# THE NAVIGATOR


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## A Little Clarity and Common Sense Can Go A Long Way: The Liability of a Bailee

The *Kew v. Herber & Herber Transport Ltd.* case (*1) from Newfoundland provides a nice study of the peril that can come with the parties to a contract not being clear as to their intentions and where the manner of performance lacks a degree of common sense.

This "bailment" case involves simple facts and lessons for the unwary.

Bailment occurs when the owner or person in possession of goods (the bailor) asks another party (the bailee) to take the goods into their care and possession for a stated purpose. As an example, warehousing agreements are by their very nature contracts of bailment. Where the bailee derives a benefit from the bailment mandate – such as payment of fees or charges by the bailor - the relationship is then said to be that of a "bailment for reward". Pursuant to well established case law, once a bailor has established that its goods were damaged while under the control of a bailee for reward, the onus of proof switches to the bailee to establish that he took reasonable steps to prevent damage to the item(s) bailed. In order to avoid liability the onus is therefore on the bailee to show that the loss, damage or destruction was not due to its negligence. (*2)

*Mr. Kew's Trailer*

Herber Transport Ltd. agreed to haul certain cargo in a trailer belonging to Mr. Kew from Ontario to Newfoundland. The trailer, being the subject of this litigation, was described by Mr. Herber (the defendant's pick-up driver) as being "old", "poor" and "deplorable" condition. This notwithstanding, Mr. Herber connected the trailer to his tractor at the origin point and towed it from Ontario to Newfoundland. Along the way he had to make a couple of stops, once to replace a couple of tires on the trailer, and once to get some welding done to the landing gear, including the fabrication of dolly shoes. Mr. Herber also reported that there were issues with the trailer brakes while en route.

## FIRM AND INDUSTRY NEWS

- The Firm is pleased to announce that it has been ranked by *Chambers & Partners* as a leading Transportation (Road & Rail) and Transportation (Shipping) Law Firm. *Chambers and Partners* identifies and ranks leading law firms and their lawyers in over 180 jurisdictions throughout the world. **Rui Fernandes** and **Gordon Hearn** have been ranked as leading lawyers in the areas of "Road & Rail". **Rui Fernandes** and **Kim Stoll** have been ranked as leading lawyers in the area of "Shipping".

- **Rui Fernandes**, **Gordon Hearn** and **Kim Stoll** have been recognized by their peers by being listed in *Best Lawyers in Canada - 2022* in the area of Maritime Law.

- **Rui Fernandes**, **Gordon Hearn** and **Carole McAfee Wallace** have been recognized by their peers by being listed in Best Lawyers in Canada - 2022 in the area of Transportation Law.

- The **Women's International Shipping & Trading Association (Wista)** AGM & Conference will take place in person and virtually from October 12- 15, 2021 in Hamburg, Germany. **Kim Stoll** will be in attendance virtually in her role as Wista Canada VP Central Region.

- The **Canadian Transport Lawyers Association** AGM and Conference will take place virtually on October 22, 2021. Incoming President **Carole McAfee Wallace, Rui Fernandes (CTLA President 2006), Gordon Hearn (TLA President 2013)** and **Kim Stoll (CTLA President 2012)** will be in attendance.

- The **International Maritime Law Seminar** will take place October 28, 2021 in London England.

- Mark your calendars. The next **Fernandes Hearn LLP Annual Seminar** will take place on February 10, 2022. Send us an email to info@fhllp.ca to let us know

Mr. Herber's instructions were to deliver the trailer and its cargo to Mr. Kew's yard in Newfoundland. Mr. Kew wished to be present to show Mr. Herber where to put the trailer. As Mr. Kew had been called away at the last moment, Mr. Herber was left to his own devices in parking the trailer. Mr. Herber testified that he left the trailer "as far to the side of the driveway as possible" in accordance with Mr. Kew's instructions. That area of the yard was sloped where the gravel driveway gave way to a grassy area. When Mr. Herber backed the trailer into the yard, the rear tires of the trailer went onto the grass. After unhooking the tractor, owing to its weight and that of the cargo the trailer sank into the grass. The trailer thereafter became "one with the landscape". Stuck, efforts then had to be undertaken to try to prevent the trailer from rolling over. This involved shoring up the trailer with jacks and cribbing, with a chain connected to a pickup truck to stop the trailer from rolling over.

The trailer, which was said to be in a sorry state at the beginning of carriage from Ontario was naturally now in a sorrier state. It couldn't move and somehow through the shoring and securement process it incurred damage. Mr. Kew complained that the roof of the trailer had ripped open and that the legs of the trailer had been bent. Unfortunately, owing to the general condition of the trailer there was only speculation as to *what* type of damage had happened *when*. The roof *might* have been ripped and the legs bent through stresses caused by the sinking and sloping of the trailer. Those damages may have occurred with subsequent efforts to extricate the trailer from the landscape. The evidence was not totally clear.

The trailer had cargo in it at the time of the misadventure at Mr. Kew's yard. Mr. Kew had to shrink-wrap the roof three times and put sheets of plywood and a tarp of the top of the trailer to keep the contents dry and protected from the weather.

*The Lawsuit*

Mr. Kew claimed that the defendants owed him $25,000.00, plus interest and costs, for the losses resulting from the damage to the trailer and contents "after the trailer leaned over, flexed, and buckled under the weight of the load in it". Mr. Kew also claimed the cost of shrink-wrapping the trailer, as well as the costs of jacking and cribbing the trailer, from the defendants.

Citing the general bailment principles cited above, the Court had little difficulty finding Mr. Herber and his carrier company liable for "breach of bailment", however the basic question was for what and to what extent would they be responsible for the damages claimed. As to the breach of the duty as a bailee, the Court found that Mr. Herber should never have unhitched the trailer from the tractor until he determined that it was safe to do so. The Court found that "the tilting of the trailer would probably not have happened if Mr. Herber had gotten down from his rig and walked around the parking area to make sure that it was not soft enough to give way under the weight of the trailer. He had no explanation for his failure to have done an inspection of the ground, other than the fact that he had just driven all the way from Port aux Basques, and that he was tired. That is not due diligence. It does not rebut the presumption of liability".

The Court noted the absence of any contract terms that might have altered the defendant's liability under common law bailment principles. There was a "freight estimate" for $6,900 which included the words "Not responsible for damages on freight", which the plaintiff claimed to have seen for the first time on the morning of the trial. In any event the Court paid no attention to this document, there being no evidence that the parties had addressed any limit on the potential liability for damage or loss sustained to the trailer itself in transit.

