

CONSTRUCTION RISK MANAGEMENT CONFERENCE

**“DAMAGES: A RISK MANAGER’S GUIDE TO FIVE
DEVELOPING ISSUES”**

Glaholt & Associates
Barristers & Solicitors
141 Adelaide Street West
Suite 800
Toronto, Ontario
M5H 3L5

Duncan W. Glaholt
Markus Rotterdam

© Duncan W. Glaholt
November, 1998

Introduction

The topic of damages is an enormous topic, even when confined to the perspective of the professional risk manager. Many learned books have been written on the subject of damages,¹ and the law is undergoing bedrock deep changes, even as this paper is being written. These are truly shifting sands. Few generalities that can safely be ventured about this topic. For example, not every injury results in an award of damages, and some damage-like remedies are recoverable even though there is no injury to person or property. In *Soulos v. Korkontzilas*,² for example, a real estate agent clearly breached his duty to the plaintiff by withholding crucial information from the plaintiff, causing the plaintiff to walk away from a purchase, only to find some time later that the property had been purchased by the agent's wife a few days later. In *Soulos*, however, there were no real damages. The market had fallen and the real estate agent and his wife had actually suffered a substantial diminution in value, just as the plaintiff would have done had he closed. Should there be a remedy? There was. The Supreme Court of Canada found the defendant agent liable to the plaintiff for breach of a constructive trust and ordered the defendant to convey the property to the plaintiff. The facts in this case are remarkable. It was important enough for the plaintiff to own this particular property that he actually agreed to make all necessary financial adjustments including indemnification for the loss sustained by the defendant when the market fell. In other words, the plaintiff actually succeeded in shifting the loss from the defendant to himself.

¹ See, for example, H. McGregor, *McGregor on Damages*, 15th ed. (London: Sweet & Maxwell, 1988); Harvin D. Pitch and Ronald M. Snyder, *Damages for Breach of Contract*, 2nd edition (Scarborough: Carswell, 1989).

² [1997] 2 S.C.R. 217; 146 D.L.R. (4th) 214.

The Canadian law of damages is also developing in the areas of economic loss and relational economic loss. Such cases offer another good example of courts' willingness to award damages to shift even potential losses and to shift them even when there is no physical injury to person or property. To make this point more clearly, as risk managers you know perfectly well that if a contract is delayed and bonding capacity remains fully utilized for an extended duration, bid capacity is reduced, jobs are not booked and profits are lost. A very real economic loss has been suffered, but without physical injury to person or property. Should there be a remedy in damages in such circumstances? Once the answer in Canada was a qualified "no"; now the answer is a qualified "yes". Our Supreme Court has recently moved away from a strict legalistic analysis to what is described as a more reasoned or principled, but still inherently cautious, approach.³

All that can be attempted in this paper, therefore, is to select a few developing areas that may be of particular interest to construction risk managers, and to canvass these in some detail. The selected areas are as follows:

1. Remoteness and Delay Damages;
2. Personal Liability for Corporate Damages;
3. The Rising Tide Economic Loss;
4. Frontiers of Damage Law; and

³ *Rivtow Marine Ltd. v. Washington Ironworks* [1974] S.C.R. 1189, (1973), 40 D.L.R. (3d) 530; *Canadian National Railway Co. v. Norsk Pacific Steamship Co.* [1992] 1 S.C.R. 1021, 91 D.L.R. (4th) 289; *Winnipeg Condominium Corp. No. 36 v. Bird Construction Co.* [1995] 1 S.C.R. 85, 18 C.L.R. (2d) 1; *Bow Valley Husky v. Saint John Shipbuilding* (1997), 153 D.L.R. (4th) 385.

5. Damage and the Dispute Resolution Process.

1. Remoteness and Delay Damages

It is by now trite to observe that construction contract delays can be divided into three broad categories: excusable delays, for which neither party is responsible and for which there is, generally, no compensation; compensable delays, for which the other contracting party is responsible; and non-compensable delays, for which the other contracting party is not responsible.⁴ From a contractor's point of view, the first category may result in an extension to the contract time, the second category may result in an entitlement to both time and money, and the third category may expose the contractor to actual or liquidated damages claimed by either the owner or the trades or both.

A contractor claiming damages for delays caused by an owner will have to prove that the delay was caused by the owner, or some cause for which the owner can be held responsible at law, that the specific delay resulted in a specific loss and that it was not excused by the contractor.⁵ Similarly, in theory, an owner claiming delay damages must show that the delay was actually caused by the contractor.⁶ In practice, however, this is a relatively light burden for the owner as the owner's control of contract funds allows *de*

⁴ See Stephen G. Revay, "Construction Claims: Causes and Options", *Construction Law Letter, Special Report* (Toronto: Build/Law Publications) 42-47; "Selected Damage Issues in Construction Litigation" (1986) 16 C.L.R. 217.

⁵ *Boone v. R.* [1934] S.C.R. 457; *Winger v. Streetsville (Village)* (1909), 13 O.W.R. 635 (K.B.), affirmed (1909), 14 O.W.R. 216 (C.A.); *Acme Masonry Ltd. v. Bird Construction Ltd.* (1986), 20 C.L.R. 228 (B.C. C.A.).

⁶ *Alberta Engineering Co. v. Blow* (1914), 28 W.L.R. 391 (Alta. T.D.); *Kimstar Contracting Ltd. v. Hub City Framing Contractors Ltd.* (1986), 22 C.L.R. 308 (B.C. C.A.). See C.E.D. on CD ROM, Release May 1998.

facto compensation for liquidated damages or alleged set offs, forcing the contractor to assume a plaintiff's burden and chase its money in court.

As the reader will appreciate from even this brief and superficial analysis, causation is the biggest single issue in any delay claim case. In order to obtain a judgment for delay damages, the causal link between each established breach of contract and some identifiable cost or other real loss arising from that very breach must be proven on a balance of probabilities.⁷

The earliest legal statement to give some shape and definition to the extent of damages recovery occurred in a breach of contract case. This is what lawyers call the Rule in *Hadley v. Baxendale*:⁸ a party is entitled to recover losses that necessarily arise from the breach, and, in addition, such losses as were within the reasonable contemplation of the parties at the time the contract was entered into. Alderson B. held as follows:

We think the proper rule in such a case as the present is this: where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e. according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.

⁷ I. N. Duncan Wallace, *Hudson's Building and Engineering Contracts*, Vol. 1, 11th edition (London: Sweet & Maxwell, 1995) 1029.

With apologies to anyone reading this with legal training, a brief reference to the facts of *Hadley v. Baxendale* is necessary. The plaintiff miller's broken millshaft was to be taken to the manufacturer as a model for a replacement shaft. The defendant was the carrier who was to transport the broken millshaft. The defendant knew that the plaintiff miller needed the millshaft returned quickly. The defendant carrier broke its contract by substantially delaying the delivery of the shaft and the plaintiff miller sued for loss of profits during the time the mill did not work for want of the shaft. The Court held as follows:

If a court holds that damages were not reasonably within the contemplation of the parties at the time the contract was formed, it calls the damages "remote" and will not award them.

While the principle of remoteness continues to apply in assessing delay damages, in many cases "remoteness" seems to be just a name courts call damages that they have decided not to award for other, better reasons. Consequently, the full nature and extent of delay damages that may be awarded for breach of a construction contract will depend to a large extent on the nature of the project and what was known to the contractor at the time of contracting. It is foreseeable, for example, that delay in the completion of a factory might affect the profit of such an enterprise; delay in completion of a condominium building may delay closings and cause all sorts of losses, even to non-contracting purchasers. *Hadley v. Baxendale* was applied in this country in a construction delay setting as early as 1918 in the Privy Council case of *Canada Foundry Co. Ltd. v.*

⁸ 9 Ex. 341.

