

INFONEX CONSTRUCTION SEMINAR LEGAL UPDATE & OVERVIEW



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1. Introduction

This paper outlines recent developments in the case law and highlights the impact these developments can have in practice. The law of tendering and insurance law have received significant attention. In addition, cases outlined in this paper consider indemnity clauses, warranty clauses, election clauses, partnership provisions, and arbitration agreements and illustrate how these provisions have been interpreted by the courts, which raises important considerations in terms of contracting strategies.

2. Tendering

The law of tendering has seen extensive development in the cases. The leading case of *Ontario v. Ron Engineering & Construction (Eastern) Ltd.*, [1981] 1 S.C.R. 111 established the Contract A/Contract B analysis. According to this framework, a call for tenders constitutes an offer by the owner to all potential bidders to enter into Contract A. Contract A comes into existence when a contractor submits a tender that complies with the terms of the tender documents. The owner and successful contractor will then be able to enter the construction contract, referred to as Contract B. In *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.*, [1999] 1 S.C.R. 619 the Supreme Court of Canada held an owner cannot accept a tender which does not comply with the terms of the tender documents. Recent cases address additional issues.

In *Graham Industrial Services Ltd. v. Greater Vancouver Water District*, [2004] B.C.J. No. 5 (C.A.) the Greater Vancouver Water District (“Water District”) issued a call for tenders for the Capilano Pumping Station. After tenders were opened, Graham Industrial Services Ltd. (“Graham”) sought to withdraw its bid without penalty, alleging that it contained a \$2,000,000 mathematical error. The Water District refused, relying on the provision in the tender documents concerning irrevocability of bids. Graham then sought a declaration that (1) its bid failed to comply with the instructions to tenderers and therefore no contract was formed with the Water District; and (2) its bid was not capable of acceptance. The central issue in this case concerned the interpretation of clause 10.1 in the instructions to tenderers (called the “Discretion Clause” in the case) which stated:

- 10.1 If a Tender contains a defect or fails in some way to comply with the requirements of the Tender Documents, which in the sole discretion of the Corporation is not material, the Corporation may waive the defect and accept the Tender.

The Water District argued that clause 10.1 enabled it to waive any defect in Graham's tender and accept it. The chambers judge and the Court of Appeal disagreed.

The Court of Appeal held that the Water District's right to rely upon the Discretion Clause only arises if a valid Contract A is formed. Contract A is only formed if a bid is substantially compliant. The Discretion Clause does not allow the owner to waive material defects to render the bid capable of acceptance. Finch C.J.B.C. explained:

¶ 16 In my view, the Discretion Clause in the instructions to tenderers cannot permit the Water District to determine subjectively whether a defect is material. This is not a matter of interpretation of the Discretion Clause. Rather, the very Discretion Clause which the Water District seeks to rely on does not operate until a valid Contract A is formed. The Discretion Clause can not, therefore, give the owner the power to "reach back" before the clause's operative existence and deem compliant a bid that is, on an objective analysis, materially non-compliant.

...

¶ 21 ...The Water District's right to rely on the Discretion Clause as a term of Contract A only arises if a valid Contract A is formed. Contract A is only formed if a bid is, in Estey J.'s words, "capable of acceptance in law". It is the submission of a compliant tender which establishes the legal relationship, Contract A, between the parties: *Sound Contracting Ltd. v. Nanaimo (City)* (2000), 74 B.C.L.R. (3d) 239 (C.A.) [paragraph] 18. Since the Discretion Clause does not operate before Contract A is formed, the determination of whether a bid is capable of acceptance in law must be based on an objective standard.

The Court held that interpreting the Discretion Clause in a manner asserted by the Water District would allow owners to circumscribe the tendering process. The mandatory requirements of the instructions to tenderers would be completely negated if an owner had the right to exercise its discretion to waive any defect or non-compliance by deeming material omissions to be non-material. The Court felt its restrictive interpretation was necessary to protect the integrity of the tendering process. The effect of the Discretion Clause (clause 10.1), then, was explained as follows:

¶ 30 What meaning, then, is to be given to the Discretion Clause? In my view, the clause simply recognizes that the test for determining whether a tender is valid is one of substantial compliance rather than strict compliance. The clause allows the Water District to accept tenders with minor irregularities or non-material defects. This substantial compliance test is consistent with an objective analysis of whether Contract A has arisen . . .

The Court of Appeal agreed that on an objective basis the deficiencies in Graham's bid amounted to material non-compliance with the instructions to tenderers and it could not be accepted.

In *Double N Earthmovers Ltd. v. Edmonton (City)*, [2005] A.J. No. 221 (C.A.), the City of Edmonton (the "City") called for tenders for four pieces of heavy equipment to move refuse. The tender call required all equipment to be 1980 or newer. Both Double N and Sureway submitted bids. On its face Sureway's bid was compliant. It promised to provide equipment which was 1980 or newer. However, the serial number corresponding to one of the units was that of a 1979 machine. After the close of tenders, Double N contacted the City alleging that Sureway's equipment was older than 1980. The City was not bothered by these allegations, taking the position that it would insist upon compliance with the terms of the tender. The City awarded the contract to Sureway. After contract award, Sureway sought to use a 1979 machine. The City initially insisted upon a 1980 being provided as tendered, but ultimately waived that requirement. Double N's claim was dismissed by both the trial judge and the Court of Appeal.

