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By Stephen G. Revay

The University of Calgary is proposing to create a Chair in Contractual Arrangements and has requested our assistance.

This proposed Chair would work towards the development of a collaborative relationship framework between owners and contractors on the design, procurement, and construction of 'projects. The goal of 'this framework is to provide an atmosphere for building trust between the different parties and increasing the level of innovation and creativity. through the application of constructability, and value engineering Concepts.

The Chair's focus would be on the structure of the construction contract with Particular emphasis on the legal, financial and human components. This includes among other things, proper risk allocation, gain sharing and incentives and a proactive dispute resolution.

Additionallv, it will focus us on enhancing the positive trend in the construction industry, i.e. encouraging construction owners to save money and avoid disputes, by revisiting their risk allocation and contracting policies and procedures. Building on this trend and momentum, a research of and a change to risk allocation practice will be conducted to promote an enabling atmosphere to innovate and aggressively apply value engineering and constructability taking into consideration the legal professional implications.

BENEFITS TO INDUSTRY CONTRIBUTORS

The Chair will offer the following services, building on the success of the Project Management Specialization Program at the University of Calgary.

- *Short courses*
- *Conferences and seminars*
- *Industry directed research*
- *Publications and guidelines for industry practitioners*

Financial contribution from industrv will be acknowledged by the U of C in an appropriate and suitable fashion.

CONSTRUCTION DISPUTES: Where are we heading?

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Sometime in 1998, the Supreme Court of Canada will hear the appeal of *M.M. Enterprises Ltd. v. Defence Construction (1951) Limited.* After some fifteen years or so of litigation, we will find out whether the words lowest or any tender not necessarily accepted"-the so-called privilege clause in the bidding contract - entitle the owner not to accept the lowest or any tender.

The industry will be relieved to have the matter finally settled. But, surely, it is astonishing to find the highest court in the land studying a contractual term the meaning of which must be clear to anybody with a post-kindergarten education. The reason is that the legal framework surrounding construction disputes is not what it used to be, and is still changing.

Privilege Clause. The privilege clause is a term of the bidding contract, or Contract A, introduced in 1981 by the Supreme Court of Canada in the well-known *Ron Engineering*[1] decision. The underlying objective was, in the words of Justice Estey, to preserve the "integrity of the tendering process ... where under the law of contracts it is possible so to do"

Some courts took a different approach in following the same objective: they adjusted the law of contracts to fit. They decided that **fairness** was an implied term of Contract A so that an owner could not hide behind the privilege clause and make an unfair award[2]. Other judges stuck with the law as it used to be: a contract is a contract and it is the court's job to uphold its terms rather than improve them [3].

The privilege clause itself is of minor importance compared to the general principle at stake: the role of the courts in the conduct of the construction process.

Construction, like most other business activities, is driven by economic forces. Competitive bidding

represents only the first round of many in a contest where the economic interest of the owner may be opposed to that of the contractor, just as the economic interest of the contractor often clashes with those of its subcontractors.

If fairness is going to be enforced in round one, why not in the rest? Why not check the fairness of claims for extras? Are delay claims always fair? Are we going to have the courts acting as referees in the construction process, from start to finish?

Considering the amount of litigation and uncertainty following *Ron Engineering,* the thought is scary.

Bid Shopping. The Supreme Court will, also decide whether the privilege clause allows the owner "to *commence bid shopping with contractors submitting tenders and contractors not submitting tenders.'* If the court outlaws bid shopping by owners, the decision will presumably apply to the same practice by contractors.

It is a safe bet that bid shopping will continue regardless of what the courts do, only less blatantly. In an industry where the contract is awarded to the lowest bidder, the inherent low profit margins and the high degree of risk work against the contractors striving for the greatest degree of expertise, the best equipment and the most experienced and skilled work force.

General contractors are mostly brokers, all depending on a limited number of subcontractors. The lowest bidder will be either the general contractor who makes the biggest mistake, or the one who can, one way or another, squeeze the lowest price out of subcontractors-hence bid shopping. The subcontractors are following the same line of least resistance and squeezing sub-subcontractors and suppliers.

Fortunately, the idea of awarding the design contract to the architect or engineer bidding the lowest fee, although tried often enough, has not caught on. It is easy to see how the whole process almost inevitably leads to claims and disputes. Better ways may prevail in the future, but not because of court decisions.

Negligence. While the top court is about to lock the door of the contractual stable, the horse may have already bolted-into the wide open range of the tort law, i.e. negligence. There, judges enjoy much more creative freedom, using tools such as duty of care, or of fairness, good faith, honest dealing, and so on, while bypassing boring contractual terms such as the privilege clause. That is where future legal rodeos will likely take place.

