VICARIOUS LIABLITY OF THE LESSOR: *SCHOENBACH V. TRUONG*

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by Michael Slater, QC

In motor vehicle accident cases where the plaintiff has suffered serious injuries, the damages will often exceed the third party insurance coverage specified in the owner's certificate. If the driver does not have the financial means to pay any of the judgment exceeding the coverage, then the plaintiff is often left with no recourse except the underinsured motorist protection provisions of the *Insurance (Motor Vehicle) Act*, which in most cases provides only $1 million of coverage inclusive of costs less all of the statutory deductions.

In the last ten years there has been a significant increase in the number of vehicles that are leased as opposed to purchased. Under the certificate of ownership the lessor is listed as the owner of the vehicle. A lessor is an owner as defined by both the *Insurance (Motor Vehicle) Act* and the *Motor Vehicle Act*.

VICARIOUS LIABILITY OF THE OWNER

Section 86(1) of the *Motor Vehicle Act* makes the owner of a vehicle vicariously liable with the driver where the driver acquires possession of the motor vehicle with the consent of the owner:

> (1) In an action to recover loss or damage sustained by a person by reason of a motor vehicle on a highway, every person driving or operating the motor vehicle who is living with and as a member of the family of the owner of the motor vehicle, and every person driving or operating the motor vehicle who acquired possession of it with the consent, express or implied, of the owner of the motor vehicle, is deemed to be the agent or servant of that owner and employed as such, and is deemed to be driving and operating the motor vehicle in the course of his or her employment.

Sections 1 and 115 of *the Motor Vehicle Act* define "owner" as:

> section 1
>
> "owner" includes a person in possession of a motor vehicle under a contract by which he may become its owner on full compliance with the contract.

section 115

"Owner as applied to a vehicle means:

(a) the person who holds legal title to the vehicle,

(b) a person who is a conditional vendee, a lessee or mortgagor, and is entitled to be and is in possession of the vehicle, or

(c) the person in whose name the vehicle is registered.

The *Insurance (Motor Vehicle) Act* defines the lessor as owner in section 8:

An applicant for an owner's certificate shall set out in the application from:

(a) the name of the owner, followed by the word 'lessor'

(b) the name of the lessee of the vehicle, followed by the word 'lessee'; and

(c) the address in the province of either the owner or the lessee of the vehicle.

However, section 86(3) of the Act provides that where a vehicle has been sold and is in the possession of the purchaser under a contract of conditional sale, the seller or his assignee shall not be deemed an owner:

> (3) If a motor vehicle has been sold, and is in possession of the purchaser under a contract of conditional sale by which the title to the motor vehicle remains in the seller until the purchaser becomes the owner on full compliance with the contract, the purchaser is deemed an owner within the meaning of this section, but the seller or the seller's assignee is not deemed to be an owner within the meaning of this section.

The important issue that must be resolved is whether an agreement in a particular case constitutes a true lease or a conditional sale. The problem arises in cases where the agreement is a lease with an 'option to purchase". In *Huddleston v. Ramzan.* 1988 CarswellBC 187, 26 B.C.L.R. (2d) 266 (B.C.S.C.) the issue was whether a long term lease with an unexercised option to purchase constituted a contract of conditional sale thereby exempting the owner from vicarious liability. Spencer, J. held that the lease agreement was a conditional sale as provided

in the definition under the *Sale of Goods on Condition Act*, R.S.B.C. 1979, c. 373, but that because of the option to purchase, the vehicle could only be “sold” for the purpose of section 79(3) when the lessee exercised the option to purchase:

