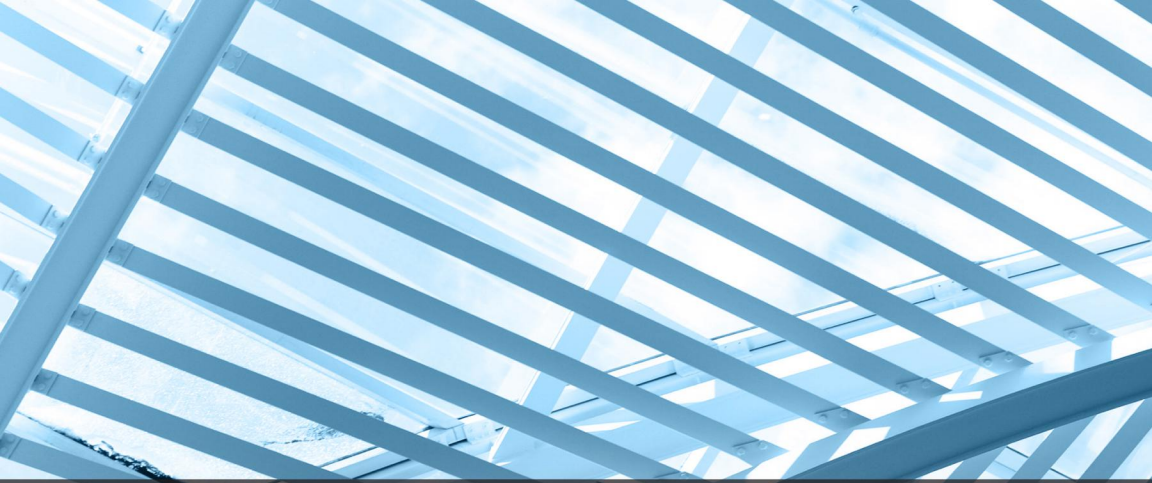

LAW FOR PROFESSIONAL ENGINEERS

Fifth Edition

Canadian and Global Insights

DONALD L. MARSTON

Mc Graw Hill Education

Law for Professional Engineers

Canadian and Global Insights

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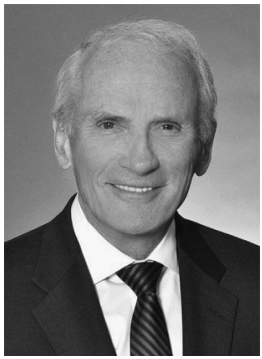
Dedicated to the importance of engineering excellence, engineering leadership, and the rule of law.

About the Author



A lawyer and member of the Law Society of Ontario since 1973, Don Marston now practises as an arbitrator and mediator. He has also been a registered professional engineer in Ontario since 1965. Throughout his law career, Don's Canadian and international practice focus has been on construction law, engineering, energy, and infrastructure project matters. His broad experience has included all aspects of project law as well as litigation and alternative dispute resolution (ADR). His ADR practice as an arbitrator, mediator, and dispute resolution neutral involves him in Canadian and international issues.

The first edition of this text was published in 1981, inspired by the early years of Don's teaching engineering law and professional liability courses at the University of Toronto, a teaching engagement he thoroughly enjoyed for more than 20 years. The initial publication of this text coincided with the implementation by Professional Engineers Ontario (PEO) of its professional practice examination program for candidates for licensure as professional engineers in Ontario. Don has been responsible for setting and marking the engineering law examination portion of those professional practice examinations since 1981.

Experienced on PEO committee and task force initiatives over the years, Don marked 12 years as a member of PEO's enforcement committee in 2018.

A long-time partner of the major law firm Osler Hoskin and Harcourt LLP, Don was the founder of its construction law and infrastructure group and a member of the firm's commercial arbitration group. He is now an independent international arbitrator, mediator, and dispute resolution neutral. His 12-year dispute resolution board experience includes chairing roles on major projects in Eastern Europe and in New Brunswick, Canada. His arbitration and mediation experience also includes both Canadian and international disputes.

Don's participation in professional organizations is extensive. A Fellow of Engineers Canada, he is also a Fellow of the Chartered Institute of Arbitrators and a Fellow of both the American College of Construction Lawyers and the Canadian College of Construction Lawyers. He is a former chair of the International Construction Projects Committee of the International Bar Association, a former chair of the Construction Law Section of the Canadian Bar Association (Ontario), and a member of the International Dispute Resolution Board Foundation. He is also the Canadian correspondent to *The International Construction Law Review.*

Contents

Preface

This fifth edition continues the author's mission to provide a reference law text for the Canadian engineering profession, as well as for project managers and other participants in related industries. It is also written, as it has been from its outset, to assist candidates for licensure as professional engineers in preparing for their requisite engineering law and professional liability examinations.

Two relatively recent landmark Canadian Supreme Court decisions are referenced for the first time in this fifth edition. Included is the *Tercon Contractors* case, a 2010 construction law decision addressing the final retirement of the doctrine of fundamental breach. The second is *Bhasin* v *Hrynew*, a 2014 decision of the Supreme Court endorsing the long-awaited recognition in Canada of the concept of good faith in contracting, a concept previously recognized in many other common-law and civil-law countries.

Also referenced in this fifth edition is the major overhaul of Ontario's construction lien laws that occurred in 2017. The overhaul was the result of the enactment of the 2017 Construction Act that significantly revised many aspects of Ontario's Construction Lien Act. The extensive changes included modernizing provisions, prompt payment provisions, and statutory adjudication provisions intended to expedite the resolution of payment disputes, on the basis of similar legislation in place in England and in some other commonwealth countries. Some modernizing provisions are in force at the time of publishing this fifth edition. However, the regulations relating to the adjudication provisions are currently not scheduled until October 1, 2019. This major overhaul is attracting attention federally and in some other provinces.

Court decisions focused on the importance of public safety are also included in this fifth edition. In the 2013 *Metron Construction* decision, a penalty of $750,000 was imposed on a company for not taking proper steps to prevent the deaths of four construction workers who fell from more than 100 feet to the ground. In 2015 in *R* v *Kazenelson*, the project manager in the *Metron* case was sentenced to 3½ years in jail for criminal negligence.

The 2014 *Report of* the *Elliot Lake Commission of Inquiry* into the tragic mall roof collapse that resulted in deaths and injury is also referenced in this edition. So also is the subsequent 2017 acquittal of the unlicensed engineer who had inspected the mall. He was charged with criminal negligence causing death and bodily harm. The court ultimately held that the Crown had failed to prove, beyond a reasonable doubt, that the accused unlicensed engineer/inspector had shown unrestrained disregard for the consequences of his behaviour. As pointed out in the *Report of the Elliot Lake Commission of Inquiry* (copy available online), there were many participants over the years in positions that contributed to the tragic outcome. At a minimum, the report constitutes a chilling cautionary tale, one that reflects the complexity of issues, evidence, and proof that may arise where a number of contributing project participants may be involved.

Global Project Opportunities for Engineers

Canadian engineers continue to play important leadership roles on a broad range of Canadian and international projects. The protection of the world's natural environment, the need for cleaner energy sources, the need for improved water treatment methods and transportation systems, the development of artificial intelligence, and ever-increasing robotics are amongst global demands that will continue to increase the need for engineering leadership. The interest of governments in privatizing infrastructure initiatives in Canada and abroad, through public/private partnerships and similar hybrid projects, can lead to contractual complexities for engineers.

Given this globalization of project opportunities, this fifth edition continues to provide insights into selected legal and business considerations relating to participation in the world marketplace. Amongst these are a summary of some distinctions

between common-law and civil-law systems and an explanation of creative dispute resolution techniques being implemented in Canada and elsewhere.

