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Few people will disagree with the proposition that innovation is a key to economic well-being as we move into the next millennium. We believe that Americans and Canadians are by nature innovative people. North America has been a leader in innovation and technology but, over the past decade, some have become concerned with the question of whether external factors are suppressing this inherent strength in our economy.

We met here just five years ago to discuss the aspects of product liability affecting innovation in the Canada-U.S. context. I spoke on the question of whether Canada's legal environment inhibited innovation. A lot has changed in those five years, and I would like once again to consider this question, in light of the changes we have seen.

Let me begin by defining the two stages to innovation which occur to me. First, there is the creative/research stage which leads to innovative changes or product improvements. The second stage is implementation of these innovations in commercial production. A company may develop an innovative product in Canada or the United States. It will then have to consider whether it will implement this innovation by selling the product in either or both of those countries. Many external factors could inhibit innovation at either stage. These factors become significant at the implementation stage since companies can point to specific cases where they have chosen not to market a product or to remove it from the market.

I. Canadian Legal Environment

When I spoke on this subject five years ago I suggested that technological innovation had not been significantly inhibited by the Canadian legal system and product liability laws. It was my opinion that the Canadian experience had been different than the American experience, perhaps as a result of some of the following factors:

1. Differences between Canadian and American social systems and basic cultural differences;

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2. Procedural differences within the American and Canadian judicial systems;
3. Differences between our substantive laws relating to damage awards; and
4. Differences in our respective substantive product liability laws.

While there have been some changes in Canada's legal environment, I still conclude that it provides a non-hostile environment for innovation.

A. The Social/Cultural Differences

Canadians are generally less aggressive in their use of the civil justice system. An example from our office comes to mind. We act for a manufacturer which faced in excess of 2,000 claims involving a particular product in the United States. In all of Canada, it faced less than fifty for the same product. Only one of the Canadian cases has gone to trial. In the same period, over one hundred cases have been tried in the United States. That company's experience is that Canadian cases settle earlier, and for much less, while a much higher percentage of American cases go through to a full trial. This does not appear to be an isolated case. As a rough measure of comparative numbers of product liability trials, we conducted a computer search of Lexis and a comparable Canadian database. Lexis had 3,184 Federal and State product liability cases reported during the period from 1992 to 1994. During this same period, the Canadian database had only seventy cases reported. This represents a factor of forty-five to one. Differences in population, sales, and use could not account for the significantly lower number of claims. We believe that there is a greater reluctance on the part of Canadians to make use of our judicial system. This reluctance may not be attributable solely to a sense of individual responsibility. Canadians have available to them a network of medical, health, and social security programs which reduce the need to litigate. We also have government-sponsored Workers' compensation providing "without fault" rehabilitation, retraining, and a guarantee of income for people who suffer work-related injuries.

Accordingly, while perhaps not capable of precise statistical/academic analysis, we believe that these social/cultural differences between our two countries have reduced the need for Canadians to use our civil court system.

B. Procedural Differences

Three key differences in our systems are the judges, juries, and costs. While jury trials are the norm in the United States, they are the exception in Canada. Many counselors never exercise their right to request a jury. Where a jury is requested, the Court may at any stage of the proceedings dismiss the jury based upon the complexity of the is-

sues. Over the past five years, our appellate courts have suggested that judges should be more reluctant to dismiss a jury, but the number of jury trials still remains relatively small.

Our judges are, subject to good behaviour, appointed for life; therefore, they are not subject to the same concerns as those American judges who must be elected.

There are really two separate but related ways in which costs deter product liability litigation in Canada. The first relates to the disproportionality between costs and potential recoveries, along with the question of who will assume the risk of costs incurred to prosecute a product liability claim. The second relates to costs sanctions which can be imposed upon plaintiffs by the trial judge.

