GOODMANS UPDATE

Construction Law • What You Need To Know • Fall/Winter 2002

Ask...But You May Not Receive.

Livingston Excavation and Trucking Inc. v. *Maple Engineering and Construction Ltd.*

by Howard M. Wise

In the case of the *Livingston Excavation and Trucking Inc.* v. *Maple Engineering and Construction Ltd.*, a decision of the Ontario Superior Court of Justice released on May 28, 2002, the Court was required to deal with two issues, the first being whether or not a breach of contract had occurred between the plaintiff and defendant, and secondly, if a breach of contract did occur, the appropriate measure of damages suffered as a result of the breach.

The facts of the case are as follows:

1. In September, 1997, Maple Engineering and Construction Ltd. ("Maple") negotiated a contract with the Hamilton Harbour Commission to construct a pier in the Hamilton Harbour of Lake Ontario. The plaintiff, Livingston Excavation and Trucking Inc. ("Livingston") had done dredging work for Maple the year prior under a verbal contract at a different location.

2. From July, 1997 onward, the parties had discussions surrounding the Hamilton Harbour project and the form of contract to be entered into. Maple wanted a contract based on a price per metre dredged, but Livingston did not want to enter into a "unit price" contract.

3. The parties ultimately entered into some form of agreement to begin dredging operations of the Hamilton Harbour. Maple issued a purchase order and the work started the first week of March, 1998.

4. On March 9, 1998, the Project Manager for Maple advised Livingston that another company had been hired and that Livingston's equipment and operator were no longer required.

5. Livingston argued that it had an oral contract with Maple to provide the dredging services at an hourly rate of $140.00 per hour to continue until the work was complete. Livingston relied on the written purchase order as evidence to the oral agreement.

6. It was Maple's position that the contract was for hourly services only with no fixed duration.

After reviewing the evidence, and assessing the credibility of the witnesses, the Court concluded that there was in fact an oral contract which was confirmed by the purchase order. In making this determination and in determining the terms of the contract, the Judge went on to state:

> …I find the plaintiff has met its burden of proof establishing an oral contract that was subsequently fortified and con-

The construction industry is one of Canada's largest. It is one of the industries by which our economy is measured. From heavy equipment manufacturers to suppliers from subcontractors and general contractors to owners and developers changes in the industry can have a dramatic effect on day-to-day business.

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firmed by a written contract, in the form of the purchase order.

To establish the contract's purpose I have reviewed its context. That context includes many weeks of planning between the parties, negotiating and compromising various terms like overtime and the cost of mats, transporting a giant piece of equipment from the Simcoe area to Hamilton, and a request by Maple that the equipment be left on-site. Applying a "common sense", objective interpretation of the parties' intention and conduct within this context, I am satisfied that I can reasonably construe the nature of the contract.

Having concluded that there was in fact a contract between Livingston and Maple, the Court had to assess that the damages suffered as a result of the breach.

Livingston put forth expert testimony and argued that its claim for loss of profit should be based on the assumed number of days that the machinery would have worked multiplied by 10 hours per day. Livingston's expert then gave a credit against that amount for the assumed labour costs and fuel costs which would have been incurred in carrying out the work. However, the expert failed to factor in contingencies such as wear and tear, depreciation and down time.

In rebutting the claim for damages, Maple's expert argued that the damages should be calculated based on "industry" standards rather than the plaintiff's assessment which was tied to the terms of the contract and the breach.

The Court rejected Maple's argument and held that once the contract was established, the Court, in assessing damages, should base its calculation on the damages flowing from the breach rather than from "industry" standards.

The Court, in awarding the damages ultimately made its own assessment of the lost hours in determining the gross revenues earned. While evidence was led the number of hours worked by the replacement contractor was 1354 hours, the Court assessed the plaintiff's loss at 1000 hours at a rate of $140.00 per hour.

After determining the gross amount of the loss incurred by the plaintiff, the Court also considered the issue of mitigation of damages, contingency and other deductions from the gross profit.

The Court confirmed that it was appropriate to make a deduction from gross revenues based on the theory of mitigation and the assumed ability of the contractor to utilize the equipment elsewhere. In so doing, the Court affirmed the legal principal that an aggrieved party has a positive duty to mitigate its damages. As is apparent from this case, the Court appears willing to make a reasonable deduction to arrive at an appropriate amount for mitigation. The Court further confirmed that it was appropriate to make a further deduction for unforeseen difficulties which would have been incurred in carrying out the work. However, in assessing the damages of Livingston, the Court concluded that this had already been taken into account in the establishment of the lost hours.

