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Commercial Litigation Update

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This newsletter is designed to bring news of changes to the law, new law, interesting decisions and other matters of interest to our commercial litigation clients and friends. We hope you will find it interesting, and welcome your comments.

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IN THIS ISSUE:

"Owners must be aware that if they breach the contract, they can be exposed to damages that may exceed the value of the contract."

OWNERS AND DEVELOPERS BEWARE: UNANTICIPATED LIABILITY FOR BREACH OF CONTRACT HIGHLIGHTED IN THE *LANDMARK II* DECISION

Chad Kopach

Owners sometimes refuse to make payment, and as a result, unpaid contractors sometimes walk off the job. It happens daily in Ontario.

In some circumstances, it comes out that the owner was entitled to withhold payment. In any event, owners usually think they can evaluate their exposure in the event a court finds that they were in breach of contract for withholding payment; at most, they will be on the hook for the unpaid invoices, plus some amount for profit that the contractor would have received had the contract been completed. This is wrong. Owners must be aware that if they breach the contract, they can be exposed to damages that may exceed the value of the contract.

The Court of Appeal's decision last year in *Landmark II Inc. v. 1535709 Ontario Ltd.* [2011] O.J. No. 3866 ("*Landmark II*") is a reminder that an owner can be exposed to liability for the value of the work performed by its contractor, which can be greater than the contractual damages.

In *Landmark II*, the owner had a large piece of land, part of which it was renting out as a parking lot. The owner hired *Landmark II* to expand the parking lot. The parties signed an agreement requiring the owner to pay *Landmark II* four equal installments of $14,712.50, to be paid when certain milestones were met. The contract was worth $58,850.00.

Unfortunately for the parties, they could not agree on whether the payments would be made at the beginning of each phase, or after each phase was completed. The owner refused to make "payments in advance", and *Landmark II* walked off the job having been paid only $14,712.50. In the Court of Appeal, *Landmark II* asserted that it ultimately lost about $24,500.00 in profit.

On the issue of timing of payments, the trial judge sided with *Landmark II*, concluding that the payments were due at the beginning of each phase, not after it was completed. The judge found that the owner breached the contract when it refused to pay at the start of the second phase, and that *Landmark II* was at liberty to walk off the project when it did.

Landmark II could have presented its case as a breach of contract action, and sought payment for the profit it would have made had the owner not breached the contract. If it could prove its lost profits, it would be entitled to damages for $24,500.00.

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"If an owner breaches a contract and the contractor withdraws its services, the contractor gets to decide between damages for breach of contract or damages for quantum meruit."

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But *Landmark II* did not seek damages for breach of contract.

Landmark II started its action as a *Construction Lien Act* action. It alleged that it supplied services and materials to the project worth $44,138.00 that improved the land. *Landmark II* did not present its case as a breach of contract entitling it to recover its lost profit as contractual damages. Instead, *Landmark II* sought damages based on *quantum meruit*; that is, it wanted to have judgment for the value of its work supplied.

Quantum meruit damages would have been secured by the lien. The breach of contract damages would not. This explains why *Landmark II* advanced a *quantum meruit* claim. It does not explain why it did not seek damages for breach of contract.

In addition to failing to plead in the alternative, *Landmark II* made another error; it registered its lien out of time. This meant its judgment could not be a charge against the land. It also exposed *Landmark II* to damages for registering a lien when it should have known it had no lien rights.

The Court of Appeal noted that the plaintiff had two mutually exclusive claims that it could have put forward in the alternative; a claim for breach of contract that would entitle it to contractual damages (in this case lost profit), and a claim for *quantum meruit*, which would entitle it to payment based on their value of the work it had done, less the amounts that it had been paid.

Landmark II did not seek damages for breach of contract, and only advanced a claim in *quantum meruit*. The owner got lucky on this point, because much of the material *Landmark II* had supplied before it walked off the project was obtained by *Landmark II* for free. Also, *Landmark II* did not have any credible evidence regarding the value of the work it supplied up to the day it walked off the job. The trial judge accepted the only other evidence she had regarding value, being that of the replacement contractor (hired by the owner). The replacement contractor thought that the value of *Landmark II*'s work was only about $16,000.00.

At the end of the day, *Landmark II* was found to be entitled to $16,000.00 for the work it performed, less the $14,712.50 it had been paid on the project. It would have had judgment for $1,287.50 had it not registered the improper lien, which made *Landmark II* liable to the owner for about $5,150.00. At the end of the day, *Landmark II* actually had judgment against it for $3,858.89.

At first blush this seems to be a victory for owners. It was certainly a victory for the owner in this specific case. However, at the Court of Appeal, Justice Laskin (writing for the court) reminded all that the proper way to plead these breach of contract cases, even in lien actions, is to plead *quantum meruit* and breach of contract damages in the alternative, then to make an election prior to judgment.

Laskin J. referred to a 1979 trial decision of Justice Borins called *GNC Realty Products Ltd. v Welglen Ltd.* [1979] O.J. No. 3456 ("*GNC*"). In that case, *GNC* had plead its claim (mostly) properly; it sought $283,574.10 for breach of contract and in the alternative for *quantum meruit*. The contract price was $516,822.04, and *GNC* had been paid $233,247.95.