> 8 The question now arises who is responsible vicariously for Esson's negligence. Certainly Caltron, his employer, is because he was driving on its business at the time of the accident and he was driving with its consent. But the question remains whether Docksteader, the registered lessor and, I find, the owner in fact of the vehicle, is liable vicariously. Docksteader retained the right to control who should drive this vehicle while it was in the hands of the hirer: see cl. 10 of the lease. It had the right to control what accessories might be added to the vehicle by cl. 8(s). It had the right to replace the vehicle with another of similar or more recent year under cl. 2 and to require re-delivery of the vehicle to itself under cl. 4. Those and other clauses preserved a degree of dominion over the vehicle which constitute Docksteader an owner. Mr. Hartshorne, however, argued that Docksteader should be exempt from liability pursuant to the provisions of s. 79(3) of the Motor Vehicle Act. Section 79(1) makes the owner vicariously liable for those who drive a vehicle with its consent, and subs. (3) sets up an exemption clause in the following words:
>
> > (3) Where a motor vehicle *has been sold*, and is in possession of the purchaser under a contract of conditional sale whereby the title to the motor vehicle remains in the seller until the purchaser becomes the owner on full compliance with the contract, the purchaser shall be deemed an owner within the meaning of this section, but the seller or his assignee shall not be deemed an owner within the meaning of this section. [The italics are mine.]
>
> 9 I am of the view that this lease agreement amounts to a conditional sale because it contains a handwritten clause which says, "may purchase vehicle after forty-eight months for $3,269.00 plus tax". In my opinion, if Caltron had sought to buy the vehicle at the end of the 48 months at that price, and if Docksteader had refused, the court would enforce that clause as an option, provided Caltron was not in default under the lease. It would require the implication of reasonable terms, such as a term that the option must be exercised within a reasonable time after the end of 48 months, but in my opinion the court would do that. Such a term would fall within the test of one which was within the parties' intention, and necessary to lend business efficacy to the contract. See *Lyford v. Cargill Co.*, 59 B.C.R. 492, [1944] 1 W.W.R. 273, [1944] 1 D.L.R. 696 (C.A.), and *Luxor (Eastbourne) Ltd. v. Cooper*, [1941] A.C. 108, [1941] 1 All E.R. 33 (H.L.). That being an enforceable option, this contract of hiring therefore becomes a conditional sale within the definition of the Sale of Goods on Condition Act, R.S.B.C. 1979, c. 373, s. 1, where "conditional sale" is defined to mean a contract:

> (*b*) for the hiring of goods by which it is agreed that the hirer shall become, or have the option of becoming, the owner of the goods on full compliance with the terms of the contract.
>
> In my opinion it does not matter that Docksteader had the right to replace this vehicle. The option would apply to whatever vehicle was in the possession of the hirer pursuant to the contract at the end of the 48 months. However, the exemption provided by s. 79(3) of the Motor Vehicle Act only applies "where a motor vehicle *has been sold*". Under the ordinary conditional sale contract, a vehicle is immediately subject to an agreement for purchase and sale. In that sense it is sold, although title does not pass until the final payment is made. Under this contract of hiring, with its included option, the vehicle might never be sold to the hirer. It would only be sold in the event the hirer exercised the option. Therefore, in my opinion, the leased vehicle could not, on the date of this accident, be described as one which "has been sold" and therefore s. 79(3) has no application to this case. Section 79(1) sets up a statutory form of vicarious liability applicable to all owners. Subsection (3) then goes on to provide an exemption to that statutory liability and can only be effective with respect to those who bring themselves strictly within the words of the exemption. It follows that in my opinion the defendant Docksteader Investments Inc. is vicariously liable for the negligence of Mr. Esson, who acquired possession of it with the express or implied consent of Docksteader.

Huddleston v. Ramzan was not followed by the Court of Appeal in *Schoenbach v. Truong* 1996 CarswellBC 928, 19 B.C.L.R. (3d) 313. The lessor, Ford Credit, brought an application under Rule 18A to determine whether it could be held vicariously liable for the negligence of the driver and lessee. McEachern, C.J.B.C. was of the view that the Legislature intended to define "owners" in such a way as to exclude those who hold legal title under conditional sales agreements and held that the word "sold" in section 79(3) refers to an arrangement where the purchaser or lessor acquires possession of the vehicle on terms that permit legal title to be transferred when later specified events occur:

> 8 In *Huddleston*, the court distinguished between two types of conditional sales agreements: the "ordinary" and the "lease option". The court then found that s. 79(3) exempted only those sellers under an "ordinary" conditional sales agreements; sellers under "lease option" agreements continued to be liable as "owners" under s. 79(1). The court drew the distinction based on a literal interpretation of the word "sold". I cannot agree that the Legislature intended to divide the conditional sales agreements in s. 79(3) into two categories, one of

which would be exempt from vicarious liability and one of which would not, on the basis of a literal interpretation of the word "sold".

