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IN THIS ISSUE

Discoverability and the Plausible Inference of Liability Standard

Following the recent Supreme Court of Canada decision in *Grant Thornton LLP v. New Brunswick*, 2021 SCC 31, the Ontario Court of Appeal has offered guidance on the standard to be applied in determining whether a plaintiff has the requisite degree of knowledge to "discover" a claim and trigger the limitation period for commencing a legal proceeding.

In *Gordon Dunk Farms Limited v. HFH Inc.*, 2021 ONCA 681, the Ontario Court of Appeal applied the "plausible inference of liability" standard from *Grant Thornton* to its discoverability analysis under section 5(1) of Ontario's *Limitations Act, 2002*, SO 2002, c 24, Sched B (the "*Limitations Act*").

Notwithstanding, it is likely that plaintiffs in Ontario actions will still enjoy the limits on discoverability afforded by subparagraph 5(1)(a)(iv) of the *Limitations Act,* particularly in the context of claims arising during a construction project.

As a practical point, when entering into a contract, parties should perform a risk assessment and identify key contractual issues. Where one party has any discretion with respect to these key issues, it is important to explore the potential consequences of the exercise

of such discretion and negotiate the appropriate limitations. Generally, the Court will not "save" a party from a bad bargain, so it is critical to draft contracts precisely.

Background

In *Gordon Dunk Farms*, Gordon Dunk Farms Ltd. (the "Owner") engaged a designer, general contractor and concrete trade contractor for the design and construction of a new hog barn on its property. After construction, the barn collapsed on May 6, 2014. The Owner and its insurer jointly retained counsel to sue the designer, general contractor, trade contractor and the municipality for negligence, among other things. The Owner sued to recover the deficiency between its coverage and its actual losses, and the insurer sued on a subrogated basis to recover its payment to the Owner. However, the action was not commenced until May 24, 2016 (i.e., more than two years after the barn collapse).

On motions for summary judgment by all parties, the lower court held that the action was statute-barred under the two-year basic limitation period pursuant to section 4 of the *Limitations Act*. The Owner appealed, which appeal raised two salient discoverability sub-issues:

> (i) the applicable date on which the claim was "discovered" under section 5 of the *Limitations Act*; and
>
> (ii) whether separate negligent acts or omissions alleged in the statement of claim constituted separate claims under the *Limitations Act*.

(i) Date on which the claim was discovered

Shortly after the barn collapse, the insurer retained two engineering firms to prepare causation reports. The first firm, R.J. Burnside & Associates Limited, provided a preliminary view on causation, but then discovered a conflict of interest and had no further involvement. The second firm, Brown & Beattie Building Science Engineering ("Brown & Beattie"), provided a causation opinion on May 21, 2014.

Since May 21 through 23, 2016 was a long weekend, the parties agreed that if the limitation period began to run on May 21, 2014, the date of Brown & Beattie's causation report, the action commenced on May 24, 2016, was in time. Accordingly, the issue here turned on whether the Owner knew or reasonably ought to have known, pursuant to section 5 of the *Limitations Act*, the cause of the collapse before they received the Brown & Beattie report.

Lemon J. of the Ontario Superior Court of Justice held that the Owner knew, or ought to have known, the necessary facts by May 12, 2014 (the date on which they met with their insurance adjuster to discuss the collapse). This was based on the following findings of fact:

> (i) the Owner was experienced in the building of this exact type of hog barn and the barn was of simple construction;
>
> (ii) the barn collapse was not a complicated process and the Owner observed what had occurred; and
>
> (iii) the May 21, 2014 Brown & Beattie report contained no new information that the Owner did not already know.

In dismissing the Owner's appeal on this ground, the Ontario Court of Appeal applied the "plausible inference of liability" discovery standard as set out in *Grant Thornton*:

> And what is meant by "knows" is that the plaintiff has the evidentiary basis to believe that the defendant did an act or made an omission that caused a loss for which a court proceeding is appropriate to obtain a remedy – the basis of a plausible inference of liability, in the words of Moldaver J [in *Grant Thornton*].

Relying on the findings of fact of the motion judge, the Ontario Court of Appeal held that, since the Owner knew that the barn collapsed due to faulty design, construction or inspection, the Owner had a plausible inference of liability in respect of the alleged acts or omissions of the respondents as of May 12, 2014. This finding of the Court was based, at least in part, on testimonial evidence given by the Owner during the conduct of the proceedings.

(ii) Separate actions or omissions of negligence

The Owner also argued that each causal or contributory act or omission of negligence enumerated in the statement of claim constituted the basis of a separate "claim" as defined by the Act. It was the Owner's position that each act or omission required a separate discoverability analysis and, consequently, while some claims tied to specific acts or omissions were statute-barred, others were not. This was also rejected by the Court of Appeal.

In relying on two central cases, *Kaynes v. BP p.l.c.*, 2021 ONCA 36, and *Grant Thornton*, the Ontario Court of Appeal stated:

> Because a claim is for a legal remedy in a court proceeding, one can have a claim for the same remedy based on one or more acts or omissions that may have caused the loss. In pleading parlance, different acts or omissions may constitute particulars of the claim. However, the claim, as defined, is for the remedy itself – in this case, damages for negligence and breach of contract.

Accordingly, the plaintiff "need not know the exact act or omission by the defendant that caused the loss

in order to start the limitation period running". Instead, the plaintiff must know "that the defendant did or failed to do something to cause [the plaintiff's] loss".

