

# From the Ground Up - Everything you need to know about Construction Law (Part II)

October 4, 2017



# The Power and Pitfalls of Covenants to Insure

Hovsep Afarian



# Overview

## Covenants to Insure

- Nature
- Purpose
- Far-reaching Effects
- Drafting Tips
- Closing Comments



# Covenants to Insure

## → Nature and Purpose

- What are they? A contractual promise by one party to obtain insurance for the benefit of a counter-party
- Purpose is to allocate risk



# Covenants to Insure



## **Effect: Why are they so powerful and laden with landmines?**

- Interpreted as meaning that beneficiary of the insurance clause is immune from liability – powerful weapon to shift liability
- If you undertake to put insurance in place, you are undertaking not to sue the beneficiary of the insurance even when the beneficiary has been negligent – trap for the unwary
- SCC Trilogy – Leasing context; subsequently broadened to other commercial contexts

# Covenants to Insure



## Effect – Extent of Immunity

- Extends only to losses contemplated by the covenants
  - Within scope of insured risks
  - Within specified policy limits
  
- Immunity enjoyed even if insurance not obtained (or if inadequate insurance is obtained)

# Covenants to Insure



## Effect – Third Party Beneficiaries

- The protection of covenants to insure can extend beyond contracting parties to third parties (e.g. employees of counter-party).
- Two-part test by SCC, relaxing privity requirements
  - Intent to benefit third party
  - Activities of third party are contemplated by the contract

# Covenants to Insure



## Effect – no subrogation right

- Insurer's position can only be as strong as party undertaking to provide insurance



# Covenants to Insure

## Effect – Conflict with Indemnity Clause or Limitation of Liability Clause

- Historically, covenant to insure prevails over conflicting provisions in contract
- Per recent case law, can use language to prioritize other provisions over covenants to insure (e.g., “Notwithstanding X...Y”; “In the event of a conflict, X prevails”)

# Covenants to Insure

## Content – Drafting Tips



- Right type of insurance?
- Is such coverage available in the market?
- Insurance portfolio more extensive than minimum contractual obligations
- Adequate limits? Greater limits = greater immunity

# Covenants to Insure

## Content – Drafting Tips



- Limits/deductible per claim? per occurrence? aggregate limits?
- Limit deductible; make counterparty responsible to fund it
- Ensure appropriate parties are named as additional insureds
- Be attune to conflicts; paramountcy clause

# Covenants to Insure

## Content – Drafting Tips



- Obtain copy of insurance
- Insurance is primary; other insurance is excess
- If claims-based coverage, ensure obligation to keep in place years after termination of relationship
- Cross-liability clause; waiver of subrogation

# Covenants to Insure



## Content – Drafting Tips

- Counter-party shall not do anything to invalidate coverage (e.g. misrepresentation; failing to give timely notice)
- No cancellation or change of key terms without notice

# Covenants to Insure

## Concluding Comments



- Covenants to insure have wide-ranging ramifications
- Immense opportunity to shift risk and negate potential liability
- To be drafted with care, pro-actively – initial investment will pay huge dividends

## BILL 142 – Changes to the Ontario *Construction Lien Act*

Julie Parla



# Introduction to Amendments

- CLA has not been amended for 34 years (since 1983)
- Industry changes, e.g: AFP, including financing components
- *Construction Lien Act* review – experts retained by Ministry of Attorney General and Ministry of Economic Development, Employment and Infrastructure
- 60 industry groups/stakeholders – 100 recommendations
- Three key issues:
  1. Modernizing the Act;
  2. Prompt Payment; and
  3. Dispute Resolution/Adjudication
- Status – second reading debates September 2017
- Not yet in force: still subject to change!





# Overview

1. Prompt payment regime
2. Mandatory adjudication
3. AFP projects
4. Technical amendments:
  - a. timelines (preserve/perfect liens)
  - b. trust accounting
  - c. definitions



# Prompt Payment Regime

- Balancing interests: freedom of contract/prescribed timelines to support prompt payment mandate
  - Can't contract out of regime
  - Can establish payment milestones, otherwise default is 30 days
- Proper invoice – **NB:** cannot be contingent on certification or owner approval
- Cascading timelines:
  - Owner 28 days after receipt of proper invoice
  - General contractor 7 days receiving payment
  - Subcontractor 7 days after receiving payment
  - Subsub/supplier 7 days after receiving payment
- **Notices of non-payment** – undisputed amounts to be paid
- Release of holdback

