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Builder’s risk insurance: Insurable interest and subrogation rights

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I. INTACT, COMPAGNIE D’ASSURANCES V. THÉBERGE & BELLEY (1985) INC. AND L’UNION CANADIENNE COMPAGNIE D’ASSURANCE AND EBC INC.[1]

In this case, the Court of Appeal held that an insurer who indemnified its insured pursuant to “contractors’ equipment” coverage cannot exercise its subrogation rights against the subcontractor who committed a fault.

FACTS

EBC was the general contractor for the construction of a deep water wharf. Théberge & Belley (hereinafter “T & B”) was the subcontractor chosen by EBC to carry out the electrical work.

Two of the five construction trailers owned by EBC, as well as their contents, were damaged by fire.

T & B admitted liability.

It was also admitted that T & B’s work, which caused the fire, was not related to the construction of the wharf despite the fact that the trailers were located on or near the construction site.

Intact had issued a commercial insurance policy offering several types of coverage, including “builder’s risk” and “contractors’ equipment” coverage, to the named insured, EBC, and to various additional named insureds.

The relevant clauses of the builder’s risk insurance were as follows:

[TRANSLATION]

INSURED PROPERTY
(...)
1.3 The constructions, scaffolding, stands, fences, temporary formwork, excavations, site preparation work and work of a similar nature, provided that the value thereof is included in the amount of coverage and then only to the extent that they must be repaired or replaced for carrying out the work.

EXCLUDED PROPERTY
(...)
1.6 Except pursuant to section 1.3 of the Insured Property, the tools, equipment, materials,

replacement parts and accessories of contractors or subcontractors, whether or not owned by such contractors or subcontractors.

Pursuant to the “contractors’ equipment” coverage, movable buildings (trailers) were expressly covered, provided they were related to the professional activities of the insured as described in the declarations.

SUPERIOR COURT

The trial judge found that the trailers and their contents were included in the [TRANSLATION] “constructions (…) site preparation work and work of a similar nature” (Clause 1.3). However, while acknowledging that these items of property were not [TRANSLATION] “intended to be incorporated in the designated work”, he nonetheless concluded that they had to be repaired or replaced for the work to continue.

The Court held that in light of the fact that Intact had indemnified EBC for its loss under the builder’s risk coverage, it could not exercise its subrogation rights against T & B.

COURT OF APPEAL

The Court of Appeal found rather that these items of property were covered under the “contractors’ equipment” coverage.

Accordingly, the issue raised on appeal was whether Intact could exercise its subrogation rights against the subcontractor, T & B, who was not a named insured under the “contractors’ equipment” coverage.

In other words, under the principles applicable to the builder’s risk insurance, T & B ought to be considered an unnamed insured with respect to that coverage, which precluded Intact from instituting subrogation proceedings against it. The issue was whether Intact had retained a recourse against T & B after having indemnified its insured under the “contractors’ equipment” coverage.

The Court noted that even if the coverage under review was different from the builder’s risk insurance, the “contractors’ equipment” coverage which EBC had purchased also constituted property insurance covering a risk related to the same type of activities, namely, construction activities in a general contractor capacity.

The Court referred to the Alberta case of *Medicine Hat College v. Starks Plumbing & Heating Ltd.*[2] In that case, the insurable interest of a gas and plumbing subcontractor was confirmed not only with respect to the ongoing construction project for the expansion of a building, but also for the existing building, pursuant to builder’s risk insurance obtained by the client, Medicine Hat College, in which only the client was a named insured.

In its subrogation proceedings against the professionals, the general contractor and the subcontractor, the insurer argued that it was not precluded from exercising its recourse as a result of the fact that the indemnity claimed had been paid to Medicine Hat College under the property policy.

According to Justice McDonald, it is logical to conclude, in the context of work being performed in connection with the expansion and modification of an existing structure or near such a structure, that subcontractors participating in the work have an insurable interest in all the interconnected structures and not just the new one. He ruled that the fact that the principal amount of coverage was less than the total value of the building taken as a whole was not sufficient to conclude that the policy covered nothing more than the damages to the new structure under construction. In order to reach such a conclusion, the terms of the policy ought to have provided for a clear exclusion of the adjoining structures.

