

**Contractors' Liability To Third Parties:
An Indeterminate Liability To An Indeterminate Class?**

Andrew J. Heal, LL.M.©

Blaney McMurtry LLP¹

February 7, 2013

¹ LL.M., (Osgoode), J.D. (University of Toronto), B.A. (Hons) (McGill University). Chair of the Construction Section (Ontario Bar Association), Chair of the Architectural/ Construction/ Engineering/ Services Group at Blaney McMurtry LLP, and a partner of the firm. Member of the Toronto Construction Association Allied Professions Committee. Presented at the Ontario Bar Association 2013 Institute. The author gratefully acknowledges the assistance of Nadia Costantino, student at law, in the preparation of this paper.

Contractor Liability to Third Parties:
An Indeterminate Liability to an Indeterminate Class?²

Introduction

The question of remoteness has vexed courts in dealing with problems arising both in contract and in tort. This paper deals primarily with the tort law liability concept as it arises in the contractual context, since most construction taking place in the modern world does so under written contract, usually, standard form contracts.³ Further, it is the contractual relationships that initially create the proximity within which the duty of care arises.

Construction often represents the leading edge of design and building processes to renew our built environment. Such construction processes can be the straightforward transformation of the old for the new, or may additionally involve highly skilled and specialized workers and professionals using new building materials and techniques. At the same time, such renewal can take place under tremendous time constraints and budget constraints.

This leads to disputes, and to lawsuits.

Over the past twenty-five years, there has been a significant increase of liability exposure relating to the construction process. For policy reasons, users of the built environment (whether

² The Author gratefully acknowledges the assistance of Nadia Costantino for her tremendous assistance in preparation of this paper, Student-at-law

³ Such as, for example, found at the Canadian Construction Documents Committee forms of contract. Such forms of contract are frequently updated and new forms of construction management contract were introduced in 2010, and new forms of fixed price contract were introduced in 2008.

the initial purchaser or subsequent) have been seen as deserving of protection. It has been said that there is no risk of liability in an indeterminate amount because liability will always be limited by the reasonable cost of repairing the dangerous building defects to a non-dangerous state. The time of liability exposure is limited to the “useful life of the building.”⁴ This proposition takes us into an analysis of the Supreme Court decision in *Winnipeg Condominium v. Bird Construction*, and the cases that have interpreted and applied it.

Review - *Winnipeg Condominium*

In *Winnipeg Condominium*, the owners of condominium units (all subsequent purchasers) brought an action for damages claiming they had suffered for the negligent installation of certain metal ties which rendered the exterior brick cladding, potentially dangerous to the condominium owners and others. The argument had been framed as “damage to other property”, rather than damages for “pure economic loss”, which had previously been regarded as unrecoverable.

The Supreme Court, almost 20 years ago, found such economic loss was recoverable in tort unanimously holding that where a defect poses a real and substantial danger, then liability follows. The builder’s obligations to avoid latent defects could not be limited to only a contractual duty, as between builder and original purchaser, because subsequent purchasers

⁴ *Winnipeg Condominium Corporation No. 36 v. Bird Construction Co.*, [1995] 1 S.C.R. 85 [hereinafter referred to as “*Winnipeg Condominium*”]. Often overlooked in *Winnipeg Condominium*, is the admonition of Justice LaForest that the “degree of danger to persons and other property created by the negligent construction of a building is a cornerstone of the policy analysis that must take place in determining whether the cost of repair of the building is a cornerstone of the policy analysis that must take place in determining whether the cost of repair of the building is recoverable in tort” (at para 12).

could be put in a similar danger throughout the useful life of the building. In other words, they were within the class of persons that could reasonably be expected to be harmed.⁵

In this analysis, the focus is on foreseeability of harm, and not privity of contract. The policy reason supporting this is that negligent builders (or anyone responsible for the negligent design and/or construction of a building) can “create a foreseeable danger that will threaten not only the original owner, but every inhabitant during the useful life of the building”.⁶ This is to be contrasted with “shoddy workmanship” which involves non-dangerous defects only involving questions of quality of work and fitness for purpose.

