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CONSTRUCTION DEFICIENCY CLAIMS & THE CGL POLICY: LIFE BEFORE AND AFTER *A.R.G. & SWAGGER*

by

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TABLE OF CONTENTS

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Construction Deficiency Claims & The CGL Policy: Life Before and After *A.R.G* & *Swagger*

1. INTRODUCTION

Commercial general liability policy ("CGL") coverage for construction deficiency claims is an issue that has long troubled the construction and insurance industries and the judges who decide their disputes. Critics blame the insurers,

> *For the past fifty years, the insurance industry has endeavoured to eliminate property damage coverage for defective construction from its commercial general liability (CGL) policies. … One would think that after fifty years, the insurance industry would figure out how to "write out" property damage coverage for defective construction – if it were serious about the matter. The problem is the industry has chosen to demonstrate its seriousness by selectively litigating the issue instead of dramatically and unequivocally altering the scope of the CGL policy. The demand in the construction industry for broad property damage coverages – and the premiums collected as a consequence of that demand – drives the insurance industry to offer with one hand what it tries to take away with the other. The mechanism of the CGL policy, however, does not allow for a graceful slight of hand.*[1]

and the courts,

> *[J]udicial decisions in certain jurisdictions continue to fail to recognize the intended scope of the CGL insurance policy in the construction defect context. Even in jurisdictions that correctly acknowledge the existence of insurance coverage for damage caused by inadvertent construction defects, properly drawing the coverage distinctions intended by the policy exclusions is often problematic and leads to divergent outcomes.*[2]

Questions concerning the CGL initial coverage grant clauses arose occasionally in the past but until recently the construction deficiency cases have mainly centered on the "work" and "product" exclusions. Judges assumed or found, often without much analysis, that an insured's liability for its own construction deficiencies and resulting damage fell within the grant and the real task lay in determining how much coverage survived the exclusions.

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[1] J. O'Connor, "Construction Defects: 'Property Damage' and the Commercial General Liability Policy" (Spring, 2004) 24:2 *Construction Lawyer* 11.

[2] C. Shapiro, "Business Risk in Construction Coverage: The Business Risk Exclusions in Commmercial General Liability Insurance Policies" (DRI Insurance Law Centre Insurance Coverage and Claims Institute, April, 2005), 337, at 339.

R. Glen Boswall, T. 604.643.3125

More recently, the focus has shifted back to the initial coverage grant. In the 2004 Ontario case of *A.R.G. Construction Corp. v. Allstate Insurance Co. of Canada*[3] and three Brirish Columbia cases beginning with the 2005 British Columbia decision in *Swagger Construction Ltd. v. ING Insurance Company of Canada et al.*[4], several lower court judges ruled the grant provided no coverage to general contractors and developers for construction deficiencies and resulting damage to their projects. However, in the 2005 Saskatchewan case of *Westridge Construction Ltd. v. Zurich Insurance Co.*[5] and the jointly decided 2006 Ontario cases of *Bridgewood Building Corp. (Riverfield) v. Lombard General Insurance Company of Canada* and *Beige Valley Developments Ltd. v. Lombard General Insurance Company of Canada*[6], the appeal courts have gone the other way, finding coverage under the grant and looking to the exclusions and exceptions to determine the ultimate result.

This paper will address the decisions and the rationale that led us to this point. We begin with a crash course on the purpose of the CGL and its structure followed by a quick review of judge made rules for interpreting insurance policies and proving coverage. We next examine the evolution of the CGL and look at the state of the law before and after the *A.R.G.*, *Swagger*, *Westridge*, and *Bridgewood/Beige Valley* cases. Finally, we try to predict what lays ahead.

2. CGL PURPOSE & STRUCTURE

It is important to know what the CGL does and learn its basic structure in order to understand the arguments and judgements surrounding it.

The CGL obliges the insurer to defend the insured from any claim alleging liability for losses falling within coverage and, if the insured is liable, to indemnify the insured (i.e. pay the related damages on the insured's behalf) up to the policy dollar limit.

The standard CGL, like most insurance policies, is made up of the initial grant of coverage, exclusions from the grant and exceptions to those exclusions. The grant is a brief set of statements about what broad types and causes of loss are covered by the policy and within what time period. The Insurance Bureau of Canada ("IBC") issues standard form insurance policy wordings for adoption and modification by the insurance industry. The initial coverage grant in IBC's current standard form CGL is as follows:

> We will pay those sums that the insured becomes legally obligated to pay because of "bodily injury" or "property damage" to which this insurance applies. No other obligation or liability to pay sums or perform acts or services is covered unless explicity provided for under SUPPLEMENTARY PAYMENTS – COVERAGES A, B AND D. This insurance applies only to "bodily injury" and "property damage" which occurs during the policy period. The "bodily injury" or "property damage" must be caused by an "occurrence". The "occurrence" must take place in the "coverage territory". We have the right and duty to defend any "action" seeking those compensatory damages BUT:

[3] [2004] O.J. No. 4517.
[4] 2005 BCSC 1269.
[5] 2005 SKCA 81.
[6] 2006 CanLII 10205 (ON C.A.).

1) The amount we will pay for compensatory damages is limited as described in Section III – LIMITS OF INSURANCE.

2) We may investigate and settle any claim or "action" at our discretion; and

3) Our right and duty to defend end when we have used up the applicable limit of insurance in the payment of judgments or settlements under Coverages A, B or D or medical expenses under Coverage C.

The exclusions make up a series of more precisely worded statements removing specific types and causes of loss from the broad coverage provided by the grant. The exceptions are another set of precisely worded statements that return some of the coverage taken away by the exclusions. The following exclusions and exceptions, also taken from the current IBC standard form CGL, are particularly important when analyzing coverage for construction deficiency claims:

Exclusions.

This insurance does not apply to:

h. "Property damage" to:

5) That particular part of real property on which you or any contractor or subcontractor working directly or indirectly on your behalf is performing operations, if the "property damage" arises out of those operations;

6) That particular part of any property that must be restored, repaired or replaced because "your work" was incorrectly performed on it.

Paragraph 6) of this exclusion does not apply to "property damage" included in the "products-completed operations hazard".

…

j. "Property damage" to "your work" arising out of it or an part of it. 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.

The way these exclusions and exceptions interact is a bit complex.

Exclusion h.5 removes coverage for any damage to property that occurs while the insured or its subcontractors are working on it.

Exclusion h.6 removes coverage for property damage caused by "your work" but there is no time restriction and so the loss is excluded whenever it occurs. The term "your work" is defined to include operations by the insured's own forces and work done on its behalf (i.e. work by subcontractors) and the materials, parts and equipment furnished in connection with the operations. However, the "products-completed operations hazard" phrase in the exception is

defined so as to return to coverage that damage which occurs after the work has been completed and no longer in the control or possession of the insured.

Exclusion j. takes some of this returned coverage back outside the CGL protection. It again removes coverage for losses arising out of work done by the insured's own forces. This leaves in place the coverage for post-construction loss arising out of subcontractor work that was returned in the last paragraph.

The upshot of all of this is that damage to the insured's work product arising from the operations of the insured's own forces is excluded at all times. Damage to the work product during construction and resulting from subcontractor operations is also excluded. However, post-construction damage to the work product arising from subcontractor operations escapes these exclusions.

3. PROOF & INTERPRETATION RULES

The CGL is a complicated contract but the world is more complex. It would be impossible to draft a practical insurance policy addressing all possible types and causes of loss. As a result, the grant, exclusions and exceptions are necessarily general in application and it is not always clear whether a particular loss or cause is covered by an insurance policy. To address this problem, judges have developed a number of rules for interpreting insurance contracts. Many of these rules are at the crux of the recent disputes over construction deficiency coverage for developers and general contractors under the CGL policy.