*Edmonton Portland Cement Co.*⁹ In *Canada Foundry*, the installation of machinery in a cement factory was delayed due to a delay in completion of the factory building itself. Cement could not be made without the installation of the machinery, the machinery could not be installed without the building, and this led, logically, to the certain conclusion that the building delay resulted in the loss of cement profits. The Privy Council concluded:

So that the loss of this profit was at once what fairly might have been considered as arising naturally, that is, according to the ordinary course of things, from the breach the appellants complained of, and was also such a loss as might reasonably be supposed to have been in the contemplation of the parties at the time they made the contract as the probable result of the breach of it. If so, both the tests laid down in *Hadley v. Baxendale* and the cases which have followed it would appear to be satisfied.

The Privy Council accepted the trial judge's assessment of damages, which ran as follows: During the 153 days of delay the factory would have produced 110,865 barrels of cement. The cost of production would have been \$1.39 per barrel, the selling price \$2.10. The plaintiff would therefore have sold its 110,865 barrels of cement at a profit of 71 cents each, for a total of \$76,584.15. However, given the disproportionate size of such an award to the original contract price (\$37,000.00), the Privy Council concluded that substantial justice would be done by simply fixing the damages at \$10,000.00. This is not a case to build on.

Another vexing question in the area of the remoteness of delay claim damages is that of overhead recovery. Every dollar of price usually includes some element of

[1918] 3 W.W.R. 866

overhead recovery and courts here and abroad have searched for years for some rational basis upon which to fairly allocate overheads over a lengthy period of delay. In the United States, with its huge volume of public construction, a formula has developed that is now known by the name of the case in which it first received judicial approval, the *Eichleay* formula. The so called *Eichleay* formula has been simplified to the following by the learned author Harvey Kirsh:¹⁰

Step 1:

Calculate proportion of overhead attributable to the Project:	<u>Billings on Delayed Project</u> All billings during project period	X	All overhead during the Project
---	--	---	---------------------------------

Step 2:

Calculate Project Overhead on a <i>per diem</i> basis	<u>Project Overhead (from Step 1)</u> Project period as per contract	=	Per Diem Overhead
---	---	---	-------------------

¹⁰ H.J. Kirsh, "The Eichleay Formula: Computing and Recovery Unabsorbed Home Office Overhead Incurred by Contractors as a Result of Owner-Caused Delay" (1993), 2 C.L.R. (2d) 236. The Ontario Court of Justice has recently confirmed that this formula has not been formally endorsed in Canada, see *Doran Contractors Ltd. v. Russell (Township)* (1997), 35 C.L.R. (2d) 314.

Step 3:Calculate Delay
Overhead:

Per Diem Project Overhead

X Days of Compensable
Delay

The Supreme Court of Canada grappled with the same issue in the 1964 case *Shore & Horwitz Construction v. Franki Canada Ltd.*,¹¹ when it held that:

The overhead in a year is figured as a percentage of the direct cost and then that percentage is assigned to the direct cost of each individual job. When the job here in question occupied 4¾ months more of the plaintiff's (appellant's) time than during that 4¾ months the overhead costs were continuing to run but it was obtaining no revenue from which to defray the overhead costs.

In that case, Spence J. held that one of the main factors contributing to the plaintiff's unproductive year was the fact that during the delay the plaintiff could not devote its enterprise to other undertakings while its fixed costs kept running.

A subsequent trial decision of the Supreme Court of Ontario in *Ellis-Don Ltd. v. Parking Authority of Toronto*,¹² allowed overhead costs as a simple percentage of the tender sum. This rough and ready approach does have the advantage of simplicity, but it hardly does justice to the subtleties of overhead recovery, or the need to prevent double recovery. In the *Ellis-Don* case, the contractor was delayed because of the owner's failure to obtain an excavation permit. The contractor recovered its site overheads for the delay period.

¹¹ [1964] S.C.R. 589.

More recently, an *Eichleay*-like formula has been used in Alberta to determine a plaintiff's net loss of revenue in the form of overhead and profit. The trial judge listed the steps as follows:

1. Determine the number of days of actual production that the [...] crew of the plaintiff could have worked during the period in which it was committed to the [...] project
2. Determine the number of days that the [...] project should have taken.
3. The difference between No. 1 and No. 2 equals the total number of days of lost production.
4. The daily gross revenue of a crew on production must be calculated.
5. The total number of days of lost production multiplied by the daily gross revenue produces a gross loss of production figure.
6. There must then be a determination of the percentage return for overhead and profit that the plaintiff could have realized on the gross loss production.
7. Applying that percentage to the gross loss of production produces a net revenue loss.
8. From that net revenue loss is deducted a 10 per cent contingency to cover occurrences such as bad weather.
9. From the net loss figure so determined is deducted the overhead and profit return from any other jobs actually performed by the [...] crew during the period at issue. The resulting figure is the plaintiff's net loss of revenue on the form of overhead and profit.¹³

In applying these points to the case before him, Waite J. held that the plaintiff's crew was committed to the project for a total of 182 working days between 1979 and 1980. The contractor's schedule was accepted as proving that the work could have been performed in 72 working days. The net loss of production was therefore 110 days. The daily gross revenue of the crew was calculated at \$4,550.00. The Plaintiff asked for a

¹² (1978), 7 C.L.R. 82.

return of 18% for profit and overhead, a percentage it expected to realize, on average, from all the work on all projects in any given year. The Court accepted this figure as reasonable. This led to the following calculation: 110 days of lost production at \$4,550.00 resulted in a gross loss of \$500,500.00, which at an 18% rate of return, produced an overhead and profit cost of \$90,000.00 in round numbers. The plaintiff's own 10% contingency further reduced this to \$81,081.00 and a credit of \$7,354.00 earned by one of the plaintiff's crews on another job, brought the net loss down to \$73,727.00.

As risk managers, you will no doubt appreciate the problems of proof inherent to such calculations and the need for reliable standardized accounting systems which facilitate such proof. A further conclusion to be drawn from such formulas is that to overstate overhead recovery in a claim or pleading is to undermine in advance the credibility of your client's cost accounting system.

The Ontario Court of Justice has recently decided two cases involving delay, one caused mainly by the contractor and the other by the owner, which reveal other aspects of delay damages, such as the current state of the law on the standard contract requirement for contemporary notice of claim as a condition to future recovery.

More often than not, delays are caused by a multitude of causes. In *West York Construction (1984) Ltd. v. Walton Place (Scarborough) Inc.*,¹⁴ the defendant owner developed a residential/church facility. The plaintiff was the general contractor and the

¹³ *Interprovincial Concrete Ltd. v. Robert McAlpine Ltd.* (1985), 14 C.L.R. 121.

¹⁴ (1997), 35 C.L.R. (2d) 32.

job was found to be no more complex than many. The judge summarized the causes for the delay as follows:

Start-up was delayed because West York did not have a Contract. There wasn't a contract because MOH had to approve it. Before MOH would approve the Contract, the foundation permit had to be authorized. The City would not issue a foundation permit without consensus with respect to shoring. Shoring couldn't be done without an agreement with the PUC [Public Utility Commission] about the conditions including the cost. Until the agreement with PUC, the foundation permit wasn't issued. Without a foundation permit, all West York could do was to dig a hole. When the agreement was finally reached with PUC, it's (sic) workers went on strike. By the time serious excavation and shoring work was done, inclement weather struck which contributed to the mud problem. Some of the foregoing are the fault of the Owner. For example, if the shoring issue had been resolved before the Contract went to tender, then the foundation permit would have been almost immediately available and the excavation and shoring could have been done before inclement weather. Others, such as the PUC strike, were clearly beyond the Owner's control. But had the Owner been ready to proceed in a timely fashion when the Contract was awarded, the effects of the PUC strike would also have been avoided.