While the plaintiff was successful in establishing the breach of contract, as is apparent from the assessment of damages, it received damages in an amount far less than it initially claimed. While an aggrieved party is entitled to the damages which flow as a result of the breach, it appears clear that the Courts will look at various factors in determining the appropriate amount for damages. Unforeseen contingencies, risk factors and mitigation issues can lead to a large reduction in a claim for loss of profit.

This should be considered when pursuing claims of this nature.

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Tendering: A Contractor's Rights and Obligations with Respect to Subcontractor Bids

by Kenneth Crofoot

The general contractor bid contains an amalgamation of its own estimating and pricing with that submitted by its subcontractors. The Courts have struggled with the issue of determining when the submission and acceptance of a contractor bid requires the contractor to enter into a subcontract with a particular subcontractor. No subcontractor wants to submit a bid which is carried by the general contractor to achieve acceptance, only to have some new party show up to undercut its price and obtain the subcontract. The Courts have basically considered the issue as one of determining when the tender terms and circumstances require the contractor to enter into a bid with a low bidding subcontractor or alternatively, the subcontractor carried in the general contractor's bid.

No consideration of this issue is complete without a review of the recent Supreme Court of Canada decision in *Nayler Group* v. *Ellis Don Construction* (2001), 204 D.L.R. (4th) 513, in which Ellis Don carried the Nayler bid in its contract, despite the fact that Nayler had an in-house union and there was an outstanding Ontario Labour Relations Board ("OLRB") decision pending as to whether Ellis Don would have to deal with an IBEW subcontractor. When the OLRB decision was released confirming Ellis Don's obligation to use only electrical subcontractors affiliated with the IBEW, Ellis Don attempted to offer the subcontract to Nayler based upon the condition that it align itself with IBEW. Nayler refused and Ellis Don then offered the work to another IBEW subcontractor for roughly the same price as had been bid by Nayler. The trial judge relied upon a line of cases, discussed further below, as the rules of contract formation, i.e., that there could be no contract until Ellis Don had communicated its acceptance of Nayler's bid to Nayler, which had never been done. The trial judge found that the contract for electrical work had been frustrated by the OLRB decision, which precluded Ellis Don from contracting with a non-IBEW subcontractor. The Court of Appeal, however, allowed the appeal on the basis that in exchange for binding itself to an irrevocable bid, Nayler acquired the right to be awarded the contract. The tender terms only allowed Ellis Don not to award the contract if there was a reasonable objection to the subcontractor. The Court found that Ellis Don's objection was not reasonable because it had "shopped" Nayler's bid and had failed to attempt to negotiate with the OLRB to allow the contract to proceed with Nayler.

In the Supreme Court of Canada, the Court accepted Ellis Don's argument that Ellis Don was not automatically obligated, upon acceptance of its bid, to award the contract to Nayler. In order for a construction contract to arise, Ellis Don had to notify Nayler of the acceptance of the subcontract bid. However, the Court also found that Ellis Don was obligated to notify Nayler of the acceptance of its subcontract bid unless it had a reasonable objection to the contract with Nayler. The Court found that there was no frustration of the contract between Ellis Don and Nayler because the OLRB decision was a foreseeable outcome to the parties at the time of the tender. The Court found Ellis Don's decision to carry Nayler instead of an IBEW contractor was done to assure itself a low bid and that it could not, therefore, escape from its obligation to Nayler merely because the OLRB decision had gone the wrong way. The Court, therefore, found that Ellis Don had not demonstrated to the Court that its objection to Nayler was reasonable.

The important result of *Nayler* is that most invitations to tender which require the identification of chosen subcontractors will result in an obligation by the contractor to award the contract to the named subcontractor as the result of *Nayler*. The only issue is whether the general contractor can demonstrate a reasonable objection after it has named a particular subcontractor. *Nayler* seems to have suggested that the basis for such a rejection would have to be based on some unknown issue which had arisen subsequent to the naming of the subcontractor, such as

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some inability to perform or a previously unknown financial problem.