3.1 Proof

(a) Onus of Proof

The responsibility for proving something in court is called the "onus of proof". In an insurance coverage battle, the onus shifts back and forth between the insurer and insured depending upon what part of the policy is in issue. The insured has the onus of proving the loss is covered by in initial grant. If the insured fails, there is no coverage and the lawsuit is over. If the insured succeeds, the onus falls on the insurer to prove the loss is removed from coverage by one or more of the exclusions. If the insurer succeeds in this task, the onus shifts back to insured to prove that exceptions return the coverage initially provided by the grant.[7]

(b) Burden of Proof

Exactly what must be proven and the degree of certainty required is known as the "burden of proof". In an insurance coverage lawsuit, different degrees of certainty apply when determining whether the insurer must defend or indemnify the insured.

[7] *Supra* note 3 at p. 3.

R. Glen Boswall, T. 604.643.3125

To trigger the insurer's duty to indemnify, it must be proven on a balance or probabilities that a particular claim falls within coverage. This determination may only come at the end of a trial which does not assist an insured who wants to be defended before and during the trial.

To make an advance determination of the insurers duty to defend, it need only be proven there is a *mere possibility* that the claim alleged against the insured, if subsequently proven at trial, will fall within coverage.[8]

3.2 Interpretation

(a) Usual and Ordinary Meaning

Perhaps the primary rule of contract interpretation is that that every word and phrase in the document is to be construed according to its plain, ordinary and popular sense.[9] If, despite application of this rule, there is more than one reasonable interpretation of a word or phrase, the following rules come into play.

(b) Contra Proferentum

The party who chooses the particular words or phrases bears the consequences of any reasonable but adverse interpretation. This is known as the rule of *contra proferentum* (i.e. contrary to the interest of the one who proffers).

With few exceptions, insurance companies draft the insurance policies and so they choose the wording. The insured has only limited power to change the wording, perhaps by purchasing endorsements which are also usually drafted by the insurance companies. If any word or phrase in the policy is capable of more than one reasonable interpretation, a judge should select the interpretation most favourable to the insured.

Another version of this rule is that the initial coverage grant is to be interpreted broadly since it increases the amount of coverage available to the insured and the exclusions are to be interpreted narrowly so the least amount of coverage is removed.[10]

(c) Intent and Reasonable Expectations

Subject to or in conjunction with the *contra proferentum* rule, judges will consider the insurers intent when drafting the policy and the insured's reasonable expectations upon obtaining it.[11]

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[8] *Nichols v. American Home Assurance Co.* [1990] ILR 1-2583 (SCC).
[9] *Robertson v. French* (1803), 102 E.R. 779 at 781-782; *Ocean Construction Supplies Ltd. v. Continental Ins. Co.* [1978] 5 W.W.R. 681 (BCSC) at 686, aff'd, [1981] 1 W.W.R. 60 (BCCA).
[10] *Non-Marine Underwriters, Lloyds of London v. Scalera* [2000] 1 S.C.R. 551 at 591.
[11] G. Hilliker, *Liability Insurance In Canada* (4th ed. 2006) at 36-37.

(d) Public Policy

Insurers can resist adverse interpretation of the insurance contract on the grounds of public policy. This rule arose out of the contract interpretation principle that a person should not benefit or be protected from his or her own intentional wrongdoing. In liability insurance law, the principle has expanded to rule out protection from "business risks". That is, public policy dictates that a liability insurance policy should not cover the ordinary costs of doing business.

In construction, business risks include deficiencies and damage to the insured's own work. If the CGL covered these, the insured would be encouraged to engage in shoddy practices secure in the knowledge that the insurer would pay for the consequences. In rejecting this result, judges often state that the CGL is not intended to fulfill the function of a performance bond[12] or cover contractual claims or economic losses[13]. As will be seen later, there is some debate as to whether this intention is properly reflected in the initial coverage grant or the exclusions. The difference has significant implications.

(e) Exceptions to Exclusions Do Not Create Coverage

An exception to an exclusion may precisely describe a particular loss but the exception does not, in itself, create coverage.

Exclusions remove parts of the broad coverage provided by the grant. An exception to an exclusion can only return to coverage something that was originally covered by the grant. If there was no original coverage for the loss under the grant, an exception to an exclusion cannot provide any cover.[14]

Some judges have taken this rule to mean they need not look at the exclusions and exceptions if loss appears to fall outside the initial coverage grant. As will be seen, this approach has had repercussions in recent construction deficiency cases and it neglects the next rule.

(f) Entire Policy Must Be Considered When Interpreting Any Part

Particular provisions of an insurance policy are not to be read in isolation. The contract as a whole must be considered in order to construe properly any given term in its wider context.[15] So, while an exception to an exclusion cannot create coverage that never existed under the grant, a judge should examine the exceptions and exclusions when determining the meaning of the grant.

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[12] *Ohio Casualty Insurance Co. v. Bazzi Construction Co.,* 815 F.2d 1146 (U.S.) 7th Cir. Ill., 1987) as cited in *Privest Properties Ltd. v. Foundation Co. of Canada* (1991), 6 C.C.L.I. (2d) 23 (B.C.S.C.).
[13] *Carleton Iron Works Limited v. Ellis Don Construction Ltd.* [1996] I.L.R. 1-3373 at p. 4222; *Bird Construction Company Ltd. v. Allstate insurance Company of Canada* [1997] I.L.R. 1-3378.
[14] *Supra* note 11 at 27.
[15] *Hillis Oil & Sales Ltd. v. Wynn's Canada Ltd.*, [1986] 1 S.C.R. 57 at para. 15.

For example, if an exclusion or exception has no purpose unless a particular loss is originally covered by the grant, it suggests that the grant should be interpreted to provide that coverage. This is in accordance with the widely accepted principle of contract interpretation that, where possible, effect is to be given to all terms of the contract and none are to be rejected as surplusage or as having no meaning.[16]

(g) Specific Wording Prevails Over General Rules of Interpretation

The rules set out above serve as guides when policy wording is ambiguous. If the policy wording is clear, it prevails over any general rule of interpretation.[17]

4. CGL EVOLUTION

A review of the CGL evolution is useful to better understand the reasoning behind recent disputes over CGL coverage for construction deficiencies. [18]

Pre-1966	The CGL covered property damage claims, although the policy form did not define the phrase "property damage". This broad wording led to successful claims for loss of property value caused by shoddy workmanship, even if no physical damage occurred.
1966	The CGL policy is modified to eliminate diminution-in-value damages. Property damage is defined as "injury to or destruction of tangible property". Subsequently, some judges still allow value diminution claims on the basis that loss of value could constitute an "injury" to physical property.
1973	A new definition of property damage is provided in a further attempt to eliminate diminution-in-value damages. Property damage is defined as "physical injury to or destruction of tangible property."
1976	The Broad Form Property Damage Endorsement (BFPD) is issued. Exclusions remove coverage for damage to property in the "care, custody and control" of the insured and coverage for damage to property on which the insured is working. General contractors accept the exclusion for work done by their own forces but increasingly demand coverage for losses arising out of subcontractor work.

[16] *Steinberg Inc. v. Tilak Corp.* (1991), 2. O.R. (3d) 165 at 169 (Gen. Div.); *Scanlon v. Castlepoint Development Corp.* (1992), 11 O.R. (3d) 744 at 770, 776 (C.A.).
[17] *Ellet Industries Ltd. v. Laurentian P&C Insurance Co.* (1996), 17 BCLR (3d) 201 (CA) at para. 11; *Alie v. Bertrand & Frere Construction Co.* [2002] O.J. No. 4697 (CA) at para. 26.
[18] See *Lennar v. Great American Insurance Co.* 2005 Tex. App. LEXIS 4214, at. 11-12 ;and *supra* note 2 at 342-343.

1986 The BFPD is clarified in favour of coverage for subcontractor work. Liability arising from damage to the insured's work caused by work done by the insured's own forces is still excluded whether it occurs during or after construction. However, liability arising out of damage to the insured's work caused by a subcontractor's work is excluded only if it occurs during construction.

