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# FROM THE GROUND UP

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## Construction All-Risk Insurance Policies: Key Exclusions and Conditions

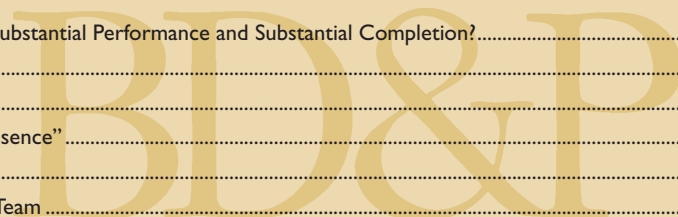
By David H. Strand<sup>1</sup>

**T**his paper begins with a brief discussion about the purpose and scope of construction all-risk (CAR) insurance. It proceeds with a review of common exclusion clauses, notably for faulty workmanship, faulty design, latent defects and inherent vice. The paper concludes by examining common conditions (or warranties) that may bar an insured from recovering under a policy or result in the cancellation of the policy altogether. Case law is referred to throughout to illustrate how the courts have interpreted and applied particular exclusion and condition clauses.

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## 1. WHAT IS CONSTRUCTION ALL-RISK INSURANCE?

CAR insurance is not liability insurance. Rather it is a form of property insurance, specifically intended for a building or structure under construction. CAR insurance is an agreement between an insurer and a contractor or owner in which the insurer agrees to indemnify the contractor or owner for physical loss or damage to the insured property.<sup>2</sup>

A CAR policy typically begins with a broad insuring agreement: for example, “...this policy insures against all risks of direct physical loss or damage to the property insured.” However, that broad coverage provision is then subject to exclusions. The exclusions significantly reduce the coverage provided by the policy. As a result, CAR insurance should *never* be considered as providing protection against all risks of physical damage to the property under construction. The devil is in the details. And in the case of CAR insurance, the most important details are the exclusions.

## 2. CAR INSURANCE ONLY COVERS ACCIDENTAL LOSS

Before turning to the key exclusions, one overriding principle of property insurance should be kept in mind. Property insurance only insures against damage caused accidentally. Damage that is intentionally caused or inevitable in the ordinary course of events is not insured.

## 3. KEY EXCLUSIONS

Most CAR policies contain a clause similar to the following:

This policy does not insure:

The cost of making good:

- (i) faulty or improper materials;
- (ii) faulty or improper workmanship;
- (iii) faulty or improper design;

provided, **however**, to the extent otherwise insured and not otherwise excluded, **resulting damage to the property is insured**. [Emphasis added]

The bolded words outline an *exception to the exclusion*. The insurers exclude from coverage the cost of making good defective materials, workmanship or design. But they do cover any *resulting damage* to the property insured. What does this mean practically? This is a difficult question to answer and one that the courts have wrestled with.

The reason for the exclusion however is clear: CAR insurers do not intend to guarantee or warrant the work of contractors, other trades, engineers or architects, or material suppliers. Each party has certain contractual duties. But ensuring those duties are met is not the role of CAR insurers. That is the role of performance bonds.

That said, CAR insurance is intended to insure damage to the construction project that results from or is caused by defective work, materials or design. If, for example, a conveyor belt bearing seizes due to improper workmanship, materials or design, and a fire results, burning down an entire oil sands project under construction; one would reasonably expect the damage to be covered.

The key issue is deciding where to draw the line. Is there resulting damage? Or does the physical damage merely fall within the *making good* exclusion? The defective workmanship and defective design exclusions have led to most of the case law distinguishing *making good* from *resulting damage*.

## 4. FAULTY WORKMANSHIP

*Workmanship* refers to the combination of skills that are required to build a particular structure. A contractor's failure, for example, to follow prescribed procedures or systems will likely constitute faulty workmanship.

A few examples of the interpretation of the faulty workmanship exclusion by Canadian courts are discussed below.

### (a) *Canadian National Railway Co. v. Royal and SunAlliance Insurance Co. of Canada*, [2004] O.J. No. 4086 (Sup. Ct.)