Focus of the Text

Although broad in scope, this is not an exhaustive legal text. It deals with selected areas of the law. The approach taken has been to focus on salient aspects of the law in these areas and to illustrate issues and principles through summaries of selected court decisions. Obviously the purpose of this text is not to make lawyers of engineers, but rather to provide engineers with insights into legal issues and principles that can be applied advantageously in planning contracts and in dealing with legal issues should they arise.

This is a general reference text. It is not a substitute for appropriate legal advice on particular matters. It is most important for engineers to appreciate the advisability of taking specific legal advice. Such advice is highly recommended in the interest of avoiding problems through preventive planning and contracting, and is essential should legal problems arise.

In its focus on fundamentals and legal principles of relevance to engineers, this book includes certain statutory examples that place emphasis on Ontario legislation, but some similar statutes of other common-law provinces may be generally referenced.

The chapter on the Law of Quebec, as relevant to engineers, has been updated. The update was prepared by Olivier Kott, a very experienced and highly regarded Quebec counsel who originally authored the chapter. It is important that Canadian engineers are aware of the unique nature within Canada of the civil-law system in the province of Quebec.

Exam Preparation

To further assist candidates preparing for engineering law examinations, some additional samples of typical examination questions have been added, together with examples and guidance on how to analyze, identify issues, and explain how applicable legal principles are in answering examination questions. The appendix on examination preparation at the back of the text is strongly recommended to all examination candidates.

Acknowledgements

The broad scope of areas of the law summarized in this text has generated the need to update several chapters in this fifth edition dealing with some specialty areas and specific issues. In this regard, I am extremely grateful for the excellent assistance of the following lawyers, many of whom have been my long-time partners at Osler Hoskin and Harcourt ("Osler"):

- Michael Bowman (for his helpful input on development and subdivision issues; Chapter 21);
- Joel Heard, a leading construction lawyer at Osler (for his insightful comments and revisions on the 2017 major overhaul of Ontario lien legislation; Chapter 30);
- Peter Franklyn, a senior partner of Osler and a leading advisor on competition/antitrust matters, and Gajan Sathananthan of Osler (for their insightful revisions on competition law; Chapter 31);
- Lee Webster, a senior partner of Osler (for his insightful comments on intellectual property matters and proposed changes to the Trade-marks Act; Chapter 33); and
- Allan Wells, a senior employment and labour law partner (for his extensive and detailed comments and updates on employment law, court decisions on safety issues in construction, and important business insights for employers and employees; Chapter 35).

I am also most grateful to my friend and colleague Olivier F. Kott, a senior partner of Norton Rose Fulbright Canada, in Montreal. He has very generously contributed and updated the important Chapter 34 on the Law of Quebec. Mr. Kott is a very experienced commercial litigator and an outstanding construction lawyer. His insights into legal issues of relevance to engineers in the province of Quebec are an extremely important contribution to this fifth edition and a most valuable reference for the benefit of engineers practising, or engaged in transactions or projects, in the province of Quebec.

I would be remiss indeed if I did not also acknowledge the important opportunities to gain insight into engineering, construction, and infrastructure law provided through my many years of practice with Osler's construction and infrastructure

project group, now most ably led by my brilliant friend and colleague Rocco Sebastiano.

My Canadian and international ADR practice as an arbitrator, mediator, and dispute resolution neutral provides me with significant insights into the important engineering law issues described in this text. I am fortunate indeed to practise in an area that is of such enormous personal interest.

Donald L. Marston

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CHAPTER 1
The Canadian Legal System

Historical Basis

The legal system of the nine common-law provinces and the territories of Canada is based upon the English common-law system. It is important to understand something of the evolution of the English system in order to appreciate how the Canadian system operates.

At one of its early states of development, the English legal system was very rigid. Certain specific remedies were available in only certain circumstances. This system of specific remedies was called the "common law." As time passed, it became evident that the specific remedies provided by the common-law courts were not sufficient. Where relief beyond the scope of the common law was sought, special appeals were made to the English monarch; if the monarch saw fit to exercise his or her discretion, a remedy more "equitable" than that provided by the common law was declared. Eventually, the English "courts of equity" were developed as a separate court system, providing more reasonable remedies as circumstances required. As pointed out in *Black's Law Dictionary*, the term "equity," in its broadest and most general sense, denotes a spirit of fairness, justness, and right dealing … grounded in the precepts of conscience.

Eventually, the two systems—the old common-law system and the courts of equity—were combined, and an improved system was developed to provide remedies premised on both common-law precedents and on equitable principles. This improved system continued to be called the common law, and is the system from which the present Canadian common-law system evolved.

The Theory of Precedent

In deciding cases, the courts apply legal principles established in previous court decisions that involved similar or analogous fact situations; this is called "the theory of precedent." But the courts also dispense equitable relief and thus there is flexibility in the court's decision-making process. At times, to slavishly follow precedent would not reflect society's values: hence a court can exercise its equitable discretion to reach a policy decision that may represent a departure from case precedents.

Factual distinctions between cases may also provide the basis for flexibility. A court may see fit to dismiss the application of a precedent on the basis of relatively minor factual distinctions between the precedent and the facts of the case before the court, provided the end result is justified.

However, departures from established precedents are often very slow to evolve. This slow evolution is a characteristic of our legal system that may, at times, be criticized; nevertheless, the theory of precedent is of major importance and is the basis of predictability in the legal system.

The Common Law

A major source of law is "judge-made law"—court decisions establishing legal principles.

Legislation

In addition to the common law or judge-made law, an extremely important source of law is "legislation"—statutes enacted by elected legislatures. A "statute" is a codification of the law as the legislature determines at the time of enactment; it may be codification of existing common law or the enactment of new law.

Applicability of a statute can be an issue in a lawsuit; if so, it is up to the court to determine whether the statute does apply to the facts of the case. The court must apply the statute appropriately.

Some statutes provide for regulations as a further source of law. The Professional Engineers Act of Ontario[1] (and similar statutes of other common-law provinces), for example, provides that an elected and appointed council may prescribe the scope and conduct of examinations of candidates for registration, and may regulate other matters, such as the designation of specialists.

When made in accordance with an authorizing statute, regulations are another source of law.

Many statutes are relevant to the professional engineer. It is important that the engineer complies with federal and provincial statutes of relevance to his or her practice and that the engineer is aware of amendments and new statutes.

Federal and Provincial Powers

Under the Canadian Constitution, the British North America Act, 1867 (renamed the Constitution Act, 1982), the federal government and the provinces have authority to enact legislation. The division of powers between the federal government and the provinces is expressed in Sections 91 and 92 of the Constitution Act, 1867, excerpts from which are reproduced, for illustrative purposes, as follows:

> Legislative Authority of Parliament of Canada
> **91.** It shall be lawful for the Queen, by and with the Advice and Consent of the Senate and House of Commons, to make Laws for the Peace, Order, and good Government of Canada, in relation to all Matters not coming within the Classes of Subjects by this Act assigned exclusively to the Legislatures of the Provinces; and for greater certainty, but not so as to restrict the Generality of the foregoing Terms of this Section, it is hereby declared that (notwithstanding anything in this Act) the exclusive Legislative Authority of the Parliament of Canada extends to all Matters coming within the Classes of Subjects next herein-after enumerated; that is to say, … .

[1]RSO 1990, c. p-28
(Note that, in the interests of brevity, statute citations throughout the text do not include amendments.)

