PALLETT VALO LLP
Lawyers & Trade-Mark Agents

Your Authority For:
Business Law • Commercial Litigation • Commercial Real Estate
Construction • Insolvency and Corporate Restructuring
Labour and Employment • Wills, Estates & Trusts

www.pallettvalo.com

Construction Law

December 2008

Year in Review

2008 saw a number of important cases in the construction industry, including *Kennedy Electric Ltd. v. Dana Canada Corporation, Design Services Ltd. v. Canada,* and *R. v. Transpave Inc.*

1) What Constitutes a Lienable Interest: *Kennedy Electric Ltd. v. Dana Canada Corporation*

The decision of the Ontario Court of Appeal in *Kennedy Electric Ltd. v. Dana Canada Corporation*, released in late September 2007, raises the age-old question of what constitutes a lienable interest. Leave to appeal to the Supreme Court of Canada was denied on February 28, 2008. The question now becomes complicated for electrical and mechanical contractors, or for anyone who supplies prefabricated portable components to a construction project.

In order to manufacture truck frames for Ford, Dana Canada hired Rumble Automation to design, build and install a new assembly line at its plant in St. Marys, Ontario. A portion of the work was subcontracted to Kennedy Electric. Under a separate contract, Dana arranged for the construction of a 160,000-square-foot addition to its plant to accommodate the assembly line. The assembly line consisted of 100 platforms, 165 robots and covered 100,000 square feet of the floor of the building, weighed 500,000 tons and stood 20 feet in height. It had taken 165 transport trucks to ship the assembly line to the plant. The components, which were manufactured offsite, were assembled at the plant and securely attached to the building floor by several thousand mechanical and chemical bolts. The critical issue very quickly became whether this gave rise to a lienable interest under the Ontario *Construction Lien Act*.

The Court of Appeal held that the trial judge had made no palpable and overriding error in finding that the assembly line was portable and accordingly lien rights did not arise under the *Construction Lien Act.* A construction lien will not arise where work and materials have been supplied in respect of an installation that is portable because such work does not improve or become an integral part of the building. The trial judge had made several key findings of fact in determining the question of portability:

- While the project included the construction of the new addition to the plant which would accommodate the assembly line, the steps taken on the site did not constitute an integrated construction project;
- Kennedy was not involved in the construction of the new addition or in connecting the assembly line to the existing building services. These connections were made by other trades;
- The evidence established that the assembly line could be disconnected from the addition without damage to the addition and its services;
- Dana had a history of moving some of its other assembly lines from one plant to another.

Based on those findings of fact, the Court of Appeal held that while a different judge might have come to a different conclusion on the issue of portability, the Court was satisfied that the trial judge had not made a reversible error in reaching the conclusion that he did.

For some, it is difficult to understand how the trial court could have concluded that the contract was not part of an integrated project when the addition to the plant was built for the sole purpose of housing a complex robotic assembly line. It was also likely a surprise to the subcontractors whose contract provided for a 20 per cent holdback until completion of the job. The judgment of the Court of Appeal demonstrates the reluctance of appellate courts to interfere with factual conclusions drawn by trial courts in the absence of clear evidence that the trial judge misapprehended the evidence or committed a serious error in interpreting that evidence.

The Court of Appeal did, however, reject the broad proposition stated by the trial judge that the installation or repair of machinery used in a business operated inside a building does not give rise to lien rights. The court noted

that in most cases, the installation or repair of machinery used in a business operated in a building, particularly where the machinery is portable, will not give rise to lien rights. Where, however, machinery is installed in a building for the use of a business and is completely and permanently integrated into the building, a lien claim will arise. It will be a factual determination in each particular case as to whether the installation of equipment or machinery is sufficiently and permanently integrated into the structure to fall into the latter category.

The decision does raise a number of unanswered questions. In light of the Court's focus on portability, what is the status of prefabricated structures? Virtually any structure can be made "portable." In what circumstances will installation of equipment or machinery trigger the holdback requirements of the *Construction Lien Act*? If the project includes both the installation of equipment and separate improvements to the building structure, when should the project be treated as governed by separate contracts which may give rise to lienable and non-lienable improvements? Can a security interest under personal property security legislation be registered in respect of a portable structure? Given this recent decision, owners and contractors should carefully consider their legal rights where the construction project includes installation of equipment or machinery or prefabricated components.