Key Takeaways

Summarily, the *Gordon Dunk Farms* decision includes at least three important aspects in respect of discoverability under section 5 of the *Limitations Act*:

(i) based in part on the evidence given during cross-examination, the court found that the Owner knew of the cause of the collapse before an engineering causation report was issued;

(ii) different acts or omissions as pleaded comprise a claim for a legal remedy, and are not claims in themselves; and

(iii) the court adopted and applied the "plausible inference of liability" standard from *Grant Thornton* to the discoverability analysis under section 5 of the *Limitations Act*.

Interestingly, however, in this case, there was very little attention paid to subparagraph 5(1)(a)(iv) of the *Limitations Act*, which provision does not exist in New Brunswick's limitation legislation (recall that *Grant Thornton* was an appeal from the New Brunswick Court of Appeal to the Supreme Court of Canada regarding New Brunswick's *Limitation of Actions Act*, SNB 2009, c L-8.5). Although likely attributable to the surrounding factual circumstances in *Gordon Dunk Farms*, there will no doubt be cases where the "plaintiff has the evidentiary basis to believe that the defendant did an act or made an omission that caused a loss" but is saved by subparagraph 5(1)(a)(iv) of the *Limitations Act*.

In any event, considering *Gordon Dunk Farms*, those with potential claims for structural failure should be wary of the two-year limitation period starting to run in advance of receiving any expert report on causation. This is particularly the case where the would-be plaintiff has knowledge of the involvement of all would-be defendants.

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Admissions and Definitions: The Case of *Alumtech Bond*

Is a general contractor the same as a "contractor" under the *Construction Act*? Does a "closer than usual" relationship between an owner and contractor turn the contractor into a co-owner? These were two of the questions recently considered in *Alumtech Bond Inc. v. Epic Precast Ltd.*, 2021 ONSC 4447. In this case, the defendant general contractor, Suncity, successfully brought a motion under section 47 of the *Construction Act* to declare the lien of the plaintiff lien claimant, Alumtech, expired on account of a failure to be perfected.

Background

Epic Precast Ltd. ("Epic") was the owner of a commercial property. In 2018, Epic hired Suncity Development Ltd. ("Suncity") under a CCDC 3-2016 Cost Plus Contract ("the Construction Contract") to build a commercial plaza at cost, with a guaranteed maximum price of $25,000,000. The Construction Contract also specified that Suncity would earn a fee of 3% of the cost.

In turn, on June 19, 2019, Suncity entered into an agreement with Alumtech Bond Inc. ("Alumtech") whereby Alumtech was to, amongst other things, supply and install aluminum composite panel, fascia, capping and soffit for two of the buildings in the plaza. Alumtech proceeded with its work, and its last date of supply was September 30, 2020. A dispute then arose, after which Suncity terminated its agreement with Alumtech on December 16, 2020.

On October 21, 2020 Alumtech registered a claim for lien in the amount of $26,067.21. The parties did not dispute the timeliness of the preservation of the lien. What was disputed, however, was whether Alumtech perfected its lien in time. Alumtech waited until January 12, 2021 to commence its action. On January 13, 2021 it registered a certificate of action, a period of 109 days after the date of last supply.

A threshold issue before the Court was what version of the *Construction Act* applied: the statute as it read on June 29, 2018 (the "Old CA"), or after that date (the "New CA"). If the former applied, then Alumtech had 90 days to perfect its lien, and therefore it was out of time (109 days was 19 days too late). If the latter, then it had 150 days to perfect.

On the motion, Alumtech argued that its lien was properly perfected. Its principal argument was that the Construction Contract between Epic and Suncity was a sham: Suncity was actually an "owner" under the *Construction Act*, making Alumtech a "contractor". If so, then Alumtech's lien was properly perfected for two reasons:

1. Section 87.3(1)(a) of the *Construction Act* specifies that if "a contract for the improvement was entered into before July 1, 2018", the Old CA applies. But if the Construction Contract was <u>not</u> a valid contract, then it would <u>not</u> trigger the application of this provision. Thus the period for perfection would be 150 days (under the New CA) and not 90 days.

2. If it were a "contractor", Alumtech's lien period would not start to run until the date of formal contract termination, December 16, 2020, as opposed to the date of its last supply, September 30, 2020.

Alumtech's Admissions

In examining these arguments, the Court first noted that, by its own admission, Alumtech had conceded that it was not a "contractor" but a "subcontractor" under the *Construction Act*. In the Court's opinion, these admissions were "telling". For instance, Alumtech had pleaded that Epic was at all material times the owner of the Property, but made no reference to any other entity as being an owner. It also pleaded that Suncity was a "general contractor". Both of these admissions were reiterated in its claim for lien, in which it again named Epic as an owner and Suncity as a general contractor.

The Court found that the above were "clear admissions" and held that Suncity could rely on them on its motion to declare the lien expired. Simply, there was one owner on the project, Epic, and one general contractor, Suncity. There was no cross-motion by Alumtech seeking to withdraw these admissions, nor evidence containing a satisfactory explanation for these admissions.

Alumtech did, however, advance an argument that the reference to Suncity as a "general contractor" was a "colloquialism" with a different meaning than the defined meaning of the word "contractor" in the *Construction Act*. The Court rejected this argument, finding the suggestion "puzzling", and held as follows (at para. 21):

> In my experience, the common use of the words, "general contractor," parallels exactly how the CA defines "contractor," namely the party with the contract with the owner. It does not include the concept of ownership. That is how I interpret the use of the words, "general contractor," in the statement of claim.

Accordingly, the Court found that Alumtech had admitted to Epic being the owner, and Suncity being a contractor. As such, the Construction Contract between them was a "contract" as defined under the *Construction*

Act, and, as it was entered into before July 1, 2018, triggered the application of the Old CA. This meant that as a subcontractor, Alumtech only had 90 days under the Old CA to perfect its lien, which it failed to do.

