SUPREME COURT OF CANADA

CITATION: Progressive Homes Ltd. *v.* Lombard General Insurance Co. of Canada, 2010 SCC 33, [2010] 2 S.C.R.245

DATE: 20100923
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BETWEEN:

Progressive Homes Ltd.
Appellant
and
Lombard General Insurance Company of Canada
Respondent

CORAM: McLachlin C.J. and Binnie, LeBel, Deschamps, Fish, Abella, Charron, Rothstein and Cromwell JJ.

REASONS FOR JUDGMENT: (paras. 1 to 73)

Rothstein J. (McLachlin C.J. and Binnie, LeBel, Deschamps, Fish, Abella, Charron and Cromwell JJ. concurring)

Progressive Homes Ltd. *v.* Lombard General Insurance Co. of Canada, 2010 SCC 33, [2010] 2 S.C.R.245

Progressive Homes Ltd. *Appellant*

v.

Lombard General Insurance Company of Canada *Respondent*

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2010 SCC 33

File No.: 33170.

2010: April 20; 2010: September 23.

Present: McLachlin C.J. and Binnie, LeBel, Deschamps, Fish, Abella, Charron, Rothstein and Cromwell JJ.

ON APPEAL FROM THE COURT OF APPEAL FOR BRITISH COLUMBIA

Insurance — Liability insurance — Insurer's duty to defend — Commercial general

liability policy — Scope of coverage — Claims against insured for negligence in construction of buildings and for breach of contract — Insured alleging inadequate construction completed by subcontractors — Insurance policy covers property damage caused by an accident — Whether "property damage" limited to third-party property damage — Whether defective workmanship considered to be an "accident" — Whether insurer owes a duty to defend claims against insured.

Insurance — Liability insurance — Insurer's duty to defend — Policy exclusion — Whether exclusion for "work performed" includes work completed by subcontractors.

The insured, Progressive Homes, was hired as a general contractor to build several housing complexes. After completion, four actions were initiated against Progressive claiming breach of contract and negligence. It was alleged that significant water damage caused rot, infestation and deterioration to all four buildings. Progressive had secured several commercial general liability insurance policies with the insurer, Lombard. The policies required Lombard to defend and indemnify Progressive when Progressive is legally obligated to pay damages because of property damage caused by an occurrence or accident. Lombard claimed that it did not have a duty to defend because the claims were not covered under the insurance policies. Progressive brought an application for a declaration that Lombard was under a duty to defend in the four actions. The applications judge found that the claims did not fall within the initial grant of coverage under the policies and therefore Lombard did not owe a duty to defend. A majority of the Court of Appeal dismissed the appeal.

Held: The appeal should be allowed.

An insurer is required to defend a claim where the facts alleged in the pleadings, if proven to be true, would require the insurer to indemnify the insured for the claim. It is irrelevant whether the allegations in the pleadings can be proven in evidence. What is required is the mere possibility that a claim falls within the insurance policy. Where it is clear that the claim falls outside the policy, either because it does not come within the initial grant of coverage or is excluded by an exclusion clause, there will be no duty to defend. In examining the pleadings to determine whether the claims fall within the scope of coverage, what is determinative is the true nature or substance of the claim, not the labels selected by the plaintiff.

The focus of insurance policy interpretation should first and foremost be on the language of the policy at issue. For insurance policies that set out coverage, followed by exclusions, followed by exceptions, such as those found in this case, it is generally advisable to interpret the policy in the order of: coverage, exclusions and then exceptions. Each of the insurance policies in this case cover "property damage" caused by an "accident". The onus is on Progressive to show that the pleadings fall within the initial grant of coverage. The plain and ordinary meaning of "property damage" in this case includes damage to any tangible property and is not limited to damage to third-party property. Hence, damage to one part of a building arising from another part of the same building could be included in the definition. "Accident" should also be given the plain meaning prescribed to it in the policies and should apply when an event causes property damage neither expected nor intended by the insured. The accident need not be a sudden event and can result from continuous or repeated exposure to conditions. Whether defective workmanship is an accident is necessarily a case-specific determination. It will depend both on the circumstances of the defective workmanship alleged in the pleadings and the way in which "accident" is defined in the policy.

The duty to defend only requires a possibility of coverage, and that possibility is made out in this case. The pleadings reveal a possibility of "property damage". The pleadings describe water leaking in through windows and walls and allege deterioration of the building components resulting from water ingress and infiltration. The pleadings also describe defective property. The pleadings also sufficiently allege an "accident" for the purpose of deciding whether Lombard owes a duty to defend. There is no reference to intentional conduct by Progressive which would suggest that the property damage was expected or intended. The pleadings allege negligence, which, on its face, suggests that the damage was fortuitous. In addition, it is clear from the pleadings that the damage alleged is the result of "continuous or repeated exposure to conditions", which squarely fits within the definition.

Having found the claims in the pleadings fall within the initial grant of coverage, the onus shifts to Lombard to show that coverage is precluded by an exclusion clause. Lombard has not discharged its burden of showing that the "work performed" exclusion clearly and unambiguously applies to all of the claims made against Progressive and there is thus a possibility of coverage under each version of the policy. Depending on which version of the policy applies, there is a possibility of coverage for damage to work completed by a subcontractor, for damage resulting from work performed by a subcontractor, or for damage resulting from the particular part of the Progressive's work that was defective. Therefore, the duty to defend is triggered.