2) No Duty of Care Owed to Subcontractors – *Design Services Ltd. v. Canada*

The tendering process can be fraught with difficulties for owners and bidders. The decision of the Supreme Court of Canada on May 8, 2008 has clarified the law of tendering as it applies to subcontractors. Owners owe no duty of care in tort to subcontractors, architects or consultants of an unsuccessful bidder.

Design Services Ltd. v. Canada involved a contract for the construction of a naval reserve building for Public Works and Government Services Canada. Olympic Construction Ltd. submitted an unsuccessful bid for the design-build contract. Olympic sued the owner, claiming that the owner had improperly accepted a non-compliant tender. Olympic's subcontractors joined in the litigation, their claim to recover economic losses restricted to an action in tort. Ultimately the owner settled with Olympic, but the tort claims of the subcontractors continued. Notwithstanding that Canadian caselaw had not to date recognized a duty of care between owners and subcontractors, the trial judge granted judgment to the subcontractors.

Understanding why the Supreme Court disagreed with the conclusion of the trial judge requires a quick review of tendering law. Pursuant to long accepted tendering principles, when a compliant bid is submitted in response to a tender call, the bidder and the owner enter into "Contract A". The existence of "Contract A" imposes certain obligations on an owner, including the obligation to treat all bidders fairly, and to accept only compliant bids. It imposes a corresponding obligation on a bidder to enter into "Contract B" which arises when an owner awards the contract to the successful bidder. Awarding "Contract B" to a non-compliant bidder may permit an unsuccessful bidder to recover the lost profit that bidder would have earned if "Contract B" had been properly awarded.

In the *Design Services* case, there was clearly a "Contract A" between Olympic and the owner, which the owner breached by awarding the contract to a non-compliant bidder. However, because Olympic and the subcontractors had no formal joint venture or partnership arrangement, the subcontractors did not become parties to "Contract A". They argued that despite the lack of contractual privity with the owner, the owner had invited subcontractors to be part of the tendering process and had breached a duty of fairness to the design-build team in awarding the contract to a non-compliant bidder. In those circumstances, it was foreseeable that the subcontractors would suffer economic losses.

The Supreme Court concluded that the subcontractors' tort claim did not fall into any previously recognized categories in which recovery of economic loss is permitted. To recognize a new duty of care required both a sufficiently close relationship between the parties and a lack of policy considerations which would limit the scope of the duty. The Supreme Court was not prepared to recognize a new duty of care between owner and subcontractor for two

principle reasons. First, although it was foreseeable that awarding a contract to a non-compliant bidder would result in financial losses to the subcontractors, the subcontractors had an opportunity to protect their position, but had specifically declined to enter into a joint venture arrangement with the bid proponent which would have given them the ability to sue the owner in contract. The subcontractors could not substitute a tort claim for their inability to sue on "Contract A". Second, to recognize a duty of care on the part of an owner would open the door to indeterminate liability to a pool of potential suppliers and sub-subcontractors, given the realities and complexities of the construction supply chain.

The decision, while a welcome one for owners, also serves as a reminder that owners must consider the legal relationships between general contractors and their subcontractors when drafting tender documentation. While generally subcontractors, suppliers, architects and consultants are not parties to "Contract A", if a bid is submitted in the form of a joint venture, unintentional contractual privity could be created with other parties in the construction supply chain. The decision also serves as a reminder to subcontractors that it is insufficient for a subcontractor to simply rely upon a bid proponent to protect its economic interests in the tendering process.

3) First Criminal Conviction for Violation of Occupational Health & Safety Obligations - *R. v. Transpave Inc.*

Construction companies are generally aware of their health and safety obligations under provincial regulatory legislation. They may not be aware that such obligations are also found in the criminal law. Amendments to the *Criminal Code* enacted in 2004 following the Westray mine disaster have recently resulted in the first criminal conviction in Canada for a workplace fatality. In March 2008, following a guilty plea and a joint sentencing recommendation by the Crown and the accused, a Quebec court imposed a $100,000 fine (and a $10,000 "victim surcharge") on Transpave Inc., in respect of the death of a worker crushed by heavy machinery after its guarding mechanism had been deliberately disabled with the knowledge of senior management.

In 2004, subsection 217.1 was added to the *Criminal Code* which defines legal duties respecting health and safety obligations. It provides that:

> "Everyone who undertakes, or has the authority, to direct how another person does work or performs a task is under a legal duty to take reasonable steps to prevent bodily harm to that person, or any other person, arising from that work or task."