The Court of Appeal held that the City did not have a duty to investigate beyond the face of the tender. It was entitled to assume that a successful bidder would be obliged to comply with the terms of its bid. The Court of Appeal also held that the Contract A's formed with various bidders during the tendering process were terminated upon the award of Contract B. At the post-tendering stage, any issues of non-compliance of Contract B are between the owner and successful tenderer. This is necessary to ensure commercial efficacy. The Court of Appeal explained:

¶ 56 . . . Contract A arises when, by submitting a substantially compliant tender, a bidder accepts the owner's offer to receive and consider tenders according to the terms and conditions of the tender call. The obligation of the bidders under contract A is to enter into contract B at the price quoted in the bids. The obligation of the party calling for tenders is to fairly evaluate the bids and to

enter into contract B with a compliant bid. But in the absence of a term in contract A to investigate the bidder's capacity to comply with the terms of the tender, once an owner accepts in good faith a tender which is compliant on its face in all material terms, all obligations to other bidders are discharged. Were that not so, parties to contract B might be subject to constant surveillance and scrutiny of other bidders, challenging any deviation from the original terms of contract A, thereby ultimately frustrating the tendering industry generally, and introducing an element of uncertainty to contract B. While any non-compliance by the bidder discovered subsequent to the formation of contract B would be actionable by the owner, that discovery does not compel the owner to re-tender.

This case is important as it provides certainty in two respects. First, it indicates that an owner is entitled to rely on the face of the tender documents when evaluating bids. Second, it indicates that the obligations under Contract A end once Contract B is formed. Other tenderers cannot complain if the parties to Contract B waive their rights or amend the contract terms. The Supreme Court of Canada recently heard the appeal in this case and reserved its decision.

3. Insurance – Commercial General Liability Insurance Policies

Another area of law which has seen extensive development concerns Commercial General Liability (“CGL”) insurance policies. In particular, one issue is to what extent, if at all, do CGL policies cover damages caused by defective workmanship. Central to the debate are two conflicting principles. The first principle is that the scope of insurance coverage is determined by the policy wording. The other principle is the general proposition that CGL policies are not meant to cover faulty workmanship and are not performance bonds. The interaction between these two principles has been discussed in recent cases.

In *Swagger Construction Ltd. v. ING Insurance Co. of Canada*, [2005] B.C.J. No. 1964 (S.C.), the British Columbia Supreme Court found that all claims against the contractor were outside the scope of policy coverage and the contractor’s insurer had no duty to defend. The general rule is that a duty to defend will arise if the claim alleges acts or omissions which, if proven, would fall within the scope of insurance coverage and are not excluded. In this case, Swagger Construction Ltd. (“Swagger”) acted as the general contractor for construction of the Forest Science Center at UBC. Swagger sued UBC seeking compensation for extra work and delays. UBC issued a counterclaim against Swagger. Of the counterclaim, the Court stated:

¶ 22 Giving the pleadings their broadest possible interpretation, the counterclaim against Swagger contains the following basic elements:

- a) a claim that Swagger was in breach of its obligations under the construction contract;
- b) a claim that Swagger was negligent in performing its contractual obligations;
- c) a claim that Swagger's breach of contract and negligence resulted in construction deficiencies;
- d) a claim that UBC has had to repair the construction deficiencies;
- e) a claim that the construction deficiencies have caused additional damage, including damage to other parts of the building that were not in themselves defective. This claim and includes failure of the building envelope and resulting leaks; and
- f) a claim that as a result of the construction deficiencies, resultant damage and dangerous defects, UBC has suffered a loss of use of the property.

Swagger's application for a declaration that its insurers owed a duty to defend was dismissed. As the damages alleged in UBC's counterclaim all related to the building Swagger contracted to build, the CGL policies did not apply. The Court explained:

¶ 4 The leading authority in this Court on the duty to defend under insurance policies of the type at issue here is *Privest Properties Ltd. v. Foundation Co. of Canada. Ltd.* (1991), 57 B.C.L.R. (2d) 88, 6 C.C.L.I. (2d) 23 [Privest]. Drost J., at [paragraph] 208, adopted American authority describing the general purpose of CGL policies:

Comprehensive general liability policies ... are intended to protect the insured from liability for injury or damage to the persons or property of others; they are not intended to pay the costs associated with repairing or replacing the insured's defective work and products ...

Citing *Ohio Casualty Insurance Co. v. Bazzi Construction Co. Inc.*, 815 F. (2d) 1146 (C.A. 7th circ. 1987), at [paragraph] 209 Drost J. added:

There is a policy reason for this. If the insurance proceeds could be used to pay for the repairing or replacing of defective work and products, a contractor or subcontractor could receive initial payment for its work and then receive further payment from the insurer to repair or replace it. Equally repugnant on policy grounds is the notion that the presence of insurance obviates the

obligation to perform the job initially in a good and workmanlike manner: see *Centex Homes Corp. v. Prestressed Systems Inc.*, 444 So. (2d) 66 (Fla. App. 3 Dist., 1984).