Other Circumstantial Evidence of The Alleged "sham" Construction Contract

Interestingly, and while not necessary to disposing of Suncity's motion, the Court went on to opine on other aspects of Alumtech's arguments. Specifically, it considered the argument that the evidence created a triable issue of a Suncity interest in the plaza as a co-owner. A triable issue would have defeated Suncity's motion.

To that end, Alumtech introduced several pieces of circumstantial evidence, including:

1. Suncity introduced Epic to the property and entered into an alleged construction contract with Epic just a day after Epic bought the plaza;

2. the Construction Contract had a fee for Suncity, 3%, that was well below market rate thereby creating an unusually favourable contract for Epic;

3. Epic did not keep holdback on periodic payments to Suncity creating unusually favourable payments to Suncity and risk to Epic;

4. Suncity admitted having a side agreement with Epic giving Suncity naming rights on signs in the plaza and in advertisements;

5. Suncity marketed plaza properties for sale; and

6. Suncity employees referred to the relationship between Epic and Suncity employees as a "partnership."

Yet, despite the fact that this was "evidence of a closer-than-usual relationship between a contractor and an owner", the Court doubted that it would be enough to create a triable issue. The Court accepted Suncity's argument that the evidence could "point in other directions or in no direction (at para. 27):

> A close relationship between an owner and contractor is not unheard of and does not per se make the contractor an owner. One does not have to be an owner to sell units in the plaza. The agreement about naming rights could be a license agreement and nothing more. There was no evidence as to what the market rate for a management fee for a project of this size was at the time and, therefore, it is unclear whether the contract was indeed favourable to Epic. Furthermore, 3% of $25,000,000, namely $750,000, is not an insignificant amount of money. In addition, a failure to retain holdback by an owner, while not common, is not unheard of, particularly when there is inadequate legal advice on the matter. As to the references to "partnership" in emails, I was not shown evidence that the authors of those emails clarified what they meant by those references. They could, as a result, have been talking about a "contract" relationship.

Ultimately, the Court did not have to rule on any of these evidentiary matters. The judgment does, however, suggest that had Alumtech not made its admissions, perhaps a clearer (less circumstantial) set of facts could have resulted in the Court finding that the relationship between Epic and Suncity was one of co-ownership, not owner-contractor.

In the result, the Court granted the motion to declare the Alumtech lien expired, and ordered that it be vacated and the posted security returned to Suncity. The case is a salutary example of how parties should be careful in framing their pleadings, as the status of a lien claimant being a contractor, as opposed to a subcontractor, could matter for the purposes of whether a lien is preserved or perfected in time.

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The Use of Promissory Estoppel to Save an Expired Lien

Introduction

In our Spring 2019 Newsletter, we discussed the decision of Justice Doi in *J.D. Strachan Construction Limited v. Egan Holdings Inc. and Egan Funeral Home*, 2019 ONSC 522. In that case, the lien claimant attempted to rely on the doctrine of promissory estoppel to argue that its lien had not expired for failure to perfect it in accordance with the timelines of the *Construction Act*.

While in the result, the court declared Strachan's lien expired and allowed the claim to continue in contract, the court did so on the basis that the defendants had not made any representations that would have led the lien claimant to expect that strict legal rights and obligations under s.31(2)(a)(i) of the Act would not be enforced. In other words, the court held that on the facts, the test for estoppel had not been met; the court did not find that the doctrine had no application in the context of construction lien timelines to begin with.

On that basis, the court distinguished two earlier Ontario decisions that had applied estoppel in lien actions, *Valo v. 430327 Ontario Inc.* (1982), 36 OR (2d) 439 (Master) and *Soo Mill & Lumber Co. v. 499812 Ontario Ltd.* (1984), 17 C.L.R. 306 (Ont. H.C.).

We commented in 2019 that the difficulty with Justice Doi's analysis regarding promissory estoppel was that such an argument was not consistent with the *Construction Lien Act* or the *Construction Act*, since the period to perfect a lien under section 36(2) of the *Construction Lien Act* is an expiration period, not a limitation period, the wording of section 36(2) is clear that a preserved lien expires unless it is perfected in time, that once the expiration period to preserve or perfect a lien has lapsed, the lien cannot be revived, and that parties cannot contract out of the Act.

The Ontario Divisional Court has now upheld the judgment of Justice Doi on the basis that the decisions in *Valo* and *Soo Mill* were distinguishable on the facts before him, and that was enough to dispose of the appeal. In *obiter*, however Justice Corbett made the following comment (emphasis added):

> 17 I note, further, that a construction lien does not just affect the rights and interests of the claimant and the owner. It can affect the position of other claimants on the site (contractors, subcontractors, workers and suppliers), and it can affect the position of lenders, including construction lenders. The CLA expressly provides that parties may not contract out of provisions of the Act: it is arguable that this provision would not permit promissory estoppel to operate to defeat deadlines stipulated in the Act.
>
> 18 Promises to pay, even ones that are stated to be contingent on a claimant altering his position to his detriment (for example, promising to pay next week so long as a lien is not registered), happen frequently in construction contracts. If such promises — to pay — could have the effect of extending deadlines, then lenders would not be able to be sure that a lien will not emerge later that would otherwise be out of time. The "promises" could cascade down the "construction ladder". The strict deadlines on the Act could be defeated. I would not decide this issue in this case, where it is clear that the facts do not give rise to promissory estoppel.

However, this decision does not signal that promissory estoppel can arise to defeat the deadlines in the CLA.

