

A Commentary on Recent Cases and Relevant Legal Issues

1. Construction Disputes – Lessons Learned.

The Superior Court of Justice recently heard a 15-day trial (*Dirm Inc. v. Dalton Ltd.*), which exemplifies what can happen when two experienced contractors fail to implement an effective process to resolve disputes arising during the course of a construction project.

The project at issue involved renovating existing space and adding new space to a community college building, including the conversion of a multi-level auditorium into additional classroom space. The work entailed interior demolition, excavation, pouring new footings to carry the increased load, and pouring new concrete slabs for the floors.

The concrete subcontractor's role was to form and pour concrete piers and slabs beginning in January 2003. The general contractor (the "GC") terminated the subcontractor's contract in June 2003. They disagreed over numerous items and, as a result, the GC withheld payment for some of the work performed and invoiced by the subcontractor.

The subcontractor registered a lien for the amounts owing in respect of materials and services. The trial proceeded in June 2006 against only the GC.

At trial, it was found that the subcontractor was entitled to its contract price and to various amounts for extras, damages for delay, and back-charges. However, having regard to the sums already paid by the GC, the total award at trial was for only \$31,436.93. Costs were not addressed and were to be dealt with by the Court at a later date.

We cannot comment on the subcontractor's actual costs of the action or the amount ultimately awarded because that information is not available. Having said that, we would estimate that a 15-day trial handled by a lawyer charging \$300.00 per hour would cost the client approximately \$45,000.00 in fees, plus GST (not including trial preparation and all of the other steps taken from the time the lien was registered up until trial, and not including disbursements). Based on that hourly rate (which may be higher or lower depending on the lawyer's year of call and experience), we would expect total fees for the action and the trial for each party to be in the range of \$85,000-\$100,000.00 (plus GST), if not substantially more.

In short, even if the successful subcontractor is able to recoup a portion of its costs, it is clear - based on the economics alone - that this matter should not have gone to trial.

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As for the unsuccessful Defendant, the action ended up costing the GC \$31,436.93, plus (presumably) a portion of the subcontractor's costs, in addition to all of its own costs incurred during the lawsuit.

This decision illustrates the importance of effectively dealing with construction disputes as they arise during a project and not after the fact, where possible. In this case, if the contract had contained provisions for mandatory arbitration or mediation during the course of construction, the parties may have been able to resolve their differences without the need for the GC to terminate the subcontractor and without the need for protracted and costly litigation over a three-year period. The case also demonstrates why parties should carefully assess their positions and those of their opponents before proceeding to a lengthy and expensive trial, where the result is usually uncertain.

2. Civil Procedure – Offers to Settle – Cost Consequences.

In our October 2006 edition of Gibbs Law, we presented a general overview of the various factors that the Courts may consider in exercising their discretion to award costs to a successful party at trial.

In addition to the factors addressed previously, another factor that the Courts will take into account in determining who should be awarded costs, and the appropriate scale and quantum of those costs, is whether the parties have exchanged any offers to settle before trial.

Because the Courts wish to encourage parties to make - and to carefully consider - reasonable offers, there are special cost consequences that apply to formal offers to settle that are made seven or more days before trial and that remain open until after the opening of trial. These are also referred to as Rule 49 offers.

In particular, if the Plaintiff serves a Rule 49 offer, and his or her recovery is equal to or greater than the amount of the offer, the Plaintiff usually receives costs on a partial indemnity basis up to the date of the offer and costs on a higher scale (substantial indemnity) thereafter. This is one of the reasons why Plaintiffs should always consider making an early discounted offer, which they can realistically expect to beat at trial.

By contrast, if the Plaintiff's recovery is less than or equal to the Defendant's offer, the Plaintiff usually receives partial indemnity costs only up to the date of the Defendant's offer and then receives no costs whatsoever after that date. More importantly, the Plaintiff is usually ordered to pay the Defendant's costs on a partial indemnity basis after the date of the Defendant's offer. As such, Defendants must also carefully consider making early realistic offers where they may have liability exposure.

In the latter scenario, depending on when the Defendant served its formal offer, the Plaintiff could wind up paying a portion of the Defendant's trial costs notwithstanding that the Plaintiff has obtained a judgment against the Defendant.