When Justice Dandie of the Ontario Court recently handed down his decision in *Twin City Mechanical v. Bradsil (1967) Limited*[4] it contained the first finding of negligence against an owner for actions which harmed a subcontractor in the bidding process. Bradsil, a general contractor, engaged in blatant bid shopping and saved a lot of money at the expense of Twin City, the mechanical subcontractor who submitted the lowest bid through the bid depository specified by the owner, the Ontario Ministry of Agriculture. The Ministry did nothing to stop the bid shopping; it only made sure that its own interests were protected.

The court found that the Ministry, as the tender calling authority, ... *had a duty of* care *to* assure that *everyone who* participated in *the*

> *process it had initiated was treated fairly in accordance with the good faith principle.*

In particular, said the judge, the Ministry had a duty to protect Twin City against Bradsil's bid shopping. A breach of a duty of care is negligence, a tort, so the Ministry was also found liable (along with the bankrupt contractor) and may end up paying $1.25 million in damages-the subcontractor's unrealized profit.

The Ontario example was quickly followed by Justice Burnyeat in British Columbia, in *Ken T*oby *Ltd. v. BC Buildings Corporation.*[5] The judge adopted the reasoning of the Ontario court and found that BCBC owed to Ken Toby, *"a duty of fairness which requires [the owner] to act in good faith."* BCBC breached that duty when it failed to follow the bid depository rules and had to pay steep damages.

Both *Twin City* and *Ken T*oby represented punishment on a grand scale, meted out to owners who had no inkling that they were so liable. It was punishment that could easily wipe out an owner. Yet courts normally restrict punishment to criminal cases. They will not enforce a liquidated damages clause which they perceive as being a penalty, and will look long and hard at the behaviour of a defendant before awarding punitive damages of a few thousand dollars.

Contractual Obstacles. The *Ken* Toby decision is a good example of how ineffective contractual provisions may be in saving the parties from liability in the face of a judge determined to enforce fairness.

In that case, the owner was found liable for breaking a bid depository rule and harming the subcontractor.

However, another depository rule, entitled "Exclusion of Liability" and stretching over two pages, purported to exclude liability for negligence by anybody in any way connected to the depository, including the tender calling authority. The clause moreover required all bidders to agree not to pursue any action against anybody and for any reason imaginable, including negligence.

The rule was written in excruciating legalese, but the intention was clear: the bid depository was to be used on the understanding that no new liability for anybody concerned would flow from its use. Justice Burnyeat threw the rule out as ambiguous.

Of course, there was also a privilege clause in the bidding contract. It also went by the board.

The courts used to consider contracts and agreements as "the law of the parties" and enforced their terms according to their plain and natural meaning. In the age of fairness, this is no longer the rule. Fairness is such a lofty objective, that no obstacle is insurmountable in order to achieve it. That is why the contracting parties no longer can know in advance with any degree of certainty what the courts will do with their agreements.

The beneficial effect of such decisions may be that lawyers will re-examine the boilerplate they so often put into con tracts and try to write in simple, clear English. But, of course, the privilege clause is always written in simple, clear English-and it has gone all the way to the Supreme Court!

Fairness for All. Both *Twin City* and *Ken* Toby decisions have been appealed and may prove to be just two flashes in the pan. However, it is instructive to look at the two decisions as part of the overall legal picture.

Over the last twenty years or so, the Supreme Court has led the way in creating a version of "just society" in which everybody has a duty of care to everybody else. In the process, it has made some drastic changes to the law.

It may now seem incredible that, until as recently as 1963, the courts would not even consider liability outside contract for simple loss of money, or "pure economic loss" in legal terminology. Such business losses are common, usually very messy to sort out, may result in indeterminate liability and may also open the "floodgates of litigation.' Therefore, the courts simply refused to touch pure economic loss.

In 1963, the House of Lords opened the door a crack, when it decided that a banker who carelessly gave a misleading reference and so caused financial loss, should be liable for negligence[6].

