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Blaney McMurtry
BARRISTERS & SOLICITORS LLP

Commercial Litigation Update

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

Feel free to contact any of the lawyers who wrote or are quoted in these articles for more information, or call the head of our Commercial Litigation group, Lou Brzezinski at 416.593.2952 or lbrzezinski@blaney.com

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"Used properly, arbitration is a short, quick process through which the parties can resolve their disputes..."

ARBITRATION A GOOD TOOL IN RESOLVING CONSTRUCTION CONTRACT DISPUTES

Andrew J. Heal

Most lawyers know clients, who routinely ignore their construction contracts until a dispute arises, and only then pull the contracts out of the drawer, dust them off and take a close look at the dispute-resolution processes that the contracts actually provide. What they find is that most construction contracts provide for the arbitration of any dispute arising out of, or in connection with, the interpretation or performance of the contractual agreement.

This is to be welcomed. Used properly, arbitration is a short, quick process through which the parties can resolve their disputes (although not often at much cost saving). In principle, it ought to be less adversarial than the court process, since by its private nature and by the choice of a mutually acceptable arbitrator, or at least sufficiently qualified and neutral arbitrator, construction parties can expect a result that is more predictable and private, which is, presumably, why they chose in their commercial agreement to resort to arbitration in the first place. More predictable and privately determined outcomes are ultimately more supportive of the kind of continuing relationships which members of the construction industry, and other commercial parties, seem generally to desire and promote.

Obviously different contacts have different dispute resolution language, and regard must be had to the particular language of any given contract. However, a number of important principles ought to be kept in mind.

Principle 1 - If asked, the courts wlll typically stay litigation in favour of arbitration

For well over a decade, the Ontario Court of Appeal and courts elsewhere, have ruled that an arbitration clause can be enforced through a stay of any pending litigation. This is so even where local lien legislation (eg. the Ontario *Construction Lien Act*) grants lien rights. In *Automatic Systems Inc. v. ES Fox Ltd. and in Automatic Systems Inc. v. Bracknell Corp.,* the Ontario Court of Appeal settled the question of whether there was any inconsistency between requiring arbitration (as provided in the contract) and the lien legislation. It is not uncommon in today's industry to have foreign domiciled contractors, or specialty subcontractors, whose contracts contain arbitration provisions. Indeed the arbitration may be international, and not domestic. In both *Automatic Systems Inc.* cases, the arbitration was to be held in Missouri in accordance with Missouri law. The thrust of the analysis on the question of stay, whether of a domestic or international arbitration, seems to be the court's deferential

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"For well over a decade, the Ontario Court of Appeal and courts elsewhere, have ruled that an arbitration clause can be enforced through a stay of any pending litigation."

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treatment of the parties' choice of arbitration as a dispute resolution tool.

Principle 2 - Multi-party or multi-issue disputes may not fit into bilateral arbitration

In the complex set of relationships that constitutes a construction project, there are overlapping contractual relationships, as well as other relationships often characterized as creating duties of care (mitigating foreseeable harm) owed among the various participants: subcontractors, contractor, owner, consultant architect, and engineer. Recently, Justice Pierce declined in *Penn - Co Construction Canada v. Constance Lake First Natio*n to compel a mandatory arbitration process on the basis that the contractor, having commenced litigation and having chosen its "horse" (including suing the aforementioned other construction participants), was precluded by the application of s. 7 of the *Arbitration Act* (domestic arbitration) from enforcing the stay provisions of the *Arbitration Act*. Justice Pierce reasoned that to grant a stay would be an abuse of process in the circumstances, and would effectively hold the defendant/owner to ransom by a threat of duplicate proceedings. The owner did not apply for a stay of proceedings pending arbitration, and an earlier consensual arbitration process by way of peer review had failed. I find more troublesome, the court's description of claims by the contractor as "outside the ambit of interpretation, application or administration of the contract", and therefore beyond what the parties agreed was arbitrable. The decision is on stronger footing to have relied on s. 7 of the *Arbitration Act* rather than to attack many claims as non-arbitrable, as a deciding factor in declining to grant a stay of the litigation.