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If the Plaintiff's action is dismissed, the Defendant will usually receive its partial indemnity costs throughout the action, unless it is appropriate to award costs on a substantial indemnity basis to signal the Court's disapproval of the Plaintiff's conduct.

Unlike the Rule providing Plaintiffs with an automatic right to costs on a substantial indemnity basis when they beat their own offers at trial (for costs incurred after the date of the offer), Defendants do not have the same right under the *Rules of Civil Procedure*. Having said that, costs are always in the discretion of the trial judge, and there may be appropriate cases where costs may be awarded on a higher scale based on an offer to settle made by the Defendant before trial.

In light of the cost consequences associated with Rule 49 offers, parties must give careful consideration to serving early reasonable offers to settle. The serving of a realistic offer at least seven days before trial should also be viewed as a mandatory minimum costs strategy. As a Defendant, doing so could result in recouping the costs of trial (at least partially) even in the face of a judgment in the Plaintiff's favour.

In addition to Rule 49 offers, parties will sometimes serve time-limited offers to bring about a speedy resolution. These include, for example, offers that remain open for 30 days or until a stated event occurs (e.g., the start of discoveries). While such offers have a strategic purpose and can effectively bring about settlement, they do not give rise to

automatic cost consequences and should not be viewed as an alternative to making a reasonable Rule 49 offer before trial.

3. "Cost Premiums" against Unsuccessful Defendants.

In Ontario, several recent decisions from the lower courts have awarded successful counsel a cost premium based on the Plaintiff's outstanding success at trial, the Defendant's failure to admit liability, and the risk undertaken by the Plaintiff's counsel of non-payment of his fees. Many of these awards have been upheld by the Court of Appeal.

For example, in the June 2006 decision of *Sandhu v. Wellington Place*, the Superior Court of Justice awarded the Plaintiff's counsel a premium of \$350,000.00. The Court concluded that it was open to a trial judge to award a premium in a proper case because of the risk assumed by counsel and the result achieved.

The trial judge stated that a premium was only appropriate where the Plaintiff had been awarded substantial indemnity costs and where the "risk and result" criteria were both satisfied. In other words, the lawyer must have achieved an outstanding result for his/her client and met the following four risk factors: (1) the Plaintiff lacked the financial resources to fund lengthy and complex litigation; (2) the litigation was financed by legal counsel; (3) the Defendant contested liability; and (4) the Plaintiff's counsel assumed the risk of delayed payment or non-payment of his/her fees.

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In contrast to the *Sandhu* decision, the Supreme Court of Canada recently came to the opposite conclusion in its October 2006 decision of *Ritchie v. Walker*.

In that case, the Plaintiffs sued the Defendants for injuries sustained in a motor vehicle accident. The Defendants denied liability throughout the lawsuit. Prior to trial, the Plaintiffs served a Rule 49 offer. At trial, their award exceeded their offer. Accordingly, the Plaintiffs were awarded partial indemnity costs up to the date of their offer and substantial indemnity costs thereafter.

In addition, the trial judge made a further award to the Plaintiffs in the amount of \$192,600.00 constituting a "risk premium" on the basis that the Plaintiffs' counsel had carried the lawsuit for four years without remuneration because the Plaintiffs could not afford it. Based on the positive result achieved at trial and the risk of non-payment, the trial judge deemed it appropriate to order the additional premium against the unsuccessful Defendants.

On appeal, the Ontario Court of Appeal upheld the "risk premium" awarded by the trial judge. On further appeal, the Supreme Court of Canada set aside the award, concluding that the risk of non-payment was not one of the factors that a trial judge could consider in exercising his/her discretion in awarding and quantifying costs against an unsuccessful Defendant.

The Court went on to say that Defendants should not be expected to pay higher cost

awards based on the private arrangements entered into between Plaintiffs and their own lawyers. The Defendants would have no knowledge of such arrangements and would therefore not be in a position to assess the true risk of engaging in the litigation if such arrangements were a factor to be considered by the Court in increasing cost awards to successful Plaintiffs.

It is noteworthy that the Supreme Court of Canada made its decision based on the cost scheme that was in place prior to the recent amendments (which came into force in July 2005). As a result, the Supreme Court makes it clear that whether or not its decision applies to the new costs scheme will be a question for the Courts to decide as the issue arises.