This history indicates that in 1986, the insurance industry made a positive decision to extend coverage to liability for post-construction losses to an insured's work arising from subcontractor work.

5. LIFE BEFORE A.R.G. AND SWAGGER

5.1 Overview

Although the law was never completely settled prior to the *A.R.G.* case in 2004 and the *Swagger* case in 2005, one could generally expect the following results in construction deficiency cases:

Liability arising from,

(a) intangible damage (e.g. diminution in value) to intangible property (e.g. ownership rights) of third parties caused by defective work or products of insured or subcontractor = covered if insuring agreement not restricted to "physical" or "tangible" loss or property;

(b) physical damage to tangible property of third parties caused by defective work or products of insured or subcontractor = covered;

(c) any damage to insured's project arising from faulty work or products supplied by insured's own forces = not covered

(d) physical damage to the insured's project caused by faulty work or products supplied by insured's subcontractors = not covered during construction but covered for damage after completion if policy has subcontractor exception to "completed operations hazard" exclusion.

Because most modern construction projects are built almost completely by subcontractors, the post-completion coverage for subcontractor work and products is important to developers and general contractors. As will be seen, the *A.R.G.* and *Swagger* decisions purport to remove that coverage.

5.2 Damage to Property of Third Parties

Insurers always intended CGL's to cover losses arising from harm suffered by third parties – that is, parties other than the insurer and insured. The legal disputes concerning CGL coverage for third party harm have centered instead on the types of harm and property.

Within the context of this paper, "third party property" refers to property owned by a third party excluding any work or products sold by the insured.

(a) Physical vs. Intangible Losses and Property

Because of the almost infinite variety and value of intangible losses, insurers probably intended to provide CGL coverage only for physical damage to physical property. However, courts analyzing the pre-1996 CGL grant found the words "damage", "injury" and "property" to be ambiguous as to whether they included both the physical and the intangible. Applying the *contra proferentum* rule of interpretation, the courts found coverage for both. This led to a plethora of successful claims for intangible losses such as decreased value to intangible property such as ownership rights.

As noted in section four above, the insurers responded by adding the modifiers "tangible" and "physical" to the CGL grant in 1966 and 1973. While the new wording clarified the insurer's intention, it could still be difficult to determine whether a third party had suffered a physical injury to tangible property - particularly when the insured's faulty product or work was incorporated into a larger structure owned by a third party.

In the 1986 case of *Carwald Concrete & Gravel Co. v. General Security Insurance Co. of Canada*[19], the insured supplied cement to a project. During construction of a concrete pad, it was poured over rebar, reinforcing steel, ducting, wiring, plumbing and anchor bolts. The concrete did not have adequate compression strength and had to be replaced. Although the concrete did not physically alter the enclosed wires, etc., these items could not be separated from the concrete and so they were rendered useless. The Alberta Court of Appeal concluded this constituted physical injury to the enclosed items.

If the insured's defective work or product did not physically alter surrounding or enclosed property and could be separated, the other property was not considered to be physically injured. The other property might, however, have suffered an intangible economic injury because it was worth less money while attached to the defective item. The effect of this distinction on different CGL grant wordings was highlighted in the 1991 case of *Privest Properties Ltd. v. Foundation Co. of Canada*[20]. The lawsuit concerned a general contractor hired to carry out building renovations. During the work, a subcontractor sprayed asbestos impregnated fireproofing onto parts of the building. When this was discovered, the Workers Compensation Board ordered the work stopped until the insulation was removed. The building owner sued the general contractor for the resulting expense and delay. The general contractor sued its CGL insurers when they refused to defend the underlying action.

[19] (1986), 17 C.C.L.I. 241 (Alta. C.A.).
[20] *Privest*, *supra*, note 12.

Because there was primary and excess liability insurance and different insurers covered different periods while the losses continued, several CGL policies were in issue. Some of the CGL's used the old grant wording, covering "injury" or "damage" to "property". Others used newer wording, restricting the grant to "physical injury or destruction" to "tangible property". The judge ruled that because the fireproofing did not physically alter other parts of the building and could be removed, its presence did not constitute a physical injury to tangible property. However, it did represent an infringement of the owner's intangible property rights. The judge therefore released those insurers with grants restricted to physical or tangible loss and ordered those without the restriction to defend the contractor.

The *Privest* judge went on to examine the "work" and "product" exclusions and, in doing so, discussed the public policy reasons behind refusing CGL coverage to correct an insured's own shoddy work. Some commentators say this public policy is given effect in the CGL exclusions[21] but some judges have read it into the initial coverage grant. In the 2003 case, *Celestica Inc. v. ACE INA Insurance*[22], the Ontario Court of Appeal analyzed CGL coverage in another situation where the insured's faulty component caused economic rather than physical damage to other property. The insured's faulty transformers were installed in photocopiers made by others. Mr. Justice Armstrong, writing for the Court, cited the *Privest* decision and noted the discussion of public policy in that case was in connection with the CGL exclusions. Mr. Justice Armstrong, without explanation, found the public policy was equally applicable to the CGL grant. Based on this, he concluded the economic loss caused by the faulty component was not caused by an "accident" within the meaning of the CGL grant. He wrote,

> *There are good policy reasons for refusing to find that defective design or manufacture can constitute an accident. In Privest Properties Ltd. v. Foundation Co. of Canada (1991), 6 C.C.L.I. (2d) 23 at 72 (B.C.S.C.), Drost J. stated:*
>
> > *There is a policy reason for this. If the insurance proceeds could be used to pay for the repairing of replacing of defective work and products, a contractor or subcontractor could receive initial payment for its work and then receive further payment from the insurer to repair or replace it. Equally repugnant on policy grounds is the notion that the presence of insurance obviates the obligation to perform the job initially in a good and workmanlike manner*
>
> *While Drost J. made the above statement* [in Privest] *during his consideration of a "work/product" exclusion, I believe the policy is equally apt when applied to the issue of coverage in the case at bar.*[23]

As will be seen in our discussion of the *A.R.G.* and *Swagger* decisions, importing this public policy into the CGL grant has significant ramifications.

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[21] *Supra* note 2 at 340.
[22] 2003 CanLII 12210 (Ont. CA).
[23] *Ibid* at para. 31.

(b) Preventative Measures

Although there is some conflicting law on the subject, it is unlikely that a CGL will cover the cost of measures taken to prevent bodily injury to third parties or physical injury to their property. This issue was addressed in the 1997 case of *Bird Construction Company Ltd. v. Allstate Insurance Company of Canada*[24]. In that case, pins holding up exterior wall cladding panels on a recently completed building were susceptible to corrosion. This presented a risk of falling panels and injury to passers-by. The building owner sued the contractor for the cost of correcting this hazardous condition. The contractor's CGL insurer refused to defend the case and the contractor launched its own action, demanding coverage. The Manitoba Court of Appeal ruled,

> *The claim is obviously not one for 'damages because of bodily injury'. Nor it is one for 'damages because of property damage' as those latter words are defined in the policy. As LaForest J. remarked in Winnipeg Condominium Corporation No. 36 v. Bird Construction Co. Ltd., supra, at p. 98:*
>
> > *I observe that the losses claimed by the Condominium Corporation in the present case fall quite clearly under the category of economic loss.*
>
> *Loss of use is the only economic loss which the policy covers. No claim for loss of use is advanced against the policy holder. If follows that the claim lacks the potential of falling within the indemnity coverage. No defence is therefore owed.*[25]

5.3 Damage Arising From Insured's Own Faulty Work and Products

CGL policies are generally intended to cover an insured's liability to third parties but not including the cost of repairing or replacing the insured's defective work or product.[26] There is almost universal agreement among Canadian and American judges that, within the context of the CGL exclusions, an insured's "work" or "product" encompasses the entire project for which the insured was engaged.[27] For a developer or general contractor, this might encompass an entire building even though the work and products were supplied by subcontractors. Coverage for physical damage to the insured's project arising from the subcontractor's work may or may not attract coverage depending upon the existence of an exception to the "work" exclusion discussed below. As for damage to arising from work performed or products provided by the insured's own forces, there is no question that these are removed from coverage by the "work" and "product" exclusions. Because of this, there is little controversy over whether this loss also falls outside the initial coverage grant.