¶ 5 This principle has been sometimes summarized by saying a CGL policy is not a performance bond. However, that general principle is always subject to the specific terms of the policy at issue. . . .

. . .

¶ 36 The basic principle set out in *Privest* and the authorities on which it is based is that for the purpose of CGL policies, damage to "tangible property" does not include the cost of remedying defects in the insured's own work. Drost J. also said that a general contractor's "work" is the project for which the contractor was engaged ([paragraph]238). The effect of *Winnipeg Condominium and Bird Construction* is that, subject to one possible exception that I will discuss below, this basic principle cannot be avoided by an artificial division of the insured's work into component parts.

¶ 37 Of course, parties to insurance contracts might expand the definition of property damage and the scope of coverage to include some, but not all, of the insured's own work, based on what might be a difficult and arbitrary division of building components. However, I can find no language in these contracts that can be stretched to include such a departure from the usual purpose of a CGL policy.

In *Westridge Construction Ltd. v. Zurich Insurance Co.*, [2005] S.J. No. 396 (C.A.), however, the Saskatchewan Court of Appeal held that there was a duty to defend the contractor in claims arising from the premature failure of a roof on a barn. In *Westridge*, Genex contracted with Westridge to construct a barn. The roof of the barn suffered a premature failure due to the use of inappropriate materials. Genex sued Westridge for breach of contract and negligence and claimed damages for repair to the barn and for interruption to its business. Westridge's CGL policies provided coverage for property damage, but not if due to faulty workmanship. The insurers denied coverage and refused to defend. The trial judge held that the claims did not fall within the insurance coverage because it is a fundamental principle of insurance law that CGL policies do not cover a contractor's own defective workmanship or materials. The Saskatchewan Court of Appeal disagreed with this approach. It held that the trial judge erred in applying a general principle of insurance law rather than interpreting the terms of the policies. Genex's claims fell within the policies and not excluded as they were not based solely on fault workmanship but also on negligent misrepresentations. The Court of Appeal explained:

¶ 33 In the concluding paragraphs of his reasons for decision (paragraphs [38] to [42]), the trial judge found that the claims against Westridge did not fall within the insuring agreements. In doing so, he made no reference to the terms of the policies themselves, but appears to have relied on what he termed to be a fundamental principle of insurance law that a Comprehensive General Liability Policy is not intended to be a means for a contractor to cover the expenses to cover its own defective workmanship or materials, or to be a performance bond (paragraphs [24] to [28]).

¶ 34 While the statement of principle is sound, this was an erroneous approach, as the judge was obliged to decide the issue not upon general insurance principles, nor upon the general nature of the policies, but upon the exact terms of the insurance policies themselves. As noted by the Alberta Court of Appeal in *J.A.S. v. Gross*, [2002] 5 W.W.R. 54 at para. 29:

[29] Further, the argument does not take into account the wording of the Policy. The key to coverage lies not in the general nature of the policy itself but in whether the alleged acts fall within its provisions and coverage is not excluded. As Justice Iacobucci noted at para. 67 of *Scalera*, general principles of insurance contract interpretation are "merely interpretive aids that cannot decide any issues by themselves". The provisions of the Policy are discussed below.

The Court of Appeal then considered the policies noting that coverage provisions should be construed broadly, while exclusion clauses should be given a narrow interpretation. The Court explained that the definition of property damage in the policy was not qualified to mean only physical injury to property other than the insured's own work product and cannot be read as though it were so qualified (subject to the exclusion clause which was discussed). The Court also explained that the pleadings alleged negligence in failing to warn. This fell within the policy:

¶ 40 The pleadings in this case, and in particular subparagraphs 45(c)(iii), (iv) and (xii), allege that Westridge was negligent in failing to warn Genex that the galvalume roof, used with the foil back insulation, was unsuitable for a swine facility and, if so used, would cause premature failure. Paragraph 46 alleges that the negligence did, in fact, cause the premature failure of the roof system and walls. These pleadings clearly suggest that the exposure of the roof system to the conditions of the swine barn over the years caused the damage and that the damage was neither expected nor intended from the point of Westridge, the insured. These facts, if proved, amount to an "occurrence" within the meaning of the policy, and would bring this aspect of the claim within coverage.

Therefore, the claims fell within the policies' coverage. On the issue of whether the claims fell within an exclusion, both policies exclude coverage for faulty workmanship and materials. However, the Court of Appeal interpreted the pleadings as raising issues which were not excluded. It explained:

¶ 48 Insofar as the claims in this case are claims in contract for faulty workmanship or materials, the exclusions apply. However, as noted previously, the pleadings support not only a cause of action in contract, but also a separate cause of action in tort for negligent misrepresentation, a cause of action to which these exclusions would not apply since they do not necessarily involve allegations of faulty workmanship or materials. For example, paragraph 39 of the claim alleges that the building was built in accordance with the specifications, and paragraph 45(c)(iv) alleges that the insured failed to warn Genex that the roof system was unsuitable for use in a swine barn and that such use would affect the durability and longevity of the building. These allegations raise a cause of action arising not from faulty workmanship or defective material, but from failure to warn, before the contract was entered into, that the work and materials called for by the contract were unsuitable for the conditions of the swine barn. Furthermore, the problems did not arise solely from the work or materials themselves, but from the effect of the conditions prevailing in a swine barn over a period of time upon a roof system such as used in this case.