This decision pertains to the construction of a tunnel beneath Ontario's St. Clair River. The plaintiff, Canadian National Railway Co. (“CNR”), hired a third party to oversee the design and manufacture of a tunnel-boring machine. Once the tunnel-boring machine commenced work, however, it was plagued by problems. On multiple occasions, the device's drill-head had to be removed, transported to the manufacturer's plant and refurbished. This delayed the opening of the tunnel, in addition to generating unforeseen expenses.



CNR claimed for these losses under its construction all-risk policy. The defendant insurer denied coverage, arguing that the plaintiff's claim was precluded by the policy's exemption for faulty workmanship. Ground J.'s decision focused on the foreseeability of the tunnel-boring machine's problems. He began his judgment at para.61 by stating that, "Our courts have... held that, if the cause of the failure was something which was not foreseeable, the exclusion of faulty or improper design is not applicable". He went on to find that mechanical failure was not necessarily foreseeable simply because it was within the realm of the possible. In this case, a committee comprised of the world's foremost experts in tunnel boring had failed to anticipate the problems in question.

CNR was permitted to recover its losses under the CAR policy.

(b) *Greene v. Canadian General Insurance Co.*, [1991] N.J. No. 170 (Nfld. S.C. (T.D.))

A contracting company was hired to construct a house. As the building site was located in a high-wind area, prudent construction practices dictated that temporary bracing be erected to stabilize the unfinished building. The contractors failed to install such structures on the building; the house was unable to withstand the strong winds and began to list dramatically. The building was later deemed to be beyond repair and had to be dismantled down to the first floor. The owners filed a claim under their construction all-risk policy. They were denied recovery on the basis that their claim fell within the scope of the policy's exemption clause for faulty workmanship. At trial, Adams, J. sided with the insurers and held that:

I am convinced that bracing the walls of a structure in the early stages of their erection before all the permanent components necessary for their strength and stability are in place is an element and a function of workmanship. **Failure to utilize such fundamental precautionary and protective measures is a serious departure from the standard of workmanship to be expected of a builder and constitutes faulty workmanship** (at 12). [Emphasis added]

In other words, the contractors' failure to comply with industry-wide standard served as *prima facie* evidence of faulty workmanship. As the plaintiff's claim fell within the scope of the construction all-risk policy's exemption clause, the plaintiffs were denied coverage.

(c) *Landru v. Inter-City Contractors Ltd.*, [1987] 54 Sask. R. 53 (Q.B.)

A contractor was hired to build a home for the plaintiffs. The basement floor was constructed out of concrete slabs. A year after taking possession of the residence, the plaintiffs noticed that the basement was heaving and cracking. In certain spots, the floor had heaved up to four inches. An expert informed the homeowner that the basement floor would have to be replaced entirely. The homeowner claimed under his all-risk insurance policy, but the claim was denied because of the faulty workmanship exemption. At trial, McLellan J. focused

on the *faulty workmanship/damage resulting from faulty workmanship* dichotomy. He concluded that:

The faulty workmanship, I find, was the failure to properly [treat the sediment underlying the basement floor] after the basement slab was poured. The damages that occurred to the basement slab and the interior of the basement were *resultant damage to the property* and are insured under the terms of the policy (at para. 118).

As the contractor's negligence lay in his treatment of the sediment, as opposed to the pouring of the concrete, damage to the concrete floor due to the expansion of sediment below was considered to be "resultant damage". The plaintiffs were permitted to recover for this claim.

## 5. FAULTY DESIGN

*Faulty design* refers to a design that is defective and unsuitable for the end that the structure was meant to serve. Courts in Alberta and Saskatchewan have affirmed that negligence is not a pre-requisite to a finding of flawed or faulty design.<sup>3</sup>

(a) *B.C. Rail Ltd. v. American Home Assurance*, [1991] B.C.J. No. 697 (C.A.)


B.C. Rail Ltd. re-graded some of its railroad tracks. The railroad tracks were poorly aligned and located on top of a steep embankment. To address these deficiencies, B.C. Rail Ltd. brought in an engineer to re-grade the tracks through a process known as "sliver fill". Shortly after the re-grading was completed, the foundation soils began to shift. A major landslide ensued; the railroad tracks were swept away and B.C. Rail Ltd. had to divert its trains for months. It claimed under its construction all-risks policy but was denied compensation on the basis of the exclusion for faulty design. At trial, Cummings J.A. held that the landslide was, indeed, the product of an error in design within the meaning of the exclusion.

