

# BRIEFING NOTE

## **Failing to Address Foreseeable Risks May Trigger Faulty Workmanship Exclusions**

*Acciona Infrastructure Canada Inc v Allianz Global Risks US Insurance Company*, 2014 BCSC 1568

Faulty or improper workmanship exclusions allow insurers to deny coverage where the claimed loss is caused by shoddy workmanship. The British Columbia Supreme Court has recently addressed what constitutes this kind of workmanship in *Acciona*, a decision on the recovery of costs to remedy several stories of concrete slab work. The court concluded that workmanship is not faulty simply because it fails to meet a standard of perfection in relation to all foreseeable risks. Rather, there must be a lack of foresight that amounts to a defect in the workmanship.

In this case, the faulty workmanship exclusion applied but only to exclude the costs that would have prevented or rectified the defective workmanship before the damage occurred. In comprehensive reasons for judgment, Mr. Justice Skolrood reviewed fundamental principles of insurance and general principles of policy interpretation, affirmed that the concept of fortuity is incorporated into insurance policies even where not explicitly mentioned, and confirmed that workmanship must be state of the art, in accordance with the leading Supreme Court of Canada decision, *CNR v Royal*, on the application of the faulty design exclusions.

### ***Facts***

The plaintiffs, Acciona Lark Joint Venture, were the design-build contractors for the construction of a 500 bed patient care facility at the Royal Jubilee Hospital in Victoria, British Columbia. They sought recovery for losses incurred during the project. The design called for an eight storey, reinforced concrete structure comprised of columns, shear walls, and suspended slabs. The defendants, Allianz Global Risks US Insurance Company, Temple Insurance Company, and GCAN Insurance Company (the “Insurers”), underwrote and issued a course of construction insurance policy.

The claim for coverage arose due to problems with the concrete slab floors. As the concrete cured, the slabs suffered over-deflection that resulted in a concave recession at the centre of the slabs, as well as some cracking around support walls and columns.

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**Issues**

The first key issue was whether the imperfect slabs constituted “property damage” as defined in the policy. Second, the parties disagreed on whether the sagging and cracking were caused by faulty workmanship and, if so, excluded under the policy.

**Decision**

Based on expert evidence, the court concluded that the defects in the slabs were caused by the failure of the formwork and shoring procedures to account for the thin design of the slabs. With that established, Skolrood J. set out to determine (1) whether the costs incurred to fix the slabs fell within the scope of coverage; and (2) whether the claim was excluded under the faulty workmanship exclusion.

***(1) Coverage under the Policy—Property Damage or Defective Product?***

Testing showed that, although safe, the slabs required repair work to ensure they could be used as intended. The plaintiffs argued that the deficient slabs fell within the meaning of “physical loss and damage” in the perils insured clause. By contrast, the Insurers characterized the sagging and cracks as *defects* in the slab product. In other words, the Insurers argued that the slabs could not be considered damaged given their essential state had not been altered, and they continued to function as slabs. The Insurers argued that the policy did not cover the cost of fixing defective products.

Skolrood J. was unconvinced. He found that the sagging and cracks fell within the perils insured clause as fortuitous damage. Key to this finding were his observations that there had been significant and varying degrees of over-deflection and cracking from slab to slab, and that the unsuitable slabs rendered the facility unfit for its intended purpose. Overall, the extent and permanent nature of what had occurred meant the slabs were left in an altered physical state. Contrary to the Insurers’ position, the slabs did not function as proper slabs if patient beds and other equipment would inevitably roll to the centre of a concave concrete floor.

***(2) The Exclusions under the Policy: Failure Is Not Always Fault but Lack of Foresight Is***

The court then considered the applicability of the faulty workmanship exclusion. The Insurers argued that the losses claimed fell outside the scope of policy coverage due to the following exclusion clause:

This Policy does not insure:

- (b) all costs rendered necessary by defects of material workmanship, design, plan, or specification, and should damage occur to any portion of the Insured Property containing any of the said defects the cost of replacement or rectification which is hereby excluded is that cost which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage.

