ICLG

The International Comparative Legal Guide to:

Construction & Engineering Law 2015

2nd Edition

A practical cross-border insight into construction and engineering law

Published by Global Legal Group, with contributions from:

A LINEA Law Firm
Al Busaidy, Mansoor Jamal & Co.
Allen & Gledhill LLP
Ashurst
Attorneys-at-law Mäkitalo Rantanen & Co Ltd
Baker & McKenzie s.r.o., advokátní kancelář
Bloomfield Law Practice
BMT Law Chambers
COMAD, S.C.
Dentons Canada LLP
DLA Piper LLP (US)
Dr. Colin Ong Legal Services
Duncan Cotterill
Echevarría Leunda & Echevarría Petit Abogados
FALM – Sociedade de Advogados, RL
Herbert Smith Freehills LLP
Karimov and Partners Law Firm
Kesikli Law Firm
Koep & Partners
Lahsen & Cia. Abogados
Mattos Filho, Veiga Filho, Marrey Jr. e Quiroga Advogados
McCann FitzGerald
Moravčević Vojnović i Partneri in cooperation with Schoenherr
Nagashima Ohno & Tsunematsu
Osterling Abogados
PETERKA & PARTNERS Kancelaria Prawnicza sp.k.
Simmons & Simmons LLP
Sysouev Bondar Khrapoutski (SBH Partners)
Tan Swee Im, P.Y. Hoh & Tai
Terry Mahon Attorneys

GLG
Global Legal Group

GLG
Global Legal Group

Contributing Editor
Tim Reid, Ashurst

Head of Business Development
Dror Levy

Sales Director
Florjan Osmani

Commercial Director
Antony Dine

Account Directors
Oliver Smith, Rory Smith

Senior Account Manager
Maria Lopez

Sales Support Manager
Toni Hayward

Sub Editor
Nicholas Catlin

Senior Editor
Suzie Levy

Group Consulting Editor
Alan Falach

Group Publisher
Richard Firth

Published by
Global Legal Group Ltd.
59 Tanner Street
London SE1 3PL, UK
Tel: +44 20 7367 0720
Fax: +44 20 7407 5255
Email: info@glgroup.co.uk
URL: www.glgroup.co.uk

GLG Cover Design
F&F Studio Design

GLG Cover Image Source
iStockphoto

Printed by
Ashford Colour Press Ltd
July 2015

ISBN 978-1-910083-52-9
ISSN 2054-7560

Strategic Partners

MIX
Paper from responsible sources
FSC® C011748

General Chapters:

Country Question and Answer Chapters:

Canada

Karen Martin

Claude Morency

Dentons Canada LLP

1 Making Construction Projects

1.1 What are the standard types of construction contract in your jurisdiction? Do you have contracts which place both design and construction obligations upon contractors? If so, please describe the types of contract. Please also describe any forms of design-only contract common in your jurisdiction. Do you have any arrangement known as management contracting, with one main managing contractor and with the construction work done by a series of package contractors? (*NB* For ease of reference throughout the chapter, we refer to "construction contracts" as an abbreviation for construction and engineering contracts.)

Traditionally, the most utilised project model has been Design-Bid-Build (DBB), in which the owner engages an architect/engineer to design the project before engaging a general contractor to undertake construction. The use of alternative models has recently grown, including: Design-Build, in which the owner contracts with a single designer-builder; Construction Management, in which the owner contracts with a construction manager to manage design development and procurement, and then enters into separate contracts with trade contractors; and Public Private Partnerships (P3), in which a public owner contracts with a private contractor, utilising a Build-Operate-Transfer (BOT) delivery model (typically Design-Build-Finance-Operate (DBFO) or Design-Build-Finance-Operate-Maintain (DBFOM)), and usually involving a concession of 25 to 30 years.

Use of standardised construction contracts, modified to reflect project-specific requirements, is commonplace in Canada. The Canadian Construction Association (CCA) and the Canadian Construction Documents Committee (CCDC) develop licensed standard construction contracts. The Royal Architectural Institute of Canada (RAIC) and the Association of Consulting Engineers of Canada (ACEC) develop standardised design contracts, which are commonly used.

It should be noted that Canadian courts have found that a contract arises in most procurements between the tendering authority and each compliant bidder (known as "Contract A") as soon as the bidder submits its compliant bid to the tendering authority. Under Contract A, the tendering authority has a strict duty to follow the terms set out in the procurement documents and to treat all the bidders fairly and equally.

1.2 Are there either any legally essential qualities needed to create a legally binding contract (e.g. in common law jurisdictions, offer, acceptance, consideration and intention to create legal relations), or any specific requirements which need to be included in a construction contract (e.g. provision for adjudication or any need for the contract to be evidenced in writing)?

In Canada's common law jurisdictions (every jurisdiction outside of Québec), a legally binding contract requires offer, acceptance, and consideration. In Québec, the civil law provides that a contract is formed "by the sole exchange of consents between persons having capacity to contract" and it must have an object permitted by law (articles 1385 *ff.* of the *Civil Code of Québec* ("*Civil Code*")), which, in the construction context, is usually the physical, material, mechanical or intellectual work to be performed with or without consideration. In Canada, there is generally no requirement for a construction contract to be in writing, though any substantial construction contract will usually be reduced to writing. There is no statutory adjudication scheme in Canada, but certain statutory provisions are effectively deemed to be included in construction contracts, such as, for example, Builders' Lien holdback requirements.

1.3 In your jurisdiction please identify whether there is a concept of what is known as a "letter of intent", in which an employer can give either a legally binding or non-legally binding indication of willingness either to enter into a contract later or to commit itself to meet certain costs to be incurred by the contractor whether or not a full contract is ever concluded.

In Canada, letters of intent are used to indicate a willingness to enter into a subsequent contract or a commitment to certain obligations regardless of whether a final contract is ever concluded. Whether a letter of intent is enforceable depends on whether the parties intended it to be an independent agreement, which is enforceable, or a mere "agreement to agree", which is not enforceable, taking into account the language of the letter of intent, and the conduct of the parties. On larger construction projects, where there is a risk of schedule delay, parties may enter into "early works" contracts or "limited notices to proceed", defining a specific scope-of-work and maximum compensation payable, and allowing work to begin before the execution of a final contract.

