ONTARIO

Superior Court of Justice

Justices' Office
Central West Region

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FROM: **Justice MacKenzie's Office**
Fax No. (905) 456-4834

DATE: August 13, 2007

NO. OF PAGES, including cover sheet: **96**

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COMMENTS:

**Re: *The Corporation of the City of Guelph v. Super Blue Box***

**Attached is a copy of Justice MacKenzie's Reasons for Judgment in the above-named matter. Thank you.**

**COURT FILE NO.:** 446A/03
**DATE:** 20070810

**ONTARIO**

**SUPERIOR COURT OF JUSTICE**

| | |
|---|---|
| **B E T W E E N:** | |
| THE CORPORATION OF THE CITY OF GUELPH | Mr. J.G. Richards, Mr. M. Statham and Mr. N. Iatrou, for the Plaintiff (Defendant by Counterclaim) |
| Plaintiff (Defendant by Counterclaim) | |
| **- and -** | |
| SUPER BLUE BOX RECYCLING CORP. | Mr. J.C. D'Angelo and Mr. T. Squire, for the Defendants (Plaintiff by Counterclaim) |
| Defendant (Plaintiff by Counterclaim) | |
| **- and -** | |
| EASTERN POWER LIMITED | |
| Third Party | **HEARD:** October 12, 13, 14, 17, 18, 19, 20, 24, 25, 26, 27, 28, 31; November 7, 8, 9, 10, 14, 15, 16, 17, 28, 29, 30; December 1, 2, 5, 6, 7, 8, 9, 12, 13, 14, 15, 2005; January 3, 4, 5, 16, 18, 19, 20, 24, 25, 26, 27, 2006 (46 hearing days) |

**REASONS FOR JUDGMENT**

**MacKENZIE J.**

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## INTRODUCTION

[1] What is the nature of the duty of performance of contractual obligations? What is the impact of that duty in interpreting the terms of a contract that set out significant events or milestones in the performance by parties of their respective contractual obligations? Is there a duty of good faith performance upon a municipal corporation *vis-à-vis* a private sector party in relation to a contract, the subject of which is the demonstration of a novel technology relating to municipal solid waste management?

[2] These are the overarching concerns raised in the litigation between the Corporation of the City of Guelph (Guelph) and Superior Blue Box Recycling Corp. (Subbor) arising out of their contract for the demonstration by Subbor of its technology for municipal solid waste management.

[3] It must be emphasized at the outset of these reasons that nothing herein should be construed as a finding on the ultimate viability of Subbor's technology that was the subject of its contract with the City.

## OVERVIEW

[4] In 1997, Eastern Power Limited (E.P.), the parent of Subbor at all material times, was seeking an arrangement with a municipality for purposes of

collaborating in the demonstration of E.P.'s technology for handling municipal solid waste (MSW).

[5] By 1997, E.P. had done considerable research and development into its MSW technology and its technical officials had concluded the technology was ready for a pilot project and then demonstration.

[6] In this regard, the technical officials at E.P. concluded that the City would be a good candidate for their pilot and demonstration project on the basis that the City had previously been involved in innovative programs for MSW treatment.

[7] To this end, E.P. initiated contacts with the officials of the City and in due course, a meeting was held in November of 1997. Negotiations continued between the officials of both the City and E.P. and by June of 1998, the City gave direction to its staff to develop a draft agreement based on a staff report on Subbor's proposal.

[8] Throughout the summer and early autumn of 1998, many draft agreements were exchanged between the parties.

[9] On November 2nd, 1998, City council passed a resolution authorizing the City's entry into an agreement with Subbor. On or about the 6th of November, 1998, the City and Subbor formally executed an agreement (the '98 Agreement) governing their relations respecting Subbor's demonstration project on a half-

acre site (the Site) located in part of the City's waste management premises, described as the Wet-Dry facility. This agreement comprises two aspects, the first being a grant by the City of a leasehold interest to Subbor of the Site for Subbor's demonstration project and the second being the rights and obligations of the parties in relation to the conduct of Subbor's demonstration project. The relevant terms for each of the two aspects in the '98 Agreement will be discussed at length hereunder.

[10] In or about April of 1998, construction began on the Subbor facilities at the Site in accordance with the '98 Agreement and continued throughout 1999. During this period, issues arose between the City and Subbor relating to costs, being development charges, allegedly payable by Subbor to the City in the course of construction of the Subbor facilities. Subbor, in a letter dated July 6, 1999, to the City sought exemption from payment of such charges. No such exemption was granted.

[11] In late December 1999, Subbor informed the City that in January of 2000, it would begin its operations for the demonstration project. On or about the 28th of January, 2000, approximately 30 tonnes of MSW was delivered to and received by Subbor for processing in its facilities. As of the above date, Subbor had not completed the testing of all components in its facilities.

[12] In the autumn of 2000, Subbor began discussions with the City on a proposal for Subbor to process all of the City's MSW.

[13] Despite lengthy discussions and negotiations on this proposal, the parties were unable to come to an agreement.

[14] In December of 2000, the City began requiring Subbor to pay charges (tipping fees) with respect to waste which Subbor was receiving from third parties. Subbor contested the validity of such charges, adding another strain to the relationship between the parties.

[15] In February of 2001, an event crucial to this litigation occurred. By letter dated February 23rd, 2001, the City informed Subbor that the second three-year term provided for in the '98 Agreement had commenced on January 28th, 2000, being the date of the first delivery and receipt by Subbor of MSW at the Site. As will be seen in the analysis section of these reasons, the City's position on the commencement date of the second three-year term of the '98 Agreement was of paramount significance in the eventual breakdown of the contractual relationship between the parties and the consequences of such breakdown as reflected in this litigation.

[16] However, the ultimate impact of the City's communication did not crystallize at the time: the parties continued negotiations respecting amending agreements to the '98 Agreement.

[17] In July of 2001, City Council directed staff to negotiate a short-term agreement respecting a separate arrangement from that contemplated in the '98 Agreement, under which Subbor would process all of the City's residential MSW. This proposal never resulted in a separate agreement nor an amendment to the '98 Agreement.

[18] As there were various items in their relationship under the '98 Agreement that were not susceptible of resolution by the parties, they agreed it would be appropriate to engage a facilitator to assist them in resolving the outstanding issues between them. A facilitator was appointed on consent and facilitated negotiations were conducted on July 31st, October 15th, November 30th, 2001 and February 19, 2002. However, the facilitated negotiations were unsuccessful in resolving the outstanding issues.

[19] In February of 2002, the City took actions which denied Subbor the ability to receive any MSW for processing, on the basis of Subbor's refusal to pay to the City outstanding invoices for various charges which Subbor contested.

[20] At or about the same time, the Ministry of the Environment (M.O.E.) issued an environmental non-compliance order against Subbor, although such order was revoked after two weeks. In March of 2002, M.O.E. issued a similar form of order against the City. Both these orders related to air management issues arising from the operation of the City's and Subbor's facilities. The

responsibilities and obligations of the parties in relation to the air management issues and their respective plant and equipment in dealing with air management issues became further items of dispute between the City and Subbor.

[21] By letter dated May 9th, 2002, the City informed Subbor that the City regarded the second three-year term of the '98 Agreement which the City alleged began on January 28th, 2000 as ending on January 28th, 2003. The City alleged Subbor was in default of its obligations under the relevant terms of the '98 Agreement and that the conditions or requirements for the '98 Agreement to extend beyond the second three-year term had not been satisfied. The above position was set out in a report to the City's Planning Works and Environment Committee dated May 13, 2002.

[22] This report was adopted by the Planning Works and Environment Committee on or about May 13th, 2002 and confirmed by City council at a meeting held May 21st, 2002.

[23] Notwithstanding this situation, during the summer and autumn of 2002, the parties continued in their difficult course of dealings with each other. Among other things, the City denied Subbor access to the City's composting facilities for stabilizing its peat until Subbor obtained M.O.E. approval. The problem here was developing a peat test protocol acceptable to both parties and which also satisfied M.O.E.

[24] In December, 2002, there was correspondence between the parties in which (among other things) the delay in obtaining agreement as to the peat test protocol and M.O.E. approval was canvassed at length from the perspective of each party. By letter dated December 24, 2002, Subbor reiterated its position that the second three-year term under the '98 Agreement would not expire January 28, 2003.

[25] On January 20, 2003, City council by resolution confirmed the expiry date of the second three-year term under the '98 Agreement as being January 28th, 2003.

[26] By letter dated January 27th, 2003, the City informed Subbor of council's January 20th, 2003 resolution as to the expiry date being January 28, 2003. Subbor again stated its position that the alleged expiry date of January 28th, 2003 for the second three-year term was not valid since the delivery and receipt of MSW by the City to Subbor on January 28th, 2000 was not a "triggering event" for the second three-year term. On or about January 29, 2003, the City issued a letter requiring Subbor to surrender possession of the Site and remove its Demonstration Plant no later than July 28, 2003.

[27] In or about the end of March, 2003, the City terminated access by Subbor to the City's Wet-Dry facility for decommissioning of the Subbor Demonstration Plant.

[28] In early May of 2003, City council authorized a court application seeking a declaration as to the length of the term of the '98 Agreement.

[29] At a City council meeting in early June of 2003, Subbor asked that the City's termination of access to its Wet/Dry facility be suspended pending a decision on an additional funding application for its Demonstration Project which Subbor had in train since July of 2002. Although Subbor's request resulted in a motion to have City staff negotiate with Subbor on its funding application, that motion was deferred by a bare majority vote.

[30] On or about June 18, 2003,, the City issued its notice of application with respect to declaratory relief as to the expiry date of the '98 Agreement.

[31] On or about July 11th, 2003, Subbor issued its counter-application, challenging the City's position respecting the expiry date of the '98 Agreement, alleging breaches by the City of its obligations under the '98 Agreement and seeking damages in respect thereof exceeding $30,000,000.00.

[32] In July of 2003, counsel for the City proposed to counsel for Subbor that Subbor would be allowed to continue to have the use of the City's facilities for the delivery and processing of MSW pending the determination by the court of the expiry date of the '98 Agreement. In response, counsel for Subbor sought clarification as to whether the City would be prepared to assume the costs of decommissioning the Subbor facility.

[33] As the parties were unable to agree on their respective proposal and counter-proposal, Subbor began the process of decommissioning the Demonstration Project in or about July of 2003. The decommissioning was completed in September/October 2003.

**BACKGROUND**

[34] In 1997, the City had in operation a facility for the processing of MSW. This facility (the Wet/Dry facility) combined two functions. Through an aerobic process, the "Wet" plant rendered organic materials into compost for sale purposes. (The process in the "Wet" plant utilized oxygen; hence the description aerobic). The "Dry" plant processed dry materials such as paper, plastics, ferrous and non-ferrous metals for recycling purposes.

[35] E.P. is a firm of professional engineers with a business focus of developing environmental technology and a particular emphasis on the generation of electric power from landfill gases.

[36] Subbor was incorporated in the mid-1990s as a wholly-owned subsidiary of E.P. Subbor became the patent holder of a process involving anaerobic digestion of MSW with resulting benefits to MSW processing of increasing the volume of recyclable products and thereby diverting MSW from landfill sites. (This digestion of MSW did not utilize oxygen, hence the description anaerobic.)

The Subbor patented process (the "Technology") had been tested by E.P. and Subbor on a bench or lab scale by 1997.

[37] As E.P. and Subbor wished to proceed to the next stage in developing the Technology, they looked for a municipality that could as a host and collaborator in the building and operation of a prototype facility. The purpose of such prototype was to conduct a demonstration of the Technology at a level and in circumstances which would enable Subbor to showcase the success and viability of the Technology to municipalities and other MSW processors on a world-wide scale.

[38] As previously described in the Overview section of these reasons, after numerous meetings between representatives of the City and of E.P./Subbor, Subbor submitted a written proposal to the City.

[39] In the result, pursuant to a resolution passed on November 2, 1998 by council, the City was authorized to enter into an agreement with Subbor for Subbor's demonstration project. On or about November 6, 1998, the '98 Agreement was executed by both parties.

The '98 Agreement

[40] As previously noted, the '98 Agreement is characterized in its text as an "Agreement and Lease". Schedule A to the '98 Agreement, incorporated into and forming part of the '98 Agreement, consists of the May 21, 1998 proposal by E.P. This proposal (the Proposal) provides, among other things, that: "Eastern Power will indemnify the City of Guelph against liability that may arise as a result of the pilot demonstration project": (p.2). However, E.P. is not a signatory to the '98 Agreement.

[41] Before proceeding to a full review and discussion of the terms of the '98 Agreement and the application of the terms to the issues between the parties, it will be useful to refer to some terms in the '98 Agreement.

> **ARTICLE I – "DEFINITIONS":**
> Whenever used in this Agreement and Lease the following terms shall have, unless otherwise expressly indicated, the meanings defined as follows:
>
> . . .
>
> 2. "Demonstration Plant" shall mean any and all equipment required for a facility to demonstrate the Subbor Technology and any associated structures including material handling, digestion, biogas collection and energy conversion equipment, Utilities Interfaces and other related equipment as deemed appropriate and supplied by the Company [Subbor] to demonstrate their Subbor Technology.
>
> 3. "Commencement Date" shall be the date this Agreement and Lease is executed by both parties.
>
> 4. "MSW Feedstock" shall mean any municipal solid waste material supplied to the Demonstration Plant.
>
> . . .