B.C. Rail Ltd. was not permitted to recover for damages stemming from the landslide.

(b) *Simcoe & Erie General Insurance Co. v. Royal Insurance Co. of Canada* (1982), 19 Alta. L.R. (2d) 133 (Q.B.)

A bridge was constructed for Calgary's light rail transit ("LRT") system. On December 16, 1979, the bridge for the southbound rail of the project collapsed; it was damaged beyond repair and had to be entirely re-built. Due to multiple insurance policies, the main issue was whether damage was excluded from coverage under a CAR policy. At trial, Kryczka J. examined the definition of *design*. He found that:

...it appears abundantly clear that '**design**' encompasses the **totality of the superstructure and that each and every part of the superstructure was integral to the whole, and what, in fact, overturned in the Elbow River was the whole structure.** The 'design' was, in my view, fundamental to the whole, and when the design was in error the whole of the superstructure was doomed to fail... (at para. 41) [Emphasis added]



...an inherent vice refers to internal decomposition or some quality that brings about an object's own damage or destruction.

The CAR policy excluded the costs of *making good* a faulty design. Since the bridge's design encompassed all of its structure and *making good* entailed replacing the entire structure, this exclusion was found to apply. Only the loss of some rails stored on the bridge was within the resulting damage exception. All other damage was excluded.

## 6. LATENT DEFECT/INHERENT VICE

As well as excluding the costs of making good defective materials, workmanship or design, CAR policies typically exclude damages arising from latent defects and inherent vices. For example:

This policy does not insure wear and tear, gradual deterioration, latent defects or inherent vices, provided, however, to the extent otherwise insured and not otherwise excluded under this policy resultant damage to the property is insured.

As discussed earlier, this exclusion contains an exception for resulting damage.

A latent defect is a defect that cannot be detected through reasonable inspection.<sup>4</sup> In contrast, an inherent vice refers to internal decomposition or some quality that brings about an object's own damage or destruction.<sup>5</sup>

(a) *Dawson Creek (City) v. Zurich Insurance Co.*, [2000] B.C.J. No. 263 (C.A.)

The roof of Dawson Creek's municipal arena collapsed following a larger-than-average snowfall. The area was extensively damaged. Investigations revealed that joints and trusses in the roof had not properly joined when the roof was constructed 40 years earlier.

The municipality claimed under its property policy, but the claim was denied on the basis that the damage in question fell under the exemption for latent defects and inherent vices. On appeal, Esson J.A. considered whether the collapse of the arena roof could be described as fortuitous. He concluded:

...the collapse of the roof in January 1997 was a fortuitous event caused by the combination of two perils, i.e.: the weakness of the structure produced by the faulty construction and the snowload” (at para. 35).

Having established that Dawson Creek’s claim satisfied the threshold requirement of fortuitousness, Esson J.A. turned to the question of latent defects, and found that the construction error did not constitute a latent defect as the problems with the roof could have been detected through reasonable due diligence. Since the damage was not caused by a latent defect, the exclusion did not apply and Dawson Creek was entitled to coverage.

(b) *University of Saskatchewan v. Fireman’s Fund Insurance Co. of Canada*, [1997] S.J. No. 642 (C.A.)

The University of Saskatchewan had stonework on one of its buildings. The stone façade began crumbling and eventually, large chunks of rock fell away from the building. According to an expert, the problem was attributable to the galvanized steel pins affixing the stonework to the building. The pins expanded when they came into contact with moisture, causing the stone to crack. Coverage was sought but disputed by the property insurer. On appeal, Sherstobitoff J.A. considered whether the damaged stonework could be regarded as an inherent vice. He found that:

**An inherent vice is a condition inherent in the property insured which is not discoverable on an examination by a reasonably skilled person.** In this particular case, the stone cladding on the building was not adequate to stand up to normal Saskatchewan weather because of the design error, which led to the use of the galvanized steel pins (at para. 53). [Emphasis added]

Sherstobitoff J.A. then examined whether the damaged stonework could be classified as *damage resulting from an inherent vice or latent defect*. To this end, he held that, “This exception is not meant to apply to damage to the building itself, but only damage to other property or persons. Otherwise, there would be no point to the exclusion clause.” As the damaged stonework constituted an inherent vice and latent defect, the University of Saskatchewan was denied the right to recover.

