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IN THIS ISSUE FEBRUARY 2010

- >> CASE NOTE - *TERCON V. BRITISH COLUMBIA* 2010 SCC4
- >> FACILITY NAMING RIGHTS: WHAT HAPPENS WHEN HYPE IS GREATER THAN REALITY
- >> LIMITATIONS ISSUES IN CONSTRUCTION LAW: CALCULATING LIMITATION PERIODS FOR CONTRACTUAL INDEMNITY PROVISIONS
- >> CONTACT US

CASE NOTE – *TERCON V. BRITISH COLUMBIA* 2010 SCC4

BY PETER D. BANKS

In the recent decision of *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways)*, 2010 SCC 4, the Supreme Court of Canada dealt with the important issue of exclusion of liability clauses in the tendering context.

This case involved a Request for Proposals by the Province of British Columbia for the Kincolith project to construct a section of \$35 million highway. Initially, the project was intended to cover both design and construction. The Province issued a Request for Expressions of Interest (“RFEI”). The Province changed its mind and decided to design the project itself and issued a Request for Proposals (“RFP”) for the construction of the project only. Pursuant to the RFP it was contemplated that only the original six eligible bidders under the RFEI would be eligible.

In Canada, the law of tendering is governed by the Contract A/Contract B analysis set out in *Ontario v. Ron Engineering & Construction (Eastern) Ltd.*, [1981] 1 S.C.R. 111. This involves two distinct contracts *i.e.*, Contract A and Contract B. Contract A is the tendering contract. Contract B is the substantive construction contract. The terms of Contract A are determined by the

terms of the tender documents and the intention of the parties. Terms typically implied in Contract A are the obligations of an owner to accept only a tender that complies with the tender documents and to treat all tenderers fairly and equally.¹

The Province’s RFP contained an express exclusion of liability clause which stated:

2:10 . . . Except as expressly and specifically permitted in these Instructions to Proponents, no Proponent shall have any claim for compensation of any kind whatsoever, as a result of participating in this RFP, and by submitting a Proposal each Proponent shall be deemed to have agreed that it has no claim.

Tercon Contractors Ltd. (“Tercon”) submitted a proposal for the project. Its rival in the bidding process Brentwood Enterprises Ltd. (“Brentwood”) also submitted a proposal. Brentwood was an eligible bidder as it had participated in the RFEI, but it had entered a pre-bidding arrangement to form a joint venture with a party who had not participated in the first round and was therefore not eligible as a bidder itself. The Province awarded the project to Brentwood.

Tercon sued the Province claiming that the Province breached Contract A (*i.e.*, the tendering contract) by awarding the project to an ineligible bidder and sought damages for lost profit.

The trial judge found that the Province breached Contract A and that the RFP’s exclusion of liability clause was ambiguous and did not protect the Province from Tercon’s claim for damages. The trial judge awarded Tercon damages in excess of \$3.2 million.²

The Court of Appeal overturned the trial judge. In a short decision, it held that the exclusion of liability clause

¹ The Contract A/Contract B principles can apply to the RFP context. This case at the trial level raised the interesting question concerning RFP vs. tender. See: 2006 BCSC 499 at paras. 78 – 95.

² 2006 BCSC 499

was clear, unambiguous and effectively barred Tercon's claim.³

In a 5-4 split, the Supreme Court of Canada overturned the Court of Appeal. Both the majority and dissent agreed on the general analytical framework to be applied in addressing the issue of exclusion of liability clauses, but divided on the interpretation of the clause itself.

The general analytical framework is as follows:

1. First, as a matter of contractual interpretation, does the exclusion clause in question apply to the circumstances of the case?
2. Second, if the exclusion clause does apply, is the exclusion clause unenforceable because it was unconscionable at the time the contract was entered?
3. Finally, are there any overriding public policies based upon which the Court should refuse to enforce the otherwise valid exclusion clause?⁴

Justice Cromwell, for the majority, narrowly interpreted the exclusion clause and concluded that it did not apply to the circumstances of this case. The majority emphasized the "special commercial context of tendering" and the idea that "[e]ffective tendering ultimately depends on the integrity and business efficacy of the tendering process".⁵ According to the majority, the eligibility requirements of the RFP were at the "very root of the RFP".⁶