There was some evidence that the parties had discussed insurance, however that was in and of itself contradictory. Mr. Kew had insisted that Mr. Herber told him that his trailer was insured for

$250,000.00, and that, based on that, the plaintiff did not get his own insurance on the trailer. Mr. Herber for his own part countered that by claiming that he told Mr. Kew that he should "self-insure" for the trailer.

A bill of lading had been issued for the cargo by Mr. Herbert at origin, describing the haulage of the trailer from Ontario to Newfoundland as a collect delivery of a "locked and sealed" 53-foot-long van unit for $6,000.00. Under the heading "declared value" "$0" was written followed by the words "insured by customer". The Court regarded this as only addressing the carriage of the cargo as opposed to any allocation of risk in regard to the trailer itself.

As a result, the Court found that the plaintiff has established *some* liability on the part of Mr. Herber for *some* of the losses sustained due to the incorrect placement of the trailer. That is, Mr. Herber and his company failed in their duties as bailees and there was no contractual release or limit of liability that applied.

The above said, the Court took issue with the scope of the plaintiff's claim. The Court found that there was no evidence to support a claim for $25,000, or "anything close to it". There was no direct evidence that the damages to the trailer were the result of the placement of the trailer. The Court noted that the use of a pickup truck by a third party to try to pull the trailer out from its predicament with a chain may also have contributed to damage to the trailer. The defendants were not involved in that exercise and any related errors were "remote" as far as the defendants were concerned.

The Court took note of the old age and general condition of the trailer at the outset of the mandate, also noting that the plaintiff "should have designated someone to stand in his stead and supervise the trailer being parked and unhooked from the tractor". His failure to do that left the tractor trailer operator Mr. Herber to park the trailer where he thought that the plaintiff wanted it.

Given the evidence, the Court refused to extend the liability of the defendants past the point of the costs for the stabilization of the trailer with the cribbing. That is, the defendants should pay what it would have reasonably cost to shore up the trailer, the analysis apparently resting with the conclusion that the defendants had in fact left the trailer where the plaintiff wanted them to with the only criticism being that they left it where they did *without securement*. (*3) At that point, it would have then been safe for Mr. Herber to leave the scene, and the trailer was then entirely within the responsibility and control of the plaintiff and his agents. Subsequent losses were accordingly to be considered those uniquely lying at the feet of the plaintiff. In light of the foregoing, the Court awarded damages equivalent to the amount of invoices that were produced to "shore up trailer & supply 6 sheets of plywood to cover roof of trailer" in the amount of $1,380 another for jacking up the trailer and cutting torch rental, in the amount of $929.20.

The Court found that the other charges claimed were either simply not proven to have been caused by the defendants or were too remote from the parking of the trailer to implicate Mr. Herber.

In the result the plaintiff was awarded $2,409.20 of the $25,000 claimed.

*The Take Away*

Each bailment case will necessarily involve a fact specific assessment of duties owed, whether reasonable care was taken or not, and what damages are tied into any established breach of duty by a bailee. The suggested take away items in this case are not tied into the unique facts of this case and what the judge ruled. Rather, from a bigger picture perspective:

1. Parties to a commercial contract should identify risks and allocate responsibility accordingly. In this particular case it is fortunate that the trailer did not cause an accident causing injury or property damage to third parties. How would liability then have been dealt with

between Mr. Kew, the defendants and any insurers?

2. A related consideration falls on general carrier safety and regulatory requirements that may apply to carriers. Carriers have a duty of compliance and care to third parties using highways and roads, above and beyond any duty that might be said to be owing in bailment to an owner of goods.

3. The question of insurance coverage is always a critical consideration in a transportation mandate let alone any other commercial undertaking.

4. Parties are best served by stipulating instructions, expectations and terms of liability in a written contract.

*Gordon Hearn*

*Endnotes*

(*1) 2021 CarswellNfld 289(Newfoundland and Labrador Provincial Court)

(*2) See: *Travers (Joseph) & Sons v. Cooper*, [1915] 1 K.B. 73, *Permanizing Ltd. v. Western Expressways Ltd.* (1961), 28 D.L.R. (2d) 32, and *England v. Heinbecker, 1977 CarswellSask 149, [1977] 2 A.C.W.S. 506, 78 D.L.R. (3d) 117*.

(*3) This is an interesting approach. Without getting lost in further analysis on the unique facts of this case, it is interesting that the Court wanted to award only reasonable prevention (i.e. shoring) costs against the defendants rather than damages resulting from their negligence – likely expanding the scope of the plaintiff's damage recovery - which is what another Court might have ordered. Without this Court coming out and saying it, it appears that this is the "contributory negligence" sanction being applied against the plaintiff – as the plaintiff was not present or did not have someone present to direct the exercise of placement, all that the defendant would be expected to do is to have shored up the trailer. While exuding an element of fairness, the practical answer, should another case arise on similar facts, would however seem to be for the delivering carrier to simply deposit a trailer on firmer ground elsewhere rather than engaging in a shoring up / securing exercise.

**2. Corporate Director Liable to CRA for Debt of Company**

Generally speaking, corporations are considered to be distinct legal entities, separate from their stakeholders. This separation serves to protect shareholders and directors from the liabilities of their corporations. However, in cases where the Canada Revenue Agency ("CRA") is unable to collect the tax arrears of a corporation, it can sometimes "pierce the corporate veil" and hold third parties personally liable.

Under Canadian tax laws, the CRA, for example, can hold directors personally liable for corporate debts, including any interest and penalties for unpaid payroll source deductions under section 227.1 of the *Income Tax Act* and unremitted GST/HST under section 323 of the *Excise Tax Act*.

To be liable the individual must have been a director of the corporation during the period when the tax debt arose.

In the recent decision of *Tran v. The Queen*, 2021 TCC 51, a taxpayer attempted to challenge a director assessment on the basis that he had resigned more than two years prior to the assessment. Unfortunately for the taxpayer, the Tax Court held that the limitation period had not lapsed, as the taxpayer had not properly resigned.