Linked to this analysis, and beyond the scope of this paper and presentation, is whether a failure to meet for example the mandatory provisions of the *Ontario Building Code* always amounts to more than shoddy workmanship.⁷

The facts of *Winnipeg Condominium* as we look back in time, seem clearly to relate to a real and substantial danger and it is hard to disagree with the imposition of liability. However,

⁵ In contrast, in the UK in *D & F Estates v. Church Commissioners*, [1988] 2 All.E.R. 992, the House of Lords decided that in the absence of a contractual relationship, the cost of repairing a defective structure (where the defect is discovered before any physical damage or personal injury), is not recoverable by the remote buyer of real property. In other words, *caveat emptor* has real teeth. A buyer must use its own investigations and inquiries, supplemented by warranties by the vendor, and if not available to hedge its risk through insurance.

⁶ *ibid* at para. 35

⁷ In other papers, I have argued that not every failure to comply with a Provincial *Building Code* regime is in itself a dangerous defect as not every provision in a Provincial *Building Code* regulates health and life safety. However many provisions do relate to health and safety.

the Supreme Court of Canada's silence on the issue of *quality of the necessary danger required* has posed problems in subsequent cases. For instance, must the danger be imminent, or is it enough for the danger to simply exist? Does the dangerous defect have to be structural or is the logic enunciated in *Winnipeg Condominium* equally applicable to component parts not in themselves dangerous? Yet another issue courts have grappled with post- *Winnipeg Condominium* is whether the defect in question has to be dangerous at all⁸.

These issues, and how their interpretation by the Courts may affect questions of liability, will be canvassed in greater detail below.

Concurrent Liability in Tort and Contract

Winnipeg Condominium's principle effect was to grant a right of action to a subsequent purchaser who lacks contractual privity with the negligent manufacturer/builder (and purchasers with contractual privity can also sue in tort, providing the terms of the contract do not exclude tort liability in the circumstances). The rationale for the extension of a right of action absent contractual privity was based on the idea that a manufacturer/builder's obligations should not be limited to a contractual duty, existing only in relation to an original purchaser, where subsequent purchasers could be put in equally similar danger throughout the useful life of a thing. Policy reasons have justified imposing liability in tort, so as to ensure contractors (and other entities associated with the building process) undertake to meet reasonable and safe standards of

⁸ The bulk of appellate authority in the wake of *Winnipeg Condominium* suggests that the answer to whether the defect must pose a real and substantial danger must be answered in the affirmative, as will be discussed below.

construction in order to avoid liability. It also worked to reimburse plaintiffs who were tasked with remedying a potentially dangerous defect before actual harm was occasioned. Also, it has been argued (turning the idea a bit on its head) that:⁹

“Maintaining a bar against recoverability for the cost of repair of dangerous defects provides no incentive for plaintiffs to mitigate against potential losses and tends to encourage economically inefficient behaviour.”

Scholarly consideration of the issue on concurrent liability has been critical of the resulting interference with commercial relations (when recovery is allowed absent contractual relationships), as well as of the inappropriateness of the reallocation of risk which inevitably flows from this¹⁰. This is premised on the argument that parties to a contract are free to assign their liabilities and responsibilities from the outset of the commercial relationship (through limitation of liability clauses and so forth), and that the same protective measures could just as easily be undertaken by 3rd parties, or additionally by builders at the outset of their contract with

⁹ *supra* note 3 at para. 37

¹⁰ For instance, Professor Feldthusen argues that the allocation of risk to the contractor is in fact a reallocation of risk, as the contract between the contractor and the original purchaser will have previously allocated the risk for the types of defects considered in *Winnipeg Condominium*. For a detailed analysis of this issue, see Casey Chisick, “Winnipeg Condominium Co. No. 36 v. Bird Construction Co.: The Death of the Contractual Warranty?” (1998) 25 Manitoba L J 393-409.

