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Thomas Heintzman's practice specializes in arbitration, mediation and litigation relating to corporate disputes, shareholder's rights, securities law, broadcasting/telecommunications and class actions.

He has been counsel in many important actions, arbitrations, and appeals before all levels of courts in many Canadian provinces as well as the Supreme Court of Canada.

Thomas Heintzman is the author of Heintzman & Goldsmith on Canadian Building Contracts, 4th Edition which provides an analysis of the law of contracts as it applies to building contracts in Canada.

Heintzman & Goldsmith on Canadian Building Contracts has been cited in over 183 judicial decisions including the two leading Supreme Court of Canada decisions on the law of tendering:

An Insurance Clause Does Not Necessarily Bar A Claim By The Owner

When does an insurance clause in a construction contract bar a claim by the owner against the contractor? Is it barred if the contract requires that the contractor obtain insurance and that the owner is to be named as an additional insured and that subrogation is waived against the owner? That was the issue in the recent decision of the British Columbia Court of Appeal in ***Lafarge Canada Inc. v. JJM Construction Ltd.***

The Background

The contract in question was for the charter of barges by the owner, JJM, to the charterer, Lafarge, but the principles in question appear to be no different than in a construction contract.

The contract placed the sole responsibility on Lafarge for the barges' good condition during the term of the contract. The contract contained "insurance clauses" which required Lafarge to maintain insurance on the barges with loss payable to JJM and also required that the insurance name JJM as an additional insured and expressly waive subrogation against JJM as the owner.

When the barges were returned to JJM at the end of the contract they were damaged. JJM repaired the barges, made a claim under the insurance and then claimed against Lafarge for the additional costs that it incurred over the insurance recovery. The parties agreed to arbitrate the claim.

In the arbitration, Lafarge argued that the "insurance clauses" barred any claim against it. It relied upon a series of decisions of the Supreme court of Canada (***Agnew Surpass v. Cummer-Yonge***, ***Ross Southward v. Pyrotech Products***, ***T. Eaton v. Smith*** *and* ***Commonwealth Construction v. Imperial Oil***) and various lower court decisions which applied the principles in those decisions.

In some of those cases, claims by owners against tenants and contractors were dismissed based upon insurance clauses in which the owner had agreed to obtain insurance covering the building or project. In other cases, the owners' claims were dismissed based upon clauses requiring the tenant or contractor to contribute to the insurance premiums incurred by the landlord. In both cases, the courts held that these clauses effectively passed the risk of loss to the owner, even in the presence of a general duty placed on the tenant or contractor to repair and maintain the building or project.

The arbitrator agreed with JJM that the insurance clause in question did not protect Lafarge. The arbitrator's decision was upheld by the British Columbia Supreme Court and Court of Appeal.

The Court of Appeal held that the prior decisions relied upon by Lafarge did not apply to the present circumstances. Those cases involved two situations.

The first situation is a claim by the party which undertook the obligation to insure the other party. That was the situation in each of the Supreme Court of Canada cases in which the owner, expressly or impliedly, undertook to obtain insurance on the building or project, and then sued the tenant or contractor when there was damage to the building. The obligation to insure was express if the lease or construction contract stated that the owner would insure the building or project. The obligation to insure was implied if the lease stated that the tenant would contribute to the insurance maintained by the landlord. In either situation, the courts held that the owner had assumed the risk of damage to the building and could not sue the tenant or contractor.

The second situation is a subrogated claim by an insurer of the owner. The claim may be against a tenant or contractor which was a named or unnamed insured under the insurance policy taken out by the owner. Or the claim may be against a tenant or contractor which the owner agreed to name as an insured party in the insurance policy to be taken out by the owner,

but the owner failed to take out that insurance. In both cases, the courts have held that the insurer could not maintain such a claim.

Neither situation existed here. In this case, the claim was by the owner but the owner had not contracted to take out insurance. Rather, it was the charterer, Lafarge, which had contracted to take out the insurance, and insurance naming the owner as an insured party. Here, the claim was not by the insurer but by JJM for its uninsured loss after giving full credit to Lafarge for all insurance proceeds it had received.

