An obiter of the Québec Court of Appeal makes its way up to the Supreme Court of Canada

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The facts

The client, Station Lands Ltd. ("**Station**") retained the general contractor Ledcor Construction Ltd. ("**Ledcor**") to build the Epcor tower in Edmonton. As is customary, Station and Ledcor purchased a builders' risk all-risk property insurance to cover property damage which may occur in the course of the construction project. This insurance also covered all the subcontractors participating in the project.

At the end of the project, Bristol Cleaning ("**Bristol**") was hired to clean the windows of the Epcor Tower. However, in doing so, Bristol damaged the windows. The replacement cost of the windows was $2.5 million.

The insureds, Station and Ledcor, filed claims with their insurers, Northbridge Indemnity Insurance Company, Royal & Sun Alliance Insurance Company of Canada and Chartis Insurance Company of Canada. The insurers denied coverage, relying on the faulty workmanship exclusion:

> "4. (A) Exclusions
>
> This policy section 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."
>
> [emphasis added]

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The decisions of the lower courts

The insureds were successful at trial[2] on the basis of the contra proferentem interpretation principle applied to Clause 4. (A), which was deemed to be ambiguous. However, the trial decision was reversed by the Alberta Court of Appeal[3], which concluded that coverage denial was justified on the basis that the damage to the windows was related and closely connected to the object of Bristol's contract.

The issue of the interpretation of Clause 4. (A), which seemed to exclude damages for faulty workmanship while seeming to cover damages resulting from it, ended up before the Supreme Court of Canada[4].

The common law principles

To determine the scope of coverage and nature of the insured property, the common law jurisprudence of the Canadian provinces developed a three-step analytic approach for assessing whether the damages claimed by the insured were excluded from coverage or covered under the exception to the exclusion. Accordingly, the following had to be determined:

a) the nature of the damages claimed, making a distinction as to whether they consisted in the cost for making good defective workmanship, that is, re-do the faulty work or damages to property resulting from faulty workmanship;

b) the damages caused to property which was the very subject of the contract of the contractor or subcontractor at fault were invariably excluded, whether they were claimed for making good faulty workmanship or resulted from faulty workmanship;

c) the damages to property which were not part of the object of the contract of the contractor or subcontractor at fault were covered under the exception to the exclusion.

The above principles expressly or implicitly resulted from the following decisions:

> *Poole-Pritchard Canadian Ltd. and Armstrong Contracting Canada Ltd.* v. *Underwriting Members of Lloyds* (Supreme Court of Alberta), (1969) (1970) I.L.R. 1-324;
> *Poole Construction Ltd.* v. *Guardian Assurance Co.* (Supreme Court of Alberta), (1977) I.L.R. 1-879;
> *Sayers & Associates Ltd.* v. *The Insurance Corp. of Ireland et al.* (Court of Appeal of Ontario), (1981) I.L.R. 1-1436);
> *Simcoe & Erie General Insurance Co.* v. *Royal Insurance Co. of Canada et al.* (Alberta Queen's Bench), (1982) (183) I.L.R. 1-1597;
> *Bird Construction Co. Ltd. et al.* v. *United States Fire Insurance Co. et al.*, (Court of Appeal of Saskatchewan), (1985) (1986) I.L.R. 1-2047;
> *Mr. Elegant Ltd.* v. *Canadian General Insurance Co. Ltd.*, (New Brunswick Queen's Bench), (1987) 78 N.B.R. 225, reversed by the Court of Appeal of New Brunswick, 31 CCLI 243.

However, a discordant note was heard in 1989, in the decision of the Québec Court of Appeal in the matter of *Commercial Union Compagnie d'assurance du Canada* v. *Pentagon Construction Canada inc.*, 1989 CanLII 657 (QCCA). In that case, the insured, Pentagon Construction Canada, was claiming an insurance indemnity from its insurer, Commercial Union Compagnie d'assurance du Canada, for damages caused to a stake-pile jacket while in the process of being rammed in the ground. Writing for the Court, the Honourable Marcel Nichols concluded, as had the trial judge, that no faulty workmanship was involved. Accordingly, the exclusion of the policy did not apply.

As an *obiter*, Mr. Justice Nichols stated that even if faulty work had been involved, the exclusion would not have applied to damages to the insured property resulting from the faulty performance of the construction contract. He analysed the subject of the exception to the exclusion as follows:

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[TRANSLATION]

"The appellant maintains that the damage to the stake-pile in itself constitutes "faulty workmanship" irrespective of the fault or mishap of the contractor and thereby falls within the scope of the exclusion.

The appellant however forgets to consider the proviso which follows the exclusion.

The word "provided", in the context of such an exclusion clause translates the idea that this particular exclusion does not apply to a case where faulty workmanship results in a damage being caused to the insured property.

In other words, the insurer will not pay to make good the faulty workmanship, but will pay the damage to the insured property even if it results from faulty or improper workmanship.

The word "provided" is nothing more than a condition to which the insurer intended to submit the exclusion it stipulated. The exclusion stipulated as to "faulty or improper workmanship" will not apply if such "faulty or improper workmanship" translates into a damage to the insured property.