**ARTICLE 3 –**
**SUBBOR DEMONSTRATION PLANT - INSTALLATION AND OPERATION**

(9) the Lease granted herein including the right to build, test, demonstrate, modify and operate the Demonstration Plant in any and all pertinences or activities related thereto shall be at no cost to the City.

**ARTICLE 4 –**
**TERM**

(1) The term of this lease shall be for three (3) years from the date of execution of the Agreement and Lease by both parties. Should the Demonstration Plant accept MSW Feedstock within the first three (3) years of this lease, the lease shall then be automatically extended for a further three (3) years from the date such MSW Feedstock is accepted.

(2) Provided that, if the Company has fully complied with all the terms and conditions herein set out, and the Company has deemed the Demonstration Plant a success, and the City has realized auditable and independently verifiable cost savings or other financial benefits over $250,000.00 based on criteria established solely by the City acting reasonably and the Company has given to the City six (6) months prior notice, in writing, of its intention so to do, the Agreement and Lease may be extended for a further term of ten (10) years on mutually agreeable terms and conditions as negotiated between the parties acting reasonably.

**ARTICLE 5 –**
**RESPONSIBILITIES**

(1) Responsibilities of the Company [Subbor]

(a) At no cost to the City, design, test, demonstrate, modify, build, operate and maintain the Demonstration Plant and a demonstration of the Subbor Technology;

(i) reimburse the City for any additional cost specifically incurred by the City at the Company's request within 30 days of receipt of an invoice;

(j) reimburse the City within 30 days for the cost of any utilities or services provided to the company at the City's expense, including but not limited to water, sanitary and storm sewers, natural gas, electrical services including installation, metering and utility interfaces;

(n) ensure that the Company pays for all costs related to the interconnection between the Demonstration Plant and Guelph Hydro.

(p) ensure that the Company complies with all federal, provincial and municipal laws including, but not limited to, zoning, environmental, emissions, noise, labour, etc.

(s) Reimburse the City for all increased costs and/or including any loss of revenue, incurred in any year related to the diversion of any MSW Feedstock from the Wet/Dry Facility to the Demonstration Plant, taking into account the loss of revenue and changes in operating costs of the City including any savings realized by the City within the same year.

(2) Responsibilities of the City:

(a) The City will lease the Site to the Company at fair market value, as determined by the appraisal of the Site, and the value of such lease payments shall be reduced by any costs savings or other financial benefits realized by the City, as determined according to clause 3, subclause 2 (Term);

(b) Co-operate with the Company in the permitting, design, financing, construction, modification and operation of the Demonstration Plant.

. . .

(g) Dispose of any of the output from the Demonstration Plant resulting from the processing of MSW Feed Stock *which has been supplied by the City,** at the company's request at no cost to the company as long as such tonnage requiring disposal is equal to or less than such tonnage that would require disposal in absence of Demonstration Plant. (*Note: italics represent a handwritten addendum*);

(h) The City shall assume no cost whatsoever in connection with or arising directly or indirectly from the Demonstration Plant or from this Agreement.

. . .

**ARTICLE 6 –**
**DEMONSTRATION PLANT**

(1) The Company will design, construct, test, demonstrate, modify and operate a Demonstration Plant substantially as set out in the attached Plans with all costs, risks and liability associated with this activity to be borne by the Company. The Plans which are attached as Schedule "B" are incorporated into and form part of this Agreement.

. . .

**ARTICLE 7 –**
**THE COMPANY COVENANTS**

. . .

(2) To obtain all required licences and permits, including but not limited to all permits and authorities under applicable Municipal, Provincial and Federal environmental laws, for the construction and operation of the Demonstration Plant and the sale, transmission or transport of products.

(3) To maintain and operate the Demonstration Plant. It is acknowledged by the parties that the continuity of the Demonstration Plant operation will be subject to interruption caused by routine maintenance, equipment breakdowns, testing schedules, feedstock availability, forced outages and *force majeure*.

**ARTICLE 8 –**
**ENVIRONMENTAL PERMITS: AVAILABLE DATA: CO-OPERATION**

In co-operation with the City, the Company shall at its own expense prepare and file applications and diligently prosecute the processing of such applications for the purpose of obtaining all environmental and other permits which may be required under applicable Municipal, Provincial and Federal environmental laws and regulations for the installation and operation of the Demonstration Plant. In connection therewith, the City agrees to make available to the company copies of all environmental information reports, environmental impact reports, air impact, assessment studies, copies of all environmental applications filed and other available data relating to and used in connection with obtaining any environmental permits necessary for the installation and operation of any equipment or the conducting of any other related activities on the Site...

...

In order to facilitate the design, construction and reliable operation of the Demonstration Plant, the City shall provide to the Company, at the Company's request, copies of any information, reports, consultant studies, engineering drawings, surveys or measurements pertaining to the Wet/Dry Facility which the City may have in its possession and has the authority to disclose and which may be of assistance to this Project.

...

**ARTICLE 16 –**
**FORCE MAJEURE**

Notwithstanding anything contained in this Agreement and Lease to the contrary, it is expressly understood and agreed that the obligations imposed upon the Company and the City may be suspended so long as and to the extent that the Company and the City are prevented from or delayed in performing such obligations by the elements, accidents, strikes, lockouts, riots, delays in transportation, inability to secure fuel, materials, utilities or services in the open market, delays by suppliers of equipment, acts of war or conditions attributable to war or compliance by the Company with federal, provincial, municipal or other governmental agency or quasi-governmental agency regulations, rules or orders, fire or other acts of Gods, the act or omission of any governmental authority or of the City, the order of any court or other causes beyond the reasonable control of the company, whether similar or dissimilar to the foregoing. This Agreement and Lease shall remain in full force and effect during any suspension of any of the Company's or the City's obligations under any provisions of this section and for a reasonable time thereafter.

...

**ARTICLE 30 –**
**INTENTION OF THE PARTIES:**

For greater clarity and notwithstanding any other provisions in this Agreement and Lease, the parties acknowledge and agree that it is the intention and agreement of the parties that the City shall be responsible for no costs whatsoever related to, arising from or in connection with, either directly or indirectly, this Agreement and Lease or the Demonstration Plant.

Salient Events and Conduct

(a) *November 6, 1998 to January 28, 2000*

[42] In April of 1999, Subbor proceeded with the construction of its facility on the Site. In the course of Subbor obtaining its building permit, the City required payment of development charges relating to the proposed construction. In due course, Subbor paid such charges, under protest. As noted in the Overview section of these reasons, the liability of Subbor for payment of the development charges continued to be a source of dispute between the parties.

[43] By correspondence dated October 5, 1999, Subbor notified the City it was prepared to receive MSW in 2000 and that its construction schedule for its facility would extend into the spring of 2000.

[44] By letter dated December 20, 1999, Subbor informed the City that the Subbor facility would commence operations in January of 2000. In January 2000, the construction of the entire Subbor facility was not completed, although Subbor had installed the components and equipment for the first phase or section of its facility, sometimes described as the "Front End".

[45] On January 28, 2000, Subbor received at its request 30.79 tonnes of MSW from the City. This waste was then used by Subbor in its testing, i.e., commissioning, of the components and equipment then in place and operating in the Front End.

(b) *January 28, 2000 to May 22, 2002*

[46] Throughout the winter, spring and summer of 2000, varying amounts of MSW were delivered to Subbor for processing in its facility.

[47] In mid-September of 2000, Subbor proposed that it process all the City's MSW, beginning immediately at 100 metric tonnes per day for an annual volume of 25,000 tonnes, eventually building up to a volume of 250,000 tonnes per year.

[48] Although discussions ensued between the parties on the Subbor proposal, which was a commercial arrangement for Subbor to produce all the City's MSW on a long-term basis, the parties were unable at that time to come to an agreement on the proposal. However, the issue was not devoid of life and discussions continued.

[49] In November of 2000, Subbor stopped taking the City's MSW but began accepting MSW from third parties.

[50] In December of 2000, the City began imposing tipping fees on third party MSW received by Subbor. Further discussions and negotiations continued in January of 2001 between the parties on the possibility of long-term commercial arrangements between them for MSW management, again without success.

[51] By letter dated February 23, 2001, the City notified Subbor that the City was treating January 28, 2000, being the date of first delivery of MSW to the

Subbor facility, as the commencement date of the second three-year term under the '98 Agreement. In its responding letter dated March 6, 2001, Subbor continued to address terms for a potential commercial arrangement for its processing of the City's MSW but made no mention of its disagreement respecting the alleged commencement date of January 28, 2000 for the second three-year term.

[52] Although further correspondence between the parties occurred in March and April of 2001 on various aspects of their dealings, there was no mention by either of them about the alleged commencement date of January 28, 2000 for the second three-year term.

[53] However, by letter dated May 2, 2001, Subbor informed the City that Subbor would not accept the alleged commencement date of January 28, 2000 until certain issues between the City and Subbor could be resolved. Such "issues" included, among other things, alleged lack of co-operation between the staff of the plaintiff's Wet/Dry Facility and of Subbor at the Site.

[54] By letter dated May 11, 2001, Subbor forwarded to the City a draft amending agreement for the '98 Agreement. The amendments included, among other things, a change in the term of the '98 Agreement, extending it to 10 years rather than the original three-plus-three years in the 1998 Agreement, plus a 10 year option upon certain conditions.

[55] At a City council meeting on June 4, 2001, representatives of Subbor appeared and spoke to Subbor's desire to have a more extensive agreement or a longer term than the period in the '98 Agreement. In the result, council directed that the matter of any amending agreement be referred to its Planning Works and Environmental (PWE) Committee for consideration and report.

[56] By report dated June 25, 2001, City staff recommended a short-term agreement to have Subbor process the City's MSW, concluding December 31, 2001, with the costs of such agreement to be within the City's approved 2001 operating budget on the basis such agreement was not to be treated or regarded as an amendment to the '98 Agreement. The staff report of June 25, 2001 was adopted by the PWE Committee at its meeting of the same date.

[57] On July 9, 2001, City council authorized staff to negotiate a short term agreement for processing the City's MSW, adopting the recommendations of the PWE Committee.

[58] At this time, in recognition of the issues in dispute and the difficulties in negotiations between the parties respecting both the short-term agreement and their long-term relationship arising from the '98 Agreement, the parties agreed to engage an external facilitator to assist them in addressing their problems. A facilitator was hired by the City with the consent of Subbor.

[59] As previously mentioned, facilitated discussions took place July 31, October 15 and November 30, 2001, without resolution of significant issues in dispute.

[60] On or about November 30, 2001, a conference call took place between representatives of the City and representatives of Technical Partnership Canada (TPC), one of Subbor's funding agencies. The City received information as to the extent of TPC investment in Subbor to that date and that TPC was not inclined to make any further grants to, or investments in, Subbor.

[61] In December, 2001, the City received information that the Federation of Canadian Municipalities (FCM) through its Investment/funding arm was considering loans or grants to Subbor. A representative of F.C.M. requested a meeting with City staff to discuss the Subbor project. In due course, communications and correspondence took place but without resolution of outstanding disputed matters.

[62] On February 8, 2002, the M.O.E. issued an order to Subbor under the *Environmental Protection Act* directing Subbor to obtain a ventilation study of the air management system involving the Site and the City's composting building. This order was revoked on February 21, 2002 in order to accommodate a proposed meeting to deal with the air management issues.

[63] In mid-February, 2002, the City imposed a "dump-lock" on Subbor, that is, Subbor was denied access to the City's tipping floor for delivery and handling of MSW. The reason for the dump-lock was Subbor's non-payment of the City's invoices for fees and charges under the '98 Agreement. The dump-lock was, however, lifted by the City on March 11, 2002 upon Subbor's paying these invoices.

[64] On March 7, 2002, the MOE issued a non-compliance order against the City relating to air management issues. In effect, this Order stated that the addition of the Subbor facility's air product to the City's biofilter systems for dealing with air quality/contamination necessitated amendment of the City's Certificate of Approval – Air ("CA-Air") issued by M.O.E. The order required the City by March 20, 2002 to return to compliance with its CA-Air.

[65] The City took remedial steps in obtaining ventilation studies by consultants. Discussions took place between the parties respecting the recommendations from the consultants for remedial measures without the City having to amend its CA-Air. In due course, a recommendation of the consultants that was acceptable to the parties satisfied M.O.E. and the order was revoked.

[66] In April, 2002, City staff were preparing a report to council relating to MSW management options for the budget period beginning August 31, 2002.

[67] By letter dated April 10, 2002, City informed Subbor that if there was to be an agreement for Subbor's handling of the City's MSW, such agreement would have to be reached on or before August 1, 2002.

[68] By end of April, 2002, as the facilitated negotiations for the agreement had not been successful, the City's position remained that the governing agreement between the City and Subbor was the '98 Agreement. In a report on the status of the '98 Agreement prepared for the PWE Committee, the Commissioner of Environment and Transportation (J. Laird) opined, among other things, that Subbor was not in compliance with its obligations under the '98 Agreement and that Subbor had not adequately demonstrated the viability of the Technology in accordance with its objectives in the '98 Agreement. In addition, the report informed the PWE Committee that the City had issued a letter to Subbor informing Subbor of the City's position respecting these concerns.

[69] By its letter dated May 9, 2002, the City stated that Subbor was in default of at least two of the conditions in Article 4(2) of the '98 Agreement and that unless Subbor complied with the two conditions, the City would treat the '98 Agreement as being at an end effective January 28, 2003. This letter enclosed the following items:

(1) the report of the City's auditors stating there were no savings to the City as identified in the '98 Agreement;

(2) a memorandum by the City's Wet/Dry Plant superintendent setting out alleged acts of non-compliance by Subbor with the '98 Agreement; and

(3) the report by J. Laird to the PWE Committee setting out the status of the '98 Agreement.