Having distilled the compensable and non-compensable delays down to manageable concepts, the judge held that the lack of a contract, a foundation permit, and various shoring and weather issues, taken together, cost the contractor about two months of progress and the plaintiff was therefore entitled to a contract extension of eight weeks. Reimbursement for the resulting expenses was denied, however, because the plaintiff did not follow the contractually required procedure to make such a claim. A standard general condition, GC7, in the contract stipulated that the Plaintiff must give notification during the work that it would seek reimbursement for expenses. No such notification was given.

Another standard general condition, GC4, addressed the process for asserting a mere claim for extension of time, but it did not address the process for asserting a claim for reimbursement of costs. The plaintiff was entitled only to a further time extension of 47.5 days for the owner's delay in processing change orders and 2 months for implementing them. The trial judge, Justice Kiteley, held that:

The delay attributable to CO processing and implementation falls within GC4.1 and consequently the plaintiff is entitled to claim reimbursement. While I have required compliance with the notification provisions of GC7, I do not require that the process of dispute resolution envisaged in the Contract would apply thereafter. The failure to pay the holdback and the ensuing litigation obviously made it impossible to carry on as required by the Contract. Having given notification, the plaintiff can reasonably expect the Court to resolve the compensation issue.

With regard to the calculation of the claim, the defendant had argued that overhead could not be claimed as a delay cost. The court ruled that:

(Defendant's counsel) takes the position that the Contract does not permit the Contractor to claim overhead as a delay cost. However, the Contract does not prohibit it. GC4.1 permits reimbursement for "reasonable costs incurred by the Contractor as the result of such delay". I find that the attribution of those expenses constitutes "reasonable costs".

However, the calculation must be revisited. In Exhibit 2, the plaintiff asserts that the total expenditure of \$750,835.00 should be divided by the 267 days of delay asserted in that Exhibit. By the conclusion of the trial, the days of delay had been reduced to 192. And I have found the plaintiff entitled to compensation only for 47.5 days for processing and two months for implementation. [It is regrettable that days and months must be used but that is because of the way

the evidence was delivered.] The more appropriate approach is to apply the expenditure of \$750,835.00 over the 20 months from mid-November, 1989 when work did begin to mid July, 1991 when the Certificate of Substantial Performance was issued. That yields \$37,541.75 per month, and divided by 21.75 days, as was done in Exhibit 2, it yields \$1,726.06 per day. Accordingly, the plaintiff shall have judgment for \$81,987.85 (representing 47.5 days) and for \$75,083.50 (representing two months) for a total of \$157,071.35.

In another recent case, *McAlpine v. Woodbine Place Inc.*,¹⁵ we see an example of a fact based delay analysis. In *McAlpine*, the owner of a commercial building sued the contractor for damages resulting from a delay in substantial completion of a building. The contractor admitted liability for delay, but disputed the length of the delay and the calculation of damages. With regard to the beginning of the delay period, the court had no difficulty in holding that as substantial completion, according to the contract, was scheduled for October 31, 1989, the delay period begun the next day, November 1, 1989. It was more difficult for the court to establish the end of the delay period. In order to do so, the court looked at what it termed “hard” and “soft” evidence. By “hard” evidence the court meant evidence demonstrating that certain physical aspects of the building were not substantially completed, such as temporary doors being left in place, work being done by trades on upper floors, the incomplete status of the lobby and parts of a glass curtainwall remaining uncompleted. Such hard evidence tended to show that the building was not in fact complete until March 31, 1990. The “soft” evidence related to the impact of the alleged delay on committed and prospective tenants. The contractor had argued that some of the tenants moved in before substantial completion and began to pay rent and that the inference could reasonably be drawn from this that at that time the building was

sufficiently complete to stop the delay period. The judge held that the somewhat desperate circumstances that compelled the tenants to move in before substantial completion could not overcome the weight of the hard evidence showing that the building was not completed by then. While evidence of actual tenancies was admissible on this issue, evidence of prospective tenancies was not.

These prospective tenancies were relevant, however, on the issue of damages. The determination of damages applicable to the committed tenants was fairly straightforward but the judge allowed only a conservative amount for the loss regarding prospective tenants. The owner's expert had compared the actual cash flow to the probable cash flow over a five year period and included losses from diminished market confidence and a stigma resulting from the fact that the project was on the market for too long. The judge held that as the project was partly speculative, the impact of the high level risk undertaken by the owners should not fall on the shoulders of the contractor just because of the delay.

In short, delays will occur. They always have and they always will. What is required from risk managers in this area is to shoulder the evidentiary burden and have systems in place to track and properly attribute delay costs, including overheads, and to give early and frequent notice of claims to comply with contract terms.

2. Personal Liability for Corporate Damages

¹⁵ (1998), 37 C.L.R. (2d) 38.

This is an area that has been much overlooked, but shows all the signs of renewed vigor on the part of the plaintiff's counsel. Personal as well as corporate defendants are more likely to be pursued now than ever before. One aspect of this development is the need for independent representation. Risk managers must be finely attuned to the developing law in this area so as to steer their clients either toward or away from personal liability, as the nature of the retainer requires.

It is best to start from general rules. As a general rule, corporate status provides an effective insulation from personal liability for damages. The general rule is that a corporation is a legal entity distinct from its shareholders.¹⁶ Like any rule, however, the exceptions are often more interesting than the rule itself. Some of the broad categories of these exceptions are as follows:

- 2.1 Liability in Tort: such as for design professionals who prepare unbuildable drawings;
- 2.2 Liability in Contract: such as guarantors or indemnitors of the corporation's bonding company;
- 2.3 Statutory exceptions: such as Part II of the *Construction Lien Act*, and the oppression remedies provided by the *Ontario Business Corporations Act*, R.S.O. 1990, c. B-16.

¹⁶ *Salomon v. Salomon & Co., Ltd.* [1897] A.C. 22 (H.L.).

Whenever this topic is raised, difficult questions of policy arise. These were aptly described by LeDain J. of the Federal Court of Appeal in his 1978 decision *Mentmore v. National Merchandising Co.*:¹⁷

On the one hand, there is the principle that an incorporated company is separate and distinct in law from its shareholders, directors and officers, and it is in the interest of the commercial purposes served by the incorporated enterprise that they should as a general rule enjoy the benefit of the limited liability afforded by incorporation. On the other hand, there is the principle that everyone should answer for his tortious acts.

In *Constitution Insurance Co. of Canada v. Kosmopoulos*, the Supreme Court of Canada held that:

The law on when a court may disregard this principle by ‘lifting the corporate veil’ and regarding the company as a mere ‘agent’ or ‘puppet’ of its controlling shareholder or parent corporation follows no consistent principle. The best that can be said is that the ‘separate entities’ principle is not enforced when it would yield a result ‘too flagrantly opposed to justice, convenience or the interests of the Revenue’.¹⁸

Let us consider the broad headings of exceptions we have set out, in order.

2.1 Liability in Tort:

¹⁷ (1978), 89 D.L.R. (3d) 195 at 202.

In *Disal Contracting Ltd. v. J. Salamon Holdings Inc.*,¹⁹ the Ontario General Division held that an architect should not be shielded from personal liability for a drawing approved by him and made pursuant to a contract with his professional corporation. The architect had prepared drawings for the purpose of soliciting quotations, but the drawings were so ambiguous and uncertain that it took several expert witnesses and the Court four weeks to “ponder the true meaning and intent of the drawings”. The Court held that:

The provisions in the *Architects Act* and Regulations thereunder requiring the licensed architect who has supervised the particular work to affix his professional seal for the purposes of indicating approval, take the liability exposure of the principal of such corporation outside the normal incidence of preventing personal liability exposure on the part of officers of corporate bodies.