The Court of Appeal set aside the chambers judge's decision and declared that the insurers had a duty to defend Westridge.

In *Bridgewood Building Corp. v. Lombard General Insurance Co. of Canada*, [2006] O.J. No. 1288 (C.A.) the Ontario Court of Appeal also adopted a liberal approach to CGL policies. It held that Lombard General Insurance Co. of Canada was required to indemnify Bridgewood Building Corp. for the cost of repairing structural defects that were the result of defective concrete supplied by one of Bridgewood subcontractors. The insurer argued that it was settled law that CGL policies are not intended to cover repair or replacement costs arising out of the insured's own defective work or product, whether by the insured or a subcontractor. A CGL policy is only intended to cover an insured's tortious liability to third parties. It is not meant to be a performance bond. The insurer also raised the public policy argument that interpreting the policy as extending coverage would encourage poor workmanship and would open the floodgates to claims that would include building code infractions, drywall repairs and essentially all of the insured's work. The insurer further argued that it would encourage general contractors

to hire incompetent subcontractors because they could be reimbursed by their insurers for the poor quality of work.

The Court of Appeal rejected these arguments. It noted that the fact that the general contractor receives coverage does not relieve the subcontractor of ultimate liability for defective work. The insurer will have subrogation rights against the subcontractor who performed the defective work. Ultimate responsibility for poor workmanship would still lie with the one who performed it. As well, general contractors who habitually hire incompetent subcontractors will soon find themselves out of work. Finally, if insurance companies do not wish to indemnify general contractors for the shortcomings of their subcontractors, they need only say so in clear and unambiguous language in their policies.

In this case the policy stated:

This insurance does not apply to:

“Property damage” to

- 1) that particular part of “your work”,
- 2) that particular part of the machinery or equipment forming a part of “your work” described in 1) above, or
- 3) a component or constituent of “your work” described in 1) above, whether such component or constituent is a separate physical part or an integral element of “your work”, that is defective or actively malfunctions. This exclusion applies only to “property damage” to “your work” in the “products completed operations hazard”.

This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.

(emphasis added)

The Court of Appeal held that on plain reading of the exclusion clause, coverage would be provided if the damaged work was performed by a subcontractor. The Court of Appeal rejected the argument that a general principle exists which precludes coverage of an insured’s own defective work regardless of the working of the policy. Rather, this proposition is merely an interpretive aid in interpreting CGL policies.

The insurer in this case has applied for leave to appeal to the Supreme Court of Canada.

See also: *ING Insurance of Canada v. A.M.L. Painting*, [2006] NSSC 203.

4. Indemnity Clauses

In *TransCanada Pipelines Ltd. v. Potter Station Power Limited Partnership*, [2003] O.J. 1879 (C.A.) the Ontario Court of Appeal outlined the principles governing the interpretation of indemnity clauses. In this case the issue was whether an indemnity clause was limited to claims made by third parties or whether it required the contractor to indemnify the owner for damage to the owner's property caused by the contractor itself. The plaintiff, TransCanada Pipelines Limited ("TransCanada"), operated a natural gas pipeline between Alberta and Ontario. Its facilities included a compressor station that produced exhaust gas as part of the natural gas transmission process ("waste heat"). Potter Station Power ("Potter Power") entered into an agreement with TransCanada giving it the exclusive right to purchase the waste heat produced by the compressor station. The indemnity in the agreement stated:

10. Potter Power shall indemnify and save harmless TransCanada from and against all liability, actions, claims, losses, costs and damages which may be brought against or suffered by TransCanada and which TransCanada may incur, sustain or pay arising out of or in connection with:
 - (a) construction, operation and maintenance of the Facility (including the Duct System);
 - (b) the negligence or willful misconduct of Potter Power, its directors, officers, employees, agents, servants, contractors and subcontractors arising out of or incidental to this Agreement; or
 - (c) a breach by Potter Power of any of the terms and conditions set forth in this Agreement,

except to the extent that such losses or damages, result from the negligence or willful misconduct of TransCanada.

(emphasis added)

TransCanada's compressor station was damaged when the land on which it was situated subsided. Relying on the indemnity clause, TransCanada issued a statement of claim against Potter Power. It alleged that Potter Power caused the subsidence which damaged the station by

removing groundwater from an underlying aquifer in order to operate the Facility. Potter Power added its insurer as a third party. The insurer brought a summary judgment application to dismiss the action. The insurer argued that the indemnity clause only applied *to claims brought by third parties*. It argued that the clause did not cover first party losses (*i.e.*: damages suffered by TransCanada directly).