Cases Cited

Referred to: *Swagger Construction Ltd. v. ING Insurance Co. of Canada*, 2005 BCSC

1269, 47 B.C.L.R. (4th) 75; *Nichols v. American Home Assurance Co.*, [1990] 1 S.C.R. 801; *Monenco Ltd. v. Commonwealth Insurance Co.*, 2001 SCC 49, [2001] 2 S.C.R. 699; *Jesuit Fathers of Upper Canada v. Guardian Insurance Co. of Canada*, 2006 SCC 21, [2006] 1 S.C.R. 744; *Non-Marine Underwriters, Lloyd's of London v. Scalera*, 2000 SCC 24, [2000] 1 S.C.R. 551; *Co-operators Life Insurance Co. v. Gibbens*, 2009 SCC 59, [2009] 3 S.C.R. 605; *Brissette Estate v. Westbury Life Insurance Co.*, [1992] 3 S.C.R. 87; *Consolidated-Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888; *Winnipeg Condominium Corporation No. 36 v. Bird Construction Co.*, [1995] 1 S.C.R. 85; *Bird Construction Co. v. Allstate Insurance Co. of Canada*, [1996] 7 W.W.R. 609; *Alie v. Bertrand & Frère Construction Co.* (2002), 222 D.L.R. (4th) 687; *Bridgewood Building Corp. (Riverfield) v. Lombard General Insurance Co. of Canada* (2006), 266 D.L.R. (4th) 182; *Westridge Construction Ltd. v. Zurich Insurance Co.*, 2005 SKCA 81, 269 Sask. R. 1; *Celestica Inc. v. ACE INA Insurance* (2003), 229 D.L.R. (4th) 392; *Erie Concrete Products Ltd. v. Canadian General Insurance Co.*, [1969] 2 O.R. 372; *Harbour Machine Ltd. v. Guardian Insurance Co. of Canada* (1985), 60 B.C.L.R. 360; *Supercrete Precast Ltd. v. Kansa General Insurance Co.* (1990), 45 C.C.L.I. 248; *Canadian Indemnity Co. v. Walkem Machinery & Equipment Ltd.*, [1976] 1 S.C.R. 309; *Martin v. American International Assurance Life Co.*, 2003 SCC 16, [2003] 1 S.C.R. 158; *Fenton v. J. Thorley & Co., Ltd.*, [1903] A.C. 443; *American Family Mutual Insurance Co. v. American Girl, Inc.*, 673 N.W.2d 65 (2004).

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APPEAL from a judgment of the British Columbia Court of Appeal (Ryan, Huddart and Kirkpatrick JJ.A.), 2009 BCCA 129, 90 B.C.L.R. (4th) 297, 307 D.L.R. (4th) 460, 268 B.C.A.C. 235, 452 W.A.C. 235, [2009] 8 W.W.R. 261, 72 C.C.L.I. (4th) 163, 78 C.L.R. (3d) 171, [2009] I.L.R. ¶I-4826, [2009] B.C.J. No. 572 (QL), 2009 CarswellBC 744, affirming a decision of Cohen J., 2007 BCSC 439, 71 B.C.L.R. (4th) 113, [2007] 6 W.W.R. 734, 48 C.C.L.I. (4th) 64, 59 C.L.R. (3d) 225, [2007] I.L.R. ¶I-4626, [2007] B.C.J. No. 651 (QL), 2007 CarswellBC 635. Appeal allowed.

Gordon Hilliker, Q.C., and *Neo Tuytel*, for the appellant.

Ward K. Branch, *Michael J. Sobkin* and *Christopher Rhone*, for the respondent.

The judgment of the Court was delivered by

[1] ROTHSTEIN J. — The issue in this appeal is whether the insurer, Lombard General Insurance Company of Canada ("Lombard"), owes a duty to defend claims against the insured, Progressive Homes Ltd. ("Progressive"). For the reasons that follow, I conclude that Lombard owes a duty to defend.

I. Overview

A. *Facts*

[2] British Columbia Housing Management Commission ("BC Housing") hired Progressive as a general contractor to build several housing complexes. After completion, BC Housing initiated four actions against Progressive alleging significant damage caused by water leaking into each of the four buildings. The claims allege breach of contract and negligence. The water damage has allegedly caused significant rot, infestation and deterioration to all four buildings. BC Housing alleges that the buildings are unsafe and pose a serious risk to the health and safety of the occupants.

[3] Progressive had secured five successive commercial general liability insurance policies ("CGL policies") with Lombard. These successive policies were in place from the time of construction until the time the actions against Progressive were brought. There were three versions of the five successive policies: the first version being the first policy; the second version being the second, third and fourth policies; and the third version being the fifth policy. The policies are "occurrence policies" which insure Progressive against damage caused by "occurrences" or "accidents". The policies require Lombard to defend and indemnify Progressive when Progressive is legally obligated to pay damages because of property damage caused by an occurrence or accident.

[4] Lombard initially defended Progressive, but later withdrew claiming that it had no duty

to defend because the claims were not covered under the insurance policies. The withdrawal was, at least in part, a result of a prior B.C. Supreme Court decision, *Swagger Construction Ltd. v. ING Insurance Co. of Canada*, 2005 BCSC 1269, 47 B.C.L.R. (4th) 75 ("*Swagger*"), which found that similar damage was not covered by a similar insurance policy.

