RECENT DEVELOPMENTS IN CONSTRUCTION LAW AND CURRENT TOPICS OF INTEREST

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Introduction

This paper reviews recent decisions that analyze the duty of fairness and the tendering process, reviews several recent decisions dealing with the interplay of construction claims and insurance law, reviews common mistakes that can, and continue to be made, preserving or perfecting a lienable interest under the Ontario *Construction Lien Act*, and deals with some recent cases of note on the issues of construction arbitration, and holdback and trust claims.

I. Tendering Law in Canada

The Canadian law of tendering is complicated and difficult to understand. It starts with the concept of two separate contracts, as set out in *Ron Engineering*, and ends with a duty of fairness in the law of tendering, as established in *M.J.B.* and *Martel.* From these foundations, clever lawyers and frustrated clients have litigated the tort and contract issues which overlap. While these issues are often lost in the shuffle they have recently been brought to light, and are clearly articulated in two recent cases in *Hub Excavating Ltd. v. Orca Estates Ltd. (April 2009)* and *Design Services Ltd. v. Canada (May 2008).*

Any discussion of Canadian tendering law and the duty of fairness must begin with reference to three seminal decisions of the Supreme Court of Canada: *R. .v Ron Engineering & Construction (Eastern Ltd.)*[2], *M.J.B. Enterprises Ltd. V. Defence Construction (1951) Ltd.*[3] and *Martel Building Ltd. v. R.*[4] These three decisions established the legal principles that underlie the implied duty of fairness in a bidding context, and the recent developments in construction law are built on these cases.

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[2] [1981] 1 S.C.R. 111 (S.C.C.). [*Ron Engineering*].
[3] [1991] 1 S.C.R. 619, 170 D.L.R. (4th) 577 (S.C.C.). [*M.J.B.*].
[4] 2000 SCC 860, 2 S.C.R. 860 (S.C.C.). [*Martel*].

Ron Engineering established that when a contractor submits a bid to tender, a contract is formed between the contractor and the owner. The court referred to this as "Contract A". The terms of Contract A are established by the provisions of the tender documents. The principal terms are the irrevocability of the bid, and the obligations of both parties to form a subsequent contract (Contract B), if the bid is accepted.

The Supreme Court affirmed these principles in *M.J.B.,* but further elucidated the terms was included in Contract A. Specifically, the Court held that Contract A imposes obligations on the owner. However, the Court also explained that *Ron Engineering* does not stand for the proposition that Contract A will *always* be formed. Whether a preliminary contract is formed through the tendering process is dependent upon the terms and conditions of the tender call. Where a contract is formed, it will include express obligations, as set out in the tender documents, but also implied obligations. The implied terms may be based on custom or usage, or on the presumed intentions of the parties.

Finally, in *Martel* the Court held that Contract A includes an implied term that the owner must be fair and consistent in the assessment of the tender bids. The Court held implying this obligation was consistent with the goal of protecting and promoting the integrity of the bidding process, and benefits all participants. A privilege clause cannot exclude the duty to treat all bidders fairly, but the extent of that duty will be defined in the context of the express terms of the tender documents.

(a) *Hub Excavating Ltd. v. Orca Estates Ltd.*

These principles and the issue of an owner's duty of fairness in the tendering process were most recently discussed by the British Columbia Court of Appeal in *Hub*

Excavating Ltd. v. Orca Estates Ltd.[5] The defendant had developed several phases of a residential subdivision, and it decided to proceed with Phase 12 on the basis of an oral estimate provided by the owner's engineer. Hub was the low bidder. Shortly after bidding closed, a representative from the defendant led Hub to believe that it would be awarded the contract, as a result Hub decided not to bid on a contemporaneous project. In the end, the defendant rejected all bids and decided not to proceed with Phase 12.

Hub brought an action against the defendant for a breach of an implied contractual duty of fairness in the tendering process. While the trial judge allowed the action for breach of duty of fairness, the Court of Appeal reversed. In doing so, the Court reinforced that there is "no free-standing duty of fairness in the bidding process independent of that contractual duty".[6] The duty of fairness does not arise until Contract A has been formed. Here, there was an express term that "the Owner is in no way obligated to accept this or any other tender, or specific parts of this tender".

The Court further added that the duty of fairness is confined to an obligation to treat all bidders fairly and consistently in the process of assessing the bids. It does not extend to other aspects of the tendering process. Once a compliant bid has been submitted, and Contract A is formed, the court should to look back and evaluate the entire tendering process to ensure that integrity is maintained. In rejecting this argument, the court held that to allow the duty of fairness to be forward-looking would create uncertainty for owners as to what degree of pre-bid investigation and economic certainty be required to avoid potential liability before going to tender. Here, the complaint from Hub was that it bid into a "futile tender call". The court suggested that any perceived

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[5] 2009 BCCA 167, B.C.W.L.D. 3492. [*Hub Excavating*].
[6] *Supra* at 30.

indifference on the part of the owner may affect their reputation, and the future responsiveness of bidders to other tender calls.

(b) ***Coco Paving (1990) Inc. v. Ontario (Minister of Transportation)***

The Ontario Court of Appeal also discussed the duty of fairness in *Coco Paving (1990) Inc. v. Ontario (Minister of Transportation).*[7] The plaintiff Coco submitted its bid after the deadline had expired. Coco claimed that this was the result of a computer error, and brought an application to have the MOT list Coco as a compliant bidder. The application judge accepted the submissions of Coco and found that the MOT ought to have accepted the bid. This decision was appealed by the Bot Group, or compliant bidder.

In reversing the decision of the application judge, the Court of Appeal emphasized the importance of carefully controlling the tendering process. The court pointed out that "an owner that considers a late bid would breach its duty of fairness to the other tenders" and that "late bids can unfairly advantage the non-compliant bidder over the compliant bidders who met the bid submission requirements and erode the integrity of the building process."[8] The court highlighted this issue by pointing out that Coco had waited to the last minute to submit its bid and stating that "It was open to Coco, as it was to the other bidders, to submit its first bid well in advance of Tender Closing and to update it thereafter. Unlike the other bidders, Coco chose not to avail itself of this opportunity."[9]

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[7] [2009] O.J. No. 2547, ONCA 503. [*Coco*].
[8] *Supra* at 12-14.
[9] *Supra* at 23.