1.4 Are there any statutory or standard types of insurance, which it would be commonplace or compulsory to have in place when carrying out construction work? For example, is there employer's liability insurance for contractors in respect of death and personal injury, or is there a requirement for the contractor to have contractors' all-risk insurance?

Several Canadian jurisdictions require new home warranty coverage for residential construction (single family or multi-family).

Although not required by statute, a general contractor will typically carry Builders' All Risk insurance, also known as "contractors' all-risk insurance" or "course of construction insurance", and often the construction contract will require such insurance. A Builders' All Risk policy is a first-party property policy which insures the construction project against the costs of repairing or replacing damage to project property while construction is ongoing. This insurance generally covers named parties (i.e., the owner, the general contractor, etc.), as well as most of the other parties (such as subcontractors) who perform work at the site of the project.

In addition, the owner or general contractor on a large project will also commonly carry a wrap-up liability policy that is specific to the project and covers the third-party liability of the parties involved in the project, covering the construction period as well as an additional period after completion for first-party property damage and third-party liability, commonly referred to as Completed Operations Hazard.

Other common insurance policies include: Professional Liability for error or omissions of design professionals; Commercial General Liability (CGL) to address the contractor's risks of liability to third parties; and, on some large projects, Subcontractor Default for losses stemming from a subcontractor's default. Increasingly, the owner or general contractor will also carry Environmental Impairment Liability (EIL) insurance, often as a contractual requirement.

In Québec, articles 2118 to 2120 of the *Civil Code* provide the owner with default warranties, based on public policy, with respect to the work of the contractor, the architect, the engineer, and/or the subcontractor. The warranty is for five years in the event of loss of work and for one year in the event of defect and poor workmanship.

With respect to death or personal injury risks for employees, all provinces and territories have statutory workers' compensation regimes that insure employees for the replacement of wages and the costs of injury in exchange for the employee relinquishing any right to sue the employer. Each employer is required to participate in these regimes by paying premiums assessed by the applicable Workers' Compensation Board.

1.5 Are there any statutory requirements in relation to construction contracts in terms of: (a) general requirements; (b) labour (i.e. the legal status of those working on site as employees or as self-employed sub-contractors); (c) tax (payment of income tax of employees); or (d) health and safety?

Although there are generally no specific statutory requirements in Canada applicable to construction contracts *per se*, they are subject to various provincial or territorial and federal laws of general applicability.

Labour relations and employment are primarily governed by the laws of the province or territory in which the employee works. These laws are generally consistent across Canada, but the specifics of the legislation and administering agencies vary between jurisdictions, and each province has enacted comprehensive minimum standards which serve as the basis for employer/employee relations. These address matters such as: payment of wages; minimum wages; recordkeeping; hours worked; overtime; paid public holidays; vacation with pay; benefit plans; parental leave; termination; and severance. At the federal level, Canadian immigration law requires foreign workers to obtain work permits before they can legally work in Canada.

With regard to payroll, a contractor is responsible as an employer for the payment of an employee's income taxes, which is accomplished through wage deductions. Employers must also deduct Canadian Pension Plan (CPP) contributions and Employment Insurance (EI) premiums from employee wages.

Occupational health and safety (OHS) is primarily governed by the laws of the province or territory in which the employee works, typically imposing a general duty on employers to take reasonable precautions to protect the health and safety of workers and others, including provisions that apply specifically to the construction industry. For example, these laws generally require a contractor to eliminate or control the hazards of which they are aware or could reasonably foresee and ensure that employees/subcontractors have sufficient health and safety knowledge to ensure compliance with the law.

1.6 Is the employer legally permitted to retain part of the purchase price for the works as a retention to be released either in whole or in part when: (a) the works are substantially complete; and/or (b) any agreed defects liability is complete?

Construction projects in Canada are generally structured as a pyramid, with an owner at the top, followed by a general contractor at the next level, followed by subcontractors and material suppliers at the bottom. All jurisdictions in Canada have lien legislation (which, in Québec, is included in the *Civil Code*), known as either Builders' Liens, Construction Liens, Mechanics' Liens or Legal Hypothecs, giving contractors and material suppliers (and sometimes architects and engineers) the right to file a claim of lien against most land on which construction takes place to secure a claim for payment for work or services performed, or materials supplied to the project. Some lands are exempt, including highways, certain land owned by First Nations or the Federal Crown.

In addition, under lien legislation, a person making a payment, including the owner, to a person immediately below it in the pyramid, must retain a "holdback", a percentage of that payment, typically 10% to 15% in most provinces, for the benefit of the person(s) under the person to whom payment is being made. The holdback is calculated as a percentage of the value of labour and materials provided to the construction project based on either the contract price or the actual value of the labour and materials provided.

Generally, the payor must cumulatively collect and retain the holdback until the expiration of a defined period, after the project is substantially completed, abandoned, or terminated. In general terms, if a lien claim is filed within the deadline, the holdback is used to pay such liens. Otherwise, the holdback is released.

Canadian construction contracts commonly provide for a separate deficiency holdback, typically twice the value of the estimated cost to rectify deficiencies.

1.7 Is it permissible/common for there to be performance bonds (provided by banks and others) to guarantee performance, and/or company guarantees provided to guarantee the performance of subsidiary companies? Are there any restrictions on the nature of such bonds and guarantees?

Performance bonds, issued by a licensed surety to provide security to

the owner or another contractor for the performance of a contractor's obligations under a construction contract, are commonly used. Labour and Material Payment bonds, in which a surety provides security to the subcontractors that the contractor will pay the subcontractors amounts to which they are legally entitled, are also common. Depending on the size of the construction project, such bonds are typically issued in amount(s) equal to 50% of the contract price. It is also common for owners to require bid bonds (typically 10% of the bid price) for bidders' obligations under the Contract A arising in a procurement.

It is becoming increasingly common for contractors on large construction projects to be permitted to submit a letter of credit to owners in *lieu* of providing bonds. Depending on the project, this letter of credit may be in the amount of 10% of the contract price.

