THE INTERFACE OF TORT AND CONTRACT IN THE CANADIAN CONSTRUCTION CASE

by

Todd William Kathol

A thesis submitted in conformity with the requirements for the degree of Master of Laws, Graduate Department of Law, University of Toronto

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Todd William Kathol
Masters of Laws, 1999
Graduate Department of Law, University of Toronto

This thesis considers jurisprudence testing the boundaries of tort and contract law. Of particular interest are those cases arising from and impacting on construction disputes. Important recent developments in fundamental legal doctrine are analysed as well as the construction contracts and insurance policies forming part of the factual matrix to the construction case. The writer's conclusion is the courts should be especially deferential to private ordering in these cases. The direct and indirect contractual arrangements between the litigants help define or limit tort duties between them.
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CHAPTER I

INTRODUCTION

"Now there is no tort more likely to co-exist with breach of contract than negligence. In a great number of instances a contractor fails in what he has promised because he has acted incompetently."¹

I. A. THE THESIS WORKSITE

In the past two decades the Supreme Court of Canada has undertaken two important projects in private law. The Court has endeavoured to rationalize tort and contract law in both enterprises. In the first line of cases, the Court settled the principle of concurrency of the two causes of action. The Court next continued its struggle to define the governing principles in relation to the recovery of pure economic loss. The resulting body of jurisprudence has a significant impact on the many cases that test the boundary between tort and contract.

The construction dispute is one such case. It is not by chance that many of the leading cases in these rapidly evolving areas of the law arise from construction disputes and, in particular, cases where the negligence of someone involved in the construction project has resulted in economic loss to some other party either within or outside the typical construction chain.

The above quote is particularly true of the negligent party to a construction contract. Indeed, it is almost invariably the case that a negligent act or omission constitutes a breach of that party’s obligations pursuant to a construction contract. This is especially so in light of the rationalization of the common law duty of care owed by a builder to statutory standards to contractual warranties. In this thesis, I canvas these important developments in the legal doctrine as well as the construction contracts and insurance policies at issue in

an effort to find the most appropriate interaction of tort and contract in the construction case.

This first chapter outlines typical construction contractual and insurance arrangements as well as the statutory framework within which these parties carry on business.

The second chapter canvasses the law relating to the concurrency and applicability of contract and tort liability in the construction case including the application of exclusionary clauses and the issue of the third party beneficiaries to such provisions.

Recent developments in the recovery in tort of pure economic loss is reviewed and analyzed in the third chapter. This discussion includes a comparative analysis of the state of the law in Canada, England, Australia and New Zealand.

The fourth chapter discusses the contractual provisions made for insurance in the standard construction contract and the actual coverage provided by the insurance policies used in the typical construction project. The second part of this chapter consists of an essay on the merits of the existence or availability of insurance as a consideration in grounding tort liability.

In the fifth and final chapter, I propose how a court should address construction disputes in each of three scenarios: (i) claims brought by a third party outside of the contractual chain; (ii) concurrent claims in tort and contract; and (iii) claims brought by a plaintiff within the contractual chain but without privity with the defendant in question. My conclusion generally is that courts should be careful not to upset the obligations and expectations founded in the mostly standard contractual language used to structure a construction project. This is particularly so of the second and third scenario discussed.
I.B THE CONSTRUCTION SITE

We shall see in later chapters that the Courts are increasingly inclined to consider the nature of the litigants and the full context of the circumstances giving rise to the dispute at issue. The factual matrix surrounding a construction dispute is typically very structured. The full context will include a number of established roles and relationships that are usually documented by a series of express contracts. The following is an overview of the typical construction project. It is often viewed as a contractual pyramid with the landowner at the apex.

I.B.1 The Traditional Construction Pyramid

Once an owner makes a decision to proceed with a project, it enters into a contract with a design professional, normally an architect or engineer licensed to practice in the province where the construction is taking place, to design and administer the construction of the building. Standard form agreements between the owner and consultant are widely used in the construction industry. There is no contractual relationship between the owner’s consultant and the contractors and neither have any contractual rights or obligations against the other notwithstanding the fact that the consultant is often actively involved during the course of a construction project and may have daily contact with the contractors and their forces.

The owner will next enter into a separate contract with a general contractor (also known as the “prime” or “main” contract and contractor) who will assume responsibility for the construction of the project and to hire, supervise and co-ordinate subcontractors. In a project of any significant scale, the general contract will be put out to tender on the basis of specifications prepared by the owner’s consultant.

The pyramid expands as the general contractor enters into a series of subcontracts with specialty contractors, suppliers and trades. These subcontractors are often already identified as the prime contractor will have solicited their bids while preparing its tender
for the general contract. Each subcontractor may, in turn, enter into sub-subcontracts with labourers, suppliers and tradespeople.

It is important to note that, except in the case of an assignment, the general contractor remains contractually bound to the owner and that there is no contractual relationship between the owner and the subcontractors. Accordingly, the subcontractor has no right to pursue the owner for payment of any work done even if the owner assents to the subcontract. This is so even if the prime contract contains a provision under which the general contractor undertakes to pay the accounts of his subcontractors and suppliers.

This also means that it is no defence to a claim by the subcontractor under the subcontract that the subcontract was prohibited by the terms of the prime contract. On the other hand, if the work of a subcontractor does not comply with the specifications or requirements of the prime contract, the owner’s contractual complaint is against the prime contractor and not against the subcontractor and the owner has no contractual right to direct a subcontractor’s work.

The pyramid results in a complex matrix of relationships. Each party arranges for the supply of materials or services for the project in question knowing that the materials or services contracted for may well be supplied by some third party. Conversely, each supplier looks to the party it contracted with for payment knowing that the payment usually depends on money flowing from the owner down the pyramid. The stability of the

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3 Irving v. Matheson (1900), 32 N.S.R. (C.A.). It is another matter if the owners enters into a subcontract with the subcontractor to see that it is paid: Imperial Roofing Company v. Dick (1913), 10 D.L.R. 484 (Alta. S.C.).


pyramid is jeopardized by the fact that the flow of money may be interrupted by the misconduct of a contractor with whom most others have no contractual relationship.

The owner’s consultant holds a unique and critical position in that he or she is authorized to make very significant decisions affecting the rights of both the owner and general contractor. The standard construction contract will expressly set out the rights of the consultant including the authority to administrate the construction contract and act on behalf of the owner notwithstanding the consultant’s lack of privity with the general contractor. These responsibilities include the evaluation and certification of progress payments as the project proceeds. The consultant must not only act competently but must also act independently and in an unbiased manner or “judicially” notwithstanding the consultant’s retainer by the owner. This means that the consultant’s decisions must be dictated by her or his own best judgment of the most efficient and effective way to carry out the contract.\(^6\) The impartiality of the consultant is further strained by the fact that many misunderstandings on the site are the result of gaps it left in the design documents at the tender call.

In the mid to late 1980’s, a second arrangement became popular: the “design-build” contract wherein the general contractor assumed responsibility for the design of the structure as well as the actual construction itself. One popular type of design-build contract is the so called “turn-key” project. The concept is that the owner takes no legal responsibility for the project until the building is completed and the design-builder provides the owner the key to the building.

One of the greatest advantages of the turn-key contract is the avoidance of the many disputes between the contractor, consultant and owner such as over the interpretation of building specifications and the contractor’s claims for extra work and whether a deficiency is due to faulty workmanship or a defect in design. In addition, the design-build project

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structure is conducive to “fast-tracking” or construction proceeding before the design
details are finalized. The main disadvantage is that it is very difficult for the design-builder
to estimate the scope of its obligations or the price of the project prior to the design
being completed.

Another variation on the traditional arrangement is construction management wherein a
construction manager acts in the capacity of agent for the owner rather than as an
independent contractor. The owner engages the trade contractors directly and thereby
assumes much of the role of the traditional general contractor. The construction manager
works in conjunction with the engineering and architectural consultants and serves as the
owner’s adviser and agent, providing site management, administration and technical
services solely for the benefit of the owner.

I.B.2 The Tender Package

The tender package prepared by the owner’s consultant and distributed by the owner to
prospective contractors should contain all special project requirements and specifications
in addition to the notorious “privilege clause” or express reservation by the owner that
“the lowest or any tender shall not necessarily be accepted”. Additionally, the bid
documents often contain a “reservation of rights” provision which states that the owner
“reserves the right to reject any or all tenders”. Typically the form of contract to be
executed will be included in the tender package. Contractors frequently request changes
in the specified contract’s terms and conditions when submitting bids.

I.B.3 Standard Contracts

Standard form contracts are widely used in the construction industry. A series of standard
documents have been created and are periodically revised by the Canadian Construction

7 In M.J.B. Enterprises Ltd. v. Defence Construction (1951) Limited. (22 April 1999), File No. 25975, the
Supreme Court of Canada ruled that the privilege clause was incompatible with and overrode any
obligation to accept the lowest compliant bid but compatible with the presumed intention of the parties
and implied term that the owner would only accept a compliant tender. M.J.B. is one of a long line of
difficult cases following The Queen (Ont.) v. Ron Engineering (1981), 119 D.L.R. (3d) 267 (S.C.C.),
ruling on the contractual obligations arising from a response to an invitation to tender.
Documents Committee ("CCDC"). The CCDC is a national joint committee made up of representatives from the Association of Consulting Engineers of Canada, the Canadian Construction Association, the Canadian Council of Professional Engineers, Construction Specifications Canada, the Royal Architectural Institute of Canada/Committee of Canadian Architectural Councils as well as owner representatives. It is responsible for the development of standard construction documents and industry guides for use in the public and private sectors by owners, contractors, design professionals and others in the construction industry.

The Canadian Construction Association and its provincial counterparts provide a standard form of subcontract. Again, contractors often make use of their own subcontract. The detail in the subcontract often turns on the size and detail of the work in question. A simple subcontract often takes the form of a purchase order.

Jackett J. of the former Exchequer Court of Canada explained the advantage of standard forms of contract in a 1967 address to the Canadian Construction Association:8

It seems to me that the desirability of what might be referred to as standard forms of contract is obvious ... If every contract is specially negotiated for the particular job and particularly if terms of the contract are framed by lawyers working for the Owners, it would, I should have thought, be literally impossible for the contractor to take into account, in determining the amount of his bid, all the varying risks and responsibilities involved in each such custom made contract, even if the terms of the contract are known to him before he settles the amount of his bid.

If on the other hand, there is a standard contract which is the basic document for every job, he is in a position to formulate his bid for the particular job having regard to the normal risks and responsibilities, and such deviations are emphatically brought to his attention, he can then adjust the amount of his bid having regard to his appraisal of such deviations.

The advantages of the use of standard form contracts are enhanced by the fact that contractors frequently do not have the time or resources to review and assess custom made contracts during the bidding process. This is particularly true of subcontractors who

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often respond to a quote solicitation by a prospective general contractor shortly before the tender deadline.

It should be noted that governments and large contractors have developed and make use of their own contract forms. These are not “standard” contracts in the sense discussed as they are almost invariably biased in some ways towards protecting the interests of the drafter and must be reviewed carefully to determine whether the other party is assuming some unexpected risks and responsibilities. This is particularly true of contracts “issued” by private parties.

There are certain types of contracts which are widely used in the construction industry today. The following is a brief description of these contracts and their distinguishing characteristics.

I.B.3(a) Stipulated Price or Lump Sum Contract - CCDC 2

The stipulated price or lump sum contract is self-explanatory and is also known as a “fixed price” contract. The general contractor undertakes to complete all of the work he has agreed to perform for a fixed price. It is the most frequently used standard form contract and is the subject of CCDC 2 - Stipulated Price Construction Contract. It offers the owner the advantage of certainty in the cost of the project subject to the normal additions and deductions in accordance with contract general conditions on account of changes, for example.

The fixed price contract assumes the existence of a full and complete set of plans, drawings and specifications which have been prepared by or on behalf of the owner prior to soliciting bids from contractors. It is critical that the consultant’s drawings and specifications are detailed and accurate at the time of contract as the contractor is exposed to considerable risk in quoting on stipulated price contracts. The relative disparity in the knowledge of the owner and tenderers, the importance and technicality of the information in question and the opportunity or time for tenderers to investigate and verify information
all contribute to the duty on owners to ensure that tender documents are accurate.\textsuperscript{9} Bidding contractors are entitled to presume that the drawings on which they are bidding adequately depict project requirements absent express notice to the contrary.\textsuperscript{10}

**I.B.3(b) Unit Price Contract - CCDC 4**

This sort of construction contract, too, is self-explanatory and is also commonly referred to as a “time and materials” contract. It shifts the risk of labour and material exceeding initial estimates from the contractor to the owner. For its part, the contractor assumes the risk that the quoted price for each unit of work will not increase.

**I.B.3(c) Cost-plus Contracts - CCDC 3**

This type of contract provides for reimbursement to the contractor for actual costs of construction together with a fee payable to the contractor, usually either on a lump sum or percentage of actual cost basis. This arrangement is often used on urgent or unique projects where detailed drawings and specifications cannot be finalized prior to starting construction and the parties are prepared, in the circumstances, to proceed on the basis of estimates.

The cost-plus contract has some practical risk to the owner as the contractor has no real incentive to reduce costs or expedite the project. For this reason, the owner’s consultant should be especially vigilant in monitoring the progress of the work to ensure that it is proceeding on a reasonable cost basis.

**I.B.4 Relevant Contractual Provisions**

The construction contract usually is made up of general and special conditions along with the express incorporation of the precise details of the work to be performed. General

\textsuperscript{9} Opron Construction Co. v. Alberta (1994), 151 A.R. 241 (Alta. Q.B.). In Begro Construction v. St. Mary River, (1994) 15 C.L.R. (2d) 150, the Alberta Court of Queen’s Bench confirmed that the owner and its consulting engineer’s duty is supplemented by the requirement to disclose in the tender information all material information in their possession in order to enable the contractor to prepare a proper bid.
conditions address the relationship between the parties as opposed to details of the work. Special conditions also deal with the relationship between the parties but are applicable to a particular contract rather than to contracts in general. Special conditions will take precedence over general conditions when there is a conflict between them.\footnote{Immanuel Goldsmith and Thomas G. Heintzman, *Goldsmith on Building Contracts*, 4th ed. (Toronto: Carswell, 1988) at 2-7 - 2-8.}

Standard or accepted liability and warranty provisions in the construction contract are of particular interest to this thesis. Important general conditions from the CCDC-2 are highlighted in this part. We can start with the proposition that the parties agree that their rights and liabilities are not exhausted by the four corners of their contract.

**PART 1 GENERAL PROVISIONS**

**... GC 1.3 RIGHTS AND REMEDIES**

1.3.1 Except as expressly provided in the Contract Documents, the duties and obligations imposed by the Contract Documents and the rights and remedies available thereunder shall be in addition to and not a limitation of any duties, obligations, rights, and remedies imposed or available by law.

There is the express expectation that the general contractor will be responsible for its activities and that of its subcontractors. Further, the general contractor must incorporate the general contract into any subcontracts.\footnote{J.P. Metal Masters Inc. v. David Mitchell Co. (1997), 34 C.L.R. (2d) 257 (B.C.S.C.), affirmed (1998), 37 C.L.R. (2d) 1 (B.C.C.A.).} Accordingly, the common practice of issuing short form purchase orders to suppliers violates this requirement unless the purchase orders specifically refer to and incorporate the terms and conditions of the general contract. In a given case, the court will determine to what extent the terms of the general contract have been incorporated into the subcontract. In carrying out this exercise, the court will consider and try to give business efficacy to the express arrangement between

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\footnote{The courts are apparently inclined to infer that a contractor will subcontract the same work on the same terms as the original contract absent evidence to the contrary: *Qit Fer v. Upper Lakes Shipping* (1994), 21 C.L.R. (2d) 122 (Ont. C.A.) at 124.}

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the owner and general contractor, on the one hand, and that between the general contractor and subcontractor, on the other.\textsuperscript{13}

PART 3 EXECUTION OF THE WORK

GC 3.1 CONTROL OF THE WORK

3.8.1 The Contractor shall preserve and protect the rights of the parties under the Contract with respect to work to be performed under subcontract, and shall:

1 enter into contracts or written agreements with Subcontractors and Suppliers to require them to perform their work as provided in the Contract Documents;

2 incorporate into the terms and conditions of the Contract Documents into all contracts or written agreements with Subcontractors and Suppliers; and

3 be as fully responsible to the Owner for acts and omissions of Subcontractors, Suppliers, and of persons directly or indirectly employed by them as for acts and omissions of persons directly employed by the Contractor.

General Condition 3.2 provides that the owner maintains responsibility for its own forces as well as damages arising from design error. This is consistent with the underlying concept that the owner, consultant and contractor maintain separate and distinct job functions. The prime contractor takes general responsibility for the work-site but the owner and general contractor remain liable for their wrongful acts or neglect. Generally, the owner exposes itself to greater liabilities as it becomes more directly involved in the actual work.\textsuperscript{14}

The expectation that a party is responsible for its own activities and that of its subcontractors is manifest in General Condition 9.

GC 9.1 PROTECTION OF PERSONS AND PROPERTY

The Contractor shall protect the Work and the Owner’s property and property adjacent to

\textsuperscript{13} Spade Const. Ltd. v. Impala Const. (1985), 18 C.L.R. 124 (Nfld. S.C.A.D.). See also Central Reinforcing Steel Service Ltd. v. Pigott Project Management Ltd. (1992), 3 C.L.R. (2d) 124 (Alta. C.A.), where it was held that in order to give the payment clause expressly incorporated into the subcontract its full meaning, it was necessary to also include the general contract’s acceleration clause.

\textsuperscript{14} In D.A. Sharp v. Martin (1994), 22 C.L.R. (2d) 239 (Ont. G.D.), the conduct of the owner including his entering into direct subcontracts substantiated the finding that his express fixed price contract with the general contractor was terminated midstream and replaced by an oral unit price contract.
the Place of the Work from damage which may arise as the result of the Contractor’s operations under the Contract, and shall be responsible for such damage, except damage which occurs as a result of:

.1 errors in the Contract Documents;

.2 acts or omissions by the Owner, the Consultant, other contractors, their agents and employees.

...

GC 9.2 DAMAGES AND MUTUAL RESPONSIBILITY

9.2.1 If either party to the Contract should suffer damage in any manner because of any wrongful act or neglect of the other party or of anyone for whom the other party is responsible in law, then that party shall be reimbursed by the other party for such damage. The reimbursing party shall be subrogated to the rights of the other party in respect of such wrongful act or neglect if it be that of a third party.

In keeping with the contractor’s overall responsibility for the work site, General Condition 11 requires the prime contractor to provide general liability and “all risk” property insurance in the joint names of the general contractor, owner and consultant. The intention is to require a single comprehensive general liability policy covering all parties who may be active at the site in order to avoid the difficulties of a multiplicity of coverages, or worse, a gap in coverage.

Similarly, standard form subcontracts require the subcontractor to provide general liability insurance and include provisions wherein the subcontractor agrees to indemnify and hold harmless the contractor from any claims arising from the negligence of the subcontractor or its sub-subcontractors. The recently issued standard design-build contract works the same way. The design-builder is obligated to provide general liability insurance and is responsible for the negligence of the design-builder, the consultant and all subcontractors.

General Condition 11 operates “without restricting the generality” of General Condition 12.1 wherein the prime contractor undertakes to indemnify the owner and consultant for damages arising from its own negligence or that of its subcontractors. This assures the
parties that any restrictions or limits in the coverage provided by the insurance policies issued pursuant to General Condition 11 do not compromise the general application of the indemnity in General Condition 12.1. It does not result in restricting General Condition 11 so as only to require coverage for vicarious liability arising from the construction activities of the contractor.  

PART 12 INDEMNIFICATION - WAIVER - WARRANTY  

GC 12.1 INDEMNIFICATION  

The Contractor shall indemnify and hold harmless the Owner and the Consultant, their agents and employees from and against claims, demands, losses, costs, damages, actions, suits, or proceedings (hereinafter called “claims”), by third parties that arise out of, or are attributable to, the Contractor’s performance of the Contract provided such claims are:  

.1 attributable to bodily injury, sickness, disease, or death, or to injury to or destruction of tangible property, and  

.2 caused by negligent acts or omissions of the Contractor or anyone for whose acts the Contractor may be liable, and  

.3 made in writing within a period of 6 years from the date of Substantial Performance of the Work …  

In the CCDC-2, the general contractor and owner agree to waive any and all claims they may have against each other including those that might arise from the negligence or breach of contract at the date of final payment with the notable exception of those claims already made in writing or those arising from the indemnification or warranty provisions. The Canadian Construction Association’s Stipulated Price Subcontract (L-1 and S-1) have similar provisions between the general contractor and subcontractor. The same is true of the standard design-build contract as between the owner and design-builder.  

The standard warranty period is one year from the time of substantial completion of the project.  

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15 Design-Build Stipulated Price Contract (Standard Construction Document 14-1997) was developed by the Joint Design-Build Working Group comprised of representatives from the Canadian Construction Association, Construction Specifications Canada and the Royal Architectural Institute of Canada.  

I.B.5 Bonding Considerations

Most tendered projects and many others require that the general contractor, at least, be bonded. The general contractor will often require its significant subcontracts to be bonded. Suretyship or bonding is simply an agreement by the surety to answer for the default or debt of the principal (the contractor) in respect to its contract with the obligee (the owner). The contractor is responsible for carrying out the bonded contract and only in the event of its failure to do so does the surety become involved in a project.

There are three main types of surety bonds used in a construction project: the bid bond, the performance bond and the labour and material payment ("payment") bond. The bid bond serves to protect the owner against the extra costs arising from the failure of the successful tenderer refuses to execute a formal contract and deliver required additional security (usually performance and payment bonds) required by the owner. The face amount of a bid bond is usually substantially less than the face value of the tendered contract, often in the range of 5% to 10%.

A performance bond is the owner’s guarantee that the contract will be performed. If the principal defaults in performing its obligations, the owner, as obligee, is entitled to look to the surety to be indemnified against any loss which the owner has suffered as a result of the principal’s default. It should be noted that the liability of the surety is determined, in the first instance, by the wording of the bond, not by the wording of the construction contract to which the surety is not a party. Accordingly, the bond should be worded so that any default by the contractor under the construction contract triggers the surety’s liability in order to afford effective protection to the owner. The obligation of the surety to a performance bond is generally worded as follows:

Whenever the Principal [contractor] shall be and declared by the Obligee [owner] to be, in default under the Contract, the Obligee having performed the Obligee’s obligation thereunder, the Surety may promptly remedy the default, or shall promptly:

(1) complete the contract in accordance with its terms or conditions, or;
(2) obtain a bid or bids for submission to the Obligee for completing the contract in accordance with its terms and conditions …
The third “option” for the surety is to simply forfeit the penal amount of the performance bond to the obligee. This obligation assumed by the surety is of obvious significance and the steps it takes when notified of the default by the principal must be made in relatively short order and is very consequential to all parties involved in the project.

The payment bond serves to protect the subtrades by reason of the bonded contractor’s default by obliging the surety to make payment for “all labour and material used or reasonably required for use” in the performance of the bonded construction contract. It should be noted that this protection is expressly only extended to those subtrades who have direct contracts with the bonded contractor (the principal named in the bond). The payment bond also substantially alleviates the problem of construction liens being filed upon default by the general contractor.

1.B.6 Regulatory Context

Participants in the construction industry are subject to and benefit from a broad array of regulations. The following are outlines of the most pertinent in this statutory regime.

1.B.6(a) Building Codes

The National Building Code is a model code that forms the basis of all provincial and municipal building codes and has been widely adopted either unchanged or, in some cases, modified to suit regional requirements. The widespread use of the National Building Code since about the late 1960’s has substantially alleviated the difficulties and inefficiencies inherent in the previous myriad of different local standards. The province of Ontario, for example, enacted the Building Code Act\textsuperscript{17} for the purpose of providing “a comprehensive and unified code for all areas in the Province to which it applies without variations arising from local municipal enactments”\textsuperscript{18}. Section 35 of Ontario’s current Building Code Act\textsuperscript{19} provides that the Act and the regulations made thereunder governing standards for the

\textsuperscript{17} S.O. 1974, c. 74.

\textsuperscript{18} Re Minto Construction Ltd. and Township of Gloucester (1979), 23 O.R. (2d) (H.C.) at 367.

construction and demolition of buildings supersede all municipal by-laws respecting the construction or demolition of buildings.

The general scheme is that an applicant, usually the owner's consultant, is entitled to a building permit from the chief building official if the proposed construction is compliant with the applicable building code and municipal zoning by-laws. Once the building permit is issued, the building must be constructed in accordance with the plans, specifications, documents and any other information on the basis of which the permit was issued. Municipal building legislation authorizes inspectors to inspect the construction of a building and issue whatever orders are necessary to direct compliance with the applicable code.

It is noteworthy that building inspection is one activity that may attract liability to a party who is not responsible in any way for a building defect and who is not a part of the construction pyramid. Indeed, we shall see in later chapters that in several seminal Anglo-Canadian tort cases, government inspectors have been held liable to building owners for negligently failing to detect a construction defect.²⁰

A breach of the applicable building code does not, of itself, lead to a finding of negligence. In the Saskatchewan Wheat Pool case²¹, the Supreme Court of Canada held that the civil consequences of a breach of statute should be subsumed in the law of negligence. Proof of a breach of statute is merely evidence of negligence. The courts have readily accepted that building code provisions provide a standard against which the impugned construction may be measured.²²

²⁰See e.g. Anns, infra note 241, Kamloops, infra note 132, and Just v. British Columbia (1989), 64 D.L.R. (4th) 689 (S.C.C.). See also Petrie v. Groome (1991), 45 C.L.R. 132 (B.C.S.C.), wherein the municipality and house designer were held jointly and severally liable for the cost of repairing a foundation that was not built to the National Building Code standard.


²²Per Ferrier J. in Carroll v. Metropolitan Toronto Condominium Corp. (31 March 1992), Toronto 270015/86U (Ont. H.C. (G.D.)).
A breach of a statutory provision designed for the safety and protection of members of the public and which is an effective cause of an accident imposes at least a prima facie liability on the person in breach.

It is common for construction contracts to include a general specification that work be done in accordance with building code standards. Further, we shall see in the next chapter that the courts will imply that materials must be supplied and work must be done in compliance with the applicable building code unless there is some contractual term that negates such an obligation.\(^{23}\)

Finally, it should be noted that it is recognized that the building codes prescribe minimal standards and that parties are free to contract for higher or stricter standards.\(^{24}\)

**I.B.6(b) Occupational Health and Safety Legislation**

The various provincial Health and Safety Acts regulate project workplaces for the purpose of minimizing health and safety risks. The underlying concept is to hold responsible those parties who are in the best position to identify and take steps to minimize health and safety risks. Accordingly, the Health and Safety Acts impose duties on different parties including, owners, employers, constructors, supervisors, workers and suppliers.

Ontario’s Act\(^{25}\) is typical in that the legislators’ seek to designate one party to have overall responsibility for compliance with health and safety laws and procedures during the course of the project. The role of “constructor” under Ontario’s Act is particularly important.\(^{26}\)

Constructor means a person who undertakes a project for an owner and includes an owner who undertakes all or part of a project by himself or by more than one employer.

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\(^{24}\) *Minto, supra* note 18 at 635. But see *F.P. Construction Ltd. v. B.U.K. Investments Ltd.* (1993), 8 C.L.R. (2d) 35, wherein the British Columbia Court of Appeal interpreted and enforced a contract that expressly disclaimed the contractor’s responsibility for complying with municipal fire rating requirements.


\(^{26}\) *Ibid.*, s. 1(1).
The responsibility associated with being found a constructor on a project is extensive: 27

(1) A constructor shall ensure, on a project undertaken by the constructor that,

(a) the measures and procedures prescribed by this Act and the regulations are carried out on the project;

(b) every employer and every worker performing work on the project complies with this Act and the regulations; and

(c) the health and safety of workers on the project is protected.

The provincial counterparts to Ontario's Act are similar in concept and practice. For example, Alberta's Act imposes on the "prime contractor" the responsibility to "ensure, as far as it is reasonably practicable to do so, that [Alberta's Occupational Health and Safety Act] and the regulations are complied with in respect of the work site". 28

This means that an owner who adopts a project structure such as the construction management arrangement described earlier may find itself responsible for extensive health and safety measures and procedures. The operation of the Health and Safety Acts is such that an owner who actively engages in construction may expose itself to primary or shared statutory liability notwithstanding the execution of a stipulated price contract designating a general contractor for the project. This is recognized in General Condition 3.2 of CCDC-2 which provides that where the owner uses its own forces or other contractors to perform certain work, the owner shall "assume overall responsibility for compliance with the applicable health and construction safety legislation at the Place of the Work".

I.B.6(c) Construction Lien Legislation

"Mechanics’, "builders’” or “construction” lien acts are intended to provide financial protection to those parties who have contributed to the improvement of real property. A construction lien is a remedy in the nature of a charge or encumbrance against the improved real property to secure payment for the supply of labour, materials or services.

27 Ibid., s. 23.
Lien-holders are also given the right to lien funds owed to the party with whom they have contracted immediately above them in the construction pyramid. The most significant aspect of the lien remedy is that it is available to all those persons who supply services or materials to a particular construction project despite the fact that there may be no privity of contract with the owner. For this reason, construction liens are recognized as purely statutory rights without a basis in common law or equity.

I.B.6(d) Occupier’s Liability Legislation

Provincial occupiers’ liability legislation relatively uniformly impose a duty of care for the safety of those making use of their buildings. Ontario’s Occupiers’ Liability Act is typical.

An occupier of premises owes a duty to take such care as in all the circumstances of the case is reasonable to see that persons entering on the premises, and the property brought on the premises by those persons are reasonably safe while on the premises.

There may be more than one occupier of a premises including the person in “physical possession” as well as the person “who has responsibility for control over the condition of the premises or the activities there carried on”.

It is noteworthy that, in appropriate circumstances, an occupier may be absolved for the negligence of its independent contractor:

(1) An occupier is not liable under this Act when the damage is due to the negligence of an independent contractor engaged by the occupier if

(a) the occupier exercised reasonable care in the selection and supervision of the contractor, and

29 Although the different provincial Acts share the same purpose and overall scheme, they operate in relatively distinct and complex ways. The Alberta, Prince Edward Island and New Brunswick Acts are distinguishable in this particular regard as the holdback provision is only imposed on the owner.
31 Ibid., s. 3(1), .
32 Ibid., s. 1 of the Alberta Act.
33 Ibid., s. 11 of the Alberta Act. See section 6 of the Ontario Act.
(b) it was reasonable in all the circumstances that the work that the independent contractor was engaged to do should have been undertaken.

(2) Subsection (1) does not operate to abrogate or restrict the liability of an occupier for the negligence of his independent contractor imposed by any other Act.

**I.B.6(e) Sale of Goods Legislation**

Provincial *Sale of Goods Acts*[^34] regulate the sale of goods by implying warranties of quality and fitness for purpose of goods defined by the Ontario Act as "chattels personal, other than things in action and money, and includes ... things attached to or forming part of the land that are agreed to be severed before sale or under the contract of sale". The sale contract in question must be for the purpose of selling goods. If the sale of goods is merely incidental to what is primarily a contract for services, then the legislation will not imply a warranty.[^35]

The basic two-fold warranty imposed by this legislation is set out in section 15 of Ontario's Act:[^36]

1. Where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required so as to show that the buyer relies on the seller's skill or judgment, and the goods are of a description that it is in the course of the seller's business to supply (whether the seller is the manufacturer or not), there is an implied condition that the goods will be reasonably fit for such purpose, but in the case of a contract for the sale of a specified article under its patent or other trade name there is no implied condition as to its fitness for any particular purpose.

2. Where goods are bought by description from a seller who deals in goods of that description (whether the seller is the manufacturer or not), there is an implied condition that the goods will be of merchantable quality, but if the buyer has examined the goods, there is no implied condition as regards defects that such examination ought to have revealed.


[^36]: S. 15(1) of Ontario’s Act, *supra* note 34.
Section 51 of Ontario’s Act provides that where there is a breach of warranty by the seller, the buyer may reject the goods and claim the diminution or extinction of the price or may maintain an action against the seller for damages for the buyer’s loss.\(^{37}\)

(2) The measure of damages for breach of warranty is the estimated loss directly and naturally resulting in the ordinary course or events from the breach of warranty.

In *Products Liability*\(^{38}\), Professor Stephen M. Waddams explains that this remedy provision applies to breach of warranty the general contract rule of “expectation damages”, namely that the party complaining is entitled to be put into as good a position as would have enjoyed had the contract been fulfilled. He goes on to note that it is significant that provisions such as s. 51(2) of Ontario’s Act, set out above, have been interpreted and applied to extend the seller’s liability to all consequential damage caused by defective goods including personal injury, property damage and economic loss.\(^{39}\) Consequential economic losses caused by defective products, including loss of profits and wasted expenses, have been regularly allowed as damages for breach of the implied warranties and conditions in the *Sale of Goods Act*.\(^{40}\)

The *Sale of Goods Acts* contemplate that parties may contract out of the statutory provisions by way of the awkward provision that an “express warranty or condition does not negative a warranty or condition implied by this Act unless inconsistent therewith”\(^{41}\). In the *Hunter v. Syncrude* case\(^{42}\), the Supreme Court of Canada ruled that the mere presence of an express contractual warranty is not enough to displace a statutory warranty. This can only be done through “clear and direct language”\(^{43}\). Section 53 of the Ontario Act speaks more clearly on the issue of excluding implied warranties:

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\(^{37}\) *Ibid.*, ss. 51(1) and 51(2).


\(^{39}\) *Ibid.* at 89.

\(^{40}\) Professors Waddams’ observation is not overstated. In *Houweling Nurseries Ltd. v. Fisons Western Corporation* (1988), 37 B.C.L.R. (2d) 2 (C.A.), leave to appeal to S.C.C. dismissed (1988), 37 B.C.L.R. (2d) 2 (note), the defendant supplied defective potting soil mix to the plaintiff nursery and was held liable for $400,000 in damages for loss of profits.

\(^{41}\) *Supra* note 34, s. 15(4) of the Ontario Act.


\(^{43}\) *Ibid.* at 332-333.
Where any right, duty or liability would arise under a contract of sale by implication of law, it may be negatived or varied by express agreement or by the course of dealing between the parties, or by usage, if the usage is such as to bind both parties to the contract.

I.B.6(f) **New Home Warranty Legislation**

Only British Columbia and Ontario have enacted legislation to provide basic protection to purchasers of new homes. The purpose of Ontario’s Act is “to provide major protection for purchasers against the added cost and inconvenience caused by poor workmanship in home construction”. Under the Ontario regime, builders and vendors are screened by the requirement that they register with the body administering the New Home Warranty Plan. The basic warranties of quality apply for one year from the date of possession and are as follows:

1. Every vendor of a home warrants to the owner,
   a. that the home,
      i. is constructed in a workmanlike manner and is free from defects in material,
      ii. is fit for habitation, and
      iii. is constructed in accordance with the Ontario Building Code;
   b. that the home is free of major structural defects as defined by the regulations; and
   c. such other warranties as are prescribed by the regulations.

Section 13(2) of Ontario’s Act sets out several exceptions to warranty coverage including “normal wear and tear”.

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44 Homeowner Protection Act, S.B.C. 1998, c. 31 and New Home Warranties Plan Act, R.S.O. 1990, c. 31, respectively. Other provincial housing acts do not impose warranties on home builders but have as their principal purpose to “improve and increase the housing stock of the Province”, s. 3 of the Housing Act, R.S.N.S. 1989, c. 211. See also the Housing and Renewal Corporation Act, R.S.M. 1987, c. H 160, the New Brunswick Housing Act, R.S.N.B. 1973, c. N-6, the Housing Corporation Act, R.S.N.. 1990, c. H-13 and the Housing and Special-care Homes Act, R.S.S. 1978, c. H-13.


46 S. 6. In Bognar v. Borg (1989), 40 C.L.R. 286, the Ontario District Court ruled that the builder’s failure to register rendered the building contract in issue illegal and unenforceable. As a result, the builder was ordered to return the progress payments made by the purchasers. But see Townsgate, ibid. at 676-679, wherein the Ontario Court of Appeal overturned the trial judge’s declaration of sale contracts as void for illegality in circumstances where the vendor had complied with all of the onerous requirements of registration and was registered shortly after the contracts were entered into. Brooke J.A. ruled that it was the intention of the parties to make a legal contract and to carry it out. Public policy favours that contracts should not be rendered unenforceable because of technical deficiencies.