9 This court decided in *Re Nishi Industries Ltd.*, [1978] 6 W.W.R. 736 (B.C.C.A.), that a lease option agreement is a conditional sales agreement, which is defined in the *Sale of Goods on Condition Act*, R.S.B.C. 1979, c. 373:

> "conditional sale" means a contract
>
> > (b) for the hiring of goods by which it is agreed that the hirer shall become, or have the option of becoming, the owner of the goods on full compliance with the terms of the contract.

10 I agree with counsel for Ford that this is a case where s. 8 of the *Interpretation Act*, R.S.B.C. 1979, c. 206, must be applied. It provides:

> Every enactment shall be construed as being remedial, and shall be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects.

11 With respect, I do not read s. 79(3) as an exemption to s. 79(1), but as part of the definition of "owner" for the purposes of that section. Section 79(3) defines "owner" in a way which excludes sellers under contracts of conditional sale. Although I have no doubt that s. 79 was enacted to extend vicarious liability to legal owners in certain circumstances, I do not believe that it was the intention of the Legislature to extend that liability to legal "owners" under certain kinds of commercial paper but not others. I believe that the Legislature intended to define "owners" in such a way as to exclude those who hold legal title under conditional sales agreements.

12 I am not persuaded that the inclusion of the word "sold" is an indication that the Legislature intended to depart from the definition of "conditional sale" found in the *Sale of Goods on Condition Act*. In my view, and contrary to the view of the court in *Huddleston*, the context of s. 79(3) indicates that the word "sold" refers to an arrangement where the purchaser or lessor acquires possession of the vehicle on terms that permit legal title to be transferred when later specified events occur. I do not agree that "sold" should be read in this context in its literal and legal signification, involving the completion of a purchase and sale including the transfer of legal title.

As a consequence of the *Schoenbach* decision, lessors have been exempted as owners under section 86(3) thereby avoiding any liability to pay any judgment in excess of the policy limits under the certificate of ownership. In cases involving multimillion dollar claims, counsel for the lessor would threaten an application under Rule 18A. The lessor would be released unless

counsel for the plaintiff could distinguish *Schoenbach* on the basis that the lease agreement did not contain an "option to purchase" and was therefore not a "contract of conditional sale".[1]

One such example was the decision in *Heringa v. Mah*. The plaintiff was struck by a van while walking in a crosswalk. He suffered a mild traumatic brain injury and was diagnosed a few months later with Parkinson's disease. He was claiming damages of in excess of $7 million on the basis that the Parkinson's disease was caused by the injuries sustained in the accident. The van was driven by an employee of Clark's Audio Visual Ltd. who had leased the vehicle from GMAC. Counsel for GMAC was also counsel for the lessee and driver and admitted that GMAC was an owner of the vehicle. Following the release of the Reasons for Judgment of the Court of Appeal in *Schoenbach*, GMAC succeeded in amending their statement of defence to withdraw the admission of liability. They then applied under Rule 18A to have the action dismissed on the basis that the lease contained an "option to purchase" and was therefore a contract of conditional sale and accordingly GMAC was exempt from vicarious liability under section 86(3) of the *Motor Vehicle Act*.

In the course of the application GMAC revealed that the policy limits on the certificate of ownership were $2 million. Counsel for the driver and the lessee tried to distinguish Schoenbach on the basis that notwithstanding the "option to purchase" contained in the lease agreement, the lessor was nevertheless an "owner" as defined by the *Motor Vehicle Act.* I was counsel for the plaintiff and did not take any position on the application because I was unable to distinguish *Schoenbach.* The court applied *Schoenbach* and found that the lease in question was a contract of conditional sale and the lessor was entitled to the exemption under section 86(3). This was unfortunate for the plaintiff as the final judgment was close to $7 million and the lessee did not have the ability to pay anything in excess of the $2 million in policy limits.

