FEBRUARY 2010

Newsletter

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FUNDAMENTAL BREACH OF CONTRACT ELIMINATED BY SUPREME COURT OF CANADA

The Supreme Court of Canada has "laid to rest" the doctrine of fundamental breach in Canadian contract law. Under that doctrine, an innocent party could stop performing its obligations under a contract if the other party had committed a breach that was so "fundamental" that it denied the innocent party of "substantially the whole" of the contract's benefit. Even if the contract contained a clear and express "exclusion clause" limiting liability, a fundamental breach allowed a court to refuse to enforce this clause, thereby enabling the innocent party to sue for damages that would have otherwise been excluded.

In *Tercon Contractors Ltd. v. British Columbia (Transportation and Highways),* 2010 SCC 4 Province of British Columbia issued a request for expression of interest ("RFEI") for the design and construction of a highway. Six teams responded with submissions including Tercon and Brentwood. A few months later, the Province informed the six proponents that it now intended to design the highway itself and issued a request for proposals ("RFP") for its construction. The RFP set out a specifically defined project and contemplated that proposals would be evaluated according to specific criteria. Under its terms, only the six original proponents were eligible to submit a proposal; those received from any other party would not be considered.

The RFP also included an exclusion of liability clause which provided: "Except as expressly and specifically permitted in these Instructions to Proponents, no Proponent shall have any claim for any compensation of any kind whatsoever, as a result of participating in this RFP, and by submitting a proposal each proponent shall be deemed to have agreed that it has no claim." As it lacked expertise in drilling and blasting,

FIRM AND INDUSTRY NEWS

- **Rui Fernandes** will be presenting a paper on April 23rd 2010 at the Canadian Institute's Conference on Managing Risks in Maritime Carriage of Goods Contracts.

- May 26th and 27th 2010 – Canadian Board of Marine Underwriters Semi - Annual Meeting will take place in Montreal Canada.

Brentwood entered into a pre-bidding agreement with another construction company ("EAC"), which was not a qualified bidder, to undertake the work as a joint venture. This arrangement allowed Brentwood to prepare a more competitive proposal. Ultimately, Brentwood submitted a bid in its own name with EAC listed as a "major member" of the team. Brentwood and Tercon were the two short-listed proponents and the Province selected Brentwood for the project. Tercon successfully brought an action in damages against the Province.

The trial judge found that the Brentwood bid was, in fact, submitted by a joint venture of Brentwood and EAC and that the Province, which was aware of the situation, breached the express provisions of the tendering contract with Tercon by considering a bid from an ineligible bidder and by awarding it the work. She also held that, as a matter of construction, the exclusion clause did not bar recovery for the breaches she had found. The clause was ambiguous and she resolved this ambiguity in Tercon's favour. She held that the Province's breach was fundamental and that it was not fair or reasonable to enforce the exclusion clause in light of the Province's breach.

The Court of Appeal set aside the decision, holding that the exclusion clause was clear and unambiguous and barred compensation for all defaults.

The Supreme Court of Canada agreed on the appropriate framework of analysis but divided on the applicability of the exclusion clause to the facts. The majority found that the Province had breached the tendering contract by entertaining a bid from an ineligible bidder. Another majority of the Court found that the exclusion clause did not bar the Tercon's claim for damages for the breaches of the tendering contract. The exclusion clause, which barred claims for compensation "as a result of participating" in the tendering process, did not, when properly interpreted, exclude Tercon's claim for damages. By considering a bid from an ineligible bidder, the Province not only acted in a way that breached the express and implied terms of the contract, it did so in a manner that "was an affront to the integrity and business efficacy of the tendering process."

What is important in the decision is the establishment of a framework of analysis when a claimant seeks to escape the effect of an exclusion clause or other contractual terms to which it had previously agreed. The first issue is whether, as a matter of interpretation, the exclusion clause even applies to the circumstances established in evidence. This will depend on the court's interpretation of the intention of the parties as expressed in the contract. If the exclusion clause applies, the second issue is whether the exclusion clause was unconscionable and thus invalid at the time the contract was made. If the exclusion clause is held to be valid at the time of contract formation and applicable to the facts of the case, a third enquiry may be raised as to whether the court should nevertheless refuse to enforce the exclusion clause because of an overriding public policy. The burden of persuasion lies on the party seeking to avoid enforcement of the clause to demonstrate an abuse of the freedom of contract that outweighs the very strong public interest in their enforcement. Conduct approaching serious criminality or egregious

fraud are but examples of well-accepted considerations of public policy that are substantially incontestable and may override the public policy of freedom to contract and disable the defendant from relying upon the exclusion clause.