Case Law

In *Valo*, the owner met with a contractor during the time in which the lien could be preserved. During negotiations, the owner told the contractor that the lien rights "were not a problem because we were mutually extending time for payment in order to allow him to complete the calculations at which time he expected to be able to pay the moneys owing for supervision services and materials, and for the bonus, if any". The contractor testified that it was his clear understanding based on this that he would still be able to register a lien. The court held that he was justified in thinking that, particularly in view of the fact the owner was a lawyer. In the end, based on that representation, the contractor did not register the claim for lien in time, and the owner applied to have the lien discharged on the basis that it was expired.

The court refused to discharge the lien. Even though it was presented with law to the effect that the time for registering a claim for lien could not be extended by agreement, the court found that in circumstances before it, the owner's conduct estopped him from raising the defence that the claim for lien was registered out of time.

That decision was followed in *Soo Mill*, where the defendants advised the claimant that if it did not file a lien, they would make appropriate arrangements for payment. The judge agreed that the defendants were later estopped from arguing that the lien, when eventually filed, was out of time.

Both decisions were heavily criticized in other jurisdictions but were not discussed in any detail in subsequent Ontario decisions until *Strachan*. The only support for the Ontario line of cases came out of Alberta, where courts held that there could not be an absolute prohibition to applying this doctrine whenever there is a lien: *TRG Developments Corp. v. Kee Installations Ltd.*, [2014] 12 W.W.R. 385 (Alta. Master); affirmed (2014), 39 C.L.R. (4th) 93 (Alta. Q.B.), affirmed [2015] 10 W.W.R. 639 (Alta. C.A.). The most recent authority on point before *Strachan* was the Alberta Master's decision in *Boulevard Real Estate Equities Ltd. v. 1851514 Alberta Ltd.*, 2015 ABQB 619, in which the court held that where supported by appropriate evidence, an owner of land in Alberta may be estopped from asserting that a builders' lien filed against its land was filed out of time.

Throughout the rest of Canada, the Ontario cases were rejected. The Nova Scotia Supreme Court, in *Gateway Materials Ltd. v. B.H. Fancy Construction Ltd.*, (1994), 17 C.L.R. (2d) 128, held that *Soo Mill* was contrary to established law that parties cannot agree to extend the time for filing a lien.

In *Catt Steel Services Ltd. v. Delta (Corp.)*, (1995), 26 C.L.R. (2d) 170, the British Columbia Supreme Court held that the time limitations in the Act were to be strictly applied and that the doctrine of promissory estoppel had no application.

A Newfoundland court, in *Weir's Construction Ltd. v. D.A.R. Enterprises Ltd.*, 2005 NLTD 16, held that both *Valo* and *Soo Mill* were unsound law and that regardless of the facts, the equitable doctrine of estoppel could never validate an expired lien.

A 2005 Ontario case, *H.H. Angus & Associates Ltd. v.* Salter Farrow Pilon Architects (2005), 42 C.L.R. (3d) 305 (Ont. S.C.J.), without discussing *Valo* or *Soo Mill*, refused to apply estoppel in a *Construction Lien Act* context:

> In my view, estoppel cannot arise in circumstances where a statute provides mandatory terms. The legal relationship in matters involving construction contracts is governed not only by the contract between the parties, but also by operation of statute. While estoppel may apply on those parts of the contract which are not effected [sic] by the *Construction Lien Act*, they cannot in my view apply to permit waiver out of the statutory provisions.

It is respectfully submitted that this is a sound approach. As Justice Orsborn stated in *Weir's Construction*:

> 23 The authorities are clear that a mechanics lien is a creature of statute. It is a security interest created in derogation of the common law; it is intended to protect the interests of a defined class, and proceedings are structured to benefit not simply one lien claimant, but the entire class of lien claimants who have claims against any particular owner.
>
> 24 The exercise and enforcement of a mechanics lien depends on strict compliance with the statutory provisions. In essence, the lien lives and breathes and dies according to the statute.

Similarly, the Ontario Divisional Court, albeit in a different context, has made it clear that the Act provides a complete code for securing the price of services and materials provided to an improvement: see *Scepter Industries Ltd. v. Georgian Custom Renovations Inc.*, 2019 ONSC 7515 (Div. Ct.).

Justice Corbett's *obiter* comments in *Strachan* indicate that going forward, Ontario courts will likely follow that reasoning and lien claimants who miss the statutory deadlines to preserve or perfect their liens will have a much more difficult time to persuade a court to apply the doctrine of promissory estoppel to save their liens.

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Mandatory Arbitration and Incorporation by Reference Clauses: Determining Party Intent

Malcolm Drilling Company Inc. v. The Graham-Aecon Joint Venture[1] is a reminder to contracting parties of the need to craft clear dispute resolution clauses.

During the construction of an odour control treatment facility, Malcolm Drilling Company Inc., the subcontractor on the project, encountered difficulties during drilling and was forced to abandon some of its equipment.

Malcolm Drilling later filed a civil claim in the British Columbia Supreme Court against the general contractor, Graham-Aecon Joint Venture, for the cost of the abandoned equipment valued at $530,000.

Graham sought a stay of proceedings on the basis that the parties were contractually bound to arbitrate project disputes. Malcolm Drilling took the position that arbitration was voluntary, and the parties had the choice of resolution through the Court.

The sole legal issue was whether the dispute resolution clauses in the subcontract mandated arbitration.

The Court found that arbitration was indeed mandated under the subcontract.