SCHOENBACH REVISITED

Since the judgment, I have had several other cases in which the lease with option to purchase issue has arisen. Counsel for the lessor in each case have threatened to apply under Rule 18A

to have the action dismissed if I would not agree to the dismissal of the action against the lessor. I discussed the lease versus conditional sale issue with several persons in leasing and automobile sales. They were clear that the majority of the leases containing an option to purchase were intended to be "true leases" and not "conditional sales contracts". One of the principal commercial reasons for this is that the lessor or able to write off the capital cost allowance on the capital cost of the vehicle if the vehicle was considered a true lease as opposed to a conditional sales contract. In addition, Part 5 of the *Personal Property Security Act*, R.S.B.C. 1996, c. 359 (PPSA) does not apply to true leases with a term of more than one year, which means that the lessor can take advantage of the common law remedies and can both seize the vehicle and sue for any deficiency.[2]

In discussing this issue with other personal injury lawyers, I found that we all attended law school before the enactment of the PPSA, which came into force on October 1, 1990, and accordingly were unfamiliar with how the PPSA changed the law with regard to secured transactions. I met with Professor Macdougall at the University of British Columbia law school who teaches a course on the PPSA. I wanted to know whether the PPSA affected the lease/conditional sale issue under section 86(3) of the *Motor Vehicle Act.*

In order to argue that *Schoenbach* was wrongly decided, it would be necessary to have the Court of Appeal constitute a five person bench to hear the appeal. It would be much simpler to distinguish *Schoenbach* on the basis that the definition of "conditional sale" relied upon in *Schoenbach* in the repealed *Sale of Goods on Condition Act*, no longer has any application to the issue of whether a lease agreement containing an option to purchase is a contract of conditional sale.

The argument has been summarized in an Outline submitted in an upcoming Rule 18A application to have the action against the lessor dismissed.

O U T L I N E

Position of the Plaintiff/Respondent:

1. The application of the Defendant lessor ("Lessor") should be adjourned until the after the examination for discovery of both Defendants.

2. The Plaintiff opposes the application of the Lessor, seeking an order that the Lessor, is not liable pursuant to Section 86(3) of the *Motor Vehicle Act*, R.S.B.C. 1996, c. 318.

Basis for opposing relief:

3. The Lessor, is the owner of the motor vehicle pursuant to Section 86(1) of the *Motor Vehicle Act* and as such is vicariously liable for the actions of the Defendant lessee ("Lessee") who was driving the motor vehicle at the time of the accident with the consent of the Lessor.

4. The Lessee had been driving a 1998 GMC Pick-up truck (the "Truck") which he had leased from ER Pontiac Buick GMC Ltd ("ER") pursuant to an agreement entitled "Vehicle Lease" (the "Agreement") dated August 4, 1998.

5. The Agreement was assigned by ER to the Lessor pursuant to the terms of the Agreement.

6. The term of the Agreement was for 60 months commencing on August 4, 1998. The retail price of the Truck was $40,600.00. The down payment was zero dollars. The monthly payments were $754.32 and would total $45,259.20 at the end of the term. Clause 25 of the Agreement gave the Lessee the option to purchase the Truck at the end of the term for $17,059.05 (the "Purchase Option Price") if he was not in default of the Agreement at that time. The Purchase Option Price was deemed by clause 25 of the Agreement to be Fair Market Value on that date.

7. The relevant clauses in the Agreement are:

1. RETAIL SELLING PRICE of Vehicle (including additional equipment, accessories, freight, air tax and pre-delivery	$45,600.00

inspection but not GST or PST)
…

5. TOTAL COSTS AND CREDIT DUE UPON SIGNING

a) Cash down payment	$0.00
+ b) Net Trade-in allowance	$0.00
+ c) Taxes on 5(a) and 5(b)	$0.00
+ d) Advance payment (3(d)) plus, if applicable, pro-rata payment for adjustment to payment date and taxes	$456.99
+ e) Security Deposit	$0.00
+ f) Registration and License Fees	$12.40
+ g) Administration and Other Fees (describe)	$0.00
= h) Total Costs and Credits Due Upon Signing	$1,069.39
6. Total Costs of Lease Transaction upon completion excluding charges for excess wear and tear, excess kilometers and late payment (3(f) + 5(h) – 3(d) – 5(e)	$46,328.59

7. OPTION TO PURCHASE/BUY-OUT OPTION

You have the option to purchase the vehicle during the Term of this lease or at the end of the Term for the price and in accordance with the terms set out in this Lease.

a) Option Price	$17,059.05
b) Total transaction costs if you elect to purchase the vehicle at end of the term (6 + option price in Lease plus applicable taxes on option price at time of purchase)	$63,387.64
c) Total transaction costs if you elect not to purchase	$46,328.59

the Vehicle at end of the Term (same as 6)