[5] Progressive brought an application for a declaration that Lombard is under a duty to defend in the four actions.

B. *Pleadings*

[6] The issue of the duty to defend requires the consideration of the pleadings in the actions against Progressive to determine if there is a possibility of the claims falling within the insurance coverage. There are four actions against Progressive — one for each housing unit. The four sets of pleadings are very similar. The pleadings allege that Progressive was negligent in its construction of the housing units and that it breached its contract with BC Housing. The pleadings allege that Progressive's conduct resulted in the following:

> DEFECTS
>
> 29. As a result of the breaches of contract by Progressive and the negligence of the Defendants and others, and all of them, the Development has sustained since the date of construction and continues to sustain defects and ongoing damage including the following:
>
> (a) water leaking through the exterior walls;
>
> (b) improper and incomplete installation and construction of framing, stucco walls, vinyl siding, windows, sheathing paper, flashings, ventilation, walkway membranes, flashing membranes, eaves troughs, downspouts,

gutters, drains, balcony decks, pedestrian walkways, railings, roofs, and patio doors;

(c) insufficient venting and drainage of wall systems;

(d) inadequate exhaust ventilation system;

(e) water leaking through the windows;

(f) improper use of caulking;

(g) poorly assembled and installed windows;

(h) deterioration of the building components resulting from water ingress and infiltration

all of which are collectively referred to as the "Defects" and were caused by the Defendants and all of which constitute further breaches of the terms of the agreements referenced above.

30. As a reasonably foreseeable consequence of Defects and particulars outlined above, significant portions of the Development have suffered since the date of construction and continue to suffer considerable moisture penetration, resultant rot and infestation which has caused the Development to be unsafe and hazardous and to pose a substantial physical danger to the health and safety of the occupants.

. . .

DAMAGES

33. As a result of the Defects and of the negligence and breaches of contract by the Defendants the Plaintiffs have suffered damages including but not limited to the following:

(a) inspection and professional advice concerning the Defects;

(b) cost to date of remedial work, both permanent and temporary;

(c) cost of relocation and alternate housing of tenants during remediation work and other tenant expenses;

(d) diminution in value of the Development; and

(e) expense, inconvenience and hardship caused by the construction and design deficiencies and their repair.

In essence, the pleadings allege that the condos were inadequately constructed, resulting in significant water damage.

[7] Progressive asserts that the inadequate construction was completed by subcontractors. The pleadings identify several subcontractors who were responsible for the installation of vinyl decking, a waterproof membrane and a ventilation system.

C. *Insurance Policies*

[8] At all material times Progressive has had successive CGL policies in place from 1987 to 2005. While the details of the individual policies differ, the basic features of the policies are the same. Under each policy, Progressive is covered (subject to specific exclusions) for property damage caused by an accident. The description of coverage is not materially different in each version of the policy. The first policy states:

> COVERAGE B – Property Damage Liability
>
> To pay on behalf of the Insured all sums which the Insured shall become legally obligated to pay as damages because of property damage caused by accident.

[9] Under each policy, Lombard owes a duty to defend Progressive. For example, the first policy states:

> As respects insurance afforded by this form, the Insurer shall:
>
> (1) defend in the name and on behalf of the Insured and at the cost of the Insurer any

> civil action which may at any time be brought against the Insured on account of such bodily injury or property damage but the Insurer shall have the right to make such investigation, negotiation and settlement of any claim as may be deemed expedient by the Insurer; [Emphasis added.]

[10] "Property damage" is a defined term in the policies. The first policy defines "property damage" as:

> "Property damage" means (1) physical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom, or (2) loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an accident occurring during the policy period.

[11] "Accident" is a defined term in the first policy:

> "Accident" includes continuous or repeated exposure to conditions which result in property damage neither expected nor intended from the standpoint of the Insured.

In subsequent policies, the term "occurrence" is used. It is defined in the second and third versions of the policy as:

> "Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.

[12] Even if the claims fall within the initial grant of coverage — that is, there is property damage caused by an accident — then coverage may still be excluded if the insurance company shows that an exclusion clause applies. Of particular importance to this appeal is the "work

performed" exclusion, which appears in three forms in the successive policies. This exclusion precludes coverage for damage to the insured's own work once it has been completed. The details of this exclusion will be examined more closely below.

II. Judicial History

A. *Supreme Court of British Columbia, 2007 BCSC 439, 71 B.C.L.R. (4th) 113*

[13] Mr. Justice Cohen examined the pleadings and policies to determine whether there was a possibility that the claims in the pleadings fell within the insurance coverage. He concluded that Lombard did not owe a duty to defend. Cohen J. followed a line of authority, most recently the *Swagger* decision, that upheld the proposition that defective construction is not an "accident" unless it causes damage to the property of a third party. He found that the court could not artificially divide the insured's work into its component parts for the purpose of establishing resulting property damage.

[14] Cohen J. concluded that the pleadings against Progressive were "simply [a] claim for the cost of remediating parts of the unified whole and not 'property damage'" (para. 57). Therefore, the claims did not fall within the initial grant of coverage under the policies and Lombard did not owe a duty to defend.