The taxpayer was an employee and director of a corporation. The corporation struggled financially and by October 2011, the taxpayer had gone five months without a salary. In October 2011, the taxpayer sent an email to the president of the corporation advising that he was resigning as an employee. Afterwards, he called the president and said he was resigning as an employee and as a director. The taxpayer did not confirm in writing that he was resigning as a director and never notified the government of the resignation (with a change of information form).

Five years later the taxpayer was assessed as owing over $300,000.00 in regard to the corporation's liabilities. The taxpayer appealed to the Tax Court relying solely on the two year limitation period set out in section 227.1(4) of the *Income Tax Act* which provides that the CRA has two years to assess after a director resigns from a corporation.

The Tax Court held that the taxpayer was liable on this basis, subject to the assessment being correct. The Judge relied on a 2016 Federal

Court of Appeal decision, stating (at paragraph 11):

> In the 2016 Federal Court of Appeal decision, *Chriss v. R.*, at paragraph 10, ample guidance was provided on what is required for the Tax Court to find that a director has resigned. The Federal Court of Appeal, in referencing Subsection 121(2) of the *Ontario Business Act*, R.S.O. 1990, c. B.16 (OCBA) (which is also applicable in this case) stated that a resignation of a director is effective at the time a written resignation is received by the Corporation or at a time specified in the resignation. In this case, there was no written resignation sent by the appellant nor received by the corporation. Therefore I am unable to agree with the appellant's position that he had resigned at any time prior to the assessment before the Court.

The taxpayer challenged the underlying assessment. The taxpayer led evidence from Peter McBride, a U.S. resident who was also a director, CEO, President and Secretary of the corporation Karora Technologies Canada Inc. ("Karora"). Mr. McBride testified that the assessment of Karora was based on T4s prepared at Mr. McBride's request and direction and that the T4s did not reflect reality in that they were incorrectly prepared. Specifically, the T4s relied upon by the Minister did not accurately reflect the salaries that were actually paid to the employees. They also did not reflect the timing of when the payments were received by the employees. In some cases, employees were paid in a different year than what was listed on the T4s. Employees were also often paid different overall amounts than were listed on the T4s.

The Court found that the evidence was not challenged by the CRA and therefore concluded that the assessment was incorrect and overstated. The Court was not prepared to conduct a fresh audit and held that "with no evidence before the Court to allow me to reduce the underlying assessment to its proper amount, I must find in favour of the appellant [taxpayer]". The appeal was allowed.

The takeaway from this decision is that resigning from a corporation must be done in accordance with the legislation, which in Ontario requires notice in writing and filing a notice of change of corporate information with Service Ontario and obtaining confirmation from the corporation.

*Rui M. Fernandes*

**3. Cargo Insurance: How Much is "Sufficient", Anyway?**

Carriers around the world would be foolish not to obtain cargo liability insurance to protect themselves in the event of a loss. That much is abundantly clear. In Ontario, however, the question becomes much less clear when one considers the amount of insurance to purchase.

How much cargo liability insurance does a carrier in Ontario *really* need, anyway? It seems straightforward; however, this question (like many issues that arise in the trucking industry) is actually not so easy to answer.

Consider, first of all, that in Ontario, the Carriage of Goods Regulation (O.Reg 643/05) requires carriers to maintain "sufficient" insurance to cover the loss of or damage to the goods they carry. Section 3 of the regulations, promulgated under the *Highway Traffic Act*, R.S.O. 1990, c. H.8, provides:

> **3.** (1) For each motor vehicle operated by a carrier for the carriage of goods for compensation, the carrier shall provide or effect and carry with an insurer licensed under the *Insurance Act* liability insurance for loss or damage to goods in an amount sufficient to cover the loss or damage of the goods carried.

But what exactly does "sufficient" mean?

Consider a hypothetical scenario. A carrier purchases cargo insurance in the amount of $250,000, because it usually ships loads that would never reasonably exceed that value. Thus, from the carrier's point of view, all is well, and the carrier is in full compliance with s. 3 of the above regulation.

However, suppose that (as can easily be the case) the carrier is contacted by a new shipper, who asks the carrier to deliver a load of goods with which the carrier is unfamiliar. Moreover, the shipper (as is almost always the case) does not disclose the value of the goods to the carrier.

How, then, is the carrier to know whether its insurance is "sufficient"? If the value of the new load turns out to be much higher than the amount of the insurance policy, then the carrier has (unknowingly but) arguably violated s. 3 of the above regulation. But how could the carrier have known to take out more insurance for that particular load?

The above dilemma then leads to another question: what happens to a carrier that breaches s. 3, anyway? Again, it's not entirely clear.

On the one hand, the *Highway Traffic Act* contains a "general penalty" clause providing that everyone who breaches the regulations is liable to pay a fine of between $60 and $1,000. So, if a carrier does not have "sufficient" insurance, there could be just a minor fine for the carrier to pay, and nothing more.

On the other hand, if a carrier breaches the regulations by failing to maintain "sufficient" insurance, can it still rely on the $2/lb. limitation of liability provisions (that are found in the very same set of regulations)? It's not entirely clear, and this precise issue does not appear to have come before the courts yet. But it's a real question, because in some other jurisdictions (notably British Columbia, for example), courts have held that technical breaches of the carriage of goods regulations can result in harsh consequences. For example, the British Columbia Court of Appeal has held that failure to properly issue a compliant bill of lading can result in the complete loss of a carrier's ability to limit its liability (for loss of or damage to cargo) to the usual $2/lb. (*1)

In British Columbia, therefore, an offending carrier (with respect to issuing a non-compliant bill of lading) can find itself unable to avail itself of the limitation of liability provisions in the regulations. But what about the failure to carry "sufficient" insurance? Would that regulatory breach also be enough for a court to find that a carrier should not be entitled to the protection of the limitation of liability?

Unfortunately, it's not clear. Unless and until the courts provide guidance on this issue, a prudent carrier should (1) make sure that the shipper is aware of the amount of the carrier's available insurance coverage, and (2) try to confirm with the shipper that that amount of coverage is sufficient. If the shipper refuses to confirm, then the carrier can argue later in court that it tried to comply with s. 3 but that the shipper did not co-operate. In those circumstances, it would be hard for a court to blame the carrier and take away its ability to limit liability.

As always, carriers finding themselves facing these types of issues should always be sure to speak with a competent transportation lawyer.

James Manson

(*1) See, for example, *Valmet Paper Machinery Inc. v. Hapag-Lloyd AG*, 2004 BCCA 518 (CA).