47 A claim for major structural defect must be made within four years after the basic warranty expires: s.14(1)(c) of the Ontario Act, supra note 44.
British Columbia’s new *Home Owners Protection Act*\textsuperscript{48} prohibits any person from building or selling a new home unless it is covered by home warranty insurance.\textsuperscript{49} The insurance policy must cover:\textsuperscript{50}

(a) defects in materials and labour for a period of at least 2 years after the date in which the warranty begins,

(b) defects in the building envelope, including defects resulting in water penetration, for a period of at least 5 years after the date on which the warranty begins, and

(c) structural defects for a period of at least 10 years after the date on which the warranty begins.

The insurance requirement does not apply to the owner builder.\textsuperscript{51} However, any builder or vendor is bound by the following statutory warranty provisions:\textsuperscript{52}

(1) A residential builder and a vendor of a new home are both deemed to have agreed with the owner, to the extent of labour, materials and design supplied, used or arranged by the residential builder or vendor, that the new home

(a) is reasonably fit for habitation;

(b) had been constructed from materials that are of good quality and reasonably fit for the purpose, and

(c) has been designed and constructed with ordinary competence, skill and care.

(2) Any term of an agreement that purports to waive, exclude, limit or qualify the protection under subsection (1) is of no effect.

We shall see in the following chapter that these statutory warranties are very similar to the warranties implied by the common law into contracts for residential construction. The most important exclusion is for consequential damage described in the Ontario Act as “secondary damage, caused by defects, such as property damage and personal injury”.\textsuperscript{53}

I.C **SUMMARY**

A building is usually constructed by a number of relatively sophisticated parties including owners, engineering and architectural consultants and contractors. Perhaps the only common exception to this proposition are some owners of residential homes at the top of the construction pyramid and some trades at the bottom of the pyramid.

\textsuperscript{48} It took force May 1, 1999.

\textsuperscript{49} S. 22(1) of the B.C. *Act*, *supra* note 44.

\textsuperscript{50} Ibid., s. 22(2).

\textsuperscript{51} Ibid., s. 22(3).

\textsuperscript{52} Ibid., s. 23.

\textsuperscript{53} *Supra* note 44, s. 13(2)(b)
These parties carry on business in a regulated area and under a contractual framework wherein work responsibilities and liability are frequently expressly defined. The risk for certain outcomes including a contractor's default, construction deficiencies, worksite injury and warranty are consciously and carefully allocated by regulation and private volition.

We have, then, a highly regulated transaction based setting involving relatively sophisticated parties. This special nature of the construction industry is further characterized by the fact that it operates at a relatively pure market level in that most large contracts are tendered for bidding. This is, therefore, a context wherein we would expect that the primacy of private ordering should be recognized. It follows that the courts should pay keen attention to the existence and substance of contractual relationships between participants in a construction project with a view to imposing liability or upholding rights consistently with the reasonable expectations of the parties before them.

In the chapters that follow, we shall evaluate how the courts actually treat contract and tort claims arising from construction disputes.
CHAPTER II

THE ACTION IN TORT AND CONTRACT

"The question of justice, which is urged by the proponents of both views on the issue of concurrent liability, is not free from ambiguity or ambivalence. What may appear just to one party may appear unjust to the other."54

II.A INTRODUCTION

The construction site is a breeding ground for disputes between property owners and the contractors paid to improve the lands at issue. Breaches of contact by the contractor relate almost exclusively to the performance of the work since that is the contractors’ principal obligation. A party suffering damages as a result of building deficiencies may sue for breach of express or implied contractual warranty or in negligence.

An aggrieved contractor may sue in contract or prosecute a lien claim for labour or materials provided but not paid for. In the absence of an express contract or where the contract ambiguous as to consideration, the plaintiff contractor may also pursue a claim in *quantum meruit* for the value which has been added to the property.55 If the contract has been wrongly terminated as a result of the owner’s conduct, the contractor may elect to recover damages for breach of contract or on a restitutionary or *quantum meruit* basis for the value of the work performed prior to repudiation.56 In *Mawson Gage Associated Ltd. v. Canada*57, the Federal Court held that the plaintiff subcontractor’s claim could succeed on any of the causes of action in negligent misrepresentation, breach of contract, breach of collateral warranty or unjust enrichment against the defendant owner for negligently omitting significant pages from the plaintiff’s tender package.

55 The cause of action is sometimes called “contractual quantum meruit”. See, for example, *Vanir Const. Ltd. v. Field Aviation Co.* (1992), 48 C.L.R. 99 (Alta. C.A.) at 101.
57 (1987), 13 F.T.R. 188.
If the contractor has improved the property of a third party, a claim for unjust enrichment may succeed. If, however, the contractor and owner share contractual privity, it is unlikely that the contractor will be in a position to sue for quantum meruit or unjust enrichment as the contract will be held to govern their relationship. The terms of the construction contract may provide the juristic reason foreclosing the claim against the owner defendant in unjust enrichment.

II.B LIABILITY IN CONTRACT

In Chapter 1, we canvassed the web of contracts and relationships that make up the traditional construction pyramid. The most common action arising from a construction dispute is the claim for breach of contract.

II.B.1 Interpreting the Construction Contract

Generally speaking, construction contracts should be interpreted in accordance with the same principles as other contracts. In Scanlon v. Castlepoint Dev. Corp., Robins J.A. outlined the rules of interpretation applicable to a commercial contract.

The agreement with which we are concerned is a negotiated commercial document which should be construed in accordance with sound commercial principles and good business sense. To the extent that it is possible to do so, it should be construed as a whole and effect should be given to all of its provisions. The provisions should be read, not as standing alone, but in light of the agreement as a whole and the other provisions thereof ...


60 In Piotrowski Consultants Ltd. v. Osburn Cotman Belair Architects Inc. (1995), 23 C.L.R. (2d) 211 (Ont. G.D.), Sharpe J. ruled that the entire contractual setting of the project in issue including the contract between the plaintiff contractor and the defendant owner's architectural consultant provided a juristic reason for refusing restitutionary relief. See also Farmer Construction Ltd. v. Surrey (District), (1997), 34 C.L.R. (2d) 35 (B.C.S.C.) at 43.

61 Lester v. MacMaster (1925), 28 O.W.N. 307 (C.A.), is correctly cited as authority for this rule but should be relied on carefully given the fact that it is a brief and relatively undeveloped judgment on a narrow contractual issue and in light of the 75 years of jurisprudence that has fleshed out the interpretation of construction contracts since the judgment was handed down.


63 Ibid. at 770-771.
The court should strive to give meaning to the agreement and "reject an interpretation that would render one of its terms ineffective" ...

The court is "to search for an interpretation which, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time of entry into the contract ... In searching for the intention of the parties, the court should give particular consideration "to the terms used by the parties, the context in which they are used and ... the purpose sought by the parties in using these terms" ...

In the event that the court is unable to resolve a contradiction or ambiguity in the terms of a contract, the language of the contract will be construed against its author in accordance with the contra proferentem rule: ...

It is also an accepted principle of contract interpretation that the commercial setting in which a contract is made can be of assistance to the court in interpreting the contract's terms regardless of whether there is an apparent ambiguity. The courts do give particular consideration to the language commonly used by the parties to a construction contract. Case law including the watershed judgment of the Supreme Court of Canada in the Ron Engineering case recognize that the tender process, in particular, modifies what would be considered accepted rules governing offer and acceptance. In so doing, Estey J., for the Court, stressed the importance of respecting and protecting the integrity of the construction industry's bidding system "where under the law of contracts it is possible to do so".

The courts will accept evidence as to the custom of the trade relating to the interpretation of express and implied terms of a construction contract. The party urging a court to consider the general practice must prove that such practice was agreed and customary.

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66 Ibid. at 273.
67 Cardinal Const. Ltd. v. Brockville (1984) 4 C.L.R. (Ont. H.C.) at 186. But see Kencor Holdings Ltd. v. Saskatchewan, [1991] 6 W.W.R. 717 at 720-721, wherein Saskatchewan's Court of Queen's Bench doubted the admissibility of expert evidence that apparently crossed the line from information as to custom and usage to interpretation of the privilege clause at issue. See also Arrow Const. V. N.S. (A.G.) (1996), 27 C.L.R. (2d) 1 (N.S.C.A.) at 14, leave to appeal dismissed, where the Court of Appeal held that a lay witness could not give a legal opinion with respect to the interpretation of contract documents.
68 Farmer Construction, supra note 60 at 39-40.
The use of such evidence is particularly prevalent in the difficult cases determining the existence and terms of a contract created upon submission of a tender or bid.69

The special treatment of the construction case is consistent with the general principle of contract interpretation requiring the court's appreciation of the factual backdrop to the contract in question:70

The contents of the contract are not necessarily confined to those that appear on its face. The parties may have negotiated against a background of commercial or local usage whose implications they have tacitly assumed and to concentrate solely upon their express language may be to minimize or distort the extent of their liabilities.

All this said, the Alberta Court of Appeal in *C.N.R. v. Volker Stevin Contracting Ltd.*71 confirmed that the courts will give effect to the plain meaning of language used in a construction contract:72

It is curious that some of the scientific and engineering witnesses gave opinions on the nature and types of construction contracts, and on how to interpret certain clauses in this contract. The trial judgment quotes some of that evidence, and seems to rely upon it. But these are legal matters which must be submitted to the court as argument. It is not a subject for evidence, or weighing of the qualifications of the person who submits it. The contract here contains very little jargon or technical matters, and is composed almost entirely of ordinary English. It is for the court to interpret that; even a professor of English should not testify on that point: ... Therefore, still less can a scientist or engineer testify about the meaning of ordinary English.

The following *dicta* of White J. demonstrates that the courts have also ruled that custom and usage cannot override the obligations of an actual contract which is contrary to the custom and usage:73

Any “custom of the trade”, as hitherto defined is extirpated in its efficacy in the contractual relations of the parties by the explicit words ... to which I have referred, which form a legal context in which the plaintiff's tender was submitted. As a matter of law, that

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69 This includes the implied term obligating the owner to treat all bidders fairly and equally: *Best Cleaners & Contractors Ltd. v. Canada*, [1985] 2 F.C. 293 (C.A.) and *Northeast Marine Services v. Atlantic Pilotage Authorities*, [1995] 2 F.C. 132 (C.A.). See also *Chinook Aggregates Ltd. v. Abbotsford* (1989), 35 C.L.R. 241 (B.C.C.A.) wherein the privilege clause did not give the defendant town the right to exercise a local preference not expressed in the tender documents.


72 *Per curiam, ibid.* at 137.

context precludes the operability of such "custom." To deny this would be to destroy the doctrine that contractual relations between parties are based on their objective manifestations of intent to exchange binding promises.

These passages demonstrate the classic tension between heeding the primacy of contractual intentions as opposed to the judicial inclination to interpret language or implying terms necessary to give business efficacy to a contract. Of course, the courts' contextual interpretation is often used as a device to impose optimal contractual terms on the basis of perceived fairness. White J. might put a greater emphasis on protecting the objectively determined will of the parties than does Professor Waddams who gives the following simple description of the "objective theory of contract formation": 74

The principal purpose of the law of contracts is to protect the reasonable expectations engendered by promises.

Implicit in this debate is the courts' broader effort to control what is perceived to be an unfair contractual provision. One obvious illustration of this phenomenon is the tremendous body of litigation surrounding the meaning and application of the privilege clause used in tenders. One would forgive the lay-person's bewilderment at the legal controversy surrounding the words "lowest or any tender not necessarily accepted".

Professor Waddams' observation illuminates this issue. The court will often import implied terms or make use of the contra proferentum rule in interpreting a construction contract when the aggrieved party is unfamiliar with the industry and its terms of art and the party's understanding of the contract is consistent with that of a reasonable lay person in the circumstances. On the other hand, Volker Stevin is a good example of the courts' deference to the plain meaning of contractual language in a dispute between a sophisticated owner and general contractor. In the notorious case of the privilege clause, the courts' have accepted that established construction industry practice has given rise to reasonable expectations by parties as to the meaning and application of what otherwise might appear to be a rather plain contractual provision.

II.B.2 **Express Contractual Warranties**

The practical advantage of claiming on the basis of an alleged breach of warranty is that the plaintiff can succeed without proving negligence. At a basic level, if a builder has warranted his work or has agreed to build in accordance with certain plans and specifications, then a failure to live up to the standards promised will constitute a breach of contract.

Standard form construction contracts provide for a one year warranty wherein the contractor is liable to correct "defects or deficiencies in the Work which appear prior to and during the warranty periods". There is a difficult body of case law addressing the issue of defects only becoming apparent beyond the warranty period. Of course, much will turn on the actual warranty at issue. It is clearly enough for the plaintiff property owner to discover only the symptoms and not the defects themselves within the warranty period.75

As noted in the first chapter, the plans and specifications are generally expressly incorporated into the construction contract and the builder must comply with them. It has been held that a contractor's failure to follow the specifications amount to a fundamental breach of contract justifying immediate termination of the contract notwithstanding the notice required by the termination provision.76

II.B.3 **Implied Contractual Warranties**

The general principles for finding an implied contractual term were outlined by Le Dain J. in the *C.P. Hotels case*77. Terms may be implied in a contract:

(1) on custom or usage;

(2) as the legal incidents of a particular class or kind of contract; or

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(3) based on the presumed intention of the parties where the implied term must be necessary to give business efficacy to a contract or as otherwise meeting the "officious bystander test" as a term which the parties would say, if questioned, that they had obviously assumed.

The following passage by Cory J.A., for the Ontario Court of Appeal in *G. Ford Homes Ltd. v. Draft Masonry (York) Co.*[78] is frequently cited in cases where parties seek to imply terms into a construction contract:[79]

When may a term be implied in a contract? A court faced with that question must first take cognizance of some important and time-honoured cautions. For example, the courts will be cautious in their approach to implying terms to contracts. Certainly, a court will not rewrite a contract for the parties. As well, no term will be implied that is inconsistent with the contract. Implied terms are as a rule based upon the presumed intention of the parties and should be founded upon reason. The circumstances and background of the contract, together with its precise terms, should all be carefully regarded before a term is implied. As a result, it is clear that every case must be determined on its own particular facts.

In *Canadian Pacific Limited v. Ontario Hydro*[80], Reid J. of the Ontario Divisional Court approved and applied this cautious approach:[81]

There is thus no warrant, as I understand the law, for implying terms into any contract on the basis of principle or in the interests of logic, fairness or justice. We are limited to implying terms that reflect a common intention where that is necessary in the interests of business efficacy.

*Volker Stevin* serves as a reminder of the important limitation that no term will be implied that is inconsistent with or contrary to express terms of the contract.[82]

**II.B.3(a) Warranties Implied in the Construction Contract**

The following is a summary of the terms to be implied into a construction contract:[83]

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[78] Supra note 23.
[79] Ibid. at 264-265.
[81] Ibid. at 238.
[82] Supra note 71. See also Cartwright, supra note 73 at 697 wherein Rinfret J. rules that "there can be no recognized custom in opposition to an actual contract, and the special agreement of the parties must prevail".
... a contractor undertaking to do work and supply materials impliedly undertakes:

(a) to do the work undertaken with care and skill or, as sometimes expressed, in a workmanlike manner;

(b) to use materials of good quality. In the case of materials described expressly this will mean good of their expressed kind. (In the case of goods not described, or not described in sufficient detail, it is submitted that there will be reliance on the contractor to that extent, and the warranty in (c) below will apply);

(c) that both the work and materials will be reasonably fit for the purpose for which they are required, unless the circumstances of the contract are such as to exclude any such obligation (this obligation is additional to that in (a) and (b), and only becomes relevant, for practical purposes, if the contractor has fulfilled his obligations under (a) and (b)).

This last term is accepted to mean reasonably fit for human habitation upon the completion of a residential building.\(^{84}\)

These “standard” implied terms are supplemented by the courts’ ready finding that construction contracts import the building plans and specifications as well as workmanship of a standard equal to good building practice such as that mandated by the National Building Code.\(^{85}\) In *G. Ford Homes*\(^ {86}\), the Ontario Court of Appeal relied on the reasoning in the English cases of *Young and Marten*\(^ {87}\) and *Independent Broadcasting*\(^ {88}\) to imply the contractual warranty that the staircase supplied and installed would be in compliance with Ontario’s Building Code. The Court did so on the grounds of business efficacy.\(^ {89}\)

It is no contract to have stairs installed that must, by requirements of the law, be taken out for failure to comply with the code. To sanction the installation of such a staircase in contravention of the code would be tantamount to sanctioning an illegal contract.

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\(^{84}\) See e.g. *Trimble Hill Properties Ltd. v. Zaharko* (1996), 27 C.L.R. (2d) 139 (B.C.C.A).


\(^{86}\) *Supra* note 23.

\(^{87}\) *Infra* note 90.

\(^{88}\) *Infra* note 98.

\(^{89}\) *Supra* note 23 at 268.
All of this is not tantamount to the imposition of a warranty of durability on a builder. Subsequent manifestations of defects should be taken as evidence of the quality and fitness of work and materials at the time of closing.

II.B.3(a)(i) Suitability of the Work and Materials

There is little to add to the proposition that a contractor is obliged to work in a skilled manner. The matter of liability for materials purchased from some third party and properly installed but defective or unsuitable for the job, however, is more contentious. The same sort of issues arise in cases where a contractor does its work in accordance with a flawed design.

II.B.3(a)(ii) English Authorities on Fitness for the Job

The implied warranty that materials supplied will be of good quality and reasonably fit for their purpose was tested in *Young and Marten v. McManus Childs*\(^9\) wherein a roofing subcontractor purchased and installed tiles specified by the general contractor. The tiles proved to be defective and the developer was sued by a number of home-owners. The developer claimed over against the roofing subcontractor and it was accepted that a contract existed between the developer and subcontractor by way of the agency of the general contractor. The subcontractor argued that it was not liable for any implied warranty of the fitness or quality of the tiles since they were chosen by the developer’s representative.

In a series of concurring judgments, the House of Lords agreed that in the circumstances there was no warranty of reasonable fitness for the job but maintained that a warranty of quality endured. The Law Lords shared the view that the subcontractor would have been liable for simply supplying defective tiles under England’s *Sale of Goods Act* and should not escape liability by virtue of having both supplied and installed the tiles. Lord Reid expressed the merits of sustaining the normal chain of liability as follows:\(^9\)

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There are in my view good reasons for implying such a warranty, if it is not excluded by the terms of the contract. If the contractor's employer suffers loss by reason of the emergence of the latent defect, he will generally have no redress if he cannot recover damages from the contractor. If, however, he can recover damages the contractor will generally not have to bear the loss: he will have bought the defective material from a seller who will be liable under ... the Sale of Goods Act ... because the material was not of merchantable quality; and if that seller had in turn bought from someone else there will again be liability, so that there will be a chain of liability from the employer who suffers damage to the author of the defect. Of course the chain may be broken because the contractor (or an earlier buyer) may have agreed to enter into a contract under which his supplier excluded or limited his ordinary liability under the Sale of Goods Act ... but in general that has nothing to do with the employer and should not deprive him of his remedy. If the contractor chooses to buy on such terms, he takes the risk of having to bear the loss himself if the goods prove to be defective.

Lord Upjohn agreed with this approach.92

Under our principles of jurisprudence, apart from a so far scarcely charted sea of the law of torts in this area, the practical business effect and just solution to this type of breach of contract is that each vendor or contractor of labour and materials should warrant his supply of materials against patent and latent defects so that by the well-known chain of third party procedures the ultimate culprit, the manufacturer, may be liable for his defective manufacture.

Lord Upjohn's reasoning is consistent with that of Lord Denning in his judgment for England's Court of Appeal in the Hancock case93 wherein the defendant builder purchased and installed defective hardcore in accordance with the specifications. The builder's own lack of negligence did not absolve it of liability to the developer.94

I know the builders were not at fault themselves. Nevertheless this is a contract: it was their responsibility to see that good and proper hardcore was put in. As it was not put in, they are in breach of their contract. If it is any consolation to them, they can try and get hold of their suppliers and sue them if they can prove it against them; but they have to take responsibility so far as the purchasers are concerned.

Returning to Young and Marten, Lord Reid agreed that the availability of third party indemnification is a risk better left with the party in privity with the product supplier, the tile manufacturer.95

No doubt there will be some cases where, although the contractor had a right of recourse against the manufacturer, he cannot in fact operate that right. The supplier may have become insolvent, or, as in the present case, the action against the contractor may be so

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92 Ibid. at 1177.
94 Ibid. at 904.
95 Supra note 90 at 1172-1173.
delayed that he has no time left in which to sue his supplier. But these cases must be relatively few, and it would seem better that the contractor should occasionally have to suffer than that the employer should very seldom have any remedy at all. It therefore seems to me that general principles point strongly to there being an implied warranty of quality in this case.

Of particular interest is the House of Lords apparent agreement that the existence of the implied warranty of quality between the developer and roofing subcontractor could turn on the developer's knowledge of the contract between the tile manufacturer and the roofing subcontractor. Lord Reid reasoned as follows on this point:

It would make a difference if that [tile] manufacturer was only willing to sell on terms which excluded or limited his ordinary liability under the Sale of Goods Act ... and that fact was known to the employer of the contractor when they made their contract. For it would be unreasonable to put on the contractor a liability for latent defects when the employer had chosen the supplier with knowledge that the contractor could not have recourse against him.

The House of Lords should not compromise Lord Denning's persuasive reasoning. In Hancock and Young and Marten, the subcontractor contracted to supply and install good hardcore and tiles, respectively. The roofing subcontractor in Young and Marten may for good business reasons willingly accept this (additional) risk. The parties are free to stipulate that the contractor's warranty shall be the same as the manufacturer's or otherwise. This issue is alleviated by the express inclusion in most standard form construction contracts of the requirement that the contractor obtain any product warranties in favour of the owner.

Of further interest is the acceptance by the House of Lords of the proposition that the developer in Young and Marten had no direct cause of action against the manufacturer in tort in respect of goods which create no peril or accident but simply result in substandard work under a contract unknown to the manufacturer. We shall see in the following chapter that, in Junior Books v. Veitchi Co. 97, the majority of the House of Lords would momentarily have a change of view of the merits of this sort of claim.

96 Ibid. at 1172.
97 [1982] 3 All E.R. 201 (H.L. (Sc.)), discussed in Part III.D.
In Independent Broadcasting Authority, the House of Lords followed Young and Marten and added that in the absence of any contractual term to the contrary, one who contracts to design an article for a specified purpose undertakes that the design is reasonably fit for that purpose. The House of Lords held that such a design obligation was consistent with the statutory law regulating the sale of goods.

III.B.3.(a)(iii) Canadian Authorities on Fitness for the Job

In Brunswick Construction Ltd v. Nowlan, the majority of the Supreme Court of Canada found the experienced general contractor liable for defects arising from the construction of a home in accordance with defective architectural plans. The architect was neither sued nor, apparently, subjected to a claim over by the contractor. It should be noted that the trial judge found that there was some evidence of bad workmanship but that the architect was responsible for the majority of the extensive rotting in the home. In so doing the following passage from Hudson's Building and Engineering Contracts was adopted and applied by Ritchie J. for the majority of the Court:

So a contractor will sometimes expressly undertake to carry out work which will perform a certain duty or function, in conformity with plans and specifications, and it turns out that the works constructed in accordance with the plans and specifications will not perform that duty or function. It would appear that generally the express obligation overrides the obligation to comply with the plans and specifications, and the contractor will be liable for the failure of the work notwithstanding that it is carried out in accordance with the plans and specifications. Nor will he be entitled to extra payment for amending the work so that it will perform the stipulated duty.

Dickson J. disagreed that the contractor should be liable for the whole of the damage for the reason that its contractual obligations were contained within the “four corners” of the building contract and were distinct from that of the architect:

... each contractor is liable for damage caused by him in breach of his contract, but not for damage caused by someone else under a separate contract respecting the same work. In my opinion in the case at bar the building contractor was not a concurrent wrongdoer ...

Dickson J. preferred and applied the following proposition from Hudson's Building and Engineering Contracts:

98 Independent Broadcasting Authority v. EMI Electronics Ltd. et al. (1980), 14 B.L.R. 1.
100 Hudson’s, supra note 83 at 291-292, cited ibid. at 98.
Where the employer does not employ an architect or other adviser so that he is relying on
the skill and judgment of the contractor, and the latter provides the design or specification,
there is an implied term not only that the work will be carried out in a proper and
workmanlike manner and with proper materials, but also that the work, when completed,
will be fit for its purposes (for instance, in the case of a dwelling-house, fit for human
habitation).

But no such term for fitness will be implied if what the contractor undertakes is to build a
house in accordance with the employer's plans and specification, a fortiori if also to the
satisfaction of the employer's architect or engineer.

The reasoning of Dickson J. is consistent with the construction industry's understanding
and expectation that the owner, architect and contractor maintain separate and distinct job
functions. The contractor is hired by the owner to build according to plans and
specifications prepared by the architect. In these circumstances, only where very clear and
strong language is used in the contract will it be said that the contractor has agreed to take
responsibility for the design integrity of a building. This is so even where the contractor
has some role or involvement in the design process or is part of the design team.103

If accepted at face value, the ruling of the majority in Brunswick would force the prudent
contractor to retain its own architect to review the design prepared on behalf of the owner
or to confirm the advisability of the owner's directions at the work-site. In fairness, the
facts in Brunswick are special in that the architect never actually supervised the
contractor's work and it was found that the design defect in issue (the failure to provide
ventilation) was a glaring error that should have been discovered by the contractor.

The prudent contractor who does not wish to be liable for more than his own work, or
take upon himself the responsibility for the work of others over whom he has no control,
should include appropriate exclusionary language in its contract.

101 Ibid. at 102.
102 Hudson's, supra note 83 at 51, cited ibid. at 103.
C.L.R. 182 (Sask. C.A.).
Neither *Young and Marten* nor *Independent Broadcasting* was considered by the Court in *Brunswick*. Presumably, this is because of the fact that in *Brunswick* the impugned work was the construction of a complete building as opposed to the installation of one component in a building.

Professor Waddams is wary of the distinction between the builder of a house and a manufacturer of an article and is of the view that it is not sustainable in modern circumstances at least with respect to consequential damages. The English Court of Appeal and House of Lords share the same view of the seller of installed products or labour and materials.

This point is well taken in circumstances where the plaintiff purchaser simply contracts with the defendant for the construction or sale of a table or a house. The same is true of a contract to supply and install a product into a house or building. The concern of Dickson J. is when the contract is for the construction of a building or the installation of a product in a manner specified by the building owner or her or his consultant. Here, to use the words of Lord Denning, the plaintiff building owner cannot complain that it was the responsibility of the defendant to see that a good and proper building was built or that a good and proper roof was installed. Absent contrary contractual provisions or special factual circumstances as in *Brunswick*, the responsibility of the builder should be limited to seeing that its work is true to the design and specifications of the owner's consultant.

In *CCH Canadian Limited v. Mollenhauer*, the defendant-builder purchased and installed the type of brick specified by the plaintiff-owner and under the supervision of the owner's architect. The bricklaying was done in good and workmanlike practice but the brick itself proved to be unsuitable for the structure. Presumably, the owner alleged an implied warranty that the brick would be suitable for the building in its action against the

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104 Indeed the quoted passages from *Hudson's* are the only authorities cited.
105 *Products Liability, supra* note 38 at 108.
106 In *Brunswick*, there was de facto reliance on the know how of the builder, the builder was at least partially slipshod in its work and the design error was blatant.
builder. This issue was not, however, expressly canvassed by Ritchie J. for the Supreme Court of Canada, who simply reasoned that the owner could not say that it relied on the skill and judgment of the builder to select the brick in issue in the circumstances.

The Court apparently did not consider Young and Marten or Independent Broadcasting and, regrettably, the judgment of Ritchie J. was very brief. CCH is contrary to Lord Denning's reasoning in Hancock and the result in both Hancock and Young and Marten. The important distinguishing fact is that the brick used in CCH failed for suitability reasons rather than quality. The crux of CCH does not, however, contradict the important rationale of the House of Lords in Young and Marten that the plaintiff should not be denied the benefit of a chain of liability ending with the original supplier's liability under the Sale of Goods Act. Under Canada's legislation, neither the original supplier nor the bricklayer in CCH would be exposed to such liability as the bricks in issue were of merchantable quality and there was no reliance on their skill or judgment in their selection.

In G. Ford Homes, the defendant residential staircase company constructed and installed staircases for the plaintiff owner. The staircases had less headroom than that prescribed by Ontario's Building Code and the owner was required by the local building inspector to remove and replace them. In upholding the judgment against the staircase company, Cory J.A., for the Ontario Court of Appeal, found two principles from Young and Marten to be attractive and compelling. The first is that the common law principles codified in the Sale of Goods Act apply to contracts for work and materials. The second is that there will be an implied term in contracts for work and materials that the materials will be reasonably fit for the purposes for which they were intended unless the circumstances of a particular case are sufficient to specifically exclude it.

108 Remarkably, Brunswick was not expressly considered notwithstanding that it was handed down only eight months earlier.
109 Supra note 23.
110 Ibid. at 265-266.
Cory J.A. found that these principles resulted in the implied term that the staircase company would supply and install the staircases in compliance with Ontario’s Building Code. Alternatively, “or additionally”, the staircase company breached the implied term that its work and materials would be reasonably fit for the purpose required. Given that the staircase company held itself out at an expert in the field, there were no circumstances such as to exclude this obligation.

Cory J.A. distinguished CCH on the basis that the contract in CCH impliedly excluded the implied term that the defective bricks would be fit for the purposes intended. This reading of CCH is probably right but is contrary to the law reviewed in the next section to the effect that a contract must expressly exclude the implication of the three-fold warranty in the construction contract. The cases are factually distinguishable in that the unsuitable brick in CCH was selected and specified by the owner’s consultant without any input from the defendant-builder. In G. Ford Homes, the owner did not specify the product to be installed in its homes but chose one of the staircase company’s staircases and plainly relied on its skill and judgment.

The implied warranty of fitness for purpose of work and materials is particular to the construction industry. In ter Neuzen v. Korn, Sopinka J., for the Supreme Court of Canada, canvassed the issue of the availability of an implied warranty in a contract for goods and services in the case of a plaintiff infected by the human immunodeficiency virus (HIV) as result of artificial insemination by the defendant physician. Sopinka J. cited both Young and Marten and G. Ford Homes with approval but stressed that the important policy rationale for the findings in those cases is that, through the operation of the Sales of

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111 Ibid. at 267.
112 Ibid. at 268.
113 Ibid. at 266.
114 Supra note 35.
115 In her concurring judgment, L’Heureux-Dubé J. generally agreed with Sopinka J. on this point, ibid. at 615.
**Goods Act**, one can usually “proceed up the chain of production and ultimately recover from the one who should bear responsibility for the production of faulty goods”.

Sopinka J. agreed that in the context of commercial cases where recovery is not available, it is better that the supplier bear the cost of defects than leaving the consumer without a remedy. The court must, however, be alive to all of the facts of the case:

Accordingly, it is apparent that apart from the Sale of Goods Act, a court must consider whether a common law warranty of fitness and merchantability should be implied into the contract which includes services as well as the provision of materials. However, such a warranty will not be implied in all the circumstances. The court must examine the specific nature of the contract and the relationship between the parties that such a warranty be implied. As Cory J.A. observed, courts must be very cautious in their approach to implying contractual terms.

In summary, a warranty that a contractor’s work will be fit for its purpose will be implied whenever the skill of the builder or contractor is relied upon, but does not apply if the contractor is employed to supply labour and materials in accordance with drawings and specifications supplied by the owner or its architect and there is no reliance on the builder’s skill and judgment. The cases show that whether a contractor will be absolved by the defence of following plans will turn on the reasonable reliance by the owner on the know-how as well as the skills of the contractor. An important part of this inquiry is whether the owner’s professional consultant, in fact, supervised the contractor’s work. In the *Bonavista* case, it was held that the contractor was not liable to the owner for damages resulting from design errors since the contractor brought the design problem to the attention of the architect and complied with the architect’s further instructions. However, on the authority of the *Young and Marten* and *G. Ford Homes* case law, if a contractor simply undertakes to do work and supply material for a known purpose, the

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117 *Ibid.*., the reference to Cory J.A. is the passage from *G. Ford Homes* set out above, *supra* note 79.
119 In *Batty v. Metropolitan Property*, [1978] 2 All E.R. 445 (C.A.), the builder was held jointly liable with the developer for the negligent decision to build a home on unstable real property as it participated in the decision to build on the site.
work done and materials supplied must be reasonably fit for the purpose for which it is required.\textsuperscript{121}

\textbf{II.B.4 The Doctrine of Caveat Emptor}

\textit{Croft v. Prendergast}\textsuperscript{122}, is frequently cited for the proposition that the implied warranties set out above protect the purchaser of a building in respect of both work already done as well as to the work to be done following the execution of the contract for sale of the property. The courts will frequently use the device of collateral agreement to enforce these implied warranties in the face of the parol evidence rule.\textsuperscript{123} In the case of an incomplete home, the third or additional warranty is that the house will be fit for human habitation. In the case of a used home or a new home that was complete at the time of purchase, however, the common law does not provide any relief for construction deficiencies save those expressly covered by the contract of sale (and in the absence of fraud).

In \textit{Fraser-Reid v. Droumtekas}\textsuperscript{124}, the Supreme Court of Canada refused the plaintiff's appeal to abolish the distinction between the protection afforded incomplete as opposed to completed houses. As outlined above, the former receives the benefit of the implied warranties outlined earlier while the doctrine of \textit{caveat emptor} applies to the latter. The perceived injustice of the dichotomy has sometimes resulted in strained judicial fact-finding that a construction is incomplete.\textsuperscript{125} This line of jurisprudence rests uncomfortably next to those cases in which courts strain to find a construction substantially complete in


\textsuperscript{122} [1949] 2 D.L.R. 708 (Ont. C.A.).

\textsuperscript{123} \textit{Barak supra} note 121. See also \textit{Henderson et al. v. Raymond Massey Builders Ltd.} (1963) 43 D.L.R. (2d) 45 (Man. Q.B.).

\textsuperscript{124} (1979), 103 D.L.R. (3d) 385 (S.C.C.).

\textsuperscript{125} In \textit{Strata Plan NW2294 v. Oak Tree Construction Inc.} (1994), 16 C.L.R. (2d) 1 (B.C.C.A.), Taylor J.A. reasoned that the completed condominium must be found incomplete as further repair work would be required to fix the construction deficiency that violated the implied warranty that the building be reasonably fit for human habitation. See also \textit{Trimble Hill, supra} note 84 at 147-148, wherein Williams J.A. discusses the shortcomings in the law surrounding this distinction and the resulting availability of implied warranty.
order to avoid the "monstrous" injustice of an owner getting substantially what he bargained for and yet not having to pay for it.\textsuperscript{126}

Dickson J., for the Court in Fraser-Reid, conceded that the doctrine of \textit{caveat emptor} was judge-made and, therefore, was within his authority to compromise or abolish. Nevertheless, he declined to do so citing the complexity of the problem, the difficulties of spelling out the ambit of a court imposed warranty, and the major cost impact upon the construction industry. Dickson J. concluded that the task of removing the irrational distinction between completed and incomplete houses was best left to legislative intervention. In the first chapter, we saw that only Ontario and, very recently, British Columbia enacted new home warranty legislation.

\textbf{II.C LIABILITY IN TORT}

The two causes of action in tort of interest to this thesis is the action in negligence and the action for negligent misrepresentation.

\textbf{II.C.1 Negligence}

Notwithstanding its predominance in 20\textsuperscript{th} century legal practice and writing, the cause of action in negligence\textsuperscript{127} has escaped a definitive formulation. It is notorious that the plaintiff must establish that the defendant owed it a duty of care, that the duty of care was breached and that the breach or wrong caused the plaintiff some harm. The issue seems to be how best to articulate these three core elements.