B. *Court of Appeal for British Columbia, 2009 BCCA 129, 90 B.C.L.R. (4th) 297*

[15] A majority of the Court of Appeal dismissed the appeal. Ryan J.A., writing for herself and Kirkpatrick J.A., accepted that the duty to defend must be resolved on the wording of the policy. She also accepted that the plain meaning of the insuring provisions could support the conclusion that the claims against Progressive fell within the insurance coverage. However, she concluded that "such an interpretation flies in the face of the underlying assumption that insurance is designed to provide for fortuitous contingent risk" (para. 69). In her view, damage resulting from faulty workmanship could not be considered fortuitous.

[16] In any event, Ryan J.A. examined the "work performed" exclusion contained in the contracts. Ryan J.A. accepted that in some circumstances work performed by a subcontractor could be covered by the policies, but only if the damage was caused by a distinct item installed by a subcontractor, such as a boiler exploding. However, she found that this was not the situation in this appeal. On her reading, the pleadings alleged that integral parts of the building itself failed to function properly and were not "distinct" components that could be covered. Therefore, she held that Lombard did not owe a duty to defend.

[17] Madam Justice Huddart dissented. She found that the language of the policies supported the conclusion that damage resulting from subcontractor negligence is covered. In her view, the definition of property damage could apply where the damage was to the same building out of which the damage arose. On her reading of the policies, the exclusion clauses did not exclude damage resulting from work by subcontractors. Huddart J.A. would have found that Lombard owed a duty to defend.

III. Issue

[18] The only issue in this appeal is whether Lombard owes a duty to defend the claims against Progressive.

IV. Analysis

A. *The Duty to Defend*

[19] An insurer is required to defend a claim where the facts alleged in the pleadings, if proven to be true, would require the insurer to indemnify the insured for the claim (*Nichols v. American Home Assurance Co.*, [1990] 1 S.C.R. 801, at pp. 810-11; *Monenco Ltd. v. Commonwealth Insurance Co.*, 2001 SCC 49, [2001] 2 S.C.R. 699, at para. 28; *Jesuit Fathers of Upper Canada v. Guardian Insurance Co. of Canada*, 2006 SCC 21, [2006] 1 S.C.R. 744, at paras. 54-55). It is irrelevant whether the allegations in the pleadings can be proven in evidence. That is to say, the duty to defend is not dependent on the insured actually being liable and the insurer actually being required to indemnify. What is required is the mere possibility that a claim falls within the insurance policy. Where it is clear that the claim falls outside the policy, either because it does not come within the initial grant of coverage or is excluded by an exclusion clause, there will be no duty to defend (see *Nichols*, at p. 810; *Monenco*, at para. 29).

[20] In examining the pleadings to determine whether the claims fall within the scope of coverage, the parties to the insurance contract are not bound by the labels selected by the plaintiff

(*Non-Marine Underwriters, Lloyd's of London v. Scalera*, 2000 SCC 24, [2000] 1 S.C.R. 551, at paras. 79 and 81). The use or absence of a particular term will not determine whether the duty to defend arises. What is determinative is the true nature or the substance of the claim (*Scalera*, at para. 79; *Monenco*, at para. 35; *Nichols*, at p. 810).

B. *General Principles of Insurance Policy Interpretation*

[21] Principles of insurance policy interpretation have been canvassed by this Court many times and I do not intend to give a comprehensive review here (see, e.g., *Co-operators Life Insurance Co. v. Gibbens*, 2009 SCC 59, [2009] 3 S.C.R. 605, at paras. 20-28; *Jesuit Fathers*, at paras. 27-30; *Scalera*, at paras. 67-71; *Brissette Estate v. Westbury Life Insurance Co.*, [1992] 3 S.C.R. 87, at pp. 92-93; *Consolidated-Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888, at pp. 899-902). However, a brief review of the relevant principles may be a useful introduction to the interpretation of the CGL policies that follow.

[22] The primary interpretive principle is that when the language of the policy is unambiguous, the court should give effect to clear language, reading the contract as a whole (*Scalera*, at para. 71).

[23] Where the language of the insurance policy is ambiguous, the courts rely on general rules of contract construction (*Consolidated-Bathurst*, at pp. 900-902). For example, courts should prefer interpretations that are consistent with the reasonable expectations of the parties (*Gibbens*, at para. 26; *Scalera*, at para. 71; *Consolidated-Bathurst*, at p. 901), so long as such an interpretation

can be supported by the text of the policy. Courts should avoid interpretations that would give rise to an unrealistic result or that would not have been in the contemplation of the parties at the time the policy was concluded (*Scalera*, at para. 71; *Consolidated-Bathurst*, at p. 901). Courts should also strive to ensure that similar insurance policies are construed consistently (*Gibbens*, at para. 27). These rules of construction are applied to resolve ambiguity. They do not operate to create ambiguity where there is none in the first place.

[24] When these rules of construction fail to resolve the ambiguity, courts will construe the policy *contra proferentem* — against the insurer (*Gibbens*, at para. 25; *Scalera*, at para. 70; *Consolidated-Bathurst*, at pp. 899-901). One corollary of the *contra proferentem* rule is that coverage provisions are interpreted broadly, and exclusion clauses narrowly (*Jesuit Fathers*, at para. 28).

[25] With these interpretive principles in mind, I turn to the insurance policies at issue in this appeal.

C. *The Lombard Insurance Policies*

[26] The insurance contracts in this appeal are CGL policies. CGL insurance policies typically consist of several sections (see *Jesuit Fathers*, at para. 34; see also M. G. Lichty and M. B. Snowden, *Annotated Commercial General Liability Policy* (loose-leaf), vol. 1, at p. 1-9). The policy will set out the types of coverage contained in the agreement, for example, property damage caused by an accident.