## 7. CONDITIONS

Typically, certain conditions are attached to CAR policies. The failure to fulfill such conditions may bar the insured from recovering under their insurance policy or result in the cancellation of the policy altogether (depending on the terms of the policy in question). Examples of common conditions include installing an alarm system, hiring a full-time security patrol, installing firebreaks between buildings on adjoining lots, maintaining a fire extinguisher on the construction site, taking certain precautions when welding or using a blow-torch, storing building materials off-site and not burning refuse at the construction site.

While most conditions are explicit (i.e. written into the insurance policy), conditions can also be implicit (i.e. implied into the insurance policy by law). Limitations periods, which are statutory enactments setting out timelines for the filing of insurance claims, are an example of an implicit condition.

Unfortunately, there is little relevant case law on conditions in the insurance context. The cases discussed below address conditions in general property liability policies. The reasoning however, should apply to conditions in CAR policies.

(a) **Security Conditions: *Nathen Printing Services v. British Columbia Insurance Co.***, [1996] B.C.J. No. 2098 (S.C.)

A company was offered insurance coverage subject to the installation of a monitored burglar alarm. A \$250,000 printing press was subsequently stolen from the business. When the plaintiff claimed for the loss, the insurer refused to pay.

The insurer reasoned that the plaintiff had installed a local alarm system rather than a monitored alarm system; the plaintiff had thus violated a warranty, justifying the cancellation of the policy. At trial, the plaintiff was ultimately permitted to recover on a technicality. Notes taken by one of the insurer’s employees during an inspection of the plaintiff’s premises showed that the insurer had been aware of the non-complying alarm system. The fact that the insurer chose not to raise this matter with the plaintiff was interpreted as tacit consent to the breach of warranty. Apart from this technicality, it seems clear the Court would have upheld the denial of coverage.

(b) **Hot Works Condition: *Reimer Farm Supplies Ltd. v. AXA Pacific Insurance Co.***, 2002 MBQB 12

Rainer Farms suffered a fire loss. It had a general liability insurance policy that included the following warranty:

It is warranted that **during all operations involving the application of heat** away from the insured’s premises as described under the declaration of the Policy, the following precautions will be taken: (a) **before and after all operations involving the application of heat, the immediate area will be hosed down;** (b) A foreman... will be at the site of operations involving the application of heat with a suitable fire extinguisher... to monitor all operations involving the application of heat and will remain and continue to monitor the site of said operations for two hours after completion of operations involving the application of heat (at para.3). [Emphasis added]

Contractors had been hired by Rainer Farms to re-surface the roof of their business premises, a task which required the use of propane-fuelled torches. A fire broke out during the course of the roofing work, resulting in more than \$1 million in damage to the building. The roofers did not, at any point during the day, hose down the area upon which they were working. Moreover, it was not clear that the job site had been monitored for two hours following the completion of the torching operations. The plaintiff’s insurer thus denied liability for the claim on the basis that this party had violated the *hot works* warranty.

**Typically, certain conditions are attached to CAR policies. The failure to fulfill such conditions may bar the insured from recovering under their insurance policy.**

At trial, McKelvey J. found that it would have been impractical for the contractors to hose down the roof, as the adhesive panels they were using did not stick to wet surfaces. He further affirmed that, as per employee pay records, several roofers remained on-site for more than two hours following the completion of the work. The plaintiff was permitted to recover its losses, as it was not found to be in breach of the *hot works* warranty.

On the facts of the case, the insurers appear to have had reasonable grounds for claiming the *hot works* condition had been breached. The decision shows how reluctant a Court may be to deny coverage for breach of condition.

## 8. CONCLUSION

CAR coverage does not cover all risks of damage to the insured property under construction. Only those risks that have not been specifically excluded by the terms of the policy are covered. A loss must also be fortuitous to fall within coverage.

The standard exclusion for faulty materials, work or design may result in the entire claim for damage being excluded. Where the cause of a loss is faulty material, work or design, coverage depends on the loss falling within the *resulting damage* exception. Deciding this, as the case law shows, is often a difficult task.