The judgment of Justice Pierce echoes the comments of Justice Sharpe (as he then was) in *Rosedale Motors Inc. v. Petro-Canada,* to the effect that where claims are joined with other claims which may not be arbitrable, it is highly desirable that arbitrable and otherwise non-arbitrable claims proceed together in the same forum to avoid a multiplicity of proceedings. Justice Sharpe argued that the *Arbitration Act* s. 7(5) supports the existence of a discretion to refuse a stay where it is not reasonable to separate the matters dealt with in the agreement from other matters in dispute between the parties. The *Rosedale Motors Inc.* case, now ten years old, involved a franchisor/franchisee dispute which does not directly translate into the relationships seen in the construction project. Further, lurking in the background in that case was an attempt by the plaintiff to certify a class action (unsuccessfully, at first instance), and responding motions by the defendant/franchisor for partial summary (early) judgment staying the dispute based on an arbitration clause. There are many reasons why it was not appropriate that the proceeding be a class proceeding, but on a broad reading, perhaps the arbitration clause would have been enough to permit the defendant to compel the plaintiff to participate in an arbitration of the contractual claims.

In the context of international arbitrations, the decision of the English House of Lords in the Fall of 2007, reinforced the view that arbitration clauses should be construed liberally, and in the absence of clear wording to the contrary, commercial parties should be taken to have intended to use arbitration as the *only* forum to resolve all of their disputes. Generally the courts ought to support an approach that gives primacy to the

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"Prime contractors who bid on contracts and lose out to competitors whose submissions did not comply with the bidding rules will sometimes be able to recover their damages from the project owners."

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parties' choice to resolve their disputes through arbitration. A necessary exception to this principle might be where the plaintiff/claimant itself seeks to change horses after commencing litigation to move into arbitration, or has engaged a multi-party process from the outset that does not easily fit within a bilateral arbitration.

Principle 3 - Choice of Arbitrator: Choose Experience

Again the commercial agreement in question should provide exactly how the arbitrator is to be chosen. For example, the January 2008 Canadian Construction Documents Committee revised form of construction contract (CCDC2), and the rules for the mediation and arbitration of construction disputes (CCDC40), provide for the appointment of a project mediator (often not done), and following an unsuccessful mediation, a reference to an arbitration which consists of a one to three person panel depending on what the party has requested, and whether the amount in dispute exceeds $250,000. If not chosen ahead of time, there often can be a long delay while there are competing applications to the court as to whose proposed arbitrator should be appointed.

One such dispute was recently adjudicated in the context of an agreement to arbitrate disputes arising from a settlement, in *Morbuild Inc. v. Singh*. There, Master Glustein agreed to the owners' proposed architect as the project arbitrator. Since most commercial agreements provide that the decision of the arbitrator, a neutral third party who may be an experienced architect or engineer, will be final and binding, the choice of arbitrator is an important consideration. Further appeal to the court from a final and binding award is limited to very narrow circumstances.

In the *Morbuild Inc. v. Singh* case, it was ultimately the wealth of experience of the owners' proposed arbitrator that persuaded the court to appoint him. ■

SUBCONTRACTORS INVOLVED IN PROJECT BIDS ARE ISSUED HEADS UP BY SUPREME COURT

Howard Krupat

Prime contractors who bid on contracts and lose out to competitors whose submissions did not comply with the bidding rules will sometimes be able to recover their damages from the project owners.

A Supreme Court of Canada decision issued May 8, however, limits the possibility that subcontractors involved in the bid with the prime contractor will be able to recover their own damages from the project owner.

This added clarity in tendering law flows from the Supreme Court's study of an action taken against the federal government's public works department by Design Services Ltd. and other potential subcontractors in connection with the design and construction of a new naval reserve building in Newfoundland.

In its decision, the court ruled that the project owner (Public Works and Government Services Canada) had no legal obligation to the potential subcontractor, Design Services Ltd. The nature of the relationship between the public works department and Design Services was not one that would give rise to a claim by Design

"It is common for a tendering process to include a requirement for bidders to identify their proposed subcontractors, trades and suppliers in their bids."

Services. (In other words, the owner did not owe a duty of care in tort to potential subcontractors.) To put the court's decision into context, it is useful to review the principles of Canadian tendering law.

Tendering Law 101

Beginning with the SCC's decision 1981 decision of *Ontario v. Ron Engineering & Construction (Eastern) Ltd.*, a complex framework for tendering disputes has evolved that is well known to participants in the construction industry: Upon the submission of a bid in response to a tender call, a project owner and bidder enter into "Contract A", the terms of which are defined by the relevant case law and the tender documents circulated by the owner to potential bidders. From the perspective of the bidder, the most significant term of Contract A is the obligation to enter into "Contract B", the construction contract, upon the project owner's acceptance of the bid. The project owner must in turn ensure that it complies with its own obligations under Contract A. These may include the obligation to award Contract B to compliant bidders only and the obligation to treat all bidders fairly.