[70] On May 9, 2002, the City issued a press release indicating that in the future, it would be processing its own MSW independently of Subbor.

[71] By letter dated May 10, 2002 from Subbor to the City, Subbor disagreed (among other points) with the City's position as to the expiry date of January 28, 2003 and the City auditor's conclusions as to no identifiable savings to the City in accordance with the '98 Agreement.

[72] On May 13, 2002, the PWE Committee adopted the staff report on the status of the '98 Agreement and directed staff to notify Subbor accordingly.

[73] On May 21, 2002, City council confirmed and adopted the above position of the PWE Committee respecting the termination date of the '98 Agreement in accordance with the staff report.

[74] By letter dated May 27, 2002 from the City to Subbor, Subbor was formally notified of the City's position.

(c) *May 22, 2002 through July 31, 2003*

[75] On or about May 22nd, 2002, a meeting took place between representatives of the City and Subbor in relation to the City's position set out in its letter dated May 9, 2002. The purpose of the meeting was to have Subbor respond to the City's position. Subbor reiterated its disagreement with the City's alleged termination date of January 28, 2003 and in the course of discussions about other things, raised the possibility of Subbor taking legal proceedings if the City purported to terminate the '98 Agreement on January 28, 2003 before Subbor had completed the demonstration project.

[76] In July of 2002, the City and Subbor continued discussions respecting Subbor's proposed peat test, from time to time engaging inputs from MOE respecting the test protocol and in particular, MOE's requirements for air management issues arising from the proposed peat test. By e-mail dated August 21, 2002, MOE gave notice to the parties of its requirements for the proposed peat test by Subbor.

[77] Throughout the autumn of 2002, negotiations continued relating to: (a) Subbor's proposals for F.C.M. funding; and (b) finalizing the peat test protocol to the satisfaction of the City, Subbor and MOE.

[78] On September 3, 2002, City Council passed resolutions: (a) awarding a design/build contract for $5,097,411.00 for modifications to the City's Wet/Dry

facility; and (b) approving the conversion of the residential waste sorting practice from a two-stream to a three stream program.

[79] By letter dated September 4, 2002, Subbor acknowledged the City's modifications, stating such modifications would impact Subbor's program but reserved details of any impact until it was able to "see the details of these changes".

[80] By letter dated October 18, 2002 the City referred to its correspondence to Subbor from May 9, 2002 to date on the continuing dispute as to the status of the '98 Agreement, the conditions under which the City would consider entering into a new and separate agreement with Subbor and the termination date of the second three-year term under the '98 Agreement. By responding letter dated November 12, 2002, Subbor stated that the *force majeure* clause in the '98 Agreement operated to extend the term of the '98 Agreement in light of the difficulties in the demonstration project and that Subbor considered itself to be in full compliance with its obligations under the '98 Agreement.

[81] In its reply by letter dated December 11, 2002, the City expressly denied the validity of Subbor's position respecting the *force majeure* clause and again set out its position that January 28, 2003 was the expiry date of the second three-year term of the '98 Agreement.

[82] By letter dated December 24, 2002, Subbor reiterated its position that January 28, 2003 could not be the expiry date of the '98 Agreement, that the *force majeure* clause under the '98 Agreement had been engaged in the enumerated circumstances and that the City had been in breach of its obligations under the '98 Agreement.

[83] At its meeting on January 20th, 2003, City council by resolution adopted the recommendation in the PWE Committee report that termination date of the second three year period under the '98 Agreement was January 28, 2003. By the City's letter dated January 27, 2003, Subbor was formally notified of Council's resolution adopting January 28, 2003 as the termination date.

[84] By its letter dated March 6, 2003 to Subbor, the City requested a copy of Subbor's decommissioning plan in accordance with provisions of the '98 Agreement and stating, in default of receipt of the decommissioning plan, the City would deny Subbor access to Site. At Subbor's request, a meeting was arranged and held between representatives of the City and Subbor in relation to the City's notification of its requirement for Subbor's decommissioning plan, however no resolution of the issues were obtained.

[85] By its letter dated April 2, 2003 to Subbor, the City confirmed its imposition of a dump-lock on Subbor, i.e., no further access to the Site, but indicated it was prepared to assist in Subbor's decommissioning operations.

[86] In mid-April, 2003, the parties corresponded in relation to the F.C.M. funding proposal initiated by Subbor. However, due to inability of both parties to obtain clarification on their respective positions respecting the F.C.M. funding proposal, the proposal was never the subject of staff recommendations to City Council.

[87] On May 5, 2003, City Council adopted the recommendations in a staff report that the City institute legal proceedings to obtain a court declaration as to the termination date under the second three-year term in the '98 Agreement.

[88] At the June 2, 2003 council meeting, a representative of Subbor requested that the dump lock, i.e., the denial of access by Subbor to the Site, be lifted pending consideration of the F.C.M. funding proposal. Council did not accede to this request.

[89] On June 18, 2003, the City initiated an application for a court declaration as to the termination date under the '98 Agreement, plus other relief. By letter dated the same date, Subbor confirmed its proceeding to decommission the Demonstration Plant but affirmed its disagreement with the City's position as to the termination date and informed the City of its claim for damages against the City.

[90] Through the balance of June and into the first week of July, 2003, the City and Subbor continued to investigate through correspondence possible resolution of their differences through F.C.M. funding.

[91] By letter dated July 11, 2003 addressed to counsel for the City, counsel for Subbor provided its draft Application Record disputing the City's alleged termination date of January 28, 2003; alleging breaches by the City of the '98 Agreement and claiming damages in respect thereof in excess of $30,000,000.00.

[92] By letter dated July 16, 2003, counsel for the City proposed that Subbor would have access to the Site for processing waste pending court proceedings, on a without prejudice basis in relation to the termination date issues. By letter dated July 18, 2003, counsel for Subbor declined the City's proposal on the basis that to accept the same would entail significant expense in recommissioning its facility and that unless the City was prepared to assume such expense, Subbor would not incur that expense in the absence of an "overall resolution of the outstanding issues. The proposed arrangement never came to fruition.

**ISSUES**

(1) Whether the receipt and processing by Subbor of approximately 30 tonnes of MSW on January 28, 2000 was the start date for the second three year period pursuant to Article 4 of the '98 Agreement?

(2) Whether the City, through the actions of its staff, breached its obligations (or any of them) under the '98 Agreement?

(3) Whether the City was under an implied duty of good faith in the performance of its obligations under the '98 Agreement?

(4) If the City is found to be in breach of its contractual obligations, or any of them, or its implied duty of good faith in performing its contractual obligations, what is the measure of damages (if any) arising from the breaches, *vis-à-vis* (a) Subbor and (b) E.P.?

(5) If the City is liable in damages to Subbor and/or EP, does the City have a right of indemnity against EP for damages to Subbor, pursuant to EP's proposal forming part of the '98 Agreement?

**ANALYSIS**

*The gist of the City's position*

[93] By operation of s.4(1) of the '98 Agreement , the first three-year period of the '98 Agreement expired on January 28, 2000, on the basis of Subbor's receipt on that date of 30 tonnes of MSW.

[94] By the termination date of the second three-year period on January 28, 2003, Subbor had not successfully demonstrated its technology and had also failed to comply with conditions in the '98 Agreement that would have further extended the term of the '98 Agreement.

[95] In any event, Subbor incurred no compensable financial loss in relation to its demonstration of the technology, since its expenses in the demonstration project were covered and made on its behalf by EP.

[96] In the alternative, if there are any damages payable to Subbor, its claim in excess of $30,000,000.00 is grossly overstated.

*The gist of Subbor's position*

[97] Subbor's receipt of approximately 30 tonnes of MSW on January 28, 2000 did not trigger the commencement date of its technology demonstration, having regard to the intention of the parties and the nature of the project. January 28, 2000 was simply the date of the first action by Subbor in commissioning the Front End of its Demonstration Plant.

[98] Subbor's actions which triggered the commencement of its demonstration project took place on October 30, 2001, being the start date of the second three-year term which terminated on October 30th, 2004, approximately 20 months after the January 28, 2003, the termination date alleged by the City.

[99] In addition, Subbor contends the City breached its obligations under the '98 Agreement in various respects, including (a) the imposition of development charges on Subbor which caused a delay in the connection of its Demonstration Plant to the Guelph Hydro power grid by imposing a dump lock in February of

2002; (b) denying Subbor access to the City's composting facility; (c) withholding technical reports from Subbor in possession of the City; and (d) generally failing to cooperate with Subbor and perform its obligations in good faith.

[100] Subbor states the provisions of the '98 Agreement, particularly in Article 4, should be interpreted in the context of the purpose and subject-matter of the '98 Agreement to arrive at the appropriate commencement date for the second-three year period. Subbor's receipt of the 30 tonnes MSW on January 28, 2000 was solely for the purpose of commissioning the Front End. The City's position that such delivery and receipt constituted the triggering event under s. 4(1) of the '98 Agreement for the second three-year term is untenable and would lead to an absurd or irrational result. The Demonstration Plant's components were not ready on/about January 28, 2000 to begin the demonstration project.

[101] Subbor's damages in excess of $32,000,000.00 are reliance interest damages and not expectation interest damages, even though Subbor's position is that the actions of the City under the '98 Agreement have effectively destroyed any prospects of the commercial success of Subbor's technology.

## ANALYSIS

Whether the start date of the second three-year period for Article 4 of the '98 Agreement was January 28, 2000?

[102] The answer to this question essentially focuses on the proper interpretation of Articles 1(2) and 4(1) of the '98 Agreement.

[103] Initial regard must be had to the provisions of Article 4(1), the full text of which appears above. The operative words for this part of the analysis are as follows:

> Should the Demonstration Plant accept MSW Feedstock within the first three years of this lease...

[104] Article 1(2) is also set out in full, above, and the operative words therein are as follows:

> "Demonstration Plant" shall mean any and all equipment required for a facility to demonstrate the Subbor Technology and any associated structures...and other related equipment as deemed appropriate and supplied by the Company [Subbor] to demonstrate their Subbor technology.

[105] There is no question that the commencement date, pursuant to the definition in Article 1, was the date of execution of the '98 Agreement, namely, November 6, 1998, and that 30.79 tonnes of MSW Feedstock within the meaning of Article 4(1) was supplied to Subbor at its facility on January 28th, 2000.

[106] The neat issue here is whether the delivery and receipt of MSW Feedstock to Subbor at the facility on January 28th, 2000 was delivery to and "acceptance" of the "Demonstration Plant" within the meaning of the defined terms.

[107] The City contends that the delivery of this MSW Feedstock to Subbor was the triggering event, i.e., the commencement of or start date of the second three-year period even if such MSW Feedstock was then being used solely for purposes of commissioning the Front End of the Demonstration Plant.

[108] Subbor contends that the reference in Article 4(1) to the Demonstration Plant accepting MSW Feedstock of necessity requires engaging in Article 4(1) the operative words in the definition of Demonstration Plant in Article 1(2) and that the 30.79 tonnes accepted by Subbor on January 28, 2000, were solely for purposes of commissioning or testing the Front End of the Demonstration Plant. Accordingly, Subbor submits that the triggering event under Article 4(1), i.e., delivery and acceptance of MSW Feedstock, could only be regarded as properly engaged when "...any and all equipment required...to demonstrate the Subbor Technology" was in place and "deemed appropriate...by Subbor to demonstrate its technology."

[109] In response to this submission, the City points out that such an interpretation requires the court to insert into the language used in Article 1(2) the

words "substantial completion" referring to the components and equipment comprising the Demonstration Plant, since those words are absent. The City submits this flies in the face of the fact that as of October 30, 2001, being the day Subbor alleges the Demonstration Plant was in "demonstration mode", i.e., operating on a continuing basis, Subbor had over 150 days accepted delivery of approximately 2,670 tonnes of MSW, which amount constituted just over 70% of all the MSW that Subbor ever received at the Site.

[110] The City also takes exception to Subbor's position that pursuant to Article 1(2), the Demonstration Plant is not engaged for purposes of Article 4(1) i.e., accepting MSW Feedstock, unless and until the structures and related equipment for Subbor's facility are "deemed" appropriate and supplied by the Company [Subbor] to demonstrate their Subbor Technology." In this regard, the City's position is that such a construction would effectively nullify the triggering event concept contemplated in Article 4(1). In effect, such a construction would create a wholly subjective criterion for establishing the incidence of the triggering event.

[111] The difficulty in establishing such a subjective criterion is highlighted by the absence of any form of communication, written or otherwise, by Subbor in support of its position that the "deeming" of the Demonstration Plant under Article

1(2) took place on October 30th, 2001, being Subbor's position as to the effective start date of the second three-year period.

[112] In sum, Subbor's theory as to the "deeming" of the Demonstration Plant for purposes of engaging the triggering event in Article 4.1 is not tenable and I reject the same. However, this rejection does not dispose of the question of whether the delivery to, and "acceptance" by, Subbor's "Demonstration Plant" of MSW Feedstock of 30.79 tonnes on January 28, 2000 constituted the triggering event. At this stage, the focus must be on the basic principles engaged in the interpretation of contracts.