2. The Regulation of Trade and Commerce… .
3. The raising of Money by any Mode or System of Taxation… .
10. Navigation and Shipping… .
15. Banking, Incorporation of Banks, and the Issue of Paper Money… .
21. Bankruptcy and Insolvency.
22. Patents of Invention and Discovery.
23. Copyrights… .
27. The Criminal Law… .
29. Such Classes of Subjects as are expressly excepted in the Enumeration of the Classes of Subjects by this Act assigned exclusively to the Legislatures of the Provinces.

And any Matter coming within any of the Classes of Subjects enumerated in this Section shall not be deemed to come within the Class of Matters of a local or private Nature comprised in the Enumeration of the Classes of Subjects by this Act assigned exclusively to the Legislatures of the Provinces.

Exclusive Powers of Provincial Legislatures

Subjects of Exclusive Provincial Legislation
92. In each Province the Legislature may exclusively make Laws in relation to Matters coming within the Classes of Subject next hereinafter enumerated; that is to say… .

2. Direct Taxation within the Province in order to the raising of a Revenue for Provincial Purposes… .
5. The Management and Sale of the Public Lands belonging to the Province and of the Timber and Wood thereon… .
10. Local Works and Undertakings other than such as are of the following Classes:
    (*a*) Lines of Steam or other Ships, Railways, Canals, Telegraphs, and other Works and Undertakings connecting the Province with any other or others of the Provinces, or extending beyond the Limits of the Province;
    (*b*) Lines of Steam Ships between the Province and any British or Foreign Country;
    (*c*) Such Works as, although wholly situate within the Province, are before or after their Execution declared by the Parliament of Canada to be for the general Advantage of Canada or for the Advantage of Two or more of the Provinces.

11. The Incorporation of Companies with Provincial Objects… .
13. Property and Civil Rights in the Province.
14. The Administration of Justice in the Province, including the Constitution, Maintenance, and Organization of Provincial Courts, both of Civil and of Criminal Jurisdiction, and including Procedure in Civil Matters in those Courts… .
16. Generally all Matters of a merely local or private Nature in the Province.

Note that Section 92 of the Constitution Act, 1867, grants to the provinces certain exclusive powers. Section 91, on the other hand, enumerates specific matters that fall within the exclusive legislative authority of the Parliament of Canada. It also provides that the federal Parliament shall have authority "to make laws for the peace, Order, and good Government of Canada" with respect to matters that are not within the exclusive authority of the provinces. This general reference to "Peace, Order, and good Government" is open to broad interpretation, providing a basis for extensive federal legislative powers where circumstances may raise concerns of national importance.

The provincial legislatures are generally empowered to enact statutes dealing with matters of a provincial nature, including property rights. Mechanics', construction, or builders' lien legislation is an example of provincial statute law that may be of particular importance to the engineer.

At times, a dispute may arise as to who has the authority to enact a statute—the federal government or a provincial legislature. Traditionally, if a party sought to challenge the "constitutionality" of a statute, the party had to convince a court that the statute was beyond the authority of the government that enacted it. Provincial statutes would be challenged on the basis that they dealt with a matter assigned to the federal Parliament in Section 91 of the Constitution Act, 1867 (for example, the regulation of trade and commerce and criminal law). Federal statutes would be attacked on the grounds that they dealt with a matter within a province's jurisdiction (for example, local works, property, and civil rights in a province). If a court could be convinced that the statute was beyond such authority, or "ultra vires," that statute would be effectively rendered void.

Before the Canadian Charter of Rights and Freedoms was enacted as part of the Constitution Act, 1982, courts could strike down legislation on the basis that it was beyond the

authority of the government that passed it. But the courts could not void a law because it offended civil liberties. Canadian courts had adopted the British "doctrine of Parliamentary Supremacy." This meant that, theoretically, the courts could not question the wisdom of any statute, even one that offended civil liberties. Although a court might find that a particularly offensive piece of legislation was beyond the authority of one level of government, that same legislation would be within the authority of another level of government. Theoretically, then, all the rights of the citizens of Canada could be removed by the government if it so desired. The only question would be which of the governments, federal or provincial, would have the ability to remove each right.

This has been dramatically changed through the enactment of the Canadian Charter of Rights and Freedoms as part of the Constitution Act, 1982. The Charter provides that everyone has certain rights. For example, Section 2 provides that:

Everyone has the following fundamental freedoms:

(a) freedom of conscience and religion;

(b) freedom of thought, belief, opinion and expression, including freedom of the press and other media of communication;

(c) freedom of peaceful assembly; and

(d) freedom of association.

The Charter is particularly significant because Section 52(1) provides:

> The Constitution of Canada is the supreme law of Canada, and any law that is inconsistent with the provisions of the Constitution is, to the extent of the inconsistency, of no force or effect.

Courts now have the power to rule that statutes are invalid because they violate rights guaranteed by the Charter. The Charter has reduced the effect of the doctrine of Parliamentary Supremacy by placing some limits on the powers of Parliament and the provincial legislatures.

However, it is important to realize that the Charter does not completely eliminate the concept of Parliamentary Supremacy. Section 1 provides, in effect, that governments may, through statutes, place "reasonable limits" on the rights outlined in the

Charter. However, if called upon, the government will have to show that such limits are necessary.

Further, Section 33 of the Charter provides that a government may expressly override certain provisions of the Charter. That is, the government may declare that a statute is valid even if the statute violates certain Charter rights. The theory is that a government will be reluctant to announce to its citizens that it believes it is violating the rights of the people. Accordingly, it is assumed that the Section 33 override power will be used sparingly.

The Federal and Provincial Court Systems

The most persuasive precedent is usually the decision of most recent date from the highest court. Decisions of the Supreme Court of Canada rank highest, followed by decisions of the Court of Appeal of the province in which a case is commenced. Precedents from other common-law jurisdictions may also be followed. For example, where a provincial court cannot follow a precedent from a higher court within the province or from the Supreme Court of Canada, it may follow a precedent set by the courts of another province, or by a court in another common-law jurisdiction. England and the United States provide common-law precedents; Canadian courts have more often preferred to follow English case precedents than U.S. common law.

The court system within each of the common-law provinces is generally the same; the system was modelled on the English system, and consists of a number of different province-wide courts responsible for a variety of matters. For example, the Court of Ontario is composed of two divisions: the Superior Court of Justice (formerly the Ontario Court General Division) and the Ontario Court of Justice (formerly the Ontario Court Provincial Division). The Superior Court of Justice deals with large claims and federal criminal matters. Small Claims Court falls under a branch of the Superior Court of Justice and deals with disputes involving relatively small amounts of money. The Ontario Court of Justice deals with domestic matters (except divorce) and criminal matters involving provincial offences. The province is divided into eight regions. Each region has a regional Senior Judge for each Division (the Superior Court of Justice and the Ontario Court of Justice) who manages

the judicial resources in the region. The Court of Appeal for Ontario is the final Court of Appeal for the province.

Federal courts include the Federal Court of Canada, which has jurisdiction over federal matters, such as patents, trademarks, and copyright, and the Supreme Court of Canada, Canada's final appeal court.

Public and Private Law

Certain areas of the law are often classified as either public or private law.

Public law deals with the rights and obligations of government, on the one hand, and individuals and private organizations, on the other. Examples of public law are criminal law and constitution law. Private law deals with rights and obligations of individuals or private organizations. Examples of private law that will be discussed in this text are contracts and torts.