As a result, a prudent owner should not rely solely on a CAR policy. Faulty design can be protected against by a professional liability policy and performance bonds can be obtained to protect against contractors or subcontractors not fulfilling their contractual duties.

Lastly, conditions or warranties are often attached to CAR policies. The failure to fulfill such a condition may lead to the insured being barred from recovery or result in the cancellation of the policy altogether. That said, case law suggests courts will look for reasonable ways to avoid denying coverage for breach of a condition.

### Footnotes

<sup>1</sup> The writer gratefully acknowledges the assistance of Susan Martyn, Student-at-Law with Burnet, Duckworth & Palmer LLP

<sup>2</sup> Provided that the value of the policy exceeds the value of the damage, and subject to deductibles.

<sup>3</sup> See *Simcoe & Erie Gen'l. Ins. Co. v. Willowbrook Homes*, [1980] ILR 1-1236 (Alta. C.A.) and *C.I.C. Mining v. Sask. Gov't. Ins. Co.* (1993), 16 C.C.L.I. (2d) 102 (Q.B.).

<sup>4</sup> *Triple Five Corp. v. Simcoe & Erie Group*, (1994) 159 A.R. 1 (Q.B.), appeal dismissed [1997] A.J. No.248 (C.A.)

<sup>5</sup> *Canadian Encyclopedic Digest*, "Insurance" 1178

# What is the Difference between Substantial Performance and Substantial Completion?

by Robert O. Millard and David H. Strand

**Y**ou may hear the terms “substantial performance” and “substantial completion” used interchangeably in the construction industry. Be careful: these terms do not necessarily mean the same thing.

## BUILDER'S LIEN ACT

“Substantial performance” is a term defined by Section 2 of the Alberta *Builders' Lien Act* which states that:

For the purposes of this Act, a contract or a subcontract is substantially performed

- (a) when the work under a contract or a subcontract or a substantial part of it is ready for use or is being used for the purpose intended, and
- (b) when the work to be done under the contract or subcontract is capable of completion or correction at a cost of not more than
  - (i) 3% of the first \$500 000 of the contract or subcontract price,
  - (ii) 2% of the next \$500 000 of the contract or subcontract price, and
  - (iii) 1% of the balance of the contract or subcontract price.

Substantial performance under the *Builder's Lien Act* may have significant consequences:

1. It may allow an Owner to pay out the 10% holdback (on the value of the work done and material furnished to the date the certificate is issued) without waiting until the head contract is completed.
  - (a) The Owner is required to retain the holdback for a period of 45 days from the date the Certificate of Substantial Performance is issued (90 days if the work relates to improvements in respect of an oil or gas well, or to an oil or gas well site) but may release it thereafter if no liens have been registered.

- (b) Whether the Owner is required to actually release the holdback at that time depends on the payment terms of the head contract.

2. If the Owner does pay the holdback out, the payment triggers the trust provisions of the *Builder's Lien Act*. The contractor receiving the payment holds that money in trust for the benefit of any of its subcontractors or suppliers who are owed money for the work done or materials furnished to the date of the certificate. Similarly, any subcontractor or supplier receiving payment holds the money in trust for the benefit of persons below them in the contract chain who are owed money.

3. Two lien funds are created: a major lien fund and a minor lien fund.

- (a) The major lien fund is the holdback on the value of the work done and services furnished to the date of the certificate of substantial performance.
- (b) The minor lien fund is the holdback on the value of the work done and services furnished **after the** date of the certificate.

4. Any subcontractor, supplier, or any person below them in the contract chain, who wants to register a lien against the major lien fund, must do so within the 45-day or 90-day holdback period.

- (a) To alert potential lien claimants that time is running on them, the contractor issuing a certificate of substantial performance is required (within 3 days of issuing the certificate) to post a signed copy of it in a conspicuous place on the job site.

- (b) A subcontract issuing a certificate of substantial performance is required to do the same.

- (c) The trade off under the *Builder's Lien Act* for limiting the period in which to lien is having the benefit of the trust provisions discussed above.