Few cases in Canada result in multi-million dollar judgments or settlements. Punitive damage awards are of little if any consequence, and damage awards for pain and suffering are capped at approximately $250,000 dollars. All cases, except those involving truly catastrophic losses, are assessed at less. In some Canadian provinces, including the most populous province of Ontario, lawyers are not yet permitted to work on a contingency fee basis. They can choose to bill at the end of the case knowing they will not be paid if the claim is dismissed, and they can even personally fund the disbursements, but they cannot then take a percentage of the recovery. Their fees will be limited to the reasonable fees for the services provided. In the vast majority of cases, contingency fees, even if available, will not cover the costs required to prosecute a complex product liability claim. In other words, it is often uneconomic for plaintiff's counsel to take a case to trial. Experienced trial lawyers know that the cost of preparing and handling a complex product claim at trial will be disproportionate to the potential recovery. Against this back drop, those counselors also know that the costs they do recover, if any, will not justify the risk of funding disbursements and not being paid at the end of the day. In fact, few lawyers who work for injured claimants can afford to assume those risks. Most law firms, our own being one, discourage such "speculative" practice.

As a rule, "costs follow the event" in Canadian courts. This means that a successful defendant will be entitled to recover "taxable costs" from the plaintiff. This will usually work out to fifty percent of the actual legal expenses. Many provinces also have rules which provide that the defendant will get its costs where it has made an offer to settle which was equal to or greater than the amount recovered at trial. I can assure you that plaintiffs and their counsel are influenced by the prospect of cost sanctions.

One substantial change over the past five years has been the enactment of class action legislation in Ontario. The legislation was the result of an extensive consultation process involving consumer groups and major industry representatives. While this legislation has increased the

exposure of certain companies to large groups of claims, it has a number of positive benefits. In cases where there are a number of substantial claims, it can reduce the total legal fees and allow for the claims to be efficiently managed. In cases where there are a large number of very small claims, however, the company will be faced with a liability it may have avoided in the past.

We do not think that class actions will substantially alter the total liability of companies where the product claims relate to serious or catastrophic injury. In fact, when handled properly, class action suits can result in a more cost-effective way in which to resolve product liability claims.

C. *Damages*

There are two significant areas where Canadian courts assess damages very differently: the first is non-pecuniary general damages for pain and suffering, loss of enjoyment of life, etc., and the second is punitive damages.

Traditionally, punitive damages were rarely awarded, and have not been available in cases of breach of contract. This has begun to change. In 1989, the Supreme Court of Canada held that punitive damages could be awarded in wrongful dismissal cases, but only where the defendant was deserving of punishment because of harsh, vindictive, reprehensible, and malicious conduct.[1] That same year, an Ontario judge awarded punitive damages of $10,000 dollars against a bank which had dismissed the plaintiff.[2] On appeal, the Court of Appeal increased the punitive damages to $50,000 dollars.[3] Then, in 1994, the Ontario Court of Appeal upheld a jury verdict awarding a Crown Attorney $800,000 dollars in punitive damages for defamation by the Church of Scientology and its solicitor.[4] While we do not expect to begin seeing multi-million dollar awards for punitive damages in products liability cases, we do believe that our courts will make punitive damage awards in appropriate cases where they find a defendant's conduct to be truly reprehensible and worthy of punishment.

As indicated earlier, the Supreme Court of Canada placed a "cap" of $100,000 dollars on non-pecuniary general damages in 1978. With inflation, this limitation has risen to approximately $250,000 dollars in 1995 Canadian currency.

D. *Substantive Law*

Canada does not impose strict liability, except to the extent that it

[1] Vorvis v. Insurance Corporation of British Columbia, 58 D.L.R. 193 (S.C.C.) (1989).
[2] Ribeiro v. Canadian Imperial Bank of Commerce, 67 O.R. 385 (Ont. H.C.J.) (1989).
[3] Ribeiro v. Canadian Imperial Bank of Commerce, 13 O.R. 278 (Ont. C.A.) (1989).
[4] Hill v. Church of Scientology of Toronto, 18 O.R. 385 (Ont. C.A.) (1994).

flows from breach of an express or implied warranty. While some courts have imposed a "heavy onus" upon product manufacturers, they have been careful to emphasize that the finding of liability is not based upon strict liability but upon traditional standards of negligence. In fact, the Ontario Court of Appeal recently affirmed its commitment to these principles in a product liability case, *Gregorio v. Intrans Corp.*[5] The trial judge held the Canadian distributor liable for the negligent manufacture of a product. The Court of Appeal held that the distributor, even where it is a wholly owned subsidiary of the manufacturer, cannot be held liable for the negligence, if any, of its parent company.