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[24] *Bird Construction, supra* note 13.
[25] *Ibid* at para. 11.
[26] *Alie, supra* note 17 at para. 27.
[27] *Privest, supra* note 12; *J.N.A. Distributors v. Permacool Mechanical Systems Inc.*, [1993] O.J. No. 1807 at para. 8.

5.4 Damage Arising From Subcontractor Work or Products

(a) The Completed Operations Hazard

The modern CGL often contains an exception to the "work" exclusion for damage to subcontractor work occurring after operations are complete. This is generally known as the "completed operations hazard" exception. One version – not restricted to subcontractors - was considered in the year 2000 case of *Hearn/Actes v. Commonwealth Insurance et al.*[28] The insured was a general contractor for the construction of a large student residence for the University of British Columbia. The contractor's CGL for the project contained an exclusion for "property forming part of or to form part of the Project insured". However, there was an exception for "such coverage as is afforded under the Completed Operations hazard." The Completed Operations Hazard was defined as including,

> Bodily Injury (Definition 4(a)) or Property Damage arising out of operations on the Project, but only if the Bodily Injury or Property Damage occurs after such operations have been competed.

Following completion of the project, the insured sued the university for the cost of extra work and delay allegedly due to errors by the university and its architect. The university counterclaimed for the cost of fixing deficiencies in the work done by the insured and its subtrades. The insured then sued its CGL insurer for refusing to defend the counterclaim.

The judge hearing the insurance case noted his obligation to construe the CGL grant liberally and found the words "accident", "occurrence" and "property" were broad enough to encompass the counterclaim. He then turned to the exclusions and noted the completed operations hazard exception. He based his ruling on the reasonable expectations of the insured contractor and the *contra proferentum* rule. He wrote at paragraph 35:

> *Hearn/Actes paid an additional premium for Completed Operations coverage which it intended would provide coverage with respect to a separate category of risk. Accordingly, the Policy should not be interpreted in such as way as to avoid coverage which was specifically obtained by the insured. Hearn/Actes would not have paid for something which would be of no value to it. Such an interpretation would not accord with the reasonably expectations and purpose of ordinary insureds regarding coverage.*
>
> …
>
> *At best, the co-existence of the Completed Operations Hazard as defined in Cluase 5 of the Definitions section of the Policy; the exception for Completed Operations coverage to the exclusion in Clause 11 of the Policy; and the Work/Product Exclusion within the same policy leads to confusion and ambiguity with respect to coverage. This was the situation in* Commercial Union Assurance Cos. v. Gollan, *118 N.H. 744, 394 A. 2d 839 (1978). … The court emphasized the*

[28] 2000 BCSC 764.

> *complexity of the 17 page standard policy and found that the insurer's interpretation "would require the unwary insured to understand a distinction [between the insured's work/product and the property of third persons] that the clauses do not clearly specify." The court found this interpretation unreasonable and thus found inherent ambiguity in the policy which it resolved in the insured's favour on the basis of the insured's reasonable expectations of coverage.*

(b) Work vs. Product

Because there is usually no completed operations hazard exception for the CGL "product" exclusion, it is confusing when a particular item can be classified as both the insured's "work" and "product". In these circumstances, does the exception to the "work" exclusion return coverage or does the lack of an exception to the "product" exclusion still preclude coverage?

In *Axa Pacific Insurance Co.* v. *Guilford Marquis Towers Ltd.*[29], the judge observed that since the definitions of both "work" and "product" might apply to the insured's entire project, the court was entitled to apply the *contra proferentum* rule and chose the definition most favourable to the insured. In a case where there is post-completion damage to a project arising from a subcontractor's work, the most advantageous selection for a general contractor would be the "work" exclusion if it had the completed operations hazard exception for subcontractors.

(c) Is Damage Arising from Subcontractor Work Covered by the Grant?

The completed operations hazard exception to the work exclusion cannot return coverage if it never existed under the initial grant. The Ontario Supreme Court of Justice found coverage under the grant in the 1999 case of *Nipissing Condominium Corp. No. 18 v. Mayco Homes Ltd.*[30]. The insured general contractor built a condominium complex and was later sued for the cost of fixing a subcontractor's deficiencies and the resulting damage to the building. The general contractor's CGL insurer refused to defend the case, arguing the negligent work and damage was not an "occurrence" within the meaning of the coverage grant. In rendering his decision in the ensuing insurance coverage lawsuit, the judge noted the paramount importance of the CGL language.

> *It is the position of the insurer, Zurich, that there is no coverage for the defects alleged, because a comprehensive general liability policy such as this one is not intended to be the equivalent of a performance bond. As a general proposition, the case law cited supports that argument. However, the determination of whether this policy covers the claims in this action depends on an analysis of the pleadings in the action and the language of the contract. In this case, Counsel for Zurich concedes that this policy covers work negligently done by a sub-*

[29] [2000] B.C.J. No. 208 (S.C.).
[30] 14 C.C.L.I. (3d) 150 (Ont. S.C.J.).

contractor where damages result, provided that the damage which is complained of is the result of an "occurrence" as defined in the contract.

Counsel for the defendants submits that the Statement of Claim alleges occurrences which should be covered by the policy, pointing to paragraph 30.

> 30. The Condominium complex has defects, damage and deficiencies ...
>
> j ... the presence of increased amounts of water leakage into the building during periods of wind driven rain;
>
> k other defects damage and deficiencies, some of which the true causes are now just revealing themselves or being discovered[31]

Relying on the principle that an insurer must defend if there is a mere possibility that a claim, if proven, will fall within coverage, the judge concluded,

I am satisfied that, given the definition of accident in this policy, the pleadings cited, and that damage is alleged to have been caused as a result of work done by sub-contractors, that the policy of insurance may be interpreted as providing coverage against such claims.[32]

6. THE NEW CASES

6.1 A.R.G. Construction Corp. V. Allstate Insurance Co. of Canada

In 2004, the Ontario Superior Court of Justice went the other way on the CGL grant. In *A.R.G. Construction Corp. v. Allstate Insurance Co. of Canada*[33] the judge ruled that construction deficiencies in a condominium building and resulting water damage to the building were not caused by an accident within the meaning of the general contractor's CGL coverage grant. He based his decision on public policy, noting a liability policy was not a performance bond and that it would be contrary to the public's interest to indemnify an insured for its own flawed work or product or work performed on the insured's behalf.

The judge did not explain why the public policy should be given effect in the CGL grant rather than the "work" and "product" exclusions. The contractor argued that the exclusions and exceptions should be considered in interpreting the grant but the judge retreated behind the rule that exceptions to exclusions cannot create coverage. He wrote,

[31] *Ibid* at para. 1c.
[32] *Ibid* at para 1d.
[33] *Supra* note 3.

R. Glen Boswall, T. 604.643.3125

> *A.R.G. argued that with respect to the completed operations hazard, exclusion (z) did not exclude work performed "on behalf of" the named insured. That being so, if a subcontractor's work caused damage to property (as may be the case on the pleadings) there is coverage for such damage. I disagree. The overriding requirement that the property damage be caused by an "accident" prevails. the cases cited above concerning such claims include claims arising from subcontractor's work which were held not to be included in coverage.*[34]

In fact, none of the cases the judge "cited above" considered the principle that the contract as a whole must be considered in order to construe properly any given term in its wider context. His interpretation of the grant rendered the work exclusion and the completed operations hazard exception meaningless, violating the rule that effect is to be given to all terms of the contract and none are to be rejected as surplusage or as having no meaning.

