued by the appellant to the respondent and a number of other insured. Before the Court of Appeal the respondent also relied on endorsements 2 and 11, but in this Court the claim was restricted as at the trial.

The policy is dated November 17, 1947, for the period from noon, November 30, 1947, to noon, November 30, 1950. By it, the appellant agreed to indemnify the insured against certain liabilities with which we are not concerned but the policy is made subject to certain conditions, one of which may be noted:—

B. This policy applies only to accidents or occurrences which originate during the policy period.

Endorsements Nos. 10 and 11 to the policy are dated November 30, and by endorsement No. 12, dated December 2, 1947, the additional premium to cover "Damage to property of others as per Endorsements No. 10 and No. 11" was fixed at $426.67. By clause 1 of endorsement No. 10, in consideration of the additional premium, the policy was extended:—

1. TO INDEMNIFY the Insured against the liability imposed by law upon the Insured for damage to or destruction of property of others caused by accident during the policy period and arising out of the handling or use of or the existence of any condition in merchandise products or containers manufactured, sold, or handled by the Insured after the Insured has relinquished possession of such merchandise products or containers to others and away from premises owned by, leased to or controlled by the Insured;

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Kerwin J.

The first question is whether the damage suffered by the lumber company was caused by accident. I agree with the trial judge and the Court of Appeal that it was, although not resting that conclusion in any respect on there being, as the Court of Appeal held, "nothing in the glue ingredients nor in the glue itself which was inflammable or explosive", since there is no evidence in the record upon which to base such a finding. The evidence does show that the glue sold to the lumber company had been prepared and tested in the usual manner by the respondent but that, owing to the appliance used by it for testing being out of order, a misleading result was achieved. As a consequence of further investigation, a number of possibilities emerged as to the manner in which the defect in the glue had occurred but the cause was left undetermined. Under these circumstances, the defective condition was unsuspected and undesired and, therefore, there was an accident which caused the damage to "property of others".

The trial judge considered that to be within the terms of clause 1 the accident must have occurred "after the insured has relinquished possession . . . . to others and away from premises owned by, leased to or controlled by the insured." If that be so, it is the end of the matter as it cannot be successfully argued that any accident occurred after the glue had left the respondent's possession. The Court of Appeal disagreed with the trial judge's construction of the clause and I think they were right in deciding that it is the damage only that must occur after the events specified. In view of condition B in the policy itself, the words in clause 1 of endorsement 10 "during the policy period" may be disregarded. With them deleted, the clause would then read: "To indemnify the Insured against the liability imposed by law upon the Insured for damage to or destruction of property of others caused by accident and arising out of the handling or use, etc.", and the word "arising" relates to "damage to or destruction of property of others" and not to "accident". Furthermore, it is appropriate to speak of damage or destruction, rather than accident "arising out of the handling or use, etc." In any event it is open to that interpretation and the clause must be construed *contra proferentem.*

However, the respondent must bring itself within the opening words of clause 1 by which the appellant agreed to indemnify the insured against the liability "imposed by law" upon it. These words also appear in the policy and in endorsements Nos. 2, 7 and 11. Clause 1 of endorsement 11 reads:—

> 1. TO PAY on behalf of the Insured all sums which the Insured shall be obligated to pay by reason of the liability imposed by law upon the Insured or by written contract for damage to or destruction of property of others of any or every description not hereinafter excepted, resulting solely and directly from an accident due to the operations of the Insured as stated in the said Policy, provided such damage or destruction occurs during the policy period;

This endorsement was added at the same time as No. 10 and both are part of the policy. While endorsement 11 contemplates an entirely different class of risk, the inclusion therein of "the liability imposed . . . . upon the Insured . . . . by written contract" indicates that the phrase "imposed by law" in endorsement 10 does not include a liability imposed upon the respondent as a result of its own volition in entering into the contract with the lumber company. "As the relation of contractor and contractee is voluntary, the consequences attaching to the relation must be voluntary" (Holmes', *The Common Law*, p. 302). To the same effect, in expanded form, is *Chitty on Contracts*, 20th edition, page 3:—

> It therefore appears that, as stated above, the kind of obligation involved in a contract is that which the parties themselves *intend* shall be created. It arises from their volition and is not imposed on them *ab extra* by the law. A and B are not obliged to enter into any contract unless they wish to do so; if they do so, they create their own obligation, the one to the other; they intend that their bargain shall, if necessary, be enforced by the law.

