

CONSTRUCTION

MARK ALEXANDER
Miller Thompson, LLP
Edmonton, Ab

navigant.com

About Navigant

Navigant Consulting, Inc. (NYSE: NCI) is a specialized, global professional services firm that helps clients take control of their future. Navigant's professionals apply deep industry knowledge, substantive technical expertise, and an enterprising approach to help clients build, manage and/or protect their business interests. With a focus on markets and clients facing transformational change and significant regulatory or legal pressures, the Firm primarily serves clients in the healthcare, energy and financial services industries. Across a range of advisory, consulting, outsourcing, and technology/analytics services, Navigant's practitioners bring sharp insight that pinpoints opportunities and delivers powerful results. More information about Navigant can be found at navigant.com.

LOOKING THROUGH A DIRTY WINDOW: BUILDERS' RISK POLICIES AND THE "FAULTY WORKMANSHIP" EXCLUSION

On March 30, 2016, the Supreme Court of Canada heard argument in the appeal of the Alberta Court of Appeal's decision in *Ledcor v Northbridge Indemnity Insurance Company*¹. In doing so, the SCC was asked consider, among other things, the proper test to distinguish between the concepts of "faulty workmanship" and "resulting damage" in comprehensive builders' risk policies.

The dispute in this case arose in relation to the construction of the EPCOR Tower, a 29 storey office building in Edmonton, Alberta, completed in 2011. The owner, Station Lands Ltd. ("Station Lands") retained Ledcor Construction Ltd. ("Ledcor") as a construction manager to coordinate construction of the building. An "All Risks" policy was obtained by Station Lands from a number of insurers to cover all "direct physical loss or damage" subject to certain defined exclusions. The policy named both Station Lands and Ledcor as insureds, and the additional insureds included the owners, contractors, sub-contractors, architects, engineers, consultants, and all individuals or firms providing services or materials to or for the named insureds.

As the building was nearing completion, Station Lands hired a contractor, Bristol Cleaning ("Bristol"), to perform a "construction clean" of the exterior of the building to remove dirt, paint and other construction debris from the windows. During the cleaning process, a number of the windows were damaged due to Bristol using inappropriate tools and methods and had to be replaced at considerable cost.

As a result of the damage to the windows, Station Lands and Ledcor made claims under the policy for the costs incurred to replace the windows. The insurers denied the claims on the grounds that the damage was "faulty workmanship" and was therefore captured by an exclusion:

1. *Ledcor Construction Limited v Northbridge Indemnity Insurance Company*, 2015 ABCA 121 (CanLII)

1. Property Insured

- a) Property undergoing site preparation, demolition, construction, reconstruction, fabrication, insulation, erection, repair or testing ...

4(A) Exclusions

This policy does not insure ...

- b) the cost of making good faulty workmanship construction materials or design unless physical damage not otherwise excluded by this policy results, in which event this policy shall insure such resulting damage.

At trial, the judge characterized the question of whether the exclusion under the policy applied as a question of whether “making good” related to the faulty workmanship, being the cleaning of the windows, or to the thing on which the faulty workmanship was performed, in this case, the windows:

In my view, whether cleaning or constructive, as I have said, one is working. Plainly in this case, the work done by Bristol was faulty. In the result, I think the words of the exclusion portion of clause 4(A) are clear and free from ambiguity. The “cost of making good” Bristol’s faulty workmanship is excluded. However, the meaning of the words “making good” in the exclusion portion of clause 4(A) must be determined. Does “making good” relate to the faulty workmanship, in this case the cleaning? Does the “making good” relate to the thing on which the faulty workmanship was performed, in this case the building exterior?²

Station Lands and Ledcor argued that excluding the cost of “making good” the faulty cleaning simply excluded recovery of the cost for having someone else perform the work correctly, and that Bristol’s defective methods and tools were not “faulty workmanship” because no product was created by its efforts. Conversely, the insurers asserted the correct interpretation of the clause required “making good” to extend to the damage done by the faulty cleaning otherwise the exclusion clause would effectively be rendered meaningless. The insurers further argued that such an interpretation would transform the “all risks” policy into a “no risks” policy, analogizing it to a form of “construction warranty” contract.

The Court found that both of the interpretations advanced were plausible and applied *contra proferentem*³ to conclude that the

insurers had failed to establish that the exclusion applied, such that the damage caused to the windows by Bristol was covered under the policy.