The Law of Quebec

Quebec's legal system is not founded upon the English common-law system. The civil law or Civil Code of Quebec has evolved from the Napoleonic Code, and is different from the common-law system. A summary of the Law of Quebec, written by a prominent Quebec lawyer, Olivier Kott, a senior partner of the Norton Rose Fulbright Canada firm in Montreal, is included in Chapter 34 of this text. Mr Kott is very experienced on construction and engineering legal matters. It is important that engineers doing business in the Province of Quebec seek legal advice from a Quebec lawyer.

Reference to the civil law of Quebec can create confusion, as the term "civil" is also used in our common-law system. In the common-law system, "civil" usually means "private." "Civil litigation," for example, refers to a dispute under *private* law, rather than a *criminal* law dispute.

The Rule of Law

As previously noted, Canada's primary sources of law are the decisions of our courts and the statutes that are enacted by our democratically elected legislatures. The powers of our judiciary and our elected legislatures to make laws are separate and independent from each other under our Canadian legal

system. The independence of our judiciary is key to the most fundamental premise of our "Rule of Law," that is, no one is above the law. Our independent judiciary and court system provide us with a basis to enforce our laws and protect our fundamental rights and freedoms. Our Canadian legal system is also fundamental to our business dealings, facilitating interaction between individuals and organizations by providing a legal system to enforce legally binding agreements, and our precedent theory provides a basis for predictability of outcome when disputes arise in the course of business dealings. These are but some examples of the important protections provided by our Canadian legal system and our Rule of Law.

Basic Terminology

In order to appreciate references in this text, an understanding of some basic terminology is important.

(a) Litigation—A lawsuit.

(b) Plaintiff—In civil litigation, the party bringing the action or making the claim in the lawsuit. In criminal matters, the "plaintiff" is usually the Crown.

(c) Defendant—The party defending the action, or the party against whom the claim has been made. In criminal matters, the "defendant" is called the "accused."

(d) Appellant—The party appealing the decision of a lower Court, in either civil litigation or criminal matters.

(e) Respondent—The party seeking to uphold a decision of the lower Court that is being appealed. The term applies in both civil litigation and criminal matters.

(f) Privity of contract—Describes the legal relationship between parties to a contract.

(g) Creditor—A party to whom an amount is owing.

(h) Debtor—A party that owes an amount to a creditor.

(i) Indemnification—A promise to directly compensate or reimburse another party for a loss or cost incurred. An indemnification, or "indemnity," is similar to a guarantee; the essential difference is that indemnity rights can be exercised directly. For example, a guarantee works

as follows: suppose that Jason Smith promises John Doe that Smith will guarantee the debts of ABC Corporation. Enforcement of the guarantee requires that ABC Corporation defaults in making its payment to John Doe and that John Doe first looks to ABC Corporation for such payment. Only then may Doe require payment from the guarantor, Jason Smith. An indemnification, however, works as follows: suppose that Jason Smith had indemnified John Doe on account of ABC Corporation's indebtedness to him. As soon as any such debt is incurred, John Doe can require payment directly from Jason Smith without first pursuing ABC Corporation for payment. (As a practical matter, it is very difficult to distinguish a guarantee from an indemnity, as the guarantee may, for example, by its terms cover the essential difference as described above. That is, a guarantee may expressly provide that the creditor need not exhaust his or her remedies against a debtor before pursuing the guarantor for payment.)

CHAPTER 2
Business Organizations

Basic Forms

An awareness of the three basic forms of business organizations—sole proprietorships, partnerships, and corporations—is essential to the engineer's appreciation of legal rights and liabilities.

In a sole proprietorship, as the name suggests, an individual carries on business by and for himself or herself. The proprietor personally enjoys the profits of the enterprise and personally incurs any business losses of the enterprise.

A partnership is an association of persons who conduct a business in common with a view to profit. Individuals or organizations carrying on business in partnership share profits and losses personally. One presumed advantage of partnership is that there is strength in numbers, and the combining of energies and talents of individuals may well be advantageous. The essential risk of partnership, however, is that the partnership may incur substantial debts, which the partnership business is unable to pay, with the result that the partnership's creditors may obtain judgments against the partners personally. Such judgments are sometimes satisfied only by seizure and sale of the partner's personal assets—a grim possibility.

Unlike the sole proprietorship and the partnership, the corporation is an entity unto itself, distinct from its shareholder owners. The corporation as an entity has been described as a "fictitious person." The corporation itself owns its assets and incurs its own liabilities; it can sue or be sued in its own name. In fact, a shareholder of a corporation can contract with or sue that corporation.

The Independence of the Corporate Entity

The existence of a corporation as separate and apart from its shareholder-owners, and the basic premise that a corporation's liabilities are its own and not those of its shareholders, has long been recognized by our courts. This separate existence provides a strong incentive for individuals to incorporate rather than carry on as sole proprietors or as partners, as the personal assets of sole proprietors and partners remain vulnerable to business creditors.

The courts' recognition of the separate status of the corporation was confirmed in the 1897 decision of the English House of Lords in *Salomon* v *Salomon & Co Ltd*[1] Salomon had, for many years, carried on business as a leather merchant and wholesale boot manufacturer. Eventually he incorporated a company, to which he sold his business. The shareholders of the company consisted of himself and his family, and Salomon held the majority of the shares personally. As part payment of the purchase price for the sale of his business to the corporation, shares of the corporation were issued to Salomon; in addition, debentures constituting security, to evidence the corporation's indebtedness, were also issued to him. All of the requirements of the governing corporate statute were complied with, and at the date of the sale the business was solvent. Eventually, however, the business experienced difficult times and went into insolvency. A lawsuit resulted. The issue was whether Salomon ranked before the general unsecured creditors of the corporation by virtue of being a secured debenture holder. The English Court of Appeal was of the opinion that the incorporation and the sale of the business was a scheme to enable Salomon to carry on business in the name of the corporation with limited liability. The Court of Appeal also thought that Salomon had been trying to obtain a preference over unsecured creditors of the company. However, on appeal, the House of Lords recognized Salomon's corporation as a separate and distinct entity from himself. The House of Lords emphasized that there was no evidence of intent by Salomon to deceive or defraud.

[1] [1897] AC 22

But where it can be established that the limited-liability characteristic of a corporation is being used for the protection of an individual in perpetrating a fraud, the courts will refuse to recognize the separate identities of the individual and the corporation. To illustrate: in the 1972 decision in *Fern Brand Waxes Ltd* v *Pearl*,[2] the Ontario Court of Appeal determined that the defendant, who was a director, officer, and accountant of the plaintiff, Fern Brand Waxes Ltd., had used his position to transfer unauthorized funds. He used the funds as a loan, which was made by the plaintiff to two companies controlled by the defendant. Part of those transferred funds were used to pay for shares in Fern Brand Waxes Ltd. The court determined that such payment for the shares of Fern Brand Waxes Ltd. did not constitute a proper payment for such shares. The court stated that the defendant should not be allowed to profit from his breach of trust. In such circumstances, the corporate character of his two companies was no shield for his conduct, because each company was his instrument and was used to divert funds for his own purposes.

There are other exceptional circumstances, short of fraud, where the courts will intervene to "lift the corporate veil." One such case was *Nedco Ltd* v *Clark et al*,[3] a 1973 decision of the Saskatchewan Court of Appeal. Nedco Ltd. was a wholly owned subsidiary of Northern Electric Company Limited. Employees of Northern Electric Company Limited went on strike and picketed the premises of Nedco Ltd. In an action to restrain the Northern Electric employees from picketing Nedco, the court had to decide whether to consider Northern Electric Company Limited and Nedco Ltd. as separate corporate entities. In concluding its judgment, and stressing the exceptional nature of the facts of the case, the court stated, in part:

> After reviewing the foregoing, and many other cases, the only conclusion I can reach is this: while the principle laid down in *Salomon* v *Salomon & Co, Ltd*, supra, is and continues to be a fundamental feature of Canadian law, there are instances in which the Court can and should lift the corporate veil, but whether it does so depends upon the facts in each particular case.