**4. Fourth Extension to Ontario's IDEL**

In earlier editions of *The Navigator*, we had written in depth about Ontario's *Infectious Disease Emergency Leave* regulation ("IDEL") (*1) under the *Employment Standards Act, 2000* (the "*ESA*")(*2), which came into effect in May 2020. IDEL is retroactively applicable from March 1, 2020, and while it was scheduled to remain in place until September 25, 2021, it has, for a fourth time, been extended to remain effective until January 1, 2022.

To recap, unless the employer has the contractual right to lay the employee off, a lay-off will generally constitute a dismissal at common law. IDEL is geared towards providing employers with temporary relief from certain legal obligations as the regulation permits employers, for reasons relating to the COVID-19 pandemic, to temporarily reduce a non-unionized employee's hours or wages, or temporarily lay off a non-unionized employee altogether, without triggering the *ESA* lay-off and constructive dismissal provisions.

While IDEL provides some relief for employers forced to cut hours or wages or place an employee on a temporary leave due to workplace slowdowns and closures, the regulation has caused some confusion in the employment law world regarding whether IDEL restricts an employee's common law right to pursue a civil claim against their employer for constructive dismissal when temporarily laid off pursuant to IDEL. As discussed in July 2021 edition of *The Navigator*, there are two competing decisions from the Ontario Superior Court of Justice on point, one or both of which will likely be appealed to the Court of Appeal for Ontario, and until there is a decision on appeal, the issue remains unsettled.

In the meanwhile, unless IDEL is further extended, employers ought to turn their minds to the possibility of either recalling those employees who are currently on IDEL, or terminating their employment before January 1, 2022, being the date on which IDEL is scheduled to expire. In the event that an employer does make the difficult decision to terminate the employment of any employee on IDEL, we recommend seeking legal advice in order to determine the employer's obligations with respect to providing the employee with a termination package. We also recommend that employers provide notice of the IDEL extension to any employees on IDEL and the current status of their employment.

*Janice C. Pereira*

*Endnotes*
(*1) O. Reg. 228/20.
(*2) S.O. 2000, c. 41.

**5. Duty to Defend: Insurer Had No Duty**

The Ontario Court of Appeal has recently found that an insurer, XL Specialty Insurance Company ("XL")(*1) had no duty to defend its insured Panasonic Eco Solutions Canada Inc. ("Panasonic") in an arbitration procedure.

Panasonic had entered into two agreements with Solar Flow-Through Fund ("Solar").

The first was an Engineering, Procurement, and Construction Agreement (the "Engineering Agreement") that required Panasonic to procure, construct and install roof-mounted solar electricity generating systems. Solar planned to sell the generated electricity through 20-year contracts it had entered into with Ontario's Independent Electricity System Operator (the "IESO"). The Engineering Agreement required Panasonic to achieve substantial completion by a guaranteed date. Panasonic failed to do so, resulting in the IESO cancelling seven of its contracts with Solar.

In the resulting arbitration claim, Solar pleaded that Panasonic failed to achieve substantial completion "in breach of its contractual obligations" and claimed liquidated damages of $92,309.62, the sole remedy provided in the Engineering Agreement for a contractor's failure to reach substantial completion by the guaranteed date.

Solar further pleaded that following the cancellation, the three parties – Panasonic, Solar and the IESO – entered into negotiations that resulted in the IESO reinstating two of the seven cancelled contracts with Solar, and re-issuing the remaining five contracts, but to Panasonic.

The re-issued contracts were part of an agreement between Solar and Panasonic, referred to as the Proceeds Agreement, although it was never finalized or signed. According to that agreement, Solar would provide its expertise for the five contracts that had been re-issued to Panasonic, and in exchange, Panasonic would pay Solar a portion of the proceeds from its sale of the projects. Solar anticipated that it would recover, at a minimum, its sunk costs of $1,300,000 on the re-issued contracts with the IESO.

In the arbitration claim on the Proceeds Agreement, Solar claimed damages for breach of contract, or in the alternative for negligent misrepresentation, or in the further alternative, for unjust enrichment. The negligent misrepresentation claim was based on Panasonic's ongoing representations to Solar, made in order to obtain its assistance with the re-issued projects, that it would pay Solar in accordance with the Proceeds Agreement, but Panasonic then failed to pay. The unjust enrichment claim was based on Panasonic enriching itself at Solar's expense by retaining the full benefit of the sold re-issued projects and depriving Solar of compensation for its assistance.

The XL policy insuring Panasonic was an errors and omissions policy, formally named a Professional and Contractor's Pollution Legal Liability Policy. The policy covered monetary judgments that Panasonic became legally obligated to pay because of a claim "resulting from an act, error or omission in Professional Services". XL agreed that Solar's claim arose from the delivery of professional services.

Under the policy, XL had a duty to defend any claim against Panasonic "to which this insurance applies" regardless of the merits of the claim. Whether the insurance applied depended on the interpretation of the following exclusion and exception to the exclusion clause:

> This Policy does not apply to any Claim … arising from the Insured's:
> 1. assumption of liability in a contract or agreement; or
> 2. breach of contract or agreement.
> This exclusion does not apply to: (i) liability that the Insured would have in the absence of the contract or agreement…

XL argued to the application judge that it had no duty to defend because Solar's claim for liquidated damages arose out of Panasonic's breach of contract in failing to achieve substantial completion by the guaranteed date in accordance with its contractual obligation, and was therefore excluded by the exclusion clause.

The application judge rejected this argument. He reasoned that Solar's claim for liquidated damages arose out of Panasonic's "acts or omissions" in failing to meet the guaranteed date, and Panasonic's delay could have been caused by its negligence, in which case Solar's claims could fall within coverage. It depended on the cause of the delay. Further, the fact that Solar did not plead negligence did not undermine the analysis as long as it pleaded facts that were capable of supporting the tort of negligence.

The application judge was unable to determine on the record before him whether the damages Solar sought were attributable to negligence by Panasonic or to circumstances beyond Panasonic's control. He presumed that this may be one of the issues in the underlying arbitration. The application judge noted, as an aside, that if it turned out that the delay was due to deliberate acts or omissions by Panasonic, as opposed to negligence, then there would be no coverage.
XL therefore had a duty to defend.