The Supreme Court of Canada did not disagree with the general proposition that the subcontract only arises when the general contractor notifies the subcontractor of acceptance. As a result, it may still be possible that the tender terms permit the general contractor more latitude than was available under the tender terms in *Nayler* to substitute another subcontractor. It is necessary to closely review the terms of the invitation to tender to determine the parameters. There are a number of older cases which hold that the mere effect of carrying a subcontractor's price in a bid did not constitute an acceptance, conditional or otherwise, of the subcontractor's bid and did not create an obligation on the part of the contractor to award the subcontract to the subcontractor whose bid was carried. (See *Vipond Automatic Sprinklers* v. *E.S. Fox* (1996), 27 C.L.R. (2d) 311, *Bate Equipment* v. *Ellis Don* (1992), (Ont.Gen.Div.) 2 C.L.R. (2d) 157 and *Derrick Concrete* v. *Central Oilfield* (1994), 17 C.L.R. (2d) 120 (Alta.Q.B.).) All these cases may still be applicable where the invitation to tender terms can be distinguished from *Nayler* to provide a latitude for the general contractor to choose a subcontractor other than that carried in its bid. One can expect that where a bid shopping process has occurred however, the Court will not be particularly sympathetic to the contractor's position unless the invitation to tender terms are very clear that such a process was contemplated throughout.

The use of a bid depository and the ability to incorporate the bid depository rules is one practical way of monitoring dealings with respect to subcontractor bids and to make clear all parties' obligations.

Bid Depositories

In order to limit bid shopping with respect to subcontractor bids, many tenders utilize the facilities of a bid depository. A bid depository is a central facility, usually run by a local construction association, where the subcontract bids are filed and are available to all general contractors bidding. The invitation to tender typically requires that the bid depository be utilized and that its rules be applicable with respect to subcontracts. The rules of bid depositories are quite standard and usually require the general contractor to utilize the services of a subcontractor's bid which its utilizes. The invitation to tender will usually require the general contractor to name the subcontractor whose bid it has utilized. The bid depository rules also provide that the general contractor is required to award the subcontract in accordance with the invitation to tender documents. If CCDC contracts are in use, for instance, the only basis not to award the subcontract to a subcontractor whose bid is carried is if either the contractor or the owner have a reasonable objection under paragraphs 3.8.5 and 3.8.3, respectively. As a result, in most cases, *Nayler* has meant that the contractor can no longer take the position that its obligations to the carried subcontractor only arise when the acceptance letter has been sent. The sending of the acceptance letter, though required, is not a significant contractual event because the general contractor may very well be obligated to send it.

Once a bid depository is specified as required, all parties in the process must follow the rules. In *Ken Toby Ltd.* v. *B.C. Building Corp.* (1997), 34 C.L.R. (2d) 81 (B.C.S.C.), the plaintiff Subcontractor was the only bidder for masonry work. The owner issued a post-tender addendum requiring a cash allowance to be substituted due to its concern that the single bid was too high. As a result, the plaintiff's bid no longer had to be carried and the plaintiff was not awarded the subcontract. The owner's addendum was found to have breached the rules of the bid depository. The owner was considered to have owed the subcontractor a duty of care and was found liable to the subcontractor. An owner therefore should not specify use of a bid depository if it is not prepared to abide by the depository's rules.

There is no doubt that the use of a bid depository and the ability to incorporate the bid depository rules is one prudent method to police dealings with respect to subcontractor bids and to clarify the parties' respective obligations.

Negotiating The Best Contractual Deal

by Joseph Cosentino

Introduction

The terms and conditions of a contract are what create the legal obligations that flow between the parties. It is essential that one knows and understands what expectations exist between the various parties.

When negotiating a contract, extra care should be taken to ensure that contractual language is carefully reviewed and is the subject of discussion between the parties. One must not blindly accept standard form contracts presented to you for signature. These standard forms are typically slanted in favour of the party that has drafted the contract. Clauses which shift the risk in situations where this assumption of risk has not been expressly bargained for, are potentially problematic and must be at the forefront of the contractual review process. Negotiating a contract is an exercise in risk management. Properly structuring a contract is critical in evaluating and shifting as much of the risk as is reasonably possible to the other party. This article will briefly review some of the key "clauses of concern" when negotiating and entering contractual relations.