[2][1972] 3 OR 829
[3]43 DLR (3d) 714

Moreover, the fact that the Court does lift the corporate veil for a specific purpose in no way destroys the recognition of the corporation as an independent and autonomous entity for all other purposes.

In the present case Nedco Ltd. is a wholly owned subsidiary of Northern Electric Company Limited. It was organized and incorporated to take over what was formerly a division of Northern Electric Company Limited. As such wholly owned subsidiary, it is controlled, directed, and dominated by Northern Electric Company Limited. Thus, viewing it from a realistic standpoint, rather than its legal form, I am of the opinion that it constitutes an integral component of Northern Electric Company Limited in the carrying on of its business. That being so, I can see no grounds upon which lawful picketing of Nedco Ltd., pursuant to a lawful strike against Northern Electric Company Limited, should be restrained.

I want to make it perfectly clear that, in reaching this conclusion, I have not attempted to lay down any general principle. It is only because of the special circumstances prevalent in this case that I have reached the conclusion which I have. While Nedco Ltd. is, for the purposes of this application, an integral component of Northern Electric Company Limited, for all other purposes it remains an autonomous and independent entity.

Duration of Partnerships and Corporations

Unless otherwise provided by the terms of a partnership agreement, pursuant to The Partnership Act of Ontario and similar statutes in other common-law provinces, a partnership is dissolved by the death or bankruptcy or insolvency of one of its partners. A corporation, on the other hand, has perpetual existence as long as the corporation complies with its governing statute, and as long as no procedural steps are taken to dissolve the corporation. The death of a shareholder does not have the effect of dissolving a corporation.

Effect of Personal Guarantees

As noted, a shareholder is not theoretically liable for the corporation's debts. However, the limited-liability characteristic of a corporation is often substantially reduced or nonexistent, as a

practical matter. For example, when setting up the banking arrangements for the corporation, the incorporator is often required to sign a personal guarantee in return for satisfactory credit terms. The incorporator shareholder who signs a guarantee becomes personally obligated to the lending institution for the debts of the corporation to the extent of the guarantee. When a loan is guaranteed, the creditor is said to have "recourse" to the guarantor. The guarantor shareholder therefore loses the advantage of the limited-liability concept of the corporation's indebtedness in relation to that creditor.

Basic Tax Considerations

The basic combined federal and provincial corporate income tax rates vary among provinces and territories. A Canadian controlled private corporation ("CCPC") for purposes of the Income Tax Act (Canada) will generally be eligible to receive a credit in respect of its tax otherwise payable on income from an active business carried on in Canada. Commonly referred to as the "small business deduction," this credit will significantly reduce a CCPC's combined federal and provincial income tax rate on a prescribed amount of its small business income per year. The result is a substantial tax savings, the amount of which will vary depending on the province or territory. The rules relating to the small business deduction are complex. For example, in the case of certain related corporations, the credit on the prescribed amount of yearly income must be shared by the related group.

When the corporation distributes its after-tax income to its shareholder or shareholders by way of dividends, each shareholder who is an individual must pay a tax on such dividend income, and is entitled to a dividend tax credit.

In some cases, the effect of the small business deduction is that the aggregate of the tax paid by the corporation entitled to such deduction on the income earned by it and the tax paid by the individual shareholder receiving the dividend is less than the tax would have been paid had the business been carried on through a sole proprietorship. In other words, dividend income from a corporation can result in less tax payable than does income derived from a sole proprietorship or partnership.

In addition, there is a timing advantage available. The taxes paid by shareholders on corporate dividends are payable only when dividends are paid by the corporation. If the board of directors of the corporation chooses to defer the payment of dividends to a subsequent taxation year, then the tax payable on that dividend is deferred.

An in-depth examination of tax law is beyond the scope of this text. However, the engineer should appreciate the need for specialized tax advice in business planning.

Summation of Exceptions to Salomon Principle

"Associating" corporations controlled by the same person or group of persons for tax purposes is an example of the dilution of the concept of separate and distinct corporate entities dictated by the economic realities of the business world. There are several other examples of such departures from the general concept of the distinctiveness of the corporate entity: the willingness of the courts to "pierce the corporate veil" in exceptional circumstances; the courts' disregard for the distinction between the individual and the corporate entity where fraud has been involved; the courts' "association" of corporations for certain tax purposes. Nevertheless, it is important to bear in mind that such departures are the exceptions.

The Engineering Corporation

The Professional Engineers Act of Ontario[4] and similar statutes governing engineering in the other common-law provinces recognize that engineers may incorporate and carry on the business of engineering as a corporation. Incorporation may provide both limited liability and tax advantages.

The Partnership Agreement

If a decision is made to enter into a partnership, it is important to define the basis of that partnership and to execute a partnership agreement. Because of the very personal nature of the obligations that partnership creates, it is advisable to retain legal counsel for the preparation of the partnership agreement.

[4]RSO 1990, c. P.-28

Indeed, each partner should ideally obtain independent legal advice about the partnership agreement. Important aspects of the agreement will include: a description of the management responsibilities of each of the partners; the basis for calculating each partner's share of the profits or losses and contributions to working capital; provisions for dissolution of the partnership; and the basis for the withdrawal or expulsion of partners.

Partnership agreements are usually between individuals. But organizations, such as corporations, may enter into a partnership. Partnerships of corporations are not uncommon business vehicles today. When corporate partners enter into a partnership, each corporate partner's assets are at risk. The scope of each proposed partnership agreement should be closely examined to determine if the purpose of the partnership justifies the risk.

Limiting Partnership Liability

Most of the common-law provinces have passed statutes that allow a partner to limit his or her liability. For example, the Limited Partnerships Act of Ontario[5] provides for the formation of limited partnerships, which consist of one or more general partners and one or more limited partners. Like the partners in an ordinary partnership, general partners in a limited partnership remain responsible for the debts of the firm. On the other hand, the limited partner's liability is normally limited to the amount the limited partner has contributed or has agreed to contribute. The Limited Partnerships Act of Ontario requires each limited partnership to file a certificate disclosing basic information about the partnership. The information includes the names of all general and limited partners and the amount of capital that each limited partner has contributed. A limited partner should ensure that his or her name is not used in the name of the partnership. If it is used, Section 6(2) of the Limited Partnerships Act states:

> … the limited partner is liable as a general partner to any creditor of the limited partnership who has extended credit without actual knowledge that the limited partner is not a general partner.

[5]RSO 1990, c. L.-16

In effect, the limited partner may be responsible, along with the general partners, for a debt that exceeds his or her contribution to the firm.

Only general partners are authorized to transact business on behalf of the limited partnership. Pursuant to Section 12(2) of the Limited Partnership Act of Ontario, a limited partner may from time to time examine into the state and progress of the partnership business and may advise as to its management. But the limited partner must be cautious, and have limited involvement. If the individual takes part in the control of the business, he or she can become liable as a general partner pursuant to Section 13(1) of that Act.

Limited Liability Partnerships

"Limited liability partnerships," which, in effect, limit each partner's liabilities to the partner's own and protect each partner from the liabilities of the other partners, are now available for professionals in a number of provincial jurisdictions. A limited liability partnership is typically referred to as an "LLP." Governing partnership legislation, in Ontario and elsewhere, requires professional liability insurance coverage for LLPs.