In the case under review, the Court of Appeal drew a parallel between the situation of the coverage of the plumbing subcontractor in the *Medicine Hat College* case and the coverage of the respondent T & B. In the Albertan case, there was a prior policy covering the property of a named insured, the property policy, and a second policy, namely, the builder's risk policy, which was superimposed over it. In the present case, there was only one insurance policy for the benefit of EBC, covering all of its construction activities. This situation further supported T & B's argument that it was an unnamed insured under the coverage provided for the "contractors' equipment". According to the principles of interpretation of an insurance contract described by Justice McDonald in the *Medicine Hat College* case, if Intact had wished to retain its subrogation rights against a subcontractor in respect of property used on site by its insured, it should have clearly stated so.

II. *VILLE DE QUÉBEC V. GÉNITECH ENTREPRENEUR GÉNÉRAL INC. ET AL.*[3]

In this case, the Superior Court had to decide whether the coverage under a builder's risk insurance policy extended to the damages caused by the work to the existing structure, or if it was only limited to the work.

FACTS

Quebec City (hereinafter "the City") awarded a contract to Génitech as general contractor for the conversion of Palais Montcalm from an entertainment venue into a concert hall.

The Lot no. 2 contract dealt with work that was to be done on the existing structure of Palais Montcalm. Under the terms of the contract, Génitech purchased a builder's risk policy from Promutuel to cover the property contemplated by the work. Furthermore, as the project required significant demolition work, Génitech retained the services of CFG as a subcontractor.

Génitech and the City were named as co-insureds under the builder's risk policy and the protection thereunder was extended to subcontractors. The insured activities were described as follows [TRANSLATION]: *"Transformation of Palais Montcalm into a house of music lot:2 structure and primary envelope"*.

Following the faulty performance of the demolition work, a fire caused significant damage to parts of the existing structures not included in Lot no. 2. Moreover, the smoke and the water sprayed on Palais Montcalm by the fire department damaged a recording studio and the refrigeration system of the Youville Square skating rink, which were manifestly not included in Lot no. 2. The City claimed the amount of $1,091,582.98 for the damages thus caused.

The defendants filed three motions to dismiss the City's action. They maintained (1) that the builder's risk insurance applied not only to the items in Lot no. 2, but also to all the property damaged in relation to the work performed on Lot no. 2, including the damages to the existing structure of Palais Montcalm, (2) that the City no longer had a recourse against them because it had withdrawn from, and filed a declaration of settlement in, another matter relating to the same facts and claiming almost the identical damages against them, and (3) that the City could not sue them, due to its status as a co-insured under the builder's risk insurance.

While the City acknowledged that the general principles related to builder's risk insurance were applicable, it argued that it had not lost its recourse because the damages to the existing structure were not covered by this builder's risk insurance, since it specifically covered the damages to property located on the site of the work, i.e. on Lot no. 2 only. In support of its argument, it relied, among other things, on the amount of the builder's risk insurance, which was obviously insufficient to cover the entire Palais Montcalm building and its contents.

Applying the same reasoning as the Alberta Court of Appeal in the case of *Medicine Hat College*, the Court concluded that all the trades and subcontractors have an insurable interest on a construction project in its entirety and, therefore, that the entire structure of Palais Montcalm was covered by the builder's risk insurance. The action was therefore dismissed, since all the damages claimed were covered by the builder's risk insurance.

In addition, the Court held that, as a co-insured, the City could not sue the defendants.

Having found that the builder's risk insurance covered all the damages claimed by the City, the Court also ruled that the settlement that was reached in the other matter had the effect of *res judicata* and, noting that the City could not institute another action based on the same facts, also dismissed the action on this ground.

The decision has been appealed.

CONCLUSION

The three judgments from Quebec and Alberta discussed in this text have held that a subcontractor's insurable interest extends well beyond the property directly connected with the work alone to include the entire work site, thereby conferring the status of an insured on the subcontractor under the related insurance coverage.

In light of these three decisions, insurers would be well advised to more clearly define the scope of the coverage they underwrite in the context of a construction site using specific exclusionary riders, as necessary if they see fit.

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[1] 2014 QCCA 787.

[2] 2007 ABQB 691.

[3] 2013 QCCS 5042, inscription in appeal 09/08-2013.