

BRIEFING NOTE

Faulty Workmanship Exclusions and Resultant Damage: Builders' Risk Insurance Policies

Ledcor Construction Limited v. Northbridge Indemnity Insurance Company, 2016 SCC 37

The Supreme Court of Canada's decision in *Ledcor* has defined the scope of the "faulty workmanship" exclusion in builders' risk insurance policies and created an exception to the appellate standard of review for standard form contracts.

An 'All Risks' or 'Builders' Risk' insurance policy typically provides blanket coverage for damage arising to a construction project, subject always to certain exclusions. The policy runs during construction and often for months or years after completion. These policies will usually cover all the parties to the construction job (named and unnamed) and are meant to create efficiencies by providing uniform insurance coverage. In most cases the coverage is purchased by the owner or developer. The contractors, subcontractors and consultants are additional insureds.

Most builders' risk policies exclude faulty workmanship but cover resulting damage arising from that faulty workmanship. The Supreme Court of Canada held that the faulty workmanship exclusion did not apply to window damage caused by a cleaning subcontractor's substandard cleaning.

Background:

The defendant insurers insured the construction of the EPCOR Tower in Edmonton through a builders' risk policy. The policy covered "all direct physical loss or damage except as hereinafter provided". One of the exclusions was for faulty workmanship:

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.

Near completion of construction, a cleaning contractor, Bristol, was contracted to do a clean of the exterior, including the windows to remove concrete specks and other debris. During the cleaning, the wiping motion damaged the windows and they needed to be replaced. The issue was whether the replacement cost of the windows was covered as resulting damage or excluded as the cost to make good faulty workmanship.

Lower Courts:

At trial the judge held that the policy was ambiguous and used the *contra proferentum* rule to interpret the clause against the insurers and allowed the claim.

Guild Yule LLP

BARRISTERS AND SOLICITORS

2100 – 1075 Georgia Street

Vancouver, BC V6E 3C9

www.guildyule.com

P 604 688 1221

F 604 688 1315

E feedback@guildyule.com

The Alberta Court of Appeal, applying the standard of correctness to the trial judge's decision, allowed the appeal and reversed. The Court of Appeal created a new test to assess the connectedness between the work, the damage, and the physical thing being worked on in order to determine if the damage was covered or excluded.

Applying this test, the court found that Bristol's cleaning was the work that caused the damage to the windows. The damage was neither accidental nor fortuitous, and the scraping and wiping were at the core of the cleaning. Replacing the windows was "making good the faulty workmanship" and not "resultant damage."

Supreme Court of Canada

The SCC overturned the Court of Appeal's decision and found in favour of Ledcor and held that the cost to replace the windows was covered by the builders' risk policy. The SCC made the following significant findings:

- the standard of appellate review for interpreting standard form contracts (like an insurance policy) is correctness. This is an exception to the SCC's decision in *Sattva* (SCC -2014) where the court held that the interpretation of a contract is a question of mixed fact and law that deserved a more deferential treatment on appeal;
- contrary to the Court of Appeal's finding, the SCC held that in the case of builders' risk policies covering physical damage, the exclusion to that coverage does not necessarily have to also relate to physical damage. The Court of Appeal's new test was rejected;
- the SCC agreed that the exclusion was ambiguous but that the ambiguity could be resolved without resort to the *contra proferentum* rule by making reference to the purpose of the builders' risk policies and the reasonable expectations of the parties;

The SCC ultimately found that the faulty workmanship exclusion in the builders' risk insurance policy only excludes the cost of re-doing the faulty work, and not the cost of repairing the damaged work.

Impact of this Case:

The decision in *Ledcor* has given us a defined interpretation of the faulty workmanship exclusion in a builders' risk policy. The SCC's decision applies in cases where the faulty work damages the work of *another* contractor. The court was clear to state in *obiter* that if Bristol was also responsible for installing the windows, the exclusion would apply as the damage would not be "resultant damage". The insurers argued that this would lead to those involved in a construction project dividing the work amongst as many contractors as possible to ensure coverage. The SCC rejected that argument and stated that the argument did not reflect the commercial realities of construction projects.

The more significant impact of this decision may be on the interpretation of standard form contracts. It also remains to be seen what happens with *Acciona Infrastructure Canada Inc. v Allianz Global Risks US Insurance Company* (2015 BCCA), a case also involving a faulty workmanship exclusion. In the British Columbia Court of Appeal's decision, the trial decision was reviewed on the standard of reasonableness. Leave to appeal to the SCC has been sought in that matter.

Guild Yule LLP
BARRISTERS AND SOLICITORS

2100 – 1075 Georgia Street
Vancouver, BC V6E 3C9

www.guildyule.com

P 604 688 1221

F 604 688 1315

E feedback@guildyule.com



C. Byron Yep

byep@guildyule.com

Direct: 604-844-5547