



The Risk Management Committee of the Canadian Design-Build Institute (CDBI) is pleased to provide this paper which discusses the challenges that design build contractors can face when undertaking contracts / projects with onerous warranty conditions. Contractual review and management is a key tool in any risk management process, and this article will highlight the critical need to understand your contract terms. As you will find in the article, design-builders need to either have reasonable contract terms, or they need to price the risk accordingly.

The Risk Management Committee of CDBI will continue to circulate articles of this nature to members as they become available. We trust this will be found to be of interest and beneficial to the members.

CONTRACTOR'S WARRANTY TRIGGERED BY DEFECT ARISING FROM OWNER'S SPECIFICATIONS

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The recent decision of the British Columbia Court of Appeal in *Greater Vancouver Water District v. North American Pipe & Steel Ltd.* serves as a warning to contractors about the risks taken when they commit to follow design specifications while also providing an unqualified warranty against design defects.

The case concerned a contract for the supply of water pipes to the Greater Vancouver Regional District (GVRD). The tender documents issued by the GVRD required that the pipes have a seal coat over a fibre mat over-wrap. The documents also included contractual terms stating the supplier "warrants ... that the Goods ... will conform to all applicable Specifications ..." and "warrants and guarantees that the Goods are free from all defects arising at any time from faulty design in any part of the Goods." North American Pipe submitted the winning bid and manufactured the pipes according to the specifications. Subsequently, the seal coat on the pipes began delaminating and it was determined that this problem was caused by the GVRD specifications. The GVRD sued under the warranty for repair costs. North American Pipe successfully defended itself at trial, arguing the warranty should be restricted to coverage for its own design errors.

The Court of Appeal disagreed, saying the warranty applied regardless of whose design gave rise to the defects. The lesson to be learned was succinctly stated by the court's Mr. Justice Chiasson when he wrote:



[Warranty clauses such as the one used in this contract] distribute risk. Sometimes they appear to do so unfairly but that is a matter for the marketplace, not for the courts. There is a danger attached to such clauses. Contractors may refuse to bid or, if they do so, may build in costly contingencies. Those who do not protect themselves from unknown potential risk may pay dearly. Owners are unlikely to benefit from circumstances where suppliers and contractors are faced with the prospect of potentially disastrous consequences. Parties to construction or supply contracts may find it in their best interest to address more practically the assumption of design risk. To fail to do so merely creates the potential for protracted and costly litigation.

What can a contractor do to protect itself from a similar fate? If possible, the best protection is to negotiate performance and warranty clauses that eliminate the contractor's liability to the owner for work defects resulting from the supplied design. For example, General Condition 12.3.2 of the CCDC-2 (2008) Stipulated Price Contract states, "The Contractor shall be responsible for the proper performance of the work to the extent the design and Contract Documents permit such performance" and GC 12.3.4 says, "Subject to paragraph 12.3.2, the Contractor shall correct promptly, at the Contractor's expense, defects or deficiencies in the Work which appear prior to and during the one year warranty period." With these clauses, the contractor is neither in breach of its work performance obligations nor liable for warranty repairs if a defect results from following the owner's design.

If such performance and warranty clause protections cannot be negotiated, the contractor should carefully evaluate the risk and price the work accordingly. Builder's Risk and Comprehensive General Liability insurance can reduce a contractor's risk of financial loss and liability caused by defects arising from an owner supplied design but coverage is generally restricted to resulting physical damage to property (or loss of use of property) other than the defective work item. Insurance typically does not cover the cost of making good the defective item itself.

Careful contract review, negotiation, risk assessment and pricing plus proper insurance coverage are all key to minimizing the chances a contractor will be out of pocket to fix a defect arising from an owner's design.

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