The application judge concluded that Panasonic's liability under the Proceeds Agreement was in effect a debt claim that arose under the contract and could not come within the exception to the exclusion. He also rejected the efficacy of the negligent misrepresentation and unjust enrichment claims. The negligent misrepresentation claim was based on representations by Panasonic that it would pay under the agreement, and was therefore based solely on Panasonic's breach of the Proceeds Agreement by failing to make payments under it. The application judge further found that the unjust enrichment claim was excluded under the policy because the policy did not cover claims for equitable remedies.

On appeal to the Court of Appeal the Court noted the following:

> Applying the principles of interpretation from *Progressive Homes*, the first question for the court is whether this exclusion clause is ambiguous. If it is not, then the court is to give effect to the clear language, reading the contract as a whole. The clause contains both an exclusion and an exception to the exclusion. They form part of a whole clause and must be read together.
>
> Looking at the contractual exclusion first, I see no ambiguity. The policy does not cover a claim that arises from an insured's assumption of liability in a contract or from an insured's breach of contract. Panasonic argues that the meaning and effect of this exclusion, read literally, is to nullify the coverage under the policy, because the insured always provides its professional services under a contract, as it did here.

The Court found that applying those principles, the meaning of the exception became clear. The policy continues to cover professional losses caused by the insured in performing its professional functions in its relationship with the claimant that arise in law, regardless of the terms of their contract. As the insurer XL submits, these would include liability for losses that third parties may suffer as a result of an insured's negligence in performing the professional services contract, as well as liability to the claimant for negligence in performing the contractual obligations under the doctrine of concurrent liability in contract and in tort.

The Court found that this interpretation made sense from the point of view of both the insured and the insurer, and gave effect to both their reasonable expectations, in light of the purpose of the professional errors and omissions insurance contract. The insurer was responsible for the losses caused by the insured's negligent performance of its professional obligations; but the insurer would not indemnify the insured for any extra obligations it undertook in a contract, or for the breach of any extra obligations that it undertook in a contract.

The Court looked at the two agreements.

*Under the First Agreement*

Did Solar's claim against Panasonic under the Engineering Agreement give rise to a duty on XL to defend the claim?

The Court noted that Solar's claim against Panasonic under the Engineering Agreement was for liquidated damages (i.e. a specific amount). It noted that while Panasonic's delay was an act or omission in performing its professional obligations that caused loss to Solar that would have been covered by the XL coverage clause, by agreeing to the liquidated damages clause, Panasonic effectively contracted out of its insurance coverage. The exclusion excluded coverage for liability arising from breach of contract, and the exception did not apply because the obligation to pay liquidated damages was purely contractual and did not otherwise arise. Furthermore, because the Engineering Agreement provided that liquidated damages were Solar's sole remedy, there was no way to read Solar's pleading to claim any other or additional remedy for the delay.

The Court therefore found that the application judge erred in his application of the test for determining the duty to defend. He focused on the fact that Panasonic could be liable for negligence in its delay, which would be within coverage, but he failed to apply the exclusion and the exception to the exclusion to his analysis of the liquidated damages clause. In particular, he failed to note that the claim for liquidated damages was Solar's sole remedy under its agreement. In other words, Solar had contracted out of any claim it may have had against Panasonic for damages for negligence. Therefore, it could not make a negligence claim against Panasonic in the arbitration.

*Under the Second Agreement*

Did Solar's claim against Panasonic under the Proceeds Agreement give rise to a duty on XL to defend the claim?

The arbitration claim stated that because of Panasonic's delay and IESO's cancellation of five of Solar's projects, Solar's pre-construction costs loss was $1.3 million. In order to recoup that loss, Solar agreed with Panasonic that if Panasonic entered into agreements with IESO to complete the projects, Solar would provide certain services to help achieve timely completion. In exchange, Panasonic would pay Solar a portion of the sale proceeds, which Solar anticipated would amount to at least $1.3 million. That was the Proceeds Agreement, although it was never finalized in writing.

The application judge found that Panasonic's liability under the Proceeds Agreement arose out of its assumption of liability under a contract and out of its breach of that contract, thereby falling squarely within the contractual exclusion. The claim could not come within the exception because Panasonic would not have had the liability to Solar to pay it following the sale of the projects, except under the contract. It amounted to a debt.

The Court of Appeal agreed with the application judge that the claim under the Proceeds Agreement was essentially for a debt owing. It arose under the contract. There would be no claim without the contract. Therefore, if the claim came within the coverage under the policy, it was excluded by the contractual liability exclusion clause and was not saved by the exception to the exclusion.

The Court of Appeal concluded that there was no duty on XL to defend the claim.

*Rui M. Fernandes*

*Endnotes*
(*1) 2021 ONCA 612

**6. Promises, Promises: The Enforceability of Promissory Notes**

While it would seem reasonable to expect that the law would be most certain where it addresses matters that are the most routine, that expectation seems to be regularly disappointed in Ontario when it comes to a particularly common instrument, the promissory note. Promissory notes are widely used to evidence loans of money both in commercial and family contexts. It is thus quite alarming how often even slight inattention can lead to loans becoming unenforceable where promissory notes are used to arrange one's financial affairs. The recent decision of the Ontario Court of Appeal in *James v. Chedli* (*1) confirms that when there has been some imprecision in characterizing a note as a "demand," rather than "term" promissory note, this could ultimately lead to the unenforceability of a loan which everyone had originally intended to be repaid.

*The facts*

Dennis Chedli had given the appellant lender two promissory notes in respect of loans made to Chedli of more than $1 million. The first of the two notes was signed both by Dennis Chedli and his wife Anna Chedli. That note was also secured by a collateral mortgage on the Chedlis' home, of which Anna was the sole registered owner. The second note was only signed by Dennis. Dennis had died in 2015. A demand for payment was made on both notes on October 12, 2016, and an action was commenced by Kenneth James, a representative of the lenders, to enforce payment on February 23, 2017.

The case was decided on a summary judgment motion. On the motion, the court ruled that both notes were unenforceable against the Chedlis; the first because either it was "paid in full" or, if not, because it was "materially altered" without the consent of the Chedlis, and the second because it was a term loan, and James had waited too long after Dennis Chedli had ceased making payments to commence an action, rendering the action statute barred for not having been brought within two years of the first default. James appealed.