The definition of “substantial performance” thus is a statutory term. But there is no statutory definition of “substantial completion” in Alberta. “Substantial completion” has no meaning under the *Builders' Lien Act*. Accordingly, if you wish to trigger the provisions of the *Builders' Lien Act*, you should define “substantial performance” by reference to the *Builders' Lien Act*.

If “substantial completion” is relied on in a construction contract, it should be clearly defined and both parties should be aware that it is not synonymous with “substantial performance” under the *Builders' Lien Act*.

## STANDARD FORM CONSTRUCTION CONTRACTS


Contracts drafted by the Canadian Construction Documents Committee (CCDC) typically define “substantial performance” by reference to the applicable provincial lien legislation—i.e. in Alberta it is the *Builders' Lien Act*. For example, under the stipulated price contract (CCDC-1994), several important consequences follow from substantial performance:

1. The warranty period is triggered.
2. For common law provinces such as Alberta, the running of the maximum period during which the Owner can make certain claims—indemnity, and breach of contract or negligence—claims against the contractor is triggered.
3. The Owner's obligations for payment of holdback are triggered.

To avoid confusion and disputes, construction contracts should only refer to “substantial performance”. If you wish to use the term “substantial completion”, be sure to define it clearly in the contract.

# An MOU – What Is It?

by Candice J. Jones, student-at-law



The parties may agree under an MOU to collaborate on a joint bid for a particular project. The primary question is whether the MOU reflects an agreement to merely negotiate, or alternatively, an agreement in principle with further details and documentation to follow. Are the parties documenting their intention to try to reach an agreement, or does it establish that they will in fact work together, with the parameters to be determined later?

## SOME RULES OF THUMB

In trying to determine whether an MOU creates enforceable obligations, there are some distinctions to consider:

- ▶ Is the MOU simply an agreement to negotiate with no attached obligations? (not enforceable)
- ▶ Is the MOU a promise to do something (enforceable), or is it merely a formal statement of the parties' intention (not enforceable)?
- ▶ If additional documents are contemplated after the MOU is executed, are those documents a condition of the MOU (meaning the MOU does not take effect and is not enforceable until those documents are created) or are those documents merely intended to determine how the MOU will be carried out (MOU enforceable)?

Ultimately, if the parties disagree about the effect of the MOU, it will be for the court to determine whether the MOU is enforceable or not.

## THINGS THE COURT WILL CONSIDER

In interpreting written agreements, the court will consider a number of factors. The first consideration is whether the parties intended the MOU to be enforceable. However, the professed intention of the parties is not always decisive. Instead, intention is determined based on the wording of the contract as well as the surrounding circumstances. Prior agreements or interactions between the parties, the particular experience and

## WHAT IS AN MOU?

The acronym MOU is used frequently in the construction industry, but what does it really mean?

An MOU, or Memorandum of Understanding, is a general term for a written document setting forth a preliminary understanding the parties have reached. An MOU defies a specific description due to its flexible nature. The form of an MOU is variable, from a brief letter agreement, to a lengthy formal document. The terms of an MOU may be very detailed or may be very general. The timing of an MOU is also variable. An MOU may be executed at the outset of dealings between the parties, or it may be executed in relation to a matter arising

from an existing contract between the parties. This changeable nature of an MOU makes it difficult to provide an exact definition.

As a result, the impact of an MOU will largely depend on the *particular* MOU and the unique circumstances surrounding its execution.

## IS AN MOU ENFORCEABLE?

There tends to be a belief that an MOU does not place any enforceable obligations on the parties. An MOU is often viewed as merely a loose arrangement to work together towards some mutual goal. While this may be true in certain circumstances, more frequently there is some degree of enforceable obligation imposed on the parties by the MOU. This would typically include terms of confidentiality, non-competition and cost allocations.

expertise of the parties, and the subsequent conduct of the parties are all examples of surrounding circumstances a court may consider.

**For example:**

- ▶ A prior practice between parties of not adhering to the specific terms of a related agreement (i.e. change orders not being signed in advance of work) may indicate that later compliance with those terms is merely the manner in which the parties implement the agreement. As a result, formal compliance with similar specific terms under an MOU may also not be required in order for the MOU to be enforceable.
- ▶ Execution of an MOU by experienced industry professionals or senior executives may support a conclusion that the terms of the agreement were understood and intended to be enforceable.
- ▶ The carrying out of the terms of an MOU may demonstrate a party's intention to be bound by it.