The fact that s. 21 of the *Sale of Goods Act* R.S.B.C. 1948, chapter 294, provides that in certain circumstances there shall be an implied condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale, and that s. 58 provides for damages for breach of such a condition (treated as a warranty) does not affect the matter. If the lumber company's cause of action against the respondent were based only on contract, the latter's liability for damage to the former's property was not imposed by law upon the respondent within the meaning of clause 1 of endorsement 10.

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Kerwin J.

We have not had the benefit of argument as to whether the rule expounded in *Donoghue* v. *Stevenson* (1), and *Grant* v. *Australian Knitting Mills Ltd.* (2), applies between the immediate parties to a contract in order to raise the contention that the lumber company had a cause of action against the respondent as well in tort as in contract. In view of exception A to the indemnity provided by clause 1 of endorsement 10, it is unnecessary to deal with the point. That exception runs:—

> A. Damage to or destruction of property where the Insured has assumed a liability therefor under the terms of any contract or agreement.

The respondent assumed liability for the damage under the terms of the contract between it and the lumber company since the implied condition provided for by s. 21 of the *Sale of Goods Act* is as much a term as if it had been expressly stated therein.

The appeal should be allowed with costs here and in the Court of Appeal and the judgment at the trial restored.

RAND J.:—The indemnity insurance undertaken by the appellant is admittedly of a type designed generally to meet the extended liability imposed on manufacturers by the rule laid down in *Donoghue* v. *Stevenson* (1) and followed in *Grant* v. *Australian Knitting Mills Limited* (2), and that circumstance is significant among the commercial facts which furnish the background to the policy. The latter, subject to the long established qualifications, must, of course, be read according to the ordinary meaning of its language; but "meaning" itself has rather shadowy boundaries, and even ordinary language must, for a true understanding of what the parties meant by it, be construed in the context and the circumstances out of which it has arisen. When the words are in the form of legal expressions which have no fixed or precise definition, those circumstances become so much more necessary to enable us to appreciate the mental perspectives of the parties when they bargained.

(1) [1932] A.C. 562. (2) [1936] A.C. 85.

Endorsement No. 10 is the provision under which the claim is made. By s. 1 the company agrees to indemnify the respondent against

> The liability imposed by law upon the Insured for damage to or destruction of property of others *caused by accident* during the policy period and arising out of the handling or use of or the existence of any condition in merchandise products or containers manufactured, sold, or handled by the Insured after the Insured has relinquished possession of such merchandise products or containers to others and away from premises owned by leased to or controlled by the Insured;

The question is whether that clause applies to what may be taken as a negligent production of inferior glue which, being used to make laminated lumber, produced a grade below what proper glue would have done and involved, therefore, a breach of warranty of fitness.

The policy contains an exclusion, among others, of liability for "damage to or destruction of property where the Insured has assumed liability therefor under the terms of any contract or agreement;".

Endorsement No. 11 provided a further indemnity in the following words:—

> 1. TO PAY on behalf of the Insured all sums which the Insured shall be obligated to pay by reason of the liability *imposed by law* . . . . or *by written contract* for damage to or destruction of property of others . . . . resulting . . . . from an accident due *to the operations* of the Insured . . . .

I take the phrase liability "imposed by law" in No. 10 to mean, as distinguished from liability arising under contract. I should have done that from the context alone, but the inclusion in No. 11 of both "imposed by law . . . . or by written contract" seems to me to put the matter beyond controversy.