[27] This is typically followed by specific exclusions to coverage. Exclusions do not create coverage — they preclude coverage when the claim otherwise falls within the initial grant of coverage. Exclusions, should, however, be read in light of the initial grant of coverage (*Annotated Commercial General Liability Policy*, vol. 1, at p. 1-10).

[28] A CGL policy may also contain exceptions to exclusions. Exceptions also do not create coverage — they bring an otherwise excluded claim back within coverage, where the claim fell within the initial grant of coverage in the first place (*Annotated Commercial General Liability Policy*, vol. 1, at p. 1-10). Because of this alternating structure of the CGL policy, it is generally advisable to interpret the policy in the order described above: coverage, exclusions and then exceptions.

(1) Coverage

[29] Each insurance policy covers property damage caused by an accident. The question, then, is what are the meanings of "property damage" and "accident" in these policies. The onus is on the insured, Progressive, to show that the pleadings fall within the initial grant of coverage.

(a) *Property Damage*

[30] The definition of "property damage" in the first policy is:

> "Property damage" means (1) physical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom, or (2) loss of use of tangible property which has not been physically injured or destroyed provided such loss of use is caused by an accident occurring during the policy period.

In later versions of the policies, the references to destruction were removed:

> "Property damage" means:
>
> a. Physical injury to tangible property, including all resulting loss of use of that property; or
>
> b. Loss of use of tangible property that is not physically injured.

[31] Lombard's main argument is that "property damage" does not result from damage to one part of a building arising from another part of the same building. According to Lombard, damage to other parts of the same building is pure economic loss, not property damage. What follows from this argument is that "property damage" is limited to third-party property.

[32] Lombard's argument stems from a distinction between property damage and pure economic loss that is drawn in tort law. It relies on a passage from this Court's decision in *Winnipeg Condominium Corporation No. 36 v. Bird Construction Co.*, [1995] 1 S.C.R. 85. This was a claim in negligence against a general contractor, subcontractor and architect after a storey-high section of cladding fell from the side of a building to the ground below. The Court found that the loss was not property damage, but a recoverable form of economic loss. The passage on which Lombard relies is the adoption of an excerpt from a House of Lords decision, which rejects the notion that a building can be subdivided into its component parts for the purpose of finding resulting property damage.

At para. 15 of *Winnipeg Condominium*, La Forest J. stated:

> In [*Murphy v. Brentwood District Council*, [1990] 2 A11 E.R. 908 (H.L.)], at pp. 926-28, Lord Bridge reconsidered and rejected the "complex structure" theory he had suggested in *D & F Estates*, criticizing the theory on the following basis (at p. 928):
>
> > The reality is that the structural elements in any building form a single indivisible unit of which the different parts are essentially interdependent. To the extent that there is any defect in one part of the structure it must to a greater or lesser degree necessarily affect all other parts of the structure. Therefore any defect in the structure is a defect in the quality of the whole and it is quite artificial, in order to impose a legal liability which the law would not otherwise impose, to treat a defect in an integral structure, so far as it weakens the structure, as a dangerous defect liable to cause damage to 'other property'.
> >
> > A critical distinction must be drawn here between some part of a complex structure which is said to be a 'danger' only because it does not perform its proper function in sustaining the other parts and some distinct item incorporated in the structure which positively malfunctions so as to inflict positive damage on the structure in which it is incorporated. Thus, if a defective central heating boiler explodes and damages a house or a defective electrical installation malfunctions and sets the house on fire, I see no reason to doubt that the owner of the house, if he can prove that the damage was due to the negligence of the boiler manufacturer in the one case or the electrical contractor in the other, can recover damages in tort on *Donoghue v. Stevenson* principles.
>
> I am in full agreement with Lord Bridge's criticisms of the "complex structure" theory. [Emphasis added.]

[33] After the defendants were found liable in *Winnipeg Condominium*, the general contractor, Bird, sought indemnification from its insurer in *Bird Construction Co. v. Allstate Insurance Co. of Canada*, [1996] 7 W.W.R. 609. The Manitoba Court of Appeal relied on the passage from *Winnipeg Condominium* to conclude that the claim was not covered because it was not a claim for property damage (para. 11). However, the court also found that coverage was precluded because of a specific exclusion for worked performed by or on behalf of the policyholder (para. 12).

[34] Lombard relies on this reasoning to assert its position that "property damage" in the CGL policies cannot mean damage caused by other parts of the same building. Lombard argues that property damage is limited to third-party property damage and does not include damage to the insured's own work.

[35] I cannot agree with Lombard's interpretation of "property damage". The focus of insurance policy interpretation should first and foremost be on the language of the policy at issue. General principles of tort law are no substitute for the language of the policy. I see no limitation to third-party property in the definition of "property damage". Nor is the plain and ordinary meaning of the phrase "property damage" limited to damage to another person's property. Indeed, the Ontario and Saskatchewan Courts of Appeal reached the same conclusion with respect to similar definitions of "property damage" in CGL policies: *Alie v. Bertrand & Frère Construction Co.* (2002), 222 D.L.R. (4th) 687 (Ont. C.A.), at paras. 26, 41 and 45, and *Bridgewood Building Corp. (Riverfield) v. Lombard General Insurance Co. of Canada* (2006), 266 D.L.R. (4th) 182 (Ont. C.A.), at paras. 6-7; *Westridge Construction Ltd. v. Zurich Insurance Co.*, 2005 SKCA 81, 269 Sask. R. 1, at para. 38.