Where a subsidiary entity enters into the construction contract, the owner may, in addition to the bonds or letter of credit, require a parent company guarantee, guaranteeing the performance of the subsidiary.

It is typical on P3 projects for the ultimate parent companies of the design-build contractor and the service provider to provide parent company guarantees to the concessionaire (assignable to the governmental authority), which guarantees the performance of the subsidiary entity.

1.8 Is it possible and/or usual for contractors to have retention of title rights in relation to goods and supplies used in the works? Is it permissible for contractors to claim that until they have been paid they retain title and the right to remove goods and materials supplied from the site?

Material suppliers may retain title to goods delivered to a construction project and enforce payment through repossession. In the common law jurisdictions, this is achieved through Personal Property Security legislation, which governs the creation, perfection, prioritisation, and enforcement of security interests; a similar regime is available under the *Civil Code*. However, once material is incorporated into the construction project, a supplier cannot repossess it. At that point, the supplier's recourse for unpaid material is to file a claim of lien or hypothecary claim.

In practice, supply agreements commonly provide that title to particular goods passes to the owner when the supplier is paid, or when the goods are delivered to the site, whichever comes first.

2 Supervising Construction Contracts

2.1 Is it common for construction contracts to be suspended on behalf of the employer by a third party? Does any such third party (e.g. an engineer or architect) have a duty to act impartially between contractor and employer? Is that duty absolute or is it only one which exists in certain situations? If so, please identify when the architect/engineer must act impartially.

Canadian construction contracts commonly permit the employer (commonly called the owner) to suspend or terminate the contract upon the determination of a third party consultant of sufficient cause. Typically, the construction contract defines the responsibilities of such consultants. For example, the CCDC fixed-price contract between an owner and prime contractor (CCDC 2) defines the consultant as the interpreter in the first instance of the terms of the contract (subject to the parties' dispute rights). The CCDC 2 also imposes upon the consultant a duty to serve as an impartial adjudicator of disputes between the owner and contractor and to act impartially in performing functions that are inherently a decision as to the rights of the parties, such as payment certification. Further, CCDC 2 permits the owner to suspend or terminate the contract upon the consultant's determination that the contractor has not properly performed the construction work or has not complied with the contract to a substantial degree. Similar provisions are commonly found in other construction contracts.

2.2 Are employers entitled to provide in the contract that they will pay the contractor when they, the employer, have themselves been paid; i.e. can the employer include in the contract what is known as a "pay when paid" clause?

Construction contracts in Canada often contain "pay when paid" clauses providing that a contractor does not have to pay a subcontractor until the owner has paid the contractor. Canadian courts have commonly interpreted such clauses as governing the timing of payment, and not the ultimate right to be paid. As such, depending on the wording of the clause, subcontractors may not have given up their right to recover against the contractor should the owner never pay. However, if the clause clearly specifies that payment is conditional on the owner's payment, then the subcontractor will likely be found to have accepted the risk of non-payment.

2.3 Are the parties permitted to agree in advance a fixed sum (known as liquidated damages), which will be paid by the contractor to the employer in the event of particular breaches, e.g. liquidated damages for late completion? If such arrangements are permitted, are there any restrictions on what can be agreed? E.g. does the sum to be paid have to be a genuine pre-estimate of loss, or can the contractor be bound to pay a sum which is wholly unrelated to the amount of financial loss suffered?

Construction contracts in Canada sometimes include a "liquidated damages" clause providing for payment of a fixed amount in the event of a contract breach. In Canada's common law jurisdictions, the ability to enforce such clauses depends on the sum bearing some relation to the realistic possible damages stemming from such a breach. If the liquidated damages are significantly more or less than the actual loss suffered and the pre-estimate is demonstrated to have been unreasonable or intended to be punitive at the time the contract was made, relief from the clause may be granted. Otherwise, the clause will likely be enforced.

In Québec, a "penalty clause" may be punitive in nature, including in relation to delay in the performance of the work, depending on its terms and the parties' intent. The Québec Court of Appeal has nevertheless ruled that, to be enforceable, *prima facie* evidence of damage is required as a fundamental condition of liability, without having to prove the extent of the damage suffered. If the owner or the contractor legally terminates the contract, the penalty clause will generally not be enforceable and the damages will be limited to the actual loss suffered, unless provided otherwise in the contract (article 2129 of the *Civil Code*). Moreover, according to article 1623 of the *Civil Code*, the courts have the discretionary power to reduce the stipulated penalty amount if the party has benefited from partial performance of the obligation or if the clause is abusive. An abusive clause is one that is excessively and unreasonably detrimental to one party, and is therefore deemed not to have been contracted for in good faith, such as when the anticipated damages and the actual loss suffered are grossly disproportionate.

3 Common Issues on Construction Contracts

3.1 Is the employer entitled to vary the works to be done under the contract? Is there any limit on that right?

Most construction contracts expressly provide that the owner is entitled to add, delete or revise the work to be done, by change order, as long as it is incidental and within the general scope of the contract. Generally, the owner provides the contractor with a written description of the proposed change, and the contractor proposes an amount or method of adjustment to the contract price and time.

If the parties do not agree on the terms and conditions of the change order prior to the performance of the work as modified, some construction contracts permit the owner to issue a change directive requiring the contractor to proceed to perform the work with the impact on the contract price and time to be determined later under the terms of the contract. If no change order or change directive has been issued, the court will assess entitlement to and the quantum of change, taking into consideration the terms of the original contract and the conduct of the parties.

Although contracts usually provide that written, signed instructions from the owner are necessary for extra work charges to be recovered, failure to comply with this formality, depending on the wording of the contract, may not be fatal, particularly where the owner's express or implicit consent is proven or where the parties waived the formality by their conduct.

Unless the contract specifically provides otherwise, the courts will usually imply that extra work must be compensated for on a *quantum meruit* basis.

3.2 Can work be omitted from the contract? If it is omitted, can the employer do it himself or get a third party to do it?

The contractor has a strict obligation to perform the work in accordance with plans and specifications. However, the contractor is independent and must choose the means to do so with care, in the best interests of the owner and in accordance with usage or custom and applicable rules of art. Therefore, construction contracts commonly provide that the contractor has a duty to review the contract and report promptly to the owner or consultant if it discovers any error, inconsistency, or omission. In such circumstances, the contractor will not be bound to proceed with the work until the contract has been duly revised and corrected. The scope of the contractor's duty in respect of its review varies based on its degree of expertise.