Although there is a warranty, is there also a collateral co-existing right in tort based on negligence? Whether the rule of *Donoghue* v. *Stevenson* (1) runs in favour of the immediate purchaser from the manufacturer has not apparently been expressly decided. But I can see no reason why the general duty of the manufacturer should not extend to his purchaser, the first in the direct line of those within the scope of the potential mischief. Where warranty is excluded, what is there in the policy of the law to deny him the same relief from the effects, say, of an explosion as would be accorded a purchaser from him on the same

(1) [1932] A.C. 562.

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Rand J.

terms? An exclusion of warranty does not necessarily involve a release of the general duty of care in manufacture; and I should say that the duty does extend to the immediate purchaser.

Does the sale, then, with warranty impliedly absorb all other liability that would, in its absence, arise out of the transaction? Where a contract expressly or by implication of fact provides for a performance with care, as in the case of carriers, the general duty is clearly not displaced and the person injured or damaged in property may sue either in contract or tort. As a settlement was made here without action, it cannot be said in what right the claim was pressed or discharged, though all liability would be satisfied.

But the question seems to be disposed of by the exclusion (A) from liability "assumed . . . . under the terms of any contract or agreement", unless Mr. MacInnes is right when he argues that the warranty is provided by the *Sale of Goods Act* and not by the contract.

No doubt every liability enforceable in the courts is, in one sense, created by law: if there were no legal order, there would be no civil rights as we know them enforced by the power of the community. But it is not in that sense that the words must be taken to be used: here again they imply a contrast between liability arising in respect of contractual relations, and that in respect of matters outside of agreement.

At common law the warranty was deemed to be an element of the intention of the parties: the purchaser was buying something that would accomplish a certain purpose and placed reliance in the seller who, in effect, undertook to furnish such a thing: it was a term of the bargain. The statute has crystallized that element but only as a term, which by agreement can be excluded. The right to damages is a creation of law annexed to the contract as an incident; and the "assumption of liability" is effected by entering into a contract to which are annexed both the warranty and the remedial right in case of breach. The liability is one, therefore, that has been assumed by contract.

The indemnity, moreover, is seen to be limited to damage "caused by accident". This presupposes a tortious act by the manufacturer creating a liability to which an accident,

in the strictly legal sense of the term, could not of itself give rise. Grammatically and in, I think, the true sense, it is related to the damage, not the liability: and in that sense, the accident must eventuate when the possession of the goods has passed to another than the manufacturer. Such cases can easily be imagined as, for instance, explosions and similar mishaps.

Was the damage here, then, produced by such an accident? The glue was used no doubt in the belief that it was of proper quality but the possibility that it was not was always present to the minds of the purchasers who tested it regularly in the course of production; but the test involved a time lag which accounts for the substantial damage. To treat mistaken action of that nature as "accident" would render the word superfluous. What is meant is something out of the ordinary or the likely, something fortuitous, unusual and unexpected, not, in the ordinary course, guarded against.

It was argued that, on such a construction, no liability could ever arise since an "accident" in that sense, resulting from defective glue, is inconceivable. No evidence was directed to that point and there is no factual basis for such a conclusion. The language of the indemnity applied to a number of different businesses and necessarily it was general. But what the parties had in mind were possibilities difficult if not impossible to foresee: what they clearly did not aim at were direct and expectable damages from the daily risks which it was part of their business of production and sale to face and eliminate. These are the ordinary consequences of a breach of warranty of fitness, a liability as old as warranty itself.

The appeal must be allowed and the judgment at trial restored with costs in the Court of Appeal and in this Court.

KELLOCK J.:—In this case the respondent brought action to recover from the appellant the sum of $9,159.79 paid by the respondent to the Canadian Western Lumber Company Limited, being the agreed amount of damage sustained by the lumber company in using, in the manufacture of its plywood, glue manufactured and sold to it by the respondent, it being admitted by the respondent, a fact which the appellant also accepts, that the glue was not fit for the

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Kellock J.

purpose for which it was supplied to the lumber company. The respondent claimed the amount of this loss from the appellant under the terms of a policy of insurance, the relevant provision of which is as follows:

> To indemnify the Insured against the liability imposed by law upon the Insured for damage to or destruction of property of others caused by accident during the policy period and arising out of the handling or use of or the existence of any condition in merchandise products or containers manufactured, sold, or handled by the Insured after the Insured has relinquished possession of such merchandise products or containers to others and away from premises owned by leased to or controlled by the Insured.