25. OPTION TO PURCHASE AT END OF TERM: At the end of the Term, if you wish you may purchase the Vehicle for the Option Price shown in Section 7 (which is a genuine pre-estimate of the Vehicle's fair market value on that date) PLUS all fees, taxes, costs, and expenses in connection with your purchase. PLUS any other amounts which may be due and unpaid under this Lease. You are not entitled to exercise this option if you are in "Default" under this Lease (see Section 28, below, for the meaning of "Default"). If you wish to exercise this option, you must give AT&T at least 35 days prior written notice and must pay the Option Price to AT&T before the end of the last month of the Lease Term. Once you have notified AT&T, you cannot cancel your purchase. The purchase of the Vehicle by you shall be on an as is, where is" basis without any condition, representation or warranty by AT&T, express or implied, except that such Vehicle is free and clear of liens and encumbrances caused by AT&T.

…

16. VEHICLE OWNERSHIP: This Lease is intended to be treated as, and constitutes, a true lease for all purposes, including, for example, for the purpose of personal property security and credit laws and income and other tax law. Accordingly, AT&T will remain the owner of the Vehicle and retain the benefits of owning it.

8. Section 86(1) of the *Motor Vehicle Act* provides that the owner of a motor vehicle is vicariously liable for the actions of a person who drives the motor vehicle with the consent of the owner:

Responsibility of owner in certain cases

(1) In an action to recover loss or damage sustained by a person by reason of a motor vehicle on a highway, every person driving or operating the motor vehicle who is living with and as a member of the family of the owner of the motor vehicle, and every person driving or operating the motor vehicle who acquired possession of it with the consent, express or implied, of the owner of the motor vehicle, is deemed to be the agent or servant of that owner and employed as such, and is deemed to be driving and operating the motor vehicle in the course of his or her employment.

9. Section 86(3) of the *Motor Vehicle Act* provides an exemption from vicariously liability for an owner if the motor vehicle has been sold under a "contract of conditional sale":

> (3) If a motor vehicle has been sold, and is in possession of the purchaser under a contract of conditional sale by which the title to the motor vehicle remains in the seller until the purchaser becomes the owner on full compliance with the contract, the purchaser is deemed an owner within the meaning of this section, but the seller or the seller's assignee is not deemed to be an owner within the meaning of this section.

10. The issue in this case is whether the Agreement is a "contract of conditional sale" which would exempt the Lessor and owner of the motor vehicle, from vicarious liability under section 86(3) of the *Motor Vehicle Act*.

11. The term "conditional sale" is not defined in the *Motor Vehicle Act.*

12. The Lessor in the case at bar relies on the decision in *Schoenbach v. Truong,* 1996 CarswellBC 928 (BBCA) to establish that the Agreement is a conditional sale and not a true lease.

13. The law and facts of this case are distinguishable from the law and facts considered by the British Columbia Court of Appeal in *Schoenbach.*

14. The agreement in *Schoenbach* was executed on February 2, 1990. The motor vehicle accident occurred on August 29, 1990.

15. The *Sale of Goods on Condition Act* R.S.B.C. 1979, c.373 was in effect when the Agreement between the lessor and the lessee in *Schoenbach* was entered into and when the accident involving the lessee occurred.

16. The Court of Appeal relied on the definition of "conditional sale" in section 1 of the *Sale of Goods on Condition Act,* R.S.B.C. 1979, c. 373 to find that a lease with an option to purchase was a conditional sale under section 79(3) [now 86(3)] of the *Motor Vehicle Act.*

17. The definition of "conditional sale" under section 1 of the *Sale of Goods on Condition Act* provided:

> "conditional sale" means a contract
>
> (a) for the sale of goods under which possession is or is to be delivered to the buyer, and the property in the goods is to vest in him at a subsequent time on payment of the whole or part of the price or the performance of any other condition; or
>
> (b) for the hiring of goods by which it is agreed that the hirer shall become, or have the option of becoming, the owner of the goods on full compliance with the terms of the contract;

18. The *Sale of Goods on Condition Act* was repealed on October 1, 1990. The definition of "conditional sale" under section 1 has been repealed with the Act.