The trial judge’s decision was reversed on appeal, with the Court of Appeal finding that the exclusion clause applied in the circumstances. In its decision, the CA expressed concern over the consequences of narrowly interpreting the faulty workmanship exclusion, stating that the effect of such an interpretation would be to give the insured “carte blanche to use faulty materials, workmanship or design”. The CA also noted the need for certainty in the interpretation of insurance contracts, particularly in the context of standard form policies:

Insurance contracts are a highly specialized form of contract. “Standard form” wording is common in the industry, and coverage is usually sold under those policies without any negotiation of the terms. Insureds realize that they are purchasing a standard form of coverage. In many cases, the contents of the policies are set, or at least highly influenced, by statutory provisions. The interpretation of insurance policies is therefore of general importance beyond any particular dispute. Any decision on the proper interpretation of standard form wording in an insurance policy has great precedential value, and the primary objective should be certainty.⁴

In this context, the CA found that the fundamental intent of the policy was to indemnify the owner for a particular type of damage that occurs during construction, and to provide coverage for some unexpected events and occurrences. It was not, however, intended to be a “building warranty” to ensure that the building was constructed in a good and workmanlike manner, using proper materials.

After a review of the general principles of interpretation, the CA observed that it is often helpful to begin with a sequential analysis when examining policies and their constituent clauses, whereby:

1. The loss is first reviewed to see whether it falls within the general coverage afforded under the policy;
2. The exclusions of the policy are then considered to see whether any apply; and
3. Finally, the court must consider whether the loss is within an exception to a given exclusion clause.⁵

2. *Ledcor Construction Limited v. Northbridge Indemnity Insurance Company*, 2013 ABQB 585 (CanLII) at para. 13.

3. A principle of contractual interpretation requiring ambiguous provisions capable of more than one interpretation to be construed against the party responsible for drafting the contract.

4. *Supra* note 1 at para. 16, citing *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, [2010] 2 SCR 245, 2010 SCC 33 (CanLII)

5. *Ibid.* at para. 26

Significantly, however, the CA noted that as the exclusion clause at issue juxtaposed the excluded “cost of making good faulty workmanship” with “resulting damage”, which was covered, the exception and exclusion were akin to two sides of the same coin and therefore had to be interpreted symbiotically.

In allowing the appeal, the court rejected the main arguments asserted by Station Lands and Ledcor: that the cleaning by Bristol was not within the phrase “workmanship”, which the insureds stated only covers efforts that result in the creation of a physical product; and secondly, that the exclusion did not apply to damage caused by one contractor to the work of another.

With respect to the first issue, the CA found that such a narrow interpretation was outside the normal interpretation of the word “workmanship”, which encompassed any application of skill or effort to a task. The court also observed that the construction contract itself defined “Work” as including “services”, and referred to the “workmanship” of Bristol, such that the final cleaning of the building exterior was as much a part of the construction as the pouring of the concrete. Moreover, the CA held that the insureds’ argument was not supported by the wording of the policy itself given there was nothing to indicate that only the creation of physical work products was caught by the term “workmanship”, particularly as the policy covered all consultants and trade contractors involved in the project, such that it would be inconsistent to then find that the consultants and contractors who did not actually create physical products were not covered.

The Court of Appeal also rejected the second argument advanced by the insureds, finding that it was artificial to draw a dividing line between the work product created by the work of other contractors, and the work performed by Bristol. Specifically, the CA held that the insureds’ argument would lead to the conclusion that coverage under the policy depended on how the work was divided up, with coverage effectively expanded the more finely divided up the work was, and narrowed or even vitiated if a single contractor did all the work associated with one component of the project.

Ultimately, the court favored the general approach proffered by the insurers; namely, that if the workmanship itself directly caused the damage, then both re-doing the work and fixing the damage from the first attempt fall into the expression “making good faulty workmanship”. The CA concluded that the proper test to be applied in determining whether the exclusion clause applies is one of connectedness between the work, the damage and the physical object being worked upon, and that the primary considerations will be:

- a) The extent or degree to which the damage was to a portion of the project actually being worked on at the time, or was collateral damage to other areas;
- b) The nature of the work being done, how the damage related to the way that work is normally done, and the extent to which the damage is a natural or foreseeable consequence of the work itself; and
- c) Whether the damage was within the purview of normal risks of poor workmanship, or whether it was unexpected and fortuitous.⁶

Finally, the CA did not agree with the trial judge’s application of *contra proferentem* in the circumstances as that doctrine could not be used to create ambiguity and the Supreme Court of Canada had previously held that this type of exclusion was not ambiguous.⁷

As the Supreme Court of Canada has recognized, builders’ risk insurance is essential for the administration of construction projects as it reduces the overall insurance costs by reducing the overlaps in coverage, which in turn serves to eliminate litigation amongst insurers over which particular subcontractor was responsible for any particular damage.⁸ Leave to appeal is rarely attained, with only approximately 12% of applications granted over the last 10 years. As such, the significance of determining the proper approach to the interpretation of this important and ubiquitous provision is demonstrated by the SCC’s decision to grant leave in this case. The construction industry and insurers alike anxiously await further guidance from Canada’s highest court.

6. *Ibid.* at para. 50

7. Citing *Canadian National Railway Co. v. Royal and SunAlliance Insurance Co. of Canada*, 2008 SCC 66 (CanLII)

8. *Commonwealth Construction Co. v. Imperial Oil Ltd.*, 1976 SCC 138 (CanLII)