In dealing with the elimination of "fundamental breach of contract" and embracing the concept of freedom of contract, Justice Binnie, writing for the Court stated:

> ...the principle is that a court has no discretion to refuse to enforce a valid and applicable contractual exclusion clause unless the [party seeking to avoid the exclusion clause] can point to some paramount consideration of public policy sufficient to override the public interest in freedom of contract and defeat what would otherwise be the contractual rights of the parties.

In the future a party to a contract will no longer be able to argue that it can circumvent a valid and applicable exclusion of liability clause on the basis of an alleged "fundamental breach" of the contract by the other party. Only if the party seeking to avoid such a clause can identify some "paramount consideration of public policy" or, as Justice Binnie later terms it, "an overriding public policy" that outweighs the very strong interest in enforcing contracts and their terms, will the court oblige this request.

While the focus of Justice Binnie's analytic framework pertains to exclusion

clauses, he suggests that this category may also include "other contractual terms", potentially signalling that other valid and applicable contractual provisions that limit parties' rights under a contract may be subject to the same analysis as pure exclusion of liability clauses.

The Supreme Court's decision solidifies the enforceability of clear and express exclusion clauses and other provisions that limit liability under a contract. Given the "very strong public interest in enforcement of contracts" affirmed by the Supreme Court and the "narrow jurisdiction" that courts have to override this freedom of contract on public policy grounds, it appears that that the cases in which an otherwise valid and applicable exclusion clause will not be enforced will be few and far between.

Rui Fernandes

2. The Ontario Superior Court Weighs In on the Appropriateness of a Large Claim for Legal Fees in a Simplified Rules Case

A recent ruling in the case of *Southworks Outlet Mall v. Bradley* (2010) 10 O.R. (3d) 796 (Ontario Superior Court) illustrates how the courts deal with two competing policy goals in our court system: while, as a general rule, "costs follow the event", there is often a practical limitation on how large a costs award will be in the circumstances of any particular case.

The "costs follow the event" concept is well known to litigation counsel and litigants in court cases. As a general rule, the party who wins a lawsuit will be entitled to a return of a significant portion of the legal costs expended in obtaining the victory. This return may potentially be increased, if the victorious party had submitted before trial a timely and proper "offer to settle" to the other side, which reflected a compromise with the "offering" party ultimately obtaining a better result at trial than the earlier settlement offer. Many will be familiar with these concepts, being a huge impetus towards out of court settlements and 'zero based budgeting' towards trial: there always should be confidence in the case, or a principled reason, to go to trial to justify facing potential costs "exposure".

Of course, trials happen. Is there a limitation on costs that will be awarded? What if a matter is not considered to have been complex, or lengthy, but the winning party's claim for costs is alleged by the 'losing party' to be disproportionate to the case, and what it had reasonably assessed as being its costs "exposure", if unsuccessful?

The *Southworks Outlet Mall* case provides some guidance on how this costs exposure is to be assessed, and taken into consideration by a litigant in the context of a 'Simplified Procedure' case. As of the beginning of 2010, lawsuits commenced in the Ontario Superior Court involving claims of less than $100,000 in terms of relief sought will be brought under the Simplified Procedure regime. (Prior to the beginning of this year, the monetary limit for Simplified Procedure cases was $50,000).

It should be noted that the goal of Simplified Procedure cases is the attempt to expedite matters towards trial, with reduced emphasis on procedural steps and resulting legal costs. Up until this year, there were no examinations for discovery in Simplified Rules cases. As of the beginning of 2010 there are now limited rights to conduct oral examinations for discovery. In Simplified Procedure cases a party may now ask questions on an examination for discovery of up to a total of two hours duration. While this does not seem like much, this is a welcomed development: the parties should be able to keep the discovery costs somewhat 'in line', and in the course of that time frame parties may be able to obtain certain key facts or admissions to assist them in assessing the relative strength or weakness of their case.

Southworks Outlet Mall v. Bradley

The plaintiff was successful in this lawsuit, which involved two different court actions. One action was on a promissory note. This involved the defendant both denying liability, as well as bringing different "counter-claims" against the plaintiff for relief in its own right. The other action involved grievances arising from a landlord – tenant relationship. The trial of all the matters lasted four days. The plaintiff recovered a total award, including pre-judgment interest, of $87,805.12 in both actions. The counter-claims were dismissed in the promissory note action. The plaintiff sought the recovery for $121,965 in legal costs on a "substantial indemnity" scale – that is, all of it's costs incurred on the matters, for the reasons set forth below. Alternatively, the plaintiff sought the return of $83,610, being the 'partial indemnity' standard calculation.