19. The *Personal Property Security Act* R.S.B.C. 1996, c. 359 was brought into force on October 1, 1990, the same day as the repeal of *Sale of Goods on Condition Act.*

20. As the Agreement in the case at bar was executed on August 4, 1998, it is governed by the provisions of the *Personal Property Security Act.*

21. The *Personal Property Security Act* clearly applies to both leases and conditional sales. Section 2 of the Act provides:

> 2(1) Subject to sections 4, this Act applies to
>
> (a) to every transaction that in substance creates a security interest, without regard to its form and without regard to the person who has title to the collateral, and
>
> (b) without limiting paragraph (a), to a chattel mortgage, **a conditional sale**, a floating charge, a pledge, a trust indenture, a trust receipt, an assignment, a consignment, **a lease**, a trust, and a transfer of chattel paper if they secure payment or performance of an obligation.

22. Section 75(1) of the *Personal Property Security Act* provides that any reference in an Act, regulation, agreement or document to the *Sale of Goods on Condition Act* that relates to a security interest is deemed to be a reference to the *Personal Property Security Act*.

> (1) A reference in an Act, regulation, agreement or document to the *Book Accounts Assignment Act,* the *Chattel Mortgage Act*, the *Company Act*, the *manufactured Home Act* or the *Sale of Goods on Condition Act* that relates to a security interest is deemed to be a reference to this Act or to the corresponding provisions of this Act.

23. Section 75(2) of the *Personal Property Security Act* provides that any reference in an Act, regulation, agreement or document to a conditional sale is deemed to be a reference to the corresponding kind of security agreement under the *Personal Property Security Act*.

> (2) A reference in an Act, regulation, agreement or document to a chattel mortgage, **conditional sales contract**, floating charge, pledge, assignment of book accounts or other similar agreement is deemed to be a reference to the corresponding kind of security agreement under this Act.

24. Accordingly, section 75 of the *Personal Property Security Act* does not permit the term "contract of conditional sale" in section 86(3) of the *Motor Vehicle Act* to be defined by reference to the definition of "conditional sale" in section 1 of the repealed *Sale of Goods on Condition Act*.

25. The term "conditional sale" is not defined in the *Personal Property Security Act.* It is submitted that the Legislature clearly intended the definition of "conditional sale" in the common law to apply to transactions after October 1, 1990 by virtue of section 68(1) of the Act:

> 68(1) The principles of the common law, equity and the law merchant, except insofar as they are inconsistent with the provisions of this Act, supplement this Act and continue to apply.

Common law principles

26. The cases and texts in the field of personal property security law are clear that there are many factors to consider in the determining whether the agreement at issue in a

particular case is in essence a "true lease" or a "conditional sale" or "disguised sale". Each case must be decided on its own facts. Dale Doan and Paul Bradley in the text, *British Columbia Personal Property Security Act Practice Manual, 2000 Update* state, at p. 5-8:

> "The leading Canadian cases on this issue are a trilogy of Ontario decisions by Henry J.: *Re Speedrack Ltd.* (1980), 1 P.P.S.A.C. 109 (Ont. H.C.), *Re Ontario Equipment (1976) Ltd.* (1981), 1 P.P.S.A.C. 303 (Ont. H.C.), affirmed (1982), 6 P.P.S.A.C. 229 (Ont. C.A.), and *Gatx Corporate Leasing Inc. v. William Day Construction Ltd*. [1986] O.J. No. 806 (Ont. H.C.).

27. The common law principles from the "core" cases in this field suggest that the court must review evidence of the role of the parties, the effect of the transaction, and the intent of the parties to determine whether the agreement is a "true lease" or a "conditional sale". Some of these elements are apparent on the face of the agreement, while others elements will only become known following the discovery of documents and the parties to the transaction.

28. In *Speedrack* Henry, J. said, at paragraphs 10 and 15:

> The nature of the transaction may be apparent on the face of the instruments, but if it is not, the court must determine its nature … from the surrounding circumstances. It is not merely a question of construing the agreement between the parties which may be quite clear. It is a question of determining the intention of the parties, notwithstanding the form used in setting up the transaction. For this, extrinsic evidence may be relevant and admissible and it is so in this case. The court's task is to determine the essence of the transaction in spite of its form…. It must determine, on the balance of probabilities, and on a practical and commonsense view of the evidence, whether the parties negotiated a loan or advance on security or a standard lease of property….
>
> … I proceed by considering three factors – the role of the parties, the intent of the parties and the effect of the transaction.