Employers and individual officers, directors, supervisors and managers can now be more readily convicted of criminal negligence offences for workplace accidents when the failure to perform this duty occurs in a manner that shows wanton or reckless disregard for the lives or safety of others. The duty imposed by this provision applies widely to lead hands, foremen or similar individuals who direct the work of others.

Prior to the amendments, corporations were only liable for the acts and omissions of persons who, given their position or authority in the corporation, constituted a "directing mind" of the corporation. This included all individuals who were given authority to design and supervise the implementation of corporate policy. Attribution of criminal responsibility to a corporation is no longer restricted to the actions of a "directing mind." Organizations are liable for the negligent act of a "representative" or the aggregate acts of "representatives" in situations where a senior officer responsible for those activities departed markedly from the standard of care that in the circumstances could reasonably be expected. The definition of "representative" encompasses broader categories of personnel than the "directing mind" concept, including such individuals as employees, agents and contractors.

While the fine imposed on Transpave appears relatively small in comparison to the maximum fine which may be imposed by Ontario regulatory standards, construction companies should note that the penalty was roughly five times the maximum available for a single charge against the corporation under Quebec's regulatory health and safety legislation. Additionally, several ameliorating factors were taken into account in setting the amount. Transpave was a small company and the fine had the

intended economic impact. Transpave also spent more than $500,000 following the accident to introduce safety improvements.

The Transpave conviction signals that the implementation and monitoring of an effective health and safety program is vital, not only to protect employees and to increase corporate efficiency and financial performance, but also to limit the risk of individual and corporate regulatory and criminal prosecution. Under the *Criminal Code*, there is no maximum fine for corporate convictions. Corporate representatives and senior officers could face prison terms of up to 25 years in addition to substantial fines. *Criminal Code* penalties may be levied in addition to penalties imposed by provincial health and safety legislation.

By having effective health and safety management practices, employers will not only minimize the risk of regulatory and criminal prosecution and workers' compensation costs, but will also increase workplace attendance, efficiency, morale and loyalty. Prudent employers should consider conducting periodic internal audits to review their existing health and safety management system as a strategy to reduce risk. A thorough audit of a health and safety program can assist in identifying areas of exposure, determining critical tasks and priorities, and ensuring implementation of policies and procedures. It is imperative that employers prepare and comply with written health and safety procedures and practices. As part of their due diligence, employers should maintain proper records and ensure regular monitoring of health and safety practices. An internal audit will also assist companies in being well positioned for government inspections or audits.

Anna Esposito is a Certified Specialist Construction Law and is the head of the Construction Law Group.

Andy Balaura has particular expertise in Labour & Employment issues in the construction industry.

Pallett Valo LLP Construction Law Group

Litigation risk management in the construction industry requires the advice and guidance of experienced construction and employment lawyers. The Pallett Valo construction department has particular expertise in the resolution of all types of construction disputes. Their practical and timely advice assists our construction clients in meeting their day to day challenges.

Anna Esposito aesposito@pallettvalo.com
Direct Dial: 905.273.3022 Ext. 260

Karen Groulx kgroulx@pallettvalo.com
Direct Dial: 905.273.3022 Ext. 281

Sophie Petrillo spetrillo@pallettvalo.com
Direct Dial: 905.273.3022 Ext. 214

Maria Ruberto mruberto@pallettvalo.com
Direct Dial: 905.273.3022 Ext. 206

Pallett Valo LLP Labour & Employment Group

Health and safety obligations are of particular concern to construction employers. Our Labour & Employment lawyers have experience helping employers conduct health and safety audits and recommending the implementation of appropriate policies.

Pamela Yudcovitch pamyudco@pallettvalo.com
Direct Dial: 905.273.3022 Ext. 218

Andy Balaura abalaura@pallettvalo.com
Direct Dial: 905.273.3022 Ext. 225

This article provides information of a general nature only and should not be relied upon as professional advice in any particular context. For more information about immigration law and your business, contact a member of our **Construction Law Group** or **Labour and Employment Law Group** at **905.273.3300**.

If you would like additional copies of the bulletin, or know of anyone who would be interested in joining our mailing list, please contact our Marketing Coordinator at **marketing@pallettvalo.com**.