Justice Allen M. Linden's six part analysis begins with the plaintiff's injury:\textsuperscript{128}

\begin{itemize}
  \item[(1)] the claimant must suffer some damage;
  \item[(2)] the damage suffered must be caused by the conduct of the defendant;
  \item[(3)] the defendant's conduct must be negligent, that is, in breach
\end{itemize}

\textsuperscript{126} \textit{Per Moir J.A. in Nu-West Homes v. Thunderbird Petroleums Ltd.} (1975), 59 D.L.R. (3d) 202 (Alta. C.A.) at 298.

\textsuperscript{127} In \textit{The Law of Torts}, 9\textsuperscript{th} ed. (Sydney: The Law Book Company, 1998) at 115, Professor John G. Fleming observes that negligence is a basis of liability rather than a nominate tort and, for that reason, it is misleading to speak of a tort of negligence notwithstanding widespread current usage.

\textsuperscript{128} \textit{Canadian Tort Law}, 6\textsuperscript{th} ed. (Toronto: Butterworths, 1997) at 99.
of the standard of care set by the law; (4) there must be a duty recognized by the law to avoid this damage; (5) the conduct of the defendant must be a proximate cause of the loss or, stated in another way, the damage should not be too remote a result of the defendant’s conduct; (6) the conduct of the plaintiff should not be such as to bar recovery, that is the plaintiff must not be guilty of contributory negligence and must not voluntarily assume the risk.

Professor Lewis N. Klar proposes seven questions to be asked starting with whether the defendant owed the plaintiff a duty of care:

(1) Does the law impose on the actor a duty to take care so that the activity in question does not harm the claimant?

(2) Assuming the answer to (1) is “yes”, and, therefore, there is no reason in law to refuse to apply negligence law to the actor or the activity in question, do the facts of the case in dispute justify the contention that the actor ought to have taken reasonable care for the plaintiff’s protection? In other words, was there “a foreseeable risk of harm” to the plaintiff?

(3) How ought the defendant to have acted in the situation? In other words, did the defendant breach the duty of care by not acting reasonably?

(4) Was this breach a sufficient cause of the plaintiff’s injury? Would the injury have occurred even if there had been no breach?

(5) For which of the plaintiff’s injuries should the defendant be held liable? Stated technically, which of the injuries are sufficiently proximate in law to justify the imposition of liability?

(6) Are there any factors in the plaintiff’s conduct which justify a reduction, or even an elimination, of the damages which otherwise would have been awarded?

The inexact formulae have not made the determination of a negligence claim unduly complicated or cumbersome in practice. In most negligence cases, the court does not break down the cause of action but focuses on the existence or weight of a factor that might serve to limit or absolve the defendant from compensating the plaintiff. In modern litigation, much of the focus is on Justice Linden’s fourth element and Professor Klar’s first question: does the defendant owe the plaintiff a duty of care? We shall see in the following chapter that in claims for pure economic loss, the result in a given case frequently turns on this inquiry.

In the London Drugs case, the Supreme Court of Canada expressed the modern approach to the law of negligence and the finding of a duty of care as follows:

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129 *Tort Law*, 2nd ed. (Toronto: Carswell, 1997) at 129-130.

130 *Infra* note 179, discussed below in Part II.E.3(a).
Our law of negligence has long since moved away from a category approach when dealing with duties of care. It is now well established that the question of whether a duty of care arises will depend on the circumstances of each particular case, not on predetermined categories and blanket rules as to who is, and who is not, under a duty to exercise reasonable care.

In *Kamloops v. Neilson*\(^\text{12}\), the two stage duty of care test of Lord Wilberforce in *Anns* was confirmed by the Supreme Court of Canada with some detailing.\(^\text{13}\)

(1) is there a sufficiently close relationship between the parties ... so that, in the reasonable contemplation of [one person], carelessness on its part might cause damage to [the other person]? If so, (2) are there any considerations which ought to negative or limit (a) the scope of the duty and (b) the class of persons to whom it is owed or (c) the damages to which a breach of it may give rise?

The tort duty imposed on builders is to use reasonable skill and care in the course of construction: “Did the builder act as a careful builder would have acted in what he did or did not do?”.\(^\text{14}\)

We have seen that the failure to comply with municipal by-laws or statutory codes may make the builder liable for breach of an express or implied contractual term. The same failure could ground a negligence claim in tort as a careful builder would be sure that its work was compliant.

**II.C.2 Negligent Misrepresentation**

The judgment of the House of Lords in *Hedley, Byrne*\(^\text{15}\) remains the leading authority with respect to the action in negligent misrepresentation. The test’s elements were considered by the Supreme Court of Canada in *Queen v. Cognos Inc.*\(^\text{16}\), wherein Iacobucci J. stated that there are five general requirements.\(^\text{17}\)

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\(^{12}\) *Per* Iacobucci J., *ibid.* at 337. See the seminal speech of Lord Wilberforce in *Anns*, *infra* note 241 at 498-499.


\(^{14}\) *Per* Wilson J., *ibid.* at 662-663.

\(^{15}\) *Batty, supra* note 199 at 455.


\(^{17}\) *Ibid.* at 643.
(1) there must be a duty of care based on a 'special relationship' between the representor and the representee;
(2) the representation in question must be untrue, inaccurate or misleading;
(3) the representor must have acted negligently in making said misrepresentation;
(4) the representee must have relied, in a reasonable manner, on said negligent misrepresentation; and
(5) the reliance must have been detrimental to the representee in the sense that damages resulted.

As in the determination of the alleged “duty of care” in the negligence case, the critical question in a claim for negligent misrepresentation most frequently is what constitutes “a special relationship”. In Cognos, Iacobucci J. specifically considered three alternatives (i) a voluntary assumption of responsibility by the defendant (ii) reasonable or justifiable reliance by the plaintiff and (iii) foreseeability that damage will be caused, proximity of relationship and reasonableness of otherwise imposing a duty of care. It was unnecessary for the Court to identify the key element as it arrived at the same result using any of the alternatives.

In England, two recent judgments of the House of Lords appear to have reoriented the necessary special relationship in the contractual, three party context toward the ‘assumption of responsibility’ test. In Henderson v. Merrett Syndicates Ltd.\(^{138}\), the plaintiffs’ claims in negligent misrepresentation against the defendant underwriting agents as well as their sub-agents were allowed but Lord Goff gave the following interesting caveat:\(^{139}\)

I wish, however, to add that I strongly suspect that the situation which arises in the present case is most unusual; and that in many cases in which a contractual chain comparable to the present case is constructed it may well prove to be inconsistent with an assumption of responsibility which has the effect of, so to speak, short-circuiting the contractual structure so put in place by the parties. It cannot therefore be inferred from the present case that other sub-agents will be held liable to the agent’s principal in tort. Let me take the analogy of the common case of an ordinary building contract, under which main contractors contract with the building owner for the construction of the relevant building, and the main contractor sub-contracts with sub-contractors or suppliers (often nominated by the building owner) for the performance of work or the supply of materials in accordance with standards and subject to terms established in the sub-contract. … if the sub-contracted work or materials do not in the result conform to the required standard, it will not

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\(^{139}\) Ibid. at 534.
ordinarily be open to the building owner to sue the sub-contractor or supplier direct under the *Hedley, Byrne* principle, claiming damages from him on the basis that he has been negligent in relation to the performance of his functions. For there is generally no assumption of responsibility by the sub-contractor or supplier direct to the building owner, the parties having so structured their relationship that it is inconsistent with any assumption of responsibility.

In *White v. Jones*\(^{140}\), Lord Browne-Wilkinson reasoned that the understanding of the *Hedley, Byrne* special relationship turns on the assumption of responsibility by the defendant:\(^{141}\)

> Although reliance by the plaintiff is an essential ingredient in a case based on negligent misstatement or advice, it does not follow that in all cases based on negligent action or inaction by the defendant it is necessary in order to demonstrate a special relationship that the plaintiff has in fact relied on the defendant or the defendant has foreseen such reliance. If in such a case [assumption of responsibility] careless conduct can be foreseen as likely to cause and does in fact cause damage to the plaintiff that should be sufficient to found liability.

This is a topic of tremendous academic and practical interest that is beyond the scope of this thesis.\(^{142}\)

The Supreme Court of Canada appears intent on maintaining reasonable reliance as an element of an action in negligent misrepresentation as opposed to negligence:\(^{143}\)

> There are, however, technical distinctions between the ordinary tort of negligence and negligent misrepresentation, in particular, that under the latter the representee must have relied, in a reasonable manner, on the negligent misrepresentation.

In the same case, McLachlin J. observed that it would be an unusual case in which the conditions for liability stipulated in *Hedley, Byrne* were met but some policy grounds existed such as to deny a duty of care under the second stage of *Anns*.\(^{144}\)

It is clear that reasonable reliance continues to be a required element of an action in misrepresentation in Canadian law.\(^{145}\) This burden of the plaintiff's case may be lightened

\(^{140}\) [1995] 1 All E.R. 691 (H.L.).

\(^{141}\) *Ibid.* at 714.


\(^{143}\) Per La Forest J. in Edgeworth Construction, *infra* note 196 at 171, discussed in Part II.E.3(b).

\(^{144}\) *Ibid.* at 176.
by recent rulings that it is sufficient that the misrepresentation was one of the factors inducing the plaintiff to act to its detriment and that the plaintiff's reliance may be inferred.146

II.D  CONCURRENT LIABILITY IN TORT AND CONTRACT

Perhaps the single most important development in private law in this century was the extension of a duty of care to plaintiffs with whom the defendant did not share contractual privity. The seminal speeches by the House of Lords in Donoghue v. Stevenson147 followed by Hedley, Byrne made available remedies in diverse new cases that have tested the imaginations and boundaries of the previously rigid domains of tort and contract. One of the many issues to fall on the heels of this jurisprudence was how to handle the many cases in which it is alleged that the defendant owed the plaintiff both contractual and tortious duties.

II.D.1 The Categorical Approach to Concurrent Claims

One conservative response to two-headed claims asserted on the strength of these authorities was to try and restrict parties within a contractual relationship to only those claims and remedies afforded by the contract itself. Hedley, Byrne and Esso Petroleum Co. Ltd. v. Mardon148 demonstrated that this restriction was not true, at least, of cases of negligent misrepresentations by professionals. In Batty v. Metropolitan Property149, Megaw L.J. dispensed with the argument that the cases of misstatement by a professional constituted special exceptions to the dichotomization of tort and contract claims:150

147 [1932] A.C. 562. Professor Klar, supra note 129 at 127, says that Donoghue v. Stevenson is the "inspiration for modern negligence law".
149 Supra note 119.
150 Ibid. at 453.
The distinction to which I have referred which counsel ... seeks to make is this: that the right of a plaintiff who sues in contract, where the facts giving rise to the breach of contract would also constitute a breach of common law duty apart from contract, to have the judgment entered on both heads, is limited to cases where the common law duty is owed by one who conducts a common calling and thus is under a special type of legal liability, and to cases where the duty is owed by a professional man in respect of his professional skill. Counsel ... contends that, although there is no affirmative authority for limiting the right in that way, it ought to be treated as being so limited because there is no case in the English books, going back over many years, which shows that the right has been allowed, or possibly even claimed, in cases other than the special types of cases to which he referred, and in particular the professional skill type of case. ... I see no reason, in logic or practical grounds, for putting any such limitation on the scope of the right. It would, I think, be an undesirable development in the law if such an artificial distinction, for which no sound reason can be put forward, were to be held to exist. In my judgment the plaintiffs were entitled here to have judgment entered in their favour on the basis of tortious liability as well as on the breach of contract, assuming the plaintiffs had established a breach by the first defendants of their common law duty of care owed to the plaintiffs.

With some very notable exceptions\(^{151}\), the idea that that the existence of a contractual relationship supplanted any tort duty that might otherwise exist took a stronger hold in Canadian law. The reluctance to altogether abandon the autonomy of the two causes of action gave rise to the Supreme Court of Canada's requirement that the impugned act or omission constitute an "independent" tort.\(^{152}\)

Furthermore the basis of tort liability considered in *Hedley Byrne* is inapplicable to any case where the relationship between the parties is governed by a contract, unless the negligence relied on can properly be considered "an independent tort" unconnected with the performance of that contract ...

This rule was perceived to unjustly exclude cases where tort liability should be imposed notwithstanding that a contract gave rise to the relationship between the parties. The Supreme Court of Canada has moved a long way in redefining the relationship between

\(^{151}\) True to the contention of counsel for the defendant in *Batty*, these were often cases of professional negligence as in *District of Surrey v. Carroll-Hatch*, *supra* note 118, as well as the cases of *Dabous v. Zuliani* (1976), 68 D.L.R. (3d) 414 (Ont. C.A.), and *Dominion Chain Co. v. Eastern Construction Co.* (1976), 68 D.L.R. (3d) 385 (Ont. C.A.), wherein the majority held that the defendant architect, engineer as well as the builder may be found liable in tort, as well as in contract, for negligent performance of contractual duties. Wilson J.A. dissented in both *Dominion* and *Dabous* on the basis that the plaintiff's action was in essence for breach of a contractual rather than a neighbourly duty of care. In *Fraser-Reid*, *supra* note 124, Dickson J. suggested that the defendant builder might have been liable in negligence but that cause of action was neither pleaded nor tried.

contract and tort since its judgment in the *Rivtow Marine* case\(^\text{153}\) in which the issues are based largely on the difficulties of imposing liability in tort where the situation is most naturally understood as being governed by contract.

II.D.2 **The Supreme Court of Canada in Central Trust v. Rafuse** \(^\text{154}\)

In this watershed case, Le Dain J., for the Supreme Court of Canada, held that the principled acceptance of concurrency of liability is true to the principles enunciated in *Donoghue v. Stevenson* and *Hedley Byrne*. Consonant with the view of Megaw L.J. in *Batty*, Le Dain J. read the "status relationship" as supportive of the general principle of concurrent liability rather than the categorization of exceptions to a rule prohibiting the assertion of both causes of action.\(^\text{155}\)

Early in his judgment Le Dain J. eloquently explained: \(^\text{156}\)

> Moreover, in the modern doctrine of concurrent liability it is not the breach of contract as such that gives rise to tortious liability, but the breach of a common law duty of care arising from the relationship created by contract.

Later on he would address the persistent response to this proposition that the plaintiff and defendant voluntarily and for good consideration set out the full extent of their respective obligations in the contract itself: \(^\text{157}\)

What is undertaken by the contract will indicate the nature of the relationship that gives rise to the common law duty of care, but the nature and scope of the duty of care that is asserted as the foundation of the tortious liability must not depend on specific obligations or duties created by the express terms of the contract. It is in that sense that the common law duty of care must be independent of the contract. The distinction, in so far as the terms of the contract are concerned, is, broadly speaking, between what is to be done and how it is to be done. A claim cannot be said to be in tort if it depends for the nature and scope of the asserted duty of care on the manner in which an obligation or duty has been expressly and specifically defined by a contract. Where the common law duty of care is co-extensive with that which arises as an implied term of the contract it obviously does not depend on the terms of the contract, and there is nothing flowing from contractual intention

\(^{153}\) *Infra* note 228, discussed at length in Part III.C.

\(^{154}\) *Supra* note 54.

\(^{155}\) *Ibid.* at 502 and 504.

\(^{156}\) *Ibid.* at 503.

\(^{157}\) *Ibid.* at 522. Professor Klar, *supra* note 129 at 193, is of the view that the reasoning of Le Dain J. in *Central Trust v. Rafuse* "clarifies" the dicta of Pigeon J. in *Nunes Diamonds*. Justice Linden, *supra* note 128 at 439, more accurately describes *Rafuse* as the triumph of concurrent liability theory, the "tacit" overruling of Pigeon J. and the vindication of the dissenting judgment of Spence J. in *Nunes Diamonds*. 
which should preclude reliance on a concurrent or alternative liability in tort. The same is also true of reliance on a common law duty of care that falls short of a specific obligation or duty imposed by the express terms of a contract.

Le Dain J. then added this critical statement:

A concurrent liability or alternative liability in tort will not be admitted if its effect would be to permit the plaintiff to circumvent or escape a contractual exclusion or limitation of liability for the act or omission that would constitute the tort. Subject to this qualification, where concurrent liability in tort and contract exists the plaintiff has the right to assert the cause of action that appears to be most advantageous to him in respect of any particular legal consequence.

In C.P. Hotels, Le Dain J. added a second important restriction on the principle of concurrency of liability:

... the principle of concurrent or alternate liability in contract and in tort affirmed in Rafuse cannot extend to the recognition of a duty of care in tort when that same duty of care has been rejected or excluded by the courts as an implied term of a particular class of contract.

II.D.3 The Supreme Court of Canada in BG Checo

In BG Checo Intl. v. B.C. Hydro159, La Forest and McLachlin JJ., for the majority of the Supreme Court of Canada, cited and applied Rafuse as authority for the frequently cited proposition that:160

... the only limit on the right to choose one's action is the principle of primacy of private ordering - the right of individuals to arrange their affairs and assume risks in a different way than would be done by the law of tort. It is only to the extent that this private ordering contradicts the tort duty that the tort duty is diminished. The rule is not that one cannot sue concurrently in contract and tort where the contract limits or contradicts the tort duty. It is rather that the tort duty, a general duty imputed by the law in all the relevant circumstances, must yield to the parties' superior right to arrange their rights and duties in a different way. In so far as the tort duty is not contradicted by the contract, it remains intact and may be sued upon.

The duty imposed by the law of tort can only be nullified by clear and valid contractual provisions such as an exemption clause, exclusion of liability or waiver of the right to seek

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158 Supra note 77 at 432. See also Catre Industries Ltd. v. Alberta (1989), 63 D.L.R. (4th) 74 (Alta. C.A.) at 95.
160 Per La Forest and McLachlin JJ. at 584.
recourse in tort. These contractual limitations of tort duties may be invalidated by the usual devices such as fraud, mistake or unconscionability.

The point of divergence for Iacobucci J.\textsuperscript{161} was his reading of \textit{Rafuse} that any cause of action in tort is ousted by the express contractual treatment of the actionable matter. The majority rejected this approach as it would, presumably, allow a concurrent action where the contract duty is defined by an implied term but not where the term was express. For La Forest and MacLachlin JJ., such a result would be an abrogation of the accepted principle that express and implied terms, arising from custom or from the conduct of the parties, are of the same effect.

\textbf{II.E \ THE EXCLUSION OF CONTRACTUAL AND TORTIOUS LIABILITY}

Parties resisting the imposition of implied contractual terms or the assertion of tort duties will seek the protection of a contract’s entire agreement and exclusionary clauses. Either or both of the plaintiff and defendant may be a party to the contract relied on.

\textbf{II.E.1 \ Entire Agreement Clauses}

In agreements of purchase and sale, particularly in residential property sales, it is very common to see an exclusionary clause, sometimes called an “entire agreement” clause, in which the purchaser agrees that there is no other representation, warranty, collateral term or condition affecting the agreement that is not expressly included in the contract itself. Notwithstanding the substantial number of actions with respect to the deficiencies in residential construction, there has not been any authoritative decision as to the effect of this sort of disclaimer.

\textsuperscript{161} Sopinka J. concurring.
In *Fraser-Reid*, Dickson J. expressed the view that the relatively standard entire agreement clause relied on by the defendant was of such breadth that a plaintiff might not be able to rely on the usual warranties implied into a construction contract.\textsuperscript{162}

We have seen that current standard form construction contracts do not include the entire agreement clause but, to the contrary, expressly acknowledge the parties’ contractual rights and obligations. The provisions are, however, popular in many contracts generated by builders and owners. The following such clause relied on by Canada’s Department of Fisheries and Forestry was considered by the Federal Court of Appeal in the *Cabott Construction* case.\textsuperscript{163}

No implied obligation of any kind by or on behalf of Her Majesty shall arise from anything in the contract, and the express covenants and agreements herein contained and made by Her Majesty are and shall be the only covenants and agreements upon which rights against Her Majesty are to be founded; and, without limiting the generality of the foregoing, the contract supersedes all communications, negotiations and agreements, whether written or oral, relating to the work and made prior to the date of contract.

The Court ruled that this provision did not bar the importation of the commonly understood and “fundamental” implied term that an owner is obliged to provide sufficient space around the site of the proposed building to enable the contractor to carry out the work.

There are many other examples of cases in which the entire agreement clause has been upheld including *Carman Construction Ltd. v. Canadian Pacific Railway Co.*\textsuperscript{164}, wherein the Supreme Court of Canada held that a term in which the plaintiff excavator acknowledged that it was not relying on any information given by the railway company in relation to the work barred the excavator’s action for cost overruns alleged caused by a railway employee’s underestimation of the rock to be removed.

\textsuperscript{162} *Supra* note 124 at 387.

\textsuperscript{163} *The Queen v. Walter Cabott Const. Ltd.* (1975), 69 D.L.R. (3d) 542 at 553.

The courts have two important devices at their disposal in cases where aggrieved purchasers seek to rescind or sue on contracts protected by entire agreement clauses. The first is the principle that a surprising or pernicious contractual provision must be drawn to the attention of the purchaser when the provision cannot realistically be expected to be part of the bargain. The judgment of the Ontario Court of Appeal in the Tilden Rent-A-Car case 165 is frequently cited as authority for this principle. The second principle is that a party who misrepresents the contents or effect of a clause inserted by the party into the contract cannot rely on the clause in the face of the misrepresentation. Lord Denning’s decision in Mendelssohn v. Normand Ltd. 166 is authority for this proposition.

The Ontario Court of Appeal applied both principles in Beer v. Townsgate I Limited 167 wherein the plaintiffs were purchasers of units in a luxury condominium project. The sales were made during a promotion in an atmosphere of extreme “hype” and “frenzy” at which the plaintiffs were told that the investment was “risk-free” and “guaranteed”. The sales staff’s assurances did not appear in the defendant’s standard form contract. Instead the agreements of purchase and sale contained an entire agreement clause expressly barring purchasers from relying on any representations not found in the contract itself.

The units subsequently lost significant value between the sale and the closing date at which time the Toronto real estate market declined rapidly. The plaintiffs sought a declaration that they were entitled to rescind their agreements and return of the $40,000 deposits. The defendant developer took the position that the entire agreement clause precluded any liability arising from a representation and, further, the evidence of misrepresentations by the sales staff were inadmissible due to the parol evidence rule.

The Court ruled that in the circumstances there was no reasonable expectation that the purchasers were assenting to the clause. Further, the parol evidence rule cannot operate to exclude evidence of a misrepresentation that induced the impugned contract and thus be used to allow the misrepresentor to rely on a clause in face of the misrepresentation. The Court declared that the three plaintiffs who proved their reliance on the misrepresentations were entitled to rescission of the sales contracts and all moneys paid thereunder.

II.E.2 Exclusionary Clauses

The courts are plainly sympathetic to building owners who discover latent defects in the buildings they have purchased. In the words of Dickson J. in Fraser-Reid, the law is reticent to uphold or fashion "a trap for the unwary". Lord Denning expressed the rationale for subjecting exclusionary clauses to close scrutiny:

\[\text{It was said that when you have a clause which says expressly what defects are to be made good by the vendor, it covers the whole ground and there is no room for the purchaser to complain of other defects. ... I think that it must depend in every case, however, on the true construction of the contract. Moreover if a builder has done his work badly, and defects afterwards appear, then he is not to be excused from liability except by clear words.}\]

The party resisting the implied warranty will be in a much stronger position if it can rely on an exclusionary or disclaimer clause that specifically negates the deficiency or wrong at issue. The judgment of the British Columbia Court of Appeal in the Strata v. Oak Tree case is one of many strong authorities for the proposition the three-fold warranties canvassed earlier will be implied into a construction contract unless they are excluded by express terms of the contract.

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\[\text{168 Ibid. at 682.}\]
\[\text{169 Supra note 124 at 397.}\]
\[\text{170 Hancock, supra note 93 at 904. Applied by the Ontario Court of Appeal in Simpsons Ltd. v. Pigott Construction Co. Ltd. (1973), 40 D.L.R. (3d) 47.}\]
\[\text{171 Supra note 125.}\]
Similarly, the exclusionary clause must clearly exempt the builder from liability for consequential damage claims in tort or contract.172

As demonstrated in the discussion of entire agreement clauses, the cases are not always reconcilable. The courts seem more likely to give effect to an exclusionary clause in cases where the builder is seeking compensation for its work above and beyond that called for by the contract as opposed to cases where owners seek compensation for damages resulting from negligent consulting services or construction work. The Alberta Court of Appeal summed up the spirit of holding an aggrieved contractor to its contract in the former type of case:173

The fact that a contract turns out to be more difficult in execution than anticipated is not sufficient to serve as a release from its express terms.

Looking at this issue from the other perspective, a court is more inclined to find that the reasonable intention of the builder was to carry out the contract in compliance with the implied warranties of quality and fitness for purpose than it is to find that the parties agreed that the builder would not be liable for damages arising from its supply of defective materials or slipshod labour, absent very clear and specific language to that effect.

Still, there are many good examples of a court allowing a party to use an exclusionary clause to resist a claim for negligent work. In Miller v. Shepherd174, the Newfoundland Supreme Court held that the following clause barred the defendant’s counterclaim for water damages resulting from flooding that first occurred beyond one year from the time her home was built:

10. The builder guarantees for one year following the date of completion of the building all defects of construction due to original materials or workmanship.

172 Dabous, supra note 151 at 419. See also University of Regina v. Pettick (1991), 77 D.L.R. (4th) 615 (Sask. C.A.) at 658-659.
In upholding this limitation of liability clause, Trainor C.J.P.E.I. was plainly impressed that the defendant's own solicitor prepared the construction contract at issue:175

It may well be that the period of one year was too short in which to test the particular type of construction when exposed to conditions as they exist in winter in Prince Edward Island. But the Defendant took his chance in limiting the period of warranty. Hindsight is always better than foresight, and it might have been better for the Defendant to have hired a contractor with greater experience in construction to meet the requirements of Island weather conditions, or to have bound the Plaintiff to a longer term of warranty. Either of those alternatives might well have resulted in greater cost but would have been more satisfactory in the long run.

In the end, the courts should take into consideration all of the circumstances of the case including the commercial context, the sophistication of the parties, the whole of the contract and how the contract was created. The courts also tend to evaluate the fairness of the enforcement of the exclusionary clause. Miller v. Shepherd is one of many occasions where a court found that the plaintiff owner got what she paid for.

II.E.3 Third Party Beneficiaries of Contractual Exclusions

The third party beneficiary rule is one side of the doctrine of privity of contract that prohibits a contract from either conferring rights or imposing obligations on a stranger to it. It was expressed by Lord Reid as follows:176

Although I may regret it, I find it impossible to deny the existence of a general rule that a stranger to a contract cannot in a question with either of the contracting parties take advantage of provisions of the contract even where it is clear from the contract that some provision in it was intended to benefit him.

Although the privity doctrine has been subjected to criticism177 and eroded by a variety of exceptions, the courts have consistently upheld and applied the third party beneficiary rule in construction cases. This is particularly so in cases where professional consultants seek the protection of provisions in the contract between owner and contractor disclaiming responsibility for the misrepresentation of site conditions.178

175 Ibid. at 360.
177 In London Drugs, infra note 179 at 266, La Forest J. calls it a "pestilential nuisance".
178 Cardinal Construction, supra note 67 at 192. See also Brown & Huston Ltd. v. York (1984), 5 C.L.R. 240 (Ont. H.C.), where the Court used the device of narrowly construing the clause in question.
II.E.3(a) The Supreme Court of Canada in London Drugs

The right of a third party to avail itself of a contractual limitation of liability was tested in the important decision of the Supreme Court of Canada in London Drugs v. Kuehne & Nagel International Ltd. The plaintiff, London Drugs, contracted with the defendant storage company to store a heavy transformer. Two of the defendant's employees negligently caused $33,955.41 of damage to the transformer when lifting it. London Drugs sued the corporate defendant in bailment, contract and negligence as well as the employees personally in negligence.

All of the defendants sought the protection of a provision in the storage contract limiting the corporate defendant's liability to $40.180

LIABILITY - Sec 11(a) The responsibility of the warehouseman in the absence of written provisions is the reasonable care and diligence required by the law.

(b) The warehouseman's liability on any one package is limited to $40 unless the holder has declared in writing a valuation in excess of $40 and paid the additional charge specified to cover warehouse liability.

London Drugs contended that the operation of the doctrine of privity of contract and the third party beneficiary rule precluded the employees' reliance on the limitation of liability clause. The trial judge agreed that the storage company's liability was limited to $40 but held that the negligent employees were liable for the full amount of the loss. The British Columbia Court of Appeal, for a variety of reasons, allowed the employees appeal and limited their liability to $40.

In three concurring judgments, the Supreme Court of Canada held that the doctrine of privity of contract did not operate to preclude protection for the employees actually doing the work.

II.E.3(a)(i) The Majority Judgment of Iacobucci J.

180 Ibid. at 326.
Iacobucci J. began his reasons by summarily dismissing the argument that the employees did not owe the plaintiff any duty of care. This argument was accepted by Hinkson J.A of the Court of Appeal who held that a plaintiff must evidence some degree of reliance in order to establish a duty of care and that factual foreseeability of damage does not by itself create a duty of care. Hinkson J.A. found that the absence of reliance was proven by the fact that the plaintiff knew about the limitation of liability clause and chose to obtain its own insurance. Iacobucci J. reasoned that on the assumption that the plaintiff’s reliance on the employees diligence was relevant, the required reliance relates to the existence of a duty of care rather than liability for breach of a duty of care:

When reliance is used in cases such as Hedley Byrne ... Junior Books ... and ... Hofstrand Farms ... in order to determine the existence of a duty of care, it is concerned with the relationship between the plaintiff’s position and the tortfeasor’s conduct, not with the relationship between the plaintiff’s position and the tortfeasor’s pocketbook.

The question of whether a duty of care arises between an employee and his or her employer’s customer depends on the circumstances of each particular case including whether the employee is performing the “very essence” of a contract between the plaintiff and his or her employer. In this case, Iacobucci J. concluded that the employees “unquestionably” owed and breached the duty of care owed to the plaintiff when handling the transformer.

Iacobucci J. accepted the employees’ invitation to reconsider the privity rule as applied to employers’ contractual limitation of liability clauses in the context of a tort case. He would later note that this invitation was extended earlier by McIntyre J. in the ITO-International case. In so doing, Iacobucci J. made it clear this relaxation of the privity rule in favour of third party beneficiaries should not be taken as affecting the law as it relates to the imposition of obligations on third parties. His conclusion was as follows:

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181 For himself, L’Heureux-Dubé, Sopinka and Cory JJ.
182 Ibid. at 336.
183 Ibid. at 337.
184 Ibid. at 335.
186 Ibid. at 361.
... when an employer and a customer enter into a contract for services and include a clause limiting the liability of the employer for damages arising from what will normally be conduct contemplated by the contracting parties to be performed by the employer’s employees, and in fact so performed, there is simply no valid reason for denying the benefit of the clause to employees who perform the contractual obligations. The nature and scope of the limitation of liability clause in such a case coincides essentially with the nature and scope of the contractual obligations performed by the third party beneficiaries (employees).

Iacobucci J. recognized that this conclusion was supported by the Supreme Court’s emphasis in *Central Trust v. Rafuse* and *BG Checo* that the law should not permit a plaintiff to escape a contractual exclusion or limitation of liability by suing in tort rather than contract:\(^\text{187}\)

> Upholding a strict application of the doctrine of privity in the circumstances of this case would also have the effect of allowing the appellant to circumvent or escape the limitation of liability clause to which it had expressly consented.

Finally, Iacobucci J. found that allowing the employees to benefit from the limitation of liability clause made “perfect” commercial sense and allowed the parties to allocate the risk of damage to the transformer and procure insurance accordingly.

Iacobucci J. then concluded that for all of these reasons, the parties must have impliedly intended to cover the employees by limiting the liability of their employer.\(^\text{188}\) The ability of third parties to claim the protection of a contractual limitation of liability if the parties to the contract so intended effectively destroys one half of the privity doctrine and is the single most important ruling to take from *London Drugs*.

In applying this new law to the facts in *London Drugs*, Iacobucci J. plainly looked for optimal contractual terms from an equitable perspective. The “warehouseman” specified in the limitation of liability clause was undeniably the employer-corporate defendant. If the employer and the plaintiff intended to extend the protection to the employer’s employees they could easily have inserted into the contract a “Himalaya Clause” of the sort found in *ITO*. Iacobucci J. was forced to, firstly, hold that a court had the power to


\(^{188}\) *Ibid.* at 365.
find that employees are impliedly third party beneficiaries of the limitation of liability clause and, secondly, that in this case the parties did not choose exclusive language resulting in something of a default finding that “warehouseman” was intended to mean “warehouse-workers”.

It is hard to argue with the assertion that the limitation of the employees’ liability is in accordance with commercial reality and justice. However, the precise wording of the clause is inescapable and it is not right to say that the opposite result would offend the rule from Rafuse. What London Drugs expressly consented to was the limitation of the storage company’s liability. It is one thing for the courts to read exclusionary clauses very carefully and, frequently, contrary to the interests of their drafters. It is altogether different to read implied terms into exclusionary clauses to broaden their application to strangers to the contract.

II.E.3(a)(ii) The Reasons for Judgment of McLachlin J.

In her short concurring judgment, McLachlin J. agreed with Iacobucci J. that the doctrine of privity of contract should not and does not bar the employees use of the limitation of liability as a defence. She disagreed that the limitation clause provides the defence they seek. She correctly observes that the term “warehouseman” plainly refers to the corporate-defendant and not its employees. The clear meaning of the limitation of liability clause prohibits the supposition of an implied term to limit the employees’ liability.

McLachlin J. held that the employees did not need recourse to the limitation clause. It was simply part of the many circumstances limiting the employees’ tort duty to London Drugs. She agreed with the conclusion of McEachern C.J.B.C., Hinkson J.A. and Wallace J.A. that London Drugs voluntarily assumed the risk of damage over $40.

II.E.3.(a)(iii) The Judgment of La Forest J.

189 Ibid. at 321.
La Forest J. disagreed with the "short shrift treatment" of the duty of care issue by Iacobucci and McLachlin JJ. He approached the case from an employee law perspective and narrowed the issue to the second part of the Amns test wherein policy considerations may negate the existence of a duty of care. Here, he had much to say on the interaction between tort and contract including the troublesome issue of economic loss. La Forest J. stressed that courts must be vigilant to guide the development of concurrent liability in such a manner as to avoid unacceptable results.\(^ {190}\)

The problems posed by the concurrent application of contract and tort in a two-party context pale in comparison to the difficulties raised by the extensive overlapping of tort and contract claims in multi-party contexts. Rules and approaches that were acceptable or at least tolerable in the relatively narrow field of tort liability that existed before the full development of the concurrent application of the two regimes of liability may need to be re-examined. The extent of overlap is obviously most acute in cases of economic loss, and the court must take due account, neither more nor less, of the contractual context in which the alleged tort duty is said to exist: ... But the critical new interaction of tort and contract is not limited to cases involving economic loss. In the vast new areas in which tort applies in conjunction with contract, Rafuse, or in contexts with contractual overtones, Norsk, and the case at bar, sensitive approaches will be required.

Further on he adds that the required sensitivity is to the contractual allocation of risk regardless of the type of damage incurred.\(^ {191}\) La Forest J. stressed that the contractual aspects of a case should not be circumvented by an action in tort. These concerns must be addressed in cases of tort liability in a contractual context or where there is a "contractual chain" linking the parties as well as the cases of pure concurrent liability:\(^ {192}\)

The mere lack of privity of contract does not justify the complete disregard of contractual concerns. In fact, since in such circumstances it is more difficult for the parties to contract out of tort liability, tort law may need to be more attuned to the contractual allocation of risk than in cases of concurrent liability.

La Forest J. next discussed with approval civil and English authority recognizing that modern industrial relations call for an indemnity regime in vicarious liability theory. The appreciation of commercial reality properly allows consideration of the conscious allocation of risk in tort cases. La Forest J. characterized the case as a commercial vicarious claim and was of the view that London Drugs freely entered into a contract with a limited liability company, passed on the opportunity to purchase extra insurance and

\(^ {190}\) *Ibid.* at 270.

agreed that the corporate defendant’s liability would be limited to $40. For their part, the warehouse employees had no real opportunity to decline the risk of liability.