A failure to perform properly the construction work or to comply to a substantial degree with the contract may be considered by the owner as a sufficient cause to suspend or terminate the contract (see question 2.1). The owner will thus be allowed to finish the contract itself or hire a third party to do so. In certain circumstances, the owner may set off the cost to complete the contract against amounts owed by the owner to the contractor. Generally, it is the contractor's obligation and privilege to perform the work which is the subject of its contract, and the owner cannot rely generally on a change provision to delete contract work and do it himself or give it to another contractor, unless that right is clearly conferred on the owner under the contract, or the contractor consents.

3.3 Are there terms which will/can be implied into a construction contract?

The duties and obligations of the parties are those set forth in the terms of the construction contract and extend to that which can reasonably be inferred from such terms. There is a general presumption in Canadian contract law that parties to a contract have expressed all material terms governing their agreement. Additional obligations may arise based on custom or usage in the construction industry, as well as on the legal incidents of a particular class of contracts or the presumed intention of the parties where an implied term is necessary to give business efficacy to a contract. Finally, certain statutory provisions are also deemed to be included in construction contracts, such as builders' lien holdback requirements.

Parties will additionally want to consider the recent Supreme Court of Canada decision in *Bhasin v Hrynew* (2014 SCC 71, [2014] 3 SCR 495) in which the Court found that there is an "organizing principle" of good faith that underlies all contracts in Canada's common law jurisdictions. The Court specifically recognised a new common law duty of honest performance, which requires the parties to be honest with each other in relation to the performance of their contractual obligations. As mentioned by the Court, this development is a measure of coherence and predictability of the law which will be closer to the reasonable expectations of commercial parties, particularly considering the principles applicable in the civil law of Québec and most jurisdictions in the United States. The ramifications of this development remain to be seen, but allegations of breach of the organizing principle of good faith, and breach of the duty of honest performance, are now being made in relation to construction contracts in common law jurisdictions.

3.4 If the contractor is delayed by two events, one the fault of the contractor and one the fault or risk of his employer, is the contractor entitled to: (a) an extension of time; or (b) the costs occasioned by that concurrent delay?

Concurrent delays are when two or more separate delay events occur during the same time period and each, independently, affects the completion date. In such cases, claims for extra time and additional costs as well as lost profits may arise and each party should be responsible, in theory, for the delays it has caused. As a result, both parties causing the delays may argue that the plaintiff cannot prove an essential condition to compensation: the proximity causation.

Canadian courts have adopted the critical path analysis approach for the treatment of concurrent delays in the presence of two alleged concurrent delays, one on the critical path and the other on a secondary portion of the project; the party responsible for the delay affecting the critical path will be held liable. If an excusable delay (i.e., a *force majeure* event, see question 3.12 below) occurs concurrently with a compensable delay attributable to a party, the delay will be treated as excusable and an extension of time should be granted to the contractor.

In most cases, after assessing all the evidence, the court will find that each party has contributed to the delays and the main challenge will be to apportion the responsibility of each party. Expert evidence will be very important and the choice of the appropriate analytical approach will depend on both the expressed and implied terms of the contract and also the context and the manner in which the whole contract was performed.

The limits of the critical path analysis approach in matters of concurrent delays are still vague in Canadian law. For example, if both parties are responsible for delays affecting the critical path, what remedy will be available? One can suppose that in these circumstances, the court would conclude that no damage was suffered by the owner considering its own responsibility in the delay. However, it would be unjust if the contractor, despite its wrongdoing, could claim additional costs. Instead, the concurrent delays could be assimilated to a *force majeure* by simply granting an extension of delay to the contractor.

In assessing damages in the context of concurrent delays, the courts of common law jurisdictions in Canada will usually apply contributory negligence legislation, even if such legislation is not necessarily applicable to contractual situations, since concurrent liability in contract and tort is available to them.

In Québec, the damages have to be (1) an immediate and direct consequence of the fault, and (2) certain, in order for the party to be held liable (articles 1607 and 1611 of the *Civil Code*). Thus, a strong causality between the fault and the damages is necessary and could lead to some disparity between Québec and common law jurisdictions' case law.

3.5 If the contractor has allowed in his programme a period of time (known as the float) to allow for his own delays but the employer uses up that period by, for example, a variation, is the contractor subsequently entitled to an extension of time if he is then delayed after this float is used up?

When the contract provides a period of time within which the work must be completed, the contractor has the benefit of all the time available to him in the contract to perform the work. Therefore, the owner is not entitled to deprive the contractor of such time by causing delays during the performance of the contract. However, the court may conclude that the contractor, who performed the work quicker than expected in the schedule, did not suffer any damage, even if delays were caused by the owner, as long as the completion date was respected.

In cases in which the contract does not contain a specific completion date, the same principle is applicable: the contractor must finish the work in a reasonable amount of time, and is simply entitled to be compensated for any delay caused by the owner.

This principle is based on the contractor's right to continue doing business and enter into other agreements by anticipating that its current contract will be completed within the predicted delay or within a reasonable delay to complete the contractual work in its experience.

3.6 Is there a limit in time beyond which the parties to a construction contract may no longer bring claims against each other? How long is that period and from what date does time start to run?

The limitation period for bringing an action in Canada varies from province to province, but is generally between two and six years. Typically, the limitation period begins when the plaintiff "discovers" or ought to have discovered its claim, which is presumed to have been when the act or omission that led to the cause of action took place. There are also alternate limitation periods (i.e., regardless of discoverability), generally in the range of 10 to 15 years. Parties can agree to extend the limitation period by contract, or in provinces where it is not precluded by statute, to shorten the limitation period. In Québec, as per article 2116 of the *Civil Code*, the limitation period begins to run from the time the work is completed (i.e., substantially performed and ready to be used for its intended purpose). In the common law jurisdictions, it is also common for limitation periods to be set in contract terms.