[36] I would construe the definition of "property damage", according to the plain language of the definition, to include damage to any tangible property. I do not agree with Lombard that the damage must be to third-party property. There is no such restriction in the definition.

[37] The plain meaning of "property damage" is consistent with reading the policy as a whole. Qualifying the meaning of "property damage" to mean third-party property would leave little

or no work for the "work performed" exclusion (discussed in more detail below). Lombard argues that the exclusion clauses do not create coverage. This is true. But reading the insurance policy as a whole is not the same as conjuring up coverage when there was none in the first place. Consistency with the exclusion clauses is a further indicator that the plain meaning of "property damage" is the definition intended by the parties.

[38] Does the definition of "property damage" exclude defects? Or, can defective property constitute "property damage" as defined in the policies? Progressive concedes that the effect of the definition of "property damage" is to exclude coverage for a claim to repair a defect. Lombard agrees that defects are not included in the definition of "property damage".

[39] While this point was not contested and nothing turns on it in this appeal, it is not obvious to me that defective property cannot also be "property damage". In particular, it may be open to argument that a defect could not amount to a "physical injury", especially where the harm to the property is "physical" in the sense that it is visible or apparent (see, e.g., *Annotated Commercial General Liability Policy*, vol. 1, at p. 10-10). Moreover, where a defect renders the property entirely useless it may be arguable that defective property may be covered under "loss of use", the second portion of the definition of "property damage".

[40] I would also note that not barring defective property from the definition of "property damage" at the outset gives meaning to the exclusion clauses discussed below. Specifically, the second version of the policies expressly excludes coverage for defects. This would be redundant if defects were excluded from "property damage" at the outset. While perfect mutual exclusivity

in an insurance contract is not required, this redundancy supports the view that the definition of "property damage" may not categorically exclude defective property.

[41] Do the pleadings allege "property damage"? In my view, they do. The pleadings describe water leaking in through windows and walls and allege "deterioration of the building components resulting from water ingress and infiltration". The pleadings also describe defective property, which may also be "property damage": e.g., improperly built walls, inadequate ventilation system, poorly installed windows. Whether specific property actually falls within the definition of "property damage" is a matter to be determined on the evidence at trial. This meets the low threshold of showing that the pleadings reveal a possibility of property damage for the purpose of deciding whether Lombard owes a duty to defend.

(b) *Accident*

[42] Progressive must also show that the property damage described above was caused by an accident.

[43] "Accident" is defined in the first policy as:

> "Accident" includes continuous or repeated exposure to conditions which result in property damage neither expected nor intended from the standpoint of the Insured.

As indicated before, essentially the same definition applies to "occurrence" which is used in later versions of the policies.

[44] Progressive again relies on the plain meaning of the definition of accident. It argues that "accident" includes the negligent act that caused damage that was neither expected nor intended by Progressive.

[45] Lombard disagrees. Lombard argues that when a building is constructed in a defective manner, the end result is a defective building, not an accident. It relies on case law that, in its view, supports its argument that faulty workmanship is not an accident (e.g., *Celestica Inc. v. ACE INA Insurance* (2003), 229 D.L.R. (4th) 392 (Ont. C.A.); *Erie Concrete Products Ltd. v. Canadian General Insurance Co.*, [1969] 2 O.R. 372 (H.C.J.); *Harbour Machine Ltd. v. Guardian Insurance Co. of Canada* (1985), 60 B.C.L.R. 360 (C.A.); *Supercrete Precast Ltd. v. Kansa General Insurance Co.* (1990), 45 C.C.L.I. 248 (B.C.S.C.)). It relies on Ryan J.A.'s conclusion, in the court below, that this interpretation would offend the assumption that insurance provides for fortuitous contingent risk. Lombard argues that interpreting accident to include defective workmanship would convert CGL policies into performance bonds. In my opinion, these general propositions advanced by Lombard do not hold upon closer examination.

[46] First, whether defective workmanship is an accident is necessarily a case-specific determination. It will depend both on the circumstances of the defective workmanship alleged in the pleadings and the way in which "accident" is defined in the policy. I, therefore, cannot agree with Lombard's view that faulty workmanship is *never* an accident. This Court's jurisprudence shows that there is no categorical bar to concluding in any particular case that defective workmanship is an accident. In *Canadian Indemnity Co. v. Walkem Machinery & Equipment Ltd.*, [1976] 1 S.C.R. 309, at pp. 315-17, the Court found that the negligent repair of a crane constituted

an accident. Therefore, I see no impediment to concluding the same in the present case, unless of course it is not supported by the specific language of the policy.

[47] Second, I cannot agree with Justice Ryan's conclusion that such an interpretation offends the assumption that insurance provides for fortuitous contingent risk. Fortuity is built into the definition of "accident" itself as the insured is required to show that the damage was "neither expected nor intended from the standpoint of the Insured". This definition is consistent with this Court's core understanding of "accident": "an unlooked-for mishap or an untoward event which is not expected or designed" (*Gibbens*, at para. 22; *Martin v. American International Assurance Life Co.*, 2003 SCC 16, [2003] 1 S.C.R. 158, at para. 20; *Canadian Indemnity*, at pp. 315-16; originating in *Fenton v. J. Thorley & Co., Ltd.*, [1903] A.C. 443, at p. 448). When an event is unlooked for, unexpected or not intended by the insured, it is fortuitous. This is a requirement of coverage; therefore, it cannot be said that this offends any basic assumption of insurance law.