(c) *Design Services Ltd. v. Canada*

Another recent decision that explored the issue of the duty of care in the tendering process is *Design Services Ltd. v. Canada.*[10] In this case the Supreme Court of Canada resolved an issue that was first raised in *Martel*: whether a duty of care can arise between a subcontractor and an owner. The Supreme Court had previously refrained from addressing this question. *Design Services* provided the opportunity.

The facts of *Design Services* are relatively straight-forward. Public Works and Government Services Canada ("PWGSC") launched a design-build tendering process for the construction of a naval reserve in St. John's Newfoundland. The tendering documents indicated that it proponents could bid on the contract alone, or in conjunction with other entities as a joint venture. PWGSC awarded the contract to a non-compliant bidder. Olympic, the contractor which should have been awarded the contract, and the subcontract who is associated with it, sued. No partnership or joint venture had been entered into between Olympic and the subcontractors, the Design Services entity would have been a subcontractor to Olympic. The trial judge found that PWGSC owed a duty in tort, but not in contract, to the subcontractors including Design Services subcontractors. The Court of Appeal set aside the trial decision concluding a new duty of care should not be recognized. The subcontractors' claims did not fall within a pre-existing category in respect of which a duty of care had previously been recognized. Since the subcontractors' damages were solely financial in nature, they qualified as pure economic losses. Of the five pre-existing categories of pure economic loss, relational economic loss was the only one within which the subcontractors' claims could possibly

[10] 2008 SCC 22. [*Design Services*].

fall. Relational economic loss occurs in situations where the defendant negligently causes personal injury or property damage to a third party and the plaintiff suffers pure economic loss by virtue of some relationship, usually contractual, it enjoys with the injured party or the damaged property. The Supreme Court reasoned that the recognition of a new duty of care between and owner and subcontractors in the context of a tendering process was not justified.

There were factors that indicated the close relationship of proximity between PWGSC, the subcontractors, but there were policy considerations, in the opinion of the Supreme Court, why tort liability should not be recognized. Here, the subcontractors have an opportunity to form a joint venture and thereby be parties to the "Contract A" made between the owner and the contractor which would have entitled them to a claim in contract. This was an overriding policy reason that tort liability should not be recognized in the circumstances.

The subcontractors did not have privity of contract with the owner, and therefore asserted a claim in tort for the economic loss suffered. There are two ways that such a claim could succeed either (1) the claim fits within a recognized duty of care category or (2) a new duty of care is recognized. The question to be wrestled with is how to define the persons to whom the duty is owed.[11] If the situation fits within or is an analogous to

[11] Proximity remains the foundation of the modern law of negligence. A legal duty extends to my "neighbor" and legal neighborhood is "restricted" to "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 into question". Proximity has generally been understood in the context of an overt act, but the notion of proximity has been extended to cover certain limited circumstances where a defendant, without causing a plaintiff to suffer person injury to property damage, caused financial loss.

a previously recognized category where a duty of care has been recognized, the analyses otherwise required by *Anns* is avoided.[12]

When this case reached the Supreme Court the big question was whether or not Canadian law recognized a duty of care between a subcontractor and owner. Rothstein J., for the court, did find that it was reasonably foreseeable that the award of the contract to a non-compliant bidder would result in a financial loss for the subcontractor, and that there was some proximity between the owner and subcontractor. However he ultimately held that forseeability alone was insufficient to satisfy the first step of the *Anns* test[13]. For Rothstein J. "the class of plaintiffs seemed to seep into the lower levels of the corporate structure of the design build team members, this case an indication of indeterminate liability". The court highlighted the fact that the subcontractors had the opportunity to protect themselves by submitting their bid as a joint venture proponent. Failure on the part of the subcontractor to protect themselves from economic loss was an overriding policy reason why tort liability should not be recognized in this context. In reaching this

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[12] The five recognized categories of negligence claims for which a duty of care has been found with respect to pure economic losses are:
(1) the independent liability of statutory public authorities,
(2) negligent misrepresentation,
(3) negligent performance of a service,
(4) negligent supply of shoddy goods or structures, and
(5) relational economic loss.
(*Design Services, supra* at para. 31). The construction contract context is one in which the indeterminacy of the class of plaintiffs can readily be seen.

[13] When determining if a public authority owes a private law duty of care, the court must consider and apply the *Anns* test, essentially:

(a) Was the harm that occurred reasonably foreseeable?
(b) Are there any policy reasons that negative the duty?

Anns v. Merton London Borough Council, [1977] 2 W.L.R. 1024 (H.L.)

conclusion, Rothstein J. emphasized that "tort-law should not be used as an after-the-fact insurer".[14]

While it was not required, the Court explored whether there were any residual policy reasons that would negate the creation of a duty of care. The main policy concern that was recognized was that of indeterminate liability. Rothstein J. stated:

> "That the facts here suggest indeterminacy is, I think, symptomatic of a more general concern in the construction contract field. Even where the subcontractors are named and known by an owner, those subcontractors will have employees and suppliers and perhaps their own subcontractors who also could suffer economic loss. And these suppliers and subcontractors will have their own employees and suppliers who might claim for economic loss due to wrongful failure of the owner to award the contract to the general contractor upon which they were all dependent. The construction contract context is one in which the indeterminacy of the class of plaintiffs can readily be seen."[15]

The result in *Design Services* is largely due to the failure of the plaintiff to protect itself in contract. Presumably, it could have contracted to be paid a termination fee if the bid effort was made and not accepted. It seems unlikely that a duty of care between subcontractors and owners will be recognized in light of the policy concerns, and the residual ability of affected subcontractors to protect their effort as part of the contractual terms of their bid.

II. Construction Claims and Insurance Law

Other recent 2008-2009 developments in construction law involve situations where insurance coverage responds to losses, and where claims are excluded from coverage. These issues were most recently discussed by the Supreme Court of Canada (November 2008) in *Canadian National Railway Co. v. Royal and Sun Alliance*

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[14] *Supra* at 57.
[15] *Supra* at 65.