[113] Both parties refer to the following principle in *Venture Capital U.S.A. Inc. v. Yorkton Securities Inc.* (1995) 75 O.R. (3d) 325 (OCA):

> The cardinal rule of contract interpretation "is that the court should give effect to the intention of the parties as expressed in their written agreement", and where the intention of the parties "is plainly expressed in the language of the agreement, the court should not stray beyond the four corners of the agreement"; *KPMG Inc. v. Canadian Imperial Bank of Commerce* [1998] O.J. No. 4746 (C.A.), at para. 5, leave to appeal refused...*Indian Molybdenum Ltd. v. R.*, [1951] (3d) D.L.R. 497 (S.C.C.) at p. 502; *Eli Lilly and Co. v. Novopharm Ltd.* [1998] 2 S.C.R. 129, at p. 166-168.

[114] Subbor submits that the above principle may be departed from by the courts if its application in the circumstances of the case would result in a commercial absurdity. Subbor contends that in the event of an interpretation resulting in a commercial absurdity, the court can go beyond the words used in the contract and look at the surrounding circumstances and the course of dealings between the parties to see what the parties intended. In support of

these propositions, Subbor refers to G.H.L. Fridman, the *Law of Contract in Canada*, 4th Edition, 1999 at pages 477-478 [5th edition, p. 455]. The above reference in Fridman, following the words "commercial absurdity", is as follows:

> In such a situation, there is a patent ambiguity and the court can go beyond the words and look at the surrounding circumstances and the course of dealing between the parties, if any, to see what the parties intended (My emphasis).

[115] On my reading of the full extract, it appears the author intended the words "commercial absurdity" as having the effect of creating a patent ambiguity. On my view of the evidence, there is no patent ambiguity in the subject words in Article 4(1) of the '98 Agreement. In a similar vein, the delivery of and acceptance by Subbor of MSW Feedstock for its Demonstration Plant, even referring back to the definition of Demonstration Plant in Article 1(2), is not limited or more specifically defined so as to exempt the delivery and acceptance of the MSW Feedstock solely for purpose of operating the Demonstration Plant as a unitary whole.

[116] Subbor further submits that the delivery and acceptance on January 28th, 2000 of 30.79 tonnes of MSW Feedstock occurred at a time when it was commissioning only the Front End of its Demonstration Plant. However, this position is at odds with representations made by Subbor to municipal authorities as well as trade journals/magazines that its Demonstration Plant was operating as of January 2000, namely, that it had commenced operations in January 2000

and that MSW was to be received in early 2000 with commissioning being completed by Spring of 2000.

[117] Having regard to these representations and the fact of the delivery and acceptance of MSW Feedstock on January 28th, 2003, Subbor's theory that the effective start date of the second three-year period was November 6th, 2001 is not tenable in terms of the evidentiary record. Records reflecting deliveries of MSW Feedstock to Subbor indicate that no MSW was accepted by Subbor on November 5, 6, or 7, 2001. In such event, the basic triggering event set out in Article 4(1) of the '98 Agreement could not have been engaged on any of those dates.

[118] Subbor's final position with respect to January 28, 2000 not being the effective start date for the second three-year period is that the provisions in Article 16 of the '98 Agreement relating to *force majeure* events were engaged and effectively extended the first three-year period of the '98 Agreement and thus the start date of the second three-year period. Even if it is a tenable proposition that the technological problems and difficulties (which will be described in detail hereafter) were "...causes beyond the reasonable control of the Company [Subbor]...", the City submits the provisions in Article 16 governing the application of the principle of *force majeure* suspend the obligations imposed on the parties.

[119] The City refers to the text of Article 16 as follows:

> This Agreement and Lease [the '98 Agreement] shall remain in full force and effect during any suspension of any of the Company's [Subbor's] or the City's obligations of this section ...

[120] The City contends that in light of these unequivocal terms, the engagement of Article 16 of the '98 Agreement cannot in law extend the term of the first three-year period under the '98 Agreement.

[121] I agree. In sum, there is no basis, either in law or on the evidentiary record, to depart from an interpretation of the ordinary and literal meaning of the words "Demonstration Plant accept MSW Feedstock within the first three years of [the '98 Agreement]". I accordingly conclude that January 28, 2000 was the start date for the second three-year period pursuant to Article 4 of the '98 Agreement.

How much time was required for completion of Subbor's demonstration project?

[122] As the start date for the second three-year period pursuant to Article 4 of the '98 Agreement was January 28, 2000, the expiry date was January 28, 2003. It is not in dispute that Subbor's demonstration project had not been completed at that date, and accordingly the inquiry must then focus on the amount of time required for its completion.

[123] As indicated in the Introduction, any discussion as to the problems encountered in the Subbor technology and Demonstration Plant are not to be construed as findings or conclusions as to the ultimate viability of that technology.

[124] The salient issue in this aspect of the case is whether the difficulties encountered in the technology and the Demonstration Plant were of such nature and magnitude as to require more time to rectify than would have been available under either of the expiry dates for the '98 Agreement alleged by the parties, i.e., in the case of the City, January 28th, 2003, and in the case of Subbor, October 30th, 2004.

[125] A veritable Niagara of expert evidence on Subbor's technology and its application in the Demonstration Plant has been adduced by both parties. There was particularly detailed examination and analysis of the various problems that arose in the course of the demonstration project.

[126] To facilitate the examination and analysis of the problems, a brief outline as to the working concept of the Subbor technology is appropriate.

[127] The experts for both parties were agreed that the novel aspect of the Subbor technology as a process for MSW management was the use of a two-stage anaerobic digestion of feedstock with intermediate steam explosion. Anaerobic digestion is a biological process which utilizes bacteria in order to

break down organic matter in the absence of oxygen, the process being performed in a closed vessel. Although steam explosion is a known technology, it had never previously been used in conjunction with anaerobic digestion for MSW management.

[128] There is no dispute that a reliable and properly functioning heat treatment unit (HTU) was essential for the success of the Subbor technology. In essence, the Demonstration Plant for purposes of establishing a successful demonstration had as its key element the HTU and the HTU had to be shown to operate regularly, reliably and for extended periods of time without interruption. The record shows that although Subbor accepted the delivery of 30.79 tonnes of MSW on January 28th, 2000, there were significant delays in the development and operation of the HTU; the initial testing of the HTU as a steam exploder did not begin until February 2002.

[129] This fact flies in the face of the testimony of Mr. Larmour, Subbor's project manager, that he "deemed" the Demonstration Plant to come into existence on or about October 30th, 2001. It strains credulity to accept that the Demonstration Plant had been "deemed" into existence approximately three months before an essential and integral component of the Demonstration Plant, i.e., the HTU, had begun initial testing, let alone regular, reliable and continuous operations as part of the whole system comprising the Demonstration Plant.

[130] Although Subbor's operations records for the Demonstration Plant establish numerous runs, i.e., operation, of the HTU from January 2002 through December 2002, these records reveal significant problems in achieving a reliable and continuous operation for the HTU: see Exhibit 1, Vol. 41, Tabs 2574, p. 5; 2691 p. 2; 2700 p. 2; 2706 p. 2; 2708 pp. 3-4; 2709, p. 1; 2710, p. 18; 2711 p. 4 and p. 21; 2713, p. 2; and 2719, p. 4.

[131] In the aftermath of the above problems with the initial HTU, Subbor proceeded to design, construct and install a "new" HTU; however, the testing of the new HTU for a three day period in July 2003 did not resolve the problem of establishing a regular, reliable and continuous operational run.

[132] In the end, Subbor's Project Manager (Mr. Larmour) met with Subbor's technical expert (Mr. Campbell) on these issues in June of 2005. At the meeting, Mr. Campbell made notes which are telling in terms of Subbor's concerns that the HTU system in place might never function according to Subbor's expectations. These notes are reproduced in part, below:

> - HTU – Nothing since HTU July 03
> - still some pluggage – problems in strainer
> - still needs some modifications – probably three to six months to prove it worked
> - if not successful go to a batch system – probably three months to perfect <u>or other alternatives</u>
>
> [My emphasis]: Exhibit 20, pp. 2 and 3.

[133] The HTU component of the Demonstration Plant, though the essential and crucial element in the whole system, was not the only system or component

in the Demonstration Plant that presented problems. The "Front End", i.e., the MSW feed preparation system, presented ongoing problems of a significant nature in relation to some articles in the MSW Feedstock such as plastics not being recoverable as recyclable material and in fact causing malfunctions by pluggages in the system.

[134] The significant part of this and other difficulties in the non-HTU components of the Demonstration Plant, (namely, the primary digester feed pump and extraction components, the "Back End" components and energy recovery component) are reflected in the fact that its operation runs were never of a sufficient capacity to meet a processing standard of 25,000 tonnes of MSW on an annual basis. To achieve this performance standard, the plaintiff's expert (Mr. Burrowes) indicated in reference to the Front End of the Demonstration Plant, that Subbor would have to achieve a rate of 7.5 tonnes per hour through the Front End components on a daily operating basis of 16 hours, or 3.8 tonnes per hour on a daily operating basis of 24 hours. See Exhibit 19A, Burrowes Report, p.2, Table 1.

[135] Subbor's records show that in 2002 the average hourly rate for the Front End component was 2.6 tonnes per hour: Exhibit 1, Vol. 42, Tab 2719, p. 20.

[136] At this point, I address the issue of the weight to be accorded the evidence of the experts for both the City and Subbor on these issues. I accept the evidence of the City's experts over the evidence of the expert for Subbor, Mr. Campbell, for the reason that a substantial part of Mr. Campbell's opinions and conclusions are based on information supplied to him by the Project Manager, Mr. Larmour. Mr. Campbell's opinions founded on this basis in most instances do not rely on his independent assessment of many of the records Subbor had compiled on various issues. In that regard, the position of the City's experts on these issues are backed up by Subbor's experience reflected in its records as opposed to the representations that EP had been making for purposes of obtaining its tax savings and credit objectives.

[137] These representations were made by Subbor to TPC as well as to FCM in seeking funding in July of 2002. The representations include, among other things, the following statements:

> "plant commissioning is complete"; ..."operations of all aspects of the plant have been completed"; ..."continuous operation of the plant has been achieved and final adjustments...initiated to obtain optimized steady state operational data for mixed MSW". Exhibit 1, Vol. 19, Tab 1406, p. 132.

[138] Subbor's witness, Mr. Holbein, acknowledged that Subbor had not achieved continuous operation of the plant but rather of individual units only, and the demonstration project had not reached the point where significant amounts of waste were being processed. On the crucial aspect of continuous operation,

Subbor in its letter to the City dated May 10, 2002 Subbor made the following statement:

> Our [Subbor] demonstration of the technology is proceeding well at this stage and we are now obtaining results from continuous full processing of MSW: Exhibit 1, Vol. 17, Tab 1261.

[139] In cross-examination as to his use of the word "continuous" in this letter, Mr. Holbein said that the word "continuous" did not mean everyday, but referred only to availability over a period of time. He also accepted in cross-examination that it would be possible to describe Subbor's operation runs of equipment as being "sporadic". He further asserted that the words "full processing" in his letter meant aspects of full processing. I dismiss his testimony as an exemplar of semantic subterfuge: Subbor's evidence through this witness on its Demonstration Plant being in a continuous operation state at the material time is of no weight.

[140] In the result, I conclude that the various components and systems in the Demonstration Plant during the material time never operated as an integrated whole on a regular, reliable and continuous basis sufficient to meet the performance standard of 25,000 tonnes on an annual basis.

[141] The question which now presents is: how much time would be required to complete the demonstration project?

[142] The City's experts, Messrs Anderson and Burrowes, opined that Subbor would require a further period of approximately three years, i.e., 34 to 40 months, to perfect the components/equipment of the Demonstration Plant and a demonstration period for an additional period of 12 months. These experts opined that a demonstration period of 12 months would be necessary to satisfy municipalities and any other risk-averse prospective customers that the requisite quality and performance standards were achievable on a regular, reliable and continuous operation at the Demonstration Plant.

[143] Subbor's expert, Mr. Campbell, opined that the necessary remedial work for the Demonstration Plant could be completed and a demonstration period of 12 months could be obtained within 19 months.

[144] The City submits that quite apart from an alleged disparity in the credentials of its experts *vis-à-vis* those of Subbor's expert, the opinions of the City's experts should be accepted over the opinions of the Subbor expert, for the following reasons.

[145] First, Mr. Campbell has not exercised the independence expected of an expert witness, pointing out that in terms of time estimates, he has relied wholly on the time estimates supplied to him by Mr. Larmour at their meeting on June 1, 2005.

[146] Second, Mr. Campbell has based his opinion on unrealistic assumptions such as a 24 hours/7 days operating scenario (24/7) and that this particular assumption is contrary to the reality inasmuch as the past experience from Subbor's records indicates that Subbor's components equipment could not handle such a level of service. In addition, the City's tip floor is used by the City as well as Subbor and thus not available 24/7, and finally that all the equipment was on the Site and operational as of March 2003, contrary to the facts as established in Subbor's records.

[147] Third, Mr. Campbell assumed all the new equipment in the Demonstration Plant and any necessary retrofits of existing equipment in the Demonstration Plant would work without difficulty.

[148] The City's experts opined that on the historical experience respecting the various components, it would not be realistic to assume the new equipment and retrofits would work without any difficulties and that such difficulties would impact on the required time frame.

[149] Mr. Campbell also assumes the MOE had approved Subbor's use of the City's compost facility for purposes of its peat-product testing. The City's experts point out that as of the date Subbor left the Site, there were no approvals by MOE in this regard.