The court will also examine the completeness and certainty of the terms of the MOU. Essentially, the court will look at whether the MOU includes essential terms enabling the enforcement of an agreement. Those essential or fundamental terms must be able to be determined with sufficient (or reasonable) precision by the court. What constitutes essential terms will vary with the agreement. The omission of minor terms

is not conclusive. Interestingly, price is not usually an essential term. As well, an MOU that anticipates further documentation or agreement at a later time does not necessarily demonstrate that the terms of an MOU are uncertain.

Some of these issues were considered in a Nova Scotia case involving a design-build contract for a power plant. (*Mitsui & Co. (Point Aconi) Ltd. v. Jones Power Co.*, 2000 NSCA 95). Part way through construction, the contractor and the sub-contractor for the mechanical and electrical work had a disagreement regarding a number of issues. In an effort to resolve these issues and move the project forward, senior executives on both sides negotiated and executed an MOU. The subcontractor subsequently claimed that the MOU was not binding on the basis that the MOU was conditional on further agreements, was incomplete and was uncertain.

While the MOU did contemplate the preparation of a change order to accomplish the MOU, the Court of Appeal held that contemplating further documentation does not mean that "legal effectiveness was conditional on it." The deal was struck by senior executives who, as was the practice in the circumstances, left the working group to work out the details.

In terms of certainty and completeness, the subcontractor argued the MOU lacked payment terms and that such terms were essential to the formation of a binding contract.

The Court of Appeal stressed that where parties reach an agreement, the courts are reluctant to find it cannot be given meaning. When reading the MOU in the context of the main contract and the practice of the parties, the Court determined it had the ability to determine the intention of the parties with reasonable certainty. This satisfied the test on certainty, which was whether the Court could find the MOU capable of being given a reasonably certain interpretation rather than a definitive interpretation.

This case demonstrates a fundamental rule of contract interpretation that where there is an original intention by the parties to be bound by their agreement, the court will attempt to give effect to that agreement. In some instances, that may require the court to provide or infer any missing terms of the agreement. To avoid this kind of intervention by the court, the terms of an MOU should be explicit.

**SUMMARY**

It is important for parties to be as clear as possible in setting out their intentions and respective obligations in any MOU, notwithstanding that further details may need to be agreed upon in the future. This includes terms and conditions for the enforcement of the MOU, as well as provisions for termination of the MOU, however rudimentary. If the MOU is not intended to be enforceable, a clear statement to this effect should be included. Clarification of basics at the outset will help prevent disputes later.

## What We've Been Up To

Arnie Olyan was Co-Chair of the "Risk Management in the Construction and Energy Sectors" conference of the Pacific Business and Law Institute, Jan. 18 & 19, 2006, and David Strand presented a paper on "Exclusions and Limits on Coverage and Conditions" at the same conference.

John Taylor will be representing BD&P at the Construction Owners Association Alberta's ("COAA") annual Best Practices Conference to be held in Edmonton in May, 2006. The COAA is an association whose mandate is to examine the issues facing the Alberta construction industry and deliver practical solutions to safety, workforce and project challenges.

Arnie Olyan and John Taylor are co-authoring and presenting a paper entitled "EPC Contracts and the Energy Lawyer" for the Canadian Petroleum Law Foundation conference being held in Jasper in June, 2006.

Simon Lee, who will commence articling at BD&P in July, 2006 recently presented a paper "The Tendering Process: Common Law and Common Practice" to the CBA Construction Law Section.

# A Moment with “Time is of the Essence”

by John K. Taylor



**W**hy should an owner, contractor, consultant or supplier care if the parties expressly state in a contract that “time is of the essence”?

Most parties to a contract care when they are paid. Most parties to a contract want to know when a warranty period begins and ends. Most parties to a contract want to understand if the period for serving a change order has expired. Most owners care when certain documents, materials, equipment or personnel are made available for their project. If you care about when people are to satisfy these and other obligations under a contract then you will want to insist on having a “time is of the essence clause” in your contracts.