6.2 *Westridge Construction Ltd.*

In 2005, the Saskatchewan Court of Appeal pushed the pendulum back in *Westridge Construction Ltd. v. Zurich Insurance Co.*[35] In that case, Genex Swine Group Inc. (yes, that is the real name) contracted with Westridge for construction of a hog barn. Westridge subcontracted with another company for the supply of the prefabricated metal building. That company further subcontracted the supply to another company. The roofing material was not rust resistant and the moisture in the barn caused it to corrode . The owner sued Westridge for breach of contract and in tort, the tort claim including allegations of negligent misrepresentation with respect to recommendations for the work and materials, and failure to warn how the work or material might be unsuitable for use in a hog barn.

Westridge demanded coverage from several insurers on risk between the time of construction and the time Genex sued. Some of the insurers refused and Westridge sued them. The trial judge dismissed the insurance suit, finding that the true nature of the claims against Westridge was that the company failed in its contractual duty to build and deliver a hog barn suitable for the purposes intended. The claims in negligence were all "derivative" of the contractual claim, and there was no suggestion of any duty of care owed by Westridge to Genex beyond that arising from the contract between them. Like the judge in *A.R.G.*, the *Westridge* judge noted it was a fundamental principle of insurance law that a CGL policy is not intended to be a performance bond. In other words, the CGL policy is not a means for a contractor (or supplier of goods) to cover expenses to correct its own faulty or defective workmanship or materials. Westridge appealed.

The Saskatchewan Court of Appeal saw things differently, finding the trial judge had mischaracterized the nature of the claim and had erroneously focused on general insurance principles rather than the exact terms of the Sovereign and Zurich insurance policies.

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[34] *Ibid* at para. 62.
[35] *Supra* note 5.

Regarding the allegedly "derivative" nature of the tort claim, the Court of Appeal ruled that the claims in contract and tort arose from different facts. The failures to advise and warn were therefore independent of any contractual duties. The concept of "derivative" claims therefore did not apply.

Turning to the terms of the policies, the Court of Appeal found that the corrosion fell within the meaning of "occurrence" in the insuring agreements. In both policies, "occurrence" was defined to include continuous or repeated exposure to substantially the same harmful conditions. The moisture in the air was the harmful condition that damaged the barn and so there was an "occurrence".

The Court of Appeal's treatment of the policy exclusions was more interesting. The Court rejected the insurers defence based on the "product" and "workmanship" exclusions. The Court noted the product exclusion specifically excepted real property, which included the barn in question. The Court accepted that faulty workmanship was excluded but noted the allegations for negligent misrepresentation and failure to warn did not arise from faulty workmanship.

In addition, the judge ruled the faulty workmanship exclusions did not apply because the corrosion did not arise solely from the work, but also from the effect of the conditions prevailing in the barn over a period of time. Although the judge did not cite the Supreme Court of Canada decision in *Derksen v. 539938 Ontario Ltd.* [36], his reasoning matches the principle established by that case: there is no general presumption that all coverage is ousted if only one of several concurrent causes of the loss is excluded.

6.3 *Swagger Construction Ltd.*

Later in 2005, the British Columbia Supreme Court declined to follow *Westridge* and instead took the *A.R.G.* approach. In *Swagger Construction Ltd. v. ING Insurance Company of Canada*[37], Swagger was a general contractor hired to construct a building for the University of British Columbia. Swagger sued the University for extra work and delays and was met with a counterclaim for building defects. Swagger turned to its liability insurers for defence and indemnity coverage on the counterclaim. Its insurers refused and Swagger sued.

Swagger did not claim coverage for repairing the alleged deficiencies themselves but only for the costs of repairing other property damaged by the defective work. The judge hearing the insurance case, Mr. Justice Smith, ruled this was not a claim for physical injury to tangible property within the meaning of the CGL coverage grant. He supported this conclusion by citing Mr. Justice Drost in *Privest Properties Ltd. v. Foundation Co. of Canada*[38] where he, in turn, cited *Harbour Machine Ltd. v. Guardian Insurance Company of Canada*,[39] stating,

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[36] [2002] S.C.J. No. 27.
[37] *Supra* note 4.
[38] *Privest, supra* note 12 at para. 60.
[39] (1985), 60 B.C.L.R. 360.

> *[T]he mere presence of a defective product in an otherwise sound structure does not, in itself, constitute damage to property.* (emphasis added).

The trouble is that Swagger was not claiming coverage for repairing defective products themselves in an otherwise sound structure. Swagger specifically stated it was not pursuing the cost of repairing the defects themselves but was only claiming for the cost of repairing the physical damage those defects caused to the structure surrounding them. With respect, Mr. Justice Smith seems to have misunderstood *Privest* and *Harbour Machine*.

Mr. Justice Smith also found support in the 1996 Manitoba building deficiency case, *Winnipeg Condominium Corp. No. 36 v. Bird Construction Co.*[40], and its insurance coverage counterpart, *Bird Construction Company Ltd. v. Allstate Insurance Company of Canada*[41]. However, *Winnipeg Condominium* was not an insurance coverage case. It was a tort case addressing whether a building owner could pursue members of the construction and design team for building defects absent a contract with them. In tort cases, recovery is barred where the repair costs are for "pure economic loss" (e.g. loss of value) rather than physical property damage. The question was whether a building defect that threatened damage to other parts of the building constituted physical damage or just an economic loss. Mr. Justice Smith quoted Mr. Justice LaForest from the *Winnipeg Condominium* where he wrote,

> *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.* (emphasis added)

Mr. Justice Smith focused on the first part of this quote to support his view that a building cannot be broken down into components such that a defective part can be said to cause property damage to other parts. However, examining the highlighted portion of the quote suggests the *Winnipeg Condominium* decision actually supported Swagger's claim to coverage. The claim in

[40] [1996] M.J. No. 363 (C.A.).
[41] *Bird Construction, supra* note 13.

Swagger was that there was a distinct item (the building envelope) incorporated into the structure (the building) which positively malfunctioned to cause positive damage (rot) to the structure in which it was incorporated. Regardless, and as noted above, *Winnipeg Condominium* is not an insurance coverage case.

The Mr. Justice Smith noted this fact and referred to the related insurance case, *Bird Construction*. He observed that the concept expressed by Mr. Justice LaForest in *Winnipeg Condominium* was applied to determine coverage in *Bird Construction*. Although this is true, the Manitoba Court of Appeal in *Bird Construction* applied the concept only to the policy exclusions, and not the insuring agreement. On this point, the judgment in *Bird Construction* reads,

> *The only damage to the property alleged in the claim against the policy holder is damage to the building itself. But this is not damage in the sense defined in the policy which expressly excludes coverage for damage to the work performed by or on behalf of the policy holder (Exclusion (k)(4). Nor can it be argued that the defect in part of the building caused damage to the rest of the building. This argument, known as the "complex structure" theory, was rejected by the Supreme Court of Canada in* Winnipeg Condominium Corporation No. 36 v. Bird Construction Ltd. (emphasis added)

The Manitoba Court of Appeal in *Bird Construction* stated it would not break down the building into component parts so that the "work" exclusion removed coverage only the defect and not any resulting damage to other parts of the structure. The case says nothing about whether the building may be broken down into components for the purpose of determining whether resulting damage to other parts of the structure constitutes "property damage" under the insuring agreement.

Further, although Mr. Justice Smith indicated in *Swagger* that insurance policies should be considered in their entirety when interpreting any clause, it appears he failed to consider one of the policy exclusions as an interpretive guide for the insuring agreements. It is not recorded in the judgment but was confirmed in a subsequent case[42] that the exclusion for the insured's own work (in Swagger's case, the entire building) contained a completed operations hazard exception for subcontractor work. There is no purpose for this exception if physical damage to any part of the building does not constitute property damage under the insuring agreement in the first place. The presence of the subcontractor exception suggests the policy drafters understood damage to a general contractor's product would be covered by the insuring agreement. That is why they removed it from coverage with the work exclusion and returned coverage for subcontractor work in the completed operations phase.

