Insurers' Duty to Defend: The Court of Appeal makes a new ruling

October 11, 2019

The Court of Appeal of Quebec was once again called upon to rule on a Wellington type application aiming to force an insurer to defend its insureds[1]. Over the years, the scope of this duty has developed extensively in case law.

In this particular case, the Court ordered that defence costs be shared, because it concluded that the part of the damages that could be covered by the insurance policy was divisible and identifiable.

Facts

Développement Les terrasses de l'Îles Inc., Darcon Inc. and Groupe Dargis Inc. (collectively the "**Insureds**") had purchased a commercial general liability insurance policy (the "**Policy**") from Intact Insurance Company ("**Intact**"). The Insureds sued Intact to force it to defend them in an action for damages brought against them by the Syndicat des copropriétaires Prince of Wales (the "**Syndicate**"), who alleged the existence of defects in the construction of a divided co-ownership building.

The originating application was amended during the proceedings to add damages resulting from water infiltration, mould and structural problems found in the building.

The issue in dispute was whether the damages claimed were covered by the Policy, and if, as a result, the insurer had the duty to defend.

The decision by the court of first instance

According to the Superior Court, there was no reason to consider a design or construction defect as a loss or accident, as the Insured were claiming. The Court thus concluded that the damages claimed did not result from a "loss" within the meaning of the Policy, but rather from defects attributable to errors the Insured or their subcontractors had made. This reasoning also applied to the allegations of water infiltration and mould resulting from alleged poor design or construction defects.

In addition, the Superior Court concluded that, in any event, the damages claimed were not covered under clauses 2.7, 2.9 and 2.14 of the Policy, which covered, respectively, material damage during construction, material damage to the work and material damage resulting from the provision of professional services.

Copyright (c) Lavery, de Billy, S.E.N.C.R.L. - L.L.P.

The appeal

The Court of Appeal unanimously overturned the trial judgment.

First, the Court reiterated the general principles set out in *Progressive Homes*[2] regarding insurers' duty to defend, namely that this duty to defend will arise when the alleged material damages, by their true nature, may possibly fall within the scope of the insurance policy. Hence, (1) the insured must demonstrate that the damage could be covered by the insurance policy.

Thereafter, (2) the insurer may defer liability by proving that a clear and unambiguous exclusion clause precludes coverage. At this point, (3) the insured may still argue that an exception to said exclusion applies.

The Court of Appeal went on to reiterate the principle that the coverage provisions must be interpreted broadly and the exclusion clauses must be interpreted restrictively. On this basis, the Court of Appeal determined that the trial judge had interpreted the terms "loss" and "accident" too narrowly in light of the legal precepts drawn from the case law. In this case, the design or construction defects had caused material damage to the building that was not anticipated, triggering the insurer's duty to defend.

Moreover, because Intact had not proven that an exclusion precluded the insurance coverage, it could be required to compensate for material damage resulting from the deficiencies, but not for the costs of correcting the latter.

In this case, the Court of Appeal noted that the Syndicate was alleging not only a series of defects, but also problems caused or likely to have been caused by the defects, including water infiltration. However, according to the Court of Appeal, it was not clear whether the alleged defects have caused damages (often referred to as resulting damages) and whether these damages were claimed.

Nevertheless, the Court of Appeal concluded, based on the proceedings, that the duty to defend had been triggered. Despite this uncertainty, it also concluded that the part of the damage that could be covered was divisible and identifiable, and it limited the insurer's duty to this part.

Comments

The Court of Appeal applies the principles developed by the courts with respect to the duty to defend. Doing so, the Court of Appeal however limited the insurer's duty to defend despite the fact that it is not clear whether the claim actually included damages other than defects.

This conclusion may pose serious practical difficulties, given that it is usually hard to establish a distinction between defense measures taken, and incidentally the costs, strictly in relation to defects and those related to the resulting damages.

It should be noted that, in Cirvek Fund I[3], the Court of Appeal held that the insurer's duty to defend should only be limited in cases where the insurer demonstrates that the tasks required for the defence of the covered items are distinct from those relating to the uncovered items.

---

1. *Développement les Terrasses de l'Îles inc. v. Intact, Compagnie d'assurances*, 2019 QCCA 1440
2. *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, [2010] 2 SCR 245, 2010 SCC 33 245.
3. *Société d'assurances générales Northbridge (Lombard General Insurance Company of Canada) c. Cirvek Fund I, l.p.*, 2015 QCCA 168

Copyright (c) Lavery, de Billy, S.E.N.C.R.L. - L.L.P.

Copyright (c) Lavery, de Billy, S.E.N.C.R.L. - L.L.P.