To begin its analysis, the Court reviewed the language of both the prime contract and subcontract. The prime contract, between Graham and the Greater Vancouver Sewerage and Drainage District, made clear that arbitration was voluntary and if the parties did not agree to arbitrate, a court of competent jurisdiction in British Columbia could decide the matter. The prime contract also contained a clause requiring all subcontracts to incorporate all prime contract terms.

There was a mirror "incorporation by reference" clause in the subcontract between Malcolm Drilling and Graham suggesting the parties would be bound by the terms of the prime contract. This, however, did not end the Court's inquiry because the subcontract also contained a stepped progression toward arbitration. That is, the contractor must provide its initial decision in a dispute between the parties and if the parties are dissatisfied with the initial decision, they move on to mediation. Then, if mediation is unsuccessful, one of the parties "shall be entitled to give the other a request to arbitration".

The stepped progression in combination with such phrases in the subcontract as "shall be settled as follows" and "shall be entitled to give the other notice of a request to arbitrate" and "the decision of the arbitrator will be final and binding upon the parties" were all viewed by the Court as key indicators of the parties' intent to make arbitration mandatory.

Despite the use of an incorporation by reference clause in the subcontract and apparent conflict between the prime contract and subcontract in utilizing arbitration, the Court reasoned that the true intent of the parties required further investigation. Ultimately, it was the use of stepped progression dispute clauses which made it clear that arbitration was mandatory in the subcontract.

Furthermore, the Court pointed to the fact that as part of the dispute resolution clauses, Graham was given a peremptory right to refuse arbitration. This right implied that arbitration must be mandatory because if it were not, the peremptory right would have no meaning.

The Court determined there was no actual conflict between the prime contract and the subcontract and the two could be read harmoniously. The dispute clauses in the prime contract allowed the parties to choose whether they wanted to arbitrate, and the subcontract's dispute clauses were merely an indication of the parties' agreement to mandate arbitration as allowed under the prime contract.

The Court focused on the structure of the dispute provision in the subcontract as the main basis for its ruling and also reflected upon the evolution of the judiciary's response to arbitration clauses in contracts. A historic period of "judicial hostility" was eventually replaced by a clear support of and strong deference to arbitration clauses as evidence by the Supreme Court of Canada's ruling in *Seidel v. Telus Communications Inc.*[2] Moreover, in British Columbia, the legislature communicated a clear intent in the province's *Arbitration Act* that arbitration clauses must be given deference by a court unless it is determined that an arbitration agreement is "void, inoperable or incapable of being performed." This is coupled with the competence-competence principle, whereby any jurisdictional issue raised with respect to arbitration agreements must first be decided by the arbitrator.[3]

Taken together, these factors were the turning point for the court in ruling that arbitration was mandatory under the subcontract. The stay of proceedings was therefore granted to Graham.

1. 2021 BCSC 1136.

2. 2011 SCC 15.

3. *Clayworth v. Octaform Systems Inc.*, 2020 BCCA 117.

Malcolm Drilling signals the importance of clear drafting especially as it pertains to dispute resolution clauses.

If it is the parties' intent to have mandatory arbitration following other dispute resolution steps, they should explicitly state that each step is a condition precedent to the next. For instance, the contactor must first provide its decision in writing concerning the dispute as a condition precedent to seeking mediation, an unsuccessful mediation is then a condition precedent to arbitration and an arbitrator's decision shall be final and binding upon the parties.

In *Malcolm Drilling*, we see the court placing emphasis on the surrounding context and contractual language incorporated by the parties even where an incorporation of reference clause is used. No party should simply rely on boilerplate language but be mindful that courts may look past the incorporation of reference clause to determine "true" intent. Parties should ensure they are familiar with the incorporation of reference clauses in both the prime contract and subcontract and have a clear means to avoid any apparent or actual conflict between such clauses in addition to the dispute resolution provisions.

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Spirit Bay Developments Limited Partnership v. Scala Developments Consultants Ltd, 2021 BCSC 1415

In *Spirit Bay Developments Limited Partnership v. Scala Developments Consultants Ltd.*, 2021 BCSC 1415, Spirit Bay Developments Limited Partnership (the "Owner"), contracted with Scala Developments Consultants Ltd. (the "General Contractor") for the construction of custom homes on Vancouver Island. Subsequent to the General Contractor commencing construction of the custom homes, and without meeting the 60-day notice requirement set out in the termination clause, the Owner terminated the contract and immediately contracted with a different contractor. Notwithstanding the termination, the General Contractor continued its work on the homes that it had already started building. The General Contractor claimed that its post-termination work was done pursuant to an oral agreement that it had made with the Owner – the agreement being that the Owner would pay for the post-termination work. The Owner denied the existence of such an agreement and failed to pay the General Contractor. Accordingly, the General Contractor commenced a private arbitration seeking payment of all outstanding amounts on its invoices given to the Owner. Generally, the arbitral award was in favour of the General Contractor and, among other things, awarded damages for the post-termination work on the basis of unjust enrichment. The Owner sought, and was granted, leave to appeal the arbitral award on questions of law from the Supreme Court of British Columbia under paragraph 31(1)(b) of the, now repealed, *Arbitration Act*, RSBC 1996, c 55. The most salient portions of the decision in *Spirit Bay* relate to: (i) the standard of review applicable to statutory appeals from private arbitral awards, and (ii) court orders for the re-hearing of a dispute before an arbitrator different than the one in the first instance.

(i) Standard of Review – Private Arbitral Awards

In carrying out the standard of review analysis, the court reviewed four cases from the Supreme Court of Canada: (1) *Sattva Capital Corp v. Creston Moly Corp*, 2014 SCC 53, (2) *Teal Cedar Products Ltd. v. British Columbia*, 2017 SCC 32, (3) *Canada (Minister of Citizenship and Immigration) v. Vavilov*, 2019 SCC 65, and (4) *Wastech Services Ltd. v. Greater Vancouver Sewerage and Drainage District*, 2021 SCC 7.