[150] The City submits that in addition to adopting, without independent verification, information supplied to him by Mr. Larmour, Mr. Campbell failed to indicate this fact in his report. Such omission calls into question his neutrality and accordingly, his reliability as an expert witness. In a similar vein, the City refers to Mr. Campbell's omission of a step described in Subbor's Commissioning Manual. This step, described as "verification of the workings of the process", is addressed by the City's expert, Mr. Burrowes, in his Supplementary Report as requiring an additional time period of about six months: Exhibit 19B, Burrowes Supplementary Report, p.2, para. 3.

[151] In the circumstances, I accept the evidence of the City's experts and reject the evidence of Subbor's experts. Accordingly, I conclude that the additional time required for completion of the Demonstration project would be between 34 and 40 months and not 19 months as contended for by Subbor. In the result, the lease agreement having expired on January 28, 2003; even taking the lower range of the City's estimate of the required time for Subbor to complete the demonstration project, i.e. 34 months, I conclude the completion of Subbor's demonstration project could not have been achieved on or before the expiry date.

Whether City breached any of its obligations on the '98 Agreement

[152] As stated above, the position of Subbor in relation to this question is that the City breached the '98 Agreement: (a) by imposing development charges or fees on Subbor; (b) by denying Subbor access to the City's facility on different occasions; and (c) by failing to deliver various reports and data in the City's possession or control. Subbor further alleges that the City generally failed to discharge its contractual obligation of best efforts in cooperating with Subbor in the demonstration of its technology.

Development charges

[153] I turn to the issue of the City's alleged breach arising from its requiring from Subbor payment of development charges.

[154] Subbor contends that it had no obligation to pay development charges under either the '98 Agreement, the City's development charge by-law (D.C. By-law) enacted pursuant to the *Development Charges Act* (1997), S.O. 1997, as amended (the *D.C. Act*), or the *D.C. Act* itself. The '98 Agreement provides in Art. 5(1)(p) for one of Subbor's responsibilities as follows:

> **Art. 5(1)**
>
> (p) Ensure that the Company's [Subbor] complies with all federal, provincial and municipal laws including, but not limited to, zoning environmental, emissions, noise, labour etc.

[155] The *D.C. Act* is, self-evidently, a provincial law and the D.C. By-Law, also self-evidently, is a municipal law. However, Subbor's argument is that the D.C. By-law does not apply to lands owned by the City that are used for purposes of "the municipality or a local board thereof". In this regard Subbor refers to s. 3.3(a) of the D.C. By-law which provides:

> **S. 3.3**
>
> This by-law shall not apply to lands that are owned by and used for the purposes of:
>
> (a) the municipality or local board thereof.

[156] In support of this argument, Subbor contends that City's involvement in its demonstration project was of such a nature as to constitute the lands relating to its demonstration project within the meaning of the phrase "lands...used for municipal purposes of the municipality ...".

[157] In response, the City submits that as the '98 Agreement did not require Subbor to process a specified amount of the City's MSW and that Subbor in fact did process MSW from other sources including other municipalities, the Demonstration Plant on the lands was built to serve the purposes of Subbor in a demonstration of its technology and not any purpose of the City.

[158] Even if there was a benefit to the City in the use of its lands for purposes of Subbor's demonstration of its technology, I reject the proposition that such a benefit constitutes a "purpose of the municipality" within subsection

3.3(a). The primary or predominant purpose of Subbor's Demonstration Plant on the City's lands was to demonstrate the viability of its technology on a full-scale, rather than a lab-scale, basis.

[159] Subbor further contends that the *D.C. Act* exempts it from paying development charges. (In the event, Subbor paid under protest approximately $45,900 in development charges.) In this regard, Subbor relies on s. 2(4) of the *D.C. Act*, as follows:

> **S. 2(4)**
>
> A development charge by-law may not impose development charges to pay for increased capital costs required because of increased needs for any of the following:
>
> . . .
>
> 5. The provisions of waste management services.

[160] The City submits the above section does not apply since the City's imposition of development charges pursuant to the D.C. By-law was not for costs being incurred by the City providing for waste management services. The City acknowledges that a municipality may not levy development charges for increased capital costs it incurs pursuant to a D.C. By-law in relation to increased waste management services, but that prohibition does not apply to Subbor as a non-municipal entity. I accept the City's argument and conclude Subbor is not exempted under the D.C. Act from paying the subject development charges.

Third Party MSW tipping fees

[161] I turn now to Subbor's allegation that the City is in breach of the '98 Agreement by requiring Subbor to pay what are known as tipping fees in respect of third party MSW.

[162] The tipping fees in issue were levied in relation to MSW received from third parties or other municipalities. Subbor submits that (a) the '98 Agreement did not provide for the City charging it third party tipping fees; (b) the particularized "no cost" provisions (Article 30) of the '98 Agreement should be construed as to mean no increased cost to the City; and (c) the City has not established to Subbor's satisfaction that the City incurred any increased costs arising out of the third party tipping fees levied against Subbor.

[163] The City responds by indicating that the absence of a specific contractual provision concerning third party tipping fees does not affect the proper interpretation of the no costs provisions in Article 30 of the '98 Agreement. Article 30 provides as follows:

> **Art. 30 INTENTION OF THE PARTIES**
>
> For greater clarity and notwithstanding any other provisions in this Agreement and Lease, the parties acknowledge and agree that it is the intention and agreement of the parties that the City shall be responsible for no costs whatsoever related to, arising from or in connection with, either directly or indirectly, this Agreement and Lease or the Demonstration Plant.

[164] Subbor now seeks to nullify the unequivocal language of the no costs provisions in Article 30 by claiming the true intent of the parties was to relieve the City of any "incremental" costs, rather than any costs.

[165] The evidence indicates that in the autumn of 2000 through January of 2001, numerous discussion and negotiations took place between the parties on the costs to be incurred in handling third party MSW. The evidence also establishes that there was a reduction of the tipping fees that had previously been set by City council for processing third party MSW. Subbor reiterated its position that any charge for third party MSW tipping fee was in breach of the City's obligation, taking the position that the reference to no costs in Article 30 meant no net costs to the City.

[166] The City responds that such interpretation constitutes an amendment of the provisions of Article 30 of the Agreement and that a reasonable construction of the words used, having regard to the '98 Agreement as a whole in the circumstances, cannot support such interpretation.

[167] I agree. In the absence of Subbor's position being a reasonable interpretation of the provisions of Article 30, Subbor's position constitutes a purported amendment of the '98 Agreement as it relates to Article 30. In the absence of a written amendment, as required by Article 22 of the '98 Agreement, there is no basis for the position being put forward by Subbor as to the costs

provisions in Article 30 being no net costs to the City. I accordingly reject the allegation that the City was in breach of the '98 Agreement respecting the levying of third party MSW tipping fees payable to Subbor.

Synchronization issues, Guelph Hydro

[168] I deal now with the problems of synchronization of Subbor's electricity generation with Guelph Hydro's power grid.

[169] Subbor's position that the City is in breach of the '98 Agreement arising out of its actions and conduct which allegedly hindered and delayed Subbor's attempts to synchronize its electricity generators to the power grid of Guelph Hydro.

[170] This position arises from the negotiations between Subbor's representatives and representatives of Guelph Hydro in relation to an agreement providing for the interface between the proposed generating system of Subbor and the sale to Guelph Hydro of any electricity generated. In essence, Subbor claims that the City's representatives influenced the decision-making of the responsible officials of Guelph Hydro in Subbor's attempts to arrive at a functioning operational agreement with Guelph Hydro.

[171] In its submissions, Subbor makes much of the provision in the draft operations agreement for what were described as synchronization fees, contending that the provision for synchronization fees was a direct result of the overriding influence of the City in the decision-making of Guelph Hydro.

[172] In this regard, the evidence of A. Stokman, the then Vice-President of Engineering and Operations for Guelph Hydro, is instructive.

[173] Mr. Stokman testified, among other things, that he supplied a draft operations agreement with Subbor to the City staff for information purposes on the basis that the proposed connection to Guelph Hydro's power grid would have been made through the City's Wet/Dry facility at the Site. He affirmed and was unshaken in his testimony that:

(a) City staff gave no direction to Guelph Hydro concerning the content of the draft operations agreement;

(b) Guelph Hydro neither required nor obtained the consent or approval of the City before arriving at a final version of the operations agreement with Subbor.

[174] It was suggested to him that a representative of Subbor (Mr. G. Vogt) was told by the then President of Guelph Hydro, (Mr. J. MacKenzie) that Guelph Hydro was unable to proceed with the operations agreement and the connection of Subbor to the Guelph Hydro Power grid unless it got the "green light" from the City's representative, Ms. J. Laird. Mr. Stokman was present at the meeting in

which the purported comments by J. MacKenzie to G. Vogt were made. In his cross-examination, Mr. Stokman addressed that issue in the following terms :

> Q. ...You will agree that if the City wasn't giving the green light to allow the connection to be made then you, Guelph Hydro, would have to abide by the City's direction, right?
>
> A. The City never – they didn't give any kind of light. They weren't involved. If we wanted to synchronize before or after, if the operating agreement was signed two or three weeks before that, the City is not involved in that process. We – the City was depending on Guelph Hydro to ensure that there were appropriate relays, that protection and control was there and that there was a third party checking the relay settings. The City expected that U would do its job, and they never – they were never involved in giving us a green light or a red light or an orange light. They didn't tell us when to stop or when to start. [Emphasis added.]
>
> Q. All right. But as you say they were relying on Guelph Hydro to protect its interests, right?
>
> A. That's right. And we were protecting, we were protecting our interests and the flow of power with an operating agreement.

[175] I reject the evidence of Mr. G. Vogt; unlike Mr. Stokman, he made no contemporaneous notes of the meeting. It is difficult to fathom why Mr. G. Vogt, a business executive of some experience, would not have noted the purported comments by Mr. MacKenzie, in light of the difficulties Subbor was facing at the time.

[176] I accept the evidence of Mr. Stokman on this point: his contemporaneous notes of the meeting in question are of telling weight, in that there was no reference therein to any of the purported comments by Mr. MacKenzie.

[177] In sum, the evidence respecting the alleged intermeddling by the City in relation to the power grid connection issues between Subbor and Guelph Hydro fails to establish any breach of the City's obligations under the '98 Agreement.

February 2002 "dumplock"

[178] I now turn to Subbor's contention that the City's imposition of a dump-lock (denial of access by Subbor to the tipping floor) in February 2002 constituted a breach of the '98 Agreement.

[179] The position of Subbor is that the City's action in imposing the dump-lock was without either notice or justification, and the City ought to have awaited the outcome or results of the facilitated negotiations the parties had previously agreed to.

[180] The response of the City on this point can be simply stated. Subbor had declined to make payment on account of invoices rendered to it by the City under the'98 Agreement for hydro consumption fees, ground lease payments and third-party MSW tipping fees on a continuing basis throughout 2001. As of February 2002, the unpaid invoices totalled $22,885.50, consisting of $17,400.00 for outstanding ground lease payments (as far back as November, 1999) and $5,485.50 for third-party MSW tipping fees (as far back as November, 2000). On

the allegation that the dump-lock was imposed without notice, the evidence discloses two notices of warning, by letters issued in May and July of 2001 by the City, that it would take action with respect to unpaid amounts and that the dump-lock procedure had been the established remedy for dealing with unpaid accounts for services rendered by the City in relation to its Wet/Dry facility.

[181] Although Subbor paid $22,885.50 on February 28, 2002 to the facilitator (the coordinator of the facilitated discussions) for redelivery to the City, Subbor nonetheless contends the matter of the unpaid invoices should have awaited the outcome of the facilitated negotiations.

[182] I reject this contention as being without merit. The City had made it clear in the facilitated discussions that any possible new agreement did not release or discharge Subbor from any obligations to the City that it incurred in the operation of the '98 Agreement.

[183] In sum, there is no evidence of any breach by the City of its obligations under the '98 Agreement in relation to this complaint by Subbor.

[184] I turn now to Subbor's allegations of breach by the City relating to (a) the City's denial of access by Subbor to its composting facility, and (b) the City's withholding of technical reports obtained by the City dealing with air management issues.

Access to City's composting facility

[185] I will deal first with the denial of access by Subbor to the City's composting facility.

[186] The circumstances under which Subbor was prevented from obtaining access to the City's compost facility arise out of Subbor's failure to comply with its obligations under the '98 Agreement in obtaining the necessary approvals from the M.O.E. to introduce its peat-like product into the City's composting facility. The approvals in question included any necessary amendments to the City's C of A-Air issued by the M.O.E. that would have been necessitated by Subbor's proposal for processing its peat-like product: see Article 5(1)(d)(ptr); Article 7(2) and Article 8, of the '98 Agreement.

[187] It is not open to Subbor now to contend that it was the actions of the City which denied it access to the City's compost facility. An exchange of correspondence between the M.O.E. and Subbor in May of 1999 establishes that the M.O.E. branch in question indicated, and Subbor expressly recognized, that the transfer of Subbor's peat-like product into the City's composting facility could require an amendment to the City's C. of A-Air. This correspondence establishes that Subbor gave an undertaking it would proceed with the appropriate investigations and analysis or any changes that might arise out of its proposed disposition of its peat-like products through the City's composting facility. In the event, the failure by Subbor to proceed through a course of action leading to

amendment to the City's C. of A. for Subbor's purposes cannot be attributed to any act or omission on the part of the City.