For all of these policy reasons, La Forest J. held that specific and reasonable reliance on the defendant employees was required in cases of employee negligence and in cases in which the defendant has no real opportunity to decline the risk.\(^\text{193}\) This reasoning is significant in two ways. The first is that La Forest J. would group these types of cases with cases of negligent misrepresentation and pure economic loss wherein plaintiffs must show reasonable reliance on the statements, acts or omissions of the defendant. The second is his disagreement with the distinction drawn by Iacobucci J. between reliance on the tortfeasor’s conduct as opposed to reliance on its pocket-book. The reliance stipulated by La Forest J. is of a very different kind:\(^\text{194}\)

The question here is whether the plaintiff reasonably relied on the eventual legal responsibility of the defendants under the circumstances.

In summary, La Forest J. did not undermine the privity analysis or conclusions by Iacobucci J. but applied the policy considerations of the second part of the \textit{Anns} test to find that London Drugs did not reasonably rely on the employees and, therefore, was not owed a duty of care.

It is hard to accept that the warehouse employees did not owe London Drugs a duty not to carelessly damage its transformer. The problem with the reasons of La Forest J. is that the \textit{Anns} test and, by extension, the finding of negligence, comes down to little more than a determining whether it is fair to hold a particular careless defendant liable for the plaintiff’s damages. La Forest J. found that it is not fair to hold the employees liable in the circumstances but expressly left it open that if the plaintiff asserted a core “compelling” interest that “it may be appropriate to find that a duty does exist under the

\(^{192}\text{Ibid. at 275.}\)
\(^{193}\text{Ibid. at 313.}\)
\(^{194}\text{Ibid. at 319.}\)
second branch of Anns. The implication being that the employees may have been held liable their carelessness had caused both personal and property damage.

II.E.3(b) The Supreme Court of Canada in Edgeworth Construction

In Edgeworth Construction Ltd. v. N.D. Lea & Associates Ltd., the Supreme Court of Canada was again faced with a tort claim between parties within a contractual chain but without privity. The plaintiff construction company, Edgeworth, contracted with British Columbia's Ministry of Highways to build a section of highway. The defendant engineering firm designed the project and prepared the plans and specifications incorporated into the project. Edgeworth lost money on the project allegedly because of errors in the design material and sued the engineering firm as well as the individual engineers involved for negligent misrepresentation.

The defendants argued that any duty it owed was to the province and further that the contract between the owner and the Edgeworth negated or subsumed the duty owed by the engineers to Edgeworth on the grounds that the engineers' work was incorporated into the owner's tender package and, thereafter, the contract. The tender documents contained the following clause:

This Contract is made and entered into by the Contractor and the Minister on the distinct understanding that the Contractor has, before execution, investigated and satisfied himself of everything and of every condition affecting the works to be executed and the labour and material to be provided, and that the execution of this contract by the Contractor is founded and based upon his own examination, knowledge, information and judgment, and not upon any statement, representation, or information made or given by, or upon any information derived from any quantities, dimensions, tests, specifications, plans, maps or profiles, made, given or furnished by the Minister or any of his officers, employees or agents, and that any such statement, representation, or information, if so made, given or furnished, was made, given or furnished, was made, given or furnished merely for the general information of bidders and is not in anywise warranted or guaranteed by or on behalf of the Minister; and that no extra allowance will be made to the Contractor by the Minister for any loss or damage sustained in consequence of or by reason of any such statement, representation, or information being incorrect or inaccurate, or on account of unforeseen difficulties of any kind.

195 Ibid. at 318.
197 From the trial decision, (1989) 37 C.L.R. 152 (B.C.S.C.) at 155.
On a pre-trial motion, the chambers judge and the British Columbia Court of Appeal agreed that neither the firm nor the individual engineers owed a duty to Edgeworth. Its only recourse was against the province.

The majority judgment was written by McLachlin J. She quickly confirmed that on the facts as alleged, the defendants owed a duty of care to tenderers like the plaintiff knowing that it would rely on information provided by the engineer in preparing its bid. The adoption by the owner of the engineer’s representations did not somehow extinguish the fact that the representations are those of the engineers. Edgeworth relied on the expertise of the engineers and not the province with respect to the accuracy of the design.

McLachlin J. then ruled that the contract exclusion did not expressly or impliedly protect the engineers. This is the test to be taken from the judgment of Iacobucci J. in London Drugs to determine whether a third party may benefit from a contractual disclaimer. London Drugs was distinguished as follows:

In London Drugs the fact that the work for which the exemption was given could only be done by the employees, taken together with other circumstances including the powerlessness of the employees to protect themselves otherwise, suggested that a term should be implied that the clause was intended to benefit them, or alternatively, that the intention of the parties manifested in the contract must be taken to limit the duty of care in tort.

The former resolution referred to by McLachlin J. was the approach taken by Iacobucci J. while the latter was her own. She observed that the firm, unlike the employees in London Drugs, could have done something to protect itself such as including a disclaimer of responsibility in the design documents. Alternatively, the firm could have insisted on supervising the project or it may have accepted the risk and insured itself accordingly. In the whole, the analysis of McLachlin J. follows the approach of Iacobucci J. as she did not

198 For herself, Sopinka, Gonthier and Cory JJ.
199 Supra note 196 at 174.
200 Ibid. at 174.
take up the question of whether Edgeworth voluntarily assumed the risk that the engineering information was inaccurate.\textsuperscript{201}

Further, it made "good practical and economic sense"\textsuperscript{202} to place the responsibility for the adequacy of the design on the shoulders of the designing engineering firm, assuming reasonable reliance and barring disclaimers, as bidders like Edgeworth were in no position to double-check the veracity of the engineering work provided as part of the tender package.

Remarkably, McLachlin J. summarily dismissed the claim against the individual engineers on the basis that it was not enough to sue them merely on the basis that they affixed their seal to the design documents. It is on this point that La Forest J. takes issue in his brief concurring judgment. He points out the anomaly in the Court's unwillingness in \textit{London Drugs} to absolve ordinary employees from liability flowing from negligence in the absence of a contractual exemption whereas the majority in \textit{Edgeworth Construction} did so without hesitation in favour of the professional employees. It is very hard to see how the \textit{Hedley, Byrne} test does not result in a finding that the individual engineers are burdened with the same duty of care as their firm. This point is well taken in practice given that parties in the construction industry recognize the significance of an engineering seal on, for example, a set of drawings and engineers themselves are very cautious in its use. Further, it is much more likely for professional engineers to be insured for errors and omissions than it is for warehouse employees for damaging personal property.

\textbf{II.E.3(f) Post Script to London Drugs and Edgeworth Construction}

The doctrine of privity of contract has been cut in half in that it is now clear that a sufficiently clear exclusionary clause may expressly or impliedly protect a third party to a contract. \textit{Edgeworth Construction} affirmed that the majority approach of Iacobucci J. in

\textsuperscript{201} In "Third-Party Beneficiaries in the Supreme Court: Categorization and the Interpretation of Ambiguous Contracts", (1995) 45 U.T.L.J. 47 at 54, Norman Seibrasse says that this "omission" was "astonishing" given the scope of the clause at issue. McLachlin J. may simply have recognized that she was bound to follow the approach of Iacobucci J. in that she spoke only for herself in \textit{London Drugs}.

\textsuperscript{202} \textit{Per} McLachlin J., \textit{supra} note 196 at 178.
London Drugs is the approach to be taken to these cases and did away with any suggestion that its ambit was limited to employee cases. A third party may be permitted to benefit from an exclusionary clause where the court accepts that such an interpretation reflects the contracting parties' intention.

The courts will pay close attention to the nature of the third party seeking to benefit from an exclusionary clause and the commercial context in the determination of whether to give effect to the third party exclusion. Individual defendants and, in particular, employees whose employers are protected by an exclusionary clause will be more likely to benefit from an exclusionary clause than corporate third party defendants. In this sense it is difficult to rationalize London Drugs and Edgeworth Construction except by tallying the results. The engineering firm in Edgeworth Construction did not benefit from an exclusionary clause notwithstanding their relative affinity with the individual employees in London Drugs and that the clause it was seeking to rely on was arguably broader in scope than its counterpart in London Drugs.

We see in all of these cases a marked tendency of the courts to use economic policy analysis in contract interpretation to impose optimal terms where they feel the term in question is ambiguous. This approach is reinforced by the consideration of who could best bear the loss in tort analysis. In London Drugs, La Forest J. did not take up the issue of interpreting and applying the exclusionary clause at issue but justified at length a rule that holding employees responsible for damage incurred during the course of their employment is neither fair nor makes economic sense in this day and age. In Edgeworth Construction, McLachlin J. held that the engineering firm owed prospective contractors a duty of care in preparing tender information because otherwise each contractor would need to retain its own engineer to investigate the project.

The case law post London Drugs and Edgeworth Construction has been true to the Supreme Court of Canada's twin directions to pay close attention to the wording of the exclusionary clause at issue while being mindful of commercial realities.
In *J. P. Metal Masters*\(^{203}\), the defendant architectural firm prepared design drawings relied on by bidders in a renovation project. It turned out that the design was unworkable and required changes calling for significantly more steel and labour. The plaintiff general contractor and subcontractor sued the architectural firm for negligent misrepresentation. The British Columbia Supreme Court upheld their claims and found that the exclusionary clauses in the standard fixed price contract, CCDC-2, entered into by the building owner and general contractor did not serve to negate the plaintiff contractors' claims for negligent misrepresentation. This decision makes economic sense and is rightly dismissive of the architectural consultant's wishful reliance on clause 2.2.8 of CCDC-2:

> The Consultant will have authority to reject work which in the Consultant's opinion does not conform to the requirements of the Contract Documents. Whenever the Consultant considers it necessary or advisable, the Consultant will have authority to require inspection or testing of work, whether or not such work is fabricated, installed or completed. However, neither the authority of the Consultant to act nor any decision either to exercise or not to exercise such authority shall give rise to any duty or responsibility of the Consultant to the Contractor, Subcontractors, or their agents, employees, or other persons performing any of the Work.

A different result was reached in *Wolverine Tube (Can.) Inc. v. Noranda Metal Industries*\(^{204}\). In this case the defendant Noranda sold three properties to the plaintiff, Wolverine. Prior to the sale, Noranda had commissioned environmental reports from the co-defendant environmental consultant. In breach of its agreement with the consultant, Noranda delivered the reports to Wolverine in advance of the property sale. Wolverine subsequently sued Noranda and the consultant when it discovered the properties were contaminated. The claim against the consultant was for negligent misrepresentation of the status of the lands.

The consultant applied for summary dismissal of the claim against it relying in part on the disclaimer clause in the reports it prepared for Noranda:\(^{205}\)

> Any use which a third party makes of this report, or any reliance on or decisions to be made based on it, are the responsibility of such third parties. [The consultant] accepts no

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\(^{203}\) *Supra* note 10.


\(^{205}\) *Ibid.* at 579.
responsibility for damages, if any, suffered by any third party as a result of decisions made or actions based on this report.

The Ontario Court of Appeal upheld the dismissal of the claim against the consultant and confirmed that this is the very sort of disclaimer of responsibility that McLachlin J. reasoned could have used by the engineering firm in *Edgeworth Construction* to avoid liability for negligent misrepresentation.\(^{206}\)

### II.E.4 The Survival of Exclusionary Clauses

The doctrine of fundamental breach is a judicial device to avoid injustice to the victim of a breach of contract.\(^{207}\) Its rationale is that the an exclusionary clause should have no force and effect when the party seeking to rely on it is guilty of a fundamental breach that vitiated the whole purpose of the contract. In a sense, this doctrine supercedes like but weaker interpretive devices such as the *contra proferentem* rule and the gentler treatment of limitation of liability clauses as opposed to total disclaimers of liability.

The doctrine was seemingly destroyed by the *Suisse Atlantique* case\(^{208}\) wherein the House of Lords ruled in clear terms that private parties are free to contract as they see fit and the role of the courts was to see that those contracts took effect. Professor Waddams explains the jurisprudence post-*Suisse*:\(^{209}\)

> One might have thought, then, that this case would mark the end of the doctrine of fundamental breach as a technique of controlling unfair exclusionary provisions. But the decision made very little difference to the practice of the courts. The Supreme Court of Canada approved of *Suisse Atlantique*, but many lower Canadian courts continued to strike down exemption clauses “as a matter of construction” wherever they found a fundamental breach. This suggests a deep rooted unwillingness to enforce agreements they see as unfair.

### II.E.4(a) Hunter Engineering v. Syncrude Canada

\(^{206}\) It should be noted that the Court of Appeal also agreed with the motion judge’s finding that the consultant did not owe a duty of care to Wolverine in the circumstances of the case.

\(^{207}\) This now discredited doctrine is not to be confused with fundamental breach meaning substantial failure of performance, relieving the injured party from future obligations under a breached contract.


\(^{209}\) *The Law of Contracts*, supra note 74 at 318-319.
In *Hunter v. Syncrude*\(^{210}\), the Supreme Court of Canada took up the issue of whether exclusionary clauses survived the fundamental breach of the underlying contract. The Court unanimously held that the following limitation of liability clause (as amended) provided full protection from implied warranties or conditions, statutory or otherwise:\(^{211}\)

Warranties - Guarantees: Seller warrants that the goods shall be free from defects in design, material, workmanship, and title, and shall conform in all respects to the terms of this purchase order, and shall be of the best quality, if no quality is specified. If it appears [24 months from date of shipment or 12 months from start up, whichever occurs first], that the equipment, or any part thereof, does not conform to these warranties and Buyer so notifies Seller within a reasonable time after its discovery, Seller shall thereupon promptly correct such nonconformity at its sole expense ... [The provisions of this paragraph represent the only warranty of the Seller and no other warranty or conditions, statutory or otherwise shall be implied.]

Wilson J.\(^{212}\) would have courts assess the fairness and reasonableness of giving effect to a disclaimer clause upon the disintegration of its contractual setting.

Dickson C.J.\(^{213}\) was of the view that it was not the courts' place to engage in such a review:\(^{214}\)

In my view, the courts should not disturb the bargain the parties struck, and I am inclined to replace the doctrine of fundamental breach with a rule that holds the parties to the terms of their agreement, provided the agreement is not unconscionable.

Accordingly, the task for the courts is nothing more than to determine whether the clause in question covered the breach in question. Dickson C.J. was appreciative of the commercial context of the dispute and freedom of parties to allocate risks between themselves as part of their bargain. In this way, he agreed with the reasoning of Lord Diplock in *Photo Production Ltd. v. Securicor Transport Ltd.*:\(^{215}\)

In commercial contracts negotiated between business-men capable of looking after their own interests and of deciding how risks inherent in the performance of various kinds of contract can be most economically borne (generally by insurance), it is, in my view, wrong

\(^{210}\) *Supra* note 42.


\(^{212}\) For herself and L'Heureux Dubé J.

\(^{213}\) For himself and La Forest J.

\(^{214}\) *Ibid.* at 337. The Chief Justice was persuaded by Professor Waddams' view that the doctrine of fundamental breach is but one of a number of ways in which the courts refuse to enforce or intervene with unconscionable bargains.

to place a strained construction upon words in an exclusion clause which are clear and fairly susceptible of one meaning only ...

Dickson C.J. was also persuaded by Professor Waddams’ view that the doctrine of fundamental breach is but one of a number of unsatisfactory techniques used by the courts to intervene with unconscionable bargains216. Accordingly, it should be discarded together with its consequent characterizations of “fundamental as opposed to minor breaches” and “exclusionary as opposed to limiting clauses”. Courts should canvass relief on the grounds of unconscionability if that is, in fact, the courts’ concern.

The brief concurring judgment of McIntyre J. is not clear as to whether he agreed with the approach taken by Dickson C.J. or that followed by Wilson J. He simply agreed with the ruling of Wilson J. that there was no fundamental breach of contract in the case at bar and, in any event, the liability of the defendant would be excluded by the terms of the contractual warranty.


Professor Nicolas Rafferty is of the view that it is critical for courts to follow the approach of Dickson C.J. rather than that of Wilson J.:217

If Dickson C.J.’s judgment is followed, then it should mean an end to courts’ distorting what are perfectly reasonable bargains between commercial parties through the incantation of some doctrine of fundamental breach.

Professor Rafferty’s hope seems to have come true in Alberta218 and British Columbia219. The Ontario courts are similarly inclined220. Most of the analysis from the courts in these jurisdictions focuses on the analysis of the bargaining power of the parties.

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218 See *Catre, supra* note 158 and *Canadian Fracmaster Ltd. v. Grand Prix Natural Gas Ltd.* (1990), 109 A.R. 173 (Q.B.) at 189-190.
Still, there has been no authoritative choice between the two approaches and it is clear that some courts have found *Hunter v. Syncrude* "not easy to apply". One court ruled that the exclusion clause in question was unenforceable as the breach was "both fundamental and unconscionable".

Professor Waddams commented that there is unlikely to be much of a practical difference between the two approaches. This has been the case in a number of decisions wherein the court comes to the same result after following both approaches.

All this said, the deep-rooted reluctance to favour the breaching party by enforcing an exclusionary clause observed by Professor Waddams is far from exorcised. In the recent *Bow Valley* case, McLachlin J. reminds us that "it must be kept in mind that generally limitation and exclusion clauses are strictly construed against the party seeking to invoke the clause".

II.F SUMMARY

We have seen the law converge in two areas of great interest to the party in the construction industry. The first is the rationalization of common law and regulatory protections for the building owner. The providers of labour and materials to a construction project are required to meet standards comparable to the warranties of fitness and merchantability imposed by statute on the seller of goods. These obligations are

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223 *The Law of Contracts, supra* note 74 at 323.
further reinforced by the implication of a contractual warranty that builders will comply with municipal and provincial building legislation based on the National Building Code. This first rationalization is furthered by the principle of concurrency of action in tort and contract which relieves the tension of imposing tortious duties on parties to a construction contract.

We have seen that these two important developments in the law are not entirely coherent. There remains, for example, the irrational rule that the law will imply important warranties in favour of the purchaser of an incomplete home as opposed to a finished home. This same sort of dichotomy is probably implicit in the different results in cases like CCH where a contractor is absolved for any liability for supplying labour and materials in accordance with the owner’s direction as opposed to cases like Brunswick wherein the builder was held responsible for following the flawed design in the construction of a completed home.

The Supreme Court of Canada has reiterated and emphasized the importance of recognizing modern commercial practice. The rationalization of regulatory and common law construction standards and warranties serves this objective well. On the other hand, the reasoning of Iacobucci and McLachlin JJ. in London Drugs are excellent illustrations of how this pursuit can result in the substitution of what a court considers to be optimal terms in spite of the clear, if commercially or otherwise unreasonable, intentions of the contracting parties.

This exposes an important concern that is outstanding after these positive doctrinal developments. As expressed by Lord Goff in Henderson v. Mewett, the courts must be alert to the expectations of the parties in a chain of contracts. That is, the court should be very careful not to substitute what it perceives to be the fairest or most efficient contract or series of contracts or project structure in place of what the parties had negotiated for themselves. We shall see in the following chapter that this concern is particularly acute in the cases of pure economic loss.
CHAPTER III

RECOVERY IN NEGLIGENCE OF PURE ECONOMIC LOSS

"The law has to accommodate all the untidy complexity of life; and there are circumstances where considerations of practical justice impel us to reject a general imposition of liability for foreseeable damage. An example of this phenomenon is to be found in cases of pure economic loss, where the so called "floodgates" argument ... compels us to recognize that to impose a general liability based on a simple criterion of foreseeability would impose an intolerable burden on defendants."\(^{225}\)

"[The courts] will refuse to accept injustice merely for the sake of the doctrinal tidiness which is the motivating spirit of Murphy. This is in the best tradition of the law of negligence, the history of which exhibits a sturdy refusal to be confined by arbitrary forms and rules where justice indicates otherwise."\(^{227}\)

III.A INTRODUCTION

Private law’s acceptance of concurrent liability is of great consequence to the construction case in which several parties share close working relationships and privity of contract. The last chapter discussed how this doctrinal development is consistent with and has furthered the rationalization of regulatory protection with the standards imposed by tort duty and implied contractual warranty. This chapter will canvass the second important doctrinal development in private law of consequence to the construction case: the recovery in negligence of pure economic loss.

We saw that Anglo-Canadian jurisprudence developed relatively harmoniously in the former line of cases. The Commonwealth courts have followed different but intersecting routes with respect to the latter issue. Using the Supreme Court of Canada’s majority and minority reasons for judgment in the 1973 case of Rivtow Marine\(^{228}\) as a baseline, English law’s accommodation of claims for pure economic loss momentarily surpassed the

\(^{225}\) Per Lord Goff in Smith v. Littlewoods Organisation Ltd., [1987] 1 All ER 710 (H.L. (Sc.)) at 736.
\(^{227}\) Per McLachlin J. in Norsk, infra note 318 at 365.
Canadian position but has since retreated to a rigidly conservative position. The divergence is manifest in the passages quoted above.

The common law reached its high point in liability for negligence with *Junior Books Ltd. v. Veitchi Co. Ltd.* Supra note 97 wherein the majority of the House of Lords, Lord Brandon in dissent, ruled that tort law permitted a claim for pure economic loss outside of the case of negligent misstatement. At the time, the House of Lords saw the ruling as the inevitable extension of the principles of negligence law set out in the seminal cases of *Donoghue v Stevenson* and *Hedley, Byrne* and consistent with the dissenting judgment of Laskin J. in *Rivtow Marine*. *Junior Books* would not, however, join the illustrious ranks of the first two seminal authorities. The House of Lords subsequently gravitated to Lord Brandon’s views and the limits of negligence law were hastily redrawn to exclude claims for pure economic loss outside of the *Hedley, Byrne* category of cases. In less than a decade, the English appellate courts reduced *Junior Books* to a doubtful authority confined to its special facts.

The Australian High Court and New Zealand Court of Appeal have rejected the House of Lords’ restrictive approach and seem satisfied to evaluate each novel claim on its own merits. The Supreme Court of Canada has also struck out on its own but, by its own admission, has struggled with the principles at issue. The dissenting judgment of Laskin J. in *Rivtow Marine* has proven to be of lasting persuasion and survived to influence the rapid development of Canadian law in this area. Although this law remains difficult, a clearer picture of when a negligent act, omission or representation will ground a claim for pure economic loss is beginning to emerge.

### III.B THE DEVELOPMENT OF THE TORT OF NEGLIGENCE

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229 Supra note 97.
229 Supra note 147.
231 Supra note 135.
Claims for pure economic loss and the quandary they pose are best understood by reviewing the legal principles upon which they are founded. Here, we must begin with the speeches of the House of Lords in *Donoghue v. Stevenson*.

III.B.1 *Donoghue v. Stevenson*

The plaintiff, Mrs. Donoghue, suffered shock and was made ill by consuming some of a bottle of ginger-beer contaminated by the decomposing remains of a snail. The ginger beer was purchased by a friend from a café. The plaintiff did not, therefore, enjoy a contractual relationship with either the café or the bottler whose negligence was alleged to have caused the introduction of the snail to the bottle. Three of five Law Lords provided the plaintiff a remedy against the bottler in the tort of negligence finding that, in the circumstances, the bottler owed and breached a duty of care to consumers to take reasonable care in the preparation of aerated waters.

Lord Atkin was of the view that the law must offer a legal remedy to, at least by analogy, such an obvious “social wrong”. His prophetic judgment sought to distill from the case law a statement of general application defining the relations between parties that give rise to a duty of care. He left us with the famous neighbour principle: ²³²

The rule that you are to love your neighbour becomes in law, you must not injure your neighbour; and the lawyer’s question, Who is my neighbour? receives a restricted reply. You must take reasonable cause to avoid acts or omissions which you can reasonably foresee would be likely to injure your neighbour. Who, then, in law, is my neighbour? The answer seems to be - persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected when I am directing my mind to the acts or omissions which are called in question.

*Donoghue* established negligence as an independent tort unlimited by the constraints of privity of contract. ²³³ It is important to note that the facts and the reasoning in *Donoghue* emphasized the danger of injury to person or property.

²³² Supra note 147 at 580.
²³³ Winterbottom v. Wright (1842), 152 Eng. Rep. 402 (1842), is recognized, rightly or wrongly, as the principle authority for the privity defence in negligence actions.
III.B.2  

**Hedley, Byrne to Anns**

Commonwealth courts did not hesitate to apply *Donoghue v Stevenson* and, in particular, Lord Atkin’s “general conception of relations giving rise to a duty of care”\textsuperscript{234} as well as Lord Macmillan’s reminder that the categories of tort are never closed\textsuperscript{235}. Nevertheless, financial loss claims continued to be problematic in tort law because the damages recoverable in contract and tort differ. Tort damages compensated victims for injury to person or to property other than that which has been purchased. Repair and replacement costs caused by the defective quality of property were considered the exclusive preserve of contract. This is the stuff of warranty and is the basis of the observation that Mrs. Donoghue would have had no case against the bottler if she was presented and drank a bottle of flat ginger beer or water, for that matter. The latter is an example of loss excluded from recovery in the tort of negligence because the only damage suffered by the purchaser is in the value of the property acquired. The cause of action would consist of her friend’s complaint against the café which charged too much for the beverage.

The tort of negligence took another tremendous advance with the judgment of the House of Lords in *Hedley, Byrne & Co. v. Heller & Partners Ltd.*\textsuperscript{236} The plaintiffs in *Hedley, Byrne* were a firm of advertising agents who were personally liable for advertising placed on behalf of a client called Easipower. The plaintiffs caused their own bank to inquire in confidence of the defendants, Easipower’s bankers, whether Easipower had the means to honour a significant advertising contract. The defendants represented in writing to the plaintiffs that Easipower had the necessary wherewithal and consequently, the plaintiffs placed advertising on Easipower’s behalf. Easipower subsequently defaulted on its bill and the plaintiffs lost money on their guarantee.

\textsuperscript{234} *Supra* note 147 at 580.

\textsuperscript{235} *Supra* note 147 at 619.

\textsuperscript{236} *Supra* note 135.
The plaintiff’s claim for negligent misrepresentation was dismissed on the basis of disclaimer language in the defendants’ correspondence to the plaintiffs but all five Law Lords agreed that a duty could be imposed in certain circumstances for negligent words in the absence of contract and without fiduciary relations. Some criticism was voiced of the distinction between financial and physical damage and Lord Devlin went so far as to call the distinction “nonsense”\textsuperscript{237}.

\textit{Hedley, Byrne} confirmed that negligence law in general will allow recovery for economic loss. The House of Lords stopped short, however, of adopting the neighbour principle of \textit{Donoghue} to govern negligent statements but limited liability for negligent misstatement to professional people in particular close proximity to those who they know are relying on their skill.

In the \textit{Ministry of Housing case}\textsuperscript{238}, Lord Denning relied on \textit{Hedley, Byrne} to expound a broader guideline on liability for negligent misstatement:\textsuperscript{239}

\begin{quote}
In my opinion the duty to use due care in a statement arises, not from any voluntary assumption of responsibility but from the fact that the person knows, or ought to know, that others, being his neighbours in this regard, would act on the faith of the statement being accurate. That is enough to bring the duty into being. It is owed, of course, to the person to whom the certificate is issued and who he knows is going to act on it. … But it is also owed to any person whom he knows or ought to know, will be injuriously affected by a mistake, …
\end{quote}

The development of tort law post \textit{Donoghue} resulted in the position that a duty of care was regularly found to be owed in circumstances of negligently caused injury to the plaintiff’s person or property. Following \textit{Hedley, Byrne}, and by the end of the 1970’s, tort law was expanding as claimants sought redress for negligence in the absence of physical harm. The idea that tort duty did not depend on the type of damage suffered by the plaintiff was articulated by Lord Salmon in \textit{Ministry of Housing}:\textsuperscript{240}

\begin{quote}
So far, however, as the law of negligence relating to civil actions is concerned, the existence of a duty to take reasonable care no longer depends on whether it is physical
\end{quote}

\textsuperscript{237} \textit{Ibid.} at 602-603 of All E.R.
\textsuperscript{239} \textit{Ibid.} at 1018-1019.
\textsuperscript{240} \textit{Ibid.} at 1027.
injury or financial loss which can reasonably be foreseen as a result of a failure to take such care.

This liberalization of tort law peaked in the reasoning and results in the House of Lords’ decisions in *Anns v. Merton London Borough Council*[^241], and *Junior Books*. In *Anns*, the local building inspector failed to take reasonable care to ensure that the foundations of a residential building were adequately constructed. Symptoms of structural shifting appeared some eight years later. The occupiers were original tenants of the builder and their assignees. They sued the building authority in negligence for approving the defective foundations. Lord Wilberforce concluded that the damage to the structure itself was “material, physical damage”[^242] for which the plaintiffs were entitled to compensation in the amount necessary to restore the structure to a condition of safety. In so finding, Lord Wilberforce articulated the two part duty of care test in the following famous passage:[^243]

> ...the position has now been reached that in order to establish that a duty of care arises in a particular situation, it is not necessary to bring the facts of that situation within those of previous situations in which a duty of care has been held to exist. Rather the question has to be approached in two stages. First one has to ask whether, as between alleged wrongdoer and the person who has suffered damage there is a sufficient relationship of proximity or neighbourhood such that, in the reasonable contemplation of the former, carelessness on his part may be likely to cause damage to the latter, in which case a prima facie duty of care arises. Secondly, if the first question is answered affirmatively, it is necessary to consider whether there are any considerations which ought to negative, or reduce or limit the scope of the duty or the class of person to whom it is owed or the damages to which a breach of it may give rise .... Examples of this are *Hedley Byrne* ... where the class of potential plaintiffs was reduced to those shown to have relied on the correctness of statements made, and ... cases about ‘economic loss’ where, a duty having been held to exist, the nature of the recoverable damages was limited...

### III.B.3 The Early Response to Claims for Pure Economic Loss

The limitation alluded to by Lord Wilberforce in *Anns* was the *de facto* rule denying recovery for pure economic loss outside of actions for negligent misrepresentation.[^244]

[^244]: The exclusory rule is often traced back to the rejection of the relational economic loss claim asserted in *Cattle v. Stockton Waterworks Co.* (1875), Q.B. 453. *Weller & Co. v. Foot & Mouth Disease Research Institute*, [1966] Q.B. 569 is a leading modern authority. Michael MacGrath cites some notable
Tort law readily compensated claimants for financial or economic loss which was causally consequent upon harm to the plaintiff’s person or property. "Pure" economic loss is defined as financial loss that is not causally consequent upon physical injury to the plaintiff’s own person or property or "a diminution of worth incurred without any physical injury to any asset of the plaintiff". This limitation was supported by the understanding that Donoghue was limited in its application by Lord Atkin’s phraseology of "injury to the consumer’s life or property".

Post Hedley, Byrne, the tendency was to dichotomize claims on the basis of the impugned conduct. Hedley, Byrne grounded recovery if the financial loss resulted from a misrepresentation or misstatement by a person with whom the plaintiff was in a "special relationship". There would be no recovery, however, in the conventional negligence case in which the loss was caused by a negligent act or omission in the absence of damage to the plaintiff’s person or property.

Jurists recognized the distinction between negligent words and actions to be non-principled and arbitrary. The Supreme Court of Canada recently identified at least some of the policy reasons behind the general judicial reluctance to grant recovery for pure economic loss:

1. the belief that economic interests were less worthy of protection than bodily security and property;
2. the fact that a single act of negligence might cause untold financial loss to a broad group of individuals and the consequent fear of imposing indeterminate liability;
3. the assumption that economic efficiency would often demand that the burden of economic loss be placed on the victim as a normal incident of conducting business; and
4. the desirability of discouraging a multiplicity of lawsuits.

246 Supra note 147 at 599.
At its core, the exclusion is best explained by the second policy reason. The judiciary is plainly troubled by the “floodgates” argument famously characterized as “liability in an indeterminate amount for an indeterminate time to an indeterminate class." In the case of relational economic loss, a single act of negligence which causes limited physical harm to one person may result in tremendous foreseeable economic loss to a very large number of other persons who are dependent on the continued operation of the damaged property. In other cases, the refusal of recovery for pure economic loss represented the limit in negligence liability and private law’s boundary between tort duty and contractual warranty.

III.C THE SUPREME COURT OF CANADA IN RIVTOW MARINE

Canadian courts were just as quick to follow Donoghue v. Stevenson and did not hesitate to compensate a plaintiff for financial loss when it was associated with personal injury or property damage of some sort. Hedley, Byrne was treated more carefully but claims for economic loss alone were recoverable if a plaintiff proved reasonable reliance on a negligent misstatement. The reasoning and results in cases where plaintiffs asserted claims for economic loss arising from negligence without physical damage or negligent misstatement were less coherent. Generally, such claims were dismissed on the basis of the exclusionary rule.

The Supreme Court of Canada was presented with a good opportunity to address this issue in the case of Rivtow Marine. The defendant Washington designed and manufactured a special type of crane leased by its exclusive British Columbia distributor, the co-defendant Walkem, to the plaintiff, Rivtow, for use on its log barge. Sometime after the installation of the crane on the Rivtow barge, another Washington manufactured crane collapsed and injured its operator. Rivtow responded to this news by withdrawing

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248 Per Cardozo J. in Ultramares Corp. v. Touche (1931), 177 N.E. 441 (N.Y.C.A.) at 444.
its barge from service during the peak of the logging season. Inspections revealed similar structural defects in the Rivtow crane requiring extensive repairs. It was later discovered that both Washington and Walkem were previously aware of the potentially dangerous defects on this type of crane but failed to warn Rivtow.

Rivtow sued both Washington and Walkem in negligence for the cost of repairing the crane and for the loss of use of the barge in a busy season during the repair period. The British Columbia Supreme Court dismissed the claim for repair costs but allowed Rivtow's claim for loss of profits calculated by taking the barge's loss of business in the busy season less the profit it would have foregone in the off-season if Rivtow had been promptly warned about the defects.

The British Columbia Court of Appeal dismissed Rivtow's claims altogether holding the law to be that "personal injury or damage to property caused by the use of a dangerous or potentially dangerous article is the very gist of an action in tort against the negligent manufacturer or purveyor of such article". The Court of Appeal reasoned that it could not extend the rule of liability from Donoghue beyond this proposition.

III.C.1 The Majority Judgment of Ritchie J.

The Supreme Court of Canada was unanimous in allowing damages for the loss of profits on the basis of both defendants' negligent failure to warn Rivtow about the potentially dangerous structural defect in the crane. Ritchie J., for the majority, stressed the close proximity between the defendants and Rivtow in that the defendants knew of the defect and further knew that Rivtow relied on them for advice, inspection and repair of the crane. These facts grounded the duty to warn Rivtow. The breach of this duty directly caused the interruption of the plaintiff's business grounding the claim for loss of profits.

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250 Supra note 228.
251 Ibid., at 535.
Ritchie J. then turned to the question of whether such damage is recoverable in an action for negligence. In so doing he considered and accepted the view of the House of Lords in *Hedley, Byrne* that where liability is based on negligence the recovery is not limited to physical damage but extends also to economic loss. The failure to warn was an independent tort unconnected with the performance of any contract. In this way, Ritchie J. averted any difficulty with the Court’s treatment of *Hedley, Byrne* in the *Nunes Diamonds*\(^{252}\) and was able to restore the trial Judge’s award without taking up “the sometimes winding paths leading to the formulation of a policy decision”.\(^{253}\)

### III.C.2 The Reasons for Judgment of Laskin J.

Laskin J., Hall J. concurring, disagreed that the case should be decided narrowly on the defendants’ failure to warn Rivtow of the probability of injury by reason of the defective design and manufacture of the crane. Instead, he saw the case as the Court’s first opportunity to determine whether recovery may be had in a negligence action for economic loss which stands alone and is not consequent upon physical injury. *Hedley, Byrne* was clear authority that such claims are recoverable in negligence.

Laskin J. confronted the arbitrariness of the denial of claims in pure economic loss by observing that there would be no question as to the manufacturer’s liability if harm had occurred. The law should not deny Rivtow’s recovery for doing the proper thing by promptly inspecting and repairing the crane. The floodgates argument was not persuasive in this sort of case as the Court was only compensating the direct economic loss of the barge owner:\(^{254}\)

> Liability here will not mean that it must be imposed in the case of any negligent conduct where there is foreseeable economic loss;... It is concerned .... with economic loss resulting directly from avoidance of threatened physical harm to property of the appellant if not also personal injury to persons in its employ.