Insurance of Canada[16] and by the BC Court of Appeal (March 2009) in *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*.[17]

(a) *Canadian National Railway Co. v. Royal and Sun Alliance*

In *Canadian National Railway*, CNR commenced an action against the insurers under a Builder's Risk Policy. The policy was issued in connection with the construction of CNR's new larger diameter tunnel constructed adjacent to an existing tunnel, and in particular, with regard to a soft ground earth pressure balance tunnel boring machine ("TBM"). The policy specifically insured CNR against "All risks of direct physical loss or damage … to … [a]ll real and personal property of every kind and quality including but not limited to the [TBM]" but excluding both "the cost of making good … faulty or improper design" and "inherent vice". Early on in the project the TBM was halted when dirt penetrated its cutting head and threatened the integrity of the main bearing that drove the machine forward. The project was delayed 229 days, thereby increasing the cost of the project. CNR made a claim on the policy, and the insurers denied coverage pursuant to the faulty or improper design exclusion.

At trial, Ground J. applied the foreseeability test that was enunciated in *Foundation Co. of Canada v. American Home Assurance Co.*[18] which stood for the proposition that an insurer has the onus to prove that all foreseeable risks had not been taken into account in the design of the affected property for the faulty or improper design exclusion to apply. Judgment was rendered in favour of CNR, as the court held that the failure of the TBM was not foreseeable.

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[16] 2008 SCC 66. [*Canadian National Railway*].
[17] [2009] B.C.J. No. 572, 268 B.C.A.C. 235. [*Progressive*].
[18] (1995), 25 O.R. (3d) 36 (Gen. Div.), aff'd [1997] O.J. No. 2332 (C.A.).

The Court of Appeal adopted a modified foreseeability test that required not only that all foreseeable risks must be taken into account in the design, but also that the design succeed in accommodating those risks. Effectively, the Court of Appeal concluded that because the TBM failed, its design was faulty.

The approach taken by the Court of Appeal was ultimately rejected by the majority of the Supreme Court of Canada. In doing so Binnie J., for the majority, noted that "at any given time risks may be foreseeable, [however] in addressing those risks in an innovative project there is inevitably a gap between the then current state of the engineering art and *omniscience,* i.e. a state of perfect knowledge and technique".[19] Ultimately, the majority of the court held that the insurer was not entitled to rely on the exclusion, as a narrower interpretation of the exclusion was in better accordance with the intention of the parties based on a plain meaning of the words "faulty or improper". Binnie J. held that the concept of a faulty or improper design implies a comparative standard against which the impugned design falls short. This standard is not that of perfection in relation to all foreseeable risks, as that is too high, nor is it the industry standard, as that is too low. Rather, Binnie J. concluded that the appropriate comparator is "state of the art". Consequently, "insurers are entitled to the benefit of the exemption unless the design met the very highest standards of the day and failure occurred simply because engineering knowledge [and prediction] was inadequate to the task at hand."[20]

Moreover, the insurer did have the opportunity to negotiate an exclusion associated with "design failure", but they chose to only exclude loss attributable to "faulty or improper design". As Binnie J. pointed out, "failure is not the same thing as

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[19] *Supra* note 9, at 194.
[20] *Supra* at 55.

fault or impropriety".[21] Thus the trial judgment was restored, and CNR was awarded approximately $40 million inclusive of costs and interest. I suppose this outcome could be explained as a simple matter of having "better," or "different," contractual protection (from the insurer's perspective).

However, the Supreme Court was not unanimous, as Deschamps, Charrron and Rothstein JJ., in dissent, would have dismissed the appeal. Rothstein J., for the dissent, held that a design that is faulty and improper means one that "does not work for the purpose for which it was intended to be used." As such, the question to ask is whether the damage to the insured property was due to an inability of the design to fulfill its purpose, in the foreseeable conditions of the property's use.

While the Supreme Court attempted to clarify what is meant by "faulty or improper design" within the insurance exclusion context, it may have simply added more ambiguity to the mix. The whole court found that the term "faulty and improper" was not ambiguous, and yet they reached divergent conclusions. Furthermore, what can be considered "state of the art" is surely a contextual and dynamic question that raises further questions regarding an insured's duty to ensure that their property is state of the art and is maintained at that level. It is likely that this question will be litigated again.

(b) ***Progressive Homes Ltd. v. Lombard General Insurance Co.***

The extent of coverage for alleged losses was also recently addressed by the BC Court of Appeal in *Progressive.* In this case, Progressive had been the general contractor on a number of condominium projects that were erected during the 1990's pursuant to a government initiative to provide affordable housing. The project had been financed by

[21] *Supra*, at 5.

the B.C. Housing Management Commission ("BC Housing"). Progressive made use of sub-contractors for much of the work. In late 2004 BC Housing brought four actions for breach of contract and negligence against Progressive with respect to significant water damage due to water penetration of the buildings' envelopes. Lombard, Progressive's insurer, initially defended the actions but soon withdrew on the basis that it was under no duty to defend the actions as they were not covered under the liability insurance policies it had issued to Progressive.

Lombard took the position that the actions were due to Progressive delivering a faulty product to BC Housing, in breach of its contractual obligations to BC Housing. The applicable policies only covered Progressive for damage to property caused by accident or occurrence. Progressive argued that the definitions of "accident" and "occurrence" in the policies made it plain that coverage may extend to property damage which takes place over a long period of time. The policies defined occurrence as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." Progressive also relied on the subcontractors exception, which stated that the "your work" exclusion of the policy was not applicable if "the damaged work or the work of which was damaged arises was performed on your behalf by a subcontractor."

The BC Supreme Court held that Lombard was not under a duty to defend Progressive. In reaching this decision, Cohen J. followed the decision in *Swagger Construction Ltd. v. ING Insurance Company of Canada*[22] which stands for the proposition that defective construction is not an accident unless there is damage to the

[22] 2005 BCSC 1269, 37 B.C.L.R. (4th) 75. [*Swagger*].

property of a third party. Consequently, coverage was not triggered as this was not an "accident" according to the *Swagger* definition. Lombard had no duty to defend Progressive. With regard to the subcontractor exception, Cohen J. held that it was improper to look to the exclusions to find coverage where none existed.