Based upon the premise that the RFP was intended for eligible bidders only, and the special context of the case, the majority interpreted the words "participating in this RFP" as meaning participating in the contest among those eligible to participate only. According to the majority, participating in a process involving ineligible bidders is not "participating in this RFP" (emphasis added). As such, the exclusion clause does not protect the Province from accepting a bid from an ineligible

³ 2007 BCCA 592

⁴ Consistent with the foreshadowing in an increasing number of earlier cases, the Supreme Court finally laid the old doctrine of fundamental breach to rest. This analytical framework was set out by Justice Binnie at paras. 122-123. Although writing for the dissent, Justice Binnie's formulation of the analytical framework was accepted by the majority (see: para. 62). The burden of establishing that the clause ought not to be enforced because of an overriding public policy is on the party seeking to avoid its enforcement.

⁵ para. 67

⁶ para. 70

bidder as that is not a claim arising from "this RFP". Justice Cromwell explained:

[74] I turn to the text of the clause which the Province inserted in its RFP. It addresses claims that result from "participating in this RFP". As noted, the limitation on who could participate in this RFP was one of its premises. These words must, therefore, be read in light of the limit on who was eligible to participate in this RFP. ... Thus, central to "participating in this RFP" was participating in a contest among those eligible to participate. A process involving other bidders, as the trial judge found the process followed by the Province to be, is not the process called for by "this RFP" and being part of that other process is not in any meaningful sense "participating in this RFP".

Clear language is needed to exclude liability for breach of such a fundamental element of the process. Justice Cromwell explained that eligibility of the bidders was a key element of the process and it seemed unlikely that the parties intended through this exclusion clause to "effectively gut" a key aspect of the process.⁷

Consequently, "this RFP" was interpreted as not including a process with ineligible bidders and, as such, the clause did not protect the Province from Tercon's claim. According to the majority "[t]his interpretation of the exclusion clause does not rob it of meaning, but makes it compatible with other provisions of the RFP."⁸

Alternatively, the majority stated that if its interpretation is wrong, it would have concluded that the language is at least ambiguous and would apply the principle of *contra proferentem*.⁹

The strong dissent of four judges refused to accept the majority's interpretation of the RFP's exclusion clause. Justice Binnie stated the fundamental issue as follows:

[85] The appeal thus brings into conflict the public policy that favours a fair, open and transparent bid process, and the freedom of contract of sophisticated and experienced parties in a commercial environment to craft their own contractual relations. I agree with Tercon that the public interest favours an orderly and fair scheme for tendering in the construction industry, but there is also a public interest in

⁷ para. 72

⁸ para. 76

⁹ para. 79

leaving knowledgeable parties free to order their own commercial affairs. In my view, on the facts of this case, the Court should not rewrite — nor should the Court refuse to give effect to — the terms agreed to by the parties.

Justice Binnie stated:

[93] ... Contract A continues to be based not on some abstract externally imposed rule of law but on the presumed (and occasionally implied) intent of the parties. Only in rare circumstances will the Court relieve a party from the bargain it has made.

[94] As to implied terms, M.J.B. emphasized (at para. 29) that the focus is “the intentions of the actual parties”. A court, when dealing with a claim to an implied term, “must be careful not to slide into determining the intentions of reasonable parties”. Thus “if there is evidence of a contrary intention, on the part of either party, an implied term may not be found on this basis”.

Justice Binnie accepted that the Province breached the terms of its own RFP, but held the exclusion clause was clear and unambiguous. The words “participating in this RFP” applied to this case. The dissent was of the view that the process still continued to be this RFP notwithstanding that an ineligible bidder had entered it. The dissent noted:

[128] ... but the conclusion that the process thereby ceased to be the RFP process appears to me, with due respect to colleagues of a different view, to be a “strained and artificial interpretatio[n] in order, indirectly and obliquely, to avoid the impact of what seems to them *ex post facto* to have been an unfair and unreasonable clause”.