*Term and Demand promissory notes*

The law on promissory notes makes a fundamental distinction between "demand" and "term" notes. The term note, unsurprisingly, requires payment as of a specified time; the "term." Should the note not be paid when payment is specifically due under the note, a lender will only have two years under Ontario's *Limitations Act, 2002* (*2) following default to commence an action for enforcement, after which time the note becomes unenforceable against the borrower (*3). A "demand" promissory note, by contrast, only becomes payable upon first "demand" for payment. Thus, however long ago the loan was made, the time to bring an action to enforce payment will not even begin to run until a formal demand for payment is made.

Dennis's first loan was for $531,000, evidenced by a note dated October 18, 2006, with simple interest of 10% per year, payable monthly, and a balance due date of October 25, 2007. Chedli borrowed the money to fund a deposit on some real estate which he flipped for a quick profit. He intended to pay the loan on November 20, 2006 but asked to keep the funds to make new investments. The term of the loan was extended by the appellant from November 15, 2007, to November 15, 2008, by letter dated on the original due date. The second note was also for a term loan, for $650,000, due on July 17, 2008.

Payment for the loans was later combined. However, all of the correspondence noting changes to the terms of the notes was from the lender to the Chedlis, with no correspondence from the Chedlis to the lender acknowledging the changes. Dennis Chedli ultimately began defaulting on payments, with the last payment made on March 17, 2010. There were two letters from the lender that purported to convert the notes to demand notes; one dated November 19, 2008, and a second dated March 20, 2010.

Both on the original motion and on appeal, the court was called on to decide whether Dennis or Anna Chedli had "assented" to the proposals to convert the two promissory notes from term notes to demand notes. The reason this was an issue was because of another peculiarity relating to promissory notes arising from provisions of the *Bills of Exchange Act* (*4). This Act provides at its section 144 that a note that has been unilaterally "materially altered" by one party after it was made is "void" as against any party that did not "assent" to the alteration. On the motion, the motions judge found that neither Dennis nor Anna had communicated assent to the change, and therefore found both notes unenforceable against the Chedlis.

On appeal, however, the court upheld the finding that Anna Chedli was not bound by the promissory notes but reversed the finding of the motions judge with respect to Dennis Chedli in relation to the first of the two promissory notes. The issue of establishing Dennis Chedli's assent to a material alteration of the notes was obviously complicated by the fact that he had died in 2015. Consequently, independent "corroborative" evidence was required to establish assent pursuant to the *Evidence Act* (*5), which requires such evidence in addition to any evidence of a claimant in an action against a deceased person. The Court of Appeal specifically rejected the finding of the motions judge that a payment of $30,000 made by Chedli following the proposal to convert the first note to a demand note, in conjunction with a letter from the lenders stating that they had accepted payment to make that first note "current," was not sufficiently "corroborative" independent evidence. As noted by the court: "Talking about owing money and the need to make payment arrangements is one thing – making payments is quite another" (*6).

*Conclusion*

The broad lesson from the appeal in *James* is that care must be taken with respect to the type of promissory notes one has agreed to in order that one not be caught out by statutory limitation periods. Demand promissory notes tend to be the preferred form where a loan is not expected to be repaid in a relatively short time. The courts have sometimes been a source of confusion in this regard. Famously, in 2008, Ontario was compelled to amend its limitations legislation to state that a limitation period for a demand promissory note commences on the date of first demand, and not when the note was first given, responding to a controversial ruling of the Court of Appeal that was contrary to the consensus opinion of the legal profession at the time (*7).

Here, however, it seems the very versatility of promissory notes as a loan instrument was in part the source of the problem. A promissory note, once given, can have its terms amended subsequently in almost any respect, so long as the parties agree. Even a later oral agreement to alter the terms would bind the parties, so long as the evidence is sufficiently clear (*8). Another important take away from *James*, then, which applies not only to promissory notes, is that amendments to agreements need to be in writing and confirmed by *both* parties to avoid potentially costly litigation. Unfortunately, we find that sometimes the most obvious things, as here, require the most frequent reminders.

*Oleg M. Roslak*

*Endnotes*

(*1) 2021 ONCA 593 [*James*].

(*2) *Limitations Act, 2002*, S.O. 2002, c. 24, Sched. B.

(*3) There are exceptions to this, however. For example, the two-year limitation period can "re-start" upon a subsequent payment by the borrower, or through an acknowledgment of the debt, following the default. In such cases the two-year limit begins to run again as of the time of the subsequent payment or acknowledgment.

(*4) *Bills of Exchange Act*, R.S.C. 1985, c. B-4.

(*5) *Evidence Act*, R.S.O. 1990, c. E.23, s. 13.

(*6) *James* at para. 55.

(*7) *Hare v. Hare* (2006), 218 O.A.C. 164.

(*8) *James* at para. 41.

**7. Business Interruption Case Overturned on Appeal**

*MDS Inc. v Factory Mutual Insurance Company (FM Global)* 2021 ONCA 594

For business interruption coverage claims, most policies require direct physical loss or damage to tangible covered property from a covered cause before there will be coverage for resulting losses including loss of use of the premises. The issue, as it has been litigated to date, rests squarely on whether particular results of the COVID 19 pandemic constitute "physical loss or damage to property". Businesses that do not have specific pandemic coverage may face an uphill battle, in this regard, in any attempt to fit their insurance policy wordings to the COVID 19 pandemic situation.

The first case of that as noted by some to be of purported relevance to Covid 19 claims was *MDS Inc. v Factory Mutual Insurance Company (FM Global)* ("*MDS*"). (*1)

On March 30 2020, in *MDS,* Justice Wilson of the Ontario Superior Court held that, under an all-risk policy, the "physical damage" requirement for coverage may be satisfied by a loss of use. *MDS* was, however, not a COVID 19 case and involved a particular and unique set of facts and specific policy wording. *MDS* was about the application of the corrosion exclusion (and whether losses were payable pursuant to the exception to the exclusion for physical damage caused by corrosion) not regarding the coverage grant.

*MDS* was appealed to the Ontario Court of Appeal, where the decision of Wilson J. was overturned. The Ontario Court of Appeal heard the appeal on April 15, 2021, with the decision released on September 3 2021.

*Facts Review*

MDS Inc. ("MDS") purchased radioisotopes from Atomic Energy of Canada Limited's Nuclear Research Universal Reactor ("NRU"). MDS then processed and sold the radioisotopes, which were used in medical products. In 2009, MDS's nuclear facility experienced a leak of heavy water containing radioactive material and there was venting of radioactivity into the air and there was also unanticipated corrosion. MDS voluntarily shut down expecting that shut down to last 36 hours, but, unfortunately, the shutdown lasted 15 months. MDS incurred losses of over $128 million.