# Mandatory Adjudication

- Interim, binding (temporarily) dispute resolution process
- Only applicable before the contract is completed (unless agree otherwise)
- Applicable to specific issues:
  - a. Valuation of services materials
  - b. Payment – change orders
  - c. Disputes re: Notice of Non-Payment
  - d. Set off claims
  - e. Non-payment of holdback
  - f. Any other matters parties agree to adjudicate/prescribed

# Mandatory Adjudication

- Authorized Nominating Authority to train, appoint (where applicable), maintain registry of qualified adjudicators
  - Expertise with construction industry and dispute resolution
  - Can't appoint in advance
  - Requesting party submits documents
  - Inquisitorial, i.e. requesting documents, site visit, etc.
  - Authorized to “draw inferences based on the conduct of the parties”
  - 30 days for a decision – limited extensions, if late no force and effect

# Mandatory Adjudication

- Party can elect to adjudicate a matter – issue written notice of adjudication
- Binding on an interim basis –unless/until determined by arbitration/court
- Limited power of review by Court (fatal flaws/process/jurisdiction)
- Provided comply with the requirements of the Act, can agree to a different process
- Enforcement – payment within 10 days or suspend work and reasonable costs paid on resumption
- Enforce adjudicator's determination in Court

## AFP Projects

- Recognition that large-scale projects involve levels of contract and extended timelines ill-suited to the current CLA terms.
- Project Co (SPV) is the Owner for certain provisions:
  - Prompt payment, mandatory adjudication, substantial performance, information requests
- Crown remains owner otherwise
- Construction contract between Project Co and Contractor is the statutory contract, applicable to Crown's holdback calculation
- Mandatory L&M/performance bond for public projects above prescribed threshold amount – each min. 50% of contract value

# Technical Amendments

- Title “Construction Act”
- More time!
  - 45 → 60 days to preserve
  - 45 → 90 days to perfect
- Trust funds must be deposited in bank account in Trustee’s name; records kept
- Definitions:
  - “price” includes direct costs for delay not caused by the contractor
  - Improvement includes “capital repair” to extend “normal economic life” excludes maintenance

# What's Happening in Quebec? Construction Hypothecs & More

Ayse Dalli





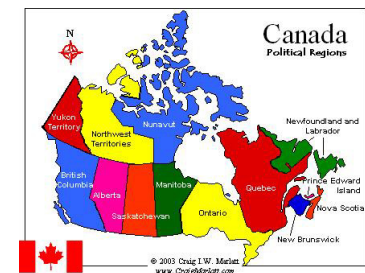
## Definition of “construction hypothec” in Quebec

- Charge against property improved through construction
- To secure payment of those involved in enhancement of property
- In favor of persons having taken part in construction or renovation
- For work requested by owner or for materials or services supplied/prepared for the work



## Main differences with common law provinces

- Not a creature of statute
- Real right affecting immovable property
- Holdbacks are less regulated
- No superimposed statutory trust system in Quebec
- Expanded duty of good faith and collaboration



## Why does it matter?

- Exceptional ranking
- If unpaid, creditor can take possession, take it as payment of debt, sell it or have it sold to receive by preference the proceeds of the sale
- Provides security and priority

## What does it cover?

- Type of work: construction or renovation
- Type of property
- Limited to increase in value or added value

## Who can benefit?

- architect, engineer, supplier of materials, workman and contractor
- subcontractor
  - for the work requested by owner (or for materials/services supplied/prepared by them)
  - If no contract with owner: limited to work, materials or service supplied after written notice of the contract to the owner

## How does it work? Formalities of validity

### → **Birth**

- No need to publish/register for it to exist
- When contract comes into existence or when owner notified by subcontractor of contract

### → **Subsistence**

- Subsists for 30 days after the « work is completed »

## How does it work? Formalities of validity (cont'd)

- **Preservation**: before expiry of 30 days after work is completed, registration (in land register) and service of notice on owner
- **Perfection**: before expiry of 6 months after work is completed, publication of action or registration of prior notice of exercise of hypothecary right in land register
- **Death**: if no further action to preserve or perfect

## Implications of notices from sub-contractors

- Different terms: disclosure, written declaration, preliminary notice, *dénonciation*
- Purpose: owner's protection
- Form: written declaration of contract to owner
- Contents:
  - Identification of subcontractor, project, subcontract, subcontract amount
  - Reserving right to publish construction hypothec



# Waivers, holdbacks and acquittances

- Waiver
- Holdbacks
  - Partial payments in exchange for statement of amounts paid and still owed to contractors
  - Deduction of sufficient amount to pay claims
- Acquittances
  - Deduction valid until contractor gives acquittance of claims