The BC Court of Appeal upheld the decision of the lower court, and dismissed Progressive's appeal on the basis that the policies did not cover losses caused by poor workmanship. The court held that there was an underlying assumption that the insurance policy was designed to cover fortuitous contingent risk and that the expected consequences of poor workmanship could hardly be considered fortuitous. As such, Progressive had to show that the policies in question were designed to cover "poor workmanship."

In an attempt to do this, Progressive turned to the subcontractor exception. In doing so, Progressive argued that much of the building in question was constructed by subcontractors who installed various building components that had subsequently failed, causing damage to other parts of the building. As such, there must be a distinction made between a defective building and the damage that a defective part causes. While Progressive agreed that the policy did not cover damage for the defective part itself, it argued that it did cover the damage arising from the failure of the part. The court rejected this argument on the basis that Progressive had failed to acknowledge that the building as an integrated whole was defective as built, not just when parts of it began to leak.

While the majority of the Court of Appeal did find in favour of Lombard, Huddart J.A. dissented. In particular, Huddart J.A. found that the policies did provide coverage for

the contingent risk that the negligence of a subcontractor might give rise to an accident or occurrence that could cause property damage.

It should be noted that Progressive received leave to appeal from the Supreme Court at the end of August, 2009. As such, we will need to stay tuned to this issue, as the Supreme Court weighs in on the interpretation of "accidents" and "occurrences" in the context of exclusion clauses.

III. Common Mistakes

In Ontario, the *Construction Lien Act* (the "Act") provides a statutory remedy of a lien against the real property of an owner for the price of services or materials supplied to an improvement.[23]

Once the threshold question of entitlement to a lien has been determined, mistakes may still occur when attempting to preserve or perfect the lien.

The Act contains a curative provision, which has been broadly interpreted, once a determination has been made as to whether the supply of services or materials gives rise to a lien. Section 6 of the Act, entitled "minor irregularities," indicates that no pertinent lien document ("certificate, declaration or claim for lien") is invalidated by a failure to strictly comply with certain enumerated provisions, including the preservation of lien claims (subsection 34(5)) unless a person has been prejudiced, and then the invalidity is only to the extent of the prejudice suffered.[24] Subsection 34(5) states:

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[23] *Construction Lien Act*., R.S.O. 1990, c.C.30, as amended

[24] *Supra* note 4 [*Act*] at s.6

Contents of claim for lien-

(5) Every claim for lien shall set out,

(a) the name and address for service of the person claiming the lien and the name and address of the owner of the premises and of the person for whom the services or materials were supplied and the time within which those services or materials were supplied;
(b) a short description of the services or materials that were supplied;
(c) the contract price or subcontract price;
(d) the amount claimed in respected of services or materials that have been supplied; and
(e) a description of the premises,

(i) where the lien attaches to the premises, sufficient for registration under the *Land Titles Act* or the *Registry Act*, as the case may be, or
(ii) where the lien does not attach to the premises, being the address or other identification of the location of the premises.

Consequently, section 6 of the Act may resolve common mistakes that occur in the preparation and registration of such lien documents provided that no prejudice is suffered by another party. Various case law demonstrates the utility of s.6 of the *Act*.

(a) Time stated for work performed misstates the date

An incorrect date of last supply is not necessarily fatal to a lien claim. This is illustrated in *Michelin Group Inc. v. Forsam Construction Ltd.*[25] However, the date of last supply may be crucial to determining whether a lien has expired. In *Michelin Group*, the plaintiff made a motion at trial to amend its claim for lien to a later last date of last supply of services. Carnwath J. dismissed the motion, and held that:

> If a lien claimant swears in an affidavit required by the Act that certain services were performed to and including a certain date, other interested parties should be able to rely on that date; to find otherwise would require the point to be litigated

[25] (1994), 18 O.R. (3d) 523 (Ont. J. (Gen. Div.))[*Michelin Group*].

> in every instance to establish the last date work was performed or materials delivered.[26]

Even though it was recognized that a claim for a lien may be amended by the trial judge to extend the actual date of last supply, the lien claimant was not successful in *Michelin Group* because although the claim for the lien was valid (i.e. had been registered within 45 days of last supply) the action to perfect the lien was commenced out of time (i.e. more than 90 days from last supply). In this instance, section 6 was held to have no application since the claim for the lien itself was valid, but was improperly perfected.

Demik Construction Ltd. v. Royal Crest Lifecare Group applied the same principle as *Michelin Group* to a different result. This was in part because the motion to dismiss the lien was brought before trial under s.45 of the Act. The lien claimant successfully defended the pre-trial motion to declare the lien had expired.[27] In dismissing the defendant's motion to challenge the lien, the court referred to the statement of claim which corrected the date from the affidavit of verification as to when the materials and services were last provided. Further, because the lien in Demik was a contractor's lien, and not a sub-contractor's lien, the motions judge declined to find the "date of last supply" to be the last date set out in the lien. Under the Act, and subject to published substantial completion certificates, a contractor's contract is deemed complete only when completed or abandoned, whereas a subcontractor's lien is subject to additional statutory language deeming sub-contract completion as of the "date of last supply" if earlier.

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[26] *Ibid*. at 526.
[27] [1994] O.J. No. 2536 (Ont. J. (Gen. Div.)) [*Demik Construction*]

If a lien claimant is able to correct the date of last supply on the evidence, and the lien has not otherwise been improperly perfected, then the mistakes in date may be treated as a minor irregularity.

(b) Failure to name person to whom material and services were supplied

Failure to state the correct person for whom the work is done is another common mistake. Provided that the owner has been named, the authors of *Constructions Builders' and Mechanics Liens in Canada* state that incorrectly naming, or omitting to name, the person for whom the work was done is curable.[28] Failure to state the name of the statutory owner is fatal since the purpose of a lien is to attach an owner's interest, either freehold or leasehold. Failure to give such notice in the claim for lien defeats the purpose of the lien.