Technical reports and air management issues

[188] I now turn to Subbor's allegations the City wilfully withheld relevant technical reports and data pertaining to the City's air handling system, with a view to not making adequate disclosure of any problems with the bio filter components of the City's air management systems that existed before Subbor's construction of its facility at the Site.

[189] In response, the City sets out the chronology of its disclosure of the technical reports, as follows:

(1) April 9, 1999; Subbor receives and makes a copy of a December 1998 report which, among other things, states that "the current facility does not have spare bio filter capacity": (Exhibit 1, Vol. 30, Tab 2179);

(2) April 9, 1999; Subbor receives two (R.W.D.I.) reports dated September 28, 1996 and May 30, 1997, respectively: (Exhibit 1, Vol. 30, Tabs 2164 and 2170);

(3) April 27, 1999; the City (per Ms. Laird) writes to Subbor advising that the City's air management system, including the bio filters, is operating at capacity (Exhibit 1, Vol. 5, Tab 148);

(4) March 5, 2001; the City (per Mr. Arndt) informs Subbor at a meeting on November 30, 2000 that R.W.D.I. (the City's retained consultant) had indicated that the confirmation of air volume being acceptable to bio filter capacity was in no way

an indicator that such bio filters could properly filter odours produced by Subbor and that if Subbor's air product caused problems with the bio-filters, then Subbor would be required to resolve those problems.

(5) September 2001; the R.W.D.I. reports described in Item 4, above, were provided to Subbor without charge. The City had previously asked Subbor to share in the cost of those reports, totalling approximately $13,000.00 on the basis the reports dealt with the effect of Subbor's operations on the City's air management system and that the '98 Agreement provided that Subbor's demonstration project was to be at no cost to the City. In the face of Subbor's refusal to share the costs, the City resiled from its position and supplied the reports on a free or without charge basis.

(6) July 19, 2002; the City provided three further reports to Subbor among which was an additional report from R.W.D.I. dated February 18, 2002. However, this report was of little consequence inasmuch as the M.O.E. order that had been outstanding against Subbor as of February 18, 2002 was revoked on or about February 21, 2002.

[190] I conclude from the above evidence that the City did not wilfully withhold relevant technical reports or data from Subbor in relation to the City's air management system and its capacity. Any necessary or appropriate information required for Subbor to deal with the impact of its operations on the City's air management systems was available to Subbor on a timely basis.

Obstruction/delaying the peat testing protocol/agreement

[191] I turn next to the allegation that the City acted in breach of its obligations under the '98 Agreement by hindering and delaying the implementation of the peat testing protocol designed to enable Subbor to process its peat-like product through the City's composting facility.

[192] Briefly, the chronology for the protocol and the operating agreement for the peat test is as follows:

(1) Subbor delivered its initial draft of the protocol on or about July 12, 2002;

(2) The M.O.E. in response notified Subbor and the City of its requirements on or about August 21, 2002;

(3) The preliminary draft of the operating agreement was delivered on or about September 24, 2002;

(4) The final draft of the protocol and operating agreement were completed and delivered to M.O.E. on or about November 7, 2002.

[193] The difficulty between the parties arose in October 2002 and related to costs associated with the peat tests.

[194] Subbor sought an estimate from the City relating to the peat testing costs, with a cap or maximum for the costs. The City had concerns as to the potential costs and did not wish to assume responsibility for costs of the peat test

which it considered were the responsibility of Subbor, pursuant to the '98 Agreement.

[195] In any event, the costs issues that arose in October, 2002 were resolved and both the testing protocol and operating agreement for the test were jointly submitted to M.O.E. on November 7, 2002.

[196] In mid-December of 2002, Subbor (per Mr. Holbein) informed the City that the peat testing could not be completed before the end of January 2003, i.e., the termination date of January 28, 2003 as alleged by the City, and requested an extension. Within three days of this request, the City (per Mr. Arndt) responded, informing Subbor that the City would not agree to an extension of the peat testing procedure "beyond the timeframe of the current partnership agreement" and that "any continuation of peat testing would have to be addressed in a new agreement between the City and Subbor": (Exhibit 1, Vol. 22, Tab 1666 pp. 2 and 3). This position was reiterated by the City (per Ms. Laird), on or about January 5, 2003, and confirmed in writing on January 10, 2003.

[197] The evidence does not establish that the City's acts or omissions hindered or delayed Subbor's peat testing through the City's composting facility. Any delay in the processing of Subbor's proposed peat test over the period from July to December 2002 arose from the dealings between Subbor and M.O.E.

[198] In sum, Subbor has failed to establish that the City has breached its specified obligations under the '98 Agreement.

The City's actions generally: bad faith?

[199] However, this does not dispose of Subbor's allegation that the City acted in bad faith with respect to its performance of its obligations under the '98 Agreement. The question here is whether there was an implied duty of good faith on the City in the performance of its contractual obligations.

[200] I note at the outset that as an overlay to its allegations of breach by the City of its specified obligations under the '98 Agreement, Subbor contends the City has generally acted and conducted itself in bad faith in relation to its obligations under the '98 Agreement.

[201] There is no express duty of performance in good faith on the City in the '98 Agreement.

[202] However, Article 3 of the Agreement, entitled "Subbor Demonstration Plant – Installation and Operation", sets out the following terms:

> **Article 3**
> (6) The City, on a best efforts basis, shall assist in the operation of the Demonstration Plant making available Wet-Dry Facility staff as requested by the Company [Subbor] ...
>
> (7) On a best efforts basis, the City will provide to the Company [Subbor], free of charge, any MSW Feedstock from the Wet/Dry Facility which the City is unable to sell or profitably process...

> (8) The City, on a best efforts basis, will assist the Company [Subbor] in marketing its products such as soil enhancer and plastics etc. [Emphasis added].

[203] Subbor has consistently throughout its submissions referred to the breach by the City of its duty of good faith in performing the '98 Agreement. In support of this position, Subbor describes various instances of the City's lack of good faith, one example of which is the City allegedly failing to exercise its best efforts in relation to its responsibilities under the '98 Agreement.

[204] In the absence of an express duty of good faith, the question is whether there is an implied duty of good faith. This question leads to more fundamental questions such as the following: What constitutes good faith? Is good faith an implied term of a contract or is merely an interpretive tool? How can the principle of good faith be reconciled with the inherently adversarial nature of contracts? (See *Good Faith in Contracts: A Continuing Evolution*, F. Morrison & H. Afarian, (2003) Annual Review of Civil Litigation 197, at p. 198.) In determining the nature of a duty of good faith, the authors pose the following question:

> Is the duty of good faith imposed by courts as a matter of law, despite the intentions of the contracting parties, or is it an interpretive principle which helps to give effect to the expectations of the parties? (Above article, p. 201).

[205] Although there are conflicting decisions from the provincial appellate courts, in Ontario the answer to the question appears to turn on the subject-matter of the contract. In *Shelanu Inc. v. Print Three Franchising Corporation* (2003), 64 O.R. (3d) 533 (O.C.A.), the court dealt with a dispute between a

franchisor and franchisee. In that case, the court found a duty of good faith existed at common law, but the basis for finding an independent or stand-alone duty of good faith appeared to be the nature of the franchisor-franchisee relationship. Notwithstanding this apparent grounding of the decision, the court concluded that a contracting party must exercise its discretion in a reasonable manner "under ordinary contract principles" (p. 563), and in the result, awarded damages in contract rather than a separate head of damages for breach of a duty of good faith.

[206] In *Transamerica Life Canada Inc. v. ING Canada Inc.*, (2003) 68 O.R. (3d) 457, (O.C.A.), the question arose in the context of alleged misrepresentations in a share purchase agreement. The court summarized the principles respecting the requirement of good faith in performing contracts in the following terms:

> ...Canadian courts have not recognized a stand-alone duty of good faith that is independent from the terms expressed in a contract or from the objectives that emerge from those provisions. The implication of a duty of good faith has not gone so far as to create new, unbargained-for, rights and obligations. Nor has it been used to alter the express terms of the contract reached by the parties. Rather, courts have implied a duty of good faith with a view to securing the performance and enforcement of the contract made by the parties, or as it is sometimes put, to ensure that parties do not act in a way that eviscerates or defeats the objectives of the agreement they have entered into: see *Gatx, supra*; *Greenburg, supra*; *Gateway Realty supra*: p. 468, para 53.

[207] Although the court in *Transamerica* noted that it was dealing with the issue in a pleadings motion rather than in a trial decision, I do not regard that distinction as altering the applicability of the enunciated principles to this case.

[208] Having regard to the subject matter of the '98 Agreement including the relationship created between the parties and specifically the obligation on the part of the City to use its best efforts relating to certain obligations on the City, a duty of good faith can be implied "with a view to securing the performance and enforcement of the contract made by the parties or...to ensure the parties do not act in a way that eviscerates or defeats the objectives of the agreement they have entered into".

[209] I now turn to an examination of Subbor's position.

[210] Subbor alleges that the City acted in bad faith i.e., failed to discharge its implied duty to act in good faith, in the following matters:

(1) requiring the payment by Subbor of development charges;

(2) requiring the payment by Subbor of third party MSW tipping fees;

(3) by hindering or delaying Subbor's connection of its electricity generating system to the Guelph Hydro power grid;

(4) by imposing the February, 2002 dump-lock i.e., denying Subbor access to the City's tip floor, in relation to Subbor's unpaid invoices for tipping fees, ground rental charges and other expenses that allegedly were Subbor's responsibility;

(5) by denying Subbor access to the City's compost facility and delaying disclosure of technical reports with respect to air management issues;

(6) by resorting to the media to publicize the status of Subbor's demonstration project, in response to Subbor's prior presentation to the media with respect to the same;

(7) by the City's letter dated May 9, 2002, setting out information on which City council had acted in confirming the termination date of the '98 Agreement and;

(8) by the City's imposition in March, 2003 of a dump-lock in response to Subbor's refusal to proceed with decommissioning of its facility on the Site, pursuant to Article 15 of the '98 Agreement.

[211] To succeed in establishing its allegations, Subbor must elicit evidence that the City "did not act in a way that eviscerates or defeats the objectives of the Agreement...". The onus is on Subbor to satisfy the court that the City acted in a manner that "eviscerate[d] or defeat[ed] the objectives of the agreement they have entered into." (ref. *Transamerica*, above).

[212] Reference has been made above to many of the specific areas in which Subbor has alleged breach by the City of obligations of the '98 Agreement and that Subbor has failed to establish that such breaches occurred. As to the City having breached its implied duty of good faith, Subbor has elicited no compelling evidence to establish that the City had acted in a way that "eviscerated or defeated" the objectives of the '98 Agreement. I find that delays or any other form of hindrance met by Subbor were occasioned by Subbor's acts or omissions; whether such acts or omissions related to dealings with the City directly, with the MOE directly or with the MOE and the City jointly, any delays or other hindrances did not have their genesis in any act or omission by the City.

[213] In the result, I conclude that there was no breach by the City of its implied duty of good faith in the performance of its obligations under the '98 Agreement.

## DAMAGES: ASSESSMENT

[214] Notwithstanding the conclusion that the City was not in breach of its obligations under the '98 Agreement, including any implied duty of good faith in the performance of its obligations, it is appropriate to assess Subbor's claim for damages.

[215] Subbor as plaintiff by counterclaim seeks damages of $32,409,267.00 plus an appropriate gross-up for taxes. However, in its written submissions, Subbor has adjusted the total cost in its ledgers according to the following table:

Subbor's adjusted costs

| | |
|---|---|
| (1) Total cost recorded to Subbor's ledgers | $35,377.00 |
| (2) Genco invoice | ($2,069,100.00) |
| (3) Labour relations and consulting | ($300,000.00) |
| (4) Double counting of wages | $136,704.00 |
| (5) Open balance correction | $37,303.00 |
| (6) Management cost relating to lawsuit | ($500,000.00) |
| (7) Revenues per Price Waterhouse, Cooper and ELCG Reports | $96,448.00 |
| (8) Equipment removed from site per Price Waterhouse Cooper Report | ($153,000.00) |
| Total adjusted costs (See Final Argument, Vol. 11, pp. 243-4, para. 793) | $32,159,819.00 |

Notwithstanding the total adjusted costs have been reduced by $249,448.00, representing about ¾ of 1% of the damages in the counterclaim, the assessment will use the counterclaim amount of $32,409,267.00 as the starting point.

[216] Before the above adjustment, the total costs recorded in its ledgers, was $35,377,768.00. These ledgers have separate entries for equipment, materials, supplies, and third party contract services, plus costs relating to direct labour. In the latter regard, the direct labour costs attributed by Subbor to the demonstration project comprise the cost of labour of (a) certain employees of EP who were employed on the Subbor project and (b) certain employees of Genco, another wholly-owned subsidiary of EP, which contributed personnel services in the construction phase of the Demonstration Plant.

[217] Subbor characterizes these as reliance interest, rather than expectation, damages, since the amount claimed is said to represent the losses incurred by Subbor i.e., the expenses relating to its project that were thrown away or "wasted".

[218] Subbor submits that approximately $6.3 million dollars of the total cost was derived from a loan to Subbor from TPC with the balance being funded by EP.

[219] Subbor's position is that an arrangement had been made between Subbor and EP relating to the expenses of the demonstration project, along the following general terms:

(1) All invoices issued to Subbor in relation to costs of the demonstration project were to be paid by EP on behalf of Subbor;

(2) EP's administrative services and personnel were available for use by Subbor in the demonstration project;

(3) The salaries of all employees working on the demonstration project would be paid by EP, such costs being charged to Subbor and booked on its expense ledgers;

(4) EP would use tax benefits relating to the demonstration project that could not be used by Subbor directly.