## Damages for unlawfully publishing a hypothec

- Compensatory
- Punitive
- Lawyers' fees

# Take-aways



- Serious implications
  - Delays
  - Costs
  - Ultimate loss of property
- Be proactive vs. reactionary
- Different stages
- BE AWARE!
- When in doubt, seek legal advice

## Other Hot Topics & Trends in Quebec

- Good faith, duty of collaboration and to provide information
- Charbonneau Commission recommendations
- *Autorité des marchés publics*

# ***Mega-Disaster Management:***



*“Am I to understand that my proposal is greeted with some skepticism?”*

# Purpose of Presentation

## *Preparing your business for major litigation*

### British Columbia (Supreme Court)



### Alberta (Court of Queen's Bench)



### Ontario (Superior Court of Justice)



### Quebec (Supreme Court)



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# MAJOR & MEGA PROJECTS

**“The iron law of megaprojects is that they are over budget, over time, over and over again.”**

- *Bent Flyvbjerg*, Management professor at the University of Oxford's Saïd Business School, as quoted in - *The Trouble with Megaprojects*, Jacques Leslie April 11, 2015, The New Yorker

## B.C

- Site C Dam
- There are 341 projects currently under construction in B.C., representing an estimated capital cost of \$75.1 B,
- The \$500 M Burrard Place Mixed Use Development in Vancouver, the \$126 M Simon Fraser University - Energy
- Systems Engineering project in Surrey, and the \$76 M South Fraser Transmission Relocation Project in Richmond.

## Alberta

- There are 127 oil & gas, pipeline and industrial projects valued at \$176.9 B.
- The Calgary Green Line
- Royal Alexandra Hospital
- \$4.7 billion in capital maintenance and improvement.
- See Canada's Top 100 Infrastructure Projects:

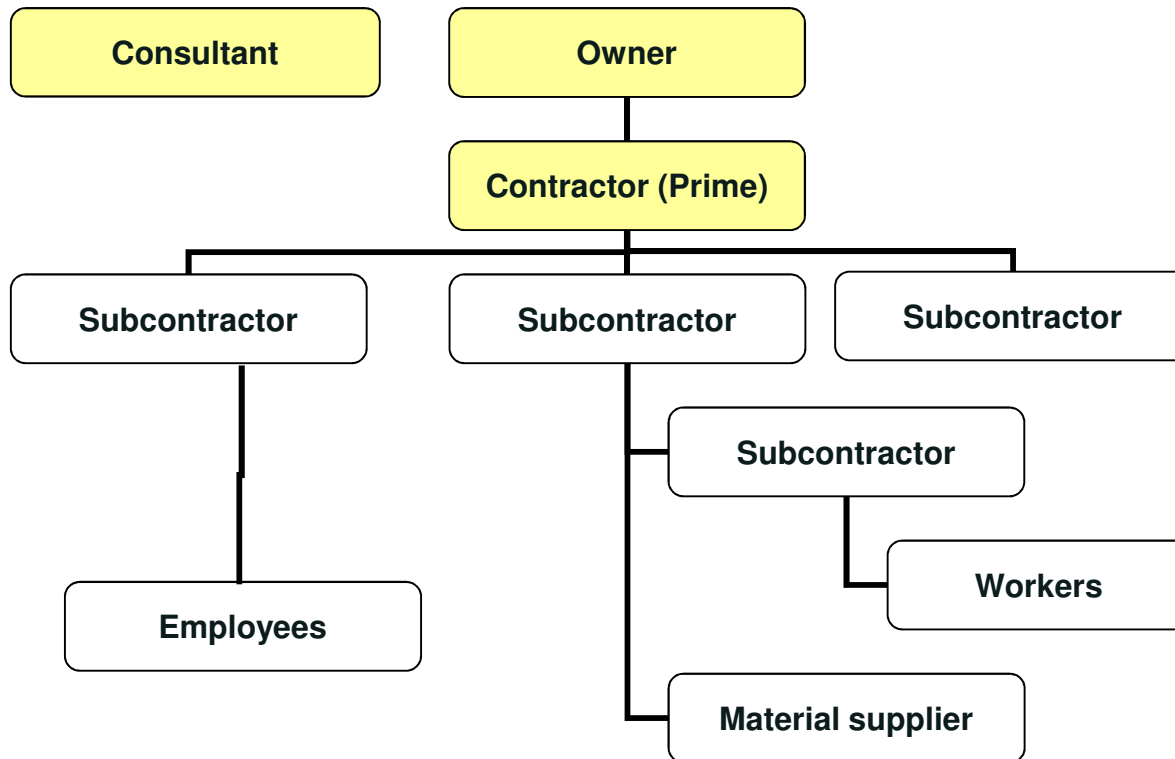
<http://top100projects.ca/2017filters/>

## Ontario

- 1,656 education and child care projects
- 37 health care projects.
- 160 transit projects
- 133 roads and bridges