Petroff Partnership Architects v. Mobius Corporation supports the proposition that the failure of the lien claimant to properly name the owner in the claim may be a minor or technical irregularity, which can be cured by s.6 of the *Act*.[29] In *Petroff*, the lien claimant architect did not specifically name the client/tenant but named the landlord/owner. The saving provision was the actual description in the e-reg lien of the following statement: "The lien claimant claims a lien against the interest of every person identified as an owner of the premises *described in the said PIN to this lien*" and the client/tenant's lease was a 25 year lease registered on title.[30] The architects' lien was struck as against the landlord, but the lien claimant had apparently not intended the lien to attach to that interest in any event (having not sent a section 19 notice.) Since the

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[28] D.J. Bristow, D.W. Glaholt. R.B. Reynolds, and H.M. Wise, *Construction Builders' and Mechanics' Liens*, 7th ed. (Toronto: Thomson Carswell) [Looseleaf] at para. 6.3.4.
[29] (2003), 65 O.R. (3d) 118, O.J. No. 2434 (Master Sandler) [*Petroff Partnership*].
[30] *Ibid*. at para. 22.

client/tenant hired the lien claimant to perform the work, Master Sandler stated that he did not find any prejudice.[31] Furthermore, the lien claimant's claim was clarified when it started its lien action naming the correct client/tenant as a defendant.

A substitution of a different entity as a lien claimant will likely invalidate a lien,[32] while a misnomer of the lien claimant may not[33].

Failing to correctly set out the status of the correct lien claimant in the affidavit of verification may be a curable error. For example, in *Carlo's Electric Ltd. v. Metropolitan Separate School Board*, the general contractor brought a motion to vacate the claim for lien because the lien claimant had made an error in the affidavit of verification.[34] The deponent in the affidavit of verification was not the lien claimant. Master Saunders found that affidavit of verification was only a matter of form, rather than substance, since the moving party was not misled by the deviation of form. In the decision, reference was made to s.27(d) of the *Interpretation Act* which states:

> 27. In every Act, unless the contrary intention appears…
>
> (d) where a form is prescribed, deviations therefrom not affecting the substance or calculated to mislead do not vitiate it.[35]

The focus is on whether the other party is misled and if the extent of the prejudice, and s.6 of the *Act* enables the court to excuse the irregularity.

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[31] *Ibid.*
[32] 573521 *Ontario Inc. v. Waldman* (1996) 31 C.L.R. (2d) 305 (Superior Court) and *Accent Design Inc. v. Walton Place* (1994) 15 C.L.R. (2d) 33
[33] *GC Rentals Ltd. v. Falco Steel* (2000) 132 O.A.C. 70 (Divisional Court)
[34] [1990] O.J. No.No.867 (Master Saunders)[*Carlo's Electric*.]
[35] R.S.O. 1980, c.219, c.219, s27(d)

(c) Cumulative effect of errors

Situations may arise where there is more than one error. S.6 of the *Act* does not restrict curative provisions to only one error. The French version of s.6 suggests this interpretation. In determining whether a claim should be invalidated, the determinative issue in the application of s.6 appears to be whether the opposing party has been prejudiced rather than the number of errors present.

(d) Affidavit of verification

A paper affidavit of verification for a claim for lien may not be technically required where there is a system of electronic verification. This issue was addressed in *Petroff Partnership* where Master Sandler held that a paper affidavit outside of the electronic format is not required.[36] A more recent (December 2008) case, *Wildberry Homes Inc. v. Prosperity One Credit Union Ltd.*,[37] applied the principles set out in *Petroff*. Justice Murray held that "while there may be practical arguments why e-registration should not obviate the requirement of an affidavit of verification, I am not prepared to accept that the failure of the plaintiff to execute and/or register an affidavit of verification of a claim for lien invalidates the lien".[38]

Even though it may not be required, it is a best practice to have a paper affidavit of verification in the file. Should a question arise, a paper affidavit is available and represents contemporaneous evidence with respect to the other matters addressed by subsection 34(5).[39] In my view, this is a best practice.

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[36] *Supra* note 27 at para. 13.
[37] [2008] O.J. No. 5441. [*Wildberry*].
[38] *Supra* at 10.
[39] In his article on electronic registration of construction liens, Roger J. Gillot suggested that because of uncertainty as to whether following the e-reg procedure alone is sufficient to comply with the requirements

Even though case law supports the view that a paper affidavit may not be necessary where the lien attaches to the premises, the situation is different when Crown lands are involved. In the case of Crown lands (and public highways), the lien constitutes a charge upon the holdbacks required to be retained under Part IV of the *Act*, and is not registered on title. In such a case, it appears that an affidavit of verification is required by s.34(6) of the *Act*, and must be sent to the Crown agency.[40] Section 87 of the *Act* defines "given" as being "sent by certified or registered mail addressed to the intended recipient".

Recently, in *John Bianchi Grading Ltd. v. Belrock Design Build Inc.*, the Divisional Court upheld the decision of Master Sandler finding the registration of the lien invalid against the crown agency, George Brown College. It appears that the solicitor registering the lien sent a photocopy of the electronically registered claim for lien but not a paper affidavit of verification. Where the lien does attach to the premises (i.e. non-Crown landowners), such registration in the proper land registry office invokes application of s.24(1) and (2) of the *Land Registration Reform Act*.[41] Liens that do not attach to the premises constitute a charge against the holdbacks under s.24(1)(b) of the *Act*, and such liens against crown agencies cannot be saved by these LRRA sections. What this meant in *John Bianchi Grading* was that the lien was ordered discharged and the security posted to vacate the registration of the claim for lien was released.[42]

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in the Act, solicitors should consider requiring that a paper affidavit of verification be sworn by the client. Roger J. Gillot, "Teranet, the Internet, and Liens: Electronic Registration Meets Construction Law" (2001), 6 C.L.R. (3d) 228. There has been discussion that the Act will be amended to require a paper affidavit of verification which must be sworn, but need not be registered.