3.7 Who normally bears the risk of unforeseen ground conditions?

The party that bears the risk of unforeseen ground conditions depends on the construction contract. Although historically, this risk was normally assumed by the contractor, most recent construction contracts set out a regime for sharing this risk.

Many procurements impose a due diligence process, including inspection of site conditions, on the contractor who may have to declare itself satisfied of the information available.

Subject to contract terms to the contrary, the owner may have an obligation to disclose all information in its possession which could have an impact on risk evaluation. In Québec, the scope of the owner's obligation to inform varies depending on the sophistication and expertise of the parties.

3.8 Who usually bears the risk of a change in law affecting the completion of the works?

In Canada, most construction contracts contain clauses allocating the risk of a change in law. The party that bears the risk of a change in law affecting the completion of the works is often a point of negotiation and will depend on which party is better able to manage such risk. Each party will usually assume all the risks related to their respective role and responsibility which materialise during the performance of the contract. The contractor shall generally comply with the laws and regulations which are in or come into force during the performance of the work, particularly those related to the work itself, to the procurement of permits, licences, inspections, and certificates necessary for the performance of the work, to the adjustment or modification of the employees' working conditions, to the preservation of the public health, and to construction safety. The owner, on the other hand, will usually be responsible for obtaining and paying for the development approvals, building permits, rights of servitude, and all other necessary approvals and permits. In exceptional circumstances, if the change in law is such that it deprives a party of substantially the whole benefit of the contract considering the parties' reasonable expectations, then the court may assimilate it to a *force majeure* event (see question 3.12 below).

If the contract does not provide an allocation of risk in the case of a change in law, the general principles when interpreting such changes are provided for in the federal, provincial, and territorial interpretation legislation. Where new legislation is enacted, specific provisions of the legislation may also provide for allocation of risk.

3.9 Who usually owns the intellectual property in relation to the design and operation of the property?

Copyright is vested automatically in the author of an original artistic work, which includes architectural works as well as any plans or drawings. If the work was made in the course of employment, the employer is the owner of the copyright (unless there is an agreement stating otherwise). This copyright remains theirs, unless the contract stipulates that it is transferred to the owner of the project.

The author of an original design can also register it as an industrial design, such as, for example, a design for a house that does not resemble another already-registered design. Industrial design

is also owned by its author, unless the author, acting as either an independent consultant or employee, executed the design for another person in exchange for good and valuable consideration, in which case the latter owns it. Once again, the design can be assigned to another person, which could be stipulated in a contract.

Owners generally retain copies of drawings, models or other work for their records but, unlike an independent consultant, usually cannot use them for any other projects without the prior consent of the author. In scenarios where the contractor will retain ownership in intellectual property, the owner will often negotiate an irrevocable licence that gives it the right to use, operate, maintain and make improvements to the contract deliverables.

3.10 Is the contractor ever entitled to suspend works?

Canadian construction contracts usually contain clauses describing the conditions and circumstances under which the contractor will have the right to suspend the work.

Even without such clause, the contractor will be entitled to suspend the work if the owner is in default of its contractual obligations, to a substantial degree, without sufficient cause. For example, if the owner, without justification, fails to pay amounts due to the contractor or does not provide the essential conditions to be able to perform the work (such as access to the construction site or public utilities), the suspension will be justified in order to force the performance of the owner's obligations.

As mentioned above in question 3.2, the contractor also has a duty to suspend the work if it discovers any error, inconsistency, or omission in the design, plans, and specifications of the contract which could be dangerous or lead to the loss or degradation of the work.

Finally, a *force majeure* event also justifies the contractor to suspend the work if it temporarily impossible to perform (see question 3.12 below).

Work shall be suspended for serious considerations only since the parties always have a duty to mitigate loss and damages.

3.11 On what grounds can a contract be terminated? Are there any grounds which automatically or usually entitle the innocent party to terminate the contract? Do those termination rights need to be set out expressly?

Canadian construction contracts usually contain termination clauses expressly listing which terms of the contract are sufficiently important to provide the innocent party with an excuse for termination in case of non-performance. Such clauses may require the innocent party to give notice of its intention to terminate the contract, followed by a grace period where the other party may correct its default and/or perform its obligation in order to preserve the contract intact.

In common law jurisdictions in Canada, if the construction contract does not contain such termination clause, a party can nevertheless terminate it on the grounds that the other party breached a term of the contract that was either expressly designated as a condition or intended by the parties to be a condition. For example, the parties can stipulate a deadline to be "time is of the essence", which means that the innocent party can terminate the contract if the other party did not fully perform its contractual duties in time. A contract can also be terminated on the grounds that, given the parties' reasonable expectations from the terms of the contract, the innocent party has been deprived of substantially the whole benefit of what it was to get from the contract. Moreover, a party can terminate the contract if the other party informs it, either explicitly or as an inference from something done, that it will not perform an obligation of the kind referred to above. Finally, a party may terminate the contract in case of frustration or *force majeure* as explained in question 3.12 below.

If a party tries to terminate the contract without cause, the other party may claim specific performance to compel the execution of the contract or suspend the performance and seek damages for breach of contract, subject to the duty to mitigate loss.

In Québec, if the construction or service contract does not contain a termination clause, the owner may terminate the contract with or without cause even though the work is already in progress (articles 1590, 2125 and 2129 of the *Civil Code*). However, the owner must compensate the contractor, in proportion of the agreed price, for the actual costs and expenses as well as the value of the work performed and material provided. Even if the owner is allowed to terminate the contract without cause, if the termination occurs in bad faith, for external or irrelevant considerations, or to intentionally cause damages to the contractor, the court will condemn the owner to compensate the damages suffered from its abusive conduct. As for the contractor or professional, article 2126 of the *Civil Code* provides that it may not unilaterally terminate the contract except for a serious reason, and never at an inopportune moment; otherwise, the court could force the specific performance of the contract or condemn the contractor/professional to compensate the damages caused to the owner by its fault.

In Canada, the rules for termination apply both to contracts between owners and contractors (engineers, architects, or other professionals) as well as to contracts between contractors and subcontractors.

3.12 Is the concept of *force majeure* or frustration known in your jurisdiction? What remedy does this give the injured party? Is it usual/possible to argue successfully that a contract which has become uneconomic is grounds for a claim for *force majeure*?