\(^{252}\) Supra note 152 at 699, considered by Ritchie J., *ibid.* at 546.

\(^{253}\) *Ibid.* at 547.

\(^{254}\) *Ibid.* at 550
Laskin J. would have held Washington liable for Rivtow’s repair costs as well as his diminished profits.255

A plaintiff injured by another’s negligence is required to act reasonably to mitigate his damages. If his damages are economic damages only, mitigation may involve him in repairing the defect which brought them about. It may not be open to him to do that because the tortfeasor is in control of the matter that invites repair or correction, .... But where the defective product which threatened injury has been in use by the plaintiff, it may be reasonable for him, upon learning of the threat of likely injury from its continued use, to expend money for its repair to make it fit for service. Such an expenditure then becomes part of the economic loss for which Washington must respond.

Laskin J. speculated but did not decide whether a manufacturer’s better ability to insure against these sort of risks would also support liability for economic loss in the case of negligently designed and manufactured products that did not pose a threat of physical harm or to claims for damage, without more, to the defective product.

III.C.3 Summary

Rivtow Marine divided the Supreme Court of Canada on some aspects of the issue of negligently caused economic loss but both the majority and minority judgments recognized that, in principle, a defendant could be held liable in tort for the economic losses arising wholly in the absence of associated actual physical injury or damage and outside of the Hedley, Byrne category of case. Regrettably, the majority of the Court chose not to address the issue squarely but grounded the plaintiff’s relief in the defendants’ negligent failure to warn. Nonetheless, both the majority and dissenting judgments would be persuasive in Canada and elsewhere in the Commonwealth.

III.D THE HOUSE OF LORDS’ DECISION IN JUNIOR BOOKS v. VEITCHI

In Junior Books256, the plaintiff building-owner contracted with a general contractor for the construction of a factory. The general contractor, in turn, contracted with the defendant flooring specialists selected and designated by Junior Books’ architect. The flooring laid by Veitchi pursuant to this subcontract developed cracks over the whole of

255 Ibid. at 553.
its surface about two years after it was completed requiring extra maintenance and early replacement.

Junior Books did not sue its general contractor but sued Veitchi notwithstanding there was no contractual relationship between the parties. The alleged cause of action was for negligent breach of care owed Junior Books by Veitchi as a flooring specialist. The claim was for the cost of replacing the flooring as well as the financial or economic loss suffered during the remedial work. The floor was defective but it was not alleged that it presented a danger to the health or safety of any person nor risk of damage to any other property belonging to the owner of the floor. This was, therefore, a claim for pure economic loss of the sort conjectured by Laskin J. in *Rivtow Marine* and subject of *obiter* comment in *Young and Marten*.

**III.D.1 The Majority Reasons in Junior Books**

Veitchi did not contest that a builder is under a duty to take reasonable care to avoid causing personal injury or damage to property in carrying out its work. Veitchi further agreed that its duty of care extended beyond the parties with whom it contracted at large subject to remoteness. Veitchi contended that any cause of action only accrued to a third party when there was an occurrence of personal injury or property damage and moved to have the claim dismissed on the basis that there was no such occurrence in this case. Veitchi’s submission is essentially that tort law imposes liability on the provider of a toxic bottle of ginger beer that has been sampled but neither against the provider of a bottle of flat ginger beer nor the seller of a toxic bottle of ginger-beer left unopen. Junior Books’ complaint should be with its general contractor who charged too much for the flooring.

Although a Scottish appeal, it was accepted that the relevant principles of Scots’ delict were the same as English tort. Four of five Law Lords agreed that Junior Books’ claim was supported in negligence law. Lord Brandon did not.

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^[586] *Supra* note 97.
Lord Roskili's speech is the most frequently cited from the majority. He began his reasons by maintaining that principle rather than policy is paramount in the development of tort law. Of course, the distinction between policy and principle is not always easy to draw. It is naïve to maintain that policy does not inform tort law. This is particularly so in cases such as this where what may be conceded as the limits of established "principles" are tested. Further, policy arguments such as floodgates are plainly called for in the second stage of Lord Wilberforce's analysis in *Anns* set out above wherein the court decides whether to "negative, reduce or limit the scope of the duty or the class of person to whom it is owed or the damages to which a breach may give rise".

Lord Roskili moved from this premise to focus on the existence and character of the duty of care rather than the damage suffered. The principled manner was to determine whether a duty of care existed in the manner prescribed by Lord Atkin in *Donoghue v. Stevenson* and Lord Wilberforce in *Anns*. Lord Roskili found that Veitchi was in as close a commercial relationship with Junior Books as it was possible to envisage short of privity of contract. He further could find no reason to restrict the duty of care arising from this proximity.

In coming to his conclusions, Lord Roskili canvassed leading Commonwealth cases and applauded the dissent by Laskin J. in *Rivtow* as being principled and appropriately dismissive of the floodgates argument. He agreed with Lord Wilberforce's comment in *Anns* that Laskin J.'s judgment was of "strong persuasive force".

Lord Fraser agreed with the views of Lord Roskili and, in particular, his emphasis and characterization of the very close proximity between Veitchi and Junior Books. This was enough, for Lord Fraser, to dispel the fears of opening the floodgates and to distinguish the case from, for example, the case of producers of goods sold to the public. Of interest,

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257 Lord Denning earlier observed in *Spartan Steel & Alloys Ltd. v. Martin & Co. (Contractors) Ltd.*, [1973] Q.B. 27 (Eng. C.A.) at 36, that "At bottom ... the question of recovering economic loss is one of policy."
Lord Fraser expressly left open the question of "What the position might have been if the action had been brought by a subsequent owner is a matter which does not have to be decided now." Presumably, the subsequent owner's chances of recovery would be impaired by the lack of any relationship with the flooring subcontractor.

Lord Russell agreed with Lords Roskill and Fraser.

Lord Keith, too, found in favour of Junior Books. He began his reasons by confirming that a relationship of proximity existed within the principle of Donoghue v. Stevenson. He then cited Hedley, Byrne as authority for the recovery of pure economic loss where it is foreseen as a likely consequence to be suffered by another standing in the requisite degree of proximity. Physical injury or property damage was not, therefore, a necessary requisite of a duty of care. Finally, he cited the judgment of Lord Wilberforce in Anns as authority for the proposition that where a duty of care has been breached, even though no personal injury or property damage has actually been caused, because the person to whom the duty is owed has incurred expenditure in averting the damage, that person is entitled to damages measured by the amount of the expenditure.

It was very straightforward for Lord Keith to spring from this foundation to find that Veitchi owed Junior Books the duty to take reasonable care to avoid acts or omissions which it ought to have known would be likely to cause Junior Books, not only physical damage to person or property, but also pure economic loss. Veitchi ought to have anticipated this sort of loss as likely to occur if its workmanship was faulty.

Lord Keith went on, however, to caution against advancing the frontiers of negligence beyond the facts of this case. It is not enough for a purchaser to show that the product or work in issue was defective. Such an extension would be disruptive of commercial practice and leave manufacturer's open to unlimited liability to ultimate consumers. Lord Keith pointed out that in the regular course, a purchaser of a defective product could sue
the seller for breach of contract who, in turn, could hold its own supplier accountable by way of third party procedure.

It seems that Lord Keith was seeking some middle ground between the majority and Lord Brandon. It is uncertain, however, how Lord Keith reconciled this forcefully worded caveat with the very case before him. On the one hand he says that he would deny an owner compensation for a bad floor rather than the good one contracted for. On the other hand, he found that the cost of maintaining and replacing the bad floor was good grounds for recovery by Junior Books’ of its economic loss.

III.D.2  Lord Brandon’s Dissent

Lord Brandon held that in the absence of contractual privity, Donoghue v. Stevenson was the only precedential foundation from which Junior Books could establish a duty of care owed by Veitchi. He found it fundamental to Donoghue that the duty of care was based on the existence of a danger of physical injury to persons or their property. He further stressed the accepted understanding that the relevant property must be property other than the very property which gave rise to the danger of physical damage concerned.

It followed for Lord Brandon that the duty of care owed by Veitchi to Junior Books was nothing more or less than to exercise reasonable care in laying the flooring so as to ensure that it did not constitute a danger of physical damage to persons or their property, other than the flooring itself. To extend the duty of care further would be to impose a warranty in circumstances where there was no contractual relationship between them and without precedential authority or policy requirement. These considerations served to justify the non-extension of the duty of care owed by Veitchi to Junior Books in a convoluted application of the second stage of the approach to duty of care established by Lord Wilberforce in Anns.258

258 Ibid. at 546.
In this way, Lord Brandon agreed with the majority that contractual obligations would be relevant to the second stage of the Anns duty of care test. Lord Roskill and Lord Russell conceded that the terms of the main contract\(^{259}\) and Veitchi’s subcontract\(^{260}\) could have served to limit Veitchi’s duty of care to Junior Books. Therefore, it may be that Veitchi would have been better served by an application for summary judgment supported by evidence including the two contracts. This said, one could forgive Veitchi’s counsel for assuming that the \textit{prima facie} duty of care imposed on its client would be to impose a non-dangerous rather than a good floor.

***D.3 The Denouement of Junior Books***

\textit{Junior Books’} tremendous implications for private law were obvious. At its most conservative reading, the judgment allowed recovery of negligently inflicted pure economic loss in tort where there existed a relationship of very close proximity between the tortfeasor and the victim regardless of physical injury. \textit{Junior Books} could, on the other hand, be fairly read to assimilate pure economic loss into the mainstream of negligence liability.\(^{261}\) From there it was a very short step to crossing the threshold of contract law by providing a remedy for non-dangerous defects in the quality of goods and services.

Academics recognized the potential of \textit{Junior Books} and were plainly concerned:\(^{262}\)

The implications of this case for the law of contracts and products liability are staggering to say the least.

One leading Canadian commentator was extremely critical of the majority reasons:\(^{263}\)

\(^{259}\) \textit{Ibid.} at 546.
\(^{260}\) \textit{Ibid.} at 534.
\(^{261}\) This is apparently the basis of the trial judgment in \textit{Muirhead v. Industrial Tank Specialities}, [1985] 3 All ER 705 (C.A.) at 709.
\(^{262}\) Per J.C. Smith and Peter Burns in “Donoghue v. Stevenson - The Not So Golden Anniversary” (1983), 46 Mod. L. Rev. 147 at 153.
It [Junior Books] is, however, a poorly reasoned decision, in striking contrast to so many other decisions in tort law rendered by the House of Lords. It commands little respect and promises to have little impact in the jurisdictions which are bound to follow it.

English commentators were more balanced in their analysis.264

For better or worse, Junior Books did not nearly realize its full potential in the English law of negligence and Scots’ law of delict as the British judiciary quickly undermined its authority. The trend was to treat Junior Books as anomalous and restrict it to its own facts and especially the finding that there was a very close relationship between the plaintiff building owner and the defendant flooring subcontractor and that the former relied on the latter’s expertise. This is a rather dubious manner of distinguishing the case in that it is not, in fact, unusual for an owner, its engineer or architect to designate a specific supplier or trade in any significant construction project.265 The English Court of Appeal was especially troubled by the relevancy to a negligence claim of contractual terms not arising under a contract between the litigants.266

III.D.3(a)  D & F Estates v. The Church Commissioners of England267

The criticism of Junior Books was taken up by the House of Lords in D & F Estates wherein a building owner sued a subcontractor among others for the cost of replacing plaster negligently installed in a block of flats as well as the loss of rent suffered while the remedial work was carried out.

Lord Bridge agreed with the consensus of judicial opinion that the majority judgment in Junior Books was to be confined to its unique set of facts. It could not for that reason be

265 The owner also often has authority to reject a subcontractor selected by the general contractor. Paragraph 3.8.3 of CCDC-2 provides that: “The Owner may, for reasonable cause, at any time before the Owner has signed the Contract, object to the use of a proposed Subcontractor or Supplier and require the Contractor to employ one of the other subcontract bidders.”.
266 See especially Muirhead, supra note 261 and Simann Co. v. Pilkington Glass, [1988] 1 All E.R. 791. In the latter case, Bingham L.J. at 803 went so far as to find that he was bound by the interpretation of Junior Books as being a case of physical damage notwithstanding that it was doubtful that this was consistent with Lord Roskill’s intention.
relied on as laying down "any principle of general application in the law of tort or delict". Lord Bridge instead preferred the dissenting judgment of Lord Brandon as a cogent and clear enunciation of fundamental principles and quoted extensively from it. He then went on to observe that Lord Brandon's reasoning was supported by the view of the Supreme Court of the United States of America and the majority judgment of Ritchie J. in Rivtow Marine.

In deference to the legislature's paramountcy in areas of consumer protection, Lord Bridge stated that he was "glad" to reach the conclusion that the cost of repairing the plaster was not an item for which the builder could possibly be made liable in negligence under the principle of Donoghue or any "legitimate development of that principle".

Lord Oliver met squarely the contention of Laskin J. that it is only fair to compensate a plaintiff for the cost of remedying a defect prior to the apprehended injury. He did not deny the logic in the argument but simply found that reasoning to be a novel concept without foundation in negligence law. Lord Oliver held that a builder is liable at common law for negligence only where actual damage to person or property results from carelessness on its part in the course of construction.

In so finding, Lord Oliver observed that it was the defendants' failure to warn of defects in the crane that grounded the economic loss award in Rivtow Marine and that, even on that basis, the damages did not extend to the costs of repairing the crane itself. Lord Oliver summarily dismissed Junior Books as being of no guidance and agreed with Lord Bridge's adoption of the reasons of Lord Brandon concerning general limits of the duty of care in negligence.

_D&F Estates_ would be the last direct consideration of Junior Books by the House of Lords. Rather than overturn its majority judgments, the House of Lords gutted them of

268 Ibid. at 202.  
269 Ibid. at 207.
any precedential value and approved of the Court of Appeal's mischaracterization of the case as arising from a unique factual situation. The House of Lords subsequently expressly rejected the general application of the Anns test\textsuperscript{270} and restated the principle that there is no recovery for relational economic loss\textsuperscript{271}. Lord Wilberforce's judgment in Anns was finally and formally overruled in Murphy v. Brentwood District Council\textsuperscript{272}.

III.D.3(b) \textit{Murphy v. Brentwood District Council}

The House of Lords followed its lead from \textit{D & F Estates} to settle the law post Anns. In Murphy, the plaintiff home-owner prosecuted a claim for economic loss against the local authority for negligently approving the faulty design of the house's foundations. The Lords frankly admitted that Murphy, like Anns, was nothing more or less than a claim in negligence for economic loss. The property owners in both cases sought compensation for repairing the structural defect itself and not just the apparent damage it caused. Anns was criticized for its miscategorization of the injury as "material, physical damage" resulting in obfuscation of the true nature of the claim and scope of the duty.\textsuperscript{273}

Anns was expressly overruled in a lengthy series of judgments that rejected the extension made by Lord Wilberforce from liability under \textit{Donoghue v. Stevenson} for damage to person or property caused by a latent defect in a carelessly manufactured article to liability for the cost of rectifying a defect in an article before harm is sustained.

Lord Keith apparently reconsidered the wisdom of Lord Wilberforce's reasoning in Anns since writing his concurring speech in \textit{Junior Books}:\textsuperscript{274}

> In my opinion it is clear that Anns did not proceed upon any basis of established principle, but introduced a new species of liability governed by a principle indeterminate in character but having the potentiality of covering a wide range of situations, involving chattels as well as real property, in which it had never hitherto been thought that the law of negligence had any proper place.

\textsuperscript{270} Caparo Industries plc. v. Dickman, [1990] 2 A.C. 605 (H.L.).


\textsuperscript{272} [1990] 2 All E.R. 908 (H.L.).

\textsuperscript{273} Ibid. at 933.

\textsuperscript{274} Ibid. at 922.
Lord Keith expressly found that the right to compensation for pure economic loss, not flowing from physical injury, did not extend beyond the situation where the loss had been sustained through reliance on negligent misstatement as in Hedley, Byrne. He included in this analysis approval of the majority decision in Rivtow Marine observing that Donoghue v. Stevenson simply did not apply because the defect in the crane was discovered and rectified before it had done any damage. The loss was, therefore, purely economic and non-compensable in negligence.

Lord Bridge stated that he read and re-read the dissenting judgment of Laskin J. with the “closest attention” and found it “wholly unconvincing”. In his opinion, Laskin J. failed to recognize that once a chattel is known to be dangerous, it is simply unusable.275

The House of Lords confirmed its ruling in D & F Estates that in the absence of a contractual duty or of a special relationship of proximity introducing the Hedley, Byrne principle of reliance, a builder owes no duty of care in tort in respect of its work. Junior Books was again distinguished as a case where such a special relationship existed.

Junior Books is now only infrequently cited as authority for recovery of economic loss in close factual circumstances. Any faint hope that the case stood for any broader proposition was recently crushed by the Scottish Court in the Strathford case276 wherein plaintiff counsel’s argument that the principles enunciated in Junior Books survived in Scots’ law post Murphy and D & F Estates was flatly rejected. The plaintiff had no claim for recovery of pure economic loss as a result of some deficiency in the quality of what it came to acquire.

III.D.4 Summary of the British Position on Pure Economic Loss

275 Ibid. at 927.
276 Strathford East Kilbridge Ltd. v. HLM Design Ltd. (24 July 1997), Scot. J. No. 214 (Scot. Ct. of Session (O.H.)).
British law has effectively retreated to its status as at *Hedley, Byrne*. The House of Lords’ analysis has been characterized as the “pockets of case law” approach in which the courts consider what is required of a duty of care in the pocket of cases wherein the loss was caused in the same way.\(^ {277} \) The only pocket now available to British plaintiffs suffering pure economic loss is when the damage is the result of negligent words. In those cases, a duty of care requires a special relationship of reliance between the plaintiff and defendant.\(^ {278} \)

### III.E AUSTRALIAN AND NEW ZEALAND CASE LAW

English and Canadian jurisprudence is closely considered by Australian and New Zealander courts faced with negligence claims for pure economic loss. The general exclusionary rule erected by the House of Lords has been rejected in both jurisdictions. The reasoning of the Supreme Court of Canada has been treated much more favourably.

#### III.E.1 Australian Jurisprudence

The leading decisions of the Australian High Court in this area are *Caltex v. The Willemstad* and *Bryan v. Maloney*. It is interesting to note that the law expounded in these cases is relatively unchanged notwithstanding that *The Willemstad* predates *Anns* and *Junior Books* while *Bryan v. Maloney* postdates *D & F Estates* and *Murphy*. The Australian High Court seemingly monitored the doctrinal tempest in the House of Lords from a safe distance.

#### III.E.1(a) *Caltex Oil v. The Willemstad*\(^ {279} \)

The dredge “The Willemstad”, using a defective track plotter chart supplied by Decca, negligently broke an underwater pipe owned by Australian Oil Refining and used

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\(^ {277} \) Jane Stapleton, “Duty of Care and Economic Loss” (1991), 107 L.Q.R. 249. At 259, Ms. Stapleton states that “read today”, *Hedley, Byrne* comes as a “shock” and would “come in for harsh treatment” by the House of Lords.

\(^ {278} \) This proposition is subject to the recent cases of *Henderson v. Merrett Syndicates*, *supra* note 138 and *White v. Jones*, *supra* note 140, discussed earlier in Part II.C.2 , in which the House of Lords arguably shifted the inquiry towards the assumption of responsibility by the defendant.
exclusively to take petroleum products from AOR’s refinery to Caltex’s oil terminal. Decca and the Willemstad took the position that Caltex’s action in negligence against them was foreclosed by the exclusory rule barring the recovery of economic relational loss. The Australian High Court not only allowed AOR’s claims for damages to its pipe and contents but ordered Caltex to be compensated for the cost of alternatively transporting its products until the pipe was repaired.

In so doing, the Court responded affirmatively but for different reasons to the same question that would later vex the Supreme Court of Canada in Norsk280: is a person entitled to be compensated in damages for economic loss sustained by that person as a result of damage negligently caused to the property of a third party?

Gibbs J. agreed with the general proposition that damages for economic loss are not recoverable unless consequential upon injury to the plaintiff’s person or property. Foreseeability is not enough to establish a duty of care. However, a duty may be imposed in the exceptional case where the plaintiff defendant has knowledge or means of knowledge that the plaintiff individually, and not merely as a member of an unascertainable class, is likely to suffer economic loss as a consequence of the defendant’s negligence. Gibbs J. declined to formulate a governing principle that would cover all cases in which such a duty is owed as such a determination would turn on the facts of the particular case.281

The Court agreed that a general exclusionary rule should be rejected but that foreseeability is insufficient as a controlling factor. In this case, Mason and Gibbs JJ. observed that the defendants’ knew or ought to have known that Caltex as a specific individual rather than merely as a member of a general class was likely to suffer economic loss as a consequence of their negligent conduct. Gibbs and Stephen JJ. emphasized that Caltex and AOR were engaged in a common adventure.

279 (1976), 11 ALR 227 (H.C.).
280 infra note 318, discussed in Part III.F.2.
281 Supra note 279 at 245.
Stephen J. explained the Court’s pragmatic approach to finding the limiting factors in claims for pure economic loss:\textsuperscript{282}

Both in actions for negligent mis-statement and in products liability actions based upon negligence, the particular fact situations encountered are likely themselves to provide material out of which formulations limiting the extent of liability may be fashioned: *Hedley, Byrne and Rivew Marine* respectively provide examples of this process in these two areas. But in the general realm of negligent conduct it may be that no more specific information can be formulated than a need for insistence upon sufficient proximity between tortious act and compensable detriment. The articulation, through the cases, of circumstances which denote sufficient proximity will provide a body of precedent productive of the necessary certainty; the gradual accumulation of decided cases and the impact of evolving policy considerations will reflect “the courts’ assessment of the demands of society for protection from the carelessness of others” ...  

### III.E.1(b) *Sutherland Shire Council v. Heyman*\textsuperscript{283}

*Sutherland Shire Council v. Heyman* arose from facts very similar to those in *Anns*. Heyman and others purchased a house for which the defendant town council had issued a building permit years earlier. Heyman discovered damage caused by inadequacy in the house’s footings soon after taking occupation and sued the Council for failing to see that the builders constructed the house in conformity with the approved plans and specifications. The Trial Judge found that the Council carelessly inspected the excavation of the home’s foundation and ruled in Heyman’s favour.

The High Court unanimously allowed the Council’s appeal. Gibbs C.J., for himself and Wilson J., held that the only duty owed by the Council to Heyman was to give proper consideration to the question of whether to exercise its powers, including the power of inspection. Heyman failed to prove that Council was negligent in this way. The other three Justices ruled that the Council did not owe Heyman the necessary duty of care such that it was liable for failing to prevent the builder’s negligence.

\textsuperscript{282} *Ibid.* at 260-261.

\textsuperscript{283} (1985), 60 ALR 1 (H.C.)
The Court considered *Anns* critically. The Council’s reliance on *Anns* for the proposition that reasonable foreseeability of loss is sufficient to establish a duty of care in negligence was rejected. The Court concluded that there was not the necessary degree of reliance or proximity as between a subsequent purchaser and a housing authority under Australian legislation.

III.E.1(c) *Bryan v. Maloney*\(^{284}\)

In *Bryan v. Maloney*, the plaintiff, Maloney, purchased from the second owner and took possession of a dwelling house built seven years earlier for the original landowner by a professional builder, Bryan. Maloney neither knew nor inquired after the identity of the builder when she bought the house. About six months later, the walls started cracking as a result of the construction of the house on inadequate footings. Maloney sued Bryan in negligence.

The Trial Judge held that Bryan was negligent and awarded Maloney compensation for economic loss in the amount necessary to remedy the footings. Bryan appealed on the grounds that the law of negligence did not impose on him a duty of care to a subsequent purchaser.

The majority of the High Court\(^ {285}\) noted that no previous decision directly determined whether the relationship between Maloney and Bryan was such as to give rise to a duty on the part of Bryan not to cause the sort of economic loss sustained by Maloney. Surely, *Sutherland* was indicative that in the absence of specific reliance, no tortious duty would be owed. However, the majority was apparently persuaded that the building itself, erected to be used as a permanent dwelling house, constituted the necessary connection between the parties.\(^ {286}\)


\(^{285}\) Mason C.J. and Deane and Gaudron JJ.

\(^{286}\) *Ibid.* at 625.
The majority reasoned that, in general, there were two important policy considerations to take into account in liability for mere economic loss in the law of negligence. The first is avoiding the imposition of indeterminate liability. The second factor militating against the recognition of a duty of care is commercial independence or laissez-faire:

... in a competitive world where one person’s economic gain is commonly another’s loss, a duty to take reasonable care to avoid causing mere economic loss to another, as distinct from physical injury to another’s person or property, may be inconsistent with community standards in relation to what is ordinarily legitimate pursuit of personal advantage.

The majority was satisfied that liability in this case would not impose on a builder the prospect of indeterminate liability as the claim is very specific: a subsequent owner is claiming for the economic loss sustained by reason of diminution in value in a house that was negligently built. In this way, the relationship between the builder and Maloney was comparable to his relationship with the first owner wherein he would have assumed responsibility for “erecting a structure on the basis that its footings are adequate to support it for a period during which it is likely that there will be one or more subsequent owners”. This finding of assumption of responsibility was fortified by policy reasons including the superior skills and knowledge of the builder and the arbitrariness of compensating a plaintiff for physical injuries caused by negligent construction but not economic loss.

The majority preferred New Zealand and Canadian jurisprudence to the reasons of the House of Lords in *D & F Estates* and *Murphy* in which a negligent builder’s tortious liability did not extend to compensating either the first or a subsequent owner for economic loss sustained when building defects manifested themselves:

Their Lordships’ view in that regard seems to us, however, to have rested upon a narrower view of the scope of the modern law of negligence and a more rigid compartmentalization of contract and tort than is acceptable under the law of this country.

In a concurring judgment, Toohey J. stressed the direct relationship between the negligence of Bryan and the loss sustained by Maloney: “It was only a matter of timing

\[287\] Ibid. at 618.
\[288\] Ibid. at 627. In “The Murphy Saga in Australia: Bryan in Difficulties?” (1997), 113 L.Q.R. 355 at 357. I. N. Duncan Wallace calls this “a sort of reliance by proxy or assignment”.
that the cracks in the wall appeared while the respondent was the owner rather than [the original owner]. 290

The majority expressly confined its decision to the particular kind of economic loss incurred involving a particular kind of property. To borrow the phraseology of Stephen J. from The Willemstad, Bryan v. Maloney is but one more “decided case” in the Australian jurisprudence and, in particular: 291

... the decision was not determinative of the question whether a relationship of proximity can, in some circumstances, exist between the manufacturer and the purchaser or subsequent owner of a chattel in respect of the diminution in the value of the chattel which is sustained when a latent defect in it first becomes manifest.

The majority also recognized that limitation provisions in the construction contract would have been relevant to the question of duty of care.

Brennan J. wrote a lengthy dissent in which he noted that the dissent of Lord Brandon in Junior Books is considered the sounder statement of principle and that the case itself now lacks authority. Brennan J. ruled that it was established that defects in the quality of a building are not compensable under the law of negligence. Tort duties serve to avoid or prevent physical injury. The interest of a purchaser in the quality of a building or chattel are governed by the law of contract. This is why he would have followed La Forest J. in Winnipeg Condo but disagreed with holding a private defendant liable for non-dangerous defects.

III.E.1(d) Summary of the Australian Position
Standing on its own, Bryan v. Maloney is a more liberal judgment than even Junior Books. In both cases the work was done pursuant to a commercial contract and there was no evidence that the damages threatened person or property or even required immediate

289 Supra note 284 at 629.
290 Ibid. at 663-664.
291 Ibid. at 630.
292 Infra note 331, discussed in Part III.F.3.
repair. In *Junior Books*, the House of Lords satisfied itself of the necessary proximity by the close commercial relationship between the plaintiff-owner and defendant subcontractor and the averred reliance by the former on the latter. Bryan and Maloney were complete strangers two transactions removed. It could be fairly said that Maloney enjoyed a warranty of quality that Bryan was not paid to provide by the original owner.

It follows that the important caveat by the majority that *Bryan v. Maloney* is one of a body of cases along with the acknowledgment that contractual provisions may be relevant to the duty of care owed a third party are important and must be followed if the High Court of Australia truly intends to maintain the position adopted in *The Willemstad* in which the broad exclusionary rule was rejected but each new situation is reviewed closely to avoid indeterminate liability.\(^{293}\) The Court has steadfastly declined to venture a formula of the sort of relationship that will ground a duty of care necessary to ground a claim for economic loss. The absence of a framework causes unpredictability in the law and some consternation in Australia’s lower courts.\(^{294}\)

That [commercial considerations] is obviously a relevant matter in this case but it must be said that there is little guidance to be found in the cases to date as to when a duty of care should be found in respect of mere economic loss where the elements of assumption of responsibility and reliance are absent. ... All I think that can be said is that in uncharted areas a court, faced with having to decide whether, in a particular category of case in which there is no reliance or assumption of responsibility, a duty of care arises in respect of purely economic loss would be obliged to take into account considerations of policy and fairness and reasonableness ... These are broad considerations but in the absence of greater guidance from binding authority, represent the salient factors which have been identified.

Another important and more narrow consideration for the next case to be added to the Australian jurisprudence is whether the plaintiff can persuade the court that it was a specific individual likely to be harmed by the defendant’s negligence as opposed to an unascertainable class. The Australian High Court was clearly impressed by the fact that, in *The Willemstad*, the operations of Caltex were very closely associated with the pipeline

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\(^{293}\) Lower Australian courts seem intent on confining the majority judgment to its specific facts. Indeed, the narrow application of *Bryan v. Maloney* by the New South Wales Court of Appeal in *Woollahra v. Sved* (1996), 40 N.S.W.L.R. 101, is reminiscent of the English Court of Appeal’s critical treatment of *Junior Books*.

damaged by the Willemstad and that, in *Bryan v. Maloney*, Maloney was the person who had the misfortune of owning and living in the home when the negligently constructed foundations started to settle. On the other hand, as in *Sutherland*, a great many Australians might be financially harmed in some way by the supervisory acts and omissions of housing authorities.

### III.E.2 New Zealand Jurisprudence

The New Zealand Court of Appeal is plainly sympathetic to a more liberal approach to negligence claims for economic loss and persuaded by the reasoning in cases like *Caltex* and *Junior Books*. The Court is also, however, subject to the Privy Council. This probably best explains why a series of New Zealand cases have run contrary to the exclusory rule but that the Court has never expressly renounced it.\(^{295}\)

#### III.E.2(a) Bowen v. Paramount Builders\(^{296}\)

The Defendant builder, Paramount, contracted to build a home for McKay on land in “peat country”. McKay became concerned with early symptoms of subsidence as the dwelling neared completion and sold it to the plaintiff, Bowen. Bowen neither noticed these symptoms nor was alerted to the problem by McKay at the time of sale. Substantial subsidence occurred shortly after the sale causing considerable damage to the house. Bowen sued Paramount for negligent construction of the foundations. Paramount issued third party proceedings against McKay on the basis that it was a term of the original construction contract that McKay would be responsible for the provision of a sand pad to support a dwelling house with foundations of a kind normally used on solid ground.

The trial judge ruled that Paramount did not owe Bowen the alleged duty to take reasonable care in relation to the foundations of the dwelling.

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295 See *e.g.* *New Zealand Forest Products Ltd. v. Attorney General*, [1986] 1 N.Z.L.R. 14 (H.C.), wherein Barker J. relied on the principles in *Anns* and *Junior Books* in support of his rejection of the decision of the English Court of Appeal in the same factual situation in *Spartan Steel*, *supra* note 257.  

The New Zealand Court of Appeal agreed with then recent English authorities to the effect that the duty to take care is independent of whether the foreseen consequence of failing to do so is physical injury or financial loss. The Court reasoned that there was no “fair” reason why it should make a difference that the damage was limited to the structure of the building itself. Moreover, it is "common sense" to take steps to avoid a more serious loss by repairing a defect.

Further, Bowen’s loss was not purely economic as, firstly, the defect caused actual physical damage to the building and, secondly, the depreciation in the home’s value was an associated effect of that damage. Woodhouse J. ruled that there was no reason why a builder ought to be relieved of the consequences of his negligence vis-a-vis subsequent purchasers of the building he has erected. Cooke J. observed that “an owner in the first year or so of the life of such a building in peat country would be likely to be especially close and directly affected by an carelessness on the part of the builder in respect of the foundations”.

III.E.2(b) New Zealand Case Law Post Bowen

Amns was decided just after Bowen and was readily accepted and applied by the New Zealand Court of Appeal. In Scott Group Ltd. v. McFarlane, Woodhouse J. accepted Amns as a practical and logical way of assessing the duty of care in a novel situation. In the Takaro case, he explained that the question of whether it is fair that a duty of care of a particular scope be imposed on a defendant should be part of the second part of the Amns test once “a prima facie situation of responsibility” has been found.

297 Per Cooke J., ibid. at 422.
298 Ibid., per Woodhouse J. at 417 and Cooke J. at 422-423.
299 Ibid. at 419.
300 Ibid. at 423.
The New Zealand courts have apparently applied the Anns test to novel negligence claims involving economic loss without difficulty. In Mainguard Packaging v. Hilton Haulage\(^ {303} \), Tipping J. explained that the New Zealand influence on the Anns test is such that at the crux of whether a duty of care of the particular scope contended for exists is whether the court considers it "just and reasonable".\(^ {304} \)

### III.E.2(c) Summary of the New Zealand Position

In an introduction to his leading judgment in the 1990 case of Brown v. Heathcote County Council\(^ {305} \), Cooke, President of the New Zealand Court of Appeal, noted the significant development in negligence law throughout the Commonwealth since Bowen was handed down in 1975. He concluded this discussion by remarking as follows:\(^ {306} \)

In the end I cannot avoid the conclusion that in the law of negligence we in New Zealand will have to continue mainly to hew our own way.

His message to the Privy Council as well as those bound by the New Zealand Court of Appeal is clear: the New Zealand courts fully intend to continue to apply Anns to negligence claims for economic loss including cases arising from structural defects.

Bowen stands as New Zealand's leading authority on the recovery of economic loss in negligence.\(^ {307} \) The New Zealand Court of Appeal finds it just to compensate a plaintiff for whatever foreseeable losses are sustained as a result of the defendant's negligence. In most cases, the spectre of indeterminate liability attracts little if any weight. The Court is also unconcerned with predetermining a specific defendant's duties in every analogous situation.

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304 See also New Zealand Forest Products, supra note 295.
305 [1986]. 1 N.Z.L.R. 76.
306 Ibid. at 80.
307 In Lester v. White, [1992] 2 N.Z.L.R. 483 (S.C.), Greig J. concluded that he was bound to follow New Zealand cases from Bowen onward and not the House of Lords' reversal in D & F Estates and Murphy.
The New Zealand approach can be fairly summarized by the following remark by Cooke P. from the *Invercargill*\(^{308}\) case wherein a local authority negligently inspected the construction of a house with a defective foundation:\(^{309}\)

Although more extensively expounded, the general approach of the Canadian Supreme Court in this area seems, with respect, much the same as the approach followed in this Court over many years. Both emphasize that formulae and doctrine do not provide the answers to new duty of care questions. In the end it is a matter of judicial judgment, formed after looking at established signposts and analogies.

The Privy Council confirmed the judgment of the New Zealand Court of Appeal in *Invercargill*\(^{310}\) as well as the Court’s authority to depart from English case law including *Murphy* when local conditions are different. This is especially so with respect to a difficult branch of the law of negligence where the “marked divergence” in common law jurisdictions demonstrate that “there is no single correct answer”.\(^{311}\)

### III.F  THE RECOVERY OF PURE ECONOMIC LOSS IN CANADIAN LAW

The acceptance of *Anns* by the Supreme Court of Canada in *Kamloops*\(^{312}\) represents a very significant point of departure in Anglo-Canadian jurisprudence. From the perspective of claims in negligence for pure economic loss, it means that the Canadian Courts are in the same position to approach these claims as was the House of Lords when it heard *Junior Books*.