[40] *Supra* note [*Act*] at s.34 (6).

[41] R.S.O. 1990, c.o.4.

[42] 257 D.L.R. (4th) 539 (Ont. C.A.).

(e) Bid mistakes

Another mistake that occurs frequently in the construction industry is a mistake in the bid. In 2005, the Ontario Court of Appeal in *Toronto Transit Commission v. Gottardo Construction Limited*, overturned a trial decision, and allowed the appeal of the Toronto Transit Commission who sought damages from a low bidder which bidder had made mistakes in their tender bid. A bidder who makes a mistake in its bid remains bound unless the mistake is plain on the face of the tender.[43] In April 2006, an application for leave to appeal to the Supreme Court of Canada was dismissed.[44] In *Gottardo*, the TTC had called for tenders for the construction of a bus garage. Shortly after the bids were opened, Gottardo contacted TTC saying it had made a mistake in the bid. Gottardo refused to submit the additional documents that the TTC and two other low bidders had requested. Gottardo did, however, submit an explanation for its costs breakdown error. The TTC said no error was visible on the face of the tender, and, therefore, Gottardo was bound to perform the work at the bid price. Gottardo refused. The TTC contracted with the next lowest bidder and sued Gottardo and its bonding company for the difference.

Both parties relied on the Supreme Court of Canada cases of *Ron Engineering* and *MJB*, as to whether Gottardo was bound to perform.[45] In *TTC*, the trial judge initially held that the failure to submit additional documents was material. The Court of Appeal took a different view, affirmed by the Supreme Court of Canada which declined to grant leave to appeal. Further, the Court of Appeal overruled the arguably *obiter dicta* of the trial

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[43] 257 D.L.R. (4th) 539 (Ont. C.A.).
[44] *Toronto Transit Commission v. Gottardo Construction Ltd.* (2006), 2006 CarswellOnt 2545 (S.C.C.) [*TTC*].
[45] [1981] 1 S.C.R. 111 [*Ron Engineering*]; *MJB Enterprises Ltd. v. Defence Construction (1951) Ltd.*, [1999] 1 S.C.R. 619 [*MJB Enterprises*].

judge that equity should grant rescission of the bid contract because Gottardo made a mistake. The Court of Appeal said where the TTC was unaware of the mistake, and did not act fraudulently or contribute to the error, equity ought not to intervene. Both the defaulting bidder, Gottardo, and its bonding company were held liable for the owner's damages.

(f) Language of prayer for relief

A recent Ontario decision shows that failure to abide by the usual language in the prayer for relief is not fatal to a lien.[46]

In *1610898 Ontario v. Dinardo*, the defendant argued that the plaintiff failed to perfect its lien because there was nothing in their prayer for relief that alleged it was an action to enforce its lien.[47] However, Baltman J. held that even though the statement of claim did not refer to the lien in the prayer of relief, there were numerous references to a lien elsewhere in the claim. Thus, the court dismissed the defendants' motion to discharge the plaintiff's lien. *1610898 Ontario* suggests a more flexible approach where failure to comply with strict language does not undermine the plaintiff's claim. In contrast, it appears there is little flexibility, on the part of the court, with regard to setting down a matter for trial within the specified time period, under s.37 of the *Act*.[48]

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[46] In an action commenced to perfect a lien, the prayer for relief typically includes very specific language that claims: (1) in default of payment of the said sums claimed plus interest costs, an order that all of the estate and the interests of the defendants (owners) in the lands which are the subject matter of this action be sold and the proceeds applied in payment of the plaintiff's claim pursuant to the Act, and in the alternative, payment of the said sums on the basis of unjust enrichment, restitution and *quantum meruit*; (2) an order that all proper directions be given, inquiries be made and accounts be taken; (3) a pleading in the body of the claim, that the "defendant owner was at all material times an owner within the meaning of the Act;" (4) a pleading in the body of the claim that in the event the sums adjudged to be owing are not paid forthwith that the plaintiff is entitled to an order requiring the sale of the said lands, and payment of the claim from the sale proceeds pursuant to s.62(5) of the Act.

[47] (2006), 2006 CarswellOnt 1495 [*1610898 Ontario*].

[48] *Supra* note 4 [*Act*] at s.7.

(g) Failure of a lawyer to set down the matter for trial

A lien claimant's solicitor plays a gatekeeper role to the statute and has a personal responsibility to all persons who might suffer damage as a result.[49]S.37(1) of the *Act* indicates that a perfected lien expires two years after the commencement of the action that perfected the lien, unless on or before the second anniversary, an order is made for the trial of an action in which the lien may be enforced, or an action in which the lien may be enforced is set down for trial[50]. Also, S. 46(1) stipulates that where a perfected lien has expired under s.37(1), upon the motion of any person, the court shall declare that the lien has expired and shall make an order dismissing the action to enforce the lien and vacating the registration of a claim for lien and the certificate of action in respect of that action.[51] Moreover, if a solicitor is responsible for prejudicing or delaying an action, costs can be awarded against him/her pursuant to s.86(1)(b) of the *Act*:

> 86. (1) Subject to subsection (2), any order as to the costs in an action, application, motion or settlement meeting is in the discretion of the court, and an order as to costs may be made against,
>
> (a) any party to the action or motion; or
>
> (b) the solicitor or agent of any party to the action, application or motion, where the solicitor or agent has,
>
> (i) knowingly participated in the preservation or perfection of a lien, or represented a party at the trial of an action, where it is clear that the claim for lien is without foundation or a grossly excessive amount, or that the lien has expired, or
>
> (ii) prejudiced or delayed the conduct of the action,
>
> And the order may be made on a solicitor-and-client basis, including where the motion is heard by, or the action has been referred under section 58 to, a master, case management master or commissioner.[52]

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[49] Duncan W. Glaholt, *The Conduct of a Lien Action*, (Thomson Carswell, 2004) at 15.
[50] *Supra* note 4 [*Act*] at s.37(1).
[51] *Ibid* at s.46(1).
[52] *Ibid* at s.86(1).

