

A Lecture Summary... February 26, 2009

Some notes on the law portion of PEO's Professional Practice Exams:
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A) Valid and Enforceable Agreements (p.79):

The requirements for a valid and enforceable agreement are reasonably clear. If the following five conditions are satisfied then you should have a valid and enforceable agreement!

- 1) There was an offer, and an acceptance of the offer;
- 2) The parties intended to be bound;
- 3) There was consideration;
- 4) The parties had legal capacity;
- 5) The purpose of the contract was lawful.

A sixth, and usually "evidentiary" requirement of an enforceable contract is the need to put the agreement in writing. Most oral agreements are valid and enforceable, but unless they have been reduced to writing, they are difficult to enforce because they are difficult to prove! Thus, all contracts should be reduced to writing. As noted in class, contracts dealing with real estate, by Statute, must be in writing in order to be enforceable.

(Note: All contracts are "verbal" in that they involve words! Verbal means words, and words can be either spoken or written! So for precision, speak of "oral" agreements or "written" agreements... and banish "verbal" agreements from your vocabulary!)

1) Offer and Acceptance:

For offer and acceptance to occur, there must be a "meeting of the minds". Each term of the offer must be accepted before this condition has been met. The acceptance must "mirror" the offer. If a counter offer is made, then there is no meeting of the minds... yet!

A fundamental principle of commercial contracts: you cannot accept an offer that you know to be mistaken. If there is a mistake, and it is known, then there can be no meeting of the minds.

Life after Ron Engineering (p.120)

Recall the case of the mistaken bidder (Ron Engineering) who submitted a tender which contained a \$750,000 mistake that was "hidden": it was not obvious on the face of the tender. Ron had submitted a \$150,000 tender deposit as bid security. Following the close of tenders, Ron found that they were the lowest bidder by \$629,000! So they checked their work; they discovered their error and notified the owner, Ontario Water Resources Commission (OWRC). In deciding whether the OWRC could keep the tender deposit,

the Supreme Court of Canada characterized the bidding process as a process that involves two contracts: Contract A, and Contract B. (See Table 1 below)

Contract A, the “Tender Contract” was formed when OWRC made an offer (Invitation to tender) and Ron accepted by submitting their bid. Some of the terms of Contract A were:

- (i) Ron agreed not to withdraw their bid after the close of tenders;
- (ii) Ron agreed that if they withdrew their bid after the close of tenders they would lose the \$150,000 tender deposit;
- (iii) Ron agreed to enter into a written agreement if OWRC accepted their tender.

Contract B. The offer to enter into Contract B occurs when Ron submits their tender. Contract B is then formed when the owner communicates acceptance of the tender to Ron... Of course, Contract B could never come into existence once OWRC learned of the mistake, 1 and ½ hours after the close of tenders.

	OFFER	ACCEPTANCE
Contract A "Tender Contract"	Owner Invites Tenders	Contractor Submits Tender
Contract B "Build Contract"	Contractor Submits Tender	Owner Accepts Tender

Table 1. Contract A and Contract B according to the Supreme Court of Canada in the Ron Engineering Case

Following this logic, the court found that since the mistake was a “hidden mistake”, (it was NOT obvious on the face of the tender) Contract A had come into existence. Since it was after the time of closing, once Ron informed the owner of the mistake, they effectively withdrew their tender. Therefore, the court found that Ron was in breach of Contract A. Thus, OWRC got to keep the \$150,000 bid deposit!

A subsequent Supreme Court of Canada case (*MJB v Defence Construction (1951) Ltd*), (p.129) followed the decision in Ron and implied a the term into Contract A that owners had an obligation to treat bidders fairly... *Contract A is a recurring theme in PPE exams...*

3) Consideration:

The doctrine of consideration arose because courts did not like enforcing “gift promises”... or promises that only obliged one party to do something! Thus there must be an exchange, or “two way flow”, in order to have a valid and enforceable agreement. In commercial contracts, the values exchanged do not have to be equal... they can be completely disproportionate, but there must be an exchange. Thus, I can offer to give you a million dollars for your 5 hours of engineering services, and the doctrine of consideration will have been fulfilled!

