

Loss of Profit Claims and Cost Estimates: Clarification on How Future Losses are Proven

The planning and approval process, manpower, equipment, insurance, materials, and other associated costs related to building make construction projects a costly undertaking. Whether the owners are a public organization, private corporation, or individuals they will have some varying sensitivity to unanticipated changes in cost related to their project. As a result, disputes related to construction costs are a common cause of relationship breakdowns between owners and contractors and can serve as a catalyst for legal action. A prudent construction contractor should provide an owner with an appropriate preliminary construction cost estimate for the project at the outset of their business relationship. In addition to any preliminary estimates, it is best practice for a construction contractor to prepare a final construction cost estimate once the construction plans are finalized, rezoning

approvals are granted, and the necessary permits are obtained. Not only does this practice provide the owner with an up-to-date estimate of the contractor's costs for the project, but this may also protect the contractor in the event that the contract is terminated or there is a construction delay which causes them to suffer financial loss. When such losses are sustained, the contractor may need to bring a legal action to recover for an anticipated loss of profits. Conversely for owners, they may recover for lost profits that are incurred as a result of a delay in a construction project caused by the contractor. In this circumstance, the loss results from the owner being unable to use their property as a result of the delay, which may result in possible damages such as loss of rental payments or a loss of resale profits due to the delay, measured by the difference in fair market value on the

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actual date of completion and the date specified in the contract. Though not the subject of this article, owners may also be able to recover liquidated damages, provided the contract allows for such recovery, on account of additional financing costs and personnel retention costs that are incurred due to a contractor's delay.

There are generally two types of loss of profit claims arising out of a breach of a construction contract: (1) loss of profits arising out of delays in construction; and (2) loss of profits arising out of the wrongful termination of a construction contract. To successfully advance a claim for lost profits (and assuming the contract allows recovery for lost profits) it must be demonstrated by the contractor that, due to the action of the other party, profits were lost and should be recovered by the contractor. To prove a claim for lost profits three elements must be satisfied:

1. the conduct upon which the action has been brought is the cause of the loss of profit (for example, profits lost on a construction project from the wrongful termination of the contract by the other party);
2. the parties contemplated the possibility of lost profits as this was a foreseeable consequence of their conduct (the parties should refer to the construction contract to determine what their agreement says regarding claims for

loss of profits and any consequences that may result from termination or breach of the contract); and

3. the lost profit damages can be proved with reasonable certainty (a finalized construction cost estimate detailing the construction costs that is supported by corroborating evidence may be satisfactory to prove the loss).

To recover for a loss of profits, the loss must have been caused by the other party's actions, there needs to be some connection between the conduct of the other party and the loss, and the loss of profits must be capable of being calculated with some reasonable certainty. When any one of these elements is not satisfied then the courts are likely to find that the contractor has failed to prove this aspect of their claim and is not entitled to compensation for this loss. Alternatively, if the courts accept that there was a loss of profits, but the amount cannot be ascertained by the evidence before them, then they may refer the matter to the court registrar to determine what, if any, compensation should be awarded.

When a contractor fails to provide clear evidence that demonstrates a loss of profits through a construction cost estimate (supported by objective evidence and corroborated by witness testimony and other documentation as may be required) then it is likely that a court will

not award any significant compensation for this loss. This issue was recently addressed by the British Columbia Supreme Court in *JM Bay Properties Inc. v. Tung Cheng Yuen Buddhist* 2022 BCSC 81.¹ In this case the owner and contractor had executed a CCDC 5A Construction Management Contract for Services 2010. Following a dispute related to the cost estimates provided by the contractor the owner terminated the contract. Thereafter, the contractor brought an action against the owner advancing, among other claims, a claim related to loss of anticipated profits from the project. The contractor alleged that their loss of anticipated profit on this project was \$275,583.70. The amount was calculated using anticipated revenue of a fee of \$429,000.00 based on a preliminary estimate, less anticipated expenses.