If this is so, one might wonder why an architect would incur the expense of incorporation in the first place. Some limits on the personal liability of professionals in tort have been firmly established by the Supreme Court of Canada. In *Edgeworth Construction Ltd. v. N.D. Lea & Associates Ltd.*,²⁰ that court held that the mere fact that an engineer affixes his or her seal to a design document is itself insufficient to establish a duty of care between the individual engineer and a contractor. *Edgeworth* was distinguished in *Disal* on the ground that the plaintiff in *Edgeworth* was not relying on the particular expertise of the individual engineer, but rather upon the corporate character of the engineering firm. In *Disal*, while the client/architect

¹⁸ *Constitution Insurance Co. of Canada v. Kosmopoulos* (1987), 34 D.L.R. (4th) 208 at 213. For a critique of this approach, see Welling, *Corporate Law in Canada: The Governing Principles*, 2nd ed. at 122 to 127.

¹⁹ (1997), 35 C.L.R. (2d) 200.

agreement was in the name of the corporation, the plaintiffs had dealt with the individual architect as their service provider. In *Disal*, the architect and the firm were held to be jointly and severally liable for all liability arising out of the defective drawings.

This is a slippery slope. A risk manager might be forgiven for thinking that officers of large corporations will be insulated by corporate status while officers of small corporations will not.

This development exposes officers and directors of professional corporations to personal liability for damages, but what of employees generally? In *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*,²¹ employees of the defendant corporation were ultimately found liable for damages to a large transformer that had been delivered to the defendant corporation for storage. The warehouse contract limited the defendant's corporation liability to \$40.00, unless additional insurance was purchased. The plaintiff opted to include the transformer on its own policy and did not buy the additional coverage. With such a limitation staring it in the face, it is a small wonder the plaintiff took a run at the employees themselves. Two of Kuehne & Nagel's employees attempted to lift the 7500 lb. transformer by using two forklifts at the same time. Safe practice required the transformer to be lifted by crane by lifting brackets attached to the transformer for that specific purpose. The transformer fell off the two forklifts, causing \$33,955.41 in damages. A conventional analysis would

²⁰ [1993] 3 S.C.R. 206, 107 D.L.R. (4th) 169, (1993), 12 C.L.R. (2d) 161.

²¹ [1992] 3 S.C.R. 299, 97 D.L.R. (4th) 261.

have found the employer and not the employees liable for any damage caused during the normal course of carrying out the employees' work for the employer and, by contract, limited the damages to \$40.00. On the issue of the employees' personal liability in *London Drugs*, however, Iacobucci J. wrote for the Supreme Court of Canada that:

There is no general rule in Canada to the effect that an employee acting in the course of his or her employment and performing the 'very essence' of his or her employer's contractual obligations with a customer, does not owe a duty of care, whether one labels it 'independent' or otherwise, to the employer's customer.

The Court held the workers generally liable, but held that they were third party beneficiaries to the limitation of liability clause in the employer's contract with the appellant. The plaintiff won the battle and lost the war.

This would seem to set up a contradiction between *Edgeworth* and *London Drugs*. In *Edgeworth*, professional employees were shielded from liability on the theory that the plaintiff thought it was dealing with the corporation that employed them, whereas in *London Drugs* negligent employees were held personally liable in spite of the fact that the plaintiff thought it was dealing with the corporation that employed them. LaForest J., who dissented in part in the *London Drugs* decision, was, in the writer's view, justifiably critical of such distinctions that have no difference:

The majority (in *London Drugs*) was unwilling to absolve ordinary workers from liability flowing from their negligence in the course of their employment except to the extent that a contractual exemption from liability had been entered into by their employer, whereas in this case the professional employees who, one would have thought, were in a better position to take steps to protect themselves, are absolved from liability resulting from their negligence in the absence of any exonerating contract... [S]uch a distinction, in so far as it favours professional employees, is, at the level of principle, lost on me.

LaForest J. would have drawn a technical distinction between the torts of negligence *simpliciter*, in which case personal liability would have been the exception, and negligent misrepresentation, in which case personal liability would be more readily attributed. This distinction has a built-in check and balance, in that in a case of negligent misrepresentations the representee must establish that it was reasonable in relying on the negligent representation. LaForest J. would be “quite happy to rely on this technical distinction to absolve the individual engineers from liability because, on balance,... there are sound reasons of policy why they should not be subjected to a duty to the appellant”. The representee in *Edgeworth* was held to have relied on the representation of the firm rather than the individual engineers, unlike *London Drugs*, in which case the damage was directly caused by the negligent employees. But this, too, is a fine distinction. If you were to ask the customer in *London Drugs*, at the time it contracted with Kuehne & Nagel, who was being “relied upon”, it would likely be answered “Kuehne & Nagel”. The Court in *Edgeworth*, however, held that to succeed the appellant would have to show it was relying on the particular expertise of an individual engineer, without regard to the corporate character of the engineering firm, which it failed to do.

Courts in Ontario appear to have adopted a legalistic, less principled test based upon an analogy from the law of strict liability torts which enters into the enquiry as to whether there has been a “personal adoption” of a specific tortious act.²² The court, in conducting such an analysis, is required to attempt to determine, by evidence, whether directors or officers acted in a representative or in a personal capacity.²³ If they acted consistently as directors or officers, they will be shielded from liability. If, after the fact, they are found to have acted consistently in a personal capacity, they will be exposed to personal liability. This gives some guidance to risk managers.

In a recent example of such an analysis, the Ontario Court of Appeal has held that there are two components to the determination of the issue of whether directors and officers should be held personally liable for failure to comply with specifications in an agreement of purchase and sale.²⁴ The first component was whether the directors and officers had held themselves out as individuals rather than as agents of the corporation to a degree that attracted personal liability; the second was to see whether there was evidence revealing a continued intention of the plaintiff to hold the individual defendants liable. The Ontario Court of Appeal found:

...a principle arising from the case law that persons wishing to benefit from the protection of the corporate veil should not hold themselves out to the public without qualification. They should identify the name of the company with which they are associated in a reasonable manner or risk

²² Christopher Gosnell, “The Personal Liability of Corporate Agents: Who Should Bear Pure Economic Loss?” (1997), 55(1) *University of Toronto Faculty of Law Review* 77.

²³ *Leon Kentridge v. STOP* (1990) O.J. 488.

being found personally liable if the circumstances warrant it: see cases such as *Watfield International Enterprises Inc. v. 655293 Ontario Ltd.* (1995), 21 B.L.R. (2d) 158 (Ont. Gen. Div.) and *Penelly Ltd. v. 449483 Ontario Ltd.* (1986), 20 C.L.R. 145 (Ont. H.C.). This principle properly flows from the fact that incorporation provides corporate officers and shareholders the legal protection thought to be necessary for modern business relations; however, if one expects to benefit from this protection, then others must, at a minimum, be informed in a reasonable manner that they are dealing with a corporation and not an individual.

The Court of Appeal held in the case before it that the individuals did not take reasonable steps to ensure they were not holding themselves out as individuals rather than agents of a corporation. The evidence showed that at no time had the plaintiff showed any intention of relieving the individuals from liability. The personal defendants were held liable. This two part test, if it is conjunctive, offers predictability and certainty of result. After all, if personal liability is not present, one would expect both sides to act accordingly. Or, put another way, if one seeks to hold a defendant personally liable, there should be no difficulty in being honest about this fact at the beginning. The vice is in bargains made and priced on the basis of corporate liability that are later ignored or swept aside when the damage is done and personal liability seems a more attractive option. How is a risk manager to deal with such exposure? Apart from adopting strict guidelines as to scope of employment duties and ensuring that the paper trail confirms either representative or personal liability, there seems to be little that can be done.