There are exceptions to the doctrine of consideration. Contracts under seal (\$0.50 red wafer placed beside the parties’ signatures!) are free from challenge for lack of consideration. As well, there is the doctrine of **equitable estoppel (p.92)**... “equitable” in this context means “in fairness” and “estoppel” is a word that effectively means “the court will STOP you from going back on your word”. *For some reason, equitable estoppel is a recurring theme in PPE exams...*

I gave an example in class where a contractor promised the University in writing to complete the B. Centre by August 31, otherwise, the contractor would have to pay \$5000 per day for every day they were late in performing! One month before the deadline, the University orally agreed to extend the completion date by 15 days... The contract clearly stated that any extension of time could only be enforceable if it were made in writing. The agreement to orally extend the contract could fail for lack of consideration since the University was not obliged to extend the contract. Basically, they made a “gratuitous promise” or a “gift promise”. The problem facing the court?... The contractor had **relied** on the promise, and completed the job by September 15. Well, when the University claimed liquidated damages of \$5000 per day for 15 days delay, and insisted that any agreement to extend the deadline would have to have been made in writing, the contractor cried foul!

Following the doctrine of equitable estoppel, since the contractor had relied on the oral promise, most courts would enforce the oral promise to extend the time, even though there was no consideration for the oral promise... out of fairness. Many writers see this result as courts protecting reasonable reliance. Under the circumstances, the contractor had reasonably relied on the University’s oral promise, and this reliance, out of fairness, is worthy of protection.

Later we will look at the \$5000 per day damage clauses...

B) Remedies for Breach of a Valid and Enforceable Contract: Damages!

A breach of contract occurs when one party to a valid and enforceable agreement refuses to perform prior to performance being due (repudiation), or performs “badly”.

Ordinarily, in commercial contracts, the normal remedy for a breach of contract is damages ... monetary compensation. Although courts can order “specific performance” such an order will usually only arise in cases involving something unique such as land and thus may order completion of a real estate transaction. In such cases, damages are not seen as sufficient!

The measure of damages often awarded is decided by considering what sum of money will put the aggrieved party (the plaintiff) in the same position they would have been in if the contract had been performed. Basically the courts try to complete the contract by awarding damages! There’ another branch that is possible. It puts the plaintiff in the same position they would have been in, had the contract never been entered into... but I didn’t explore that one! Plaintiff’s may end up on this branch if they treat the contract at an end when the other party (the defendant) breaches the agreement!

Damage Limits

1) Foreseeable: There are limits on how far courts will go in assessing damages for breach of contract. Generally, a plaintiff can only recover damages that were reasonably foreseeable (objective test!) at the time the contract was entered into...

I mentioned a case of Cornwall Gravel v. Purolator. Purolator failed to deliver a tender document to a closing on time, and thus, Cornwall Gravel didn’t get the job. Turns out, they would have been the low bidder. Since Purolator knew the consequences of failure to deliver on time, they had to pay Cornwall Gravel \$70,000 for the loss of profit on the job. This leads us to “exculpatory” or “exemption” clauses.

2) Exculpatory Clauses: Commercial parties are free to enter into agreements that limit liability. In the Cornwall Gravel case, Purolator could have limited their liability in contract. Purolator could have told Cornwall Gravel (they didn’t), that Purolator’s liability would be limited in the case of late or non-delivery to say \$50 or the value of the same day courier fees! Such clauses are known as “exculpatory clauses” or “exemption clauses”. Marston suggests that professional engineer’s could limit their potential liability in contract to their insurance limit, say 5 million dollars per occurrence... a reasonable and professional stance.

This leads us nicely to the case of Hunter Engineering v Syncrude (p.159) and the enforcement of exculpatory clauses. In the Hunter Engineering case, Syncrude had contracted with Hunter Engineering and later Allis Chalmers for the supply of bull gears for a tar sands bucket-wheel excavator. Allis Chalmers limited their liability in contract with Syncrude to “24 months following shipping of the gears or 12 months after start-up”, which ever was earlier. Allis Chalmers also excluded all other statutory warranties (Ontario Law was the agreed upon Law of the Contract. Therefore, the Ontario Sale of Goods Act would not apply!) When the gears failed outside of the agreed upon period, Syncrude tried to avoid the effect of the exculpatory clause.

Syncrude argued the doctrine of “**fundamental breach**”, *a theme that often appears on PPE exams!* The argument goes like this. Allis Chalmers wholly failed to live up to their side of the bargain. They “fundamentally breached” the agreement by providing gears that were clearly inadequate and since the gears were the “very root” of the contract, there was a total failure of “consideration”. Accordingly, Syncrude’s lawyers argued that it would be unfair to hold Syncrude to their side of the bargain (that limited their recovery) when the other side had wholly failed to live up to their obligations under the contract.