General Precautions

It is important to briefly set out some examples of "fine print" clauses that can cause difficulty for a contracting party after an agreement has been finalized.

Special attention should be given to situations where one is entering into contracts with large, sophisticated service providers. In these instances, the third party usually has a standard form of contract that they present for signature. These standard contracts have ordinarily been prepared by lawyers for the other party and may include several clauses that are "friendly" to the other party and that attempt to shift the majority of the risk.

Some of the above mentioned clauses may seem relatively harmless if read over quickly and without an understanding of what they mean. It is exactly these types of clauses that one must be careful of when contracting with outside parties. Giving proper consideration to these clauses before the contract is signed can pay off in the long run and should be considered the best kind of "preventative maintenance".

Insurance Considerations

If you know what kind of insurance coverage your owner, contractor or subcontractor carries, you know both how much of your loss the other party can carry and how much third party liability your owner, contractor or subcontractor (as the case may be) will be able to assume. Where possible, it is prudent to have the other party provide notice of the coverage that they carry, and to have that insurance coverage spelled out in your contract for services or equipment.

Consider, for example, a situation where an owner is contracting with a third party to perform some construction-related work on a building. In order to provide a degree of "safety", the contract may contain an insurance provision similar to the following, changed, of course, to be suitable to the particular circumstances:

> The Contractor shall provide, maintain, and pay for the insurance coverages specified herein. Unless otherwise stipulated, the duration of each insurance policy shall be from the date of commencement of the work until the date of the final completion of the work. Prior to commencement of the work and upon the placement, renewal, amendment, or extension of all or any part of the insurance, the Contractor shall promptly provide the owner with confirmation of coverage and, if required, a certified true copy of the policies, certified by an authorized representative of their insurer together with copies of any amending endorsements.
>
> **General liability insurance** — General liability insurance shall be in the joint names of the Contractor and the owner, with limits of not less than $3,000,000 per occurrence …

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Automobile liability insurance — Automobile liability insurance in respect of the Contractor's licensed vehicles shall have limits of not less than $2,000,000 inclusive per occurrence for bodily injury, death and damage to property, covering all licensed vehicles owned or leased by the Contractor …

Contractor's equipment insurance — "All risks" Contractor's equipment insurance covering machinery and equipment used by the Contractor for the performance of the work, shall be in a form acceptable to the owner and shall not shall allow subrogation claims by the insurer against the owner.

Other possible provisions to include when stipulating the form of Contractor's insurance are clauses that allow the owner to take out insurance on the Contractor's behalf and deduct the cost of that insurance from the contract amount (in the event that the Contractor fails to provide or maintain insurance coverage) and a clause that stipulates that the Contractor will use only insurance companies licensed to issue insurance in the Province of Ontario.

Know the Details of Your Contract

The "nitty gritty" clauses of a contract are often overlooked when focusing on the major points such as price, time to perform the work, scope of the work and payment provisions. However, as the saying goes, people often get "tripped up" in the details. Some measures that you can take for ensuring predictability in your legal relations are the inclusion of the following types of clauses:

'Four Corners' Clause. Such a clause will help ensure that you are not taken to have made any representations or warranties beyond those expressly stipulated within the 'four corners' of the written contract.

An example of this type of clause is as follows:

> The contract contains the entire agreement of the parties hereto with respect to the work and supersedes all prior agreements and understandings, oral or written with respect thereto and cannot be modified or amended except by written agreement signed by the parties hereto.

'Jurisdiction' Clause. A clause of this type will ensure that your contract is governed by the laws of Ontario. If your contract does not expressly provide for interpretation according to Ontario law, then depending where the contract was signed and the residency of the other party, you may find the contract being interpreted according to foreign laws or enforced in a foreign jurisdiction.

An example of a jurisdiction clause is as follows:

> The laws of the Province of Ontario shall govern the work performed under this contract.

Local Law Compliance Clause. If your contracting party fails to abide by local workers compensation standards or to obtain the necessary licenses and permits, you introduce an interested third party into your contract — the government. You will lose control over enforcement of elements of your agreement with the outside service provider. Have your contractor warranty that it will comply will all relevant local laws.