The glue in question is of a type known as phenolic resin glue, the basic ingredients of which are phenol, formaldehyde and caustic. The glue was deficient in adhesive strength which resulted in the plywood not being up to the standard, and it was sold at a lower price in consequence.

The process of manufacture of the glue is carried out by heating the ingredients until a chemical reaction takes place, and the volatile ingredients are driven off, leaving a residue composed of from forty to forty-five per cent of non-volatile solids.

The particular glue which was shipped to the lumber company was composed in fact of thirty-six to thirty-seven per cent only of these solids, but this condition was not discovered by the respondent owing to the fact that the apparatus which it used to test its product did not record the actual condition of the glue. The apparatus itself is a small oven in which a portion of the glue is kept under constant temperature during testing, the heat being kept constant by reason of a thermostat control. The servants of the respondent had not checked the thermostat for a period of nine months, and were not aware that it was not functioning. Evidence was given on behalf of the appellant that it was standard practice to make a check of such apparatus at least once a week. The learned trial judge found that the reason for the glue being defective had been left a complete mystery on the evidence. While in his view the defect was due to accident, nevertheless, he was of opinion that, under the terms of Endorsement No. 10, the respondent could not recover as the accident referred to in the policy was one occurring after the glue had left the possession of the respondent. He also held

that in any event the respondent could not recover as the liability of the respondent was not a liability "imposed by law" within the meaning of the endorsement but a liability assumed by the respondent under its contract with the lumber company which was excluded by express exception.

This judgment was set aside on appeal. In the view of the Court of Appeal, on a proper construction of the endorsement, the respondent was entitled to recover if the damage arose after the glue had left the respondent's premises although the accident occurred prior thereto. The court also disagreed as to the applicability of the term of exclusion.

In my opinion, the damage for which indemnity is given by the endorsement is damage caused by an accident (*a*) which occurs during the term of the policy and (*b*) which arises "after" the goods have left the insured's premises. It is the contention of the respondent that the qualifying words following the word "accident" relate not to "accident" but to the preceding word "damage," and that therefore it is immaterial if the accident occurred on the premises of the insured. I do not think the endorsement can be so read. In my opinion, the "accident" contemplated is an accident "arising out of the handling . . . . or use of . . . . or condition in" the products "after" the insured has relinquished possession. In other words, it is not "damage" arising after the insured has relinquished possession of the goods, but damage caused by "accident" so arising. In my opinion, therefore, the respondent failed to show any accident within the meaning of the endorsement.

The Court of Appeal appears to have been influenced in reaching their decision by the consideration thus expressed in the judgment of Robertson J.A.:

> There was nothing in the glue ingredients or in the glue itself which was inflammable or explosive, nor was any damage to be apprehended in connection with its manufacture. There was not any danger of this sort to be feared by its customers. There would only be one thing for which it required protection, viz., some accidental fault in the manufacture of the glue which affected its value or rendered it unfit for the purpose for which it was being sold.

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Kellock J.

As pointed out by the appellant, there is no evidence in the record to support a finding of this nature. This consideration is therefore not available to affect the ordinary grammatical construction of the language used, whatever might otherwise have been the case.

It is not necessary to consider the other questions argued. I would allow the appeal with costs here and below.

CARTWRIGHT J.:—I agree that this appeal should be allowed. For the reasons given on this branch of the matter by my brothers Kerwin and Rand and by the learned Chief Justice who presided at the trial, I am of opinion that even if the appellant would otherwise have been under liability (a question which I find it unnecessary to determine) such liability is negatived by the terms of Exclusion (A) of Endorsement 10, quoted in the reasons of my brother Kerwin.

I would allow the appeal and restore the judgment at the trial with costs throughout.

Appeal allowed with costs.

Solicitor for the appellant: *L. St. M. Du Moulin.*

Solicitor for the respondent: *J. A. MacInnes.*