MDS had purchased a worldwide all-risks policy which covered all risks of physical loss or damage to property and contingent time element coverage resulting from a supplier's business interruption. The subject policy excluded coverage for losses caused by corrosion, which was not a defined term. There was an exception to the exclusion for resulting "physical damage not excluded by this Policy."

The term "physical damage" was not defined in the policy. At para 437, the Court quoted the exclusions/exception under review as follows with emphasis in the original judgment (*2):

> C. This Policy <u>excludes the following</u>, but, <u>if physical damage</u> not excluded by this Policy results, <u>then only that resulting damage is insured</u>: ...
>
> > 3) deterioration, depletion, rust, <u>corrosion</u> or erosion, wear and tear, inherent vice or latent defect.

*Trial Decision Review*

The trial judge held that: (i) the term "corrosion" is ambiguous and should be interpreted in light of the dictionary definition of the term as modified by the "reasonable expectations of the parties", (ii) the exclusion does not apply to unanticipated and "fortuitous corrosion" and only applies to "non-fortuitous anticipated corrosion"; and (iii) the exception to the "corrosion" exclusion for "physical damage" should be interpreted broadly to include not just physical damage caused by the corrosion but economic loss caused by the inability to use the insured property during the shutdown.

The trial judge concluded that MDS' losses were covered under the Policy and, in addition to damages up to the Policy's limit, MDS should be awarded prejudgment interest at the rate of the company's actual cost of borrowing, including compound interest at 5.14 percent, as "just compensation" which losses amounted to $56,406,911. CAD inclusive of compound prejudgment interest at a rate of actual borrowing costs.

The crucial issues at trial were (i) whether the damage to the reactor was caused by corrosion within the meaning of this exclusion, such that the time element coverage would not include the loss of profits resulting from this damage; and (ii) if the corrosion exclusion applied, whether there was damage not excluded by the policy for which MDS might be covered under the exception to the exclusion.

The trial judge held at paragraph 255, held that the meaning of "corrosion" was ambiguous.

> The witnesses called on behalf of the Insurer conceded that the corrosion at J-41 is fortuitous, and that not all corrosion is excluded by the Policy. This evidence ends the argument that this exclusion can be determined based upon a definition alone, whatever that definition may be. These admissions confirm that the meaning of corrosion in the context of this Policy is ambiguous. [Emphasis in original.]

The trial judge went on to hold, at paras 315-320, that the definition of "corrosion" in respect of the subject policy was "The anticipated and predictable process of corroding, esp. of a rusting metal."

Concluding that only "anticipated and predictable" corrosion was excluded from coverage, the trial judge stated therein that

> [T]aking a narrow view of the exclusion clause, and applying the definition of corrosion outlined above, I conclude that it would be within the parties' reasonable expectations, considered objectively, that the fortuitous, unanticipated unpredicted corrosion at J-41 causing the leak of heavy water into the J-rod annulus would be covered by the all-risks Policy unless another exclusion applies. (Emphasis added]

Regarding prejudgment interest awarded at a higher rate than the *Courts of Justice Act* at a compounded rate, the trial judge concluded that it was reasonable to award prejudgment interest at the actual cost of borrowing:

> To order otherwise means that the Insurer, though losing the lawsuit on all fronts, has won. It breached the Policy with the Plaintiffs, has had the benefit of the use of the Plaintiffs' funds totaling millions of dollars over the years. To order otherwise allows the Insurer to make a considerable profit on the amounts withheld in breach of the Policy, at their client's expense.

*The Appeal*

The Court of Appeal allowed the appeal finding that find that the trial judge erred (i) in finding that the term "corrosion" was/is ambiguous; and (ii) in finding that losses other than physical damages are covered. The Court of Appeal found that, read in the context of the Policy as a whole, the meaning of the word "corrosion" was clear. The corrosion exclusion applied and MDS' losses were not covered by the Policy. Further, the term "physical damage" in the exception to the exclusion clause was clear that such term does not apply to economic losses caused by the inability to use the equipment during the shutdown.

The Court of Appeal confirmed that the correct standard of review for interpretation of standard form contracts, where there is no negotiation of terms of the policy by the parties and the issues are of general importance to all insurers and insured parties, is one of correctness. On the issue of the prejudgment interest award, the

decision to award a higher rate than the Courts of Justice Act is discretionary, and the standard of review is one of palpable and overriding error.

*i) The Corrosion Exclusion*

Regarding the interpretation of the word "corrosion", such term has not been considered by a Canadian court in similar standard form all risk policies of insurance. Looking to US authority for assistance in interpretation where there is little Canadian authority, the Court of Appeal reviewed a number of US cases where the term "corrosion" was reviewed in the context of "natural vs unnatural" and "gradual vs non-gradual" corrosion. The trial judge had found that corrosion exclusion had only applied to "non-fortuitous" corrosion, to which the Court of Appeal did not agree.

The Appeal Court in its reasons stated:

> [73] Although this is an all-risk policy that covers all claims save for those that are specifically excluded, this does not mean that the interpretation of clear terms should be changed. All-risk policies are, by their grant, limited to cover only fortuitous or unanticipated losses. The Supreme Court held in *Canadian National Railway Co. v. Royal and Sun Alliance Insurance Co. of Canada*, 2008 SCC 66, [2008] 3 S.C.R. 453, at para. 79, citing *British and Foreign Marine Insurance Co. v. Gaunt,* [1921] 2 A.C. 41 (H.L.), [1921] All E.R. Rep. 447, at pp. 46-47:
>
>> These words ["all-risk"] cannot, of course, be held to cover all damage however caused, for such damage as is inevitable from ordinary wear and tear and inevitable depreciation is not within the policies.... Damage, in other words, if it is to be covered by [all-risk] policies such as these, must be due to some fortuitous circumstance or casualty.

The Court went on to find that the term "corrosion", while undefined in the Policy, had a plain and ordinary meaning and found that it was clear and unambiguous that physical loss or damage caused by corrosion is a loss that is specifically excluded from coverage in the Policy.