We wish to point out that the recent amendments to Rule 57.01 do not list the risk of "non-payment" as a factor that may be considered by the Court in exercising its discretion to award costs. In other words, there does not appear to be any basis for a trial judge under the new cost regime to award a risk premium (particularly having regard to the S.C.C.'s decision in *Ritchie v. Walker*). Moreover, the policy argument underlying the S.C.C.'s decision; i.e., that a premium should not be imposed upon a Defendant who would reasonably have no knowledge of the private arrangements made between a Plaintiff and his lawyer, is equally applicable under the new cost regime.

However, if a Plaintiff's lawyer were to specifically put the Defendant on notice that

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the lawyer was financing the lawsuit and that the Plaintiff did not have the financial means to pay the legal fees, it might be possible for the successful Plaintiff to argue that the Defendant did in fact have notice of the risk, such that a premium might be appropriate in the event of an outstanding result achieved by the Plaintiff's lawyer.

Over the next several months, we will be following the question of cost premiums closely to assess how the Ontario Courts are handling the issue post-*Ritchie v. Walker*. We plan to revisit this issue in a future edition of Gibbs Law.

4. "Standstill Agreements" - Bill 14 - Suspending the Limitation Period in Order to Explore Settlement.

For those of you who are tracking the progress of Bill 14, you may recall our July/August 2006 article on "Standstill Agreements". These are agreements which allow parties to a potential lawsuit to agree to suspend the limitation period pending a reasonable opportunity to investigate and potentially resolve a conflict without resorting to litigation.

Before the enactment of the *Limitations Act, 2002* (the "Act") businesses, insurers and adjusters alike often entered into "Standstill Agreements" as a practical approach to avoid potential litigation. As of January 1, 2004, these agreements were generally no longer permissible under section 22 of the *Act* (although the *Act* did not affect

agreements entered into before that date). Recognizing the concern that the prohibition against "Standstill Agreements" was creating unnecessary litigation, the Ontario government addressed the issue when it introduced Bill 14/06, by introducing a clause to permit agreements to lengthen or suspend statutory limitation periods.

Bill 14 (the "*Access to Justice Act, 2006*") passed third reading on October 19, 2006 and received Royal Assent on the same day. The offending section has been amended and, although it maintains the fundamental rule that limitation periods will apply despite agreements to vary or exclude them, further exceptions have now been added.

The amendments provide that the basic two-year limitation period may be suspended or extended by an agreement made on or after October 19, 2006. The ultimate fifteen-year limitation period may also be suspended or extended on or after that date, but only if the claim has been discovered (i.e., the claimant knows or ought to know that the damage has occurred and that the damage was caused or contributed to by an act or omission of the alleged wrongdoer).

Bill 14 provides businesses with even greater latitude in their "Standstill Agreements", as long as none of the parties to the agreement is a consumer within the meaning of the *Consumer Protection Act* (defined as an individual acting for personal, family or household purposes). Businesses may now enter into agreements to vary (e.g., shorten) or even exclude the two-year limitation period. The ultimate limitation

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period may also be varied by such agreements, but only if the relevant claim has been discovered (unless the parties agree to shorten the limitation period, in which case the “discovery” of the claim is irrelevant).

With the above-noted amendments now in force (as of October 19, 2006), businesses, insurers, adjusters and others are free to resume their previous practice of postponing litigation, in the appropriate circumstances, while they explore practical alternatives to formal litigation.

For more information about this Newsletter, please contact:

**Michelle Brodey
Gibbs & Associates
Suite 1810, 150 York Street
Toronto, ON M5H 3S5
Tel: (416) 361-0024 Fax: (416) 361-1992
www.gibbslaw.ca**

To contact one of our lawyers:

**Gary Gibbs, ext. 222
ggibbs@gibbslaw.ca**

**Michelle Brodey, ext. 223,
mbrodey@gibbslaw.ca**

**Peter Mitchell, ext. 224
pmitchell@gibbslaw.ca**

**Jennifer Roberts-Logan, ext. 225
jroberts-logan@gibbslaw.ca**

**Kris Hutton, ext. 226
khutton@gibbslaw.ca**

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