Due to a lack of supporting evidence and the fact that a final construction estimate was not prepared, the court was unwilling to award compensation for an anticipated loss of profits despite accepting that it was likely some loss of profits had been sustained by the contractor but the amounts had not been proven. As a result, the matter was referred to the court registrar to determine if there was any basis for this claim and in what amounts compensation should be awarded.

JM Bay's claim is premised on the August

2017 Estimate which does not reflect a Construction Cost Estimate (let alone proposed construction cost) that was agreed to between the parties. In addition, JM Bay's estimate of its overhead is just that, an estimate not supported by objective evidence. While I have no doubt that JM Bay suffered some anticipated loss of profit, its claim must be based in part upon evidence of a realistic estimate of construction costs and evidence of its overhead supported by more than approximate and to a significant extent, verbal estimates...

The parties had not agreed to the construction cost estimate provided for in the CCDC and hence, they did not agree on the actual estimate of construction costs upon which the contractor's fee and claim for loss of anticipated profit was premised.

This case serves as a cautionary reminder to construction contractors that when entering construction contracts, they should prepare a final construction cost estimate that is reasonable and with costs that can be supported by further documentation and evidence as may be required. Not only does this practice create greater transparency and openness regarding the construction costs between the owner and the contractor but it may also protect the contractor's claim to a loss of profits in the event that there is a wrongful termination of the contract or a

delay claim that gives rise to a legal action for a loss of profits.

In standard form contracts, such as CCDC2, the delay provisions in GC 6.5 entitle contractors to receive "*reasonable costs incurred*" and/or time extension. They do not contemplate payment of lost profits. Both the owner and the contractor should be mindful of any changes introduced through supplementals that may upend the status quo. In contrast, the contractor's right to terminate the contract under GC 7.2 expressly provides for the contractor's entitlement to be paid for "*all work performed including reasonable profit, for loss sustained upon Product and Construction Equipment and such other damages as the contractor may have sustained as a result...*" which may open the door to a loss of profit claim.

It is advisable that construction contractors prepare final construction cost estimates that are accurate, and which contain monetary figures that are supported by reasonable calculations done in conformity with widely accepted industry practices and further documentation, invoices and other supporting materials that will allow the claim to be quantified with reasonable certainty. This will allow the court to award compensation to the contractor without the need to refer a matter to the court registrar, which will inevitably increase the length of time and legal costs that are required to resolve the matter. Owners should also be

mindful when reviewing the provisions of any proposed construction contract they are considering entering with contractors. Limitation clauses contained in the contract may attempt to exclude indirect or consequential damages, such as loss of profits, and the consequence of such clauses will need to be carefully considered. This can impact the damages that can be recovered and greatly limit the owner's ability to recoup any losses that are caused by the delay of the completion of their project. Owners should carefully consider provisions that waive the recovery of consequential damages before entering into any construction agreement.

March, 2022

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Footnotes

1. JM Bay Properties Inc. v. Tung Cheng Yuen Buddhist 2022 BCSC 81 at *Para 84*



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David is an associate lawyer of the firm. His practice is focused on municipal, land development and construction matters. Prior to working at Civic Legal LLP, David worked as a litigator and represented insurance corporations, local governments, construction managers and local and national companies in a variety of legal actions and disputes. David has developed a unique perspective on risk management, negotiation, and strategy from his litigation experience, which he draws on to advise his clients on a variety of legal and regulatory issues. In his solicitors practice David routinely advises clients on local government issues, procurement processes and land use planning and development regulatory matters. He has further drafted construction contracts and municipal service

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David completed his law studies in Ontario at the University of Windsor and was called to the British Columbia Bar in 2019. Prior to studying law, David worked for a credit union and legal advocacy non-profit where he worked on community outreach initiatives on Vancouver's downtown eastside. David completed his undergraduate studies at the University of British Columbia with his capstone research focused on Chinese foreign direct investment in infrastructure projects across Sub-Saharan Africa.

Our lawyers combine legal experience in local government, commercial real estate development, and construction law to provide legal services to local governments, owners, builders and developers on a range of projects, from concept to completion, and beyond.

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