Well here is the result.. (p161). “Clear and direct exemption clauses found in contracts negotiated between commercial parties of relatively equal bargaining power, have, virtually without exception, been upheld.” According to Marston’s colleague (p.161) **“the doctrine of fundamental breach is not yet officially dead but it appears to be mortally wounded.”** In theory, the effect of an exculpatory clause might be avoided if a “fundamental breach” is found by the court, but generally, in commercial contracts, the Canadian courts have refused to find that there has been a fundamental breach!

Courts don’t like exculpatory clauses, but they will respect them so long as they clearly set out the parties’ expectations. Ambiguity, as always will be resolved against the drafter (contra proferentum rule). LARGE RED INK clauses establish expectations. A properly drafted exculpatory clause between commercial parties will usually stand up in court!

3) Duty to Mitigate: When one party breaches their contract, the other party has to take reasonable steps (objective test) to reduce their losses. (p.149) Sometimes, these “reasonable steps” carried out under urgent circumstances, aggravate the damages suffered. That’s OK, so long as the steps taken were reasonable under the circumstances!

4) Penalty Clauses: Generally, courts will not enforce a clause in a contract that is punitive. (p.149) However, in the hypothetical case of the University and the B. Centre above, the contract contained a provision that the contractor would have to pay \$5000 per day for every day they were late in performing. So long as the \$5000 amount, made at the time the contract was entered into, is a genuine pre-estimate of the damages that will arise if there is delay, then the court will enforce the clause. This is known as a liquidated damages clause. A clause that is purely punitive and is in no way a measure of the damages that will be suffered, may be called a “liquidated damages clause” by the wicked. However, judges see through the charade and will NOT enforce a clause that penalizes a party!

5) Time Limits: (p.71) An aggrieved party must commence an action to recover their damages within what is known as “The Limitation Period”. If the action is brought outside of the period, it will be barred. In Ontario, a plaintiff must bring their action against an engineer within two years of “discovering” the breach of contract or breach of duty of care (negligence) that led to the damage. “Discovering” means when the plaintiff knew or ought to have known of the breach of contract or breach of the duty of care. .. Again... an objective test! There is an ultimate “cap” of 15 years running from the date

the engineer rendered or ought to have rendered the service. In commercial contracts in Ontario, parties are free to vary these statutory limitation rules.

C) Negligence and Professional Liability

When does liability in negligence arise? There are five “requirements” that must be established before a plaintiff can recover in negligence. ... (p.37+ ...Marston shows a list of three requirements on P67, but 4) and 5) have been added here!)

- 1) A Duty of Care is owed
- 2) A Breach of Duty of Care occurs
- 3) The Breach is the Proximate Cause of damage
- 4) Damages suffered are Reasonably Foreseeable
- 5) Plaintiff is entitled to recover

The following “facts” were used to illustrate the 5 elements of negligence. These “facts” have been excerpted from The Globe and Mail, December 18, 2008 and a CTV news report that appeared on December 17, 2008. Some of the facts have been changed for teaching convenience and are presented here for illustrative purposes only. Given the prompt, prudent and exemplary actions of the lift manufacturer following the accident, it is unlikely that this case will ever lead to court action.

“The company that built the gondola tower that failed at W. Ski Resort in December 2008 because of “ice jacking” acknowledged that the problem had happened before. The failure occurred when hollow steel towers that were supposed to be sealed from water entry filled up with water. Water entered into a bolted joint in the sectional tower and then froze causing the bolts to fail. D., the company that designed, built and installed the lift in 1995 immediately issued a North American wide warning to other ski resorts about the potential hazards of similar systems. D. also built the resort’s new show case PTP gondola in 2007 but the towers used in that system are peppered with holes to allow water to go in and out of the structure. The tower failed on December 16, 2008 leaving 53 passengers stranded for hours and a dozen people injured with the most serious, a broken back and others escaping with cuts and bruises.”

The injured passengers may seek recovery for their damages from W. Ski Resort either for breach of contract or in negligence. They may also seek recovery for their damages from D. in negligence. Let’s just look at the passengers bringing an action against D.

1) Assume Ontario laws apply. Engineers owe a duty of care to anyone that they can reasonably foresee (objective test) may be harmed by the engineer’s actions or failure to act. The test is an objective test, and is known as the reasonable engineer test. So, it should be clear on the facts above, engineers can reasonably foresee causing harm to skiers/passengers if they do not carry out proper design/construction/installation of the gondola lift. Thus, we can conclude that D. and the engineers working for D., owe a

duty of care to passengers who will use lifts they have designed. Passengers are reasonably foreseeable!