Since then, step by step, the scope of liability for economic loss has become wider and wider. In Britain, the House of Lords performed a U-turn in 1988, but Canada carries on. By now, everybody in construction may be liable to everybody else, regardless of contract:

- engineer or architect to contractor[7] or subcontractor[8] for losses caused by the consultant's negligence in the preparation of drawings and specifications; by the same logic, one day soon, a (sub)-contractor will be found liable for causing economic loss to the consultant by its negligent work requiring extra instructions or supervision, or some such reason;

- contractor, architect and engineer[9] and even inspector[10] to subsequent purchasers of a building for dangerous defects (but, in construction, what is not dangerous?-every condominium claim for deficiencies is now prefaced with a statement that the defects are dangerous);

- owner to supplier, for having a secret dislike of its product and preferring a contractor who offered a competing product.[11]

Thus, the liability of the owner to subcontractor for breach of a duty of care or fairness in bidding, although new, fits nicely into the general scheme of things.

Does this ubiquitous liability mean there is more justice and fairness? There is certainly much more litigation, more mutual distrust, more disclaimers of liability, and a drain of financial resources from an industry which suffers from inadequate resources probably more than any other.

The floodgates of litigation have not opened, it is true, but not for lack of incentive. The main brake is probably the cost of litigation which was always very high but was greatly increased by the various claims and counterclaims based on negligence, in addition to contract.

In a recent construction case[12], there were 85 days of discovery, 37,000 pages of exhibits and 142 days of trial; the decision-almost the size of "War and Peace"-came 6 years after substantial completion, and was promptly appealed. The parties spent more than $4 million on legal fees. The total award was approximately half of that amount. The unrecorded additional cost to the parties in lost time and effort must have been huge.

The case may have been exceptional, but for each such case that reaches trial several similar ones are settled out of sheer exhaustion, financial and physical, and there are many only marginally less extreme.

It is ironic that, while the courts expand liability in order to spread justice and fairness, those objectives may be denied by the excessive cost and delay to a large extent due precisely to the multiplication of duties and liabilities.

What is Fair ? The pursuit of fairness is all very well, but who is to decide what is fair? Many decisions having major impact on construction have been made by judges with laudable intentions but a very poor grasp of how the industry works. Justice Estey's decision in *Ron Engineering is* still a prime example, but by no means the only one.

In his groundbreaking *Twin City* decision, Justice Dandie echoed the high minded objective of Ron Engineering:

... the protection of the Bid Depository System must be at the forefront of my concerns.

So what did he do? He made owners shoulder the responsibility for the wellbeing of the subcontractors using the bid depository. Common sense, however, would indicate that owners will simply stop using bid depositories. The chances are that, this time, the judicial tender loving care will do more than just cause lots of costly

litigation: it may well kill the very institution it tried to protect.

Justice La Forest, recently retired from the Supreme Court, provided another classic example of judicial naivete:
It can, I think, safely be assumed that the great majority of those who engage building contractors to undertake a project must rely on the disinterested expertise of a building inspector to ensure that it is properly done ...[13]

They **must?** The top court has not heard of the inspection services routinely performed by architects and engineers another professionals. The result of this particular decision was a flood of judgments in lower courts costing various municipalities a fortune. Instead of the owner paying the full cost of a properly constructed home, the whole community must chip in.

In a more recent case[14] Justice La Forest sprang once again to the defence of home owners. The result was another major expansion of liability into a new area. The court decided that, with respect to dangerous defects, compelling policy reasons exist that would make contractors liable in negligence even to subsequent purchasers of the building.

One of the "compelling reasons" was the naive idea that making contractors so liable would influence them to do a better job. There are much simpler ways of avoiding liability. For example, condominiums are now built each by a limited company that has no assets soon after the ownership of the building changes hands. Quality construction, just like bid shopping, is determined primarily by complex economic factors, not by the threat of legal action in the distant future.

In a 1993 decision[15] which made engineers and architects liable to contractors for errors in their plans and specifications-another vast expansion of liability-the Supreme Court suggested that as compensation for this new risk the consultants should be able to obtain higher fees from their clients who, in turn, could expect lower bids from contractors because of the transfer of risk to consultants. Dream on.

Alternative Dispute Resolution. The courts are opening the doors to litigation wider and wider to anyone who has suffered economic loss on a project, and breaking new ground looking for fairness, but the construction industry is becoming increasingly reluctant to enter the courtrooms. It is turning to alternatives.

The preferred form of ADR appears to be mediation followed, if necessary, by binding arbitration.

There is a danger in this rush to ADR the classic danger of throwing out the baby with the bath water. In this instance, the unlikely babies in question are the litigation **procedure** and the lawyers.

The litigation **process** is long and costly, to a large extent because the lawyers skills are not properly used by their clients. It is usually the clients who wish to fight every inch of the way. The lawyers oblige. The courts are on a "justice-and-fairness-at-any-cost" mission.
Again, the lawyers oblige. They assist the judges, with creativity and imagination, in inventing implied terms and all kinds of duties.