(…)

In such a case, the insurer will not be required to pay "the cost of making good", meaning that the cost which would represent ramming a new caisson in the correct location because the insured property would not be affected by a damage.

In short, the damage which is covered is not the cost of making good faulty workmanship but the "resultant damage to the insured property."

These comments of Mr. Justice Nichols, although they do not affect the reasons for the Court's decision in Pentagon Construction Canada, seem to have made their way to the Supreme Court[5].

The appeal before the Supreme Court

The Supreme Court refused to follow the three-step analytic approach favoured by the common law, particularly the second condition related to damages caused to the insured property being the subject of the construction contract itself. As the Québec Court of Appeal[6], the Supreme Court was of the view that the exclusion for faulty workmanship only applies to the costs of making good the faulty workmanship, while the exception necessarily has to cover all the damages to the insured property resulting from the faulty workmanship. Moreover, we note that the interpretation of an insurance clause, restrictive as to an exclusion and broad and liberal as to an exception, is reaffirmed and takes on its full meaning in the *Ledcor* case.

To arrive at such a conclusion, the Supreme Court[7] used the principles of interpretation set out in *Progressive Homes*[8]. It is incumbent on the insured to demonstrate that the damages are covered either by the initial coverage[9] or by the exception to the exclusion. To promote a broad interpretation of the insurance coverage, the Court considered the reasonable expectation of the parties to a standard form contract such as most of insurance contracts. The Court noted that the underlying purpose of a builder's risk insurance is to promote the swift indemnification of the parties involved to avoid paralyzing a construction project[10]. It concluded that the parties could reasonably expect that the damages caused to the insured property by faulty workmanship of a subcontractor such as Bristol would be covered.

The Court then discussed the issue of the valid result from a commercial point of view, which is

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sought by an insured who pays significant premiums in consideration of builder's risk coverage. If the exclusion was to receive a broad interpretation, the insurer would incur no risk because the property damaged by faulty workmanship would inevitably be excluded from coverage[11].

The Court dismissed the argument of the insurers whereby broadly interpreting the initial coverage and the exception to the exclusion would allow or encourage contractors to perform their work improperly or negligently[12].

As to the principles directing consistency in the interpretation of similar insurance contract clauses, the Court noted that each matter is unique. The object of the construction work which resulted in faulty workmanship must be reviewed to determine what, in fact, constitutes an excluded damage.

The Supreme Court agreed with the trial judge, who considered that Clause 4. (A) was ambiguous, without however relying on the *contra proferentem* principle since it is a principle of last resort, as the ambiguity of the clause could be resolved using other interpretation principles.

What is to be noted

From a procedural point of view, which is however not the purpose of this bulletin, we note that the Supreme Court considers the interpretation of insurance standard contracts as an issue of law respecting which the decision of a lower court may be appealed on the basis of the standard of correctness, as opposed to the patently unreasonable standard. This decision of the Supreme Court may result in applications for review of the decision of lower courts being more frequently made.

We especially note that the restrictive interpretation of an exclusion clause in a builder's risk insurance contract, which originated from an *obiter* of the Québec Court of Appeal[13], puts the brakes on the expansion of the common law jurisprudence whereby insured property damaged as a result of a badly performed construction contract was excluded. Exclusion from coverage, henceforth, only applies to the cost of making good faulty workmanship.

Although their wording is completely different from the exclusion clause in the Ledcor case, the exclusion clauses for faulty workmanship contained in standard CGL and Umbrella commercial insurance policies had also been restrictively interpreted by the Québec Court of Appeal in 2013[14]. While keeping in mind that the underlying purpose of a builder's risk insurance policy is very particular and distinctive from that of a commercial insurance, it remains to be seen whether the Ledcor case will have repercussions in the interpretation of the exclusion clauses for faulty workmanship in commercial insurance contracts and on premiums.

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1. An *obiter* is an incidental remark that has no binding force, but is persuasive only.
2. *Ledcor Construction Limited* v. *Northbridge Indemnity Insurance Company*, 2013 ABQB 585.
3. *Ledcor Construction Limited* v. *Northbridge Indemnity Insurance Company*, 2015 ABCA 121.
4. *Ledcor Construction Ltd.* v. *Northbridge Indemnity Insurance Company*, 2016 SCC 37.
5. Id., para. 94.
6. *Commercial Union Compagnie d'assurance du Canada* v. *Pentagon Construction Canada inc.*, 1989 CanLII 657 (QCCA).
7. Id., para. 49-51.
8. *Progressive Homes Ltd.* v. *Lombard General Insurance Co. of Canada*, 2010 SCC 33.
9. *Supra*, note 4, para 52.
10. *Supra*, note 4, para 72.
11. *Supra*, note 4, para 78 and 79.
12. *Supra*, note 4, para 80.
13. *Supra*, note 5.
14. *Lombard General Insurance Company of Canada* c. *Factory Mutual Insurance Company*, 2013 QCCA 446; leave for appeal denied: *Lombard General Insurance Company of Canada* v. *Factory Mutual Insurance Company*, 2013 CanLII 55903 (CSC).

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