2.2 Liability in Contract: Guarantors and Indemnitors

²⁴ *Truster v. Tri-Lux Fine Homes Ltd.* (1998), 39 C.L.R. (2d) 6.

In *Canadian General Insurance Co. v. John Jacobs & Sons Ltd.*,²⁵ the president, a shareholder and the office manager of a construction company executed a Master Surety Agreement in favour of the insurance, which allowed the corporation to obtain a performance bond as well as a labour and material payment bond from the surety. The contractor defaulted on its obligations under the contract, and the appellant had to pay more than \$900,000.00. The insurer obtained a default judgment against the company and sought judgment against the signatories of the surety agreement. The trial judge allowed the action against the president, but denied the actions against the shareholder and office manager, arguing that in light of the fact that they were not involved in the day to day operations, the insurer failed to ensure that these individuals obtained independent legal advice before signing the agreement. Basically, therefore, the trial judge found there to be a fiduciary relationship between these two respondents and the surety. The Newfoundland Court of Appeal allowed the appeal and granted judgment against all signatories. It was held that “the Master Surety Agreement creates no relationship between the parties which would suggest a necessity for the special protection that equity affords”. Gushue C.J.N. noted that the respondents had signed similar agreements in the past, and that they had to be aware of the duties and obligations entered under such an agreement. If they did not understand the scope of their obligations, this was a result of their own carelessness or negligence.

²⁵ (1998), 36 C.L.R. (2d) 111.

The real risk here is in the sale of interests in the principal's business, or the retirement of an officer or director. It is surprising, and depressing, how often counsel simply forgets to cancel indemnity obligations to sureties. The result, inevitably in view of *John Jacobs*, may be a nasty surprise one day in the form of personal liability without meaningful recourse to the bankrupt corporate principal.

2.3 Statutory Exceptions:

A significant development regarding personal liability for corporate damages relates to the field of construction trusts. S. 13(1) of the *Construction Lien Act*, R.S.O. 1990, c. C.30, which holds that every director or officer of a corporation and any person having effective control of a corporation or its activities, who assents to, or acquiesces in, conduct that he or she knows or ought to know amounts to a breach of trust by the corporation is liable for the breach of trust. In *St. Mary's Cement Corp. v. Construc Ltd.*,²⁶ Molloy J. of the Ontario Court of Justice's General Division held the personal defendant liable for breach of trust both under s. 13(1) and at common law. The personal defendant was deemed to have knowledge that the *Act* imposed a trust upon moneys received from the owner as long as there were unpaid trades or suppliers. Personal liability was imposed on a corporate director in *Scott v. Riehl*,²⁷ in which case the director and president of a company knowingly created, maintained and operated a system misusing the trust moneys. The Court held that while the company was the instrument of its operation, the personal defendant was the director and held him personally liable. The same Court followed this decision in *Horseman Bros. Holdings Ltd. v. Panton*²⁸ in a situation where the personal defendants were not aware of the fact that they were committing a breach of trust. These principles were later held to be applicable in Ontario in *Andrea Schmidt Construction Ltd. v. Glatt*.²⁹

²⁶ (1997), 32 O.R. (3d) 595.

²⁷ (1958), 25 W.W.R. 525, 15 D.L.R. (2d) 67 (B.C. S.C.).

²⁸ (1976), 3 W.W.R. (N.S.) 745.

²⁹ (1980), 28 O.R. (2d) 672, 112 D.L.R. (3d) 371 (C.A.).

Molloy J. applied the principles enunciated by the Supreme Court of Canada in *Air Canada v. M & L Travel Ltd.*³⁰ to find the personal defendant liable. In that decision, the Supreme Court asked “whether the stranger’s conscience is sufficiently affected to justify the imposition of personal liability.” The Court took as a relevant description of fraud “the taking of a risk to the prejudice of another’s rights, which risk is known to be one which there is no right to take”. Applying these principles to the case at bar, Molloy J. held that the personal defendant not only had full knowledge of the breach of trust by the corporate defendant, it was actually he who caused the corporate defendant to commit the breach. He was accordingly held to be personally liable both under the *Act* and at common law. The British Columbia Supreme Court recently applied the same decisions to find personal defendants liable in *Van Vliet Construction 1988 Ltd. v. Jaeger*.³¹ Personal liability under s. 13(1) does not require any kind of special *mens rea* standard of liability, the test is one of reasonableness.³²

3. The Rising Tide Economic Loss

One of the more interesting aspects of the changing law of damages, soon to be felt by insurers and risk managers, can be traced back to a single decomposing snail ingested in the bottom of a bottle of ginger beer bought from a corner store. The woman drank the

³⁰ [1993] 3 S.C.R. 787, 108 D.L.R. (4th) 592.

³¹ (1998), 37 C.L.R. 285.

³² *Heritage Masonry Ltd. v. Building Team Ltd.* (1995), 28 C.L.R. (2d) 101, upheld (May 27, 1996) Southey, Stach and Adams JJ. (Ont. Div.Ct.).

ginger beer, and the snail, got quite sick, and sued the bottler when she got well. Until that time it was thought that all damages had to be an incident of either contract or an implied contract and that a manufacturer could not be held directly liable to an eventual consumer in the stream of commerce in the absence of a contract or implied contract. Not so. In their 1932 decision, the House of Lords, in *Donoghue v. Stephenson*,³³ held that a duty of care could exist between two parties quite apart from a contract. Lord Atkin held that:

You must take reasonable care to avoid acts or omissions which you can reasonably foresee would be likely to injure your neighbour. Who then, in law, is my neighbour? The answer seems to be – persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected when I am directing my mind to the acts or omissions which are called in question.

The Law Lords allowed the plaintiff's claim against the manufacturer of the ginger beer for personal injuries suffered from drinking a bottle of their beverage containing the snail's remains. The work of the next 60 years of the common law here and in England has been to develop a principled approach to the growth or restriction of this important new development.

While *Donoghue* restricted recovery of damages to reasonably foreseeable physical damage, i.e. bad digestion, thirty-two years later the House of Lords allowed recovery of pure economic loss in a case of negligent misrepresentation. Just as a more sophisticated

³³ [1932] All E.R. 1.

economy had required the law of damages to change to compensate for damages caused by manufacturers' goods put into the stream of commerce, a more sophisticated commercial world thirty-two years later required the law of damages to adapt to the sale of professional services. In this case, *Hedley Byrne*, the House of Lords held that:

If someone possessed of quite a special skill undertakes, quite irrespective of contract, to apply that skill for the assistance of another person who relies on such skill, a duty of care will arise... [if such] a person takes it on himself to give information or advice to, or allows his information or advice to be passed on to, another person who, as he knows or should know, will place reliance on it, then a duty of care will arise.³⁴

A further giant step expanding liability for damages in tort was taken in *Dutton v. Bognor Regis Urban District Council*,³⁵ where the English Court of Appeal found a municipal council liable for pure economic loss resulting from negligent inspection of a house, unrelated to any negligent misrepresentation *per se*. Lord Denning M.R. argued that if a council was liable if a negligently inspected house collapsed and injured a person, as it was under the law of the day, then it was patently unreasonable not to hold so if the home owner detected the defect and repaired it in time to prevent such a collapse. In other words, in *Dutton* no physical damages had actually been sustained and no economic loss had been realized, by sale of the house for example, by the time the claim for damages was heard. The plaintiff merely sued for the prospective cost of putting the house right. As you can see, the gates were beginning to open wide and a corresponding concern was developing that they were too wide. It took sixteen more

³⁴ *Hedley Byrne & Co. v. Heller & Partners Ltd.* [1964] A.C. 465, [1963] 2 All E.R. 575.

