

INSURANCE LAW

COMMENTARY: Appeal decision refuses to apply general insurance principle

An Alberta lawyer argues that this decision confirms that in determining coverage, general principles of insurance law are only to be used as interpretive aids and should not be used to determine the presence or absence of coverage.

By Don McGarvey

The Ontario Court of Appeal recently refused to apply a general principle of insurance law, instead preferring to determine coverage based on the precise terms of a comprehensive general liability policy. In doing so, the court stated that while a CGL policy is not meant to be a performance bond, clear and unambiguous terms of a CGL policy can provide coverage for defective materials or workmanship.

In a decision issued on April 5 in *Bridgewood Building Corp (Riverfield) v. Lombard General Insurance Company of Canada*, [2006] O.J. No. 1288, at issue was whether the CGL policy issued by the insurer provided coverage to the insured for damage occasioned to homes containing structural defects due to defective concrete supplied by one of the insured's subcontractors.

The CGL policy under consideration contained the following insuring agreement:

"We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies."

The policy also included the following exclusion:

"This insurance does not apply to:

j. 'Property damage' to:

1) that particular part of 'your work',

2) that particular part of machinery or equipment forming a part of 'your work' described in 1) above, or

3) a component or constituent of 'your work' described in 1) above, whether such component or constituent is a separate physical part or an integral element of 'your work', that is defective or actively malfunctions. This exclusion applies only to 'property damage' to 'your work' 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" (emphasis added)

In arguing against coverage, Lombard urged that the court follow the general principle that CGL policies are not intended to cover repair or replacement costs arising out of an insured's own defective work or product. Lombard went on to argue that to extend coverage in such circumstances would encourage substandard manufacturing and workmanship and open the "floodgates" to insurance claims, thereby effectively making the insurer a guarantor or the contractor's work.

The Ontario Court of Appeal agreed that, as a statement of principle, a CGL policy is not intended to be a means for a contractor to cover expenses of its own defective workmanship or materials, or to be a performance bond. However, following the Alberta Court of Appeal in *S. (J.A.) v. Gross*, [2002] A.J. No. 152, and the Saskatchewan Court of Appeal in *Westridge Construction Ltd. v. Zurich Insurance Co.*, [2005] S.J. No. 396, the court found that such a principle was only an interpretive aid to determining coverage and interpretive aids should not overshadow the importance of the precise terms of the CGL policy.

In examining the historical evolution of clauses such as exclusion (j), the court traced the subcontractor exception to the exclusion back to 1986. In doing so, the court noted that to that point in time, many contractors were unhappy that their business risks were excluded even when they had been increasingly engaging subcontractors to complete many of the phases of construction. In response, the subcontractor exception to the "your work" exclusion was developed, thereby expanding coverage to contractors under the

CGL (through the Broad Form Property Damage Endorsement). Among other things, the Broad Form Property Damage Endorsement extended coverage to contractors for damage caused by subcontractors. Eventually, this extension of coverage made its way directly into the CGL policy and became known as the "subcontractor's exception" to the "your work" exclusion.

This is not to say that there is coverage available under a CGL policy to a contractor where the contractor's own work is defective and causes property damage; rather, coverage would be normally be excluded by the "your work" exclusion, except where the damage is occasioned by the subcontractor which would trigger the subcontractor exception to the exclusion, thereby restoring coverage.

While some may continue to be

concerned that the subcontractor exception in the CGL policy operates to provide the contractor with a "performance bond", the court identified three compelling reasons why such concern may be misplaced. First, the court suggested that a general contractor often has minimal control over the work of its subcontractors and due to subrogation rights available to the contractor's insurer, the subcontractor will be ultimately liable for its own defective work.

Second, if general contractors make a habit of engaging the services of subcontractors who perform substandard work, the general contractors will not remain in business for very long by virtue of poor reputation and market forces.

Third, and most importantly in the view of the court, if insurers do not want to provide coverage for property damage occasioned by a general contractor's subcontractor, they need only say so in clear and unambiguous language in the CGL policy.

In the end, the decision in *Bridgewood Building Corp.* provides further support for the proposition that in determining coverage, general principles of insurance law are only to be used as interpretive aids and should not



Don McGarvey

be used to determine the presence or absence of coverage, in and of themselves. General principles and the policy considerations that underlie them, remain important but only in the context of what risks an insurer has agreed to cover. As such, the primary focus is, and ought to be on the terms of coverage as determined by the insuring agreement and the exclusions, even where those terms may appear to be contrary to general principles of insurance law.

Don McGarvey is a partner with the Edmonton office of McLennan Ross LLP practising in the areas of commercial litigation and insurance law.

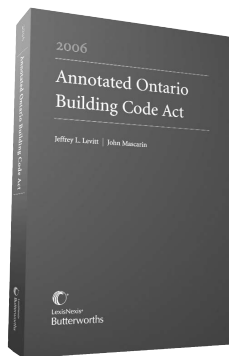
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—continued from p. 16—

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Michael F. Smith practises transportation law and insurance defence litigation with Bennett Best Burn LLP in Toronto. He is chair of the Insurance Law Section of the Ontario Bar Association.



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