#### III.F.1  The Supreme Court of Canada’s Consideration of *Junior Books*

*Junior Books* was also favourably received by the Supreme Court of Canada. In *B.D.C. Ltd. v. Hofstrand Farms*\(^{313}\), a courier failed to deliver an envelope in time to the Land Registry Department in Victoria. The envelope contained a Crown grant in favour of the B.D.C. The failure to register the grant in time resulted in B.D.C.’s loss of rights under a

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\(^{309}\) Ibid. at 523.

\(^{310}\) [1996] 2 W.L.R. 367.

\(^{311}\) *Per* Lord Lloyd, *ibid.* at 378.

\(^{312}\) *Supra* note 132 at 10.

contract. The courier was unaware of the B.D.C., the grant or that the rights of a third party could be harmed by its late delivery of the envelope.

Estey J. for the majority of the Supreme Court of Canada noted the urgency of reasonable limitations in cases involving economic losses. In so doing he approved of the focus of Laskin J. in Rivtow Marine on the direct economic loss suffered by the plaintiff whose use of the product or service was contemplated by the defendant.

Estey J. further approved of the emphasis of the House of Lords in Junior Books and in Hedley, Byrne on the close proximity between the plaintiff and defendant and found that the B.D.C. was not a party within a limited class in the reasonable contemplation of a person in the position of the courier and dismissed the claim. In so doing, Estey J. recognized the balancing act required of the Court in the following eloquent terms:314

"... the realities of modern life must be reflected by the enunciation of a defined limit on liability capable of practical application, so that social and commercial life can go on unimpeded by a burden outweighing the benefit to the community of the neighbourhood historic principle."

Of course, the articulation of the "defined limit" in negligence for pure economic loss has escaped the judiciary. We have seen that the House of Lords has abandoned its pursuit and simply closed the door on recovery of pure economic loss apart from the case of negligent misstatement. On the other hand, the Australian High Court and the New Zealand Court of Appeal allow these claims relatively care free of establishing a defined limit on their recovery.

Junior Books was next cited by the Supreme Court of Canada in Central Trust Co. v. Rafuse315 in support of its unanimous ruling that the common law duty of care in tort created by a relationship of proximity is not confined to relationships that arise from contract. In London Drugs316, Junior Books was cited along with Hedley Byrne and Hofstrand Farms in support of the proposition that when reliance was used in order to

314 Ibid., at 13.
315 Supra note 54, discussed earlier in Part II.D.2.
316 Supra note 179, discussed earlier in Part II.E.3(a).
determine the existence of a duty of care, the court is concerned with the relationship between the plaintiff's position and the tortfeasor's conduct rather than plaintiff's position and the tortfeasor's pocketbook.317

III.F.2 The Supreme Court of Canada's Reasons for Judgment in Norsk

In C.N.R. v. Norsk Pacific Steamship Co.318, the defendant's tug-boat negligently damaged a bridge owned by the Province of British Columbia and used extensively by the plaintiff railway. C.N.R sued Norsk for the economic loss it suffered as a result of the interruption of its access to the bridge.

It was anticipated that the Supreme Court of Canada would take full advantage of this case to clarify the law governing recovery in negligence for economic loss. Instead, the Court delivered three lengthy judgments that are testimony to the judicial frustration with the "vexed question of the extent to which damages for pure economic loss may be recovered in tort at common law".319 We shall see, however, that Norsk did lay important groundwork for more cohesive judgments to follow.

La Forest J., Sopinka and Iacobucci JJ. concurring, dissenting, reasoned that different types of factual situations warrant different approaches to economic loss and, for this reason, outlined three categories of economic loss: (1) consequential economic loss, the plaintiff claims for economic loss in addition to claims for property damage or personal injury; (2) non-relational economic loss, the plaintiff claims for pure economic loss unrelated to any personal injury or property damage suffered by either the plaintiff or any third party; and (3) contractual relational economic loss, the plaintiff claims as a result of damage caused to someone else's property.320

317 Per Iacobucci J., ibid. at 336.
319 Per McLachlin J., ibid. at 358.
La Forest J. would have dismissed the claim by application of the courts' "bright line" rule barring recovery for contractual relational economic loss: "... persons cannot sue a tortfeasor for suffering losses to their contractual rights with the owner of property by reason of damages caused to that property by the tortfeasor". In cases where the number of potential plaintiffs is great, recovery will be denied on the grounds of indeterminacy even though the plaintiffs may not have had any real ability to protect themselves. La Forest J. was prepared to accept that some deserving plaintiffs may be sacrificed for the sake of drawing a line.

Policy reasons including indeterminacy and modern economic considerations of which party is the better loss bearer support the perpetuation of this exclusionary rule except where there are good reasons to depart from it such as the case of joint venturers. C.N. and the bridge owner were not in this type of a relationship. La Forest concluded that "C.N.'s overwhelmingly superior risk bearing capacity on the facts of this case" justified denial of recovery.

McLachlin J., L'Heureux-Dube and Cory JJ. concurring, began her judgment with the observations that a single rule for all economic loss cases is probably unattainable. She relied on Kamloops for an incremental approach wherein the courts approach a new case by balancing the injustice of denying relief to the deserving plaintiff with the danger of unlimited liability. In this way, McLachlin too made conceptual use of additional categories of cases such as the duty to warn in Rivetow and the duty of public officials to

representation based on the defendant's voluntary assumption of responsibility; 2. The liability for the negligent performance of a service based on the defendant's voluntary undertaking. 3. The independent liability of statutory public authorities derived from the breach of statutory public duty or the improper exercise of statutory public powers."

321 Ibid. at 292. At 303-306, La Forest J. cites Cattle v. Stockton Waterworks Co., supra note 244, as the original authority for the exclusory rule. He later reasons, at 335, that its rationale is that the mere disruption of contractual rights is insufficient by itself to ground recovery.

322 Ibid. at 356.

323 Ibid. at 302.

324 Ibid. at 352.

325 Ibid. at 360-361. La Forest J., at 336, and Stevenson J., at 389, agreed with her assessment.
pursue their statutory duty in Kamloops as accepted exceptions to the exclusionary rule. Pure economic loss was prima facie recoverable when, in addition to negligence and foreseeable loss, there was sufficient proximity between the negligent act and the loss. McLachlin described this as a principled, yet flexible, approach to tort liability for pure economic loss.326

McLachlin J. found that C.N. established sufficient proximity by way of the very close alliance between its operations and the bridge owners. There was the necessary “special connection, physical or circumstantial, between the plaintiff’s operations and the property damaged”327 as C.N. and the bridge owner were in effect joint venturers. Recovery was neither anomalous nor indeterminate in that C.N., in relation to Norsk, was indistinguishable from the bridge owner. McLachlin J. would have apparently denied recovery to casual users of the bridge and those only “secondarily and incidentally affected” by the damage done to the bridge.328

Stevenson J. swung the result in favour of C.N. by way of a different analysis. His understanding of the true reason for the exclusionary rule is that the law must deny recovery of economic losses which give rise to indeterminate liability.329 Stevenson J. rejected the use of proximity as the test as to where to draw the line and adopted the approach of Gibbs and Mason JJ. in The Willemstad. Defendants will be liable for relational economic loss where they know or ought to have known that a specific party as distinct from a general class of persons would suffer financial loss as a result of their negligence. C.N. was such a “known plaintiff” to Norsk: “The loss was identifiable, the victim identifiable, the damage almost inevitable”330.

In summary, the Court was unanimous on three important issues. Firstly, Murphy does not represent the law of Canada. The Court again affirmed the duty of care test from

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326 Ibid. at 370.
327 Ibid. at 378.
328 Ibid. at 376.
329 Ibid. at 387.
Anns. Secondly, there is no broad bar on recovery of pure economic loss. Thirdly, tort law does not permit recovery for all economic loss. This is the troublesome issue of where to draw the line. La Forest J. would maintain the original bright line or “narrow” exclusionary rule barring claims for contractual relational economic loss save in special circumstances. McLachlin J. would approach the claims on a case by case basis in an effort to develop a coherent body of precedent.

III.F.3  

**Winnipeg Condo** 331: the Canadian High-water Mark in Negligence

In 1978, the plaintiff condominium company purchased a multi-residential building constructed in 1972 by the defendant general contractor, Bird Construction. In 1989, a storey-high section of exterior stone cladding collapsed. Fortunately, no person or other property was harmed but the building needed significant repair. The plaintiff sued Bird Construction, among others, for these costs. Bird Construction applied for dismissal of the claim against it on the grounds that it failed to disclose a reasonable cause of action.

The application was dismissed by the Manitoba Court of Queen’s Bench but was upheld by the Court of Appeal. In so doing, Huband J.A. relied on *D & F Estates* for the proposition that tort liability can only arise if the defect remained hidden until the defective building causes personal injury or damage to property other than the building itself. He concluded that since the defect was discovered by Winnipeg Condo before such harm occurred, the cost of destroying the building or repairing the cladding was purely economic and not recoverable in tort.

La Forest J., for an unanimous Supreme Court, returned to the categorical approach to economic loss claims outlined in his judgment in *Norsk*. This time, the categories were five in number:332

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332 *Ibid.* at 199. These are Professor Feldthusen’s five categories in their 1991 form, *supra* note 320. Jane Stapleton, *supra* note 277 at 262 and 278-279, calls the categorization approach to claims in economic loss the unintended and false legacy of *Hedley, Bryne*.
1. The Independent Liability of Statutory Public Authorities;
2. Negligent Misrepresentation;
3. Negligent Performance of a Service;
4. Negligent Supply of Good or Structures;
5. Relational Economic Loss.

This case fell into the fourth category with the critical additional caveat that the structure was not just shoddy but dangerous. Presumably this effectively established an actionable sixth category of economic loss:

... a person who participates in the construction of a large and permanent structure which if, negligently constructed, has the capacity to cause serious damage to others persons and property in the community, should be held to a reasonable standard of care.

_D & F Estates_ was rejected as a persuasive authority in Canadian tort law for two reasons. Firstly, it is inconsistent with the liberal Canadian approach to concurrent liability in tort and contract. Secondly, it is an important English authority in a line of cases rejecting _Anns_, a case whose principles are in full force in Canada. La Forest J. expressly articulated the divergence in English and Canadian law:

The decision by the House of Lords in _D & F Estates_ was the penultimate step in a path of reasoning followed by the Law Lords culminating in _Murphy_, where they overruled their earlier decision in _Anns_ and re-established a broad bar against recovery for pure economic loss in tort. This is a path this court has chosen not to follow.

Accordingly, Canadian law imposed on Bird Construction a duty in tort to subsequent owners like Winnipeg Condo to construct buildings to “reasonable standards”.

[a contractor has a] duty in tort to subsequent purchasers of a building to take reasonable care in constructing the building, and to ensure that the building does not contain defects that pose foreseeable and substantial danger to the health and safety of the occupants.

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333 _Ibid._ at 203. Lord Devlin, _supra_ note 135 at 607 of All E.R., would describe this as either the widening of an old category or as the creation of a new and similar one: “The general conception can be used to produce other categories in the same way. An existing category grows as instances of its application multiply, until the time comes when the cell divides.”

334 _Ibid._ at 206.

335 _Ibid._ at 205. At 217, La Forest J. added “and without dangerous defects” to the standard. At 218, it was described simply as “The tort duty to contract a building safely”. At 219, he spoke of “a real and substantial danger” and “a serious risk to safety”.

336 _Ibid._ at 221
La Forest J. was persuaded by the dissenting judgment of Laskin J. in *Rivtow Marine* and, in particular, his policy based reasoning that owners should not be discouraged from repairing unsafe products before personal harm occurs. Should Bird Construction be found negligent at trial, Winnipeg Condominium would be entitled to recover the reasonable cost of putting the building into a non-dangerous state but not the cost of any repairs that would serve merely to improve the quality, and not the safety, of the building.

### III.F.3(a) Discussion of Winnipeg Condo

Remarkably, La Forest J. left open the possibility of a claim where the contractor’s workmanship was merely shoddy or substandard rather than dangerously defective. Tort law will entirely usurp contractual warranty, at least at the theoretical level, without this critical distinction. It is wholly unnecessary and unsettling for Laskin J. in *Rivtow Marine* and La Forest J. in *Winnipeg Condo* to leave us with such conjecture. The universal and unanimous answer to this inquiry is no. Tort law has no remedy for the plaintiff whose complaint is that he or she paid too much for a shoddy but harmless crane, building or motor home.

Further, the sympathy for the ship or building owner who does the right thing by fixing a potentially dangerous defect is ignorant of a building owner’s incentive to avoid tortious liability itself for allowing a dangerous situation to go unremedied. This is particularly so of the building owner and occupier subject to the statutory responsibilities imposed by provincial *Occupiers’ Liability Acts* and Occupational Health and Safety legislation. In *Norsk*, La Forest J. was sympathetic to this deterrent effect of tort law in the context of

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338 In *Harder v. Denny Andrews Ford Sales Inc.* (1995), 31 Alta. L.R. (3d) 250 (Q.B. (M.C.), the plaintiff alleged that the defendant negligently repaired a motor home for one party who sold it to a second who sold it to the plaintiff. The presiding Master in Chambers at 256 described the state of Canadian law as “chaos” and dismissed the defendant’s application for summary judgment on the authority of *Norsk* and the *dicta* in *Winnipeg Condo* that the defendant’s shoddy but non-dangerous work presented a triable issue of law.
the relational loss claim wherein the defendant would already be under a substantial incentive to care for the party actually injured.339

It is further submitted that this analysis is only superficially cognizant of third party procedure that would allow defendant building owners to pursue previous owners and negligent contractors for indemnification. This argument will be significantly impacted by the terms of the general building contract, subcontracts and sale contracts between the parties. In this way, Junior Books and Winnipeg Condo may not be such upsetting precedents in practice. Both cases arose from preliminary applications to have claims dismissed on the basis of deficient causes of action in the pleadings. In such applications, the courts accept the plaintiffs allegations as proven and no actual evidence including contracts are before the court. A full understanding of the relationships between the parties including contractual rights and obligations will allow the courts to more accurately establish the existence and extent of a duty of care.

Aside from the obiter musings of La Forest J., there may be practical problems with applying Winnipeg Condo in such a way as to avoid compensating the plaintiff who simply paid to much for the object or service in question including and in particular:

(i) the factual determination of the difference between a shoddy as opposed to a dangerous defect and the risk of encouraging plaintiffs to allow the former to deteriorate to the status of the latter in order to afford an action in tort; and

(ii) the consequence of contractual provisions on the determination of the duty of care, the characterization of a “defect” and the calculation of tort loss rather than expectation damages.

With respect to the first set of concerns, the majority of cases relying on Winnipeg Condo rightly use it to compensate plaintiffs for dangerous rather than shoddy defects and have

339 Norsk, supra note 318 at 301.
applied the various articulations of the test without difficulty. In the Gauvin case\(^{340}\), for example, it was found that seepage in the sewage system of the plaintiff's residence was unsafe and dangerous and that, therefore, Ontario's Ministry of Environment was liable for approving the work of the negligent contractor. While in Privest Properties\(^{341}\), the plaintiff failed to prove that a specific fire-proofing agent installed in a large retail/commercial complex constituted a dangerous defect. Accordingly, the installer, architect and contractor were absolved of liability for its removal.

The distinction is neatly illustrated in the following passage from a case where the defendant negligently converted a barn into a home and sold it to his co-defendant who, in turn, sold it to the plaintiff:\(^{342}\)

While there is no immediate danger I have no hesitation in coming to the conclusion that in the very near future this house will be a danger to the inhabitants both physically and healthwise. In my opinion one must ignore the water supply system which falls in the category of shoddy workmanship, but the remainder is the very type of construction that La Forest, J. labelled as dangerous.

The deterrent effect of first party contractual, tortious including deceit, fiduciary and regulatory liability should serve to ameliorate the propensity of property owners to allow buildings or products to deteriorate until they are in an dangerous state of being.

In response to the second set of concerns, the effect of contractual provisions should be given weighty consideration in the second stage of the Anns test. Here, in particular, defendant builders and manufacturers should be in a strong position to differentiate between warranties of quality and disclaimers of liability.

Professor Waddams has suggested that one solution to the risk of overcompensating a plaintiff or effectively satisfying the plaintiff's disappointed expectation of quality in the service or product is to hold the negligent defendant liable for the reasonable cost of averting a safety risk on the condition that any improvement in the capital value of the


property as a result of the repairs should be taken into account to the defendant’s credit.343

This is a sensible and important suggestion that follows both the reasoning and the result in Winnipeg Condo and seems to have been taken up in practice. In Gauvin344, the Court found that the dangerously defective septic system should have had a 20 year life span and for that reason reduced the award for replacing the system by 10% representing the improvement or extra life in the system the plaintiff paid for. This finding was based on testimony from a witness with industry knowledge. Presumably, the Court would have considered and applied a contractual warranty period if it was put into evidence.

III.F.4 Pure Economic Loss in Canada: Post-Script to Winnipeg Condo
In D’Amato v. Badger345, Major J. for the unanimous Court, did not choose between the self-described “flexible” approach of McLachlin J. or the neat categorical approach of La Forest J. in Norsk. His judgment can be read to prefer the latter to the former as he noted that in Winnipeg Condo, the Court unanimously recognized distinct categories of economic loss.346 This said, his initial explanation for the distinction between Canadian and British law was based on the Canadian courts’ continued reliance on Anns: the very starting point for McLachlin J. Regardless, in D’Amato either approach resulted in the dismissal of the claim for contractual relational economic loss by the injured party’s employer.

In the Hercules Management347 and Bow Valley Husky348 cases, La Forest and McLachlin JJ., respectively, worked towards a consensus of their approaches. In Hercules Management, La Forest J. began his analysis by application of the Anns two-part test.

342 Per Turnbull, J. in Fournier v. van der Laan et al. (1997), 187 N.B.R. (2d) 11 at 36 (Q.B. (T.D.)).
344 Supra note 340 at 290.
345 Supra note 247.
346 Ibid. at 137.
347 Supra note 249.
This was done without express reference to the five categories of economic loss cited in *Winnipeg Condo* and *D'Amato*. It may be that La Forest J. felt that this was unnecessary given that *Hercules Management* was plainly a case of negligent representation the special requirements of which include the inquiry into reliance at the first stage of the test.

The following propositions are now clearly uncontroversial with respect to claims for relational economic loss:

(1) relational economic loss is recoverable only in special circumstances where the appropriate conditions are met; (2) these circumstances can be defined by reference to categories, which will make the law generally predictable; (3) the categories are not closed. La Forest J. identified the categories of recovery of relational economic loss defined to date as: (1) cases where the claimant has a possessory or proprietary interest in the damaged property; (2) general average cases; and (3) cases where the relationship between the claimant and property owner constitutes a joint venture.

The methodology is as follows:

La Forest J. set out the methodology that courts should follow in determining whether a tort action lies for relational economic loss. He held that the two part methodology of *Anns ...* adopted by this Court in *Kamloops ...* should be followed: (1) whether a prima facie duty of care is owed; and (2) whether that duty, if it exists, is negated or limited by policy considerations. In applying the second step, La Forest J. wrote that while policy considerations will sometimes result in a *prima facie* duty being negated, in certain categories of cases such consideration may give way to other overriding policy considerations.

In both *Hercules Management* and *Bow Valley Husky*, the Court found that the *prima facie* duty of care established by proximity was negated by policy considerations of indeterminate liability.

### III.G CONCLUSION

The rapid development and expansion of negligence law in the 20th century has been impeded by the claim in negligence for pure economic loss. We see in leading cases like *Rivtow Marine, Junior Books, Norsk* and *Bryan v. Maloney* fascinating demonstrations of the Commonwealth's highest courts' difficulty with those claims that test the doctrinal

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348 *Supra* note 225.
349 *Per* McLachlin J. in *Bow Valley Husky*, *ibid.* at 406.
350 *Per* McLachlin J. *, ibid.* at 408.
limits of private law. This struggle is simultaneously a classic and modern depiction of the
courts' pains to find the just balance between compensating the innocent plaintiff injured
by the defendant's breach of the applicable standard of care and the reluctance to subject
the inadvertent defendant to inordinate liability which is punitive in effect.

There is an extreme position at either end of the controversy. The progressive say that the
distinction between pure economic loss as opposed to physical damage or economic loss
consequential on physical damage is arbitrary and indefensible on accepted private law
principles. Further, the distinction, in fact, is often technical or artificial. The conservative
say that pure economic loss represents the border between tort and contract and that there
are good reasons why it should not be breached. A popular argument in the construction
context is that a stranger should not benefit from an additional or better duty of care than
the party who paid for the defendant's work. Mention must also be made of the
economist's influence in those cases in which the court takes into consideration who can
best bear the loss.

*Amns* and *Junior Books* represented a moment in English law where the House of Lords
tried to strike a balance between these positions by allowing a cause of action for pure
economic loss grounded on the existence of a special relationship between the negligent
defendant and injured plaintiff. This effort was short lived as the English courts balked at
this extension of tort law and hastily re-established the requirement of actual physical
damage or harm. The line is drawn in Britain where the House of Lords has effectively
abandoned some deserved plaintiffs for the sake of certainty in the neat boundary between
tort and contract with the exception of claims arising from negligent words. The quote
from Lord Goff's reasons in *Littlewoods* preceding the introduction to this chapter nicely
articulates this retrenchment.\footnote{Supra note 226. Lord Goff went on to observe that "in *Junior Books* ... some members of your
Lordships' House succumbed, perhaps too easily, to the temptation to adopt a solution based 'simply' on
'proximity'."}
The New Zealand case law best represents the progressive or liberal position. The New Zealand Court of Appeal is seemingly the least troubled by the problem of pure economic loss. The answer to such claims is readily resolved by use of the principles of Donoghue v. Stevenson and the Anns test. The New Zealand courts are not preoccupied by indeterminacy. The first part of the Anns test seems to be practically satisfied by reasonable foreseeability. The second part consists of the evaluation whether it is fair to impose a duty of care of the scope claimed.

Claims in pure economic loss have also been treated consistently in Australian case law if somewhat more conservatively. Although the exclusionary rule has been rejected, the Australian High Court has reiterated its concern with a negligent act attracting indeterminate liability. Mere foreseeability of economic loss is insufficient to ground a duty of care. The Court steadfastly refuses to set out a test or even a framework guiding the approach to be followed in these cases but clearly views reasonable reliance by the plaintiff and the assumption of responsibility on the part of the defendant as the hallmarks of duty of care. In their absence, the Court appears content to build a body of precedent incrementally on the basis of policy factors and the relatively unpredictable concepts of fairness and reasonableness.

Both the Australian High Court and the New Zealand Court of Appeal have applauded and, to some extent, followed the approach of the Supreme Court of Canada. Certainly, those courts agree with the words of McLachlin J. following the passage from Lord Goff at the outset of this chapter.\textsuperscript{352}

This said, and notwithstanding its clear and decisive departure from the English negligence law by the affirmation of Anns, Canadian law has developed much more cautiously with respect to claims for pure economic loss. This is probably not explained by greater deference to English authorities but rather that the Supreme Court of Canada is committed to providing practical guidelines as to when a plaintiff will be compensated for this sort of

\textsuperscript{352} Supra note 227.
loss. In this way, the Canadian position should not be too readily associated with that of Australia and New Zealand.353

The Supreme Court of Canada seems to have suspended but not yet abandoned its struggle to articulate a governing principle of duty of care. The Canadian approach suffers from obvious doctrinal messiness as result of the Supreme Court of Canada’s categorical rather than principled approach to claims for pure economic loss. In terms of the thorniest category, relational economic loss, the Court is developing sub-categories of exceptions to a general exclusionary rule.

The evolution of the law in this fashion results in uncertainty for plaintiffs and defendants whose case is outside of the categories established to that point. Plaintiffs need only satisfy the relatively low threshold of the first stage of Anns to establish a prima facie case of liability. Most cases will turn on the court’s evaluation of policy considerations negating, compromising or bolstering the prima facie duty. This analysis is nebulous and may not in practice be too far removed from the fairness question asked by the New Zealand and Australian courts. The principal check on liability in Canadian law is the prospect of indeterminate liability should the court extend the defendant’s duty of care to the sort of loss suffered by the plaintiff. Additional factors relevant to the second part of the Anns test including insurance, third party procedure, partial settlements and allocation of risk in related contracts are considered in the next two chapters.

353 Professor Fleming, supra note 127 at 194. relates that “To begin with, the first view, championed by Lords Denning and Wilberforce, was ascendant; it gained temporary dominance in the House of Lords and remains the orthodoxy in several Commonwealth courts, particularly in Canada and New Zealand”.
CHAPTER IV

INSURANCE COVERAGE AND TORT LIABILITY

"The task of the courts remains that of loss fixing rather than loss spreading and if this is to be altered it is, in my view, a matter for direct legislative action rather than for the courts."354

"With respect, I do not agree with Stephen J. that the consideration of insurance changes the task of the courts from loss fixing to loss spreading. Insurance considerations are merely one element in an analysis of where it is appropriate to fix the loss, in a case where the solution is necessarily pragmatic. Many of the extensions of tort liability that have occurred over the last 50 years would have been inconceivable in the absence of insurance."355

IV.A INTRODUCTION

The last chapter canvassed at length the Commonwealth courts' reluctance to allow recovery for pure economic loss in negligence and their frustration in articulating a limiting rule of general application. In many if not all of the leading cases, the outcome turned on the courts' policy considerations of whether recovery is appropriate. In a few of those cases, particularly in cases of relational economic loss, the question is asked as to who between the injured plaintiff and defendant tort-feasor is best able to bear or insure against the loss incurred. This analysis is sometimes included as a policy consideration negating, reducing or limiting the scope of the defendant's duty or parties to whom it is owed or to the damages to which a breach may give rise in the second part of the Anns test. Jurists are divided on the appropriateness of this sort of inquiry.

The issue is of particular interest to the construction case as a construction project of any scale is invariably a very carefully and thoroughly insured undertaking. This chapter begins by discussing the effect of the standard insurance policies commonly used in the

354 Per Stephen J. in The Willemstad, supra note 279 at 265.
355 Per La Forest J. in Norsk, supra note 318 at 347.
construction industry. It concludes by analysing the opposing viewpoints as to whether the existence or availability of insurance coverage for the loss suffered by the plaintiff and defendant is relevant to the issue of tort liability between the parties.

IV.B  INSURING THE CONSTRUCTION PROJECT

The construction site is characterized by the risk of property loss and legal liability. It follows that the nature and scope of insurance coverage is a critical concern to the owners, consultants, contractors, subcontractors and suppliers who contribute to a project. Insurance policies, like construction contracts, use standard language but nevertheless must be reviewed closely to confirm the scope of their coverage and exclusions. The two most frequently used insurance policies by parties involved in a construction project are the comprehensive general liability policy and the builders’ risk policy.

IV.B.1  Comprehensive General Liability Insurance

A public liability policy was once characterized as “a contract insuring the general responsibility in tort of the insured to the world at large”.356 Pursuant to most standard form contracts including the CCDC-2, contractors and subcontractors are required to obtain a comprehensive general liability insurance policy (“CGL”) in a minimum amount in favour of the contractor, the owner and its consultant as named insureds.

The standard CGL policy creates two fundamental obligations: to pay on behalf of the insured all sums which the insured might become legally obligated to pay as compensatory damages because of (i) bodily injury caused by accident and (ii) property damage caused by accident.357

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356 Per de Grandpré J. in Foundation of Canada Engineering Corp. Ltd. v. Canadian Indemnity Co. et al. (1977), 74 D.L.R. (3d) 266 (S.C.C.) at 270.
357 Many CGL policies have now replaced “accident” with “occurrence” defined elsewhere in the policy as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions”.

The definition of property damage in the CGL policy includes the consequential loss of use of property:

"property damage" means

(a) physical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom, or

(b) loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an accident during the policy period.

In *Ontario v. Fahesi*\(^{358}\), the Supreme Court of Canada affirmed the important distinction that the mere loss in value of property unaccompanied by any loss in use amounts to economic loss which is outside the ambit of property damage for the purpose of tort law. Supplying a defective product does not constitute damage to property merely because it is not as valuable in the hands of the purchaser as it would have been if properly manufactured. However, proof that the defective product caused an actual loss in the use of property was sufficient to trigger indemnity under the "property damage" provisions of a CGL policy notwithstanding that it was physically unchanged.\(^{359}\)

It has been observed that the CGL policy is not intended to be a performance bond.\(^{360}\)

The "Product Itself" and "Work Performed" exclusions are intended to ensure that the owner and contractor bear the business risks associated with a project:

This insurance does not apply to: …

(i) property damage to the Named Insured's products arising out of such products or any part of such products;

(j) property damage to work performed by or on behalf of the Named Insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith;

The operation of these exclusions is neatly illustrated in *Greenan v. R.J. Maber Construction Co.*\(^{361}\), wherein the defendant contractor, Maber, was sued by the plaintiff

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\(^{358}\) Supra note 245.

family in tort and contract for alleged poor workmanship in the construction of their home. Maber tried to join its CGL insurer as a third party, claiming the insurer was obliged to defend and indemnify Maber on the basis of the CGL coverage.

The dismissal of Maber’s application was upheld by the New Brunswick Court of Appeal. Hoyt J.A. ruled that the policy covered damage caused by defective workmanship but not deficiencies or flaws in the workmanship itself.362

Accident is not defined in the policy. Thus it must be defined in its ordinary and popular sense having in mind the context in which it is used and not in a technical sense. Accordingly “accident” is widely defined and means an unexpected event, often sudden, that causes damage and is either unusual or random and often without apparent cause. One of the difficulties in applying such a definition is that the application in this case was made before the trial was held and the facts were found. Generally, the question of indemnity arises following a trial. Here, we are left with the pleadings, which, in an alternative claim, allege negligence. While I doubt that faulty workmanship, which is the Greenans’ complaint, can fall within the meaning of accident, it is my opinion that in any event Exclusion clause (j) removes the faulty workmanship of Maber from coverage.

Greenan confirms that the sufficiency of the products or services supplied by an insured is not covered by the CGL policy. CGL coverage is intended to protect against tort liability attributable to physical damage and bodily injury caused to others, not against the contractual liability of the insured for economic loss because his product or completed work is not that which the injured party bargained for.

The CGL policy was tested again as a repercussion of the Supreme Court of Canada’s judgment in Winnipeg Condo363, wherein the Court ruled that the plaintiff building owner may have a good cause of action in tort against the original construction company for the cost of rectifying the dangerous condition of the building. In Bird Construction Co. v. Allstate Insurance Co. of Canada364, the defendant construction company sought a direction that its CGL insurer was obliged to defend the claim on its behalf. The Manitoba

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363 (1992), 1 C.L.R. (2d) 188 (N.B.C.A.).
364 Ibid. at 191.
365 Supra note 331.
of Court of Appeal rejected the application as none of the claims asserted by the building owner fell within the indemnity coverage of the policy. The building owner neither claimed for "damages because of bodily injury" nor "damages because of property damage". The only damage to property claimed by the building owner was damage to the building itself and this is expressly excluded in the CGL policy. The Court cited the observation of La Forest J. that the losses claimed fell clearly into the category of economic loss and concluded that the only economic loss covered by the CGL policy is for loss of use but this was not claimed.365

IV.B.1(a) The CGL Policy and Professional Liability

The CGL policy expressly excludes coverage for professional services. The following is an example of a relatively standard such exclusion:

Any liability arising directly or indirectly out of malfeasance or non-feasance in the performance of any professional services or out of any defects, errors, or omissions in any reports, specifications, maps, plans, designs or recommendations furnished to others by the Insured, or the rendering or omission of professional services in connection therewith.

The errors and omissions ("E & O") policy is intended to cover the legal liability of architects and engineers delivering professional services to a construction project. The coverage extends beyond the consultant's client to all persons damaged by the consultant's negligence and, unlike the CGL policy, there is no requirement of physical damage or bodily injury to trigger coverage.

The apparent neat distinction between the two policies is muddled by the fact that contractors frequently provide design, engineering and supervisory services and that the owner's engineer or architect will, on many construction projects, be added as a named insured to the contractor's CGL policy. The courts recognize that, although the CGL policy was not intended to indemnify losses attributable to the provision of professional services, the term "professional service" should be confined to the range of activities

365 Ibid. at 32.
which only a consultant can provide during the design stage. As a result, many activities inherent in a contractor's site activities will be covered by the CGL policy. By the same token, a consultant named in a CGL policy will be covered against those claims that do not fall within the "professional services" exception.

Coverage becomes even more uncertain in design-build or construction management arrangements described in the first chapter. This realignment of traditional relationships undermines, in particular, the assumption inherent in CGL and E & O policies that the design function is performed by someone other than the party managing the project. As a result, it may well be that neither coverage adequately guards both types of risks should a loss arise in these circumstances. For this reason, contractors intending to act as a design-builder or construction manager should obtain E & O coverage in addition to CGL.

IV.B.1(b) The CGL Policy and Contractual Liability

"Contractual Liability" is another important exclusion in the CGL policy:

This insurance does not apply to:

(a) liability assumed by the Insured under any contract or agreement except an incidental contract, but this exclusion does not apply to a warranty of fitness or qualifications of the named insured's products or a warranty that work performed by or on behalf of the named insured will be done in a workmanlike manner.

The Canadian courts have interpreted the contractual liability exclusion broadly so that it applies even if the insured would have been liable in tort without having assumed liability in the construction contract. It is critical, therefore, that contractors make certain that the CGL policy includes the following expanded definition of "incidental contract":

367 Mercer v. Paradise (Town) (1991), 47 C.L.R. 75 (Nfld. S.C. (T.D.)). At 86, Puddester J. rejected the insurer's argument that the consultant was unfairly seeking to require the contractor to provide liability insurance for which the consultant should be responsible and for which it paid nothing.
368 Baugh Construction Co. v. Mission Insurance Co., 836 F.2d 1164 (9th Cir. 1988).
any written agreement

a) which is a lease of premises, easement, agreement, agreement required by municipal ordinance, sidetrack agreement, elevator maintenance agreement, or

b) which assumes the liability of others, except agreements wherein the insured has assumed liability for the sole negligence of his indemnities.

The addition of (b) to the definition of incidental contract broadens the scope for indemnity by the CGL policy. The only circumstance in which the insured would not gain indemnity in circumstances where it would be liable in contract and tort is if it agreed to bear liability for the sole negligence of another party. This rarely occurs in the context of a construction contract and is not, for example, the case with respect to the indemnification provisions found in General Conditions 9.2 and 12.1 of the CCDC-2, discussed in chapter 1. The various provisions of the CCDC-2 relating to the protection of persons and property and indemnification should fall within the expanded definition of “incidental contract” in the CGL policy.

IV.B.1(c) The CGL Policy and Product Liability

Product liability coverage is included in the personal injury and product liability coverage provided by the CGL policy if it is included as a hazard covered in the CGL policy’s declaration page. It may also take the form of an endorsement to the policy. Some CGL policies specifically set out product liability in separate paragraphs following the personal injury liability and property damage liability clauses:

Products Bodily Injury - All sums resulting from the liability imposed by law upon the Insured for Loss or damage resulting from bodily injury to or the illness or death of any person or persons arising out of:

(a) the handling or use of or the existence of any condition in merchandise, products or containers manufactured, sold, handled or distributed by the Insured after the Insured has relinquished possession of such merchandise, products or containers to others and away from premises owned by, rented to or controlled by the Insured

(b) completed operations, if the accident occurs after such operations have been completed or abandoned at the place of occurrence thereof and away from premises owned by, leased to, or controlled by the Insured, provided operations shall not be deemed incomplete
because improperly or defectively performed, or because further operations may be required pursuant to an agreement.

Products Damage to Property of Others - All sums resulting from a liability imposed by law upon the Insured for damage to or destruction of property of others, including the loss of use thereof, arising out of:

(a) the handling or use, of, or the existence of any condition in merchandise, products, or containers, manufactured, sold, handled or distributed by the Insured, which damage or destruction is caused by Accident occurring during the policy period but after the Insured has relinquished possession of such merchandise, products, or containers to others and away from premises owned by, leased to, or controlled by the Insured;

(b) completed operations, if the accident occurs after such operations have been completed or abandoned at the place of occurrence thereof and away from premises owned by, leased to, or controlled by the Insured, provided operations shall not be deemed incomplete because improperly or defectively performed, or because further operations may be required pursuant to an agreement.