Mr. Gregorio purchased a truck from Intrans which, in turn, had ordered the truck from Paccar Canada Ltd. (Paccar), the wholly owned subsidiary of Paccar Inc., an American truck manufacturer. When he experienced problems with the vehicle, Mr. Gregorio sued Intrans and Paccar. The trial judge found the problems with the truck were not sufficient to establish fundamental breach of the contract, but he held Intrans liable for breach of implied conditions under the Sale of Goods Act. The judge found that the defendants could not rely upon limitations in the written warranty because they were not brought to Gregorio's attention prior to the contract being signed. The trial judge held Paccar liable for negligent manufacture of the truck by its parent company.

The Court of Appeal held that Paccar could not be liable for the negligence of its parent company, even though it was a wholly owned subsidiary. The court stated that distributors owe their own duty of care to the public, but that there was no evidentiary basis for a finding of negligence against Paccar. It noted that, at best, Gregorio had a claim against Paccar for breach of express warranty; therefore, Paccar was not liable to Gregorio.

The Court of Appeal affirmed the finding that Intrans was liable under the Sale of Goods Act of Ontario, and that Paccar was in turn liable to Intrans under the Sale of Goods Act since it had not effectively limited the implied conditions under that Act. The important point to note is that the Court of Appeal imposed liability based strictly upon the contractual relationships of the parties and the applicable provisions of the Sale of Goods Act.

Contributory negligence is a principle of law to which more than "lip service" is paid by our judges. The conduct of the plaintiff is carefully scrutinized. Accordingly, the expense and uncertainty of a product liability claim based upon defective design, combined with the potential for significant contributory negligence, are discouraging factors and not ones which have curtailed product innovation in Canada.

A more common theory of liability advanced by claimants has

[5] Gregorio v. Intrans Corp., 18 O.R. 527 (1994).

been the failure to warn of the potential for harm. Most cases contain such a plea against the manufacturer or the distributor. This theory may be based upon risks known to the manufacturer at the time of distribution, or problems which are subsequently identified. Our Courts have imposed a very high burden upon manufacturers to recall, or to warn consumers, where a defect is found after a product has been sold.

In *Buchan v. Ortho Pharmaceutical (Canada) Ltd.*,[6] a young woman suffered a stroke six months after she began taking an oral contraceptive manufactured by Ortho Pharmaceutical (Canada) Ltd. (Ortho). The trial judge found that Ortho had breached its duty to warn both Ms. Buchan and her doctor of the potential risks of taking the drug.

On appeal, the Court considered the duty to warn and noted that:

> [O]nce a duty to warn is recognized, it is manifest that the warning must be adequate. It should be communicated clearly and understandably in a manner calculated to inform the user of the nature of the risk and the extent of the danger; it should be in terms commensurate with the gravity of the potential hazard, and it should not be neutralized or negated by collateral efforts on the part of the manufacturer.[7]

Ortho argued that it need only warn the doctor, and that the "learned intermediary" rule should be applied. After observing that there were few Canadian or British cases dealing with these subjects, but that the United States had considerable jurisprudence on point, the Court said: "American jurisprudence dealing with products liability based on negligence, it may be remembered, is rooted in the same fundamental philosophy and is based on the same general principles of negligence. . . ."[8] The Court also held that while the learned intermediary rule would generally apply to prescription drugs, contraceptives were an exception to this rule. In the case of contraceptives, the manufacturer owes a duty to warn the ultimate consumer of the potential dangers of using the drug.