Swagger Construction appealed Justice Smith's decision but subsequently settled its dispute with the insurer and abandoned the appeal.

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[42] *Progressive Homes Ltd. v. Lombard General Insurance* 2007 BCSC 439 at para. 48.

6.4 *Bridgewood Building Corp.* and *Beige Valley Developments Ltd.*

In 2006, the pendulum swung again when the Ontario Court of Appeal concluded that project damage arising from subcontractor work deficiencies fell within the general contractor's CGL grant.[43]

Bridgewood Building Corp. and Beige Valley Developments Ltd. were Ontario builders insured by Lombard General Insurance Corp. The builders constructed a number of homes containing defective concrete supplied by subcontractors. Faced with warranty claims, the builders moved swiftly to address the necessary repairs and provided alternate accommodations to the occupants. Lombard refused to reimburse the builders for these costs and the builders sued. At trial, Lombard resisted coverage on various grounds, underscoring all of them with the principle that liability policies are not performance bonds and the public policy argument that extending coverage to shoddy workmanship or products would serve to encourage same. The Court was not convinced by these arguments and held the CGL policies covered the loss in those particular cases. Lombard appealed.

In April, 2006, the Ontario Court of Appeal released a judgment upholding the trial decision. Although the Court did not refer to the *ARG* or *Swagger* decisions, its ruling firmly rejected the reasoning underlying those cases.

Lombard argued the insuring agreements did not cover the losses, saying it was settled law that CGL policies are not intended to cover repair or replacement costs arising out of an insureds own defective work or product. This is the performance bond argument frequently raised in construction coverage cases.

The Ontario Court of Appeal followed the rule espoused by the Saskatchewan Court of Appeal in *Westridge*: The actual policy wording must take precedence over general insurance principles. Standing alone, any general principle that a liability policy is not a performance bond cannot preclude coverage for claims respecting an insureds own defective work or product if the policy provisions evidence a contrary intent. Instead, the general principle is merely an interpretive aid that can be helpful, but not necessarily decisive, in determining the scope and extent of risk that the insurer has agreed to cover in any given case.

Although it was not invoked by Lombard, who had argued the case based on general principles alone, the Ontario Court of Appeal considered the work exclusion when interpreting the coverage agreement. The Court particularly noted the exception if the damaged work or the work out of which the damage arises was performed on the insureds behalf by a subcontractor. On a plain reading, this provision suggested coverage was available if the exception was engaged.

When challenged by the Court to address the issue, Lombard argued that an exception to an exclusion cannot restore coverage which did not first exist under the grant. The Court of

[43] (2005), 26 C.C.L.I. (4th) 93 (Ont. C.A.).

Appeal ruled there was original coverage in the grant and so the exception to the exclusion did not create coverage where none existed before. The Court found that Lombard's position that there was no coverage in the grant was problematic for several reasons. First, it defied the basic principle of contract interpretation that all terms are presumed to have a purpose. If Lombard's position was accepted, the work exclusion was redundant and the exception meaningless. Second, Lombard's position "turned the *contra proferentem* principle on its head" by in effect asking the Court to construe ambiguities in the insurance policy against the insured. Third, it ignored the historical evolution of the work exclusion and the reasonable expectation of the parties flowing from this. The Court reviewed the history of the exclusion and noted the subcontractor exception was added to the standard CGL policy in 1986 because more projects were being completed with subcontractors and contractors were unhappy that the work exclusion precluded coverage for the work done by these subcontractors.

Lombard next argued that finding coverage would provide general contractors with a windfall. For low premiums, they were able to obtain insurance that permits, indeed encourages them, to hire inexpensive subcontractors, comforted in the knowledge they will be fully indemnified if the subcontractors do bad work. Insurers never intended to underwrite this "business risk". The Court of Appeal also rejected this argument for three reasons.

First, it accepted the logic from previous cases which said the business risk doctrine is less applicable to a claim by a general contractor for the defective work of its subcontractor. A general contractor has minimal control over the work of its subcontractors and providing coverage to the general contractor will not relieve the subcontractor of ultimate responsibility.

Second, Lombard's position failed to account for practical business realities. General contractors would go out of business if they routinely hired incompetent subcontractors. On this point, the judgment states, "The marketplace can be trusted to look after unscrupulous general contractors who for the sake of a fast dollar, are prepared to risk their reputation by providing defective work product on a regular basis."

Third, "and most important", the if insurance companies do not wish to indemnify general contractors for the faults of their subcontractors, "they need only say so in clear and unambiguous policy language". Standard industry endorsements designed to accomplish just that have been available for years.

In the end, the Ontario Court of Appeal ruled the trial judge was correct and Bridgewood and Beige Valley were covered for the losses. Lombard sought leave to appeal the case to the Supreme Court of Canada but the Supreme Court refused to hear the case.

6.5 *ING Insurance Company of Canada v. A.M.L. Painting Ltd.*

In June, 2006, the Supreme Court of Nova Scotia followed the *Westridge* and *Bridgewood* cases in their approach to interpreting the insuring agreement.

The facts before the Nova Scotia court in *ING Insurance Company of Canada v. A.M.L. Painting Ltd.*[44] were different in that the damage resulting from the deficiencies in the insured contractor's work was not confined to the work itself. Physical damage to third party property would normally take the insurance dispute outside the arena bordered by *A.R.G*, *Swagger*, *Westridge* and *Bridgewood* since those cases dealt only with damage to the insured's own work. However, the defendant insurer in the *A.M.L. Painting* case argued the same analysis applied because the insured contractor was being sued only for the cost of repairing its own work and not the cost of repairing damage to third party property.

The *A.M.L. Painting* case involved a painting contractor retained by the owners of the Goldboro Gas Plant to prepare the surface and apply a protective coating to piping, pipe supports and "weld-o-lets". Under a subcontract to a mechanical trade, the contractor also provided some pipe fabrication for the project. The owners sued the contractor, alleging widespread and premature failure of the paint system, including improper surface preparation and application. According to the owners' statement of claim, the paint failures caused and were continuing to cause significant corrosion of the steel which would impair its structural integrity if left unrepaired.

Before determining whether the claim was restricted to the cost of repairing the contractor's own work, Mr. Justice Warner analyzed different approaches for interpreting the policy. The insurer cited the performance bond principle in support of its argument that the cost of repairing the insured's own work is not "physical injury to tangible property" within the meaning of the insuring agreement. The insurer did not cite *A.R.G.* or *Swagger* but instead relied upon the 1991 decision of the B.C. Supreme Court in *Privest Properties*[45] and *Alie v. Bertrand & Frere Construction Co.*[46], a 2002 decision from the Ontario Court of Appeal. Both cases considered of the meaning of property damage within the liability policy insuring agreement but – just as in *A.R.G.* and *Swagger* - neither case considered that other parts of the policy might influence interpretation of the insuring agreement.