[220] Subbor further contends that under the arrangements between EP and Subbor, EP's payments relating to the demonstration project represented an investment by EP in the demonstration project, the repayment of which would be made upon Subbor generating revenues to fund such repayment.

[221] In response to this position, the City submits the expenditures made in relation to the development and operation of the Demonstration Plant were funded by EP and were not in law expenditures made by Subbor. The City contends that there is no credible evidence elicited by Subbor to establish that there has been either an equity investment or a debt investment by EP in Subbor in relation to the development and operation of the demonstration project. The

City contends that Subbor's position in this regard is flatly contradicted by the contemporaneous financial statements and tax filings of both Subbor and EP.

[222] Subbor's evidence on this point is based on the testimony of Mr. H. Vogt, Subbor's Vice-President. He testified that initially EPL regarded its payment of Subbor's costs in the demonstration project as an equity investment in respect of which EP anticipated a return; he stated that this equity investment had been concluded pursuant to an oral agreement between the principals of EP and Subbor although the oral agreement was never subsequently reduced into writing. He later in his evidence testified that EP's equity investment in Subbor was subsequently converted into a debt investment, i.e., a demand loan by Subbor to EP made at the time of September 30, 2003 financial statements for EP were being prepared.

[223] The City contends in response that the financial records of both Subbor and EP do not indicate an equity investment by EP in Subbor other than an initial $100.00 and no debt investment, i.e., loan payable by Subbor to EP in fiscal years 2003 and 2004. In support of this position, the City refers to extracts from EP's financial statements for the fiscal years ending September 30, 1999, September 30, 2000, and September 30, 2001. In each of these statements, EP shows an interest in a subsidiary (i.e. Subbor) of $100.00, reflecting a 100% ownership interest in Subbor. The City further points out that EP's financial

statements for fiscal years ending 2002, 2003, and 2004, for EP make no reference to any investment in Subbor.

[224] A further analysis of EP's financial statements for the fiscal years 1998 to 2004, inclusive, characterize the expenses incurred by EP relating to the demonstration project as "deferred development cost", indicating this cost item is an asset of EP and not Subbor.

[225] An examination of Subbor's tax returns and the supporting financial statements shows no support for the position that EP made an equity investment in Subbor to relating to the Demonstration Plant nor for the position that Subbor was the owner of the Demonstration Plant. The City submits that Subbor's income tax returns for fiscal years 1999 through 2003, both inclusive, which includes Subbor's balance sheets in each of the above fiscal years, show the value of assets as being $100.00 consistently throughout the five year period.

[226] As to any evidence to support the contention that the equity investment was converted to a debt investment in or about the year 2003, the City refers to EP's financial statements and Subbor's income tax returns for the fiscal years 2003 and 2004 which indicate no loan being shown on the EP balance sheet as owing from Subbor and no loan payable by Subbor being described in its supporting balance sheet for the 2003 income tax return.

[227] In the result, the financial statements and income tax returns for both EP and Subbor fly in the face of the testimony of the officers of EP and Subbor that there was initially a equity investment by EP in the Demonstration Plant on Subbor's behalf and that such equity investment was converted sometime in 2003 into a debt investment resulting in a form of demand loan payable by Subbor to EP.

[228] In these circumstances, I reject the submissions of Subbor. I conclude that Subbor has no expenditures in relation to the Demonstration Plant that are properly the subject of reliance interest damages in its counterclaim. I further conclude EP had title to and ownership in the Demonstration Plant (as indicated in its audited financial statements): (see asset entry described above as "deferred development costs"). The fact of this ownership as well as EP having filed for tax benefits pertaining to the project (see 2001 SR&ED Technical Reports, Exhibit 1, Vol. 44, tab 2742, p. 31, Declaration 7.2) further establishes as untenable Subbor's contention that it is entitled to recover as damages the expenditures of EP on the Demonstration Plant.

[229] Notwithstanding the above conclusion, if this court were to find that Subbor did incur losses that could properly be the subject of a reliance interest damages claim, the City contends that there are significant adjustments that must be made to the damages claimed by Subbor.

The City's comparative assessment of adjustments

[230] In the report (Ex. 26A-2) prepared by the City's expert, LECG, on damages assessment, there is a summary of the losses relating to Subbor's reliance interest damages claim. The summary sets out in a tabular format the comparative assessments for each of the adjustments to Subbor's damage claim by LECG for the City and by Price Waterhouse Cooper, for Subbor. The summary (with editorial amendments) is appended to these reasons as Schedule A as an aid to the following discussion of the adjustments. (The editorial amendments are deletions of reference to the notes in the LECG report; regard may be had to those notes for greater particularity if required).

[231] A perusal of the summary indicates that Subbor's damages ranges just over $1,000,000 to approximately $4,500,000.00 according to the City's assessment and approximately $14,250,000 according to Subbor's assessment. However, both damages amounts are acknowledged to be subject to any gross-up for taxes on the award and any amounts attributable to overruns and inefficiencies alleged by LECG.

[232] I turn to the adjustment items shown on the summary.

[233] The loan made by Technical Partnerships Canada (TPC) to EP is undisputed in the amount of $6,328,796.00. It is not in issue that the loan was to be repaid from gross business revenue generated from the commercial

application of the Subbor technology. Although acts of default were stipulated in the TPC loan agreement, it is also acknowledged that TPC has not issued a notice of any default nor has TPC demanded repayment. The City's position is that the TPC loan of $6,328,796.00 should be deducted in its entirety from the damages claim on the basis of the indeterminate term of the loan and the significant uncertainty that it will ever have to be repaid.

[234] Contrary to this position, Subbor's expert asserts that there should be no deduction of the loan amount on the basis TPC would be entitled to demand repayment of the entire loan and that it would exercise its right of repayment. However, Subbor acknowledges that there would be a tax benefit of $3,145,000.00 accruing to EP if the full amount of the loan were repaid.

[235] As noted, the TPC loan agreement required repayment of the loan out of the gross operating revenues upon the commercial application of the Subbor technology. There is no evidence at the time of trial that the Subbor technology had entered into a commercial application. For these reasons, I conclude the probability of repayment by Subbor of the TPC loan is insufficient to justify inclusion of the TPC loan amount as a component of Subbor's damages claim. The TPC loan amount is therefore deducted from the damages claim.

[236] The City further submits that an appropriate adjustment to Subbor's damages claims would be deducting the value of the retained technology. The

City's expert (Mr. Low) approached this aspect by using EP's 2004 tax return. From this tax return, it appears that a further $8,000,000.00 investment into Subbor's technology was being proposed. As there was no information as to possible future profits for the technology on which a model could be constructed to value the retained technology, the City's expert used as a proxy the proposed $8,000,000 investment sum, on the premise that a reasonable person would not invest more in any business venture than what that person believed on rational grounds it could recover.

[237] Subbor's expert's approach was that any increase in the value of the technology had been effectively eradicated as a result of Subbor having been unable to successfully complete the demonstration project, due (allegedly) to the City's acts or omissions. In response, the City points out that Subbor has retained a HTU and, more significantly, the intellectual property arising from its development.

[238] I accept the evidence of the City's expert.

[239] Accordingly, I conclude that there must be a further deduction from any damages award to Subbor. I fix this deduction at $6,000,000.00, being the minimum amount in the range set out by the City's expert.

[240] I turn now to the management labour cost issues.

[241] The City's treatment of the management labour costs component of the Subbor damages claim has two aspects. The first aspect contemplates deduction of $1,926,000.00 being the full amount of labour costs attributable to the three owners of EP (and indirectly) of Subbor, Messrs. H. Walter, G. Vogt and H. Vogt. The second aspect contemplates deduction of $682,000.00, being part of the compensation paid to the three owners.

[242] With respect to the first aspect, that is, the deduction of $1,926,000.00, the City's expert justifies the deduction of this amount on the following basis:

(a) Salaries paid to the three EP executives are non-incremental (i.e., these salaries constituted a fixed cost that would have been paid regardless of the Subbor project; and

(b) No information was presented by EP or Subbor to show that profits otherwise realizable were lost as a result of these executives being engaged in Subbor's demonstration project (see the City's Closing Argument, para. 371).

[243] In response, Subbor's expert states there should be no deduction for these salaries, either in whole or in part. Subbor's expert's position is that "the time the [three executives] spend on behalf of EP benefits [Subbor] at least as much as the cost spent on salaries": see Exhibit 26A, Price Waterhouse Cooper Report para. 56. On this basis, Subbor's expert opines there should be no deduction for the full amount of executive salaries. In reply, the position of the City is that no evidence has been adduced by Subbor to show that any

opportunity was lost as a result of the three executives being engaged on any Subbor matters.

[244] As to the partial deduction of executive salaries of $682,000.00, the City's experts rationalize this amount as a deduction on the basis that the management labour costs being claimed against the City are greater than the management labour costs actually incurred by EP. The City disagrees with the position of Subbor that a "reasonableness test" can be applied based on the assumption that Subbor's estimate of the time spent by the three executives on Subbor matters was correct, i.e. 75% of their time.

[245] The City's position is that the reasonable test has no relevance to the present case inasmuch as Subbor's claim is for actual expenditures and not reasonable expenditures based on estimates.

[246] In light of the absence of documentary support for the amount of time actually spent by the three executives on Subbor matters, I conclude the full amount of the management labour costs of $1,926,000.00 is an appropriate deduction from Subbor's damages claim.

[247] I turn now to the value of the equipment Subbor removed from the Site. The valuation by the City's expert for purposes of deduction from the damages claim is $295,000.00 whereas the valuation by Subbor is $153,000.00.

[248] The City submits that its expert's valuation should be accepted on the basis that a schedule of equipment that Subbor removed was not completed and that Subbor's valuation is based on an assumption that the salvage value of the equipment removed accurately represents the benefit to EP. In this regard, the City points out that HTU component of the Demonstration Plant, which was essential and of crucial importance to the Subbor technology, should have been valued on the value-to-owner approach rather than a salvage value approach.

[249] In light of this distinction, I accept the position of the City and reject the position of Subbor; there will accordingly be a deduction of $295,000.00 from the damages claim.

[250] I now turn to the valuation of the removable, useable or saleable equipment on the Site. On this question, the City sets out a range for the cost of the equipment between $750,000.00 and $1,000,000.00.

[251] However, Subbor's expert makes no deduction for equipment at the Site even if it were removable, useable or saleable, on the assumption that Subbor would not be required to restore the Site to its original condition nor would it be entitled to claim any of the physical assets that remained on the Site if it were compensated on a basis consistent with its claims.

[252] The City points out that the provisions of Article 15(2)(b) of the 1998 Agreement confer upon Subbor the right to remove all Demonstration Plant

equipment from the Site and an obligation to restore the Site to its original condition, at Subbor's sole expense and to the City's satisfaction. Accordingly, the City submits that the assumption relied upon by Subbor's experts on the valuation is ill-founded and in fact contrary to the terms of the '98 Agreement.

[253] I accept the argument of the City on this regard. Accordingly, a deduction of $750,000.00 from Subbor's damages claimed is appropriate.

[254] I turn now to the item described in the summary as "Subbor Revenues: Both the experts for the City and Subbor agree that the appropriate deduction for this item is $96,448.00: a deduction for this amount will be made from the damages claim.

[255] The next adjustment is a deduction of the tax savings obtained by EP of approximately $14,315,000.00 from Subbor's damage claim.

[256] The City submits since Subbor is claiming as part of its damages the expenditures made by EP, it is necessary to net out these expenditures by deducting the tax benefits received by EP. The City further points out that there has been no evidence that the oral arrangements alleged between Subbor and EP required the latter to pay the full amount of Subbor's expenditures in relation to the demonstration project, regardless of the net cost to EP, i.e. after deducting tax savings.

[257] I accept the position of the City on this point; any amount of damages to which Subbor may be entitled must be reduced by the tax savings of $14,315,000.00.

[258] The City submits an additional adjustment to Subbor's damages by way of deduction arises from EP's decision to take a write-down in fiscal year 2002 of the Subbor "deferred development costs" of $8,500,000.00.

[259] The City's expert questioned the validity of this write-down on the basis there was no documentary support rationalizing the write-down of $8,500,000.00 of the Subbor- related "deferred development costs." Although the parties in their respective submissions on this point joined issue on whether pre-trial documentary production had been properly adhered to, no document or memorandum to EP's auditor rationalizing the amount of the write-down was produced, either before or at trial. Mr. H. Vogt for Subbor testified he had prepared a memorandum respecting the write-down in preparation for the 2002 financial statements; however, such memorandum was not produced either in a pre-trial production motion or when it was referred to at trial. In the circumstances, the court will draw an adverse inference. I accordingly reject the $8,500,000.00 adjustment sought by Subbor in relation to its damages claim.

Gross-up and contingency factors

[260] I turn now to the proposed adjustments to the damages award respecting (a) the gross-up for taxes; and (b) contingency factors.

[261] The first item is the gross-up for taxes. The issue here is to determine what, if any, tax would be payable on a damages award so as to ensure that the party receiving a damages award receives the amount of the award clear and net of any tax that might otherwise be levied on the damages award.

[262] There is no dispute between the parties that a damages award to Subbor would attract tax. The real question is whether the rate of taxation would be based on the award being characterized as a capital or income receipt, taking into account that the rate of taxation on a capital receipt would be 18.06% and on an income receipt, 36.12%.