The Claim for Substantial Indemnity Costs

The successful plaintiff advanced the following arguments in favour of it's recovery of Substantial Indemnity costs – essentially 100 cents on the dollar – as opposed to the standard rule of recovering 'Partial Indemnity' or a scaled down amount of costs:

i) The Defendant [or at least one of them] "Misbehaved"

I mentioned above the fact that this "elevated" scale of costs recovery is usually adopted with the interplay between an offer to settle and the ultimate result at trial. The Court also has the discretion to award such an elevated level of costs where the other "paying" party is to be criticized or admonished for unfavourable behavior in the lawsuit seen to have had the effect of extending the litigation. The plaintiff alleged that there was "reprehensible" conduct by the defendants giving rise to the cause of action [the underlying conduct, resulting in the litigation] and in the conduct of the lawsuit itself. Specifically, one of the counterclaims advanced concerned what was ultimately found by the Court to be a groundless attempt by one of the defendants [in alleging sexual harassment] to avoid payment of a legitimate debt due and owing the plaintiff. In this respect the Court ruled that while litigation conduct like this must be discouraged, that there was already sufficient disincentive built into the court process - with the risk of an award of costs on a partial indemnity scale - that such abuse

by a litigant would not be of rampant concern so as to cry out for 'general deterrence' with an award of substantial indemnity costs. The facts of the case did not amount to "*one of those rare and exceptional ones in which the law requires the use of a substantial indemnity award of costs to mark the court's disapproval*".

ii) The Defendants Engaged in Fraudulent Activity, which should be Admonished

As a matter of simple principle [no doubt, in trying to keep any costs award in line with the amount initially in issue, regardless of what conduct came to pass] in a very terse reasons for judgment the Court ruled that fraudulent activity on the part of one or more defendants will not in and of itself entitle the plaintiff to the elevated position of recovering "substantial indemnity" costs.

iii) The Offers to Settle

The plaintiff argued that it was entitled to a "substantial indemnity" award on the basis of offers to settle that had been sent to the defendant before trial. The plaintiff had on two occasions delivered to the defendant an offer to settle both actions for $35,000 plus costs. This offer was never accepted. It was met with only a counter-offer for the payment of $10,000, inclusive of costs. The Court applied the general rule that where an award of damages at trial is manifestly more favourable to the plaintiff than it was looking for in an earlier offer to settle, the plaintiff should have most of its costs on a substantial indemnity basis. Accordingly the Court then addressed whether the plaintiff should recover its calculated demand for legal costs at 100 cents on the dollar.

The Court noted however that in any circumstance – including a case such as this calling for 'substantial costs' indemnity that a costs award must be "fair, reasonable and in accord with the reasonable expectations of the losing side". In this regard the defendants complained that the costs sought of $121,965 were excessive in light of the plaintiffs total damages recovery of $87,805.12. The Court agreed that the costs demand was something patently 'out of whack', with the claim for the recovery of costs exceeding the damage award by some 50%, and by virtue of the fact that the two actions had proceeded under the Simplified Rules regime of the court. The Court noted that, as concerns actions taken under the Simplified Rules, that, *"… that alone should reasonably lower the expectations of the losing party as to the costs which might be awarded"*.

The Court then looked to the fact that the issues in the action were rather basic, involving the collection of a debt evidenced by a Promissory Note, and the enforcement of a commercial landlord's remedies. The Court cited concern for the successful lawyer's billing rate in a case of this nature – being a senior lawyer at a 'national law firm' – relative to the nature of the claims and the amount of damages sought in the case.

The Court then reviewed the basic steps taken in the case, and pared down the winning party's costs demands by an analysis of the steps that were taken in the case, with what a 'reasonable adversary' in

the position of the losing defendant would have reasonably expected to be subjected to in losing the case.