Incorporation

Corporations can be formed in several ways. They can be created by statute of the federal or provincial legislatures, as are Crown corporations. More commonly, they are formed in accordance with either the Canada Business Corporations Act,[6] the Business Corporations Act of Ontario,[7] or similar statutes that govern incorporation in the other common-law provinces. Distinctions between incorporating procedures under the various statutes are not particularly important for the purpose of this text: the end result, incorporation, is essentially the same.

Both federal and provincial corporations have the capacity to carry on business beyond the geographic limits of their jurisdictions of incorporation.

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[6]RSC 1985, c. C-44
[7]RSO 1990, c. B.-16

In deciding whether to incorporate federally or provincially, there are certain considerations that should be borne in mind. For example, if the incorporators propose to carry on business in all provinces of Canada, then federal incorporation may be appropriate. However, if the proposed business is to be carried on in Ontario and a limited number of other provinces, incorporation in Ontario may be advisable.

A provincially incorporated business generally requires extraprovincial licences in order to carry on business in another province. A special reciprocal arrangement exists between Ontario and Quebec, which entitles businesses incorporated in either province to do business in the other without obtaining an extra-provincial licence.

Objects

Neither the Canada Business Corporations Act nor the Business Corporations Act of Ontario requires corporations to define their business purpose or "objects." However, each Act does permit a corporation to limit its objects, should it wish to do so. Under each statute, a corporation has the capacity and the rights, powers, and privileges of a "natural person."

All corporations that are incorporated for the purpose of carrying on the business of engineering must comply with the applicable provincial statute governing engineering.

"Private" and "Public" Corporations

A distinction is made between "private," or closely held, corporations and "public" corporations, the share of which is offered and distributed to the public in accordance with securities legislation and stock-exchange requirements. A "private" company is generally defined as a company in which:

(i) the right to transfer shares is restricted (for example, such transfer may be subject to the approval of its board of directors);

(ii) the number of its shareholders, exclusive of present and former employees, is not more than 50; and

(iii) any invitation to the public to subscribe for its securities is prohibited.

Most engineering corporations begin as private or closely held companies. A corporation might decide to "go public" and to thereby distribute its securities to the public. Such a decision will necessitate continuing compliance with extensive disclosure and reporting requirements of provincial securities legislation.

Shareholders, Directors, and Officers

The shareholders are the "owners" of the corporation. They receive share certificates as evidence of such ownership, usually in return for invested capital.

As its owners, the shareholders elect the directors of the corporation. The board of directors of the corporation supervises the management of the corporation's affairs and business.

The officers of a corporation are elected or appointed by its directors. The officers of the corporation usually provide for the day-to-day business management. The duties of particular officers are normally set out in the by-laws of the corporation.

Shareholders' Agreements

It is advisable for the shareholders of a closely held corporation to enter into a shareholders' agreement. An agreement commonly covers such matters as who is entitled to nominate members of the board of directors of the company, the obligations of the shareholders with respect to guarantees of the company's indebtedness, and the basis upon which issued shares of the company may be sold by a shareholder. It may also contain agreements not to communicate trade secrets of the company, or provisions to ensure that future share issuances do not dilute the respective percentage holdings of the company's shareholders.

The importance of a shareholders' agreement can be illustrated by considering the potential consequences of three individuals incorporating a company. Assume each individual takes one-third of the issued shares of the company without entering into a shareholders' agreement. Now suppose that there is a falling-out between the parties; suppose also that two of the shareholders join forces. The third shareholder may be unable to elect a representative to the board of directors of the company. That shareholder may also be ousted from a former

position as an officer and may lose his or her status as an employee of the company. The board of directors controls the declaration of dividends by the company. In our example, the board may choose not to declare dividends. Hence, the minority shareholder may be left with very little to show for a one-third shareholder interest, and may be unable to dispose of such shares. The shareholder in our example may be able to get some legal help—remedies may be available to dissenting shareholders, particularly where a "fraud on the minority" has been committed. However, it is preferable for shareholders to protect their respective interests by entering into an appropriate shareholders' agreement.

The Director's Standard of Care

Directors and officers are expected to comply with a certain standard of care in carrying out their respective responsibilities. For example, Section 134(1) of the Business Corporations Act of Ontario provides:

Every director and officer of a corporation in exercising his or her powers and discharging his or her duties shall,

(a) act honestly and in good faith with a view to the best interests of the corporation; and

(b) exercise the care, diligence, and skill that a reasonably prudent person would exercise in comparable circumstances.

Any individual who consents to act as a director of a corporation must take such responsibilities seriously. An engineer who agrees to act as a director of a corporation engaged in the business of engineering must realize that the position of director has potential liabilities. The engineer must be willing to act in good faith and in the best interests of the corporation. The obligation of a director to act honestly, in good faith, and in the best interests of the corporation, and not in a manner that is in the interest of the director personally, is often referred to as the director's "fiduciary duty" to the corporation. "Fiduciary" is a term that refers to a person acting as a "trustee," one who is required to act with scrupulous good faith for the benefit of another (in this case, for the benefit of the corporation) on whose behalf the fiduciary, as a director, has agreed to act.

In addition, there are a number of statutory provisions imposing responsibilities on directors of corporations. To illustrate:

1. Pursuant to Section 131 of the Business Corporations Act of Ontario, a director of a corporation is potentially personally liable for up to six months' unpaid wages of employees of the corporation, provided action is commenced against the corporation and the director in accordance with Section 131.

> 131.(1) *Directors' liability to employees for wages*—The directors of a corporation are jointly and severally liable to the employees of the corporation for all debts not exceeding six months' wages that become payable while they are directors for services performed for the corporation and for the vacation pay accrued while they are directors for not more than twelve months under The Employment Standards Act, and the regulations thereunder, or under any collective agreement made by the corporation.
>
> (2) *Limitation of liability*—A director is liable under subsection (1) only if,
>
> (a) the director is sued while he or she is a director or within six months after ceasing to be a director; and
>
> (b) the action against the director is commenced within six months after the debts became payable;
>
> (i) the corporation is sued in the action against the director and execution against the corporation is returned unsatisfied in whole or in part, or
>
> (ii) before or after the action is commenced the corporation goes into liquidation, is ordered to be wound up or makes an authorized assignment under the Bankruptcy Act (Canada), or a receiving order under the Bankruptcy Act (Canada) is made against it, and in any such case, the claim for the debts is proved.

2. Section 242 of the Income Tax Act (Canada)[8] provides that directors who personally participate in the commission of offences against the Act are personally liable together with the corporation.

   > 242. Where a corporation commits an offence under this Act, an officer, director or agent of the corporation who directed, authorized, assented to, acquiesced in, or participated in, the commission of the offence is a party to and guilty of the offence and is liable on conviction to the punishment provided for the offence whether or not the corporation has been prosecuted or convicted.

3. Subsection 65(4) of the Competition Act (Canada)[9] is also relevant. It provides that, if a corporation does not properly submit certain returns, which can be required in connection with an enquiry under the Act, any director or officer of that corporation who assents to or acquiesces in the offence committed by the corporation in not filing the returns is guilty of that offence personally. The penalty for each offence is a fine of not more than $5,000, or imprisonment for not more than two years, or both.
4. Section 250(1) of the Canada Business Corporations Act is also relevant. It is an offence to file a report, return, notice, or other document required by the Act or its regulations that contains an untrue statement. As well, documents cannot omit a material fact required by the Act. Where an offence is committed by a corporation, any director or officer of the corporation who knowingly authorized, permitted, or acquiesced in the offence is liable to a fine of up to $5,000, or to imprisonment for a term of up to six months, or both.