[48] Finally, I am not persuaded by Lombard's argument that equating faulty workmanship to an accident will convert CGL policies into performance bonds. There seems to be a fairly significant difference between a performance bond and the CGL policies at issue in this case: a performance bond ensures that a work is *brought to completion* (*Couch on Insurance 3D* (3rd ed. (loose-leaf)), vol. 11, by L. R. Russ and T. F. Segalla, at p. 163-20), whereas the CGL policies in this case only cover damage to the insured's own work *once completed* (see *Annotated Commercial General Liability Policy*, vol. 2, at p. 22-1: "products-completed operations hazard"). In other words, the CGL policy picks up where the performance bond leaves off and provides coverage once the work is completed.

[49] "Accident" should be given the plain meaning prescribed to it in the policies and should apply when an event causes property damage neither expected nor intended by the insured. According to the definition, the accident need not be a sudden event. An accident can result from continuous or repeated exposure to conditions.

[50] In my view, the pleadings sufficiently allege an "accident". There is no reference to intentional conduct by Progressive which would suggest that the property damage was expected or intended. The pleadings allege negligence, which, on its face, suggests that the damage was fortuitous. In addition, it is clear from the pleadings that the damage alleged is the result of "continuous or repeated exposure to conditions", which squarely fits within the definition. If at trial it emerges that the damage was expected or intended by Progressive, then Lombard would not be required to indemnify Progressive. However, the duty to defend only requires a possibility of coverage and I am satisfied that possibility is made out in this case.

(2) Exclusions From Coverage

[51] Having found that the claims in the pleadings fall within the initial grant of coverage, the onus now shifts to Lombard to show that coverage is precluded by an exclusion clause. Because the threshold for the duty to defend is only the possibility of coverage, Lombard must show that an exclusion clearly and unambiguously excludes coverage (*Nichols*, at p. 808). For example, in *Nichols*, this Court found that an exclusion clause that stated that the policy did not apply to "any dishonest, fraudulent, criminal or malicious act or omission of an Insured" (p. 807) clearly and

unambiguously precluded coverage for a claim against the insured for fraudulent conduct. Thus there was no possibility that the insurer would have to indemnify the insured on the claim as pleaded.

(a) *"Work Performed" Exclusion*

[52] The central exclusion in this appeal is the "work performed" exclusion. This common exclusion clause and its relationship to work completed by subcontractors have received a great deal of attention, both in Canada and the United States (*Annotated Commercial General Liability Policy*, vol. 2, at pp. 22-4 and 22-11). The standard form version of the "work performed" exclusion precludes coverage for damage to the insured's own work once it is completed. However, the text of this exclusion has been modified several times during Progressive's coverage by Lombard. There are three versions of the "work performed" exclusion in Progressive's successive CGL policies.

[53] Lombard's primary submissions in this appeal were with respect to the proper construction of "property damage" and "accident". Its submissions on the work performed exclusion are very brief. It argues that the "work performed" exclusion excludes coverage for damage to the worked performed by Progressive — in this case the four housing units in their entirety. It argues there is no "subcontractor exception" in the first or second versions of the CGL policies, which could operate to bring the damage caused by subcontractors or damage to the subcontractors' work back within coverage. Therefore, it says, the claims are clearly outside the scope of coverage and the duty to defend does not arise. The third version of the policy expressly includes a subcontractor exception, which provides coverage for damage caused by subcontractors or damage to the

subcontractors' work. Lombard argues that the pleadings do not trigger the duty to defend under the third version because they do not allege that subcontractors caused the damage. This is the full extent of Lombard's submissions on the "work performed" exclusion.

[54] Lombard has not discharged its burden of showing that the "work performed" exclusion clearly and unambiguously applies to all of the claims made against Progressive. In my view, there is a possibility of coverage under each version of the policy.

[55] In the first version of the policy the original "work performed" exclusion was modified by what was called a General Liability Broad Form Extension Endorsement, which Progressive purchased in addition to the basic CGL policy. The original "work performed" exclusion read:

> This insurance does not apply to:
>
> . . .
>
> (i) property damage to work performed by or on behalf of the Named Insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith; [Emphasis added.]

Clause (i) was replaced by clause (Z) in the Broad Form Extension Endorsement, which read:

> (Z) With respect to the completed operations hazard to property damage to work performed by the Named Insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith. [Emphasis added.]

[56] The clause (Z) exclusion is limited to work performed *by* the insured. Unlike the clause

that it replaced, it does not apply to work performed *on behalf of* the insured. The plain language is unambiguous and only excludes damage caused by Progressive to its own completed work. It does not exclude property damage:

- that is caused by the subcontractor's work;

- to the subcontractor's work, regardless of whether the damage is caused by the subcontractor itself, another subcontractor, or the insured.