Lafarge argued that a wider principle applied. Effectively Lafarge was seeking to broaden the first category, namely, the implied obligation to insure arising from a contribution made by a tenant or contractor to the owner's insurance premiums. Lafarge argued that this implied obligation is based upon the principle that any time a party pays for insurance under a contract relating to a project or building, all claims arising from that project or building must be made under the insurance policy, and that all other claims against that party are barred.

The Court of Appeal rejected that argument. It pointed out that Lafarge had cited no cases that supported its argument. It also noted that, in the first category of cases on which Lafarge relied, the party suing (usually the owner) was the party which had an express or implied obligation to obtain insurance for the benefit of the <u>other</u> party (usually the tenant or contractor) . In the present case, the party suing (the owner, JJM) had <u>not</u> undertaken to obtain insurance. To the contrary, the party suing was the beneficiary of the insurance to be obtained by the other party. Effectively, Lafarge was arguing that JJM should be deprived of a remedy by the very insurance that Lafarge had agreed to obtain for JJM's benefit.

The Court of Appeal concluded that the other cases cited by Lafarge were all based upon claims made by insurers and were based upon two principles of subrogation.

<u>First</u>, the insurer could not sue the other party (usually the tenant or contractor) because the other party was a named or unnamed beneficiary of the policy under which the insurer had paid. Under well known principles of insurance law, an insurer cannot bring a subrogated claim against another party insured under the same policy.

<u>Second</u>, another well know principle of insurance law is that the insurer has no greater subrogation rights than its insured (usually the owner). If the owner had contracted to obtain insurance for the building or project and to name the other party (usually the tenant or contractor) as an insured and had failed to do so, then the owner had accepted the risk of damage and the insurer could be in no better position than the owner when maintaining a subrogated claim.

The present case did not fall within those principles. JJM had not contracted to obtain insurance and the claim was not a subrogated claim.

This decision by the British Columbia Court of Appeal is a good reminder that "insurance clauses" do not necessarily create a water-tight regime which precludes claims by one party

against the other under insurance contracts. The water-tight regime may apply to, and exclude, claims by the party (or its insurer) which agrees, either expressly or by implication, to obtain insurance on the project for the benefit of the other party. But, without more, it may not apply to and exclude claims against the party which agreed to put that insurance in place.

The business logic of this decision is also sound. As the Court of Appeal pointed out, it was Lafarge which arranged for the insurance, together with the terms and the deductible that resulted in JJM's insurance claim not being paid in full. In this circumstance, it seems only fair that Lafarge bear the risk of any uninsured shortfall.

This conclusion may have several unsettling implications for a party taking out insurance for a construction project.

First, the party agreeing to take out insurance (Lafarge in this case) undoubtedly conferred a benefit on the owner (JJM). Wasn't the amount of rent paid by Lafarge for the barges likely reduced, in some measure, by the cost of that insurance and the benefit conferred on JJM? If so, isn't that benefit akin to the contribution made by a contractor or tenant to the owner's insurance premiums? And if that is so, should that fact not give rise to an implied duty on JJM to accept that insurance as its sole remedy?

Second, to the extent possible owners and contractors usually want to create a water-tight insurance regime in the construction contract. Each of them wants to ensure that the insurance regime provides the only remedies available to the other party. How can they accomplish that result?

Clearly, this case tells us that the insurance clause and the insurance itself is not sufficient, at least so far as claims against the party which agrees to take out the insurance. What is sufficient? Must the contract provide that the insurance is the sole remedy of either party? Is there any other way to create that "water-tight" regime so far as claims against the party taking out the insurance? This case will have owners and contractors scratching their heads to come up with an answer.

See **Heintzman and Goldsmith on Canadian Building Contracts** (4th ed.), Chapter 5, Part 3

Arbitration - Construction Contract – Insurance - Subrogation

***Lafarge Canada Inc. v. JJM Construction Ltd.,* 2011 BCCA 453**

Thomas G. Heintzman O.C., Q.C. **February 20, 2012**

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