Disclosure of Conflicts

As noted, as part of his or her important fiduciary duty to the corporation, a director must act in good faith and in the best interests of the corporation. As well, each director is required,

[8]RSC 1985, c. 1 (5th Supp.)
[9]RSC 1985, c. C-34

by statute governing the corporation, to disclose any personal interest in any material contract or transaction to which the corporation is a party. The director must not vote in approval of any such contract or transaction. If the director does not disclose interest in the contract, he or she is potentially accountable to the corporation or to its shareholders for any profit or gain realized from the contract or transaction.

The Joint Venture

The joint venture as a form of business organization has become increasingly popular amongst contractors, engineers, and architects in connection with large-scale projects, where it makes sense to join forces. A joint venture is often essentially a partnership limited to one particular project; joint venturers should ensure that the scope of the joint venture is limited to the single project, in order to protect the assets of the joint venturers as partners in the project. It is advisable for each of the joint venturers to indemnify each of the other joint venturers for liabilities that may arise as a result of respective services and contract obligations negligently performed. The joint-venture agreement should include a clear definition of the scope of the venture; it should also define obligations of the parties to the agreement, and the manner in which revenues and costs are to be shared.

Sample Case Study

The following hypothetical case and commentary is included for illustrative study purposes.

Smith is a 25 percent shareholder and director of Skylift Inc., a company engaged in commercial helicopter services in Ontario.

A friend of Smith, J. Johnson, sought Smith's technical and financial support in forming another commercial helicopter business in British Columbia, and Smith agreed to so participate and acquired a 50 percent shareholder interest in the second company, known as Johnson's Skyhooks Limited.

Eventually, Skylift Inc. became interested in purchasing all of the assets of Johnson's Skyhooks Limited. Smith was in no way involved in promoting the purchase of Johnson's Skyhooks Limited until the proposed purchase was presented

to the five member board of directors of Skylift Inc. for approval. At that meeting, Smith did not disclose Smith's shareholder interest in Johnson's Skyhooks Limited, and Smith cast the deciding vote in passing the directors' resolution to authorize the asset purchase. Shortly after the asset purchase had been finalized, the board of directors of Skylift Inc. became aware of Smith's shareholder interest in Johnson's Skyhooks Limited and, on further investigation, concluded that the price paid for the assets of Johnson's Skyhooks Limited was unreasonably high.

What action might the board of directors and shareholders of Skylift Inc. take in the circumstances? State, with reasons, the likely outcome of the action.

Commentary In answering, reference should be made to the director's duties to act in good faith with a view to the best interests of the corporation, to the requirement to disclose conflicts, and to the consequences of not doing so as described in Chapter 2.

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CHAPTER 3
Global Considerations

Introduction

The global marketplace continues to offer attractive opportunities for Canadian engineers. The scope of the global world marketplace is vast. Burgeoning opportunities in China, India, and elsewhere in Asia, as well as Eastern Europe, the Middle East, and South America are among the destinations of opportunity and challenge. In both developing and developed countries, lack of government capital to respond to pressing infrastructure needs continues to generate privatization opportunities for the private sector. Increasing numbers of Canadian engineers, consultants, and contractors are responding to these global opportunities.

Not surprisingly, new foreign markets generate new risks. This chapter will highlight some of the important considerations to be borne in mind by Canadian engineers and other supplying services or products to the international marketplace.

Business Organizations in Foreign Jurisdictions

The choice of business organization plays an important role in other countries just as it does in Canada. However, business organizations may be characterized somewhat differently in other jurisdictions, and tax and other issues will vary substantially from country to country. Accordingly, it is extremely important to obtain advice from an appropriately experienced lawyer in the foreign jurisdiction, or to have the advice of a consultant familiar with the country. Venturing into a foreign

jurisdiction is a significant step and one that shouldn't be undertaken without appropriate advice. When embarking on a business or project initiative in Southeast Asia, for example, it is important to commit carefully selected senior personnel and sufficient resources to the initiative. It typically takes substantial amounts of time and investment to understand the foreign market. Critical to success in that process is understanding the foreign culture and building personal relationships with business contacts within the country. Accordingly, the Canadian engineer who embarks on such an initiative should realistically schedule the time commitment for success—typically, that time commitment will have to be a relatively lengthy one.

Political Risks

Political risk is perhaps one of the more obvious risk factors, particularly in developing jurisdictions and countries with a history of instability. Changes in government can lead to significant policy changes that may affect business initiatives of foreign investors, changes in senior officials and bureaucrats with whom foreign investors may be dealing, and changes in local labour rates that may have a profound impact on anticipated profitability levels.

Depending upon the project and the foreign jurisdictions, some political risk insurance coverage may be available through funding agencies, such as the World Bank. Accordingly, political risk insurance may provide some level of protection, but careful judgment together with prudent selection of a local influential partner to assist in assessing and managing the risks involved are extremely important factors.

Foreign Legal Systems

The basis for enforcement of rights in foreign countries may be substantially different than in Canada. Countries that have a history of colonial ties to the British legal system, such as India, offer more similarities to the Canadian legal system than others. Many other jurisdictions are based on civil law, rather than common-law principles. Eastern European and other former communist countries, the People's Republic of China, and Vietnam are examples of countries where the legal system is

undergoing significant development. This occurrence results from internal changes and a growing interest in providing opportunities for foreign investors.

However, change and development take time and foreign investors can expect to encounter significant differences. In the area of property rights, for example, the typical North American approach to mortgage security on borrowed funds may simply not be available as part of the foreign legal system. Private property ownership rights have not been part of socialist communist systems. In addition, the court systems in many foreign jurisdictions may well be fundamentally different from those with which Canadian engineers are familiar. These are further reasons that point to the advisability of close alliances with carefully selected local partners or joint venturers who can assist and advise with respect to compliance with local laws and customs.

Engineers are often involved in complicated projects and transactions. An example is a typical co-generation project. Canadian engineers who have participated in co-generation projects are aware of the extent and complexity of the contractual arrangements that are necessary to implement the facility. Contractual arrangements typically include gas supply contracts, gas transportation contracts, design and construction contracts, equipment purchase agreements, steam sales and electricity sales agreements, operating and maintenance agreements, loan agreements, and compliance with requirements of regulatory authorities. As complicated a process as that is in Canada, becoming involved in a co-generation project in China or in Southeast Asia obviously requires local contacts and insights into the energy industry, not to mention appropriate contracting expertise in these jurisdictions.

Consideration of other issues relating to contracting in foreign jurisdictions is further addressed in subsequent chapters in this text, including Risks in Construction (Chapter 25); Bonds and International Performance Guarantees (Chapter 26); and ADR on International Projects (Chapter 29).

Civil law principles also apply in Canada in the province of Quebec. Olivier Kott of Montreal, a very experienced lawyer on engineering and construction matters, has provided valuable insights into the civil law system in Quebec (Chapter 34).

Licensing Requirements

Compliance with licensing requirements and obtaining necessary permits and approvals in a foreign country are important considerations that can be time-consuming. This is particularly the case when dealing with countries with a history of excessive bureaucratic procedures or inexperience in dealing with foreign investors on new types of project initiatives. Here again, the importance of local advice and relationships is emphasized. North Americans undertaking foreign project initiatives need to have a realistic assessment of the length of time that may be involved in the licensing and permitting process in a foreign jurisdiction. Personal and business licences may be required to offer engineering services in the foreign country. Whatever the nature of the foreign initiative, it is advisable to investigate well in advance as it may be a time-consuming process. A realistic view of the bureaucratic process in the foreign country is a significant factor in the important risk assessment and planning process.