[57] Had there been any ambiguity in the language of clause (Z), interpretive principles lead to the same result. In accordance with the rule of *contra proferentem*, the "work performed" exclusion should be interpreted narrowly — this favours limiting the exclusion to only damage caused by Progressive to its own work. Further, this result appears to support the reasonable expectations of the parties. In purchasing the Broad Form Extension Endorsement, Progressive would have expected to receive something different from the standard CGL form. To give clause (Z) the same meaning as the standard form clause would deprive the replacement of any meaning. Indeed, coverage for work completed by subcontractors seems to be the purpose of upgrading to the Broad Form Extension (see *American Family Mutual Insurance Co. v. American Girl, Inc.*, 673 N.W.2d 65 (Wis. 2004), at para. 68; see also M. Audet, "Broad Form Completed Operations: An extension of coverage or a trap?" (1984), 51:10 *Canadian Underwriter* 36, at p. 38; *Annotated Commercial General Liability Policy*, vol. 2, at p. 22-11).

[58] The pleadings indicate the involvement of subcontractors (see para. 7, above), which

is sufficient to trigger the duty to defend. If, at trial, it materializes that the damage was caused to a subcontractor's work, or that a subcontractor's work caused the damage, these claims will fall within the scope of coverage.

[59] The "work performed" exclusion takes on a different form in the second version of the CGL policies:

> J. 'Property damage' to 'that particular part of your work' arising out of it or any part of it and included in the 'products - completed operations hazard.'
>
> "Your work" means:
>
> a. Work or operations performed by you or on your behalf; and
>
> b. Materials, parts or equipment furnished in connection with such work or operations.

[60] Lombard again argues that under this version of the policy there is no subcontractor exception and coverage for damage is excluded.

[61] Lombard is correct that there is no exception for subcontractors in this version of the exclusion, nor is the text limited in the same way as the Broad Form Extension Endorsement. However, this does not end the matter. On my reading of the exclusion, all that is excluded is coverage for defects.

[62] Unlike the standard form version of the "work performed" exclusion (clause (i)) reproduced above, this version expressly contemplates the division of the insured's work into its component parts by the use of the phrase "that particular part of your work". For example, the

exclusion could read:

"Property damage" to "the window" arising out of "the window" or any part of "the window" and included in the 'products-completed operations hazard'.

[63] This means that coverage for repairing defective components would be excluded, while coverage for resulting damage would not (see P. J. Wielinski, "CGL Coverage for Defective Workmanship: Current (and Ongoing) Issues", paper presented at the 16th Annual Construction Law Conference, State Bar of Texas, March 7, 2003, at pp. lxi-iv and lxviii). This interpretation was not refuted by Lombard.

[64] Much like the first version of the policy, this version of the "work performed" exclusion was a specific endorsement which amended the standard version of the exclusion. The phrase "that particular part of your work" replaced the phrase "your work". The presumption must be that this change in language represents a change in meaning. Lombard has not provided any contrary rationale for the change in language.

[65] Again, I find there is a possibility of coverage under the second version of the policy. It will have to be determined at trial which "particular parts" of the work caused the damage. Repairs to those defective parts will be excluded from coverage under this version, regardless of whether they were the result of Progressive's own work or the work of subcontractors. If, as Lombard alleges, the buildings are wholly defective, then the exclusion will apply and Lombard will not have to indemnify Progressive. However, the pleadings allege that there was resulting damage:

deterioration of the building components resulting from water ingress and infiltration. This is sufficient to trigger the duty to defend under the second version of the policy.

[66] In the third and final version of the policy, the "work performed" exclusion reads:

> j. "Property damage" to that particular part of "your work" arising out of it or any part of it and included in the "products-completed operations hazard".
>
> This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.

[67] Lombard bears the burden of showing that this exclusion does not apply to any of the claims in the pleadings. Lombard accepts that there is an express subcontractor exception in this version of the policy but argues that the pleadings do not trigger the exception.

[68] The third version of the "work performed" exclusion is simply a combination of the first and second versions. The "exclusion" portion of this clause is identical to the second version of the policy, thus it only excludes coverage for defective property. Coverage would remain for resulting damage. This version of the policy also expressly incorporates the "subcontractor exception", which was previously implicit in the Broad Form Extension Endorsement. The subcontractor exception expands coverage again. It would allow for coverage of defective work where it is work completed by a subcontractor.

[69] As there was a possibility of coverage under both the first and second versions of the policies, there is a possibility of coverage under this version as well.

[70] I conclude that the "work performed" exclusions in each version of the policies do not clearly and unambiguously exclude the claims alleged in the pleadings. There is still a possibility of coverage; therefore, the duty to defend is triggered.

(b) *Other Exclusions*

[71] Finally, Lombard mentioned in passing that two other exclusions — the "contract" exclusion and "product" exclusion — may apply to remove the claims in this case from the scope of coverage. As the onus is on Lombard to show that these exclusions clearly and unambiguously apply, and it did not offer argument on these points, I am not satisfied that it has discharged its burden.

V. Conclusion

[72] I conclude that Lombard owes a duty to defend Progressive in the four actions initiated by BC Housing. Under the first version of the CGL policy, there is a possibility of coverage for damage to work completed by a subcontractor and for damage resulting from work performed by a subcontractor. Under the second version of the policy, there is a possibility of coverage for damage resulting from the particular part of the insured's work that was defective. Under the third version of the policy, there is a possibility of coverage both for resulting damage and for any damage to work completed by a subcontractor.

[73] I would allow the appeal with costs in this Court and in the courts below.

Appeal allowed with costs.

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