[263] The City's expert opines that any damages award to Subbor would be treated as a capital receipt and accordingly would attract a gross-up at the 18.06% rate.

[264] The City contends that Interpretation Bulletin IT365R2 issued by Canada Revenue Agency indicates the appropriate analytical framework for resolving this issue. It is submitted that the Interpretation Bulletin sets out the general principles and indicia in any given situation that point to a capital, rather than income, receipt.

[265] Counsel for the City submits (see the City's closing argument March 1, 2006, p.168, para. 389) there is a significant probability that any damage award would be treated as a capital receipt, citing numerous facts in support of the position. The most cogent of these facts relates to the nature of Subbor's damages claim being reliance interest rather than expectation interests,, i.e. that the claim has been advanced for expenditures and not lost profits and that the costs related to the expenditures were treated as capital, being described as deferred development costs and indicated as an asset on EP's balance sheet.

[266] Counsel for Subbor submits that according to its expert (Mr. Milgrom),

> ..."it is possible that CRA's [Canada Revenue Agency's] position will be that a damages award will be treated as income. Milgrom's opinion is that the CRA may choose the characterization that would result in a higher tax receipt (i.e. income), and that this characterization may be justified to the extent that an award could be viewed as an alternative measure of income replacement related to the loss of opportunity resulting from the termination of the demonstration."
> (see Para 88 Subbor's Final Argument, Vol. 2, p.271 para 883, citing Price Waterhouse Cooper Report, Exhibit 26A paras 95-98).

[267] Subbor contends its expert's opinion on this issue should be accepted over the opinion of the City's expert inasmuch as Subbor's expert has professional standing and credentials in tax matters whereas the City's expert does not.

[268] I accept the evidence of the City's expert over the evidence of Subbor's expert in this regard.

[269] I am persuaded that the reliance interest damages claimed by Subbor and any resulting award of damages, having regard to the basic facts of the claim for damages intended to make Subbor whole against its costs thrown away, militate against the speculative aspects of Subbor's expert's opinion that:

> "CRA may choose the characterization that would result in a higher tax receipt, i.e. income, and...an award could be viewed as an alternative measure of income replacement related to the loss of opportunity ...". (my emphasis).

[270] In the result, the gross-up damages award will be fixed at $18.06%.

[271] I turn now to the alleged budget overruns and construction inefficiencies as appropriate deductions from Subbor's damages.

[272] The City's expert on damages opines such a deduction is apt having regard to additional costs incurred by Subbor in the demonstration project arising from problems and difficulties in the course of the demonstration project that were unrelated to any act or omission attributable to the City. The City's expert asserts that a comparison of budgeted costs for the demonstration project in the amount of $27,200,000.00 that Subbor presented to TPC in 1999 for its loan and the actual costs allegedly incurred by Subbor being its damages claim of (about) $32,409,000.00 show that additional costs relating to the proposed deduction could be as high as $5,200,000.00. However, the City's expert acknowledged that in the circumstances, it was not possible to specify a dollar amount for the

proposed deduction but suggests that a "significant" reduction should be made for this item.

[273] Subbor attacks the comparative analysis by the City's expert on the basis that the TPC budget contains only eligible costs, i.e. for purposes of obtaining the loan in question, whereas Subbor's damages claim includes various cost items that would not have been stipulated in the budget submitted for the TPC loan, such as decommissioning costs, costs attributable to delay, and other soft costs necessarily arising out of the project.

[274] There is some merit in Subbor's objection to the comparative basis of the City's estimate of the amount of the deduction attributable to this item. However, the delay aspects relating to the operation of the demonstration project cannot fairly be attributed to any act omission on the part of the City. The net result is that although there were problems and difficulties in the operation of the demonstration project, which could be characterized as "inefficiencies", I conclude there is no sound evidentiary basis to attribute any dollar amount to these inefficiencies for purposes of a deduction from Subbor's damages claim. Accordingly, there will be no deduction from Subbor's damages claim for these items.

[275] I turn finally to whether contingency factors would be a proper deduction against the damages claim.

[276] The City contends there was an element of uncertainty in Subbor's capacity to utilize the demonstration plant beyond the expiry date of January 28, 2003 (or even the contended expiry date of October 30, 2004, as pleaded by Subbor). The uncertainty relates to the question of whether Subbor would have been able to complete the demonstration project within the time frames and even if it could have done so, whether the technology would be commercially viable so as to enable Subbor to recoup on an economic basis its investment costs in the demonstration project.

[277] In response, Subbor submits that inasmuch as the damages being sought are reliance interests rather than expectation interests, a contingency factor is inappropriate in assessing a deduction against the damages award.

[278] I accept the position of Subbor on this point. There will be no deduction based on a contingency factor.

Subbor's mitigation issues

[279] The City raises the issue of Subbor's duty to mitigate its damages and its failure to discharge that duty. Subbor in turn takes the position that it would be unreasonable to have required it to make further expenditures in order to re-commission the facility and continue the demonstration the project pursuant to the offer made by counsel for the City by letter July 16, 2003. Subbor's counsel

by responding letter dated July 18, 2003 asked whether the City would secure the funds to recommission the facility and continue the demonstration project. Subbor's position is that inasmuch as the City did not indicate such willingness, Subbor was under no obligation to incur additional costs. In reply, the City contends the law of mitigation would have imposed on Subbor the costs of re-commissioning the facility and if the court eventually found Subbor's claims and its positions on the '98 agreement to be validated, Subbor would then have recouped such costs. The City further submits that in the context of commercial contracts, a non-breaching party is generally required to accept an offer from the alleged breaching party for purposes of mitigation and submits that on the facts of the present case, it was unreasonable for Subbor to refuse the City's officer to permit Subbor to remain on the site and take steps to reinstate deliveries of MSW pending the results of a litigation: see para. 302-303 City's Responding Argument, March 15, 2006 and authorities referred to.

[280] I accept the submissions of the City in this regard. I accordingly conclude that Subbor has failed to mitigate its damages herein.

[281] In sum, Subbor's damages are assessed as follows:

Table of assessed damages

| | |
|---|---|
| Amount claimed:<br>(before Subbor's acknowledgement of deductions of $153,000.00: Equipment removed and $96,448.00: Revenues) | $32,409,267.00 |
| Deductions: | |
| TPC loan | $6,328,796.00 |
| Value of Subbor technology | $6,000,000.00 |
| Management labour costs | $1,926,000.00 |
| Equipment removed from site | $295,000.00 |
| Removeable, useable or saleable equipment | $750,000.00 |
| Subbor revenues | $96,448.00 |
| Sub-Total Deductions: | $15,396,244.00 |
| Plus EP Tax Savings: | $14,315,000.00 |
| Total Deductions: | $29,711,244.00 |
| Net Damages: | $2,698,023.00 |
| Plus: Gross-up for Taxes @ 18.06% | $487,262.95 |
| Total Damages Award: | $3,185,285.95 |

## THE CITY'S INDEMNITY CLAIM AGAINST EP

[282] I turn now to the City's claim for indemnity made pursuant to its third party claim. The basis for the indemnity relief is contained in EP's Proposal to the City relating to the Subbor technology. EP's Proposal was accepted by the City and was made part of the '98 Agreement which itself was the product of arrangements contained in the Proposal: see Art. 1(8) and Art. 2, '98 Agreement.

[283] The indemnity undertaking by EP in the Proposal was expressed in the following terms:

Eastern power will indemnify the City of Guelph against liability that may arise as a result of the pilot demonstration project: see Proposal, Article 1.0, Executive Summary, last unnumbered paragraph.

[284] EP resists the City's claim for indemnification on the following grounds:

(a) the enabling resolution of Guelph's City Council on November 2, 1998 made no mention of EP relating to the authorization to sign a contract between Guelph and Subbor;

(b) in the course of the drafts leading up to the '98 Agreement, there had been discussions that EP would not be a guarantor of Subbor's duties or obligations under the '98 Agreement; and

(c) a party can only be indemnified against the consequences of his own negligence where the indemnity obligation in question is imposed by very clear words: see Vol. II, Final Argument, Subbor and EP paras 909 and 910.

[285] In response, the City acknowledges that an indemnity undertaking differs from a guarantee undertaking and it concedes that EP was not a guarantor of Subbor's obligations under the '98 Agreement. However, the City contends that the intent from the clear and unambiguous words providing for indemnification by EP are not a promise to answer for the default of Subbor, but rather to compensate for losses or liability arising out of the transaction. In this case, EP is involved in the indemnity undertaking through its involvement in a larger transaction and the contractual undertaking of EP is one of indemnity and not guarantee. Here, the "larger transaction" is the demonstration project for the technology in respect of which Subbor, as a fully owned subsidiary of EP, was the delivery mechanism or vehicle for the technology.

[286] In the result, I conclude that the City has the remedy of indemnification from EP with respect to any liabilities that may arise as a result of Subbor's demonstration project.

## CONCLUSIONS

[287] For the reasons stated above, I arrive at the following conclusions:

(1) The expiry date of the '98 Agreement was January 28th, 2003;

(2) The City was not in breach of any of its specific obligations under the '98 Agreement;

(3) The City was under an implied duty of good faith in the performance of its obligations under the '98 Agreement, but discharged that duty;

(4) In light of the conclusions in #2 and 3 above there are no damages owing by the City to Subbor. However, damages are assessed in accordance with the above findings in the amount of $3,185,285.95;

(5) The City has a right of indemnity against EP for any damages recoverable against it by Subbor and any liabilities arising out of Subbor's demonstration project.

## DISPOSITION

[288] In the main action, Orders shall issue as follows:

(1) declaring the term of the '98 Agreement expired effective January 28th, 2003;

(2) requiring Subbor to discharge any outstanding obligations on the '98 Agreement including, without limitation, surrender of the premises under the '98 Agreement to the City forthwith and, at Subbor's expense, to deliver and file on title such documents of title as the City may reasonably request to quit-claim all right, title and interest in and to the City's premises Subbor may have under the '98 Agreement;

(3) requiring Subbor to remove from the Site all of the Demonstration Plant and to restore the Site to its condition prior to Subbor's use and possession at the Site, at its sole expense and to the reasonable satisfaction of the City and in compliance with all appropriate and applicable legislation and guidelines, in default of which the City may at its option proceed to such removal and restoration at the sole expense of Subbor or retain whatever elements of the Demonstration Plant remain on premises and acquire title thereto without compensation to Subbor;

(4) an order dismissing Subbor's counterclaim with costs;

(5) for the costs of this action.

[289] In the Counterclaim and Third party claim, Orders shall issue:

(1) requiring EP to pay the costs of the City in bringing its third party claim against EP;

(2) the costs of the City in defending Subbor's counterclaim in the main action;

(3) any costs that the City may be required to pay to Subbor for the main action;

(4) any costs that the City may be awarded in the main action which Subbor fails to pay; and

(5) any costs the City is required to pay in removal of the Demonstration Plant and restoration of the Site in accordance

with Article 15 of the '98 Agreement, if such costs are incurred and Subbor fails to pay such costs to the City.

[290] I will entertain written submissions of the parties respecting the costs orders set out above, not to exceed 20 pages (exclusive of supporting materials), according to the following schedule:

(1) By the City, within 30 days of the date of issuance of these reasons;

(2) Responding submissions by Subbor, within 21 days of receipt of the City's submissions; and

(3) Reply, if any, by the City, within 14 days of receiving Subbor's responding submissions.

MacKENZIE J.

Released: August 10, 2007

# Schedule A to reasons

CITY OF GUELPH V. SUBBOR et al.

SUMMARY OF LOSSES BY CATEGORY BEFORE GROSS-UP FOR TAXES

| | Reference | Amount Claimed by SUBBOR | Amount Quantified by LECG | | Amount per PwC REPy |
|---|---|---|---|---|---|
| | | | Low | High | |
| | | $ | $ | $ | $ |
| SUBBOR CLAIM | | 32,409,267 | 32,409,000 | 32,409,000 | 32,409,267 |
| LESS: | | | | | |
| Technology Partnerships Canada Loan | | | (6,328,796) | (6,328,796) | 0 |
| Value of SUBBOR Technology | | | (8,000,000) | (6,000,000) | 0 |
| Management Labour Costs | | | (1,926,000) | (682,000) | 0 |
| Equipment Removed from Guelph Site | | | (295,000) | (295,000) | (153,000) |
| Removable, Useable or Saleable Equipment | | | (1,000,000) | (750,000) | 0 |
| SUBBOR Revenues | | | (96,448) | (96,448) | (96,448) |
| SUBTOTALS | | 32,409,267 | 14,762,756 | 18,256,756 | 32,159,819 |
| Tax Savings on Repayment of TPC Loan | | | | | (3,145,000) |
| Other EP Tax Savings | | | (13,705,000) | (13,705,000) | (14,764,740) |
| Amount before Gross Up for Taxes on Award and before Overruns and Inefficiencies claimed by LECG | | 32,409,267 | 1,057,756 | 4,551,756 | 14,250,079 |

COURT FILE NO.: 446/03
DATE: 20070810

ONTARIO

SUPERIOR COURT OF JUSTICE

B E T W E E N:

THE CORPORATION OF THE CITY OF GUELPH

Plaintiff
(Defendant by Counterclaim)

- and -

SUPER BLUE BOX RECYCLING CORP.

Defendant
(Plaintiff by Counterclaim)

- and -

EASTERN POWER LIMITED

Third Party

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**REASONS FOR JUDGMENT**

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MacKENZIE J.

Released: August 10, 2007