Justice Davies commenced his analysis with a review of *Vavilov*, which provides that "where the legislature has provided for an appeal from an administrative decision to a court, a court hearing such an appeal is to apply appellate standards of review to the decision" [emphasis added]. Of course, this means that questions of law would be reviewed against a standard of correctness, and questions of fact would be reviewed against a standard of palpable and overriding error. However, Justice Davies noted that prior to *Vavilov*, the decisions in *Sattva* and *Teal* provided that the judicial standard of review for statutory appeals of arbitral decisions on questions of law was "almost always" reasonableness – the exceptions being constitutional questions and questions of law of importance to the legal system as a whole outside the arbitrator's expertise.

The central question was whether the appellate standards of review imposed upon public administrative decision makers in *Vavilov* applied, and overrode, the traditionally deferential reasonableness standard applicable to private arbitral awards from *Sattva* and *Teal*? In the light of this question, Justice Davies reviewed the recent *Wastech* decision and noted that the majority of the Supreme Court of Canada court declined to clarify what effect, if any, *Vavilov* has on *Sattva* and *Teal*.

So, in the face of the uncertainty, which standard of review did Justice Davies apply to the statutory appeal of the private arbitral award in *Spirit Bay*: reasonableness per *Sattva* and *Teal*, or the appellate standards per *Vavilov*? In concluding that the standard of reasonableness applied, Justice Davies stated that "[a]lthough…the majority in *Wastech* has allowed some uncertainty in administrative law to continue, I am satisfied that *stare decisis* requires that the reasonableness standard enunciated in *Sattva* and *Teal Cedar* must still be applied in determining the issues raised on this appeal." Those issues, of course, were questions of law.

(ii) Re-Hearing before a Different Arbitrator

Following an analysis of the case law relied upon in the arbitral award, Justice Davies found that the appeal should succeed on the ground that the arbitrator had unreasonably erred on questions of law related to contractual interpretation and unjust enrichment. Justice Davies opined that the arbitrator failed to make necessary findings of fact related to the terms of the post-termination contract. Accordingly, the arbitrator noted that it was unreasonable for the arbitrator to find an absence of a juristic reason for the Owner's non-payment without clear findings as to the terms of the post-termination contract. Consequently, the court ordered that the parties undergo a re-hearing to conduct the necessary fact-finding and accordant application of the law.

Interestingly, Justice Davies ordered that the re-hearing of the specific issues be conducted by a different arbitrator. This order was influenced by the British Columbia Supreme Court decision in *British Columbia Nurses' Union v. British Columbia (Labour Relations Board)*, 1995 CarswellBC 992. In *BCNU*, the court opined that "when a decision turns, as the case at bar does, on a disputed issue of credibility, it is approaching the impossible to ask the tribunal of first instance to revisit the matter with a view to possibly reversing those findings and making new findings." In *Spirit Bay*, Justice Davies opined that the arbitrator of first instance "made findings of credibility adverse to Spirit Bay's representatives" and "harshly characterized Spirit Bay's conduct in relation not only to the disputes in issue but also within the arbitration." Accordingly, and notwithstanding the potentially prohibitive expense, Justice Davies ordered that the re-hearing be conducted by a different arbitrator.

Conclusion

Until clarified by the Supreme Court of Canada, there remains uncertainty in which standard of review is applicable to statutory rights of appeal from private arbitral awards in Canada. At least for now in British Columbia, it seems that the deferential standard of reasonableness will apply. Additionally, *Spirit Bay* serves as a warning to arbitrators and disputants that findings adverse to a party's credibility invite the potential of a re-hearing before a different arbitrator (and the additional time and costs attached thereto). Accordingly, *Spirit Bay* underlines the importance of parties to a construction dispute appointing an arbitrator who has both experience with the underlying legal issues and a track record of impartiality and independence. Retaining counsel well-versed in contract law also mitigates the risk that relevant authorities governing the principles of contractual interpretation and unjust enrichment will be misapplied. Although trite, *Spirit Bay* also serves as a reminder that contractors should always have a written agreement in place before supplying services or materials to a project. Avoiding the uncertainty and expense of an appeal from an arbitral award is to the benefit of all.

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Lienability: The Priority to Recover Payment From Those Under Bankruptcy and Insolvency Protection

There's a passage in Ernest Hemingway's novel *The Sun also Rises* in which a character named Mike is asked how he went bankrupt: "Two ways," he answers. "Gradually, then suddenly." We've all heard the story before… It starts with a delay in payment, then one is missed entirely – the next thing you know, you are knee deep in legal proceedings trying to recover some of the costs you expended on a project.

Many contractors and suppliers in Canada are willing to risk this gradual slope, believing that they will ultimately be able to rely on their statutory lien rights to provide some protection from the impending cliff. As any construction lawyer will tell you, however, liens are not always as simple as they sound. The fundamental question that needs to be asked, specifically in an insolvency context, is whether the contractor or supplier's claim is "lienable".

The lienability of a claim is determined pursuant to s.14(1) of the *Construction Act,* which provides: "A person who *supplies services* or *materials* to an improvement for an owner, contractor or subcontractor, has a lien upon the interest of the owner in the premises improved for the price of those services or materials". In practice, the question of lienability often comes down to three things that need to be analyzed – "supplies services" or "materials" to an "improvement".