³⁵ [1972] Q.B. 373, [1972] 1 All E.R. 462.

years but, in *Anns v. London Borough of Merton*,³⁶ Lord Wilberforce took the opportunity to set forth a now famous two-part test in an effort to control the growth of the law of torts:

[I]n order to establish that a duty of care arises in a particular situation, it is not necessary to bring the facts of that situation within those of previous situations in which a duty of care has been held to exist. Rather the question has to be approached in two stages. First, one has to ask whether, as between the alleged wrongdoer and the person who has suffered damage there is a sufficient relationship of proximity or neighbourhood such that, in the reasonable contemplation of the former, carelessness on his part might be likely to cause damage to the latter – in which case a prima facie duty of care arises. Secondly, if the first question is answered affirmatively, it is necessary to consider whether there are any considerations which ought to negative, or to reduce or limit the scope of the duty or the class of person to whom it is owed or the damages to which a breach of it may give rise.

The Supreme Court of Canada adopted this *Anns* test at its first opportunity, in 1984, in the case of *Nielsen v. Kamloops (City)*.³⁷ Subsequent to this decision, however, the *Anns* case hit a brick wall, in the U.K., in the House of Lords decision *Murphy v. Brentwood District Council*.³⁸ The House of Lords used *Murphy v. Brentwood* to overrule their own earlier decision in *Anns*, a very serious development indeed. The House of Lords, lamenting the absence of any coherent and logically based doctrine for avoiding unlimited liability, which absence was bound to “put the law of negligence into a state of confusion defying rational analysis”, returned to the sixty year old test in *Donoghue v.*

³⁶ [1978] A.C. 728, [1977] 2 All E.R. 492.

³⁷ [1984] 2 S.C.R. 2, 8 C.L.R. 1.

³⁸ [1990] 2 All E.R. 908.

Stephenson and the proposition that economic loss could only be recovered in negligence where there was actual physical damage to person or property or in the otherwise well established *Hedley Byrne* negligent misrepresentation situation.³⁹ This brought the U.K. law into line with the law in the United States. The Supreme Court of Canada however took its own approach and adhered to the *Anns* test, rejecting to the U.K. development in *Murphy*. In its 1992 decision in *Canadian National Railway Co. v. Norsk Pacific Steamship Co.*,⁴⁰ Madam Justice McLachlin held that:

The incremental approach of *Kamloops* is to be preferred to the insistence on the logical precision of *Murphy*. It is more consistent with the incremental character of the common law. It permits relief to be granted in new situations where it is merited. Finally, it is sensitive to danger of unlimited liability.

The *Norsk* case is an absolutely unique piece of Canadian judicial history as it marks both a sharply independent stance of our highest court and, at the same time, a rather passionate disagreement among the members of that court as to the proper approach to be taken, a rift that was not healed until the 1997 decision in *Bow Valley Husky v. Saint John Shipbuilding*.⁴¹

In a construction law context, the crushing reality of this line of cases, literally as it turns out, was felt in the landmark 1992 decision of the Supreme Court of Canada in

³⁹ See the current development in the House of Lords in *Darlington Borough Council v. Wiltshier Northern Ltd.* (The Times Law Reports July 4, 1994) and *Alfred McAlpine Construction Ltd. v. Panatown Ltd.* (The Times Law Reports February 5, 1998).

⁴⁰ [1992] 1 S.C.R. 1021, 91 D.L.R. (4th) 289.

⁴¹ *Bow Valley Husky v. Saint John Shipbuilding* (1997), 153 D.L.R. (4th) 385.

*Winnipeg Condominium Corp. No. 36 v. Bird Construction Co.*⁴² On the facts of that case, more than 15 years after substantial completion of a condominium tower block, several tons of stone cladding fell to the ground injuring neither person nor property. The condominium corporation, which took title to remove from the original owner, claimed for the prospective costs of repairing or replacing the entire exterior stone cladding, i.e. pure economic loss. By the time the action was commenced, the only defendant left in business was the unfortunate general contractor, Bird Construction. Shocking both the insurance industry and contractors, the Supreme Court of Canada held that the costs of repairing defects in a building resulting from negligent planning and construction were recoverable from the former general contractor in tort “where that building is found to contain defects resulting from that negligence which pose a real and substantial danger to the occupants...”, even though there was no contractual *nexus* between or among any of the parties and even though the limitation periods in the contract between the general contractor and its defunct masonry subcontractor had long since expired. La Forest J. held the case to be distinguishable on a policy level from cases where the workmanship was merely shoddy or substandard but not dangerously defective. La Forest, writing for the majority, argued that it was:

...reasonably foreseeable to contractors that, if they design or construct a building negligently and if that building contains latent defects as a result of that negligence, subsequent purchasers of the building may suffer personal injury or damage to other property when those defects manifest themselves. A lack of contractual privity between the contractor and the inhabitants at the time the defect becomes manifest does not make the potential for injury any less foreseeable.

⁴² [1995] 1 S.C.R. 85, 18 C.L.R. (2d) 1.

As a society, we were simply not going to tolerate the construction of buildings at risk of falling down. Theoretically, therefore, a contractor may be exposed to liability on the *Winnipeg Condominiums* theory of liability, so long as the building stands. La Forest J. attempted to deal with this concern as follows:

Finally, there is little risk of liability for an indeterminate time because the contractor will only be liable for the cost of repair of dangerous defects during the useful life of the building. Practically speaking, I believe that the period in which the contractor may be exposed to liability for negligence will be much shorter than the useful life of the building. With the passage of time, it will become increasingly difficult for owners of a building to prove at trial that any deterioration in the building is attributable to the initial negligence of the contractor and not simply to the inevitable wear and tear suffered by every building.

Of course, there are no guidelines as to what exactly the useful life of a building might be. Lawsuits will therefore be possible as long as the building stands. Now for the hard part. Assume a fact situation in which the general contractor was defunct too, and only its surety bonding company, having a joint and several obligation with the contractor to perform the contract, is left standing. It is a very small incremental step for the court to find such a surety liable 10, 15, 20 or more years after the fact on the *Winnipeg Condominium* theory of liability. And what then: a claim against the personal indemnitors on their indemnity agreements of course? This is a new source of potential personal liability and risk managers must understand it.

The recent Ontario case of *Dominion Bridge-Ontario v. Stephen Sura (Canada) Ltd.*⁴³ can be read in this context. In this case, a subcontractor who was delayed by the contractor claimed for consequential additional labour and material costs against the contractor and the payment bond surety. While the Master dismissed the claim based on improper notice, he mentioned in *obiter* that the surety might well have been liable for the additional costs.⁴⁴

The most recent Supreme Court of Canada development of this point is *Bow Valley Husky v. Saint John Shipbuilding*, referred to earlier in this article. Two exploration companies, Husky and Bow Valley, contracted with Saint John Shipbuilding to build an oil drilling rig. An off-shore company, Bow Valley Husky (Bermuda) Ltd., was incorporated, and ownership and the construction contract were transferred to that company before construction began. The owner selected a heat trace system built by an independent manufacturer and had the builder install it. The manufacturer's specifications called for the installation of a ground fault circuit breaker to cut off the power in case of an electrical fault. The breaker was not installed. In addition, the shipbuilder and its trade knew that the insulation they had specified was particularly flammable, but they chose not to warn the plaintiff. A fire ensued because of the ground fault breaker, the cable trays spread the fire because of the flammable insulation and the rig was out of service for several months.