The concept of *force majeure* and the doctrine of frustration are both known throughout Canada.

Parties frequently negotiate frustration provisions into their construction contracts, which detail the allocation of risk should a significant change in circumstance arise. Owners on larger projects will typically seek to negotiate clauses with the goal of allocating the risks to the party that is best able to manage them, since the party bearing the risk also has a duty to mitigate the damages. If the parties do not include a specific clause dealing with this eventuality, the court shall look to whether there is an implied allocation of risk based on other provisions in the contract.

In many contracts, the parties shall insert a *force majeure* clause. *Force majeure* in Canada has been defined as something "unexpected, something beyond reasonable human foresight and skill", and the wording of a *force majeure* clause is interpreted narrowly. A *force majeure* clause will usually require the party relying on it to give notice, followed by a grace period where the situation shall be examined, then lastly a period where the parties can decide whether to terminate the contract. A finding of *force majeure* would typically allow the party relying on it to request a reduction, suspension, or relief of further obligations to the co-contracting party.

In Québec, *force majeure* is a specific case of exemption of liability provided under article 1470 of the *Civil Code*, unless the party has expressly agreed to the contrary.

In principle, economic grounds are not sufficient for a frustration claim if the performance of the contract, even commercially unprofitable, is still physically and legally possible. For example, where the phrase "non-availability of market" was included in a *force majeure* clause, the Supreme Court of Canada interpreted it to not include situations where high production costs rendered it

difficult to turn a profit in the contractual relationship. *A contrario*, the Québec courts have allowed a case where "disastrous market conditions" were considered a valid *force majeure*, when that phrase was included in the *force majeure* clause. The success of such argument will depend on the facts of the particular case.

3.13 Are parties which are not parties to the contract entitled to claim the benefit of any contract right which is made for their benefit? E.g. is the second or subsequent owner of a building able to claim against the original contracts in relation to defects in the building?

The contractors (subcontractors, architects, and engineers) who take part in the design and construction of a building owe a duty in tort to subsequent purchasers of a building if there are defects that pose a real and substantial danger to the health and safety of the occupants, but only for the cost of putting the building in a non-dangerous state and the personal injury or damages suffered when the defects manifest themselves. The duty in tort extends only to reasonable and safe standards of design, building, and construction and is not defined by the specifications of the original contract. For example, the contractor will not be held liable to subsequent purchasers if the building does not meet the special contractual high standards required by the original owner. The question of whether contractors can be held liable for pure economic loss from a non-dangerous building has not yet been settled.

In Québec, under articles 1442, 1730, and 2118 to 2120 of the *Civil Code*, contractors (subcontractors, architects, and engineers) owe a duty to subsequent purchasers, whether the defect is dangerous or non-dangerous, and rebuttable presumptions of liability are applicable if the defect manifests itself within a specific period after the completion of the work.

3.14 Can one party (P1) to a construction contract which owes money to the other (P2) set off against the sums due to P2 the sums P2 owes to P1? Are there any limits on the rights of set-off?

The scope of the right of set-off is often addressed in the construction contract but set-off is also available in common law and in equity as well as in civil law. Set-off (or compensation in Québec) can be used as payment to end an obligation deriving from a construction contract when there are mutual obligations between parties. In Canada, the obligations between P1 and P2 must generally be liquid, certain, and due.

If set-off is consensual, it becomes a matter of contract law between the parties who are free to negotiate within the usual boundaries of contract law. This provides P1 and P2 with a remedy to avoid the judicial proceedings necessary for legal or equitable set-off.

Legal set-off (including by statute) requires that the parties' obligations be mutual cross-obligations, meaning debts owed from each party to the other. These sums must be liquid, or money which can be ascertained with certainty at the time of pleading.

Equitable set-off does not require mutuality and is available where there is a claim for a monetary sum, whether liquid or non-liquid. The cross-claim in equitable set-off must be connected or interrelated with the demand of the plaintiff, in a manner which would make it unjust not to acknowledge both of them, and they need to arise out of the same contract.

In Québec, compensation is subject to articles 1672 and 1673 of the *Civil Code*, which provide that when two parties are reciprocally each other's debtor and creditor, they can set off the amount of the lesser debt, no matter the origin of the obligations. When these debts are certain, liquid, and due, and their object is a sum of money or a certain quantity of fungible property of an identical kind, the compensation is automatically effected by operation of law. If the debts are not liquid, a party may apply for judicial liquidation in order to bring about the compensation.

3.15 Do parties to construction contracts owe a duty of care to each other either in contract or under any other legal doctrine?

In common law in Canada there exists a doctrine of contract law that imposes a general duty of honest contractual performance. This means that parties cannot lie or otherwise knowingly mislead each other about matters that are directly related to the performance of the contract. In the common law jurisdictions, there are implied terms in the construction contract between the contractor and the owner that the latter will neither hinder nor prevent the contractor from completing its work, and that the owner will cooperate reasonably with the contractor in the performance of the work. A similar duty of care exists in Québec as the owner needs to collaborate with the contractor in its performance of the work.

The contractor, on the other hand, has a duty of care to the owner to properly perform the work in accordance with the contract and with the reasonable and safe standards of design, building, and construction. In a DBB, neither the owner nor the designer owes a duty of care to the contractor to advise on how to build the project. In Québec, such duty of care is codified in article 2100 of the *Civil Code* whereas the contractor is bound to act in the best interests of its client, with prudence and diligence.

The professionals (architect/engineer) are also under a duty of care to provide their client with the reasonable care, diligence, and skill expected of a reasonably competent professional in his field. They are, however, under no duty of care to advise a contractor about potential problems that might arise from the contractor's choice of construction method.

Claims for negligent misrepresentation during the tendering process also imply that a duty of care exists based on the special relationship between bidder and owner. Such duty of care does not exist between an owner and subcontractors. Negligent misrepresentation claims could also arise, for example in cases where the contractor blames the adequacy of designs or information provided by the owner (such as tests or a project's compliance with municipal bylaws).

Of course, in the construction contract, the parties may agree to adhere to a stricter standard of care.

3.16 Where the terms of a construction contract are ambiguous are there rules which will settle how that ambiguity is interpreted?