The Court reviewed evidence of considerable differences between the information provided to physicians by Ortho in Canada and by its U.S. parent company and then held that Ortho had not adequately informed Canadian physicians.

Even though the Court found that Ortho had chosen to aggressively market the drug and minimize any concerns with respect to potential risks, it refused to award punitive damages; however, Robins also said:

> [B]y way of counterclaim, the plaintiff submits that the trial judge

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[6] Buchan v. Ortho Pharmaceutical (Canada) Ltd., 54 O.kR. 92, 103 (1986).

[7] *Id.* at 101.

[8] *Id.* at 102.

> erred in failing to award punitive and exemplary damages against Ortho. While the argument is an interesting one and raises issues that will one day doubtless require the consideration of this Court, I am not prepared in the circumstances here to reassess the evidence or interfere with the express finding that this is not a case which, on the evidence, calls for punitive or exemplary damages.[9]

In *Nicholson v. John Deere Ltd.*,[10] the Nicholsons purchased a used riding mower in 1976 at a farm auction. In 1981, their home was destroyed in a fire caused by the mower. The trial judge found that the design of the mower was inherently dangerous, and that the manufacturer (John Deere), knew or ought to have known of this danger.

The John Deere designs had placed the gas tank in proximity to the battery. When a user placed the mower's dipstick/cap on top on the tank, it could bridge a gap between the tank and battery causing a spark and igniting gasoline vapours. This phenomenon was known as "arcing." The mower purchased by the Nicholsons had been manufactured in 1967. Between 1973 and 1979, a number of accidents came to John Deere's attention, all involving arcing "and therefore due in a general way to the close proximity of the battery to the fuel tank."[11]

In 1980, John Deere implemented a program to:

(1) warn users of the risk of fire and explosion due to arcing; and,
(2) distribute a battery-cover safety kit, (the Kit).

In May, 1980, John Deere sent letters to territory managers and area service managers informing them of the program and asking that they urge customers to have the Kit installed. When John Deere realized that the program was having a very limited effect, it took the following steps:

(1) placed advertisements in newspapers;
(2) sent unregistered letters to known original users;
(3) sought greater dealer participation; and
(4) began "tagging parts" which were "captive" to the models in question with a card describing the potential problem. This tagging initiative was not implemented until April or May, 1981.

The court made the following observations:

> Assuming the finding that the design was defective in that it presented a serious and unnecessary risk of harm to consumers, the duty of a manufacturer was surely not to manufacture [it] at all if he knew or ought to have known of it. If the evidence satisfied the court that there was no knowledge or imputed knowledge at the manufacturing stage, there was an acquired duty to correct the defect and/or

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[9] *Id.* at 121-22.
[10] Nicholson v. John Deere Ltd., 58 O.R. 53 (1986).
[11] *Id.* at 57.

to warn consumers once knowledge was gained.[12]

The court went on to state:

> A manufacturer does not have the right to manufacture an inherently dangerous article when a method exists of manufacturing the same article without risk of harm. No amount of or degree of specificity or warning will exonerate him from liability if he does.

At a minimum, however, a manufacturer in this case, assuming that full knowledge, actual or imputed, of the serious potential risk of harm reached him only some years after his product was marketed, had a duty to devise a program that left nothing to chance. The decal on the tank could not be counted on and neither could the manual. The newspaper advertisements could not be relied upon to reach but a small portion of the potential victims. And finally, the battery-cover kit program failed dismally to meet the high standard which the circumstances called for. All of John Deere's efforts brought home the problem to a mere fifteen percent of owners. With regard to the decal and operator's manual, they also lack the specificity required of the warning which the ever-evolving law of product liability demands of manufacturers of dangerous products.[13] I also add expressly what I earlier implied, namely, that the manufacturer ought to have foreseen and anticipated that the kinds of warnings, appearing both on the decal and in the manual, were not likely to reach a large number of consumers, particularly those of used units. I hold John Deere liable for negligence in knowingly manufacturing the unit following a faulty design. Alternatively, the efforts to warn were deficient in that the means chosen were doomed to failure with respect to the vast majority of users.[14] This case was affirmed by the Court of Appeal.