⁴³ (1997), 35 C.L.R. (2d) 1.

⁴⁴ See Charles Wiebe, "Delay Damages and Labour and Material Payment Bonds" (1998) 14:5 *Construction Law Letter* 1.

With regard to Husky's and Bow Valley's claim for pure economic loss, the Court held that contractual relational economic loss is recoverable only in certain circumstances. So far, these circumstances were defined as follows: cases where the claimant has a possessory or proprietary interest in the damaged property; "general average cases", and cases where the relationship between the claimant and property owner constituted a joint venture. The *Husky* case did not fall into any of these three categories. McLachlin J. held, however, that these categories were not closed and that the Court had to consider whether the situation was one where the right to recover such loss should nevertheless be recognized. Once again applying the *Anns v. Merton* test, the Supreme Court of Canada held that the manufacturer "knew of the existence of the plaintiffs and others like them and knew or ought to have known that they stood to lose money if the drilling rig was shut down." However, the Court went further to hold that on the facts of this case policy reasons did indeed preclude recovery. The most important policy reason was the policy against indeterminate liability. McLachlin J. held that:

If the defendants owed a duty to warn the plaintiffs, it is difficult to see why they would not owe a similar duty to a host of other persons who would foreseeably lose money if the rig was shut down as a result of being damaged... What has been referred to as the ripple effect is present in this case.

The *prima facie* duty of care was therefore negated. The trial judge's apportionment of liability was not disturbed. In a purely commercial setting, without any issues of public safety at stake, the Supreme Court seems prepared to apply the *Anns v. Merton* test against expanded liability. There is a clear trend, however, towards findings of liability in

cases with an aspect of real and substantial danger to the public, even where there is no privity of contract between plaintiff and defendant and even when no injury has actually been sustained by the plaintiff.⁴⁵

In his dissent in *Norsk*, La Forest J. recognized this difficulty when he held that “[t]he court should do more than simply establish a rule that allows judges to resolve cases as they see fit”. It is clear, as the law stands, that businesses and those of you that run them will have to come up with innovative ways to protect yourselves. New forms of insurance or contractual protection in the form of multi-party construction contracts have been mentioned.⁴⁶ In the aftermath of *Winnipeg v. Bird*, it was suggested that insurance underwriters should drastically revise their terms to exclude exposure for indeterminate liability, and that contractors should obtain a binding covenant that the owner, in the event of re-sale, enforce restrictions similar to the original one.⁴⁷ In the meantime, the scope of liability will likely continue to become wider. One of the Law Lords in *Murphy*, upon reading the Supreme Court of Canada’s decision in *Winnipeg v. Bird*, put it this way: “We are all going the U.S. way. Everyone must be able to sue for everything...”⁴⁸

4. Frontiers of Damage Law:

4.1 Bidding and Tendering:

⁴⁵ See also *Lewis (Guardian ad litem of) v. British Columbia* (1997), 153 D.L.R. (4th) 594 (S.C.C.).

⁴⁶ D. A. Brindle, “Pure Economic Loss Revisited” (1992), 48 C.L.R. 278 at 320.

⁴⁷ W.L.N. Somerville, “Plaintiffs 10 – Insurers –0.5” (1995), 21 C.L.R. (2d) 166.

⁴⁸ Quoted *ibid*.

As the law currently stands in Canada, the relevance of the principle of good faith in the tendering context differs not only from province to province, but also from court to court. Bid shopping, which flies in the face of everything the principle of good faith should stand for, is vilified in some cases, but held to be no more than undesirable in others.⁴⁹ The effect of good faith on the standard privilege clauses in tender documents is similarly disputed. Some Courts have held the clause to be a complete answer to the question. Master Funduk, for example, in Alberta, has held that:

The words used [...] are short, old, simple and readily understandable. They must not be deliberately misinterpreted by the courts to arrive at a result-oriented decision based on some vague notion of fairness... As a wise old saying goes – if it ain't broke don't fix it.⁵⁰

The British Columbia Court of Appeal, on the other hand, held that:

[E]ven if there was a privilege clause, the owner had a duty of fairness to the plaintiff which included a duty not to accept invalid bids or allow corrections. Even a mere irregularity in an bid must lead to its invalidity in order to protect the integrity of the bidding system.⁵¹

Other cases have added to the confusion and uncertainty.⁵² Damage awards have included anything and everything from the hard but relatively small costs of bid

⁴⁹ See, for example, *Ron Brown v. Johanson* [1990] B.C.W.L.D. 2145 (B.C. S.C.) (not illegal); *Fred Welsh v. B.G.M. Construction (Eastern) Ltd.* (1996), 27 C.L.R. (2d) 269 (B.C. S.C.) (breach of contract A); *Twin City Mechanical v. Bradsil* (1997), 31 C.L.R. (2d) 210 (Ont. Gen. Div.) (breach of “implied term of honesty”); *Naylor Group Inc. v. Ellis-Don Construction Ltd.* (1997), 30 C.L.R. (2d) 195 (Ont. Gen. Div.) (not illegal).

⁵⁰ *North American Construction Ltd. v. Fort McMurray (City)* (1995), 16 C.L.R. (2d) 225 (Alta. Master), reversed (1995), 33 Alta. L.R. 332.

preparation⁵³ to the more substantial profits that might have reasonably been expected had the plaintiff been awarded the contract in question.⁵⁴

On 16 October 1997, the Supreme Court of Canada granted leave to appeal the Alberta Court of Appeal's decision in *M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd.*,⁵⁵ on the issue of whether the standard clause (the lowest or any tender shall not necessarily be accepted) allows an owner a complete and unfettered discretion in awarding the contract. The case was heard on November 6, 1998, and a decision is expected soon. The appellant's factum has recently been published.⁵⁶ While it is hard to predict what direction the Supreme Court will take, recent cases such as *Soulos v. Korkontzilas*⁵⁷ seem to indicate that today's Supreme Court of Canada will not hesitate to employ an overriding policy of "fairness" in commercial dealings to curb the abuse of such clauses.

In a dramatic recent development, Ontario courts have awarded damages even to subcontractors submitting bids under a well established bid depository system. A judge of the Ontario Court of Justice has held that an owner using such a system owes

⁵¹ *Vachon Construction Ltd. v. Cariboo (Regional District)* (1996), 28 C.L.R. (2d) 145 (B.C. C.A.).

⁵² See, for example, *Midwest Management (1987) Ltd. v. BC Gas Utility Ltd.* (1997), 34 C.L.R. (2d) 186 (B.C. S.C.); *McKinnon v. Dauphin (Rural Municipality)* (1997), 35 C.L.R. (2d) 174 (Man. C.A.); *Thompson Bros. (Const.) Ltd. v. Wetaskiwin (City)* (1997), 34 C.L.R. (2d) 197 (Alta. Q.B.); *Chinook Aggregates Ltd. v. Abbotsford (Municipal District)* (1989), 40 B.C.L.R. (2d) 345 (B.C. C.A.); *G. Mallin Electric v. Westland Construction Ltd.* (1996), 29 C.L.R. (2d) 308 (Man. Q.B.).

⁵³ *Bate Equipment v. Ellis-Don Ltd.* (1992), 2 C.L.R. (2d) 157.

⁵⁴ *Ron Brown*, supra; *Fred Welsh*, supra; *Twin City*, supra.

⁵⁵ [1997] S.C.C.A. No. 245.

⁵⁶ W. Donald Goodfellow, Q.C., "Factum Submitted on Behalf of Appellant M.J.B. Enterprises Ltd." (1998), 38 C.L.R. (2d) 24.