Canadian construction contracts commonly contain a clause establishing an order of priority between the various documents that comprise them, in order to resolve partially conflicts which may arise between provisions.

If ambiguity remains, the general rules of contractual interpretation will apply. The interpretation of contracts is governed by the principle that the true common intent of the parties is to be objectively determined having regard to the words used by them, in harmony with the whole contract. When the words are ambiguous, such intention can be inferred from: (1) the nature of the contract; (2) the commercial context in which it was formed; (3) its purpose; (4) the consequences of the proposed interpretation; and (5) admissible external aids such as the usual business practices and the interpretation previously adopted by the parties.

The interpretation adopted by the court has to be justified in terms of: (1) its compliance with the text of the contract; (2) its promotion of the purpose of the contract; and (3) the reasonability of the outcome.

If the contract is still ambiguous after having considered the foregoing, the *contra proferentem* rule provides that the interpretation most favourable to the party who did not draft the contract is to be preferred.

3.17 Are there any terms in a construction contract which are unenforceable?

In Canada, the law on enforceability has evolved over the years in favour of upholding freedom of contract rather than setting aside clauses negotiated by the parties as unenforceable. Certain clauses may be unenforceable in nature, as is the case for abusive clauses and clauses contrary to public policy, or by reason of certain circumstances, such as death or incapacity of the contractor or professional if the contract was entered into in consideration of his or her personal qualifications, which is rare in the construction context.

In Québec, a clause is considered abusive when its terms are excessively and unreasonably detrimental to one of the parties and results in an unconscionable situation between the parties. Such abusive clauses must be considered as departing from the fundamental obligations arising from the rules which normally govern contracts, as they change the very nature of the contract. The clauses that are most likely to be deemed abusive in nature are clauses which provide for excessively high interest rates, a limitation of liability that deprives the innocent party of substantially the whole benefit of the contract, and penalty clauses (see question 2.3). In Québec, such a clause will be deemed not to have been contracted in good faith.

The terms of a construction contract are considered unconscionable when there is an inequality of bargaining power between the parties or a high degree of unfairness in their contractual relations. However, when two parties of roughly equal bargaining power enter into a contract in a fair commercial market, Canadian courts will generally refuse to intervene.

3.18 Where the construction contract involves an element of design and/or the contract is one for design only, are the designer's obligations absolute or are there limits on the extent of his liability? In particular, does the designer have to give an absolute guarantee in respect of his work?

Under a traditional DBB, the design professional is liable for the design he created, and the contractor is liable to complete the work in accordance with said design.

In a design contract, some obligations are typically absolute, such as the obligation to ensure designs comply with codes, and others are subject to an express or implied standard of reasonable care. It is relatively rare for designers in a design contract to give warranties and guarantees, and such are typically not insured under typical professional liability for Errors & Omissions insurance coverage (E&O).

4 Dispute Resolution

4.1 How are disputes generally resolved?

Construction contracts commonly define a "tiered" dispute resolution process under which the parties attempt to negotiate, then mediate and then sometimes use a non-binding expert decision or referee process, before proceeding to arbitration or litigation. More complex projects may use a dispute board. Generally, while the dispute resolution process is ongoing, each party is required by contract to mitigate its losses and continue to perform its obligations under the construction contract.

4.2 Do you have adjudication processes in your jurisdiction? If so, please describe the general procedures.

There is no statutory adjudication scheme in Canada, although interest groups in certain provinces have been lobbying for the enactment of "prompt payment legislation". Some recent construction contracts have incorporated an adjudicative process that mirrors the UK process as part of the tiered contractual dispute resolution process. In the absence of statutory provisions addressing enforcement of an adjudicator's decision, other options in Canada available where a party fails to act in accordance with a "binding but not final" decision of an adjudicator, include summary judgment proceedings, summary arbitration proceedings, or including contractual terms that would deem a failure to comply with an adjudicator's decision a default under the contract.

4.3 Do your construction contracts commonly have arbitration clauses? If so, please explain how arbitration works in your jurisdiction.

Arbitration and alternative dispute resolution processes are common in Canada, and construction contracts, including several standardised ones, often include arbitration clauses. Arbitration is becoming increasingly popular in part because Canada has no specialised construction court and many provinces do not have specialised commercial courts. Its popularity also reflects recent efforts to make the arbitration process more efficient, effective, and cost-effective for construction disputes.

The content of arbitration clauses may include nothing more than a statement of the parties' agreement to refer disputes to arbitration or provide that both parties must consent before arbitration is used. More sophisticated clauses will commonly contain detailed statements specifying how the parties will appoint arbitrators and describing the procedure to be followed by the parties in arbitration. With regard to arbitration procedure, a number of written arbitration procedures currently exist in Canada, including procedures specifically targeted for the construction industry, such as the CCDC Rules for Arbitration of Construction Disputes. The parties to a construction contract are free to adopt such existing procedures in their contracts, although they are not required to do so. They may also revise such procedures to reflect the unique requirements of their specific project or define their own ADR process. In Québec, if the arbitration clause is silent or incomplete regarding the specific procedure to follow, the provisions of the arbitration proceedings established in the *Code of Civil Procedure* (CCP) (sections 940 *ff.*) will apply. In other provinces, commercial arbitration legislation may apply and provide specific procedures for the process itself and for enforcing arbitration decisions.

4.4 Where the contract provides for international arbitration do your jurisdiction's courts recognise and enforce international arbitration awards? Please advise of any obstacles to enforcement.

Canada has signed and ratified the Convention on the Recognition and Enforcement of Foreign Arbitral Awards and each of the provinces has enacted enabling legislation. Canada has also adopted

the Model Law on International Commercial Arbitration and each province has enacted legislation that incorporates the Model Law. Canadian courts will generally enforce foreign arbitration awards unless to do so would offend Canadian public policy.

4.5 Where the contract provides for court proceedings in a foreign country, will the judgment of that foreign court be upheld and enforced in your jurisdiction?