the original purchaser. Despite these criticisms, the protection of subsequent purchasers appears to override concerns about limitations on commercial freedom.¹¹

Meeting the “Real and Substantial Danger” Threshold

The Supreme Court in *Winnipeg Condominium* made clear that some element of dangerousness is required, apart from mere shoddy workmanship, to justify recovery for pure economic loss for a defect. As to what sort of risk may actually satisfy this requisite element of “real and substantial danger”, various jurisdictions have taken differing approaches to answering this question.

While some jurisdictions appear to suggest that the damage, or the risk of damage, must be imminent¹², the preponderance of Ontario authority suggests that imminence is not required. Instead, preventative principles seem to govern and suggest that recovery of economic loss of repair for a defect whose dangerousness could materialize at a later point in time (for example, the potential for collapse of a negligently constructed load bearing wall)¹³ should be allowed, in

¹¹ *ibid.* This author refutes Feldthusen’s very legitimate criticism (that risks of the construction relationship are already adequately allocated by contract and should not be disturbed by the intervention of tort) on the basis that the Supreme Court in *Winnipeg Condominium* clearly had broader goals and protections in mind when reaching its decision, which could not be properly satisfied on the basis of contractual principles.

¹² For instance, see *Cardwell v Perthen*, 2007 BCCA 313, where imminence of damage was held to be a prerequisite to recovery for structural deficiencies, mould growth, and leaks throughout the home.

¹³ This was the defect in question in *Mariani v Lemestra*, [2004] O.J. No. 4283 (CA), where the Court of Appeal affirmed the liability of the Township for negligent inspection, and the builder of a home for negligent design, after

order to avoid the greater cost of recovery for personal injury if the danger eventually materializes. This imposes quite an onerous obligation on those involved in the supervision of the construction of structures, as well as the municipalities who inspect said structures, as the mere potential for a defect to manifest as dangerous at some far-removed point in time may be sufficient to trigger liability in some circumstances.¹⁴

Non Dangerous Defects and Indeterminate Liability

While *Winnipeg Condominium* may have left the door open for recovery for non-dangerous defects, a review of the case law considering this issue discloses a marked reluctance on the part of the courts to allow such recovery.¹⁵ The reasoning for this seems apparent when one considers the policy reasons behind imposing liability for dangerous defects in the first place, that is, the protection of subsequent purchasers from injury. On this reasoning, it might be hard to see how an alarm clock which malfunctions can be put on the same footing as a wall which is about to crumble, or a piece of building cladding which could fall to the ground from twenty storeys above at any moment.

cracks in the load bearing wall and dampness and mould in the basement were discovered. The Court of Appeal explicitly ruled that imminence was not a prerequisite to recovery under *Winnipeg Condominium*.

¹⁴ From a contractor's perspective, this suggests liability claims could materialize years after a defect came to exist, and could prove problematic for the actual assignment of liability where many parties have been involved in the construction of the building structure.

¹⁵ And rightly so. To avoid "liability in an indeterminate amount for an indeterminate time to an indeterminate class": *Ultramares Corp. v. Touche* 174 N.E. 441 (1931). Justice Cardozo's famous admonition.

It has been suggested by various authors that extending the principles established in *Winnipeg Condominium* to non-dangerous defects would be “akin to providing a non-contractual warranty of product quality to purchasers”¹⁶ and would circumvent the underlying policy of accident prevention those principles are logically based on. An additional concern noted is the potential “slippery slope” which would almost certainly lead to total recoverability in tort to an indeterminate class of persons for every defect in product quality. Such a result tampers with the basic notions of contract upon which civil society is justly based, and potentially leads to the *post facto* reordering of existing bargains.