In the essential licensing process, a carefully chosen local advisor or local joint venture "partner" should be in a much better position to understand the realities and to deal effectively with the bureaucracy than the foreign investor, consultant, or contractor. Knowledge of, and compliance with, local laws is most important, particularly as frustration in dealing with scheduling delays may give rise to the controversial practice of paying bribes in some countries. In Chapter 23 of this text, penalties are identified under Canadian law for engaging in offences including secret commissions, bribes, and kickbacks, as are Canadian laws relating to giving gifts or conferring benefits on government employees. In addition, Canada has enacted the Corruption of Foreign Public Officials Act,[1] prohibiting bribes by Canadian individuals or companies or their agents to foreign public officials.

Similar issues arise abroad. It is a mistake to assume that the payment of bribes in another country is not contrary to the laws of that country. It is extremely important for the Canadian engineer to be aware that even in countries where this practice may be regarded, rightly or wrongly, as common-

[1]S.C. 1998, c. 34

place, it is typically illegal and, on conviction, the penalties may be extremely severe. Accordingly, it is vital to know, and to comply with, the local laws. The development of a business or project in a particular foreign country may need to be scheduled over a sufficiently long enough time period to avoid even being drawn into this dilemma and controversy. Smart scheduling is a vital factor in the risk assessment and planning process.

Financial Risks

Many countries impose currency exchange controls or restrictions on the transfer of funds out of the country. Changes may also occur in import duties and result from local tax policy. These may all constitute significant risks related to foreign projects that need to be carefully investigated at the outset. The risk of inflation is a very important consideration, particularly on toll road, energy projects, and similar engineering initiatives undertaken by the private sector, where future revenues generated by the project are key to its financial success. Investing Canadian or American dollars at the outset on a project where payment is to be derived from future revenue streams in a foreign currency may expose the investor to enormous risks if the foreign currency is impacted by inflation (as has often been the case). These currency issues require very careful consideration and financial planning. Contracting for future payments in a more stable specified currency or obtaining governmental or other guarantees if available to mitigate or reduce the impact of potential inflation may be among advisable approaches to deal with this risk.

Many countries have special tax incentives for certain forms of foreign investment. The choice of business entity established in the foreign country can be critical to obtaining the benefit of these tax incentives. Accordingly, setting up the optimum form of business organization in the foreign country is an important consideration that will require local advice. Whether that optimum business organization is a corporation in which shares are held by the foreign investor, and by a local investor in prescribed percentages, or a joint venture approved by the foreign government, or some other form of business entity is typically a very important consideration.

Contract Forms

Another general observation that may be of interest to Canadian engineers is that the contracting forms used on projects in many foreign jurisdictions are similar to their own contract forms. For example, the "FIDIC" contract forms of the International Federation of Consulting Engineers (Geneva, Switzerland), which are favoured for use on many projects financed by the World Bank, feature an advisable independent "dispute resolution board" or "dispute adjudication board" to assist the contracting parties to resolve their disputes as they arise on the project. Countries such as China and Vietnam are, to some extent, basing contract approaches on "western" forms and have taken advice on such forms from commonwealth countries.

Clearly, differences in approaches to contract documents need to be understood and appreciated. Again, local assistance and expertise is advisable, particularly in understanding foreign cultures, foreign laws, and differences in approaches to negotiating agreements in the other country.

Global Dispute Resolution

In many parts of the world, arbitration has long been recognized by international business parties as the preferred method of dispute resolution. The selection of arbitration is often advocated on the basis that it enables at least one of the parties to the "international" contract to avoid the uncertainties and risks of exposure to the courts of a foreign jurisdiction. The selection is also advocated on the more familiar basis that, generally, it provides a speedier, more efficient, and less costly means than the courts for resolving disputes.

The widespread international acceptance of arbitration is strong endorsement of the benefits arbitration can provide. Perhaps the strongest factor influencing the preference for arbitration is that arbitration decisions are internationally enforceable under the terms of the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention"). Other such international enforcement treaties are also applicable in certain areas of the world, but the New York Convention is best known.

The prospect of a final and binding decision through efficient and internationally enforceable arbitration, rather than litigation, has great appeal on international transactions and on international projects. Canada is a signatory to the New York Convention, as are more than 150 countries and states. When contracting with a party from another country or state and agreeing to resolve disputes through arbitration, it is important to determine whether the other country or state involved has signed the New York Convention. If so, it is also important to determine if the other country or state has introduced any conditions or limitations in its adopting legislation or otherwise that may affect enforceability in that country or state.

But on major international engineering and construction projects, arbitration alone has not been sufficient to satisfy the concerns of disappointed disputants whose experience has inspired them to seek out and develop other alternative dispute resolution (ADR) techniques. In this pursuit of measures intended to avoid, reduce, or shorten disputes, a variety of other ADR approaches has developed and has gained remarkable momentum, a momentum that in some cases has somewhat surprisingly spread into other jurisdictions. Some examples of pre-arbitral ADR techniques include contractual mandatory mediation provisions, the establishment of project dispute resolution boards or dispute adjudication boards, the use of project neutrals, and, in some countries, the enactment of statutory adjudication legislation intended to significantly shorten the time for the resolution of disputes.

Mediation

Mandatory mediation provisions, as a requisite preliminary to final and binding arbitration, are not uncommon on Canadian construction projects. Mediation has become very popular in many other jurisdictions. Mediation is a means of attempting to resolve a dispute through negotiation. It typically requires common interest in settling the matter and a willingness to compromise to be successful.

Dispute Resolution Boards

The "dispute review board," or "dispute resolution board" (DRB), is a form of project-based dispute resolution that is increasingly successfully implemented on domestic and

international projects in many areas of the world. In the international FIDIC forms previously identified (and in use on World Bank projects), a board authorized to make decisions rather than settlement recommendations is referred to as a "dispute adjudication board."

The primary application of the DRB has been on construction projects, but it has also been implemented on longer-term concession agreements on privatization projects. Each DRB is typically comprised of a panel of neutral third parties (usually three) selected by the owner and the contractor prior to the commencement of the project. The DRB's mandate is usually to recommend, or decide on, early solutions to disputes that arise during the course of the project. Accordingly, the DRB provides an advisable mechanism to assist parties in resolving disputes as they arise, by recommended settlement or DRB decision. DRB procedures are intended to be less formal and less time-consuming than arbitration or litigation alternatives.

The DRB panel is usually made up of individuals with expertise in the construction or applicable infrastructure industry. It is important that the members of the DRB are carefully selected on the basis of their neutrality, integrity, and expertise. It is essential that the DRB functions on an unbiased, objective, and independent basis.

The DRB approach is "project-based" because it is premised on recommendations to resolve disputes being made by independent third parties who are in fact familiar with the project. In order to achieve familiarity with the project, members of the DRB make periodic site visits, and keep updated with respect to project correspondence and contract documentation.

As indicated previously, the DRB hearing procedure is usually structured on a less formal basis than would apply in an arbitration. Often the DRB hearing is held in a meeting setting. The chair of the DRB is responsible for the procedure applied at the meeting and, typically, for asking questions of witnesses appearing before the DRB panel. The less formal procedure of DRB meetings usually does not include direct and cross-examination of witnesses by counsel or the making of motions, objections, or arguments. Usually, legal counsel is not even present at DRB hearings.

Typically, the DRB's recommendation or decision is contractually admissible as evidence in any subsequent arbitration.