Further, the dissent pointed out that the majority’s interpretation would leave little room for clause to operate given that “[a]ssertions of ineligible bidders and ineligible bids are the bread and butter of construction litigation”. Justice Binnie stated:

[136] ... A more sensible and realistic view is that the parties here expected, even if they didn’t like it, that the exclusion of compensation clause would operate even where the eligibility criteria in respect of the bid (including the bidder) were not complied with.

The dissent ultimately concluded that “[w]hile there is a public interest in a fair and transparent tendering process, it cannot be ratcheted up to defeat the enforcement of Contract A in this case. There was an RFP process and Tercon participated in it.”¹⁰

Considering the remaining steps in the general analysis, the dissent concluded that the clause was not unconscionable at the time it was entered nor were there any overriding public policy reasons to cause the Court to decline to enforce it. The dissent pointed out that a contractor is free to decline to participate in a tendering process if it so chooses, and if enough contractors decline to participate the owner would necessarily be forced to change its terms. The dissent concluded by stating that “[s]o long as contractors are willing to bid on such terms, I do not think it is the court’s job to rescue them from the consequences of their decision to do so.”¹¹

This case will undoubtedly be seen as controversial for either side of the debate in an already extremely litigious area of the law. The case illustrates the classic conflict between the public policy that favours a fair, open and transparent bid process and the freedom of contract of sophisticated and experienced parties in a commercial context. The majority’s interpretation of the exclusion clause clearly favoured the policy of a fair, open and transparent tender process. The dissent favoured freedom of contract.

FACILITY NAMING RIGHTS: WHAT HAPPENS WHEN HYPE IS GREATER THAN REALITY

BY E. JANE SIDNELL AND JORDAN C. MILNE, CALGARY

The Montreal Forum, an arena entrenched in hockey folklore, was recently the subject matter of a far different precedent. Indeed, the Montreal Forum lies at the centre of the recent decision of the Québec Superior Court in *Forum Entertainment Centre Company v. Pepsi Bottling Group (Canada) Co.* (2008 QCCS 4672), a case with potentially far-reaching implications for real estate developers and operators alike.

In the late 1990s, the Forum Entertainment Centre Company (“Forum”) redeveloped the Montreal Forum from an abandoned hockey arena into a commercial entertainment complex consisting of shops, restaurants and a theatre. In connection with this redevelopment, Forum entered into a 15-year “exclusive supply

¹⁰ para. 135

¹¹ para. 141

arrangement" with Pepsi Bottling Group (Canada) Co. ("Pepsi"). Pepsi became the title sponsor for the complex and obtained "pouring rights" as the exclusive supplier of soft drinks. In exchange, Forum received annual sponsorship fees and a 38% commission payable on all soft drink sales. Underlying this arrangement was the mutual expectation, set out in the parties' contract, that Forum would operate the complex as a "first class entertainment facility".

Pepsi failed to make any payments to Forum and, in fact, purported to terminate the arrangement after the first year of the contract on account of the failure of Forum to achieve the threshold objective of a *first class entertainment facility*. In support of this allegation of failure, Pepsi pointed to the following facts:

- the opening of the complex was delayed by approximately one year;
- the complex was only leased to 50% of capacity;
- only one of three promised anchor tenants was delivered; and
- many of the tenants, namely Future Shop and SAQ, a liquor store, did not belong in a *first class entertainment facility*.

Forum sued for unpaid fees and commissions under the contract. Pepsi counterclaimed for termination of the contract on the basis of a fundamental breach, namely that Forum had breached its fundamental obligation to operate the complex as a *first class entertainment facility*.

The outcome of this case rested on the Court's determination as to whether the obligation to operate the complex as a *first class entertainment facility* was fundamental. Notwithstanding the presence of an "entire agreement" clause, the Court went beyond the four corners of the contract and considered extrinsic evidence to breathe life into its provisions. This extrinsic evidence included a wide volume of press releases, promotional materials, public statements and expert testimony.

Based upon its review of the evidence, the Court determined the following:

- the obligation to operate the complex as a *first class entertainment facility* was, in fact, fundamental to the contract; and

- the obligation to operate the complex as a *first class entertainment facility* related primarily to the character and diversity of the lessees.