As observed by Professor Waddams, this standard policy wording does not cover economic loss imposed by breach of warranty or for negligence except in respect of the consequential loss of use of property.\textsuperscript{370} Professor Waddams further notes that this is of significant practical consequence since the decision in \textit{Rivtow Marine}.\textsuperscript{371}

We recall that in \textit{Rivtow Marine}\textsuperscript{372}, the Supreme Court of Canada unanimously imposed liability on the manufacturer (and its distributor) for economic losses in the form of diminished profits as a result of repairs required of a crane installed on the plaintiffs' barge. The majority grounded its judgment narrowly on the failure to warn the crane's owner and user of potentially dangerous defects. Laskin J. would have awarded the plaintiffs the cost of repairing the crane as well, on the basis of the crane's negligent manufacture. The presumed easy availability to the manufacturer of liability insurance was an important consideration persuading Laskin J. that the plaintiffs should be fully compensated for their loss.\textsuperscript{373}

\textsuperscript{370} \textit{Products Liability}, supra note 38 at 170.
\textsuperscript{371} \textit{Ibid.}
\textsuperscript{372} Supra note 228.
\textsuperscript{373} \textit{Ibid.} at 551-552.
Put another way, liability has been denied on the ground that there is no duty to a consumer or user in respect of economic loss alone. It seems to me that this restriction on liability has in it more of a concern to avoid limitless claims for economic loss from any kind of negligence than a concern for the particular basis upon which manufacturer’s liability for negligence rests. That liability rests upon a conviction that manufacturers should bear the risk of injury to consumers or users of their products when such products are carelessly manufactured because the manufacturers create the risk in the carrying on of their enterprises, and they will be more likely to safeguard the members of the public to whom their products are marketed if they must stand behind them as safe products to consume or to use. They are better able to insure against such risks, and the cost of insurance, as a business expense, can be spread with less pain among the buying public than would be the case if an injured consumer or user was saddled with the entire loss that befalls him.

The reality is that the defendants in Rivtow were probably not covered by insurance for the cost of repairing the crane. In fairness to Laskin J., the focus of this passage is seemingly on the consequential financial damage suffered by the plaintiffs in respect of loss of use of the crane rather than the cost of its repair. Nevertheless, the case shows that both insureds and jurists should be careful in their presumption of the sort of losses covered by liability insurance.

**IV.B.2 Builders’ Risk Insurance**

Builders’ risk insurance is property loss insurance that covers work in progress during the course of construction of a specified project. It is also known as “course of construction” or “all risks” insurance. This policy can be purchased by contractors on their own initiative but is usually a condition of the general contract. Its purpose was recently explained in this way:  

> The policy in force here is what is commonly called a builders’ risk policy. ... It is well established by the authorities that this type of insurance has as its primary purpose the simplification of insurance coverage on complicated projects involving a number of contractors and subcontractors. It serves the salutary purpose of reducing the overall cost of insurance on this type of project. ... It is insurance from which owners, contractors and subcontractors can derive comfort and security when participating in these types of projects.

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All of the parties to a construction project seek an assurance that in the event of a loss there will be sufficient funds on hand to rebuild the project. This is why GC 11.1.1.4 of the CCDC-2, for example, stipulates that the contractor is to obtain all risks property insurance for no less than the sum of the contract price plus the value of the products to be supplied by the owner for incorporation into the project.

The standard property coverage in this sort of policy is as follows:

1. Property Insured

   (a) Property in course of construction, installation, erection, demolition, reconstruction or repair whilst at the risk of the Insured and whilst at the location of the said construction, installation, erection, demolition, reconstruction or repair operations (hereinafter called the “Construction Operations”);

   (b) Property of every kind and description (including materials and supplies) owned by the Insured and used, or to be used in part of or incidental to, the Construction Operations wherever the said property may be located …

   (c) Property of others used or to be used in, a part of, or incidental to the Construction Operations, for which the Insured may be responsible or shall, prior to any occurrence for which claim may be made hereunder, have assumed responsibility;

With respect to clause 1(c), we recall from the first chapter that pursuant to General Condition 9 of the CCDC-2, the contractor assumes responsibility for the work and the owner’s property from damage which may arise as the result of the contractor’s operations.

This clause makes it clear that the range of insureds extends beyond those owning the land and the building to other persons who contribute to its construction. Because an insurer cannot through subrogation be indemnified by its insured, unnamed insureds like subcontractors and suppliers are protected from subrogation proceedings. In the *Commonwealth Construction* case\textsuperscript{375}, the Supreme Court of Canada lauded the practicality of this arrangement:\textsuperscript{376}

\begin{footnotesize}
\textsuperscript{375} Ibid.
\textsuperscript{376} Per de Grandpré, *ibid.* at 562-563. The insurer’s subrogation rights are further limited by an express waiver of subrogation extending beyond the parties to the policy. See also *Timcon Construction Ltd. v.*
\end{footnotesize}
On any construction site … there is ever present the possibility of damage by one tradesman to the property of another and to the construction as a whole. Should this possibility become a reality, the question of negligence in the absence of complete property coverage would have to be debated in this Court. By recognizing in all tradesmen an insurable interest based on that very real possibility, which itself has its source in the contractual arrangements opening doors of the job site to tradesmen, the Courts would apply to the construction field the principle expressed so long ago in the area of bailment. Thus all the parties whose joint efforts have one common goal, e.g., the completion of the construction, would be spared the necessity of fighting between themselves should an accident occur involving the possible responsibility of one of them.

In order to enjoy this “tort immunity” under the builders’ risk policy, the nature of the activities undertaken by the negligent party must be integral to the construction project.377

The builders’ risk policy is subject to the following important exclusion:

Perils Insured

This Policy insures against all risks of physical loss of or damage to the property insured (including general average and salvage charges), except as hereinafter provided.

...  

4. Perils Excluded

(c) Cost of making good faulty or defective workmanship, material, construction or design, but this exclusion shall not apply to damage resulting from such faulty or defective workmanship, material, construction or design.

There are three important points to be made about this exclusion clause. The first is the unique feature among property loss policies of providing a limited form of indemnity if faulty workmanship causes property damage to third parties. The second is that faulty design is excluded to avoid the policy becoming a warranty of the soundness of the designer’s work. The third is that there is no coverage of the insured’s own property if

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377 Riddle, McCann, Rattenbury & Associates Ltd. (1981), 16 Alta. L.R. (2d) 134, wherein the Court of Queen’s Bench ruled that the builder’s risk policy barred the insurer from prosecuting an action against a negligent subcontractor notwithstanding clear evidence that it had not been the intent of either the owner of the contractor that the subcontractor constitute an unnamed insured under the policy.

the loss is attributable to the insured’s own carelessness. The builders’ risk insurance does not, therefore, cover the insured’s costs of remedying poor design or construction but only the damage caused thereby. The distinction has been explained neatly as follows:

Damage for faulty or improper design encompasses all the damage to the very thing that was designed faultily or improperly. Resultant damage is damage to some part of the insured property other than the part of the property that was faultily designed.

The effect of these provisions was carefully considered recently in Foundation Co. of Canada Ltd. v. American Home Assurance Co., wherein the defendant insurer issued an all risks insurance policy to the plaintiff contractor. The plaintiff contractor had built a cofferdam, a temporary structure erected in a river providing an enclosed working area free of water, on a bridge under repair. The cofferdam exploded and required significant repair. The contractor claimed that the cost of repairs was covered by the all risks policy. The insurer rejected the claim on the basis of exclusion 4(c) barring compensation for making good faulty or defective workmanship, material, construction or design.

“Design” has been defined to include the conceptual aspects of a building as contrasted with “construction” being the actual implementation. “Workmanship” is the skill used in carrying out the design while “construction” is the physical execution of a design. In Foundation, Wilson J. summarized that:

> From a review of the caselaw it appears that workmanship and construction go hand in hand. Construction involves the physical implementation of a design. Workmanship involves the qualities of skill and knowledge in performance of the construction. The two

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378 In Bird Construction Co. v. United States Fire Insurance Co. (1985), 18 C.C.L.I. 92, the Saskatchewan Court of Appeal ruled that recovery was limited to damage caused to a third party and did not go so far as to provide indemnity for the property of the insured who was responsible for the faulty workmanship.

379 In “All Risk & Builders’ Risk Policies” (1991), 2 C.I.L.R. 341, Eric A. Dolden argues that this is contrary to this policy’s original purpose of affording full indemnity to the construction industry notwithstanding the insured’s carelessness.


382 Ibid. at 241-242. But see Todd’s Men & Boys Wear Ltd. v. Diamond Masonry (Calgary) Ltd. (1985), 12 C.C.L.I. 301 (Alta. Q.B.), wherein the distinction was made and turned the case in favour of the insured as faulty “construction” was not excluded by the CGL at bar.
terms are often used interchangeably in the caselaw, as they are, to a degree, inextricably intertwined.

Wilson J. agreed with the insurer that faulty or defective design is understood to be more comprehensive than “negligent”.\(^{383}\)

The departure from the test of negligence as a prerequisite for faulty or more particularly defective design makes sense and I accept it. It would be too easy for design standards to slip, and be dictated by economic factors. Short cuts could be taken at both the insurer’s expense, and at the expense of principles of public safety. Meeting the standard of the profession at the time is not sufficient to avoid the exclusion. The onus is, however, upon the insurer to prove that the exclusion applies. To determine whether the onus of faulty or defective design has been met, the words should be given their plain and ordinary meaning. I reiterate the essence of the definitions of faulty or defective. “Faulty” implies containing faults, imperfect, unsound. “Defective” implies a product is not fit for its ordinary purpose. All foreseeable risks must be taken into account in a design. It is not the test of “reasonably foreseeable risks” applicable in the law of negligence.

This means that compliance with industry standards is persuasive but not determinative of whether the design meets the test.\(^{384}\)

Wilson J. held that the same definitions of “faulty” and “defective” should apply to the workmanship, material and construction in question. Faulty workmanship or construction does not, therefore, require a finding of negligence. This is demonstrated by cases like Greene v. Canadian General General Insurance Co.\(^ {385}\), wherein the contractor’s workmanship was found faulty or improper within the meaning of an exclusionary clause in the CGL policy notwithstanding the express finding that the omitted work was not required by either the building plans or the National Building Code. Of course, a finding of negligence is very likely to lead to a finding of faulty or defective workmanship and construction.\(^ {386}\) Wilson J. further ruled that a contractor must advise those responsible to either change the design or the method of construction should it identify an unforeseen


\(^{384}\) Ibid. at 238.

\(^{385}\) (1991), 46 C.L.R. 290 (Nfld. S.C. (T.D.)).

\(^{386}\) Ibid. at 242.
problem during the course of construction. Failure to do so will also be considered faulty construction or workmanship.\textsuperscript{387}

Wilson J. concluded that the insurer failed to bring the case within the exclusion in clause 4(c) as neither the design of the cofferdam nor the construction and workmanship were faulty or defective. She added that she would have agreed with the argument of the insurer that if the exclusion did apply, the exception to the exclusion would not apply as rebuilding the cofferdam was not “damage resulting” from the blow-in. This means that if the damage was found to be caused by the faulty or defective design of the cofferdam, the insurer would not be liable for the cost of its reconstruction. This \textit{obiter} comment is consistent with a line of cases holding that if the insured’s property constitutes a single functional unit and that functional unit has incurred damage caused by faulty workmanship, none of the property damage is to be treated as “resultant damage”.\textsuperscript{388}

\textbf{IV.B.3 \hspace{1cm} Summary of Construction Insurance}

CGL and builders’ risk policies are commonly used in a construction project to protect the insured and property owner from third party liability and damage to their own property. The protection sought is indemnification for personal injury or property damage arising during the course of construction. The CGL policy is concerned with third party loss while the builders’ risk policy is concerned with property loss suffered by contributors to the construction project. However, the actual coverage provided by the two policies is often complicated in practice.

The CGL policy expressly excludes indemnification for damage to the insured’s product itself, property damage to work performed by or on behalf of the insured as well as damage to property as the result of faulty or improper workmanship as opposed to damage caused by the property under construction. Similarly, the builders’ risk policy

\textsuperscript{387} \textit{Ibid.} at 243.
\textsuperscript{388} \textit{Simcoe \& Erie General Insurance Co. v. Royal Insurance Co. of Canada} (1982), 19 Alta. L.R. (2d) 133 (Q.B.).
covers loss of the property itself except the cost of making good faulty or defective workmanship, material, construction or design.

The risk intentionally left uncovered in a construction project is that the contractor fails to complete the project in the manner bargained for but does not cause property damage or bodily injury. Risk allocation of this type lies with the owner and its contractor and should be addressed by the terms of their bargain.

**IV.C INSURANCE AS A POLICY CONSIDERATION**

The traditional view is that the insurance status or insurability of the litigants is irrelevant to both the threshold question of liability and the issue of quantification of damages. In the 1950's case of *Lister v. Romford Ice and Cold Storage Co. Ltd.*, Viscount Simonds stated this position succinctly:

... it is urged that it must be irrelevant to the right of the master to sue his servant for breach of duty that the master is insured against its consequences: as a general proposition it has not, I think, been questioned for nearly 200 years that in determining the rights inter se of A and B the fact that one or other of them is insured is to be disregarded ...

The judiciary and legal scholars have questioned this proposition in the last half of this century but a consensus is yet to develop as to the propriety of the consideration of insurance as a factor in assessing tort liability.

Discussion of the issue surfaces only sporadically in the case law and in those instances has not been determinative of the case at hand. In those few cases where it is discussed, the discussion is relatively undeveloped. A comparative review of the judicial viewpoint on the relevance of insurance in cases of economic loss cannot, therefore, be anything more than a sampling. Nonetheless, the sample does illustrate the arguments on both sides of the debate.

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Perhaps the strongest judicial support for the merits of the consideration of insurance is from the New Zealand Court of Appeal in *Bowen*. Woodhouse J. reasoned that the availability of third party liability insurance undermined the floodgates argument. It also served a "double social purpose".

On the one hand, the serious strains that can arise if the random losses were left to lie where they fall are removed for the unfortunate and innocent victims. On the other, the opportunity for their wide distribution through insurance encourages savings in the form of premium reserves which can be used for the important purpose of supporting the economy generally.

Woodhouse J. effectively took judicial notice that third party liability insurance by builders was more feasible than first party insurance by purchasers.

The most recent comments on the issue from the House of Lords suggest that the English view at the close of this century remains the same as in the centuries leading up to Viscount Simond's statement:

> At common law the circumstance that a defendant is contractually indemnified by a third party against a particular legal liability can have no relevance whatever to the measure of that liability.

In the interim, however, the English Courts did take insurance into consideration on occasion. In *Spartan Steel*, for example, Lord Denning cited the availability of first party insurance as one of many considerations against the award of pure economic loss to the plaintiff factory resulting from the negligent interruption of its electricity supply. Lawton L.J. took a different approach to the insurance consideration.

> For nearly a 100 years now contractors and insurers have negotiated policies and premiums have been calculated on the assumption that the judgment ... in *Cattle v.*

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391 *Supra* note 296.
392 *Ibid.* at 419.
393 For himself and Cooke J. Richmond P. dissented on the facts and did not speak on the issue. Woodhouse J. reiterated his view that it is relevant that potential defendants are or should be insured in *Takaro, supra* note 302 at 322-323.
395 *Supra* note 257.
Stockton Waterworks Co. is a correct statement of the law; and those affected financially by the acts of negligent contractors have been advised time and time again that mere financial loss is ‘irrecoverable’.

In Photo Production v. Securicor Ltd.\footnote{397} the defendant security firm was protected by an exclusionary clause in its contract with the plaintiff when the defendant’s patrol man intentionally burned down the plaintiff’s factory. In so ruling, the House of Lords focused on the right of commercial parties to freely allocate risk between themselves. Lord Diplock reasoned as follows with respect to the risk of intentional loss that could not have been prevented by the reasonable diligence of the defendant:\footnote{398}

Either party can insure against it. It is generally more economical for the person by whom the loss will be directly sustained to do so rather than it should be covered by the other party by liability insurance.

Lord Denning took up the issue again in Lamb v. Camden London Borough Council\footnote{399} wherein the defendants negligently caused water damage to the foundations of the plaintiff’s house. The house subsided and the walls cracked resulting in departure of the tenant. The house was subsequently occupied by successive groups of squatters who caused significant additional damage to the house.

Lord Denning agreed with the trial judge’s ruling that the defendants’ should not be held responsible for the damage done by the squatters. In so doing, he noted that duty, remoteness and causation are all devices used by the courts to limit the range of liability for negligence but “ultimately it is a question of policy for the judges to decide”.\footnote{400} He then concluded that it was the responsibility of the plaintiff and her agents to keep out squatters and added:\footnote{401}

On broader grounds of policy, I would add this: the criminal acts here … are usually covered by insurance. By this means the risk of loss is spread throughout the community. It does not fall too heavily on one pair of shoulders alone. The insurers take the premium to cover just this sort of risk and should not be allowed, by subrogation, to pass it on to

\footnote{397} Supra note 215.  
\footnote{398} Ibid. at 851.  
\footnote{400} Ibid. at 636.  
\footnote{401} Ibid. at 637.
It is commonplace nowadays for the courts, when considering policy, to take insurance into account. It played a prominent part in Securicor. The House of Lords clearly thought that the risk of fire should be borne by the fire insurers who had received the full premium for fire risk - and not by Securicor’s insurers, who had only received a tiny premium.

Although policy is plainly at the crux of many cases of pure economic loss, Lord Denning overstated matters by saying that insurance was a common place policy consideration. It is much more accurate to characterize the recognition of insurance as a relevant modern reality as something of his own crusade.\(^{402}\)

We saw in the last chapter that the House of Lords’ preoccupation with certainty and predictability in the boundary between tort law and the fear of indeterminate liability were the forces behind the re-establishment of the exclusionary rule. Presumably, one could argue that this high level of certainty in the British law better enables parties to plan and protect themselves against risk including the securing of insurance. This is the gist of the reasoning of Lawton L.J. in the passage cited above from Spartan Steel. It is consistent with reasoning in The “Eurymedon” line of cases to the effect that third parties should be allowed to benefit from exclusionary clauses such as the Himalaya clause because this allows the definite establishment of risks and, therefore, makes certain the contracting parties’ insurance needs.\(^{404}\) This is a beneficial side effect of England’s bright-line rule against the recovery of pure economic loss, but was not voiced as a rationale supporting the rulings in Murphy and D & F Estates.

The passage from the Australian High Court’s decision in The Willemstad\(^{405}\) set out at the outset of this chapter demonstrates the strongly held view of Stephen J. that loss distribution and insurance are not considerations that the courts should entertain. His


\(^{405}\) Supra note 226.
view is that these may be desirable policy factors but are without foundation in principle in fault liability which remains the basis of the present law of tort.\textsuperscript{406} Stephen J. spoke for himself in \textit{The Willemstad}. The other four Justices did not comment on the issue.

The reasons for judgment of the Supreme Court of Canada in \textit{Norsk}\textsuperscript{407} stands as the fullest discussion of this issue in the Commonwealth jurisprudence. The difference in opinion of La Forest J. to the position taken by Stephen J. in \textit{The Willemstad} is plain from the passages quoted at the outset of this chapter. La Forest J. argued that the availability of insurance is a factor to be considered in cases of relational economic loss. La Forest J. cited \textit{Lamb} as one of a number of authorities for this proposition. The most supportive of these precedents to his position is the passage cited earlier in this chapter from the dissent of Laskin J. in \textit{Rivtow Marine}.\textsuperscript{408}

The view of La Forest J. is that the long standing rule against recovery in these cases has resulted in and is supported by the fact that first party insurance is a cheaper and more effective method of protecting against loss than liability insurance. For this reason, the courts should be very careful not to upset the status quo:\textsuperscript{409}

\begin{quote}
... if the business community is insured, then there is no point in shifting the loss from one insurance company to another at high cost. If the business community is not insured, then that reveals that other ways of defraying such losses are perceived as superior to insurance and the problem is not that serious.
\end{quote}

McLachlin J. rejected the position that insurance militated against recovery of relational economic loss on three grounds. Firstly, it is not clear that victims are in a better position to predict and insure against economic loss consequent on an accident. Further, the rule against recovery expounded by La Forest J. acts as a disincentive for commercial parties to take care. Secondly, any loss-spreading justification rests on similarly questionable assumptions and collapses altogether in the numerous cases where there is only one

\textsuperscript{406} \textit{Ibid.} at 265.
\textsuperscript{407} \textit{Supra} note 318, Part III.G.2.
\textsuperscript{408} \textit{Supra} note 373.
\textsuperscript{409} \textit{Norsk, supra} note 318 at 350.
Thirdly, the argument that persons who stand to suffer economic loss due to damage to the property of another should allocate the risk within their contracts with the property owner is unrealistic.

On a more fundamental level, McLachlin J. was plainly concerned with compromising the historical centrality of personal fault to the concept of negligence.

For his part, Stevenson J. agreed with La Forest J.'s concern with minimizing the cost associated with a given loss and agreed that the contractual allocation of risk is relevant. However, he disagreed that the prospect of cheaper casualty insurance should override the reasons of principle and policy founding tort law.411

IV.D CONCLUSION

In jurisdictions outside of England and Scotland, we can probably put to rest the argument of Lawton L.J. in Spartan Steel and La Forest J. in Norsk that extending liability for relational economic loss would upset commercial parties and the insurance industry operating under the understanding that there is a rule against recovery of pure economic loss. Indeed, one might suggest that in light of the precipitous doctrinal about face by the House of Lords in the 1980's, a prudent commercial party in Britain should consider the wisdom of third party insurance in any event. In Australia, New Zealand and Canada, the potential for liability for pure economic loss has been a reality since the 1970's, although under a legal regime of relative uncertainty.

In Norsk, McLachlin J. alluded to the important point that Stephen J. voiced directly in the passage set out at the outset of this chapter: the principle of fault is at the core of the tort system.

410 Ibid. at 372-373. McLachlin J. relied on W. Bishop, "Economic Loss in Tort" (1982), 2 Ox. J. Legal Studies 1, for the first and second arguments.
411 Ibid. at 378.
Stephen J. overstates matters as the many instances where tort law imposes strict liability on a defendant show that fault is an important but not sacred element of tort. Further, it is well recognized that the fault system is an inefficient and incomplete method of compensating accident victims. Commonwealth legislators have actively tried to remedy the failure of the tort system to satisfactorily compensate the victims of negligent acts. This legislative response includes the Workers’ Compensation regime in place throughout Canada, no-fault motor vehicle insurance in several Canadian provinces and the replacement of a large area of tort law in New Zealand by loss-oriented social insurance.

This said, there is no question that fault is a core principle of tort law and that the consideration of insurance as a factor in determining liability undermines both the principle of corrective justice and the incentive goal of deterrence. Professor Ernest J. Weinrib argues that deploying insurance considerations takes tort out of the realm of private law into a instrumentalist and legislative conception of law:412

The presence of insurance is transformed into a means for creating the liability to which it is supposed to respond.

Taken to its extreme, one may argue that once tort takes insurance into account, then tort becomes a surrogate for first party insurance.413

Apart from the theoretical debate as to the role of tort law in modern society, the practical problem with insurance as a consideration is that it is frequently unclear as to whether it is a factor in favour or against the imposition of tort liability in a given case. To this we can add the further practical reality that, at least in the context of a construction project, the availability and extent of first and third party coverage is relatively complicated.

412 "The Insurance Justification and Private Law" (1985), 14 J.L.S. 681 at 683. Professor Weinrib also rejects deterrence as relative consideration in assessing tort liability.
In *Norsk*, La Forest J. stated that the “weight of opinion is certainly to the effect that first party insurance is a cheaper and more effective method of protecting against loss than liability insurance, particularly where the liability is of uncertain amount”. La Forest J. was apparently referring to the opinion of both the judiciary and academia.

The proposition that consideration of insurance in determining tort liability is gaining recognition in the courts is dubious at best. If anything, the consideration of insurance has lost whatever momentum it once enjoyed as it has not been taken up in any of the seminal cases since *Norsk* including *Winnipeg Condo* and *Bryan v. Maloney*. It was apparently a relatively minor consideration of McLachlin J., La Forest J. concurring, in her reasons for judgment in *Bow Valley Husky*\(^{415}\), wherein the plaintiffs were denied recovery for relational economic loss. McLachlin J. held that one policy consideration negating the prima facie duty of care owed to the plaintiffs was the sophisticated contractual matrix in the case including provisions for third party claims and the purchase and maintenance of insurance.\(^{416}\)

It is certainly unsafe to say that the courts have accepted insurance as a relevant consideration in determining tort liability and that there is a further judicial consensus as to whether it is a factor encouraging or compromising liability for pure economic loss. In a number of Lord Denning’s judgments, for example, he reasoned that the victim was better placed to secure insurance against the loss in question. In *Securicor*, however, either the plaintiff or defendant could have obtained insurance. Lord Denning found that “the insurance factor cancels out”.\(^{417}\) On the other hand, the New Zealand Court of Appeal seems persuaded that the availability of liability insurance is a policy factor facilitating the extending the defendant’s tort liability.

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\(^{414}\) At 350.
\(^{415}\) *Supra* note 225.
\(^{416}\) *Ibid.* at 413.
\(^{417}\) *Securicor*, *supra* note 215 at 866.
The insurance question has received much more thorough scholarly attention. There is a general recognition by tort scholars that the steady expansion of tort liability in the last half of this century has been encouraged by the presumption of liability insurance. Professor Fleming, for example, makes the following observation on liability insurance:

... while in theory insurance follows liability, in experience insurance often paves the way to liability. In short, it is a "hidden persuader".

Of those who agree that insurance is a relevant consideration, theoreticians have generally concluded that first party loss or insurance is more efficient than a fault based system supported by liability insurance in cases of pure economic loss outside of the Hedley, Byrne type of case. This conclusion is furthered by those doubtful of the modern role of deterrence in negligent liability. Professor J. A. Smillie summarizes this view as follows:

... where the class of potential victims is as well placed as the class of potential defendants to anticipate, evaluate, and spread the risk of accidental loss and shifting the loss will have no significant deterrent effect, it is appropriate to deny liability and leave the accident victim to distribute the loss.

In Norsk, La Forest J. cited Professor Smillie and presumably agreed with his conclusion that this proposition applies to the case of purely economic loss consequent upon damage to a third person's property.

In summary, the difficulty with the reasoning of La Forest J. is that we cannot be sure of or make much out of the last sentence in the passage from his judgment in Norsk set out at the outset of this chapter. Certainly, a great many important tort cases would not have

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418 Supra note 127 at 13.
420 Fleming, supra note 127 at 8-13.
421 Smillie, supra note 419 at 236.
422 Ibid. at 241. It is surprising that Professor Smillie's article is not cited by La Forest J. in Norsk as there is much there to support his views including, at 254, a fairly scathing criticism of Stephen J. in The Willemstad.
been litigated in this century but for the reality of insurers prosecuting subrogated claims or "true" plaintiffs pursuing their claims only after ascertaining that the defendant had insurance that would satisfy a potential judgment. This is not, however, the point. The Court made no inquiry as to whether the bottler of Mrs. Donoghue’s ginger beer was covered by product liability insurance or whether professional liability insurance would have responded to the claim made against the negligently speaking bankers in *Hedley, Byrne*.

We have seen in two of the leading Canadian cases in which tort liability was extended, *Riverton Marine* and *Winnipeg Condo*, that the defendants were not protected by insurance against the losses imposed on them. With respect to the latter case in particular, the decision in *Bird Construction* nicely demonstrates that while the liability of an owner or contractor to each other, or to third parties, may evolve with case law, these doctrinal developments will not result in a consequential amendment of the owner’s or contractor’s insurance policy, since that policy is governed by its specific contractual language.

The best we can say is that there is academic support for the tentative conclusion that first party loss insurance is probably more efficient than third party liability insurance in cases of relational economic loss. The debate in *Norsk* demonstrates that any such general presumption is controversial and the courts are not equipped to make this sort of technical judgment in each individual case. Certainly, the courts cannot and should not speak with any authority on the overall social and economic impact of obliging one party or the other to bear or insure against the loss as the New Zealand Court of Appeal was apparently prepared to do in *Bowen*. Perhaps, Stevenson J. articulated the most sensible view of the issue in *Norsk* wherein he essentially reasoned that it was prudent to take out first party insurance but stood to be convinced that it was the cheapest way to cover a loss.

Moreover, and as discussed earlier, even if we reject the concept of fault as the single overriding principle in tort law, it cannot be denied its place as a fundamental inquiry. Further, the courts would run the risk of the circularity by answering the question of
liability by determining which of the parties is insured or could more easily have insured against the loss claimed. In his comment on Norsk\textsuperscript{423}, Professor Waddams argues these last two points:\textsuperscript{424}

\ldots it is another thing altogether to introduce insurance considerations to the question of tort liability. Can the wrongfulness of an act - which must, at least in part, be a social and moral question determined, to use McLachlin J.'s phrase, by "principle and policy" - really depend on the availability of insurance? And is there not a danger of a kind of circular instability, with the proposed change in the law affecting the availability of insurance, and the availability of insurance in turn affecting the substance of the law? Insurance is not part of the background against which tort law is formed: the relation between them is precisely opposite.

The first thing referred to by Professor Waddams in this passage is the consideration of insurance in the contractual context. There, such a consideration is an entirely appropriate part of the inquiry into the background against which an agreement is made.\textsuperscript{425} We have seen that this is particularly important part of the contractual relationships forming the background to a construction project. In the next and final chapter, it is argued that insurance should be taken into consideration in those construction cases where the litigants are part of a contractual chain.

\textsuperscript{424} Ibid. at 122.
\textsuperscript{425} Ibid.
CHAPTER V

ANALYSIS OF THE CONSTRUCTION DISPUTE

"The fact that the law recognizes the existence of concurrent duties in contract and tort does not mean that the existence of a contractual relationship is irrelevant to either the existence of a relationship of proximity or the content of a duty of care under the ordinary law of negligence. In some circumstances, the existence of a contract will provide the occasion for, and constitute a factor favouring the recognition of, a relationship of proximity either between the parties to the contract or between one or both of those parties and a third person. In other circumstances, the contents of a contract may militate against recognition of a relationship of proximity under the ordinary law of negligence or confine, or even exclude the existence of, a relevant duty of care."  

V.A INTRODUCTION

In the first chapter we saw that the participants in a construction project allocate roles and responsibilities between themselves fairly precisely and that this sophisticated state of private ordering takes place in a highly regulated context.

In the second chapter we saw that the terms implied into a construction contract are very similar to the duty imposed in tort on a builder and that both sources of obligations make use of and are reinforced by statutory standards. The rationalization of private obligations and liabilities is facilitated and furthered by the watershed doctrinal break-through allowing an aggrieved party to pursue an action against a wrongdoer concurrently in tort and contract.

The third chapter canvassed the difficult question of when a plaintiff may recover pure economic loss. In many of the leading Commonwealth cases in the development of this area of the law the courts were forced to address the question of whether it is appropriate for tort law to infringe on the domain of contractual warranty. The importance of this

426 Per Mason C.J., Deane and Gaudron JJ. in Bryan v. Maloney, supra note 284 at 621.
legal issue to the construction industry is manifested by the fact that much of the seminal case law arises from construction disputes.

The fourth chapter cast doubt on the appropriateness of relying on the existence or availability of insurance to ground tort liability but showed how property and liability insurance is a critical part of the careful commercial relationships outlined earlier.

The existence and substance of a contractual relationship between the plaintiff and defendant or some middle party has been a recurring inquiry throughout the doctrinal developments canvassed in the preceding chapters. The quote above from the majority judgment of the Australian High Court in *Bryan v. Maloney* is fairly representative in this respect. In this concluding chapter, I argue that the contractual arrangements in a construction case are very relevant to a claim in negligence and may define or limit tort duties not only between parties to the contract, but also with respect to third parties.

These considerations are analysed in three cases: (i) the plaintiff is a complete stranger to the building and defendant; (ii) the plaintiff shares privity of contract with the defendant; and (iii) the plaintiff is linked indirectly with the defendant through a series of contracts.

V.B REVISITING THE CONSTRUCTION PYRAMID

Many of the leading cases canvassed earlier testing the boundary between tort and contract arise in circumstances where the plaintiff is peculiarly selective in naming its defendants. In *Junior Books*, for example, there is no explanation why the building owner sued the negligent flooring contractor rather than or in addition to the general contractor it paid to build the factory including the laying of the floor. In *Edgeworth Construction*, the defendant engineering consultant argued that the underpaid prime contractor could only look to the province of British Columbia for compensation for the extra work it allegedly was required to do. On the other hand are cases like *Winnipeg Condo*, in which the defendant prime contractor maintained, among other defences, that the aggrieved building
owner should pursue the vendor it contracted with. Similarly, in *Bryan v. Maloney*, the builder denied owing a duty of care to the third owner of the house he built.

The plaintiffs in these important precedents are not interested in breaking new ground in tort law but have practical reasons to choose not to take the most obvious path of pursuing the party with whom they are in privity. One leading theorist suggests that, in *Junior Books*, the owner and general contractor previously reached a satisfactory arrangement between themselves.\(^{427}\) In *Edgeworth Construction*, the underpaid general contractor sued the design engineer of a highway project rather than the Province for the reason that it intended to continue to do business with the Ministry of Highways.\(^{428}\)

What makes these cases exceptional, at least from the perspective of the party within the construction pyramid, is that the plaintiff is seemingly circumventing the neat structure of the commercial relationships that makes up the construction project as outlined in the first chapter. This is the important consideration that is especially germane to the tort claim in the construction context; is the plaintiff's loss protected elsewhere (by contract or actual settlement with another party) or could the plaintiff have reasonably easily have readily secured the necessary protection elsewhere?

This line of reasoning was applied by Sharpe J. in *Piotrowski Consultants Ltd. v. Osburn Cotman Belair Architects Inc.*\(^{429}\) wherein the plaintiff subcontractor's unjust enrichment claim against the building owner was summarily dismissed:\(^{430}\)

> The factual basis for the plaintiff's claim amounts to little more than an assertion that it lost money on the project because of the shortcomings of another subcontractor. In my view, something more is required if the plaintiff is to escape the contractual regime which governed its relations for the purposes of the project. The plaintiff has simply failed to offer any evidence of misrepresentation, duress or other conduct or actions on the part of

\(^{427}\) In *An Introduction to the Law of Contract*, 5\(^{th}\) ed. (Oxford: Clarendon Press, 1995) at 383, n. 40, P. S. Atiyah explains that the apparent reason why the owner did not sue the prime contractor was that the two parties had previously compromised a series of claims resulting in a settlement covering all of the prime contractor's liability arising out of the prime contract.

\(^{428}\) See the trial decision at (1989). 37 C.L.R. 152 at 157.


\(^{430}\) *Ibid.* at 220.
[the owner] which could undermine [the owner’s] reliance on the contractual regime or which might provide a “juristic reason” to support a finding of unjust enrichment.

For the reasons articulated in the last chapter, the availability of first party insurance is not being offered as an alternative source of protection against the plaintiff’s loss. Instead, the reasonable arrangement or common usage of a contract with the wrongdoer or a contract with a third party are contemplated as possible policy considerations militating against recovery by the plaintiff. By the same token, in those cases where the plaintiff pursues a claim in both tort and contract, the courts should consider whether the defendant could have readily avoided the imposition of tort liability or is able or should have been in a position to seek indemnification against the claim.

In this chapter, I conclude that there are three safeguards to be considered by a court in assessing the existence or scope of a duty of care in the construction case:

(i) the threat of indeterminate liability;
(ii) whether the plaintiff had reasonably available to it and would be expected to have pursued alternative means of protection; and
(iii) whether allowing the plaintiff’s claim upsets or circumvents the clear allocation of the risk at issue in the contractual matrix of the case.