The other reason for the cost and delay of litigation is that each case has to be constructed from the ground up. The judge, as a rule, knows little about construction. Neither do the lawyers, with some notable exceptions.

The litigation procedure, however, is basically sound, as witnessed by the fact that over 90% of lawsuits are settled or discontinued before reaching the courtroom door, and, of the rest, over half never reach the end of the trial.

There is a simple reason for this rate of success. Litigation is based on a ritualized procedural continuum. It starts with the discovery of facts and preparation of arguments.

The lawyers have special skills and experience in organizing and presenting a coherent picture of their client's claim or defence. They are good at finding holes in the picture painted by the opposite side so, while at the start of a dispute, each party sees only its own position, they end up seeing for the first time **both** sides of the picture. This is a powerful incentive for both parties to arrive at a reasonable settlement.

The litigation procedure helps the process of settlement along in various ways, and provides a solution imposed by a judge if everything else fails.

By contrast, mediation and arbitration are not part of a continuum, they are separate packages, each with its shortcomings.

The great advantage of mediation is that it is non-adversarial, but it is greatly hindered by the parties' one-sided view of the dispute since there is no process of discovery. If mediation fails, the parties are back to square one.

The advantage of arbitration, when conducted by a construction professional, is that it requires very little by way of education of judge and lawyers, and the rules of evidence may be relaxed. On the debit side, arbitration is an adversarial process and may cost as much and last as long as litigation.

We may see in the future a gradual evolution of ADR that will adopt some of the best features of litigation, mediation and arbitration.

For example, the following has been found to work: a construction professional acts as a mediator but

also has fact-finding powers, while lawyers assist the parties in preparing their case and in negotiating a settlement in a non-adversarial environment. The mediator is then free to arbitrate the issues not settled by mediation.

The evolution may take ADR in a completely different direction, but it certainly is here to stay. It deserves a lot of attention and support from the entire construction industry. We cannot afford to leave crucial decisions in the hands of benevolent but sadly uninformed outsiders.

ENDNOTES

1 R. v. Ron Engineering and Construction (Eastern) Ltd. [19811 1 S.C.R. 111 (S.C.C.), discussed in **Revay Report** October 1996

2 Chinook Aggregates Ltd. v. Abbotsford (Municipal District) (1989) 40 B.C.L.R. (2d) 345, 35 C.L.R. 241 (B.C.C.A.); Vachon Construction Ltd. v. Cariboo (Regional District) (1996) 136 D.L.R. (4th) 318 (B.C.C.A.)

3 e.g. Master Funcluk in North American Construction Ltd. v. Fort McMurray (City): "The words used by the [owner] in the invitation to tender and instructions to bidders are short, old, simple and readily understandable. They must not be deliberately misinterpreted by the courts to arrive at a result-oriented decision based on some vague notion *of* fairness."

4 Twin City Mechanical v. Bradsil (1967) Limited (1996) 31 C.L.R. (2d) 210 (Ont. Ct. Gen. Div.). For a discussion of this and the following case, see article by W. J. Kenny QC and E. J. Sidnell "Subcontractors' Claims Against Owners" in **Revay Report,** October 1997

5 Ken Toby Ltd. v. BC Buildings Corporation, May 1997 (S.C.B.C.)

6 Hedley Byrne & Co. V Heller & Partners [196312 All E. R. 57 5 (H. L.)

7 Edgeworth Construction Ltd. v. N. D. Lea and Associates Ltd. [19931 3 S.C.R. 206 (S.C.C.)

8 J. P Metal Masters Inc. v. David Mitchell Co. Ltd. BC Supreme Court, June 1997 unreported

9 Winnipeg Condominium Corp. No. 36 v. Bird Construction Co. [1995] 1 S C.R. 85, 18 C.L.R. (2d) 1

10 Gauvin v. Ministry *of* Environment, Ont. Court (Gen. Div.) 1995; home purchaser successfully sued Min istry for "dangerous" faulty sewage system.

11 Arrow Construction Products Ltd. v. R.' NS Supreme Court 1995; (over turned on appeal but liability not completely excluded)

12 Foundation Company *of* Canada v. United Grain Growers, BC Supreme Court 1995

13 *Rothfield v Manolakos* [198912 S.C.R. 1259 (S.C.C.)

14 Winnipeg Condominium Corp. No. 36 v. Bird Construction Co

15 Edgeworth Construction Ltd. v. N. D. Lea

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