The Court of Appeal liberally interpreted the indemnity clause as extending to claims for damage caused to TransCanada by Potter Power directly. The Court of Appeal distinguished *Mobil Oil Canada Ltd. v. Beta Well Service Ltd.* (1974), 43 D.L.R. (3d) 745 (A.B.C.A.), *aff'd* 50 D.L.R. (3d) 158 (S.C.C.), where the indemnity clause was interpreted as being restricted to third party claims. The Court of Appeal noted that the Mobil Oil clause provided:

[Beta] shall be liable for and shall indemnify and save harmless Mobil Oil of and from all manner of actions, causes of action, proceedings, claims, demands, loss, costs, damages and expenses whatsoever which may be brought or made against Mobil Oil or which it may sustain, pay, or incur as a result of or in connection with the performance, purported performance or non-performance of this agreement or other work hereunder by [Beta] ...

By contrast, the indemnity in this case provides:

10. Potter Power shall indemnify and save harmless TransCanada from and against all liability, actions, claims, losses, costs and damages which may be brought against or suffered by TransCanada and which TransCanada may incur, sustain or pay arising out of or in connection with:
 - (a) construction, operation and maintenance of the Facility (including the Duct System).

The Court held that the key difference between the two provisions is the words “which may be brought against or suffered by” in the indemnity. The Court also distinguished *Mobil Oil* on the basis that the drilling contract at issue in that case contemplated that the contractor would perform its work in a good and workmanlike manner. This contractual standard of performance was inconsistent with the absolute liability created through the indemnity clause.

The Court of Appeal held that the indemnity clause in this case was not ambiguous. It agreed, at para 27, with the chambers judge that the wording is “appropriately read more broadly than simply the claims by third parties”. It dismissed the appeal.

This case illustrates the importance of considering risk allocation in contracts and drafting indemnity provisions that are consistent with the allocation. Indemnity clauses are not necessarily limited to third party claims. Instead, they may impose absolute liability for damages caused by the contracting party.

5. Breach of Warranty

The interpretation of warranty clauses was considered in *Levy v. Elmer Lohnes Lumbering Ltd.*, [2004] N.S.J. No. 329 (S.C.). The issue was whether a one year warranty limited rights of recovery beyond the one year period. The plaintiff Levy contracted with the defendant Elmer Lohnes Lumbering Ltd. to construct a motel building. The Court found that the installation of Maibec siding by the contractor was not in accordance with the manufacturer's instructions. The problems with siding deterioration, leakage, cupping and cracks in the siding, nails popping out and spongy window sills were all defects of the same cause, namely, the improper installation of Maibec siding which permitted moisture to build up behind the siding. The plaintiff sued for breach of contract and negligence arguing that the contractor breached its obligation to perform the work in a workmanlike manner. Lohnes had provided a one year builder's warranty with respect to the work. In clause 2(b) of the Builder's Warranty section of the Warranty Certificate, the contractor agreed:

to repair the defects in workmanship in the construction of the home and to repair or replace defective material and appliances supplied by the builder, when such later defects become apparent within one year of the date of possession of the home.

The defendant contractor argued that the owner's claim was barred because it was beyond the one year warranty period. The Court disagreed. The Court held that the warranty did not limit the owner's rights of recovery, but was *in addition* to the normal rights of recovery for breach of contract. The Builder's Warranty did not preclude or bar the owner's normal rights of recovery for breach. The Court explained:

¶ 47 . . . As noted in Hudson's Building and Engineering Contracts, *supra*, in the absence of express provision, the remedy under clauses like 2(b) are "in addition to and not in substitution for the common law rights and even where the defects have appeared within the period, the owner may sue for damages rather than call in the contractor to do the work, subject, in that event, to the possibility

of the owner's damages being limited, if he has acted unreasonably ..., to the costs to the contractor of doing the work at that time, rather than the possibly greater costs of bringing in another contractor either then or at a later date." I am satisfied that clause 2 (b) as drafted has nothing to do with limiting the common law rights of Levy to damages for breach of contract.

Therefore, the warranty was in addition to, not in substitution for, the common law rights. However, in assessing the damages Stewart J. found that Levy failed to mitigate its loss and reduced the award accordingly. This illustrates that unless expressly stated otherwise, a warranty does not necessarily limit a right of recovery for breach of contract. Instead, it is in addition to the other rights.

6. Election Clause

In *VSA Highway Maintenance Ltd. v. British Columbia*, [2004] B.C.J. No. 718 (C.A.), the British Columbia Court of Appeal interpreted the meaning of an "election clause". VSA Highway Maintenance Ltd. ("VSA") had a contract with the Province of British Columbia for highway maintenance and repair. This contract required VSA to carry out repair work up to a maximum cap of \$25,000. For work beyond the cap, the Province had the option of either electing to use VSA or another contractor. The election clause provided:

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- d) If it is estimated by the Contractor that at any particular location or Emergency Site, for any single occurrence of a flood or washout affecting the Traveled Lanes, the costs associated with the repair of the Highway ... exceed \$25,000, then the following will apply:
 - (i) the Contractor will immediately notify the Province and provide an estimate in writing of the costs associated with repair; and
 - (ii) the Contractor will continue to perform the repair to a maximum of \$25,000 as set out in section B.2.c) of this Maintenance Standard until notified by the Province to cease; and either
 - (iii) the Province may elect to cause another contractor to complete the work; or

(iv) the Province may elect to cause the Contractor to complete the work

(emphasis added)

In this case the Province did neither. Instead, it did the work itself using subcontractors. VSA sued the Province. The trial judge held that pursuant to the election clause, the Province was required to only use either VSA or another contractor. It was not entitled to do the work itself. In doing so the Province breached its contract with VSA. The Court of Appeal agreed. It also rejected the Province's argument that the election clause was satisfied by using contractors under the general direction of the Ministry of Transportation and Highways. The appeal was dismissed.