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"In certain, limited circumstances, a Court may enable a party to "rectify" the agreement to reflect what was actually intended to be contained in an agreement, although the Courts are generally loath to interfere with executed, written documents entered between commercial parties."

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GNC won at trial; Justice Borins found that the owner had breached the contract.

After going through the calculations, Justice Borins determined that the value of *GNC*'s work was $616,573.80 (it seems to have underbid the project), and held that *GNC* could recover $383,325.85 for *quantum meruit* (though this would be knocked down to $283,574.10 because *GNC* limited its request to this amount). Alternatively, Justice Borins held that *GNC* could recover $255,481.76 for breach of contract.

In *GNC*, the plaintiff then had to elect whether to take damages for breach of contract or damages for *quantum meruit*. It ultimately chose damages for breach of contract, likely because this election entitled it to interest at the contractual rate of 18% *per annum*.

The *Landmark II* and *GNC* cases highlight an important consideration for owners. If an owner breaches a contract and the contractor withdraws its services, the contractor gets to decide between damages for breach of contract or damages for *quantum meruit*. This can result in exposure to damages beyond that which would flow from breach of contract.

Before deciding on a course of action that might be considered a breach of contract, owners should consider their exposure to a claim for the value of the work performed by their contractor. ■

"THAT'S WHAT IT SAYS, BUT IT'S NOT WHAT WE MEANT" -- RECTIFYING A CONTRACT

Bradley Phillips

Parties to a contract (or one party to a contract) may discover that the contract they signed and filed away in their desks does not accurately reflect the deal they thought they had entered. This can inevitably lead to significant disputes when steps are taken by the other party to enforce a provision of an agreement that one of the parties does not believe accurately reflects the intentions of the parties.

In certain, limited circumstances, a Court may enable a party to "rectify" the agreement to reflect what was actually intended to be contained in an agreement, although the Courts are generally loath to interfere with executed, written documents entered between commercial parties.

There are now two ways that rectification can be sought; either by establishing a mutual mistake (i.e. when entering into the written agreement, neither party intended to create the obligations set out in the agreement), or by proving a unilateral mistake (where one party negligently enters the agreement, while the other party is aware of the (disputed) provision at the time the agreement is entered and intended to rely upon it). The "tests" to establish rectification differ depending upon the argument presented.

Mutual Mistake

Traditionally, proving mutual mistake was the only manner to seek the equitable remedy of rectification. The Ontario Court of Appeal case of *Royal Bank of Canada v. El-Bris Ltd.* makes it clear that the prerequisites for rectification in respect

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of unilateral mistake (which are set out below) do not apply in common or mutual mistake cases. Rather than setting out an express test for mutual mistake, the Ontario Court of Appeal cited, with approval, the following portion of the reasons of Lord Denning of the English Court of Appeal in *Frederick E. Rose (London) Ltd. v. Wm. H. Pim Jnr. & Co.*:

> **In order to get rectification, it is necessary to show that the parties were in complete agreement on the terms of their contract**, but by an error wrote them down wrongly. **And in this regard, in order to ascertain the terms of their contract, you do not look into the inner minds of the parties - into their intentions - any more than you do in the formation of any other contract. You look at their outward acts, i.e., at what they said or wrote to one another in coming to their agreement, and then compare it with the document which they have signed. If you can predicate with certainty what their contract was**, and that it is, by a common mistake, wrongly expressed in the document, **then you rectify the document**. [emphasis added]

Evidence of later conduct (throughout the contract's terms) consistent with a claim for rectification is also relevant and admissible when seeking a claim for rectification.

Unilateral Mistake

The concept of rectification by unilateral mistake is a newer concept, and because only one party is acknowledging a mistake was made, the standard to prove an entitlement to rectify the contract is much higher than proving a mutual mistake.

The Supreme Court of Canada case of Performance Industries Ltd. et al. v. Sylvan Lake Golf & Tennis Club Ltd. sets out the conditions precedent for rectification in the context where a unilateral mistake was made.

Binnie J., writing for court, set out four prerequisites for parties seeking rectification for unilateral mistake: (i) a previous oral agreement inconsistent with the written document; (ii) the other party knew or ought to have known of the mistake and permitting that party to take advantage of the mistake would amount to unfair dealing; (iii) the document can be precisely rewritten to express the parties' intention; and (iv) each of the first three prerequisites must be demonstrated by convincing proof i.e. proof that may fall well short of the criminal standard, but which goes beyond the sort of proof that only reluctantly and with hesitation scrapes over the low end of the civil "more probable than not" standard.

As can be seen, the test to establish rectification by way of unilateral mistake comes close to requiring that a party prove that a fraud has been committed. While the concept is available to an aggrieved party, the number of cases in which unilateral mistake has been proven is very rare, and pursuing rectification on this basis must be considered carefully based upon the unique facts of each potential claim. ■

Commercial Litigation Update is a publication of the Commercial Litigation Group of Blaney McMurtry LLP. The information contained in this newsletter is intended to provide information and comment, in a general fashion, about recent cases and related practice points of interest. The information and views expressed are not intended to provide legal advice. For specific legal advice, please contact us.

We welcome your comments. Address changes, mailing instructions or requests for additional copies should be directed to Kylie Aramini at 416.593.7221 ext. 3600 or by email to karamini@blaney.com. Legal questions should be addressed to the specified author.

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