⁵⁷ [1997] 2 S.C.R. 217; 146 D.L.R. (4th) 214; 32 O.R. (3d) 716.

a duty of care directly to a subcontractor in tort.⁵⁸ In the case in question, the owner was the Province itself, which was found to have breached its duty by failing to supervise a general contractor's actions in nominating subcontractors. The subcontractor was awarded damages for loss of profits, i.e. pure economic loss. The British Columbia Supreme Court has gone one step further and, after finding a similar duty owed by an owner to a subcontractor, has held the owner liable in contract as well as tort. The court found that a contract A, pursuant to the instructions to bidders as described in *Ron Engineering*, came into existence between the owner and the subcontractor at the time when the latter submitted its bid. The contract, essentially, was not to change the terms of the bid. The owner, however, issued an addendum after the close of tender and thereby breached a duty of fairness it owed directly to the subcontractor. The subcontractor in question was awarded lost profit. It now appears possible that an owner could be liable for lost profit to both the general and the subcontractor.⁵⁹

5. Damages and the Dispute Resolution Process:

Courts are empowered to review arbitrators' awards. The standard of review favors upholding the award wherever possible. If the arbitration agreement states that the award will be final and binding, courts will not review the arbitrator's decision unless the arbitrator has actually acted improperly.⁶⁰ Unless excluded by the arbitration agreement, a court can grant leave to appeal on a question of law if it is satisfied that the importance

⁵⁸ *Twin City Mechanical v. Bradsil (1967) Ltd.* (1996), 31 C.L.R. (2d) 210.

⁵⁹ *Ken Toby Ltd. v. British Columbia Building Corp.* (1997), 34 C.L.R. (2d) 81.

to the parties of the matters at stake in the arbitration justifies an appeal, and the determination of the question of law at issue will significantly affect the rights of the parties.⁶¹ The standard of review imposed by the courts in such cases depends on whether or not the parties have provided for an appeal in their arbitration agreement. In a recent case no such provision was made, and the Ontario Court of Justice held that the appropriate standard was one of “reasonableness”.⁶² In a case concerning a decision of the British Columbia Securities Commission, the Supreme Court of Canada described the range of standards as follows:

At the reasonableness end of the spectrum, where deference is at its highest, are those cases where a tribunal protected by a true privity clause, is deciding a matter within its jurisdiction and where there is no statutory right of appeal... At the correctness end of the spectrum, where deference in terms of legal questions is at its lowest, are those cases where the issues concern the interpretation of a provision limiting the tribunal’s jurisdiction... or where there is a statutory right of appeal which allows the reviewing court to substitute its opinion for that of the tribunal and where the tribunal has no greater expertise than the court on the issue in question...⁶³

The Ontario Court of Appeal, referring to this decision has held that:

...The jurisdiction of a court of appeal is much broader than the jurisdiction of a court on judicial review. Where there is a statutory right of appeal which allows the appellate court to substitute its opinion for that of the tribunal on questions of law or mixed questions of law and fact, and where

⁶⁰ *Superior Propane Inc. v. Valley Propane (Ottawa) Ltd.* [1993] O.J. No. 442 (Ont. Gen. Div.).

⁶¹ *Arbitration Act*, 1991, S.O. 1991, c.17, s.45.

⁶² *Dascon Investments Limited v. 558167 Ontario Limited* [1993] O.J. No. 731.

⁶³ *Pezim v. British Columbia (Superintendent of Brokers)* [1994] 2 S.C.R. 557.

the tribunal has no greater expertise than the court on the issue, then the standard of review is one of correctness.⁶⁴

Findings regarding the quantification of damages will regularly include findings of fact as well as rulings on the law. In *N.M. Paterson & Sons Ltd. v. A & B Rail Contractors Ltd.*,⁶⁵ for example, the appellant set out two grounds of appeal. The first ground alleged that the arbitrator “erred in law by not awarding damages based on the cost of performance, and/or in the alternative, the difference in cost to the builder.” The question was whether the loss ought to be measured based on the cost of performance or on the diminution in the building’s value. The arbitrator held that he was bound by the Saskatchewan Court of Appeal’s decision in *Sedco v. William Kelly Holdings Ltd.*,⁶⁶ which held that while the cost of performance was the *prima facie* measure of damages, considerations of reasonableness were capable of displacing it, as for example when the cost of performance was disproportionately high relative to the value of what was or might be achieved through performance. Having been given very little evidence, the arbitrator held that the cost of replacing the material in the case at bar (construction of a spur rail line) would have been disproportionately high relative to the value of what would be achieved through it, and that therefore considerations of reasonableness displaced the *prima facie* cost of performance measure. The second ground of appeal was that the arbitrator erred “in its award of damages... for winter construction, in that the award is unsupported by the evidence and in direct contradiction to the evidence of the respondent”. The court held that just like the first ground of appeal, this second ground

⁶⁴ *Wedekind v. Ontario* (1994), 21 O.R. (3d) 289.

⁶⁵ (1997), 35 C.L.R. (2d) 193 (Sask. Q.B.).

⁶⁶ [1990] 4 W.W.R. 134.

alleged errors in findings of fact rather than law and therefore the court refused to look at the evidence to attempt to determine whether or not the arbitrator's findings were supported by the evidence.

In a recent Ontario case, the arbitrator in a construction contract arbitration, finding no help in the evidence as to how losses were arrived at, concluded that he was left to reach his own conclusions "as to the fairness of the claims by virtue of the evidence I have heard..."⁶⁷ Due to the weakness of the evidence before him, the arbitrator reduced the award by 25%. The Ontario Court of Justice found no error in this assessment and dismissed the appeal.

It should, finally, be noted that punitive damages are not available in arbitration proceedings in Canada.⁶⁸ In the United States, the New York State Court of Appeal, in *Garrity v. Lyle Stuart, Inc.*,⁶⁹ held that punitive damages were a form of punishment reserved to the state. Chief Judge Breitel held that "the day is long past since barbaric man achieved redress by private punitive measures." He argued that an ability to award punitive damages would give arbitrators a power that would be unpredictable and uncontrollable. The United States Supreme Court, however, in *Mastrobuono v. Shearson Lehman Hutton, Inc.*,⁷⁰ held that investors claiming damages from brokers before a Security Arbitration Board can be awarded punitive damages.

⁶⁷ *Doran Contractors Ltd. v. Russell (Township)* (1997), 35 C.L.R. (2d) 314.

⁶⁸ *Botsis v. Unifund Assurance Co.* [1998] O.J. No. 2346 (Ont. Gen. Div.); *Lee v. Gao* (1992), 65 B.C.L.R. (2d) 294 (B.C. S.C.).

⁶⁹ 40 NY 2d 434, 353 NE 2d (1976).

⁷⁰ 115 S. Ct. 1212 (1995). For the state of law on this issue in the United States, see Franklin D. Ormsten, "Garrity and Mastrobuono: A Continuing Tale of Two Cases" (December 1995) *New York State Bar Journal* 32.

Duncan W. Glaholt obtained his LL.B. from the University of Toronto in 1977 and was called to the Bar of Ontario in 1979. He is the principal of the Toronto construction litigation firm of Glaholt & Associates, a governor of the Canadian College of Construction Lawyers, member of Ontario Trial Lawyers Association, Advocates Society, Defence Research Institute and American Trial Lawyers Association. Mr. Glaholt is a frequent lecturer and contributor on construction topics, including suretyship, insolvency, letters of credit, and insurance and reinsurance issues. He has been the co-author of Carswell's annual *Annotated Ontario Construction Lien Act* series since its inception in 1996, is the author of the recently published volume *Construction Trusts* and the upcoming volume *Construction Claims*, both by Carswell.