E. Conclusion on Canadian Environment

While there have been notable changes in Canada's legal environment over the past five years, we do not believe that there is any inhibition to product innovation in our country today. We believe, however, that with the globalization of the market place, particularly with the implementation of NAFTA, we can no longer look at the Canadian environment in isolation. That is why joint conferences such as this are important. It allows us all to understand one another better, and the problems we will have to work on together.

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[12] *Id.* at 56.

[13] *See supra* note 6.

[14] *See supra* note 10, at 60-61.

II. The Global Outlook

When we take a more global perspective on the question of Canadian innovation we, in Canada, must consider the international legal environment, particularly in the United States, just as Americans will want to better understand the positive and negative attributes of the Canadian legal system.

The insurance crisis during the mid-1980s brought the cost and availability of product liability insurance to the forefront. Many Canadian companies were unable to obtain insurance for goods being sold into the United States. We heard that insurers were concerned with the risk exposures within the American market because of unlimited damages for pain and suffering, and the punitive damage awards in product cases. In addition, the joint and several liability issues worked to the disadvantage of some defendants in certain cases, and these exposures caused anxiety among Canadian insurers who were asked to take U.S. risks. But all manufacturers, whether based in the United States, Canada, Japan, or the European Community, are faced with the same market conditions. We are not aware of any let up by Canadian companies in their effort to export goods to the United States.

In response to concerns with respect to American liability risks, many Canadian insurance policies have exclusions for products sold into the United States. Some manufacturers also choose not to sell their product in the United States. In these ways, some insurers and some producers of goods have been able to limit their risks primarily to Canada. But for the most part, the United States remains a target market for Canadian companies.

More and more Canadian products are finding their way into the United States; therefore, more American claims can be expected on insurance policies which were traditionally "Canadian only risks." Companies which have chosen to avoid the American market may find that their product is nevertheless finding its way into the stream of commerce flowing into the United States. This is not yet an issue in the Canadian insurance industry, but we believe it will become a serious concern for underwriters and risk managers over the next few years, unless the Senate of the American Congress approves a large measure of the Tort Reform Bill now before it.

For multi-national companies, these changes to globalization of trade make little difference. To small Canadian manufacturers, they may represent a significant change in their business plans. They may find their innovations inhibited at the implementation stage, when they cannot obtain insurance to cover the risks in the United States.

III. Conclusion

We do not believe there is a single simple answer to whether prod-

uct liability inhibits innovation. The answer will change from industry to industry, and from corporation to corporation. Product liability may have inhibited the distribution of some new products. Examples suggested by the pharmaceutical industry immediately come to mind. Although large corporations are able to spread the risk and costs of product liability over a large volume of sales and income, some American risks are so substantial that even large multi-nationals do not wish to accept the exposure. Most businesses attempt to obtain insurance to cover the risk. In some industries, such as the automotive industry, innovation can actually improve product liability exposures while in others, such as the pharmaceutical industry, innovative new products can attract debilitating claims.

We do not believe that the American economy has suffered from a lack of innovation solely due to the product liability laws of the United States; however, curtailment of monies allocated to research and development, toughening consumer expectations, increased government regulations, and the failure to take the long view, are factors which may have played a larger role in any curtailment of product innovation in the United States.

We are convinced that Canadian product liability laws have had little, if any, impact on Canadian capacity to be innovative. Product liability laws in Canada at their worst have acted as a safety check to indifference by product manufacturers and distributors. This is the role which was intended in Canada and which we are satisfied it fulfills.

We conclude that Canada's legal environment is receptive to innovation. The question for the next five years is whether such an analysis, made without considering the growing impact of NAFTA, is probative. We assume that if multi-nationals are inhibited by American trends and conditions, then there is an impact on innovation in Canada. This impact may expand to encompass all companies regardless of where they conduct their research, do business, or sell their product, but there is precious little evidence of negative impact available today.