Litigation often arises where, from the perspective of an unsuccessful bidder, the project owner awards Contract B to a proponent whose bid was not compliant. Although the outcome of such litigation is almost never certain, the potential consequences of breaching Contract A serve as an incentive for participants in the process to pay close attention to their obligations. Where a bidder is able to establish that a project owner breached Contract A, the damages available may include the loss of profits the bidder would have earned if awarded Contract B.

Where a project owner successfully sues a bidder who refuses to enter into Contract B, there are various categories of damages that may be available to the project owner.

It is common for a tendering process to include a requirement for bidders to identify their proposed subcontractors, trades and suppliers in their bids. Unlike the typical scenario involving a dispute between owner and bidder or contractor and subcontractor, the SCC was required, in its May 8, 2008 decision in *Design Services Ltd. v. Canada*, to consider the recourse available to these subcontractors, trades and suppliers against an owner when Contract B is awarded to a non-compliant bidder rather than the compliant bid proponent who is "carrying" them in its bid.

Design Services - The Facts

In *Design Services*, Public Works and Government Services Canada (the "Owner") initiated a tendering process for the construction of a naval reserve building in Newfoundland that contemplated a design-build contract. Only prospective bidders who succeeded in a Request for Statement of Qualifications process (the "RSQ Process") were entitled to bid. As part of the RSQ Process, prospective bidders were required to identify the other members of their design-build team. In the subsequent tendering phase, qualified bidders were given the option of bidding on Contract B in a joint venture with their design-build team or bidding alone, with the members of their design-build team as potential subcontractors.

Olympic Construction Ltd. ("Olympic") chose to bid alone and was unsuccessful. Olympic and its potential subcontractors, who had previously

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"At least in similar circumstances to those identified in Design Services, a project owner will not owe a duty of care to subcontractors in a tendering process."

been identified as members of Olympic's design-build team (the "Subcontractors"), sued the Owner for accepting a non-compliant bid. But Olympic settled its claim and the Subcontractors continued the action on their own against the Owner. Since the Owner did not owe any contractual obligations to the Subcontractors, the outcome of the case would turn on whether the Owner owed the Subcontractors a duty of care in tort. After considering the analysis of the trial judge, who found in favour of the Subcontractors, and the decision of the Federal Court of Appeal, which found in favour of the Owner, the SCC held that the Owner did not owe the Subcontractors a duty of care in tort.

The Supreme Court of Canada Analysis

To assess whether a duty of care was owed, the Supreme Court of Canada was required to consider: (i) whether the relationship between the Owner and the Subcontractors falls within, or is analogous to, a previously recognized category of tort; or, alternatively, (ii) whether it would be appropriate to recognize a new duty of care.

Is There An Existing Tort That Applies?

The first question was answered in the negative. The losses suffered by the Subcontractors were noted by the SCC to be solely financial in nature. And the pure economic loss suffered did not fall within the five categories of economic torts that the SCC has previously recognized. Extensive consideration was given to whether the fifth existing category, "relational economic loss", was applicable. This category covers claims where the defendant causes physical damage to a third party or its property, which in turn results in the plaintiff incurring an economic loss. But in this case, the third party (Olympic) suffered a breach of its contractual rights, rather than property damage. The Subcontractors' losses were therefore not tied to any physical damage and the category of relational economic loss did not apply.

Should a New Tort Be Created?

In considering whether it would be appropriate to recognize a new duty of care, the SCC followed the "*Anns*" test, named after a 1978 House of Lords decision.

Broadly, the questions that need to answered, as set out in the SCC's reasons at paragraph 46, are: (i) is there "a sufficiently close relationship between the parties" or "proximity" to justify imposition of a duty and, if so, (ii) are there policy considerations which ought to negative or limit the scope of the duty, the class of person to whom it is owed or the damages to which breach may give rise?

The first component of the *Anns* test is further broken down into the question of "foreseeability" and the consideration of various factors that would suggest a new tort should not be recognized.

While agreeing that there were factors implying a close relationship between the Owner and the Subcontractors, including the reliance of the Subcontractors on a "fair selection methodology" in the tendering process, Justice Rothstein answered the first question under the *Anns* test in the negative, finding that the Subcontractors had the ability to foresee and protect themselves

"In its most recent pronouncement...The Supreme Court of Canada has actually described an Anton Piller order as being a 'private search warrant'..."

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from their loss. This conclusion was derived from the option available to each bidder and its design-team to bid as a joint venture, which would thereby have made the Subcontractors parties to Contract A and given them other recourse.