The Court concluded that Forum did not attain the *first class* standard and found that the contract was terminated. Moreover, the Court signalled that Forum could not have avoided this outcome unless the fundamental breach, namely the failure to operate the complex as a *first class entertainment facility*, was wholly beyond its control.

In addition to the remedy of termination, the Court also lowered the sponsorship fees payable by Pepsi to Forum under the contract to 40%. In effect, this represents a finding as to the percentage of Pepsi's sponsorship dollars that Forum, through its unsatisfactory operation of the complex, had actually earned. Conversely, the commission payable on soft drink sales was left intact on the basis that it was unit-based, and not tied to the performance of Forum.

The decision in *Forum Entertainment Centre Company v. Pepsi* is presently under appeal to the Québec Court of Appeal. Until a decision is rendered on appeal, real estate developers and operators should consider that:

- developers may be held to their pre-contractual representations as to the intended quality or character of a project, particularly in relation to lessees; and
- the presence of an entire agreement clause will not necessarily preclude the Court from examining extrinsic evidence toward interpreting a developer's representations.

LIMITATIONS ISSUES IN CONSTRUCTION LAW: CALCULATING LIMITATION PERIODS FOR CONTRACTUAL INDEMNITY PROVISIONS

BY PETER A. K. VETSCH

Construction disputes in Alberta, like all other personal or commercial disputes arising in the province, are subject to the Alberta *Limitations Act*, which limits the time within which a plaintiff can commence litigation or arbitration proceedings to enforce a claim. The Act provides that a claimant must commence proceedings within two years of the time that it first knew, or ought to have known, that (1) it had suffered an injury, (2) the injury was attributable to the conduct of the defendant, and (3) the injury warranted bringing a proceeding. Limitation periods for construction claims are calculated

based on when these three requirements are met. However, this calculation process, and the determination that arises out of it, is rarely straightforward and can be complicated in the construction context depending on how the plaintiff frames its cause of action and whether there is anything in the contract between the parties to the claim that impacts how and when the claimed injury is discoverable.

The recent Alberta decision of *Penhold (Town) v. Boulder Contracting Ltd.*¹², although a lower-level authority, provides an important analysis of a limitations issue that is rarely discussed in construction law jurisprudence but that could potentially have a significant effect on the interpretation and impact of contracts throughout the industry: the calculation of limitation periods for claims based on contractual indemnity provisions. The plaintiff municipality in this case attempted to extend its time for commencing a proceeding in a construction deficiency dispute with the defendant contractor by characterizing its cause of action as a claim in indemnity and arguing that its indemnifiable loss did not arise for limitations purposes until it had actually paid funds out of pocket to remedy the deficiencies. The Court ultimately refused to allow the owner's limitation period to be extended in this fashion.

The Town of Penhold had entered into a contract with Boulder Contracting, the defendant contractor, in July 2001 for the installation of water and sewer mains in a new subdivision. The contractor completed work in the fall of 2001, but in the spring of 2002, the pavement in the subdivision began to crack and settle in locations where the contractor's work had been performed. The Town and its engineer immediately attributed this settlement to deficiencies in the contractor's work and demanded that the defendant remedy these defects and the resultant damage pursuant to its contractual warranty obligations, which required it to perform such remedial work for a two-year period after substantial completion. The contractor denied that it was responsible for the pavement settlement, and after years of further demands, the Town arranged for its engineer to conduct an on-site inspection of the damage in June 2005. The engineer issued a written report specifically outlining all observed deficiencies and the remedial work required to fix them, again concluding that all such defects were attributable to the contractor. The defendant took no steps to repair the deficiencies, and as a result, Penhold retained and paid another contractor to complete remedial work in September 2007. Penhold then commenced litigation and arbitration

proceedings against Boulder for the cost of this remedial work in December 2007.