The court in *Toronto Dominion Bank v. 450477 Ontario Ltd.*, 2016 ONSC 4908 (S.C.J., Commercial List) reviewed the test for "lienability", specifically looking at different variations where materials and services are on-site and non-construction related, or off-site and construction related. In this regard, Master C. Wiebe stated that: "The test should be a functional one, namely one that turns on the importance of the function to the project served by the work, not on the geographical location of the work or on the object of the work." Therefore, a link must exist between the services or material and the improvement to the project, and determining whether this nexus exists, requires an in-depth factual analysis.

The important takeaway from this is that not every claim will be covered by the lien and a contractor or supplier would have to recover that amount through the normal dispute resolution channels. Lienability becomes even more crucial when the main contractor goes into bankruptcy and insolvency protection, as it can then mean the difference between having a priority claim against the funds available for distribution or hoping that some scraps are left to partially satisfy a general unsecured claim. Lienability is directly linked to priority, and consequently recoverability, and the onus of proving this falls on the creditor's shoulders. It may therefore be useful to look at specific examples of what claims are and aren't lienable:

Delay Damages

In *Stucor Construction Ltd. v. Brock University*, 2001 CarswellOnt 3678, Taliano J. summarized the position in relation to delay damages: "It is clear from this section [s.14(1)] that a lien does not lie to recover damages suffered as a result of a tort or breach of contract since such a recovery would not form part of the "price" of the services and materials supplied to the improvement… Although the contract contains a provision for reimbursement to the plaintiff for costs incurred as a result of delay for which the defendant or its agents are responsible, it is one thing to have a right to recover damages for breach of contract and quite another to be entitled to a lien."

A clear distinction should be made between the entitlement to claim damages and the lienability of such claim. The Court however went on to clarify that delay costs could, in certain circumstances, be lienable: "…damages which can be equated to compensation for the supply of services or materials to an improvement can support a claim for lien. Accordingly, even though the plaintiff itself has characterized its claim as being partly for damages, if its allegations regarding the owner's delay are valid, and its claim is subsequently determined to have added value to the improvement in the form of services and materials, then the lien is enforceable."

Although the court did not specifically mention the test that applies, the reasoning provided appears similar to *Toronto Dominion*. One must also distinguish between the type of damage, which does support a lien and damages flowing from, for example, loss of profits on other jobs which it was unable to undertake because the respondent's delay unduly prolonged work on the present job. The latter claim would not be lienable.

Overhead Costs

Administrative overhead and onsite office overhead costs are generally not lienable. In *Selectra Inc. v. Penetanguishene (Town)*, 2016 ONSC 2293, the court listed a number of non-lienable services, which included among other things: Setting up a sales office; Making building permit applications; Negotiating with various building trades; Dealing with local municipal officials; Communicating with and assisting the site supervisor with respect to decision making; Supplying construction management services including *inter alia* reviewing tenders, selection of trades, supervision of site superintendent and coordination of trades; Hiring; Reviewing tender documents

and calculation of bids; Review of blueprints to assess material and labour requirements; Communications with suppliers to solicit quotes and coordination of the responses; Maintenance of binders at the office containing key project information; and preparation of progress billing statements.

These services often cannot be said to be supplied in respect of an improvement as those services are "not so directly related to the construction of the improvement" to fall within the contractual chain on construction projects that are given a financial preference and a security interest by the Act.

In *Structform International Ltd. v Ashcroft Homes Construction Inc*, 2013 ONSC 4544 (S.C.J.), the court noted that the extended duration costs claimed by the lien claimant such as crane and forming equipment as well as outside rentals such as concrete pumps being on site for the extended duration of the contract were legitimately lienable. However, other elements of the "delay costs" were simply a damage claim and not subject to lien rights. These included the "head office overhead" and meal allowance and fuel allowance charges which were never the responsibility of the owner under the contract. These amounts had to be backed out of the claim for extended duration for lien purposes.

A distinction should also be made between fixed price and cost-plus contracts. Fixed price or lump sum contracts already incorporate an element of overhead and profit in the contract price and therefore form part-and-parcel of the value of the improvement. Cost-plus contracts however, divorce overheads and profit, potentially excluding them from the value improvement.

There are a number of (often conflicting) judgments dealing with claims for overhead costs, however, the golden thread that seems to run through these judgments is a question of whether the materials or services, "*…contribute in a direct and essential way to the construction and improvement*."

Additional Labour

The classic case on claims for additional labour is *Marentette Bros. Ltd. v. City of Sudbury et al.*, 1972 CanLII 615 (ON SC); affirmed 1974 CanLII 444 (ON CA). The principle of that case is summarized as follows: "Where an owner fails, in breach of his obligation under a building contract, to facilitate the work for the contractor, and the contractor, in order to complete on time, is consequently compelled to make movements of men and machinery that would otherwise have been unnecessary, there is an implied contract that the owner, by requiring completion, will pay the reasonable value of the additional work caused to the contractor by the owner's default."

In *Structform*, the court recognized the possibility of additional labour hours forming the subject of a lien, where the labour hours reflect the labour actually used on the improvement and not already contained in change orders. The court however added an additional consideration when it comes to fixed price contracts, stating: "A contractor cannot simply charge extra labour charges to a fixed price contract because it had to use more labour than "usual". Some amount of risk of cost escalation is assumed by the contractor."

Section14(1) concludes with the following, "…improved for the price of those services or materials." This adds an additional factor to consider, as a claimant will only be entitled to the actual "price". As in *Structform*, the court in *Selectra* shared a similar view in relation to fixed price contracts:

"A lien is limited to the amount a contractor is owed. If there is a fixed price contract, in the absence of approved change orders, the contractor cannot include in its claim for lien extra labour or materials charges for work described in the fixed price contract simply because those costs were more than usual or anticipated when the fixed price contract (or change orders) were agreed to. Some amount of risk of a cost escalation is assumed by the contractor."