# Characteristics of construction litigation



- ↪ Prone to complex and expensive litigation.
- ↪ Lack of privity between parties involved
- ↪ Voluminous documents
- ↪ Number of parties involved
- ↪ Liens and trusts
- ↪ Interplay of insurance between parties

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# Discussion Topics

**Focus: Owner Perspective / Contractors and Consultants**

1. Clearly define scope of work.
2. Limit maximum liability.
3. Determine lien and/or trust rights or obligations.
4. Trigger insurance or bond protections.
5. Establish potential liability of other parties.
6. Preserve evidence and protect privileged material.
7. Engage counsel early.
8. Engaging experts early.

# 1. Clearly define scope of work

- **Primary Contract** – use clear contractual language, demand plain language work orders.
- **Construction Management** – use competent, professional contract administrators. Keep change orders impeccable. Develop and maintain project data books.
- **Close Out** – collect and store key project information.

Litigation can strike at any time



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## 2. Limit maximum liability

### **Primary Contract**

- Scope informs liability.
- Consider use of maximum liability and non-subrogation clauses.
- Require insurance certificates and lien bonds before mobilization.

### **Construction Management**

- Track other parties on the project, including roles and key personnel.
- Insist on insurance certificates and lien bonds before mobilization

### **Close Out**

- Mitigate all losses with best efforts.

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### 3. Determine lien and/or trust rights or obligations.

- Liens are established by legislation not by contract.
  - If owner, payment is stayed.
  - If claimant, lien preservation and perfecting periods must be met.
- Consider if trust obligations are triggered?
  - Corporate and personal liability for breach.

## 4. Trigger insurance or bond protections.

- Consider specific time limits and notifications
- Different insurance parties involved:
  - Your own insurer
  - Other insurers
  - Subrogated claims
    - Build into your contract no subrogated claims
- Bonds have very short notice period provisions.



## 5. Establish potential liability of other parties.

- └ Subcontractors
  - └ Architects and engineers
  - └ Sub-sub-contractors
- └ Workers
- └ Material suppliers
- └ Employees



## 6. Preserve evidence and protect privileged material.

### → **Use:**

- contract administrators
- a document management system
- litigation hold letters

### → **Identify:**

- key personnel (custodians)

### → **Collect:**

- witness statements\*
- key documents





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# And about those root cause investigation reports...



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## 7. Engage counsel early

- Early risk management
  - Pre-contract negotiation, contract drafting, review and administration
  - Engage early in dispute resolution (in-house counsel are there for a reason!)
- Investigation reports
- Document collection and internal reports

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## 8. Engage experts early

- Availability of experts
- Qualifications of experts
- Cost considerations

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# Best Practices - Checklist

## 1. Clearly define scope of work

### Primary Contract

- Carefully define scope in primary contract and work orders.

### Construction Management

- Carefully manage and track change orders.
- Use skilled contract administrators/managers both up and down the construction pyramid

## 2. Limit maximum liability

### Primary Contract

- Consider use of maximum liability and non-subrogation clauses.
- Require insurance certificates and lien bonds before mobilization.

### Construction Management

- Track other parties on the project, including roles and key personnel.
- Insist on insurance certificates and lien bonds before mobilization.

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# Best Practices – Checklist Cont'd

## 3. Determine lien and/or trust rights or obligations.

- Carefully monitor lien preservation and perfection periods.
- Determine if trust period are triggered.

## 4. Tigger insurance or bond protections

- Notify insurers early in dispute or potential dispute.
- Track bond notice requirements and trigger appropriately

## 5. Establish potential liability of other parties

- Keep detailed records of other parties on project, org charts (overtime and as they evolve) and key personnel.

## 6. Preserve evidence and protect privileged material

- **Use:** contract administrators, a document management system, litigation hold letters
- **Identify:** key personnel (custodians).
- **Collect:** witness statements and key documents.

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# Best Practices – Checklist Cont'd

## 7. Engage counsel early

- Have internal or external counsel manage investigations, witness interviews and document production and sharing.

## 8. Engage experts early

- Have counsel consider and engage with leading experts as early as possible.

**Questions? Comments?**

**Thank you from  
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