The contractor countered by arguing the court should follow the approach of the Saskatchewan Court of Appeal decision in *Westridge* and the Ontario Court of Appeal in *Bridgewood* by considering the entire policy when interpreting the insuring agreement. The judge, Mr. Justice Gregory Warner, expressed a preference for the *Westridge* and *Bridgewood* approach over that taken in *Privest* and *Alie*. He wrote,

> *The case law cited to the Court is not consistent in its approach to analysing the insuring provisions of the CGL policy.*
>
> *I have some difficulty with the approach taken by the Ontario Court of Appeal in* Alie *in its analysis of what constitutes "property damage" at paragraphs 23 to 46. It makes the statement, <u>in discussing the insuring provision and definition of</u>*

[44] 2006 NSSC 203
[45] supra, note 12
[46] supra note 17

R. Glen Boswall, T. 604.643.3125

> *property damage, that CGL policies are not performance bonds or intended to cover the cost of repairing or replacing the insured's defective work or product.*
>
> *In my view, such a general provision can only flow from an analysis of the entire policy – the insuring provisions, definitions, conditions, and exclusions, and is still subject to the actual wording of the individual policy.*
>
> *If one follows the steps described by Sanderson et al in their text beginning at page 19, or by Snowden and Lichty at Chapter 6:10, on a plain reading of the insuring agreement)(section I-C) together with the definition of "property damage", the policy clearly covers all physical damage to tangible property caused by an occurrence, and includes loss of use resulting therefrom, and loss of use of uninjured property caused by that accident. Nothing in the insuring agreement or definition of property damage limits the property damage to property of a third party or excludes property of the insured.*
>
> *It is the exclusions and liability conditions that, through several revisions of the model forms developed by ISO and IBC, have resulted in the general provision that CGL policies are not intended to cover the costs of repairing or replacing the insured's defective work or product.*
>
> *I prefer the approach adopted by the Saskatchewan Court of Appeal in* Westridge *and accepted by the Ontario Court of Appeal in* Bridgewood. *This approach requires the Court to carefully analyse the interplay between the insuring provision, the definitions, and the exclusion clauses.*
>
> *The exclusion clauses become redundant or unimportant in an analysis that follows the steps described in* Alie *and* Privest.[47] (emphasis in original text)

In the end, it made little difference whether Justice Warner followed either approach as he concluded the claim against the contractor was sufficiently broad to include the cost of repairing the resulting corrosion and the loss of use of the plant due to the corrosion damage. These claims for third party damage constituted "physical injury to tangible property" even under the *Alie* and *Privest* approach (and, by implication, the *A.R.G.* and *Swagger* approach) to interpreting the insuring agreement. Nevertheless, the *A.M.L. Painting* case stands as another endorsement of the *Westridge* and *Bridgewood* approach to interpreting the insuring agreement over that taken in *A.R.G.* and *Swagger.*

6.6 *GCAN Insurance Co. v. Concord Pacfic Group Inc.*

In British Columbia, however, the *ARG* and *Swagger* approach was further entrenched by two more cases.

[47] Supra, note 13 at paras. 38 to 44.

In February, 2007, the Madam Justice Garson of the B.C. Supreme Court issued her judgment in *GCAN Insurance Company v. Concord Pacific Group Inc.*[48] Justice Garson looked at each of the cases noted in sections 6.1 to 6.5 of this paper but naturally focused on the *Swagger* judgment, a precedent from her own court. She found the *Swagger* decision stood for two basic propositions concerning the insuring agreement, one pertaining to the phrase "physical injury to tangible property" and the other to the term "accident." She wrote,

> *I would interpret Swagger as authority for the proposition that a liability insurance policy covering physical injury to tangible property does not contemplate the artificial division of the work of the party responsible for that work into component parts for the purpose of establishing Resultant Damage, unless that is the clear intention of the policy. ...*
>
> *... Swagger is also authority for the proposition that in the context of an insurance policy covering physical injury to tangible property, defective construction is not an "accident" unless there is damage to the property of a third person.*[49]

The *GCAN* case began with two petitions in which a wrap up liability policy insurer sought declarations regarding its obligation to defend a developer, general partner of the developer, construction manager, land owner and general contractor in two leaky condo building lawsuits. The insurer relied on the *Swagger* case, arguing that for insureds whose "work" is the production of an entire project, any construction defects and resulting damage to the project are not accidents within the meaning of the initial coverage grant. The respondents argued the judge should not follow *Swagger* because it was wrongly decided and, in any event, the facts of that case were different. In the alternative, the respondents said that if the judge did follow *Swagger*, the case should apply only to the respondent general contractor and not the others.

Justice Garson noted the law compelled her to follow the *Swagger* precedent unless, (a) the *Swagger* judge failed to consider some binding legal authority, (b) subsequent cases affected the validity of the *Swagger* judgment, (c) the *Swagge*r judge had not properly analyzed the facts and law due to haste, etc. or (d) the *Swagger* judgment was clearly wrong. Justice Garson determined that only points (a) and (b) merited detailed analysis.

Justice Garson concluded the *Swagger* judge had considered all relevant legal authorities and it was irrelevant whether she – Justice Garson - might interpret the authorities differently. She did not admit to having a different interpretation but said it was up to the Court of Appeal to overrule *Swagger* if that case was wrongly decided.

Regarding the cases subsequent to *Swagger*, Justice Garson made quick work of the *Bridgewood* and *A.M.L. Painting* judgments. She concluded she need not follow *Bridgewood* because the policy wording in that case was different and the judges involved did not consider

[48] 2007 BCSC 241.
[49] Supra, note 17 at para. 42.

R. Glen Boswall, T. 604.643.3125

the *Swagger* case. She did not point out the differences in policy wording or explain their significance. Neither did she say why a case contradicting the reasoning behind *Swagger* was less influential than one that expressly mentioned Swagger. Regarding *A.M.L. Painting*, she said only that the case was not binding on her and was not on point because it concerned a CGL policy rather than a wrap-up policy. Again, she did not point out the difference in policy wording or explain its significance.

Justice Garson next considered whether the facts in her case were different from those in *Swagger*. The insureds said their exclusions were different because they allowed coverage for some resulting damage to the project. These exclusions would be redundant if the insuring agreement precluded coverage for any resulting project damage. The judge accepted that finding preliminary coverage under the insuring agreement and leaving the ultimate determination to the exclusions would result in a less tortuous interpretation of the policy. However, she ruled that exclusion clause redundancy was not enough to change the clear meaning of words in the coverage grant. Although she did not say so, it appears she found that clarity in the decisions of other judges rather than in her own interpretation of the words. She finished the point by saying she was bound by the *Swagger* interpretation of the grant.

The respondents had more success in restricting the application of *Swagger*, although the result is confusing.. Justice Garson concluded the *Swagger* interpretation of the grant precluded coverage for the general contractor but there was a possibility of coverage for the land owner, developer, the developer's general partner and the construction manager. The judge saw the logic behind denying coverage to a general contractor as being different and this affected interpretation of the insuring agreement. She observed that covering a general contractor for resulting damage to its own work would turn the liability policy into a performance bond. A contractor would have less incentive to do good work if it knew the liability policy would cover defects and resulting damage to the project. However, that rationale was not justified when applied to the others, depending upon their role. Justice Garson reasoned that an owner or developer would desire to have a project completed in a skilful and timely manner and had nothing to gain from a general contractor performing poor work. With respect, Justice Garson does not appear to have considered that an owner or developer might benefit from an artificially low contract price backed up by the "repair guarantee" provided by a liability policy.

Also, according to Justice Garson, it could not necessarily be said that the work of the general contractor is the owner or developer's "own work". The owner or developer many not have actually performed work on the project, an issue that would be determined at trial. Justice Garson said that to deny coverage to the owner/developer when they took no part in the construction of the project is essentially akin to saying the general contractor and the owner/developer are the same parties.

All this implies there should be different liability policy coverage for direct and indirect involvement in producing a construction project. If a party builds or guides construction of a project, the project is the party's work and the policy insuring agreement precludes coverage for defects and resultant damage to the project. However, if a party only contracts to have others build and guide, the project is not the party's work and the coverage grant does not preclude

R. Glen Boswall, T. 604.643.3125

coverage. With respect, this seems like a distinction without a difference. A general contractor may contract the job of building and guiding to others so why should the general contractor face different coverage considerations than a developer?