V.C.1 Plaintiff and Defendant Not Contractually Linked

In this part we are considering the pure stranger in the sense of a plaintiff without any prior direct or indirect dealings with the defendant. This is, therefore, a pure tort claim and is straight-forward in that it is not encumbered by contractual considerations as between the plaintiff and defendant. The visitor to a building injured as a result of a dangerous staircase, for example, may pursue her or his claim in tort against any or all of the building owner, occupier, builder and designer or whomever might be responsible for the building’s defect.
This is usually what takes place in practice as it is considered advisable for a plaintiff to sue any party involved in a transaction or occurrence no matter how remotely involved it may be. This was, for example, the strategy of the building owner in *Winnipeg Condo* which is, at the very least, good authority for the proposition that many parties may be liable for a building defect. There are also practical reasons for naming many parties including assuring that all relevant evidence is discovered as well as the prospect of persuading additional parties to contribute to a pre-trial settlement.

Defendants may, in turn, sort out indemnification amongst themselves. Named defendants will want to make sure that any party contributing to the plaintiff’s loss is joined in the lawsuit. They will also want to assert their right to contribution and indemnity from these parties. This can be done by way of third party procedure.

The purpose of third party proceedings are to enforce duties which the third party owes to the defendant issuing the third party notice. With reference to the following explanation of Laskin J., one can envisage how, for example, an action against the vendor of a building might ground third party proceedings that capture all consultants, contractors and suppliers involved in the building’s construction.431

What, in my view, is central to resort to third party proceedings is that the facts upon which the plaintiff relies against the defendant should issue out of the relations between the defendant and the third party. I prefer this mode of expression to statements in the cases that there must be a common question or common questions between the plaintiff and the defendant and between the defendant and the third party. ... there must be a connection of fact or subject-matter between the cause of action upon which the plaintiff sued and the claim of the defendant for redress against the third party; and, such claim would ordinarily arise out of relations between the defendant and the third party anterior to those between the plaintiff and the defendant which precipitated the main action.

In modern litigation, third party proceedings are not usually strictly limited to claims for contribution and indemnity. Their primary purpose is the proper administration of justice and avoiding a multiplicity of lawsuits and the injustice of conflicting results. The Alberta Court of Appeal has suggested that one way of determining whether a third party notice is

valid is to "ask if the judgment obtained in the original action might decide an issue raised by the third party procedure". 432

The courts in many jurisdictions are liberal in their allowance of third party proceedings but will not allow a defendant to base a third party claim on the plaintiff's own default. 433

The authorities establish that where a plaintiff contracts with two separate parties, such as a contractor and an engineer, and later sues one of them, the one sued cannot claim contribution or indemnity from the other on the ground that the other failed to properly execute his duties, where the substance of the third party claim can be raised against the plaintiff by way of defence.

Third party claims are facilitated by rules, in most provinces, allowing defendants a statutory right to claim contribution and indemnity from each other. Although careful attention should be paid to the particular language used in different jurisdictions, s. 1 of Ontario's Negligence Act is typical. 434

Where damages have been caused or contributed to by the fault or neglect of two or more persons, the court shall determine the degree in which each of such persons is at fault or negligent, and, where two or more persons are found at fault or negligent, they are jointly and severally liable to the person suffering loss or damage for such fault or negligence, but as between themselves, in the absence of any contract express or implied, each is liable to make contribution and indemnify each other in the degree in which they are respectively found to be at fault or negligent.

In the construction case, it is now settled that those parties who performed work on a project are said to have a common design and will be found joint tortfeasors in the appropriate circumstances. Contractors and architects have been described as joint tortfeasors in many cases in which they were found liable in tort or in contract for negligent performance of contractual duties. 435

432 Per Kerans J.A. in Dilcon Constructors Ltd. v. ANC Developments Inc. (1994), 155 A.R. 314 (C.A.). Ontario Rule 29 expressly authorizes the assertion by a third party claim of an "independent claim" the defendant may have against the third party. The procedural and substantive rules are more conservative in some jurisdictions. See e.g. Adams v. Thompson, Berwick, Pratt & Partners (1987), 39 D.L.R. (4th) 314 (B.C.C.A.) at 317.

433 Per McLachlin J.A. in Adams, ibid. at 317.


In *Brunswick*[^36] for example, the trial judge found that the damage to the plaintiff's house resulted from poor design on the part of the defendant architect as well as poor workmanship and poor materials supplied by the building contractor. The majority of the Supreme Court of Canada affirmed the ruling of the Appeal Division of the New Brunswick Supreme Court that the defendants were concurrent wrongdoers jointly and severally liable for the damage. Limerick J.A. reasoned as follows on this issue:[^37]

> Where there are concurrent torts, concurrent breaches of contract or a breach of contract and a concurrent tort both contributing to the same damage, whether or not the damage would have occurred in the absence of either cause, the liability is a joint and several liability and either party causing or contributing to the damage is liable for the whole damage to the person aggrieved.

Returning to the original question of liability between the plaintiff and the defendant, the plaintiff suffering a physical loss as a result of the negligence of the defendant has had little difficulty recovering compensation from the party or parties responsible for causing the dangerous condition since *Donoghue v. Stevenson*.

On the other hand, the plaintiff suffering pure economic loss has had little success in recovering compensation. None of the authorities considered so far took place in circumstances in which the plaintiff was a stranger to the building but suffered pure economic loss as a result of the negligence of one of the parties involved in its construction. We could, for example, easily contemplate a claim by a third party employer or employee suffering financial harm as a result of the incapacitation of the visitor injured on the defendant's staircase. Of course, there is nothing about this hypothetical that is peculiar to the construction case. We would again expect that, as was ruled in *D'Amato*[^38], a court would dismiss such a claim for contractual relational economic loss for the policy reason that such a claim would open the floodgates to an indeterminate number of claims in an indeterminate amount.

[^36]: Supra note 99.
[^37]: Quoted by Ritchie J., ibid. at 97.
[^38]: Supra note 247.
In a second hypothetical, we might suppose that a neighbouring business suffered the loss of expected patronage as a result of the delay in the occupancy of a multi-residential complex caused by the negligence of one of the contractors. We would expect that this claim would also be dismissed. Recovery of this type of claim also offends the limiting rule against the expansion of tort liability to cases where the number of plaintiffs would be indeterminate. To this it should be added that there is no good policy reason to shift what is essentially a business risk from the neighbouring business to the owner of the new project or its contractors.

V.C.2 Plaintiff and Defendant Share Privity of Contract

In this scenario, the plaintiff prosecutes an action in both tort and contract against the defendant. The Supreme Court of Canada in *BG Checo* outlined three situations that may arise when contract and tort are applied to the same wrong. La Forest and McLachlin JJ., for the majority, contemplated three different classes of cases. In the first, the contract stipulates a more stringent obligation than that imposed by the law of tort. In this case, subject to the consideration of limitation periods, the plaintiff is more likely to ground its claim on the higher contractual duty.

Many of the cases discussed in the second chapter demonstrate how this works in practice. In *Young and Marten* for example, the Court found that the roofing subcontractor was not negligent in its purchase and installation of defective tiling. Nonetheless, the roofing contractor was held liable to the developer it contracted with for the cost of replacing the tiling on the basis of an implied contractual warranty to install good quality tiles.

In the second class of cases, the tort duty is expressly nullified or compromised by use of an exclusion clause. In this case, the plaintiff is, by definition, forced to pursue contractual

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*439 Supra note 159, discussed in part II.D.3.*

*440 Ibid. at 584 - 586.*

*441 Supra note 90.*
claims or assert a claim in negligence with a reduced duty of care. The Supreme Court of Canada emphasized in *Central Trust* and *BG Checo* that a party to a contract should not be allowed to use tort to circumvent positive risk allocations it agreed to in the contract.\(^{442}\)

We recall that in *Miller v. Shepherd*, for example, the Court denied the home owner’s counterclaim for negligent work on the basis of an express one year warranty against construction defects.\(^{443}\) It may well be that the building owner could have evidenced that the work of a careful local contractor using reasonable skill and care in the course of construction would stand for better than one year. Nevertheless, in these cases it is right to hold owners to their bargains which means that the duty of care owed them is compromised such that the standard is to exercise such skill and care necessary to ensure that the house remains defect free for the stipulated period.

This said, it must be recognized that local building codes represent a minimal standard either implied by contract or imposed by the tort of negligence.\(^{444}\) In this regard, we recall the strong comments of Cory J.A. for the Ontario Court of Appeal in *G. Ford Homes* that a court would, in effect, be sanctioning an illegal contract if it were to find that the construction contract in question did not, at least, obligate the defendant to install the staircase in compliance with Ontario’s *Building Code*.\(^{445}\)

We recall that the three-fold warranties implied in a construction contract must be expressly excluded by contractual terms\(^{446}\) and that an exclusionary clause must clearly exempt a negligent builder from liability for consequential damage in tort or contract.\(^{447}\) It usually requires, therefore, an unusually restrictively construction contract to oust a contractor’s tort liabilities outside of cases such as *Miller v. Shepherd* in which the tort claim consists of an action in negligence for inferior work and is limited by a fixed

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\(^{442}\) See also *University of Manitoba v. Smith Carter Architects* (1996), 27 C.L.R. (2d) 215 (Man. Q.B.).

\(^{443}\) *Supra* note 174.

\(^{444}\) *Carroll v. Metropolitan Toronto Condo*, *supra* note 22.

\(^{445}\) *Supra* note 23.

\(^{446}\) *Strata v. Oak Tree*, *supra* note 125.

\(^{447}\) *Dabous, supra* note 151, and *University of Regina, supra* note 172.
warranty period. General Condition 1.3.1 of the CCDC-2, for example, states that the duties and obligations therein are in addition to rather than limiting any other legal duties, obligations, rights and remedies.

This brings us to the third class of case in which the defendant’s duty in contract and the common law duty in tort are co-extensive. Here, we must heed the direction from Le Dain J. in *Central Trust*: 448

What is undertaken by the contract will indicate the nature of the relationship that gives rise to the common law duty of care, but the nature and scope of the duty of care that is asserted as the foundation of the tortious liability must not depend on specific obligations or duties created by the express terms of the contract. It is in that sense that the common law duty of care must be independent of the contract.

We recall that the minimum terms implied in a construction contract are to (i) do the work undertaken with skill and care and (ii) to use materials of good quality. In most instances there will be the further requirement that the work and materials be reasonably fit for the purpose for which they were required. In a further rationalization of tort and contract duty, a court will impose this additional warranty in the construction case in which the contractor’s skill and expertise is actually relied on. In the absence of such reliance or in the face of contrary contractual language, the plaintiff should not be allowed to pursue this claim in negligence as the imposition of such a duty would violate the caveat of Le Dain J. in *C.P. Hotels* that a concurrent or alternate liability cannot extend to the recognition of a duty of care in tort when that same duty of care has been rejected or excluded by the court as an implied term of particular class of contract. 449

As discussed, there is the further implied contractual term that the work comply with local building codes. The failure to do work in compliance with the applicable building code would either constitute a breach of contract or be strong evidence of negligence. This is complemented by the ruling in *Winnipeg Condo* that a builder owes building owners the

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448 Supra note 54 at 521-522.
449 Supra note 77.
duty in tort to take reasonable care in the building’s construction and to ensure that it is not dangerous to its users.

Rulings that implied contractual warranties and tort duties can only be negated by clear contractual language is entirely appropriate in the construction context. The terms implied into a building contract are well established. If the roofing subcontractor in Young and Marten, for example, did not want to warrant the good quality of the tiles installed as part of the roofing contract, it could have easily included such provisions in his contract or required the tile manufacturer to provide its warranty directly to the developer.

Further, and as discussed earlier, the policy reason in favour of holding the contractor responsible for workmanship, quality of materials and, in most cases, suitability of materials is bolstered by the reasoning expressed by the House of Lords in Young and Marten and by Sopinka J. in ter Neuzen\(^{450}\) that commercial parties like the roofing subcontractor in Young and Marten can usually pursue indemnity from the tile manufacturer by way of contract, tort, or the Sale of Goods Act.

An example of one commonly used contractual device is a clause that protects the builder from liability for defects in materials chosen by the owner or “owner directed supply”.

The intention is to hold the builder liable only for defective installation and leave the risk of defects of quality with the owner who selected the product and supplier. In Bow Valley Husky, the following such clause was tested:\(^{451}\)

Builder’s liability with respect to the Owner Directed Supply shall extend only to installation thereof in accordance with the certified equipment drawings and manuals furnished by the supplier in those instances where such equipment is actually installed by the Builder. In all other instances, the sole risk and responsibility for Owner Directed Supply shall, as between Builder and Owner be borne by Owner.

The majority of the Supreme Court of Canada agreed that this clause, in conjunction with other exclusionary language in the contract, negated the defendant contractor’s tort duty

\(^{450}\) Supra note 35.

\(^{451}\) Supra note 225 at 398.
to warn the rig-owner that the product it was directed to purchase and install was inflammable.\footnote{Ibid. at 428–432.} The minority’s ruling that this provision related only to the quality of goods and workmanship of the contractor and did not bar a tort counterclaim for failure to warn demonstrates that the interpretation of exclusionary clauses remains relatively unpredictable.\footnote{Per McLachlin J., \textit{ibid.} at 398–400.}

In summary, this second category of case is very different than that of the stranger hypothetical in that there is no issue of indeterminate liability as the threshold question of duty of care is satisfied by the contract between the plaintiff and defendant. As observed by Le Dain J., the contract creates the relationship.\footnote{Supra note 156.} Indeed, the nature of the analysis directed by the Supreme Court of Canada in \textit{Central Trust and BG Checo} is to make certain that the second and third considerations asserted in this chapter are not offended: (i) whether the plaintiff had reasonably available to it and would be expected to have pursued alternative means of protection and (ii) whether allowing the plaintiff’s claim upsets or circumvents the clear allocation of the risk at issue in the contractual matrix of the case.

V.C.3 \textbf{Plaintiff Within the Contractual Chain}

All three considerations apply to this third category of construction case. There are two paradigmatic construction cases of interest to this thesis in which the plaintiff and defendant are connected indirectly by a contract or series of contracts. To be clear, both cases relate to claims in negligence for pure economic loss in that they are not grounded on physical injury to the plaintiff’s own person or property. In the words of Estey J., at issue is “a diminution of worth incurred without any physical injury to any asset of the plaintiff”.\footnote{Supra note 245.}
The first case of interest is that of a subsequent purchaser of a defective building suing a building contractor with whom the plaintiff has no contractual relationship or, often, even awareness. These parties are indirectly linked by a chain of contracts from the original construction contract through a series of sales contracts. *Bryan v. Maloney* and *Winnipeg Condo* are examples of this first type of case. The second case is that of a party to a construction project who sues or claims over against another for defective work such as in *Junior Books*. In this case, the parties are part of the construction pyramid and are indirectly linked in a contemporaneous contractual chain.

**V.C.3(a) The Subsequent Purchaser**

In the first case, the plaintiff maintains that it relied on the defendant builder or consultant, for example, to build or design non-negligently and as a result of the defendant’s negligence acquired defective property, thus suffering an economic loss. Here, there is no concern with an indeterminate number of claims in that, as was pointed out in *Bryan v. Maloney*, there is only one property owner and it is only a matter of poor timing that the defects materialized when the plaintiff took possession of the house. Further, the quantum of the claim, the cost of repairs, is not indeterminate but, in most instances, reasonably foreseeable. This is particularly true of cases of the non-commercial plaintiff without a claim for consequential loss of profits.

The defensive response to this claim is that the plaintiff’s complaint is with the vendor alone. The argument is often articulated as that the plaintiff’s claim is in contract as opposed to tort.\(^4^{56}\) To this we might add that the plaintiff should have no better claim against the contractor than the original owner would have had.

These arguments are persuasive in those cases where the construction defects do not threaten injury to person or property. The plaintiff should not be in a position to seek redress from a contractor because the building it purchased is worth less than it paid the vendor. Further, if the original purchaser would have been estopped from asserting the

\(^{456}\) *Murphy, supra* note 272 at 475.
same complaint due to the negotiated design and standard of quality, a subsequent purchaser should stand in no better position.

This was the result in *Bryan v. Maloney*, wherein the plaintiff, Maloney, third purchaser of a home built seven years earlier, won a judgment against the builder for the cost of remediencing negligently constructed footings. The Australian High Court was plainly sympathetic to her unfortunate circumstances and, as discussed earlier, recognized that the award of pure economic loss in this particular case would not open the floodgates to indeterminate liability.

The difficulty is that the majority of the Australian High Court did not heed the second policy consideration they expressed as militating against the recognition of a duty of care: the right of persons in a competitive world to organize their commercial affairs in their own interests. It is very often the case that one person's economic loss is another's gain. It is argued here that the plaintiff home purchaser in this sort of case should be denied recovery for a loss that may be easily protected against by the inclusion of warranty provisions in the sale contract or by an assignment of the vendor's rights against the builder.

The majority stated that the limitation provisions in the original construction contract would have been relevant to the question of duty of care. Presumably, the Court's suggestion goes to the argument that a subsequent purchaser does not deserve any better house than what the builder was paid to provide the original owner. In this way, the original sale contract helps define the standard of care owed by the builder of a particular house but we must accept at the outset that the builder owes a duty of care to a subsequent purchaser. It is argued here that the original construction contract might help determine the scope of the standard of care but it does not assist in the determination of the existence of a duty of care.
The sale contract helps answer this threshold issue. If there is an applicable warranty in favour of the plaintiff, then the plaintiff can and should prosecute a claim against the previous owner. There is an alternative source of protection. If there is no such warranty, then the presumption or evidence will be either that the previous owner refused to provide such a warranty or the plaintiff neglected to address her or his mind to the issue. In the first scenario, the plaintiff assumed the risk. In the second, it can be fairly said that he or she implicitly assumed the risk or should have addressed it.

In any event, the builder should not be held liable for the failure of a subsequent purchaser to secure alternative protection against paying too much for the house. In this sense, the plaintiff should not be allowed to improve at the builder’s expense on the poor bargain she struck with the vendor.

Indeed, this latter point probably goes too far in most cases as the price of the seven year old house in Bryan v. Maloney, for example, was in all likelihood discounted to account for the plaintiff’s assumption of the risk that a defect might materialize. Maloney effectively enforced a warranty that is about 6 years better than that found in the CCDC-2 and about equal to the seven year guarantee provided by the Ontario New Home Warranty Plan. In this sense, there is a good argument that if the house had been built, sold and resold in Ontario, Maloney did not suffer an economic loss: she got what she paid for.

These policy arguments were applied by the majority of the New South Wales Court of Appeal in Woollahra v. Sved, wherein the plaintiff was the second owner of a very expensive two year old home plagued with terrible water problems. It was uncontroversial that the house was negligently designed and built. Cole J.A. distinguished Bryan v. Maloney on the basis that the presumption of an assumption of responsibility by home builders and corresponding likely reliance of owners grounding a duty of care owed

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457 Smith v. Eric S. Bush [1990], 1 A.C. 831 (H.L.(E.)), is an example of the difficult case in which the plaintiff was a relatively unsophisticated individual without legal counsel who paid too much for a modest home.

458 R.R.O. 1990, Reg. 892, s. 16.
by the former to the latter was defeated by the evidence that the plaintiffs did not, in fact, rely on the skill and competence of the builders.460

Clarke J.A. agreed that *Bryan v. Maloney* should be distinguished on the presumed close proximity of the relationship between the plaintiff and builder in that case. He further reasoned that the plaintiffs’ ability to protect themselves in other ways against financial loss if the house was constructed defectively militated against the imposition of a duty of care in negligence. These alternatives included an independent inspection of the property and warranty protection in the sale contract. Clarke J.A. noted that the plaintiffs’ solicitor could be expected to have recommended an independent inspection and that this would have revealed the construction defects complained of. Instead, the evidence was that the plaintiffs relied on the local Council that had issued a certificate of building compliance.461

As alluded to earlier, it is another matter if the construction defect poses a threat to person or property. We have seen that the policy reason of preventing physical harm expressed by Laskin J. in *Rivtow Marine*462 has since been vindicated in Canadian law by La Forest J. for the unanimous Supreme Court of Canada in *Winnipeg Condo*:*463

... the present case is distinguishable on the policy level from cases where the workmanship is merely shoddy or substandard but not dangerously defective. In the latter class of cases tort law serves to encourage the repair of dangerous defects and thereby to protect the bodily integrity of inhabitants of buildings. By contrast, the former class of cases bring into play the questions of quality of workmanship and fitness for purpose.

This reasoning was reiterated by the Manitoba Court of Queen’s Bench in its judgment on a second motion by the general contractor, Bird Construction, to have the statement of claim dismissed against on the grounds that the plaintiff’s action was barred by Manitoba’s *Limitations of Actions Act*. The Court dismissed this application on the basis that the

459 (1996), 40 N.S.W.L.R. 153.
460 *Ibid.* at 152.
462 *Supra* note 228.
cause of action accrued when the damage was discovered. In so doing, Oliphant A.C.J.Q.B. made these comments: 464

The social policy that emerges from the decision of the Supreme Court of Canada in Winnipeg Condo ... is the prevention of accidents. Owners of buildings who discover defects that pose a substantial danger must be encouraged to effect repairs before someone is injured. The cost of the repairs necessary to remedy the defect(s) is to be borne by the party or parties whose negligence caused the dangerous defect and the liability for those costs is to be imposed during the life of the building.

The safety policy concern does not need to be perceived as a trump card of other policy considerations negating or limiting the duty of care in negligence. The distinction between quality as opposed to safety defects does not offend either the safeguards on the recovery of pure economic loss in the construction case discussed earlier.

Firstly, as with complaints of quality, compensating the plaintiff building-owner for the cost of repairing dangerous construction defects does not raise indeterminacy concerns as there will be a single claimant with a reasonably foreseeable loss. As noted earlier in the analysis of Winnipeg Condo, the negligent builder should only be liable for the reasonable cost of averting a safety risk and not for compensating the plaintiff’s disappointed expectation in the quality of the building.

Compensation in this case also does not upset the second policy consideration of barring a plaintiff from recovery of an economic loss for which it could have sought alternative (non first party insurance) protection. We do not expect the purchaser of a building to seek a contractual warranty that the building is reasonably safe for occupancy.

Further, the imposition of this tort duty does not allow the apparently unjust result of a subsequent purchaser benefiting from a better tort duty owed to it by the builder than the contractual obligations due the original owner. An exclusionary clause in a contract

463 Supra note 331 at 215-216.
limiting a builder’s liability for the construction of a building that is not reasonably safe for its users would be very unusual and unreliable. Indeed, it would most likely be found unenforceable for public policy either on grounds of common law illegality on the strength of the social policy expounded in Winnipeg Condo or statutory illegality for failing to comply with the applicable building code.

Returning to the Winnipeg Condo litigation, having established that Bird Construction owes a duty to owners of the apartment building to take reasonable care in its construction and to ensure that it is free from dangerous defects, both the building and the sale contract become very relevant to assessing whether that duty of care has been breached as are applicable building codes and evidence of reasonably skilled construction practice at the time the apartment was built.

The standard of care required of a builder expressed or implied in the most modest building contract will be practically indistinguishable from the minimal tort duty owed to the original owner and subsequent purchasers. For this reason, the construction case enjoys the relatively unique practical advantage that the standard of work imposed in tort is fairly clear. There is, therefore, little force in the objection of Lord Brandon, dissenting in Junior Books, that there is no satisfactory way in which to judge the standard of labour and materials supplied pursuant to a third party contract.\(^{465}\)

V.C.3(b) **Parties within the Construction Pyramid**

In this category of case, the plaintiff does not share direct privity of contract with the defendant in question but is indirectly linked to the defendant by way of the contractual chain that makes up the construction pyramid. We have seen that these parties have deliberately and carefully structured their commercial relationships through relatively precise contracts that usually include the responsibility for obtaining insurance coverage. In these circumstances, the Court should pay close attention to the allocation of

\(^{465}\) Supra note 97 at 551-552.
responsibility by the defendant or by a third party when determining the existence and extent of the duty of care in tort. The policy consideration emphasized in the last part, denying the plaintiff recovery for economic loss in circumstances where alternative protection was easily available, is heightened in cases where that plaintiff is part of the construction pyramid. In such a case, the plaintiff should not be permitted to upset or circumvent the clear contractual understanding between all parties to the project as to where the risk in question would lie.

As in the Bryan v. Maloney and Winnipeg Condo line of cases, the plaintiff building owner has little difficulty in discharging the burden of showing that carelessness on the part of a contractor would cause the owner financial harm. In Junior Books, for example, it was plain and accepted by all Law Lords that incompetent laying of the factory floor by the defendant subcontractor was likely to cause financial harm to the factory owner. Further, and unlike Bryan v. Maloney and Winnipeg Condo, the plaintiff in these cases are likely to be familiar and in some sense rely on each other to satisfy their contractual obligations or to act non-negligently. This was the case in Junior Books and we recall that the majority of the House of Lords made much of the close proximity between the owner and the flooring subcontractor.

Therefore, in most cases of a claim for pure economic loss by a party within the construction pyramid, the relatively easy establishment of a sufficiently close relationship pursuant to the Anns test will leave us to consider policy reasons why the defendant’s duty of care should be limited or negated.

Again, there is usually no concern with the floodgates issue and the defensive argument that the plaintiff’s case sounds in contract rather than tort is only partially illuminating. The true argument in cases arising within the construction pyramid is that a defendant should not be held accountable for the plaintiff’s failure to obtain a contractual warranty or indemnity available and expected to be provided elsewhere. That is, the plaintiff is denied recovery for economic loss because it had reasonable alternative means to protect
itself against the loss. In those cases where alternative protection is available or expected, defendants rightly maintain that the plaintiff should not be permitted to "leapfrog" or circumvent the contractual chain of liability.

*Junior Books* and *Simaan Contracting* are two well known cases of this sort but where the Scotch and English Courts reached different conclusions.

The former case was discussed at length in Part III.D. It is argued here that the majority judgments were wrong for failing to take into account policy considerations militating against the imposition of a tort duty to lay a good floor owed to the building owner by the flooring subcontractor. It is further argued that Lord Brandon was right to dissent but that the policy reasons he expressed as limiting the scope of the flooring subcontractor’s duty of care drive towards but are not squarely on point: (i) the damage or danger to person or property has always been an essential ingredient in a negligence action; and (ii) any wider duty of care would impose a warranty when the parties are not in privity.

As commented earlier, the case was argued on the basis of the pleadings and the Law Lords in both the majority and minority stated their interest in the substance of the prime contract and the flooring subcontract. Perhaps that evidence was necessary before the owner’s claim could be properly dismissed on the basis of the ready availability of alternative protection in the form of a contractual warranty with the prime contractor. Documentory and oral discovery should have further evidenced that imposing this tort duty in favour of the owner would circumvent the actual bargain between the owner and the prime contractor and violate a clear understanding as to where responsibility was allocated between the three parties. We would expect that in the Canadian construction case neither the prime contractor nor the flooring subcontractor would have been required or could have arranged for insurance against faulty workmanship. The risk of a

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466 The House of Lords has tried to reconcile *Junior Books* by characterizing it as a *Hedley, Byrne* category of case. See *D. & F Estates*, supra note 267 at 215 and *Murphy*, supra note 272 at 919. This argument is consistent with the reasoning here that the owner would have a case if it could prove that the flooring subcontractor accepted the risk of inferior flooring work as between itself and the owner.
shoddy floor being laid is a business risk that is to be negotiated at each link in the contractual chain.

These policy arguments are even stronger and buttressed by the rule against double recovery if the owner had, in fact, settled earlier with the prime contractor.

In *Simaan Contracting*[^467], the prime contract for the construction of a building in Abu Dhabi permitted the prime contractor to subcontract parts of the work with the owner’s approval but not so as to relieve itself from liability to the owner. The glass work was subcontracted to the walling subcontractor on similar terms to the prime contract. Contrary to the specifications, the glass units installed by the walling subcontractor were the wrong colour and refused by the owner who withheld payment for that part of the prime contract. The prime contractor sued the glass suppliers, sub-subcontractors to the flooring subcontractor.

The glass suppliers tried as a preliminary issue whether it owed the prime contractor a duty of care to avoid defects in the units which had caused the plaintiff’s economic loss. The judge of first instance accepted that the claim had merits largely on the strength of *Junior Books*. The English Court of Appeal allowed the glass suppliers’ appeal.

Lord Bingham noted that what made the case remarkable was that the prime contractor did not sue the walling subcontractor who in turn would be expected to claim against the glass supplier. Lord Bingham was clearly uncomfortable with the reasoning in *Junior Books* and cited at length the reasons of Lord Goff in *Muirhead*[^468] wherein *Junior Books* was distinguished on the basis of the alleged very close relationship between the owner and subcontractor as opposed to the instant case where “the parties had deliberately structured their contractual relationship in order to achieve the result that (apart from any special arrangements) there should be no direct liability inter se”[^469].

[^467]: *Supra* note 266.
[^468]: *Supra* note 261.
Lord Bingham’s conclusion is squarely in line with the second and third countervailing policy considerations or safeguards asserted in this chapter.\footnote{\textit{Ibid.} at 781.}

I do not ... see any basis on which the defendants could be said to have assumed a direct responsibility for the quality of the goods to the plaintiffs: such a responsibility is, I think, inconsistent with the structure of the contract the parties have chosen to make.

Lord Dillon agreed with Lord Bingham and the reasoning in \textit{Young and Marten}\footnote{\textit{Supra} note 90, Part II.B.3(a)(ii).} that the resolution of this sort of case should follow the “normal chain of liability” for a number of reasons including the full evaluation of the contractual assumption of responsibility at each link in the chain.\footnote{\textit{Supra} note 266 at 785-786.}

The Canadian precedent cited earlier of alleged circumvention of the agreed structure of relationships and responsibilities within the construction pyramid is \textit{Edgeworth Construction}\footnote{\textit{Supra} note 196, Part II.E.3(b).}. The design consultant’s argument in that case was that the project owner, the province of British Columbia, assumed the consultants’ risks and, therefore, the contractor could only look to the province for compensation for any negligence on the consultants’ part.

In this case, the Supreme Court of Canada properly recognized that contractors rely on the accuracy of the design work of the owner’s professional consultants. This is the case prior to and after winning the construction contract. We recall from the last chapter that the prime contractor is not required to obtain professional insurance and that design work is the effective boundary between CGL and E \& O coverage. Instead, it is expected and part of the standard retainer that the consultant obtain an E \& O policy. E \& O coverage extends beyond the owner to all parties damaged by the consultant’s negligence regardless of whether physical damage or bodily injury has occurred. This means that, in the
standard construction project, a contractor's *de facto* reliance on the owner's consultant is reflected and reinforced by the parties' agreed responsibilities for insurance coverage.

It is uncontroversial that the first stage of the Anns test of a duty of care in negligence is satisfied in these circumstances as are the requirements of negligent misrepresentation in *Hedley, Byrne*.

It is further submitted that Edgeworth's claim should have been dismissed if the consultants could have proved its position that the province assumed all risks previously held by the consultants and that, in addition, the prime contractor had, in turn, accepted this transfer of risk in its bargain with the province. Failing such evidence, the third policy consideration discussed in this chapter of protecting against the circumventing the understood contract structure is not offended.

This would be a difficult onus to discharge for design consultants in that it would require the execution of two contracts contrary to the customary expectations and contractual obligations of participants in a construction project. The Supreme Court of Canada correctly ruled that the more limited onus of showing that the province had assumed the consultants' liabilities was not satisfied by reliance on the clause in the prime contract seemingly directed towards the accuracy of tender information and that was, for certain, concerned with the liability as between the contractor and the province and was, in any event, silent with respect to negligent design of the work to be performed.\(^474\)

McLachlin J. simply dismissed the circumvention argument on the basis that there was no contractual promise that the consultant would not be held liable for negligent design.\(^475\)

Finally, the policy consideration of whether the plaintiff could have secured an alternative source of protection favoured the imposition of liability against the consultant rather than

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\(^{474}\) On these points see also *Trident Construction Ltd. v. W. L. Wardrop and Associates Ltd.*, [1979] 6 W.W.R. 481 (Man. Q.B.).

\(^{475}\) *Supra* note 196 at 176.
negating the *prima facie* duty of care owed the contractor. On the one hand, it would be absurd as a matter of policy for the court to deny relief to a contractor for failing to expressly deny its assumption of the risk of errors in the project design arising from the negligence of the consultant in the prime contract. On the other hand, and as pointed out by McLachlin J., the consultant was a sophisticated party that had alternative sources of protection against liability for its negligence including a disclaimer of responsibility on the design documents or by stipulating that it take responsibility for both design and supervisory duties on the project. A third source of protection, of course, would be to ensure that a true exclusionary clause was included in the prime contract that benefited the consultant in the manner sought in the application before the Court.

McLachlin J. added that “the engineering firm might have decided to accept the risk that tenderers would rely on its design to their detriment, and have insured itself accordingly”. As indicated earlier, the better point is that the contractual treatment of insurance responsibilities weighs against the negating of the tort duty of care in this particular claim for pure economic loss.
V.D CONCLUSION

The second and third chapters of this thesis canvassed at length two fundamental and related developments in private law: concurrent liability in tort and contract and the recovery in tort of pure economic loss. Both doctrinal developments are crucial to the basic inquiry into the interface between construction and tort in the context of the construction dispute. The recurring theme herein is that the courts should be especially deferential to the allocation of risk by the participants in a construction project as expressed in a chain of, typically standard, contracts between them.

We have seen that in many cases tort duties and contractual obligations do interface relatively harmoniously. This is very true of those disputes in which the plaintiff asserts a concurrent claim against a contractor. The nature of that relationship grounds the duty of care but any tort duty must give way to express contractual obligations. In the absence of specific contractual treatment, the basic duty of care required of the reasonably skillful contractor is practically comparable to the warranties implied in the construction contract. Both sources of obligations and liabilities are reinforced by statutory duties and in particular, local building codes and the Sale of Goods Acts.

Predictably, there is more tension between tort and contract in those cases in which the claim asserted is in negligence for pure economic loss. Economic loss tests the doctrinal boundary between contract law, which is designed to enforce parties' voluntarily assumed expectation interests, and tort law, which is designed to redress careless but unintentional conduct causing physical harm to others. In the first case, the courts seek to enforce the standards agreed to in the contract. An objective standard of reasonable care is imposed in the second.

The most troublesome tort claim in Commonwealth jurisprudence is, arguably, the claim for relational economic loss. This category of pure economic loss has not, however, posed much of a problem in the construction case. Firstly, this category of loss has been
very narrowly circumscribed by the Supreme Court of Canada. More importantly, the practical reality is that the participants in a construction project are almost invariably covered by and enjoy tort immunity under builders’ all risk insurance.

The courts are often challenged by the construction case in which the plaintiff is seemingly using tort to secure a contractual warranty that was not part of the contract that was the indirect nexus to the defendant. In these sort of cases, the courts have not consistently recognized that a plaintiff should not be able to claim against a third party for the economic loss suffered because the work paid for was of disappointing quality. Similarly, the plaintiff contractor has no claim against a third party in those cases in which it assumed the risk associated with uncertain design in the contract with the party paying for the work.

In this chapter, I proposed the following three safeguards to be considered by a court in assessing the existence or scope of a duty of care in the construction case:

(i) the threat of indeterminate liability;
(ii) whether the plaintiff had reasonably available to it and would be expected to have pursued alternative means of protection; and
(iii) whether allowing the plaintiff’s claim upsets or circumvents the clear allocation of the risk at issue in the contractual matrix of the case.

The first concern stands as the single overriding policy concern in the Commonwealth’s effort to settle this area of the law in the last half of this century. The second concern is not concerned with the availability of first party insurance against the loss claimed but most often focuses on the plaintiff’s own implicit or explicit assumption of risk. In this regard, the obligation to secure insurance may be relevant. To this it should be added that a party should not be expected to pursue a contractual warranty against carelessly dangerous work. The basic interest best and most appropriately protected by contractual warranty is the quality or suitability of the work. The third consideration is closely related to the second and applies when the plaintiff is a part of the construction pyramid.
These safeguards or limits on the imposition of a tortious duty of care are not novel but surface fairly haphazardly in the case law analysed in this thesis. It is argued here that diligent attention to these considerations in the construction case will result in the imposition of tort liability consistently, or at least not inconsistently, with the reasonable expectations of the owners, consultants, contractors, trades and suppliers contributing to the construction project.