"PASS-THROUGH" CONSTRUCTION CLAIMS

by Harvey J. Kirsh

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For many years, the Canadian construction industry has witnessed a proliferation of claims for damages for delay, acceleration and other impact costs arising out of problems relating to the scheduling and co-ordination of design and construction. These types of damages are difficult to assess, from both factual and legal perspectives, and require an analysis of causation and responsibility. The review process may be further complicated where a contractor not only puts forward his own claim against the owner, but also seeks to "pass through" the claims of his subcontractors.

A "pass-through" claim may be defined as a claim by a party who has suffered damages (in this case, a subcontractor) against a responsible party with whom he has no contract (namely, an owner), and which are presented through an intervening party who has a contractual relationship with both (namely, a contractor).

The respective rights and obligations of both the contractor and the subcontractor, and the procedures for presenting a pass-through claim to an owner, are often contained in a "pass-through agreement", which purports to allocate both the expenses incurred and the benefits derived when such a claim is advanced. Among other things, the terms of the agreement may provide specifics as to how the claim is to be presented to the owner, and how the obligation to pay legal fees is to be shared. The agreement may also deal with authority and control issues relating to the conduct of the litigation, including decisions regarding appeals; may outline settlement rights and obligations; and may establish terms as to how and when any monies recovered from the owner will be paid to the subcontractor. Significantly, the agreement may also contain an acknowledgment of the subcontractor's claim, and often contemplates a preliminary partial payment by the contractor to the subcontractor.

The Claim for Damages

Consider this scenario: An owner is alleged to have caused delays to a project (e.g., failure to properly manage the change order process; failure to respond to shop drawings and submittals in a timely fashion; etc.), or to have interfered with the co-ordination of the work (e.g., failure to provide timely and unrestricted access to the site; interference in the contractor's work force or work plan; etc.). As a result, both the contractor and the subcontractor might each have incurred damages (e.g., extended home office overhead; extended insurance and bond coverage; additional salary for site personnel; etc.). Alternatively, the contractor and the subcontractor, in order to meet a tight construction schedule, might have been obliged to accelerate their work (e.g., by engaging additional labour forces, working overtime, etc.), in which case each of them may similarly incur damages. In these examples, the contractor's independent claim for damages, and the separate damages incurred by the subcontractor, may differ in terms of both measure and rationale. Any delay analysis and computation of damages would be further complicated if the contractor or the subcontractor contributed to the impact on the schedule. For example, notwithstanding the owner's delays, the contractor might have failed to properly coordinate his subcontractors, or the subcontractor might have failed to plan for a foreseeable shortage of construction materials. This of course invites an inquiry as to how their involvement in the cause of the delay should affect their respective damage claims, and raises other issues of concurrent delays.

Causation and Responsibility

Construction projects typically involve multiple parties -- contractors, construction managers, design consultants, and a host of sub-trades and material suppliers -- and the cause of project delays may very well be the shared responsibility of more than one party, acting independently or in concert with others.

The analysis of the apportionment of liability is always complex and imprecise. Subcontractors tend to include all of their cost overruns in their claim, without necessarily taking into account the causation issue. Similarly, in submitting both their own claims and the pass-through claims of their subcontractors, contractors often do not necessarily undertake a fair (or any) analysis of fault. The owner is not in a particularly advantageous position to assess those claims, without

being permitted the opportunity to review a multitude of back-up documents and to understand the premises underlying the claims. Most reviews by expert construction claims consultants are often graphically depicted in a host of overlapping bar charts, each of which was created on the basis of certain assumptions. The experts, however, are not always able to agree on the assumptions, or on the methodology to be employed in the analysis, which serves to demonstrate the somewhat imprecise and arbitrary nature of claims analysis.

Owner's Defences and Limitations on "Pass-Through" Claims

The owner's perspective on pass-through claims is that the contractor and subcontractor have joined together to mount a coordinated, compound attack. Owners may seek to respond to such claims:

(i) by turning to contract provisions (e.g., "no damage for delay" or "limitation of delay damages" clauses) in order to assert that the damages are non-compensable;

(ii) by conducting a critical path scheduling analysis in order to attempt to establish, based upon project records and construction schedules, that the owner was not the effective or a contributing cause of the delay; or alternatively that the concurrent delays of others serves to preclude recovery; or that neither the contractor nor the subcontractor undertook reasonable efforts to mitigate their alleged losses;

(iii) by challenging the theory, method and details involved in the calculation of damages; and

(iv) by referring to relevant jurisprudence, such as the important 1943 decision of the United States Court of Claims in *Severin v. U.S.* There, the court was presented with a pass-through claim for subcontractor delay damages arising out of the construction of a post office. Judge Madden, delivering the opinion of the court, noted that the terms of the subcontract relieved the contractor from liability to the subcontractor for losses caused by the owner (in that case, the federal government), and therefore dismissed the claim. As noted by one commentator, "(t)he *Severin* doctrine developed into a powerful defensive tool for owners, allowing dismissal of pass-through claims if the subcontractor could not recover from the prime contractor for such claims". In other words, according to the *Severin* decision, where a contractor, by reason of an

exculpatory or release clause in the subcontract, has no liability to his subcontractor for the owner's breach of the general contract, the contractor may not successfully pass through the subcontractor's damages claim to the owner.

One of a handful of decisions in Canada on pass-through claims was rendered by the Trial Division of the Federal Court of Canada, in its 1991 decision in *Thomas Fuller Construction Co. (1958) Ltd. v. Canada*. There, the court reviewed the enforceability of a pass-through agreement in circumstances where the damages suffered by a subcontractor arose out of the owner's delay. Observing that there were no contractual arrangements between the subcontractor and the owner, Mr. Justice Dubé held that the pass-through agreement, authorizing the contractor to present the subcontractor's claim, was an attempt to assign a bare right to sue, which is not assignable unless it is coupled with a property right. However, the decision was overturned by the Federal Court of Appeal on technical grounds, unrelated to the principles under discussion.

In practical terms, permitting contractors to sponsor the pass-through claims of their subcontractors may promote economy in dispute resolution by obviating the need for a subcontractor to bring his own action. In the same vein, the contractor's interest is served by his avoiding the cost of litigating on two fronts. However, it remains to be seen whether the courts in Canada will reject or embrace this method of presenting subcontractor claims through the only party who has a contractual relationship with the owner.

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