In explaining her analysis, Justice Garson used a puzzling analogy. She said the relationship between a general contractor and owner/developer might be analogous to the relationship between a general contractor and subcontractors. She wrote,

> *Damage caused to other property by a subcontractor's work is not excluded from coverage because it would be unfair to hold the general contractor liable for work performed by a subcontractor. Likewise, it would be unfair to allow the insurer to avoid defending an owner/developer for work performed by a general contractor in which the owner/ developer took no part.*
>
> *It cannot be said at this time how the above applies to a "construction manager" as opposed to a "general contractor.*[50]

The problem with this analogy is that under *Swagger* and Justice Garson's ruling in the *GCAN* case, the general contractor has no coverage for damage caused by a subcontractor although the general contractor maybe liable for it in tort and is certainly liable in contract. The subcontractor may itself be covered by liability insurance but there is no protection for the general contractor. Why, then, is it fair to give coverage to an owner/developer while denying it to a general contractor? Furthermore, Justice Garson does not explain the difference between the work of a construction manager and a general contractor or why different coverage considerations should apply.

In the end result, the *Swagger* interpretation of the coverage grant remains the law in British Columbia but its application has been restricted to general contractors – at least for the insurer's duty to defend. Just like the *Westridge*, *Bridgewood* and *A.M.L. Painting* judgments, the new restrictions placed on *Swagger* by the *GCAN* decision undermine *Swagger*'s logical underpinnings.

Because all of the insureds were related entities and GCAN was directed to defend all them other than the general contractor, the insureds elected not to appeal Justice Garson's judgment.

6.7 *Progressive Homes Ltd. v. Lombard General Insurance*

Mr. Justice Cohen of the B.C. Supreme Court issued his decision in *Progressive Homes Ltd. v. Lombard General Insurance*[51] one month after Madam Justice Garson's judgment in the *Concord* case. Progressive Homes Ltd. was a general contractor being sued in four separate

[50] Supra, note 17 at paras. 97 &98
[51] 2007 BCSC 439

actions for construction deficiencies and resulting water damage in condominium developments Progressive had built. Progressive sued its liability insurer, Lombard, for coverage.

Justice Cohen concluded he was bound to follow *Swagger* and *Concord* unless those decisions could be distinguished from the facts and circumstances before him. Progressive Homes argued that its case was different because its policy contained a "subcontractor" exception to the "work" exclusion similar to that discussed in section 5.4 of this paper and raised in the *Bridgewood* decision. The effect of exclusions on interpretation of the coverage grant was not considered in *Swagger*. Although the issue was considered in *Concord*, Justice Garson only concluded that a redundant exclusion could not alter the clear meaning of words in the insuring agreement. In other words, the fact that the grant and the work exclusion could independently leave the claim outside coverage did not mean the allegedly clear meaning of the grant had to be altered (i.e. changed to allow coverage) to give purpose to the work exclusion.

The subtle distinction in the *Progressive Homes* case was that giving effect to the subcontractor exception would lead to a different result, that is it would allow coverage to a general contractor for damage to its project if the damage resulted from the defective work of a subcontractor. *Progressive* was not a case of an exclusion being rendered superfluous because it duplicated the effect of the coverage grant. Rather, it was a case of an exception to an exclusion being nullified if the coverage grant was interpreted as in the *A.R.G.*, *Swagger* and *GCAN* judgements.

Mr. Justice Cohen did not accept the distinction. He wrote,

> *While the argument advanced by Progressive is compelling, I find that I am nevertheless bound by* Swagger *and that based on the analysis and result in* Swagger, *Progressive's applications must be dismissed.*
>
> …
>
> *Finally, I find that it is improper to look to the exclusions and exceptions to exclusions to find coverage where none exists in the first place. This is because, as Lombard argues, the operative coverage clause in the insurance contracts acts as a condition precedent to determine coverage. The exclusion clauses then act to take coverage away where it might otherwise exist. In this regard, N. Smith J. explained, as follows [in the* Swagger *decision]:*
>
> > [11] The court must first determine whether the claim falls within the insuring agreement contained in the policy. If it does not, that is the end of the matter. If it does, it is necessary to determine if it is excluded by any of the exclusion clauses in the policy. If not, the final question is whether there is a possibility that the claim will succeed at trial: see *Ellet Industries Ltd. v. Laurentian P&C Insurance Co.* (1996), 17 B.C.L.R. (3d) 210, 34 C.C.L.I. 294.

> *Thus, only if Progressive's claim falls within the operative coverage clause can the claim fall within the scope of the insurance contracts. Only then is it proper to consider exclusions and determine whether the claim is "nevertheless excluded": See* Ramsay v. Voyageur Insurance Co., *[1988] B.C.J. No. 1187 (C.A.)*
>
> *Moreover, although I am mindful that the Court in* Bridgewood *did look to exclusion clauses to find coverage in the circumstances which bear a similarity to the terms of the policies in* Swagger *and the case at bar, I note that the Court did not refer to* Swagger. *In my opinion, and with great respect, I do not consider* Bridgewood *to settle the law on this issue in this province. Furthermore, to the extent that the result in* Bridgewood *turns on a consideration of a redundancy, I agree with Lombard that it is doubtful whether, at least in this province, consideration of a redundancy has a proper, or at best, any significant place in determining whether coverage extends under an insurance policy: See* Harbour Machine Ltd. *supra.*[52]

In the *Concord* decision, Justice Garson also made a brief reference to *Harbour Machine Ltd. v. Guardian Insurance Company of Canada* [53]in support of the point that the clear meaning of one part of an insurance policy cannot be altered because it will render another part redundant. However, the meaning of "accident" and "physical property" damage do not clearly exclude physical damage to the insured's own work. In fact, the average reader would probably assume these terms did encompass physical injury to an insured's own work so long as it was not intended or expected.

Primarily, it has been consideration of the exclusions that lead courts to develop the principle that an insurance policy is not a performance bond. Unfortunately, some judgments have ignored the role played by the exclusions and read the principle independently into the coverage grant, using the principle to find that the words "accident" and "physical damage to tangible property" do not encompass physical damage to the insured's own work. This is despite the absence of any words in the coverage grant restricting coverage to damage suffered by third parties. As noted in *Bridgewood*, these judgments appear to (1) defy the basic principle of contract interpretation that all terms are presumed to have a purpose; (2) turn the *contra proferentem* principle "on its head" by in effect asking the court to construe ambiguities in the insurance policy against the insured; and (3) ignore the historical evolution of the work exclusion and the reasonable expectation of the parties flowing from this.

The *Progressive* case is under appeal.

WHAT NOW?

[52] Supra, note 50 at paras. 53 and 61-63.
[53] (1985), 60 B.C.L.R. 360 (C.A.)

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Currently, the Saskatchewan and Ontario Courts of Appeal and the Nova Scotia Supreme Court accept that the exclusions can be used to interpret the coverage grant and, in the cases before those courts, the terms "accident", "occurrence" or "physical damage to tangible property" were held to encompass physical damage to the insured's own work.

In contrast, the Supreme Court of British Columbia has on three occasions ruled the coverage grant must be interpreted on its own and that the referenced terms in the preceding paragraph do not cover physical damage to a general contractor's work including any damage resulting from work carried out by a subcontractor. According to the *Concord* case, a developer and construction manager may be covered for damage to their work if the work is somehow distinct from that of the general contractor. Based on the case law to date, it is difficult to determine how that distinction will be drawn but it appears to rest on the difference between direct and indirect involvement in the construction.

If the B.C. Court of Appeal upholds the trial judgement in the *Progressive Homes* case, it seems likely that the issue – in this case or another - will eventually wind up before the Supreme Court of Canada. If the *A.R.G./Swagger/Concord/Progressive* approach to interpreting the coverage grant ultimately prevails over the *Hern Actes/Westridge/Bridgewood/A.M.L. Painting* approach, it seems likely the insurance industry will eventually modify the standard insuring agreement wording. The market demands that created the completed operations exception in 1986 will probably lead to the creation of a new CGL insuring agreement that permits the exception to function.

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