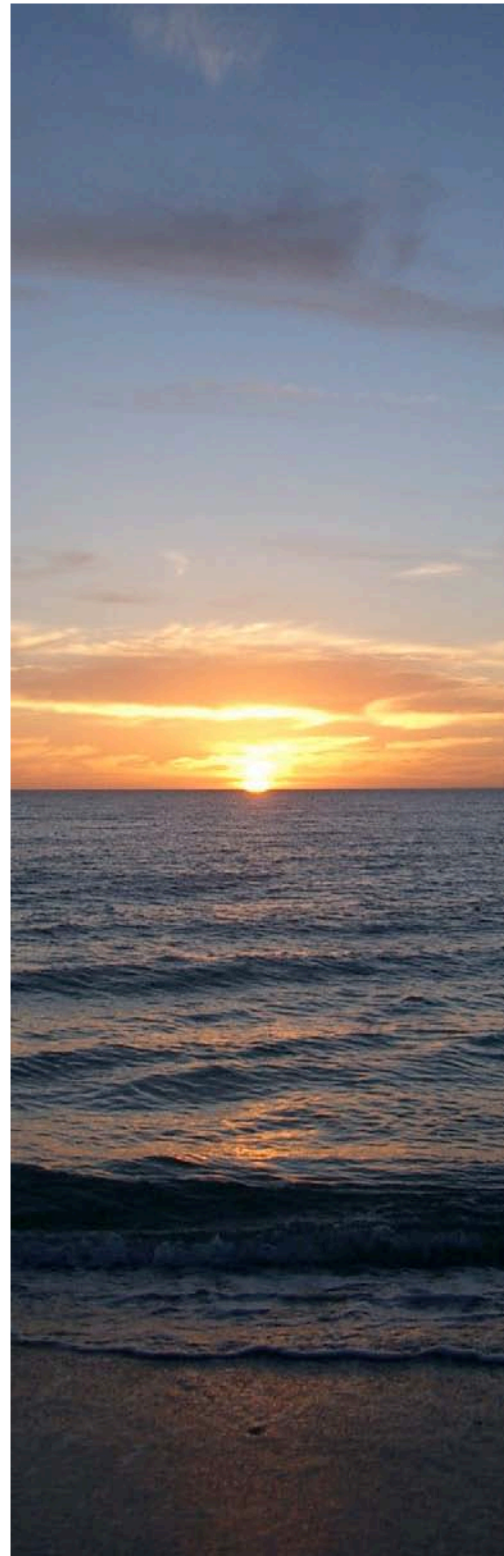
In the result, the Court reduced the plaintiff's cost recovery to $50,000 from the overall demand for a costs recovery of $121,965.

Conclusion

A couple of noteworthy items should be taken from this decision. First, litigants must accept that litigation involves risk, not only in terms of the final result never being guaranteed, but also that with a negative result there will generally be the requirement to pay certain of the winning side's legal costs. Thus, a healthy 'zero-base budget' approach must always be taken in determining whether to take a case to trial.

The above said – and secondly – even where the decision to take a matter to trial can be justified on the basis of tremendous confidence, or with the need for an important precedent to be set – the system will not countenance a 'damn the torpedoes' approach in terms of the winning party seeking to recover exorbitant legal costs. While the "Offer to Settle" regime is intended to motivate settlement, and penalize to some extent those who turn their backs on giving due credence to reasonable offers received from an adversary, the court system, and in particular the Simplified Rules regime, still vests in the Court a discretionary oversight on the awarding of costs.

Gordon Hearn



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AND FINALLY,

1. EVER SINCE I WAS A CHILD, I'VE ALWAYS HAD A FEAR OF SOMEONE UNDER MY BED AT NIGHT. SO I WENT TO A PSYCHIATRIST AND TOLD HIM

'I've got problems. Every time I go to bed I think there's somebody under it. I'm scared. I think I'm going crazy..'

'Just put yourself in my hands for one year,' said the psychiatrist. 'Come talk to me three times a week and we should be able to get rid of those fears..'

'How much do you charge?'

'Eighty dollars per visit,' replied the doctor.

'I'll sleep on it,' I said.

Six months later the psychiatrist met me on the street.

'Why didn't you come to see me about those fears you were having?' he asked.

'Well, Eighty bucks a visit three times a week for a year is an awful lot of money! A bartender cured me for $10. I was so happy to have saved all that money that I went and bought me a new pickup!'

'Is that so!' With a bit of an attitude he said, 'and how, may I ask, did a bartender cure you?'

'He told me to cut the legs off the bed! - Ain't nobody under there now!!!

AVOID PSYCHIATRISTS.. GO HAVE A DRINK & TALK TO YOUR BARTENDER.

2. Frank and his mates were planning a 5-day golf outing. Unfortunately, he had to tell them he couldn't go ....because his wife wouldn't let him.

After a lot of teasing and name calling, Frank headed home totally frustrated. The following week Frank's friends arrived at the resort to play golf. They were shocked to see Frank sitting in the lobby, drinking a well-made marguerita and admiring his putter!

"How did you talk your missus into letting you go, Frank?"

"I didn't have to" Frank replied. "Last night I slumped down in my chair with a beer to drown my sorrows. Then the wife snuck up behind me and covered my eyes and said, 'SURPRISE.' When I peeled her hands back, she was standing there in a beautiful see-through negligee.

She said, 'Carry me into the bedroom, tie me to the bed, and do whatever you want'......

SO, HERE I AM!"