29. In *Re Ontario Equipment* Henry, J. identified several significant factors including whether the agreement transfers ownership of the asset to the lessee, whether that transfer was mandatory or if an option to purchase had to be exercised, and, if so, whether the

purchase option was for a nominal amount or for fair market value. Henry, J. stated at paragraph 8:

> 8 It is of the essence of a lease intended as security within the meaning of the Personal Property Security Act that the property in the subject of the lease is to pass ultimately to the lessee, who is obliged to pay the lessor what might be reasonably regarded as the purchase price with interest and carrying charges over the life of the lease. In such a case the transaction is not unlike a conditional sale agreement or hire-purchase agreement.
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> 9 What I consider to be a practical definition of the distinction between a true lease and a lease by way of security was adopted in *Re Crown Cartridge Corp.* (1962), 220 F. Supp. 914 at p. 916, by Croake D.J. from the decision of Herzog, Referee:
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> > 'The test in determining whether an agreement is a true lease or a conditional sale is whether the option to purchase at the end of the lease term is for a substantial sum or a nominal amount ... If the purchase price bears a resemblance to the fair market price of the property, then the rental payments were in fact designated to be in compensation for the use of the property and the option is recognized as a real one. On the other hand, where the price of the option to purchase is substantially less than the fair market value of the leased equipment, the lease will be construed as a mere cover for an agreement of conditional sale.'
>
> 10 The critical issue in every case is the intention of the parties and this depends upon the facts of the case. In *Re Speedrack Ltd.* (1980), 33 C.B.R. (N.S.) 209, 11 B.L.R. 220, 1 P.P.S.A.C. 109 (Ont. S.C.), for example, the facts led to the conclusion that the lease was a security for the financing of the ultimate purchase of the subject matter, and the failure to register a financing statement left the security interest unperfected and subordinate to the interest of the trustee in bankruptcy.
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> 11 Each case must stand on its own facts. In the case at bar the terms of the lease assure to the lessor recapture of its cost plus a profit, with the guarantee that it will recoup $2,500 on the final sale at market price. As I interpret the lease agreement, the lessee is not obliged to take title at the end of the term. I am aware that Mr. Peacock in his affidavit says that under the open-end lease "the lessee agreed to purchase the leased vehicle at the agreed upon price". That, however, is not my interpretation of the agreement; clearly the lessee has an option. It may elect to purchase or not. It cannot be said that the final transaction is such that no reasonable lessee

> would refuse to purchase the vehicle, which would be some evidence that the intention of the parties was that the transaction from the beginning was in reality an agreement of purchase and sale. The prospect of the lessee reaping a profit on final liquidation of the vehicle is not conclusive of this intention. It is quite consistent with the lessor holding out an incentive to the lessee to maintain the value of the asset during the term of the lease by proper maintenance, repair and careful use.
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> 12 Parties must be free to contract as they see fit without restraint, except as clearly imposed by law. It is only if on a reasonable view of the agreed arrangements the lessor has financed the purchase of the vehicle, under the guise of a lease which is in reality a security instrument, that the Act requires registration to protect the interest of the lessor-owner against creditors.
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> 13 In the present case I am not persuaded that the lease is anything more than a straightforward leasing arrangement which recovers for the lessor, as owner, over the effective life of the vehicle, his cost, together with a reasonable profit. The lessor is entitled to do that. That is no additional evidence, as there was in *Re Speedrack Ltd.*, supra, to lead to the conclusion that the true nature of the transaction was a sale of the asset financed on the security of the lease.

30. Some of the factors which are apparent on the face of the Agreement in the case at bar which point to the Agreement being a "true lease' rather than a "conditional sale" are:

    (a) The Agreement is entitled "Vehicle Lease".

    (b) Clause 16 provides that "this Lease is intended to be treated as and constitutes, a true lease for all purposes… ." If the Lessor who has drafted the Agreement states that it is to be considered a "true lease" for "all purposes, including… for personal property security", then the Agreement <u>cannot</u> be a conditional sale as the two terms are mutually exclusive.

    (c) The down payment in the Agreement was $0.00.

    (d) The Lessee paid no GST and PST on the price of the Truck, which is required in a conditional sale agreement.

(e) The retail price of the Truck was $40,600.00. The option price to buy out the Truck at the end of the term of the leases was $17,059.05 or 42% of the retail price. Clause 25 provided that this was a "genuine pre-estimate of the Vehicle's fair market value on that date."