Contrary to what most may think, there is no general presumption in a contract that time is an important element of performance or

non-performance of a contract. Therefore, any breach of a time limit that parties agree to in a contract will not generally be viewed as the basis for claiming damages, a right to terminate, etc. unless the parties make it clear that “time is of the essence”. By parties expressing the importance of stated deadlines, the courts are inclined to provide a remedy to the affected party for the other party’s failure to meet a deadline.

Parties may be reluctant to use a “time is of the essence” clause due to a lack of understanding of the consequences that may flow from the use of the clause. For example, “time is of the essence” does *not* mean that:

- ▶ a party that has missed its deadline will automatically be responsible for all losses (including consequential damages) that the other party may claim as a result of the delay,
- ▶ a party for whose benefit a time limit has been established in the contract

*must* exercise its contractual rights to terminate if the other party has missed a timeline, or

- ▶ parties are without an opportunity to negotiate or otherwise discuss the possibility of providing latitude to the other party in the event that the other party has missed a deadline.

“Time is of the essence” is a clause that is inserted in the vast majority of common law contracts to acknowledge the parties’ agreement that each party will comply with the timelines imposed on them under the contract. With such a clause, parties are more likely to be held to their obligations in regards to time. Without such a clause, missed deadlines can leave the affected party without a remedy.

If deadlines are significant to a party negotiating a contract, why wouldn’t that party want to insist on a “time is of the essence” clause in its contract?



## BD&P's Construction Team

**B**D&P Construction Team is comprised of 15 dynamic litigators and solicitors who offer full service representation in all facets of the construction industry.

Our Team represents owners, contractors, sub contractors, engineering firms, developers, banks, and other financial institutions on a wide range of construction issues ranging from the straight forward to the complex. We review, negotiate and prepare terms and conditions and other documentation for varied construction and engineering projects; provide practical, timely and expert legal support throughout the construction process; and provide experienced litigation services when required.

BD&P's Construction Team represents a diverse range of client interests from those of small local contractors to developers of large-scale energy and infrastructure projects. Whether our clients require the review of a contract, the arbitration of a construction dispute, or the coordination and preparation of the multi-faceted and complex series of transactions demanded by a major project, BD&P is able to provide the individual lawyer or assemble a team with the appropriate depth and experience.

For your easy reference, we highlight both our Significant Areas of Service and examples of Major Projects in which either individual firm lawyers or the firm were involved, which include some of the largest projects carried out in Canada.

### SIGNIFICANT AREAS OF SERVICE:

- Negotiation and preparation of tender packages and joint venture, confidentiality, consulting, engineering services and architectural services agreements
- Negotiation and preparation of construction, construction management, sub-contract, supply and mining services agreements
- Negotiation and preparation of Engineering, Procurement, & Construction (EPC) and design/build contracts
- Negotiation and preparation of Engineering, Procurement, & Construction Management (EPCM) contracts
- Delay claims
- Industrial design disputes
- Construction and contract disputes

- Tender disputes
- Engineering claims
- Lien claims
- Insurance issues including liability, builder's risk, errors and omissions and professional liability coverage
- Regulatory and municipal planning approvals
- Preparation of construction security documentation
- Representation at arbitrations and mediations
- Service as arbitrators and mediators in construction disputes

### MAJOR PROJECT EXPERIENCE:

- **Hibernia Project** – offshore oil production platform off coast of Newfoundland
- **Terra Nova Project** – floating production, storage & offloading facility in oilfields on Grand Banks
- **Sable Island Project** – offshore natural gas recovery project off coast of Nova Scotia
- **Horizon Oil Sands Project** – oil sands project in northern Alberta
- **Muskeg River Oil Sands Project** – oil sands project in the Athabasca oil sands region of northern Alberta
- **Long Lake Oils Sands Project** – development project of heavy oil infrastructure in the Athabasca oil sands region of northern Alberta
- **Tanguh Project** – a liquefied natural gas project in Indonesia
- **Confederation Bridge Project** – fixed link bridge across Northumberland Strait
- **Sakhalin Island Project** – large scale oil and gas development project on Sakhalin Island in Russia
- **Husky Oil Upgrader** – development of Lloydminster Heavy Oil Upgrader
- **MEGlobal** – worldwide joint venture for manufacture and sale of ethylene glycols

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