In *Pineau v. Kretschmar Inc.*, the plaintiff commenced a lien action against the defendant and had brought an *ex parte* motion to have the lien matter set down for trial. When the matter had reached pre-trial stage, the Master determined that the lien had expired as a result of the plaintiff's solicitor's failure to use the proper procedure to set the matter down for trial.[53] It was argued by the former solicitors that a finding of bad faith was required before an order can be made against the solicitor pursuant to R.57.07(1) of the *Rules of Civil Procedure*.[54]

Specifically, it was argued by the former solicitors that R.57.07 sets a lower standard of behavior. However, Master Sandler rejected this argument and did not find R.57.07 to be inconsistent with the s.86(1)(b) of the *Act*.[55] Accordingly, even though it was not their intention, it was found that the conduct of the former solicitors prejudiced and delayed the conduct of the actions and they were held to be jointly and severally liable with their client to pay the costs of each of the defendants.

Sadly, after winning the issue on "lienable supply" *310 Waste Ltd. v. Casboro Industries Ltd. (No. 2)* is an example where the Ontario Superior Court of Justice invoked s.37(1) and s.46 of the *Act* to declare the plaintiff's lien expired by reason of lapse of the two year limitation period.[56] Quigley J. focused on the failure of the plaintiff to show that they had set the matter down for trial within the two year limitation period. It was argued

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[53] (2004), 42 C.L.R. (3d) 37 (Master Sandler) [*Krestschmar*].

[54] 57.07 (1) Where a solicitor for a party has caused costs to be incurred without reasonable cause or to be wasted by undue delay, negligence or other default, the court may make an order,
(a) disallowing costs between the solicitor and client or directing the solicitor to repay to the client money paid on account of costs;
(b) directing the solicitor to reimburse the client for any costs that the client has been ordered to pay to any other party; and
(c) requiring the solicitor personally to pay the costs of any party.

[55] *Ibid* at para 56.

[56] [2006] O.J. No. 101
[*310 Waste (No.2)*].

that *310 Waste Ltd (No.1*) was under appeal and the decision reserved, so to set the matter down for trial while an appeal was pending would have shown contempt for the court. The argument failed.[57]

Had the lien claimant taken steps to set down the matter for trial or to advance the litigation, and been refused, the court may have been more sympathetic to a failure under s.37. There is no discretion to extend the time period in s.37 of the *Act*[58].

310 Waste (No 2) and *Kretschmar* illustrate the importance of setting a matter down for trial within the limitation period set out by the *Act*. The other basic and important limitation periods under the *Act* are 45 days to preserve a lien from the date of completion or last supply (or from the date a certificate of substantial performance has been published), and 45 days from the last date a lien could be preserved, to perfect. Don't miss these dates.

IV. Other Cases of Interest

(a) Contractor's & Subcontractor's Trust

Section 8 of the *Act* stipulates that all amounts owing to a contractor or subcontractor, or received by a contractor or subcontract or on account of the contract of subcontract price of an improvement constitute a trust fund for the benefit of the subcontractor or other persons who have supplied services or material to the

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[57] *Ibid*. at para. 20.

[58] There is discretion under s.47(1) of the Act when considering whether a lien action ought to be dismissed and the lien vacated from the property to allow the action for personal judgment (i.e. breach of contract) to continue. The impact of the new Limitations Act, 2002 on the exercise of discretion was considered by the Divisional Court in *1339408 Ontario Inc. v. 1579138 Ontario Inc.* [2007] O.J. No. 5548 (Div. Ct). In that case, the court said having regard to the discretion under s.47(10 of the Act, "the most important factor is the prejudice that would result to the plaintiff due to the expiry of the limitation period" if the entire action were dismissed. I would suggest the court ought to carefully consider whether absent 'wilful or contumelious neglect' raising palpable prejudice, the court ought to exercise its discretion to allow the action for personal judgment to continue.

improvement. However, whether or not a trust arises will also depend upon the intent of the supplier. The intent requirement was established by Abella J. A. in *Central Supply Co. (1972) Ltd. v. Modern Tile Supply Co.*[59] where it was held that "a supplier must intend that the material sold be used for the purposes of a known and identified improvement before a lien or trust arises."

A recent 2009 decision of the Divisional Court has revisited the idea of intent, and raised questions as to whether intent is in fact needed to establish a trust. In *Sunview Doors Ltd. v. Academy Doors and Windows Ltd.*, the court, arguably in obiter, disagreed with the conclusion reached by the court earlier in *Central Supply*. Specifically, the Divisional Court disagreed that the trust provisions in the *Act* required the supplier to have intent that the materials be used for the purposes of a known and identified improvement, as it found no language in s.8, s.14 or s.15 of the Act to suggest that intent is a requirement.[60] This may create an opportunity for a reconsideration of when a trust will arise pursuant to s.8. Most of the breach of trust cases arise where the payor/ trustee breaches that trust by payment outside of the chain of beneficiaries. There is clearly a "bright line" where the beneficiaries under s.8 of the Act are those, but only those, who also have lien rights.

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[59] (2001), 55 O.R. (3d) 783 (Div. Ct.).

[60] *Ibid.* at 51.

For well over a decade it has been clear in Ontario that a contractor cannot pay overhead expenses such as wages, office expenses, rent, legal and accounting fees in reduction of trust obligations to trades and suppliers.[61]

(b) Contractual No Holdback Provisions

Sections 4 and 5 of the *Act* stipulates any agreement that states that the *Act* does not apply is void, and that every contract or subcontract relating to an improvement is deemed to be in conformity with the *Act.* The question of whether or not parties may contract out of holdback was discussed in *Myer Salit Steel Ltd. v. Mondiale Development Ltd.*[62] (May, 2009). Salit Steel, the supplier, had included in the contract a no-holdback on supply clause, but Mondiale, the developer, took the position that the no holdback provision was contrary to the *Act* and was therefore void. As a result, Mondiale held back more than $500,000, which Salit Steel insisted was to be paid out under the contract.