For the second component of the *Anns* test, Justice Rothstein found, as a matter of policy, that the recognition of a duty of care owed by a project owner to subcontractors could lead to indeterminate liability. In reaching this conclusion, Justice Rothstein made note of some of the potential players who may also seek to recover damages in such a scenario (trades, suppliers, employees).

On both components of the *Anns* test, the SCC therefore found that it would not be appropriate to find a new duty of care.

Conclusion

While recognizing that, along with unsuccessful bidders, subcontractors too may suffer the consequences of an owner's acceptance of a non-compliant bid, the SCC appears to have added some certainty to the complex world of tendering law. At least in similar circumstances to those identified in *Design Services*, a project owner will not owe a duty of care to subcontractors in a tendering process. ■

RARE COURT ORDERS CAN HELP COMPANIES TAKE LEGAL ACTION

John Polyzogopoulos

This is the second of three articles on unusually forceful, difficult-to-obtain court orders that can enable companies fearing they are the victims of such illegal activities as fraud, intellectual-property theft, and trade secret theft to capture evidence before it might be destroyed or to freeze assets that could be used to pay claims they might win.

The first article in this series, published in the January, 2008 issue of *Commercial Litigation Update*, focused on Norwich orders, which allow a person to obtain information from a third party, in particular a proposed defendant's bank, before moving forward with the claim against the defendant himself.

This article focuses on obtaining information from the target defendant immediately upon making the decision to bring the claim, without having to wait for the normal voluntary discovery of process, which may not take place until months after the lawsuit has already been started. Such orders are called *Anton Piller* orders, named after the famous English decision in which one was first made.

In its most recent pronouncement on *Anton Piller* orders, in its decision on *Celanese Canada v. Murray Demolition Corp.*, The Supreme Court of Canada has actually described an *Anton Piller* order as being a "private search warrant" In his opening paragraph in the *Celanese* decision, Justice Binney states:

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"...the Anton Piller order can be a very powerful tool to help in the investigation process and to preserve evidence."

> "An Anton Piller order bears an uncomfortable resemblance to a private search warrant. No notice is given to the party against whom it is issued. Indeed, defendants usually first learn of them when they are served and executed, without having had an opportunity to challenge them or the evidence on which they were granted. The defendant may have no idea a claim is even pending. The order is not placed in the hands of a public authority for execution, but authorizes a private party to insist on entrance to the premises of its opponent to conduct a surprise search, the purpose of which is to seize and preserve evidence to further its claim in a private dispute. The only justification for such an extraordinary remedy is that the plaintiff has a strong *prima facie* (Latin, meaning on its face) case and can demonstrate that on the facts, absent such an order, there is a real possibility relevant evidence will be destroyed or otherwise made to disappear."

As can be seen, therefore, the *Anton Piller* order can be a very powerful tool to help in the investigation process and to preserve evidence. It is difficult to obtain, however, and there are many pitfalls that can befall a litigant and counsel if not done properly.

As set out by Justice Binney in the *Celanese* decision, there are four central conditions that must be met before the making of an *Anton Piller* order:

- the plaintiff must demonstrate a strong case;
- the damage to the plaintiff as a result of the defendant's alleged misconduct, potential or actual, must be very serious;
- there must be convincing evidence that the defendant has in its possession incriminating documents or things; and
- it must be shown that there is a real possibility that the defendant may destroy such material before the discovery process can do its work.

In cases where there is fraud, it is usually easier to satisfy these requirements. The more difficult cases are the pure commercial cases involving unfair competition, where the plaintiff alleges the defendant is misusing confidential, proprietary or intellectual property claimed to be owned by the plaintiff. These cases are not on the same level as fraud and therefore the mere fact that a defendant may be using information that is claimed as proprietary by the plaintiff does not amount to the level of fraud such that a court can infer that evidence or documents will be destroyed if an *Anton Piller* order is not granted.

Where an *Anton Piller* order is granted, the plaintiff, through its counsel, is essentially given the right to show up at the defendant's door unannounced and demand that documents and other physical evidence be immediately turned over.

Anton Piller orders are so draconian and involve such a gross and serious violation of a defendant's privacy rights that the Supreme Court sought fit to delineate in *Celanese* a set of guidelines for the preparation and execution of an *Anton Piller* order. The guidelines are as follows:

- the order should appoint a supervising solicitor who is independent of the plaintiff or its solicitors and is to be present at the search to ensure its integrity;
- the plaintiff is required to provide an undertaking and/or security to pay damages in the event that the order turns out to be unwarranted or wrongfully executed;

"Experienced counsel should be engaged when considering whether to seek an Anton Piller order, as they are difficult to obtain and even more difficult to properly execute."