The following example will illustrate what is meant by a local law compliance clause:

> The Contractor shall give the required notices and comply with the laws, ordinances, rules, regulations, or codes which are or become in force during the performance of the work and which relate to the work and which are in place in the province in which the work is performed.
>
> Prior to commencing the work and prior to the final completion of the work, the Contractor shall provide evidence of compliance with Workers' Compensation legislation for the Province of Ontario, including payments due thereunder.

Some measures you can take to ensure protection are the inclusion of the following types of clauses:

- **'Four corners' clause;**
- **'Jurisdiction' clause;**
- **Local law compliance clause;**
- **'Dispute resolution' clause; and**
- **'Clean-up' clause.**

'Dispute Resolution' Clause. Contracts that stipulate that disputes will be resolved in a particular manner reduce your flexibility in resolving the disputes and can introduce uncertainty. On the other hand, such mechanisms can be tailored to the needs of the parties. Consider the benefits and disadvantages to such a clause before completing your contract.

An example of a mandatory provision in a contract which stipulates the type of dispute resolution mechanism to be employed is as follows:

> If a dispute or claim arising between the owner and the Contractor cannot be resolved to the satisfaction of both parties, the parties shall between themselves agree to submit the particular matter for arbitration by a panel of three arbitrators in accordance with the provisions of the relevant statute governing arbitrations, and amendments thereto, in place for work performed within the Province of Ontario.

'Cleanup' Clause. A clause that provides that a third party is responsible for cleaning up its work area when the work is completed may be appropriate in certain circumstances and helps to ensure that you will not be stuck with extensive and/or expensive remediation costs. A typical cleanup clause states in part:

> The Contractor shall maintain the work area in a tidy condition and free from the accumulation of waste products and debris.
>
> The Contractor shall remove waste products and debris on a daily basis and shall leave the work area clean and suitable for occupancy by the owner prior to the final completion of the work.

Conclusion

It is important to be vigilant when entering into contracts with third party providers of services and/or equipment. The preceding are only a few examples of where contractual language needs to be scrutinized. Taking the time to review the contracts that are being provided to you for signature is crucial in avoiding problems and potential litigation.

Assessing risks and managing them are essential in the contractual setting. Knowing what to look out for is half the battle. Being able to draft contracts where the risks are properly allocated between the parties can go a long way in ensuring that disputes are avoided or can be successfully defended.

In Focus

Construction Law Group News and Upcoming Events

Howard Wise has been elected Chair of the Construction Law Section of the Canadian Bar Association. On November 6, 2002, Howard will speak at a conference on construction liens held by York Communications in Toronto for the construction industry and its legal advisors. As well, Howard will be chairing the LexisNexis Butterworths Design Build/P3 conference on November 12, 2002 where Don Pierce will be part of a panel on public/private partnerships and design build in the Ontario construction industry. Don Pierce will also moderate a panel on technical trends and underpinnings of transportation public/private partnerships on November 26 at the P3 2002 Conference on Public/Private Partnerships in Toronto, Ontario November 25-26.

Joe Cosentino and Jason Hickman will be speaking at a Lorman Education Services seminar entitled "Public Construction Projects in Ontario-From Project Structuring to Implementation" to be held on November 20, 2002 in Hamilton, Ontario. Ken Crofoot will be co-chairing a conference on electronic registrations to be held by the Ontario Bar Association's construction section on November 27, 2002.

Howard Wise and Don Pierce are speakers at the upcoming Canadian Institute, Construction Superconference at the Sutton Place Hotel in Toronto on December 12 & 13, 2002. Howard's topic is "Bidding and Tendering: Key Considerations and New Legal Developments". Don will be speaking on the latest delivery methods in design-build and public/private partnerships.

Take the time to review your contracts with third party providers of services and/or equipment to ensure that disputes are avoided or can be successfully defended.

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Requests for additional copies of this newsletter or changes of address should be directed to Sandy Mitchell by e-mail at smitchell@goodmans.ca

If you have any comments about Goodmans Construction Law Update or wish to discuss industry-related issues or recent developments and trends, please contact a member of our Construction Law Group. The group handles all types of construction matters, including contractual disputes, construction liens, disputes between design professionals and contractors, and between subcontractors and general contractors. As well, we regularly advise clients on complex construction contracts including design build agreements and private public partnerships. We advise a wide variety of clients including owners, contractors, subcontractors, material suppliers, receivers and lending institutions in construction litigation matters.

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