Master Albert held that the provision was valid. In doing so she highlighted that the holdback obligation in the *Construction Lien Act* is designed to protect subcontractors below the supplier in the construction pyramid. As there were no subcontractors below Salit Steel there was no one in need of protection through lien rights.[63] Further, Master Albert held that the no-holdback clause did not eliminate a sub-contractor's lien rights,

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[61] *Rudco Insulation v. Toronto Sanitary Inc.* (1998), C.L.R. (2d 1 (Ont. C.A.). As Glaholt, as pointed out in commentary in the Annotated Construction Lien Act, the "Court of Appeal has held that the trusts under Part II of the Construction Lien Act are unique in that the costs of administering the trust are not a proper charge on the trust property".

[62] 2009 CanLII 9746 (ON S.C.). [*Salit Steel*].

[63] The Act does not actually "obligate" a payor to maintain the holdback for "every" supply to an improvement. What the Act says in Part IV, Holdbacks in s. 22 is that "each payor upon a contract or subcontractor *under which a lien may arise* shall retain a holdback. And then at s. 23(1) personal liability arises for holdbacks (on the owner only); and then at s. 24(1), payments can be made, without jeopardy, of up to 90% of the price of services or materials supplied.

rather it recognized that there were no subcontractors who would be effected by such an agreement. Consequently, Mondaile was ordered to pay Salit Steel the holdback with interest, rather than waiting the usual 45 day period for claims against the holdback to expire.

(c) Noting in Default

In *M.J. Dixon Construction Ltd. v. Hakim Optical et. al.,*[64] Master Polika recently looked at the requirements for bringing a motion to set aside both a default judgment and the noting in default in an action under the *Act.* He held that the onus is on the moving party to satisfy three elements:

1. they must show they have moved promptly once becoming aware of the default judgment;
2. they must show that there is an explanation for the default; and
3. they must show that there is evidence to support a defence.

The defendants in this case were noted in default and had a default judgment awarded against them. The defendants' lawyer had advised plaintiff's counsel that they would be delivering the Statement of Defence shortly, but the plaintiff was adamant that the defendants be noted in default, and default judgment requisitioned. As a result of those actions, the lawyer for the defendant accused plaintiffs counsel of breaching the Rules of Professional Conduct. The animosity between the two lawyers continued, and spilled into the cross-examinations of various witnesses.

In dismissing the defendant's motion, Master Polika highlighted the fact that the *Act* contains strict provisions with regard to the delivery of a statement of defence. The default provisions set out in s. 54 include the potential of severe cost consequences, and

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[64] 2009 CanLII 14046 (ON S.C.). [*Dixon*].

address the potential for delay. While Master Polika did find that the defendants had moved quickly, their failure to provide an adequate excuse for their tardiness was fatal to the motion. To allow the motion would prejudice the plaintiff, and it would also be counter to the express provisions of the Act "with a consequential deleterious effect on the integrity of the justice system". This is a reminder that there are serious consequences for the failure to deliver a statement of defence in a timely manner under the Act.[65]

(d) Stays Pending Arbitration

Issues relating to construction arbitrations and have recently been the subject of judicial comment in Ontario. Arbitration is a common dispute resolution tool, as most construction contracts provide for the arbitration of any dispute arising out of, or in connection with, the interpretation or performance of the contractual agreement.[66] Typically the courts will stay litigation in favour of arbitration, but not always.

First, the courts generally favour the use of arbitration. The Ontario Court of Appeal has consistently ruled that an arbitration clause can be enforced through a stay of any pending litigation. This holds true even where local lien legislation grants lien rights.[67]

Second, a bilateral arbitration may not allow for the resolution of multi-party or multi-issue disputes. Construction projects inevitably involve numerous parties, and

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[65] However, Master Polika did not stop there. At the end of his judgment he took a moment to rebuke the defendant's lawyer. Defendant's counsel had made serious allegations concerning the propriety of the conduct of plaintiff's counsel. Master Polika found that the allegations were completely baseless and "smart[ed] of *chutzpah* both in terms of civility and the requirements of the Rules of Civil Procedure". This is another reminder to all of us to practice law with integrity, and to let tempers cool before we act further.

[66] See: Andrew Heal, "Arbitration a Good Tool in Resolving Construction Contract Disputes", *Commercial Litigation Review* (2009) Vol. 7 No.1 p.9.

[67] *Automatic Systems Inc. v. ES Fox Ltd.*, [1994] O.J. No.829, 12 B.L.R. (2d) 148 (C.A.) and *Automatic Systems Inc. v. Bracknell Corp.*, [1994] O.J. No.828, 18 O.R. (3d) 257 (C.A.).

numerous contractual relationships. This complexity may prevent certain disputes from being resolved through arbitration. This was discussed by Justice Pierce in *Penn Construction Canada (2003) v. Constance Lake First Nation*[68] where the court declined to enforce a mandatory mediation process on the basis that the contractor, having commenced litigation, was precluded from enforcing the stay provision of the *Arbitration Act.* Justice Pierce held that to grant a stay would be an abuse of process, and would allow for the possibility of duplicate proceedings.

Finally, one of the benefits of arbitration is the ability to choose the arbitrator. As such, great care and thought must be put into this choice. The January 2008 Canadian Construction Documents Committee revised the form of construction contract which set out rules regarding the appointment of an arbitrator. The rules allow for the appointment of a project mediator. Following an unsuccessful mediation, a reference to an arbitration panel. The panel consists of one to three persons, depending on what the party has requested and whether the amount in dispute exceeds $250,000. Failure to plan ahead and to consider potential arbitrators may result in unnecessary delay. As most commercial agreements provide that the decision of the arbitrator will be final and binding, the choice of arbitrator is an important consideration that should not be made hastily.

Conclusion

The construction industry has produced more than its fair share of interesting cases for 2008-2009. Issues relating to bidding and tendering, construction insurance and exclusion clauses, and some of the unique characteristics of lien legislation in Ontario

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[68] [2007] O.J. No. 3940, 66 C.L.R. (3d) 78, aff'd 2008 ONCA 768.

and the interplay of dispute resolution clauses, have occupied the courts for the past term. New and related issues are likely to do so for the foreseeable future. H:\FILE\WORD\Operation Update 2009\Operation Update Paper - AJH Sept 16.doc