Legal Expenses

In *Franro Property Development Ltd. v. Heritage Glen North Ltd.*, 1993 CarswellOnt 2572 (Gen. Div.), the court cited *Re Canario Development Corp. and Fitzsimmons, MacFarlane*, a decision of the Ontario Supreme Court, for the proposition that "services" referred to in the *Construction Lien Act* of Ontario do not include legal services which are covered by the *Solicitors Act* of Ontario and which cannot be the subject of a claim for lien."

Conclusion

The question of lienability is often a fine line, and there isn't always a guarantee that a claim will receive protection under the Act. Parties should be cautious and open to potential signs that there is trouble up the construction pyramid. Parties should also remember to explore other potential avenues for recovery in addition to a lien, including trust claims or claims under any labour and material payment bond.

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Notable Case Law

***Volta Electric Ltd. v. 2136615 Ontario Limited*, 2021 ONSC 5403 (S.C.J.)**

In a construction lien action, a request to admit is an interlocutory step requiring leave of the court. A party to a lien action cannot deliver a request to admit without leave of the court and rely on counsel's inadvertence in failing to respond in a timely manner to gain a strategic advantage. A request for additional time as a result of counsel's inadvertence or the inability to obtain instructions from a client represents a reasonable basis to seek a short indulgence from opposing counsel for the plaintiff. There is no sacrifice of a client's rights to allow for the correction of a clear and simple mistake made by opposing counsel on a matter that has nothing to do with the merits of the dispute between the parties.

***Drummond v. O'Brien*, 2021 PESC 28**

The P.E.I. Supreme Court refused to order the discharge of a lien, even though the statement of claim made no mention whatsoever of a lien, where a statement of claim specifically identified the parties, the project, the location of the property and the amount claimed. The court held that there was nothing in the statute which required the statement of claim to specifically reference the lien, nor to specifically reference the *Mechanics' Lien Act*.

***Northstone Homes Ltd. v. Wu*, 2021 ONSC 5173 (Master)**

A set-off defence and counterclaim were struck where they were not advanced in any meaningful way. The defendant had not complied with disclosure obligations, refused relevant questions on discovery, and provided no indication of when, if at all, he intended to provide evidence supporting his positions on deficiencies, incomplete work, and other claims. In those circumstances, there could not be an orderly or fair adjudication of either the set-off defence or counterclaim, and it was appropriate that they be struck.

***1917196 Ontario Ltd. v. Kazmi*, 2021 CarswellOnt 12734 (Associate J.)**

Motions to amend pleadings are interlocutory steps that are not expressly provided for by the *Construction Act* and therefore shall not be taken without the consent of the court obtained upon proof that the steps are necessary or would expedite the resolution of the issues in dispute. The onus rests with the moving party to establish the grounds for leave.

***Scott, Pichelli & Easter Limited v. Dupont Developments Ltd.*, 2021 ONSC 6579 (Div. Ct.)**

Do prior mortgagees or lien claimants have priority over arrears in interest, fees, charges and expenses that relate to the mortgage?

The motions judge, Justice Sossin, as he then was, refused to confirm a report by Master Albert, holding that pursuant to s. 78(3) of the Act, a vendor take back mortgagees' priority did not extend to fees, charges and expenses beyond those relating directly to the sale of the property, such as legal expenses.

The Divisional Court overturned that decision and confirmed Master Albert's report. The court held that once the motions judge concluded that the VTB had priority over the lien claimants, the analysis should have ended. The whole of the mortgage had priority, and that included interest and reasonable charges to enforce the mortgage.

The court also found that when a prior mortgage is in default, arrears of interest along with reasonable charges, expenses and fees that relate to enforcement of the mortgage are not issues to be adjudicated in a proceeding concerned with priority. In such circumstances, the determination of the amount owed on a mortgage in default, be it arrears in interest and reasonable expenses incurred should be determined through proceedings such as power of sale proceedings, bankruptcy proceedings or through the appointment of a trustee.

***Mahendran v. 9660143 Canada Inc.*, 2021 ONSC 6678 (S.C.J.)**

A lien claimant entered into an agreement with the property owners pursuant to which he would build and supply services and materials for the construction of a house at the property. Upon completion, both parties would sell the house, and the lien claimant would be paid for his time, supervision and materials plus a percentage of the profit on the investment. In such circumstances, the lien claimant was held to be an owner. Being an owner, he could not also be a contractor, and the lien was ordered discharged.

***Yanic Dufresne Excavation Inc. v. Saint Joseph Developments Ltd.*, 2021 ONSC 6633**

Purchasing hockey tickets and sponsoring festivals using construction financing funds constitute a breach of the trust obligations under the *Construction Act*. Liability for such wrongdoing on the part of a fiduciary survives bankruptcy.

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Building Insight Podcasts

Episode 26: Considerations When Liening Condominiums

March 2021

John Paul Ventrella, associate, and Justyne Escujuri, law clerk, discuss key considerations when liening condominiums.

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Episode 27: Changes with the New CCDC-2 2020

April 2021

Markus Rotterdam, director of research, and Pavle Levkovic, associate, discuss the new features of the CCDC-2 2020 compared with the 2008 version and the reasoning for, and effect of, these changes

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September 2021

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Episode 31: A Lawyer's Duty to the Court (Part 2): Updates on *Blake v. Blake*

October 2021

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