Note: In *VSA Highway Maintenance Ltd. v. British Columbia*, [2006] B.C.J. No. 873, 2006 BCSC 607 the plaintiff highway maintenance company was awarded \$730,000 in damages in compensation for the profits they lost when the defendant Province breached a contract containing a similar election clause requiring the Province to either use the plaintiff or another contractor to perform the highway repairs.

7. “Partnering” Provisions

In *EBC Inc. v. New Brunswick*, [2005] N.B.J. No. 428 (Q.B.) the New Brunswick Court of Queen's Bench considered the effect of partnering provisions. EBC was awarded a \$9,660,000 contract by the Province of New Brunswick to build a new wharf and ferry terminal. The contract contemplated the construction of four large concrete caissons. The Province used “in-house” engineers. Problems arose with the LASF concrete mix and the contractor incurred additional costs. EBC sued the Province alleging that the Province's engineers negligently failed to specify a concrete mix with accelerator admixtures for the slip form method of construction of the caissons in winter conditions. The Province argued that EBC was free to choose any method of construction and should have done its own engineering analysis to determine what admixtures or other costs might be involved in that method of construction.

The Court found that the Province had experience with LASF concrete, which was a relatively new and unusual product. A senior engineer with the Province knew that the

construction schedule would entail slip form method of construction of the caissons with LASF concrete in winter conditions and that accelerators would have to be used with LASF. However, this was not disclosed to EBC.

The Court considered two Supreme Court of Canada decisions setting out two competing principles. The first was *Edgeworth Construction Ltd. v. N.D. Lea & Associates Ltd.*, [1993] 3 S.C.R. 206. The Supreme Court of Canada stated at para. 9:

The engineers undertook to provide information (the tender package) for use by a definable group of persons with whom it did not have any contractual relationship. The purpose of supplying the information was to allow tenderers to prepare a price to be submitted. The engineers knew this. The plaintiff contractor was one of the tenderers. It relied on the information prepared by the engineers in preparing its bid. Its reliance upon the engineers' work was reasonable. It alleges it suffered a loss as a consequence. These facts establish a prima facie cause of action against the engineering firm.

This supported EBC's argument that a prima facie cause of action exists where a bidder prepares its bid in reliance on information provided by the engineers. In this case the information did not state that an accelerator would be necessary.

However, in *Auto Concrete Curb Ltd. v. South Nation River Conservation Authority*, [1993] 3 S.C.R. 201, the Supreme Court of Canada stated at para 5:

It has long been established that, barring specific arrangements to the contrary, the method by which a contractor chooses to execute the work falls within its sphere of responsibility, and that neither the owner nor the design professionals employed by the owner have a duty to advise the contractor as to what method to choose, or how to go about accomplishing the work by whatever method the contractor in fact chooses.

Therefore, barring specific arrangements to the contrary the contractor is free to choose the method of work and the owner does not have a duty to advise the contractor as to what method to choose. The Province relied upon this authority, arguing that EBC was free to choose any method of construction. The Court dismissed this argument and found there to be significant evidence to show that a partnering agreement had been entered into. The standard conditions in the contract contained "partnering" provisions. These included:

961.1.1 The concept of Partnering is to develop a proactive effort and spirit of respect, trust and cooperation among all key players in a Contractual relationship. It utilizes a structured systematic methodology for developing a spirit of teamwork and cooperation through shared goals, open communication, problem identification and resolution, conflict escalation procedures and the monitoring of team performance.

...

961.3.1 In order for the partnering process to succeed, the Contractor and the Owner, with a positive commitment to honesty and integrity, agree to the following mutual objectives

- .1 Each will function within the laws and statutes applicable to their duties and responsibilities.
- .2 Each will assist in the other's performance.
- .3 Each will avoid hindering the other's performance.
- .4 Each will proceed to fulfil its obligation diligently.
- .5 Each will cooperate in the common endeavour.

The Court concluded that partnering provisions were “specific arrangements to the contrary” as contemplated in *Auto Concrete*. The Court explained:

¶ 18 Accordingly I find that item 961 of the Standard Conditions and the 16 pages of material from the workshop on partnering emphasize the themes of partnership, trust, cooperation, assistance and communication. That 'partnering' in my opinion contradicts the Province's present contention that it was "not my job" to disclose to the contractor what the Province's engineers knew about slip forming LASF concrete in winter conditions. In the words used by the Supreme Court in *Auto Concrete*, cited earlier, those partnering provisions and obligations appear to be "specific arrangements to the contrary" of the general rule reiterated in that case.