(f) If the Lessee returned the Truck at the end of the term, the Lessee did not share in any profit beyond the residual value of the Truck nor was the lessee required to make up any deficiency in the event that the Truck was sold by the Lessor at less than the residual value.

(g) There is no clause in the lease granting the lessee an equity or property interest in the Truck.

(h) By clause 8 the Lessee is precluded from driving more than 96,000 and suffers a penalty of $0.10 per kilometer driven above that distance.

(i) Clause 18 restricts the use of the Truck and precludes modifications to the Truck.

(j) Clause 21 provides that the Lessee must at the request of the Llessor disclose the location of the Truck and permit the Lessor to inspect the Truck.

(k) Clause 31 provides that the Lessee may not transfer, sublease, or rent the vehicle without the Lessor's permission.

31. These are all factors which are apparent on the face of the Agreement which indicate that the Agreement is a "true lease" and not a "conditional sale."

32. The authorities point to additional factors which would only be disclosed in an examination for discovery of the Defendants and upon disclosure of documents. These additional factors include:

(a) Was the Lessor intending to deduct the capital cost of the Truck for income tax purposes and has it done so in similar leases? The deduction would be 15% in the first year and 30% in the remaining years. The Lessor cannot do so if the transaction is a conditional sale.

(b) Did the Lessor have a master lease agreement with ER?

(c) What is the usual business of the Lessor? Is it in the business of leasing vehicles or does it buy and sell vehicles.

(d) What does the correspondence between the parties disclose?

(e) What was the acquisition cost of the Truck? Did the monthly payments over the term of the lease allow the Lessor to recover the acquisition cost of the Truck plus interest, or was there a shortfall?

(f) Was the Agreement for the economic life of the Truck or was there residual value in the Truck after the expiration of the lease term.

(g) Does the Lessor require the realization of the residual value of the Truck to make the transaction more profitable?

(h) Did the Lessor insure the residual value of the Truck in the event that it was worth less than the option price in the Agreement?

Material to be relied on:

33. Affidavit of SH.

34. Authorities:

Alexander v. Bertram and Ford Credit Canada Ltd., 2000 CarswellBC 175 (B.C.C.A.), 2000 BCCA 72.

Schoenbach v. Truong, 1995 CarswellBC 54 (B.C.S.C.)

Schoenbach v. Truong, 1996 CarswellBC 928 (B.C.C.A.)

Re Speedrack Ltd. (1980), 1 P.P.S.A.C. 109 (Ont. H.C.)
Re Ontario Equipment (1976) Ltd. (1981), 1981 CarswellOnt 186, 1 P.P.S.A.C. 303 (Ont. H.C.)

Re Ontario Equipment (1982), 6 P.P.S.A.C. 229 (Ont. C.A.)

Gatx Corporate Leasing Inc. v. William Day Construction Ltd. [1986] O.J. No. 806 (Ont. H.C.)

Statutes:

Motor Vehicle Act, R.S.B.C. 1996, c. 318.

Personal Property Security Act, R.S.B.C. 1996, c. 359

Texts:

Doan, D. and Bradley, P. *British Columbia Personal Property Security Act Practice Manual, 2000 Update*.

Cuming, Ronald and Wood, Roderick. *British Columbia Personal Property Security Act Handbook,* 4th ed., (Toronto: Carswell), 1998.

Sullivan, Ruth; *Drieger on the Construction of Statutes, 3d ed.* Butterworths,Toronto.

McLaren, Richard. *Personal Property Security: An Introductory Analysis,* 5th ed. Toronto, Carswell, 1992.

Cuming, Ronald. True Leases and Security Leases under Canadian Personal Property Security Acts (1983), 7 CBLJ 251.

[1] The following cases distinguished *Schoenbach*: *Alexander v. Bertram*, 2000 CarswellBC 175, 2000 BCCA 72 (B.C.C.A.); *Forrest (Guardian ad litem of) v. Johnson*, 1997 CarswellBC 1081 (B.C.S.C.); *Nickel v. Happy Auto Sales Inc*., 1997 CarswellBC 2641 (B.C.S.C.)

[2] Part 5 deals with the rights and remedies in default. Section 55(2) provides that Part 5 does not apply to (a) a transaction referred to in section 3 which includes a lease with a term of more than one year.