Until the Supreme Court takes a clear position on this issue, recovery (and by extension, liability) for pure economic loss occasioned by defective - but not dangerous - products or structures will not be available in respect of subsequent purchasers.¹⁷

It is worth bearing in mind, however, that although a product might not necessarily be dangerous in and of itself, it remains open for a court to allow recovery in circumstances where reliance on the apparent quality of a major building system (eg. mechanical or electrical system) is sufficient to render the situation dangerous.¹⁸ This may have repercussions in future for liability over faulty mechanical systems, or other large building-related systems, where reliance

¹⁶ *Supra* note 8 at para. 50.

¹⁷ Interesting questions arise, beyond the scope of this paper, about non-dangerous defects in a structure that cause physical damage but no personal injury.

¹⁸ *Hughes v Sunbeam Corp (Canada)*, [2002] O.J. No. 2457 (CA), where it was held that while the smoke detector itself was not dangerous, reliance on it had the potential to meet the “real and substantial danger” threshold and allow recovery.

is raised as an issue. Typically, in real property purchases however individual warranties or pre-purchase inspections are sought.

Recovery for Non-Pecuniary Loss

Strictly read, *Winnipeg Condominium* opened the door for recovery for pure economic loss arising “from the reasonable cost of repairing the defects and putting the building back into a non-dangerous state”.¹⁹ At first blush, this passage seems to contemplate recovery only for (i) the reasonable cost of repair of the defect and (ii) the cost of removing the danger.

Decisions subsequent to *Winnipeg Condominium* concerning whether recovery is authorized for amounts *other than* those falling within the above-mentioned categories have been largely conflicting. A variety of appellate level decisions have in fact alluded to the potential for recovery for loss beyond that associated with the cost of repair. For instance, recovery has been sought and allowed for loss of profits in addition to loss of repairs²⁰, and also for refund of the purchase amount of a defective product along with the cost of repair²¹.

While the potential for recovery, as illustrated above, does in fact exist apart from the costs associated with repairing and remedying a dangerous defect (which could have great implications for the issue of liability for indeterminate damages), the reality is that recovery outside the parameters established in *Winnipeg Condominium* are relatively rare occurrences. It

¹⁹ *supra* note 2 at para 21.

²⁰ See, for instance, *Brett-Young Seeds Ltd. V. K.B.A. Consultants Inc.*, 2008 MBCA 36 at para.51; *Plas-Tex Canada Ltd. v. Dow Chemical of Canada Ltd.*, 2004 ABCA 309 at para. 133.

²¹ *supra* note 14

therefore remains to be seen what route the Supreme Court will take once and for all when the specific issue of recovery for non-pecuniary loss arising from dangerous defects comes before it.

Conclusion: What does this all say about Indeterminate Liability to 3rd Parties?

Winnipeg Condominium provided much needed clarification on the law of recovery with respect to dangerous defects.

In the roughly 20 years since the decision was rendered subsequent courts have been tasked with determining the issues which arose but were left unanswered, such as whether or not to extend to duty to third parties for non-dangerous defects, or whether to instead remain more conservative in scope.

Contemporary issues still remain in the wake of *Winnipeg Condominium*, such as whether non pecuniary losses should be recoverable, whether the whole or a part of a building (or its major components: structural elements, mechanical or electrical systems) should be treated similarly, all of which still remain to be definitively answered by the Supreme Court in a future decision.

What has been established, however, is that the issues which have been referenced throughout this paper have the potential to greatly impact the various players in the construction industry, who may find themselves exposed to liabilities which they may have thought they were previously been shielded from. If anything, this points to the need for all to hedge against risk with appropriate insurance coverages.

Despite the potential for increased exposure to what some have voiced concerns over as being “indeterminate” liability, the reality is that liability remains generally limited to what was articulated in *Winnipeg Condominium* – the reasonable cost of repairing real and substantial dangerous defects to a non-dangerous state. This requirement remains operational for the useful life of a building, which has definitive spatial and temporal boundaries and works to mitigate the element of indeterminacy.