Boulder immediately took the position that Penhold's proceedings were statute-barred by the *Limitations Act*, as Penhold had first discovered the deficiencies over five years before it commenced proceedings and its engineer had formally described and attributed the defects to Boulder two and a half years before Penhold brought its claim. The contractor therefore argued, and the Court agreed, that the Town's warranty claim was commenced more than two years after Penhold knew it had suffered an injury, had attributed it to Boulder and knew that it was sufficiently serious to warrant bringing proceedings, which took it beyond the two-year limitation period. However, the contract between Boulder and Penhold also contained an indemnity provision which stated that the contractor would indemnify the Town from and against "all claims...losses, costs, damages...payments, recoveries or judgments of every nature and description arising out of or which may be attributable to the contractor's performance of the contract." Penhold argued that the defendant's defective performance of its contractual obligations resulted in the Town having to incur repair costs to a third party contractor and that the payment of these costs triggered the indemnity provision and gave rise to an obligation on the part of the defendant to reimburse the Town for such costs. It further argued that this obligation did not arise for limitations purposes until the remedial costs had actually been physically paid out by Penhold in September 2007, which was only three months before it commenced proceedings, well before the expiry of the limitation period. In support of this argument, Penhold relied on the 1988 Alberta Court of Appeal decision of *Fidelity Trust Co. v. 98956 Investments Ltd.*¹³, which stood for the proposition that, "[b]ecause the very nature of a contract of indemnity is that it is a reimbursement obligation for an amount of damages that has actually been suffered...no cause of action can even arise until the extent of the loss has been quantified."¹⁴

Master Laycock rejected Penhold's indemnity limitations arguments for two reasons. First, he held that the nature and extent of any claim by Penhold for indemnity for Boulder's deficient work had been sufficiently ascertained and determined by the June 2005 engineer's report, which specified all of the defects present at the subdivision and the work required to fix them. From this information, "[t]he cost to remediate was easy to determine by putting the work out to tender. This process could have been completed shortly after the completion of the report."¹⁴ The Town could not obtain

¹² 2009 ABOB 550 (Alta. Master).

¹³ (1988), 89 A.R. 151 (C.A.).

¹⁴ *Ibid.* at para 30.

the benefit of an extended limitation period simply because it unilaterally decided to wait over two years after the report was issued before actually incurring any remedial expenses. The Master refused to find that Penhold's limitation period started anytime later than June 2005, as such a finding "would permit the plaintiff, with full knowledge of its cause of action, to hold its limitation period in abeyance while it waited for the most opportune time to incur indemnity costs, thereby controlling the timing of its own limitation period."⁵ Fundamental to limitations regimes like Alberta's, which are based around the principles of discoverability, is the idea that a limitation period should be objectively calculable and should be beyond the ability of the plaintiff to manipulate once its claim is reasonably knowable.

In addition, the Master also held that the indemnity provision in the parties' contract was only intended to apply to liability claims by third parties and was not meant to apply to direct warranty claims for deficiencies. There was no express language in the indemnity clause to this effect, but the contract had established a separate framework to handle first party warranty claims: the warranty provision that set out a two-year warranty period within which the contractor was obligated to repair defective work. If warranty claims could also be advanced using the indemnity provision, which did not have a similar two-year expiry date, it would have made it possible for Penhold to claim for warrantable losses arising after the expiry of the contractual warranty period, which would render meaningless the warranty provision. The Court concluded that such an interpretation of the indemnity provisions would be "illogical" and that the only consistent interpretation of the contract was that the contractual indemnity was not meant to apply to warranty work. As a result, the indemnity clause in the contract did not allow Penhold to extend its limitation period for commencing proceedings beyond the standard two-year discoverability period provided in the *Limitations Act*.

The *Penhold* case is important for what the Court did **not** decide. If the Master had held that the indemnity provision in the parties' contract gave rise to a separate, independent limitation period that began to run, not when the Town's indemnifiable loss was first discoverable, but when the act of paying out indemnifiable expenses occurred, it would have created

a significant loophole in Alberta's statutory limitations regime that would have enabled parties to contracts with indemnity clauses to sit on stale claims until it was most beneficial for them to trigger their own limitation period. As it stands, parties considering making first-party indemnity claims should endeavour to do so based on the initial discoverability date of the injuries giving rise to an indemnifiable payment, regardless of when that payment was ultimately made.

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⁴ *Penhold, supra*, note 1 at para 15.

⁵ *Ibid.* at para 17.



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