Further, the Court of Appeal found that the trial judge was in error when concluding that fortuitous or unanticipated corrosion was covered by the subject policy:

a) This was not a negotiated agreement and there no evidence presented regarding the understanding of the parties at the time the Policy was entered into in 1985. There was then no evidence to assist in understanding the way in which the language of the Policy would have been understood by a reasonable person at the time of signing;

b). The dictionary definition of corrosion includes "wear away, esp. by chemical action." Such definition was not limited to anticipated corrosion but includes any kind of wearing away;

c) The clear and unambiguous meaning of the term "corrosion" is not altered by other provisions in the Policy;

d) Opinions of employees many years after the agreement was signed, do not, of themselves, alter the reasonable expectations of the parties when the Policy agreement was entered into;

e) Defining "corrosion" to include both anticipated and unanticipated corrosion is consistent with commercial reality, the clear terms of the Policy, and the need to interpret standard form policies consistently and objectively because the parties do not negotiate terms and the relationship is "take it or leave it". To allow one party's subjective intention of the meaning to alter the plain meaning of the term would enable one party to define terms in a standard form contract for many other insurers and insured;

f) Because the Policy is a standard form contract, used in many jurisdictions, consistency of interpretation is desirable;

g) Canadian courts have long looked to other jurisdictions for guidance, particularly where the same contracts are used in multiple jurisdictions in keeping with the desire for consistency and stability. American courts have consistently adopted a plain meaning approach to the term "corrosion" that includes both anticipated and unanticipated corrosion;

h) If the corrosion exclusion were interpreted to apply only to non-fortuitous or anticipated corrosion (as the trial judge held), the exclusion would be meaningless as non-fortuitous or anticipated corrosion is not covered in the first place. This is because all damage covered by all-risk policies must be fortuitous; and

i) The trial judge's interpretation may also create an incentive to avoid detection of corrosion as, if only non-fortuitous or anticipated corrosion is excluded from coverage, there would be little incentive to maintain equipment to avoid the risk of unanticipated corrosion.

*(ii) The Exception*

Regarding the exception to the exclusion, the insured has the onus of proving that the exclusion clause applies and that exception clause must be applied broadly. The question on this appeal was, if the corrosion exclusion applied was the damage suffered by MDS resulting physical damage within the meaning of the exception to the exclusion for corrosion in the Policy?

The trial judge had found that the leak did not damage the interior of the J-rod annulus and there was no physical damage beyond the corrosion in the calandria wall. However, the trial judge held that loss of use should be considered "physical damage" because the term "physical damage" was ambiguous, an all-risks policy is designed to provide broad coverage, and the loss of use of insured property caused by the leak "would constitute resulting physical damage."

The trial judge had considered cases regarding whether loss of use was covered by a policy of insurance that insured against all risks of "direct physical loss" whereas the losses in this case resulted from the need to repair the corrosion not from other property damage.

The Appeal court confirmed that Canadian authorities have long held that exclusions for physical damages do not include loss of use or pure economic loss, unless specifically provided for in the policy (*3)

The Appeal court therefore found that, although the leak resulted in a shutdown, the shutdown itself did not result in physical damage and reading in coverage for "loss of use" distorted the plaintiff language reading of the subject policy.

Therefore, the exception to the corrosion exclusion for resulting physical damage included physical damage but not damage resulting from loss of use. While economic loss may result from physical damage, economic loss itself is not physical damage.

*iii) Compounded Prejudgment interest*

Regarding the calculation of prejudgment interest, the Appeal Court was not required to review same as coverage was denied; however, the Court addressed the trial judge's use of her discretion to award interest at a higher rate based on cost of borrowing.

The Court of Appeal noted that compound interest may be awarded where there has been wrongful detention of money that ought to be paid and which the company uses in its business. Such an award is reasonable based on the theory that the wrongdoer made beneficial use of the money and is accountable for the profits.

The Court of Appeal found that, if it had found coverage, there was no error in principle in the

trial judge's discretion to award compounded interest in the manner decided.

*Finally*

What constitutes "physical damage" or "property damage" will depend on the type of insurance policy and wordings in question including exclusions and the Court's review and application of doctrines of interpretation including that of reasonable expectations.

Where a term is defined, coverage will be determined based on the meaning of the words used within the definition and in the context of case law and, specifically, the particular facts in play within the claim. If the term is not defined, then the Court's examination may include an even broader review.

In *MDS,* the policy was a global all-risk policy, which was said to be purchased to protect a business in case of unforeseen circumstances and was a "broad" coverage. Justice Wilson interpreted "physical damage" in the exclusion broadly in the context of a loss arising out of a physical event that halted production of a product and that the policy contemplated loss of business income from the failure of a third-party supplier to produce a product. The Court of Appeal overturned the trial decision.

For what it is worth, the Court of Appeal's decision in *MDS* will not assist business interruption claims due to the COVID-19 pandemic. The Court of Appeal clearly found that a shutdown does not cause physical damage and that economic loss is not physical damage.

For COVID 19 cases, there is still the argument that the threat of the presence of a virus or the actual presence of a virus should be treated differently. An actual virus contamination, for example, may be considered to be a change of material dimension determined to be a physical alteration caused by the presence of the virus thereby causing "physical damage" until a cleanup can be completed. The threat of contamination may be covered if "inevitable" or "imminent".

There have been cases in both the US and Canada involving leaks or fumes which "physically damaged" the contents of a business as the business could not continue. Please review the May 2020 edition of *The Navigator* for the earlier article. Whether or not Canadian courts will make this same leap for the COVID 19 virus cases where there is no physical alteration to a covered property remains to be seen.

So far there is no case law in Canada covering this issue though recently a class action was certified in this regard. We will remain vigilant in our reporting in this regard.

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*Endnotes*
(*1) 2020 ONSC 1924 This trial decision was reviewed by the author in the May 2020 edition of *The Navigator*.
(*2) The insurer also cited, and the Court considered a Nuclear Radiation Exclusion; however, the Court held that the Nuclear Radiation Exclusion was unambiguous but did not apply to this case. The purpose of the Nuclear Radiation Exclusion was to exclude damage from large nuclear events, not the day-to-day operational activities and this was in line with the parties' expectations in this case. This finding was not part of the appeal.
(*3) *Perry et al. v. General Security Insurance Co. of Canada et al.* (1984), 11 D.L.R. (4th) 516 (Ont. C.A.) and *Sterling Crane v. Penner Brothers Utilities Ltd.*, 12 C.C.L.I. 97 (B.C.S.C.), aff'd 14 C.C.L.I. 125.

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