2) Has there been a breach of the duty of care? Engineers must carry out their design/fabrication/ installation of the lift with care. They must live up to the standard of a reasonable engineer. Have the engineers at D. taken all reasonable steps to protect the passengers from injury? In fact, a design that relies on keeping water out of a lift tower, where the lift tower is placed in a temperate rainforest, MAY not be a reasonably prudent design. Yet, the engineers may have designed several reasonable measures into the tower system to keep water out. If these steps were “reasonable” then they have discharged their duty of care; they have lived up to the standard of reasonable care and therefore, D. would not be found to be “negligent”. Engineers don’t have to be perfect, they just have to act with reasonable prudence!

However, there are two troubling facts here. First, D. admitted that the frost-jacking had occurred before! Further, as a result of previous frost-jacking failures, they had modified the design of their new lifts. The *NEW* PTP Gondola has towers that are “peppered with holes”. These holes allow water to weep out if the seals fail. So, if the engineers were not negligent in the original design/fabrication/installation of the lift, how did they respond once they knew that frost-jacking was a problem? What would a reasonable engineer have done? Would a reasonable engineer have warned resort operators and issued a notice indicating the nature of the problem, and how to inspect for and address the problem? Again, once D. knew of the problem, they have a duty to act, because they know that harm may occur to passengers. We don’t know what steps were taken, but there can be no question, D. has a duty to act and to act swiftly once frost-jacking failure has been identified. When the failure at W. Ski Resort occurred, a North American wide warning was issued. Was such a warning issued when the earlier failure(s) occurred?

3) Let’s suppose that D.’s engineers did not do enough once the **first** frost-jacking failure occurred, and a breach of duty of care is found. Were the damages suffered by the passengers “caused” by the failure of the engineers to properly address frost jacking? If the answer is yes, then a link between the negligent act (or failure to act) and the damages has been made.

4) Were the damages suffered reasonably foreseeable? If it is reasonably foreseeable that the gondola cars may fall and passengers may be physically injured when the cars hit the ground when a tower fails, then... this test has been met!

5) Did the plaintiffs (the injured skiers) do anything to limit their recovery? Injured parties who “contribute” to their injuries may not recover all of their damages. If a party is found to be 35% at fault, then they can only recover 65% of their damages! Did the skiers do anything here to contribute to their injuries? Unlikely on the facts presented here....

A few “extra” end notes ...

Concurrent Tortfeasors: (p.55) It’s possible that W. Ski Resort and D. may both be found to be negligent. Perhaps W. and D., are found to both be contributing to the damages suffered! Suppose W. is found to be 25% at fault and D., 75% at fault. A plaintiff can recover ALL of the awarded damages from one or both parties. For example, an injured skier who suffered \$50,000 in damage could recover the entire amount (\$50000) from W. Ski Resort. It is then up to W. Ski Resort to recover \$37500 from D.

Vicarious Liability: (p.52) An employer such as D. is legally responsible of the actions of its employees including professional engineers working for D. so long as the engineers are working within the ordinary course of business!

Limiting Liability in Negligence: (p43) It may possible for D. to limit their liability in negligence to third parties. However, on the ski resort facts presented here, it is highly unlikely! W. Ski Resort can *attempt* to limit their liability in contract through the terms of sale of their lift passes, but D. is not contracting with the skiers!

However, there are ways in which a professional can limit their liability for negligence. In the case of *Wolverine Tube v. Noranda and Arthur Little*, “Little” managed to limit his liability. Little” was awarded a contract by Noranda to produce a “divestiture report” involving environmental compliance. This report was to assist Noranda in selling a mining property. “Little” completed the report on a “best efforts” basis, and CLEARLY labeled a warning to third parties that if they suffered a loss because of his report, he would not be responsible. The risk of loss was clearly placed on the purchaser of the property. Well, Wolverine Tube received a copy of the report from Noranda; they bought the property; they suffered a loss because the actual condition of the property was not quite what they had expected after reading Arthur Little’s report. They sued “Little” in negligence and were unsuccessful. Arthur Little’s clause on the report placed the risk of loss for Little’s negligence clearly on the potential purchasers.

NOTE: All of the parties here were commercial parties... and as you might expect Wolverine Tube was successful in their claim against Noranda!

That’s basically it.
All the best!

K.D.P.