Therefore, as partners, the Province could not claim that it had no responsibility to disclose to the contractor what the Province’s engineers knew about slip form construction using LASF concrete in winter conditions. The Province negligently misrepresented, by its silence, to EBC that an accelerator would not be necessary. It was held liable to compensate EBC for the additional costs of accelerator admixture and half of the testing expenses.

8. Liquidated Damages/Owner's Delay

An interesting issue arises with respect to liquidated damage clauses in contracts. If a liquidated damages clause requires the contractor to pay a predetermined amount in the event of delay, but the delay is attributable to the owner, is the contractor still required to pay? What if the delay is only partially attributable to the owner? What is the effect on the liquidated damages clause?

Traditionally, it is very difficult to claim under a liquidated damage clause. They are inherently fragile. *Hudson's Building and Engineering Contracts* (1995: Sweet & Maxwell) provides an excellent overview of the law. There are various ways in which a liquidated damages clause can become ineffectual. One of these is an act of prevention or breach of contract by the owner, even if this causes only a small part of the total delay. Such acts will invalidate a liquidated damages clause, leaving the owner to prove its damages at large. However, this can be avoided if there is a clear and specific extension of time clause which applies to delay by an owner. Interestingly, the extension of time clause is for the owner's benefit and can be used to protect its rights to liquidated damages under the liquidated damages clause (see *Hudson's* pp. 1146-1159). To be effective this clause must be sufficiently specific to apply to delays caused by the owner. If the owner has the right to extend time, and exercises it, this can protect the liquidated damages clause. If the time is not extended, and delay is attributable to the owner, the owner cannot rely on the liquidated damages clause. It does not matter whether or not the contractor is also responsible for the delay. *Hudson's* explains at p. 1147:

It is essential for the understanding of the cases below to appreciate that the courts in the nineteenth century viewed any liquidated damages clause as probably being *in terrorem* and with the greatest dislike, and were ready to hold that it was invalidated by virtually any event not expressly contemplated by the contract and not within the contractor's sphere of responsibility. Against that background, an extension of time clause, which might prima facie appear to be inserted for the benefit of the contractor, would more properly be regarded as being for the benefit of the owner, since in a case of prevention or breach by the owner it would serve to keep alive a liquidated damages clause which otherwise, under the strict rules developed by the courts, be held to be invalidated, provided that by its terms it enabled time to be extended for the breach or act of prevention in question. For this reason, extension of time clauses were themselves most strictly construed, and only if a sufficiently explicit intention could be found for them to be operated

in the particular circumstances involving prevention or breach by the owner or his A/E [architect/engineer] would they be permitted to save the liquidated damages clause where such circumstances had occurred. In particular, generalised grounds for an extension of time such as “any matter beyond the control of the contractor” or “any matter such as fairly to entitle the contractor to an extension of time” were held not to cover acts of prevention or breach by the owner. Paradoxically, therefore, while so construed they appeared to deny the contractor an extension for a matter outside his control, and so to be adverse to his reasonable interest, such interpretations in fact greatly benefited him by striking down the clause in cases of prevention or breach.

(emphasis added; footnote omitted)

This analysis involves the interaction between these two clauses (*i.e.*, extension of time and liquidated damages). See: *Hudson’s Building and Engineering Contracts* (1995: Sweet & Maxwell) (pp. 1146-1159, Time for Performance (Ch. 9), Penalties and Liquidated Damages (Ch. 10), Extension of Time (pp. 1172-1195)); *Holme v. Guppy* (1838), 3 M & W 387; *Ottawa Northern & Western Railway Co. v. Dominion Bridge Co.* (1905), 36 S.C.R. 347; *Hawl-Mac Construction Ltd. v. Campbell River (District)*, [1985] B.C.J. No. 2758 (S.C.); *Perini Pacific Ltd. v. Greater Vancouver Sewerage* (1966), 57 D.L.R. (2d) 307 (B.C.C.A.); *aff’d on other grounds* [1967] S.C.R. 189; *N.B.C. Mechanical Inc. v. A.H. Lundberg Equipment Ltd.*, [1998] B.C.J. No. 2736 (S.C.); *aff’d* [1999] B.C.J. No. 2993 (C.A.).

9. Dispute Resolution

The effect of an arbitration clause in a construction contract was recently considered by the Court of Appeal in *Babcock and Wilcock Canada Ltd. v. Agrium Inc.*, [2005] A.J. No. 171 (C.A.). Babcock & Wilcock (“B & W”) entered into a contract to perform construction work for Agrium Inc. (“Agrium”). The contract contained the following arbitration clause:

Any dispute or difference arising between the parties hereto as to the construction of this Agreement, the rights, duties or obligations of either party hereunder or any matter arising out of or concerning the performance of the Work by or the compensation to the Contractor, in accordance with the terms and conditions hereof, shall be submitted to arbitration and settled by the award of a single arbitrator.