- the scope of the order should be no wider than necessary and no materials shall be removed from the site unless clearly covered by the terms of the order;
- the terms setting out the procedure for dealing with solicitor/client privilege or other confidential materials should be included in the order with a view to enabling defendants to advance claims of confidentiality over documents before they come into the possession of the plaintiff or its counsel or to deal with disputes that arise;
- the order should specify that items seized may only be used for the purposes of the pending litigation;
- the order should state explicitly that the defendant is entitled to return to court on short notice to discharge or vary the order or vary the amount of security;
- the order should provide that the materials seized be returned to the defendants or their counsel as soon as practicable;
- the order should provide that the search be commenced during normal business hours, when counsel for the party about to be searched is more likely to be available for consultation;
- the premises should not be searched or items removed except in the presence of the defendant;
- the persons who may conduct the search and seize evidence should be specified in the order or be specifically limited in number;
- the order should require that it be served together with the statement of claim and the supporting affidavits used to obtain the order and the plaintiff's counsel or the supervising solicitor should explain to the defendant in plain language the nature and effect of the order;
- the defendant should be given a reasonable time to consult with counsel prior to permitting entry to the premises;
- a detailed list of all evidence seized should be made and the supervising solicitor should provide this list to the defendant for inspection and verification at the end of the search and before materials are removed from the site;
- where this is not practicable, documents seized should be placed in the custody of the independent supervising solicitor and defendant's counsel should be given reasonable opportunity to review them to advance solicitor/client privilege claims prior to the release of the documents to the plaintiff;
- where ownership of material is disputed, it should be provided for safe keeping to the supervising solicitor or to the defendant's solicitors;
- the order should specify that the responsibilities of the supervising solicitor continue beyond the search itself to deal with matters arising out of the search;
- the supervising solicitor should be required to file a report with the court regarding the search and seizure; and, lastly,
- the order may require the plaintiff to bring a further motion to the court for a review of the execution of the search.

In *Celanese*, the defendant sought to have the plaintiff's solicitors removed as solicitors of record because they had reviewed documents

that were protected by solicitor/client privilege that had been seized during the execution of the *Anton Piller* order. There had not been proper procedures put in place to deal with privileged documents before they would be reviewed by the plaintiff's solicitors. The plaintiff's solicitors were removed as counsel, undoubtedly resulting in much expense and inconvenience to the plaintiff.

In their initial discussions with counsel, clients should be aware of the possibility of seeking an *Anton Piller* order where there is good reason to believe that the proposed defendant was not acting in good faith and may destroy documents or evidence if put on notice of a claim. Experienced counsel should be engaged when considering whether to seek an *Anton Piller* order, as they are difficult to obtain and even more difficult to properly execute.

The third and final article in this series will focus on *Mareva* injunctions, which involve the freezing of the defendant's assets at the beginning of the case to ensure that there are assets available to satisfy a judgment for the plaintiff which may (or may not ever) be granted at the end of the case. ■

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

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We welcome your comments. Address changes, mailing instructions or requests for additional copies should be directed to Chris Jones at 416.593.7221 ext. 3030 or by email to cjones@blaney.com. Legal questions should be addressed to the specified author.

RECENT SPEAKING ENGAGEMENTS

June 23, 2008

Geza Banfai will be presenting on the "National Trade Contractors Coalition of Canada (NTCCC) Guide on Standard Documents and Pitfalls" at the 67th Annual National Conference of the Mechanical Contractors Association of Canada in Calgary, Alberta.

June 9, 2008

Geza Banfai will present on "Execution of the Work (Part 3)" as part of the Law Society of Upper Canada's seminar The Canadian Standard Construction Contract (CCDC 2-2008) - What You Need to Know.

May 29, 2008

Howard Krupat spoke on the topic "Pursuing the Insolvent Construction Company" at the Ontario Bar Association's seminar Construction Remedies: Beyond the Lien. **Andrew Heal** spoke at the same seminar on the topic "A Novel Alternative: Section 34 of the Personal Property Security Act".

May 26, 2008

Andrew Heal was a guest speaker at the 10th Annual Fraud Conference of the Certified Forensic Investigators of Canada on Monday, May 26, 2008 on "Expert Reports - Best Practices".

May 22, 2008

Rod Winsor was a guest speaker at the recent Ontario Trial Lawyers Association conference on the subject of "Good Faith".

EXPECT THE BEST

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