Canadian courts will generally enforce foreign judgments, without re-litigating the merits of the dispute, unless to do so would offend Canadian public policy. To be enforceable, the foreign court must have had jurisdiction based on a "real and substantial connection", the decision must be final, and the legal procedure followed must be just and fair. Enforcement generally requires the initiation of a Canadian lawsuit to obtain an enforcement order, although some provinces provide a simplified "registration" process for judgments from certain foreign jurisdictions.

4.6 Where a contract provides for court proceedings in your jurisdiction, please outline the process adopted, any rights of appeal and a general assessment of how long proceedings are likely to take to reduce: (a) a decision by the court of first jurisdiction; and (b) a decision by the final court of appeal.

Litigation involving construction contracts typically begins in the trial-level court and procedure is governed by Rules of Court or, in Québec, the CCP. Generally, a plaintiff initiates litigation by filing a claim document that sets out the parties to the litigation, the relief sought, and the basis for that relief including supporting facts. The defendant must then file a response within a certain period of time. In construction disputes, the defendant will often initiate third party proceedings. The parties will then proceed to "discovery". The parties are required to produce all material and relevant documents and may verbally examine the other parties under oath before trial. The rules of court generally encourage settlement prior to trial by, for example, requiring mediation after discovery. Most construction cases in Canada are tried by a judge rather than a jury (in Québec, there is no trial by jury in civil matters). Judicial settlement proceedings (or a judicial conciliation process in Québec) are available in most provinces. Significantly, the losing party at trial must indemnify the winning party for a portion of its legal fees and expenses.

The proceedings in Québec are fairly similar, but it is interesting to note the following differences. First, in Québec, the plaintiff may be examined on discovery before the defendant must file its defence, thereby allowing the defendant to present a motion to dismiss at a preliminary stage of the proceedings. However, a third party claim will often be instituted after the plaintiff's discovery, which introduces the risk of having to proceed to a second round of preliminary examinations. Second, the CCP also provides that the case must be ready for the presentation of evidence and hearing within a time limit of six months after service of the motion to institute proceedings. In most construction disputes, the court will allow this delay to be extended, often more than once, depending on the complexity of the matter.

Litigation concerning procurement is quite common in Canada because an unsuccessful bidder may recover its lost profits on a project if it can establish that it would have been awarded the contract but for the tendering authority's breach of the terms of the procurement, which includes an implied duty of fairness on the owner towards all compliant bidders. Typically these disputes are addressed by the courts, including using summary trial procedures, but disputes about federal government procurements fall within the exclusive jurisdiction of the Canadian International Trade Tribunal.

Appeals from the trial courts are taken to the court of appeal for the province or territory. The Supreme Court of Canada is the final court of appeal and it hears appeals from the appellate level courts of all the provinces and territories.

Complex construction disputes commonly take several years to reach resolution, particularly if the parties proceed to trial.

Acknowledgment

The authors would like to acknowledge the assistance of their colleagues Mélisa Thibault and Eric L. Sherbine in the preparation of this chapter.

Karen Martin
Dentons Canada LLP
250 Howe Street, 20th Floor
Vancouver
British Columbia V6C 3R8
Canada

Tel: +1 604 691 6455
Fax: +1 604 683 5214
Email: karen.martin@dentons.com
URL: www.dentons.com

Karen Martin is a partner at Dentons Canada, practising in the areas of construction/infrastructure, P3, and litigation/dispute resolution. She provides strategic legal advice to minimise risk during procurement and construction based on deep experience and the latest developments in the law. When disputes arise, she negotiates resolutions and acts as counsel in the mediation, arbitration, and litigation of all types of construction claims.

Her experience as counsel on large construction trials in the past three decades allows her to quickly understand the technical aspects of a construction claim, and to provide creative advice as to the appropriate methods to efficiently resolve disputes. She has extensive experience in disputes involving tenders, requests for proposal (RFPs), construction contracts, builders' liens, engineering issues, and negligence claims involving architects and engineers.

Ms. Martin is a frequent speaker on complex litigation and construction issues including procurement, builders' liens, and settlement of multiparty litigation, and has authored several publications.

Claude Morency
Dentons Canada LLP
1 Place Ville-Marie, 39th Floor
Montréal
Québec H3B 4M7
Canada

Tel: +1 514 878 8870
Fax: +1 514 866 2241
Email: claude.morency@dentons.com
URL: www.dentons.com

Claude Morency is the Managing Partner of Dentons Canada's Montréal office (since 2007), and a member of its Litigation and Dispute Resolution group. His practice focuses on corporate, commercial, and construction litigation.

Claude represents owners, developers, general and specialised contractors, subcontractors, suppliers and equipment manufacturers, as well as financial institutions and other lenders in negotiations and mediations, and before arbitration and judicial tribunals. He regularly advises on extraordinary remedies including seizures before judgment and injunctions, rights and recourses under corporate law, claims in construction law, procurement and tendering disputes, preparation, drafting, and review of contracts and tender documents (including turnkey contracts, design-build contracts, and engineering, procurement, and construction management (EPCM) contracts), contractual and extra-contractual liability, corporate litigation and shareholders' disputes, directors' liability, product liability, hypothecary claims, construction bonds, and insurance law. Claude also advises clients engaged in public-private partnership projects.

Other titles in the ICLG series include:

- Alternative Investment Funds
- Aviation Law
- Business Crime
- Cartels & Leniency
- Class & Group Actions
- Competition Litigation
- Copyright
- Corporate Governance
- Corporate Immigration
- Corporate Recovery & Insolvency
- Corporate Tax
- Data Protection
- Employment & Labour Law
- Environment & Climate Change Law
- Franchise
- Gambling
- Insurance & Reinsurance
- International Arbitration
- Lending & Secured Finance
- Litigation & Dispute Resolution
- Merger Control
- Mergers & Acquisitions
- Mining Law
- Oil & Gas Regulation
- Patents
- Pharmaceutical Advertising
- Private Client
- Private Equity
- Product Liability
- Project Finance
- Public Procurement
- Real Estate
- Securitisation
- Shipping Law
- Telecoms, Media & Internet
- Trade Marks

GLG
Global Legal Group

59 Tanner Street, London SE1 3PL, United Kingdom
Tel: +44 20 7367 0720 / Fax: +44 20 7407 5255
Email: sales@glgroup.co.uk

www.iclg.co.uk