(emphasis added)

In September 1999 a number of disputes arose between the two parties. The parties agreed that any unresolved issues would be settled by arbitration after B & W completed the project. The work was completed on October 2, 1999. On September 25, 2001, B & W filed, but did not serve, a statement of claim seeking additional compensation from Agrium. On May 14, 2002, B & W served Agrium with a notice of arbitration. B & W served Agrium with its statement of claim on May 23, 2002. Agrium applied to strike the notice of arbitration and statement of claim. Agrium argued that the statement of claim could not proceed because s. 7 of the *Arbitration Act*, R. S. A. 2000, c. A-43 mandates that a court must stay a court proceeding when the parties have agreed that the matter in dispute shall be submitted to arbitration. Agrium also argued that the notice of arbitration should be dismissed because it was not commenced within the two year limitation period set out in the *Limitations Act*, R.S.A. 2000, c. L-12.

The chambers judge held that since B & W did not commence the arbitration until May 14, 2002, it was barred by the two year limitation period. B & W did not appeal this finding. However, the chambers judge dismissed Agrium's application to strike the statement of claim. In her opinion, the *Arbitration Act* did not make arbitration a condition precedent to litigation unless the parties used express language to that effect (known as a *Scott v. Avery* clause). Agrium appealed this decision.

The Court of Appeal allowed Agrium's appeal. It considered whether amendments to the *Arbitration Act* in 1991 required this express wording or whether it made arbitration a condition precedent to litigation where the parties agreed to submit their disputes to arbitration. The Court held that s. 7 of the new *Arbitration Act* uses mandatory language and a court "shall" stay parallel litigation, except in five narrow circumstances. Section 7 states:

- 7 (1) If a party to an arbitration agreement commences a proceeding in a court in respect of a matter in dispute to be submitted to arbitration under the agreement, the court shall, on the motion of another party to the arbitration agreement, stay the proceeding.
- (2) The court may refuse to stay the proceeding in only the following cases:
 - (a) party entered into the arbitration agreement while under a legal incapacity;
 - (b) the arbitration agreement is invalid;

- (c) the subject-matter of the dispute is not capable of being the subject of arbitration under Alberta law;
- (d) the motion to stay the proceeding was brought with undue delay;
- (e) the matter in dispute is a proper one for default or summary judgment.

(emphasis added)

The Court of Appeal explained the new Act as follows:

¶ 12 In summary, s. 7(1) of the Arbitration Act makes arbitration a condition precedent to litigation when the parties have agreed their disputes shall be submitted to arbitration, and the previous distinction between ordinary arbitration clauses and Scott v. Avery clauses no longer exists. In those circumstances, a court must stay parallel litigation, unless the narrow exceptions contained in s. 7(2) apply. Parties to an arbitration agreement, like parties to any contract, can agree that arbitration is not mandatory. But unless they use appropriate permissive language, s. 7 applies. In this case the parties used mandatory language and none of the s. 7(2) exceptions apply. Because the underlying arbitration is statute-barred, the statement of claim should be dismissed.

(emphasis added)

B & W raised three alternative arguments to support its right to litigate the action against Agrium. First, it argued that the issues raised in the statement of claim were beyond the scope of the arbitration clause. Second, it argued that the correct interpretation of the arbitration agreement was that arbitration was only available during the course of construction, not after. Third, it argued that pursuant to s. 6(c) of the *Arbitration Act*, it would be manifestly unfair to deny B & W the right to proceed with its statement of claim since the limitation period had expired for arbitration and B & W would have no other recourse.

The Court of Appeal rejected these arguments. According to the arbitration agreement between B & W and Agrium, matters to be arbitrated were not restricted to contractual claims, but extended to disputes about the rights, duties or obligations of the parties, the performance of the work and B & W's compensation. The arbitration clause was therefore broad enough to include both the contract and tort claims set out in B & W's statement of claim. The arbitration agreement did not support the interpretation that the parties only intended to invoke arbitration to resolve disputes while construction was ongoing. Finally, it was not manifestly unfair to deny

B & W the right to proceed with its statement of claim even though it would be left no recourse. A limitation period by its nature always has the consequence of denying a party recourse. This is not manifestly unfair.

This case signifies that arbitration agreements will be given full force by the courts even if doing so results in a claim being barred. A mandatory arbitration clause can make arbitration a condition precedent to litigation, which if not followed could result in the claim being barred. The wording of arbitration clauses must be given careful consideration as this decision gives them teeth.

10. Conclusion

The cases outlined in this paper illustrate the need to carefully consider the particular wording of the contractual provisions in question. It is dangerous to rely strictly upon legal generalizations. Common assumptions about the effect of particular clauses may not apply. These cases illustrate the courts' willingness to examine the particular wording of the provision in question to determine its effect. For example, in *Westridge* and *Lombard* the CGL policies applied to damage caused to the construction itself. In *Potter Station Power*, unlike other cases, the indemnity provision was not restricted to third party claims. In *Elmer Lohnes Lumbering*, the one year warranty did not restrict the right to recover at common law beyond this period. In *Babcock & Wilcock* the mandatory arbitration provision was indeed mandatory. These highlight the importance of careful drafting. However, the case of *Graham* indicates that in the tendering context all may not be as it seems. Understanding these different approaches to interpretation is necessary in order to implement an effective contracting strategy.