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In short, the Insurers argued that the policy insured against property damage but not the cost of remedying defects due to faulty workmanship. The plaintiffs argued that the Insurers had failed to prove that the sagging and cracks were caused by defective design or workmanship. The court sided with the Insurers on this issue and found that the flaws were caused by faulty workmanship.

Based on the expert evidence, the court found that the formwork and shoring procedures were not adapted to accommodate the unusually thin slab design. With heavy reference to *Canadian National Railway Co v Royal and Sun Alliance Insurance Co of Canada*, 2008 SCC 66 [“CNR”]—the leading case on faulty design exclusions—Skolrood J. considered whether the formwork and shoring in this case fell within the exclusion. In *CNR*, the majority view held that the words “faulty” or “improper” required an insurer to establish that a design had fallen below a “realistic” standard in order to rely on the faulty design exclusion. In other words, a failed design is not always a faulty one. The standard is not one of perfection, and the exclusion does not apply if the design complies with the state of the art.

In *Acciona*, the fact that the formwork and shoring procedures employed had failed to account for the thin slabs did not mean that they were necessarily defective. Skolrood J. applied the *CNR* principle with equal force to the workmanship exclusion: workmanship is not faulty simply because it fails to meet a standard of perfection in relation to all foreseeable risks. The plaintiffs argued that the formwork and reshoring procedures were state of the art: they had been implemented by an experienced concrete contractor using the same method for years on numerous projects. The Insurers said that this method must be defective as it failed to fulfill its intended purpose.

Skolrood J. noted that in *CNR*, the engineers could only have detected the resulting defect with the benefit of hindsight. In contrast, all of the experts in *Acciona* acknowledged the foreseeable risks associated with the unusually thin design of the concrete slabs, including the problems that materialized. The concrete contractor failed to accommodate the thin design by changing the formwork and shoring procedures. This amounted to faulty workmanship, thus the exclusion applied.

#### *Excluded Costs are Limited and Other Damages Issues*

The excluded costs were those that would have remedied or rectified the shoddy workmanship before the damage actually occurred. In this case, those costs would be the additional costs that would have been incurred to implement proper formwork and shoring procedures to prevent sagging and cracked slabs. There was no evidence given to quantify those costs except that they would have been minimal.

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The court also considered the reasonableness of the extra costs claimed for expediting the slab repair. Additional subcontractor costs arising from working out of sequence, overtime expenses, and increased costs payable in connection with less desirable working conditions were excluded. Those costs arose out of the plaintiffs' contractual obligations owed to the subcontractors and were not covered under the policy. Costs claimed for increased involvement of senior executives were also denied and were not direct losses within the coverage of the policy. The plaintiffs' profit margin and overhead costs were recoverable but reduced by a percentage to account for the excluded subcontractor costs.

### **Comment**

*Acciona* provides a thorough review of the general principles of insurance and interpretation of insurance policies. It also affirms the *CNR* 'state of the art' standard of analysis from the Supreme Court of Canada, extending that principle from faulty design exclusions to faulty workmanship exclusions. Before relying on faulty workmanship exclusions, insurers will be required to demonstrate that the work fell below a realistic standard in failing to address foreseeable risks.

The significant points from this case include the following:

- Fortuity is still required in order for a loss or damage to trigger coverage;
- Even functional and safe projects are defective if they cannot be put to their intended use;
- Workmanship that fails to *address all foreseeable risks* is not necessarily faulty or improper;
- Under this standard policy wording, excluded costs are those that will have remedied the faulty workmanship before damage actually occurs;
- Extra costs to expedite repair must be reasonable; and
- Projects must employ state of the art workmanship, particularly where established methods are applied to novel or complex designs.

The full text of the British Columbia Supreme Court judgment of *Acciona Infrastructure Canada Inc v Allianz Global Risks US Insurance Company, 2014 BCSC 1568* can be [found on the CanLII website](#).



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