

Reconstructing the Your Product Exclusion



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In *Axa Insurance v. Ani-Wall Concrete*, Ontario Superior Court Justice Paul Perell adopted an approach to interpreting the "Your Product" Exclusion which, depending on the factual circumstances, further restricts its scope.

When applying the Your Product Exclusion, the courts usually find the cost of repairing or replacing the insured's own product is excluded by a Commercial General Liability policy, but any damage going beyond the insured's own product is covered. The leading example of this

approach is the Ontario Court of Appeal's decision in *Alie v. Bertrand & Frère Construction Co.*, in which the court found the cost of replacing the defective concrete was not covered.

In *Ani-Wall*, Perell found the product supplied by the insured was so fundamental to the entire structure that holding the cost of its repair or replacement was excluded would defeat the purpose of the coverage.

ANI-WALL: FACTS AND ISSUES

Ani-Wall is a concrete-forming contractor for the construction of homes in the Greater Toronto Area. It constructs concrete footings and concrete foundation walls by building forms into which concrete is poured. The forms allow the concrete to harden or "cure," at which time the forms are removed. Ani-Wall does

not manufacture the concrete, but purchases it from suppliers.

Ani-Wall in 2002 constructed concrete footings or foundations for various builders using concrete supplied by Dominion Concrete. The concrete footings or foundations were defective as a result of deficiencies in the components used to produce the concrete.

Axa insured Ani-Wall under a Commercial General Liability Policy for sums that Ani-Wall is legally obliged to pay as compensatory damages because of "property damage" that occurred during the policy period. Axa denied coverage



In light of *Ani-Wall*, depending on the particular facts, the court has indicated that if the product is such that it is the foundation, so to speak, of the overall product, then the...Your Product Exclusion will have no effect whatsoever.

under its policy relying on three exclusions: the Your Product Exclusion, the "Your Work" Exclusion and the "Rip and Tear" Exclusion. Axa applied to the court for a declaratory order that it had no obligation to indemnify Ani-Wall for its liability to the builders.

Axa conceded the property damage sustained by the builders comes within the insurance coverage provided to Ani-Wall. Nevertheless, the company submitted that the three exclusions operated to remove coverage.

The court addressed whether it was premature to determine whether indemnity was payable before a trial. Relying on the Ontario Court of Appeal decision in *Bridgewood v. Lombard*, among other decisions, the court held that in an appropriate case, an insurance contract could be interpreted on an application in order to determine whether indemnity is available under it.

Since the focus here is on the court's reasoning and finding in respect of the Your Product Exclusion, we will only briefly address its conclusions in respect of the Your Work and Rip and Tear Exclusions.

Insofar as the Your Work Exclusion is concerned, the court followed the *Bridgewood* decision, which held that the sub-contractor exception to that exclusion was applicable because the exclusion "does not apply where Ani-Wall's work was performed by a subcontractor." [Here the definition of work includes work performed on its behalf and materials furnished in connection with the work.] In this instance, the work was performed by the subcontractor that supplied the defective concrete, Dominion Concrete.

With respect to the Rip and Tear Exclusion, the court found it was not applicable because it was ambiguous; therefore, it must be read in favour of the insured. Relying on the same principle —

what Perell termed the "principle against repugnant exclusions" — the court found the Your Product Exclusion was not applicable. Perell found that if the Rip and Tear Exclusion, which was said to exclude any liability arising out of the repair or replacement of defective concrete, was applied, then it would leave a "gaping hole in the coverage." It would therefore be "repugnant to the insurance coverage" and should not be enforced.

THE YOUR PRODUCT EXCLUSION

The court's analysis in respect of the Your Product Exclusion elaborates on the "principle against repugnant exclusions."

At the outset, Perell observed the Your Product Exclusion would have applied to oust some coverage. But this was altered by two points:

- the interpretive principle that an exclusion to coverage should not be enforced when the result would be to defeat the main object of the contract or virtually nullify the coverage sought for anticipated risks; and

- an exemption in this exclusion for an insured's product that is "real property." The Your Product Exclusion provides that "the insurance does not apply to property damage to your product arising out of it or any part of it." The phrase "your product" is defined, in part, to mean "any goods or products, other than real property, manufactured, sold, handled, distributed or disposed by:

- you;
- others trading under your name; or
- a person or organization whose business or assets you have acquired."

Justice Perell considered the *Alie* decision and cited its finding that "when the insured's own defective product becomes incorporated into the property of a third party, the damage is to the property of the third party." In *Alie*, the insurers argued

that the defective concrete supplied by Bertrand consisted of the foundations themselves; this was rejected by the trial judge's finding that the damage to the foundations and other parts of the houses went beyond Bertrand's own product and constituted damage to the property of others.

In the present case, Ani-Wall's product was clearly the footings and foundations. Therefore, the court noted, the Your Product exclusionary clause would remove coverage for the cost of Ani-Wall's footings and foundations, but it would not remove coverage for the cost of the damage to the houses that went beyond the cost of the footings and foundations. However, the court continued, this was not the proper conclusion for two reasons.

First, Perell found this result would "offend" the principle from *Weston Ornamental Iron Works Ltd. v. Continental Insurance Co.* In that 1981 decision, the court stated the exclusion clause in that case should not be interpreted "in a way which is repugnant to or inconsistent with the main purpose of the insurance coverage but so as to give effect to it." Therefore, "even if the exemption clause were found to be clear and unambiguous, it should not be enforced by the courts when the result would be to defeat the main object of the contract or virtually nullify the coverage sought for protection from anticipated risks."

In addition, Perell cited the Ontario Court of Appeal's 2002 decision in *Zurich Insurance Co. v. 686234 Ontario Ltd.*, in which the court recited what was said in *Weston Ornamental* and then added that an exclusion clause will not be applied "where to apply it would be contrary to the reasonable expectations of the ordinary person as to the coverage purchased."

In applying this rationale to the facts in *Ani-Wall*, the court stated at Paragraph 70: "In the case at bar, where the costs of repairing or replacing the insured's defec-

tive product (the footings and foundations) likely approaches [sic] the costs of repairing the third parties' damaged property (the homes), applying the Work Product [sic, it appears the reference should be to Your Product] exclusion in the manner suggested by Axa Insurance would be contrary to the reasonable expectations of the ordinary person as to the coverage purchased. A review of the declaratory order sought ... by Axa Insurance reveals an enormous hole in the blanket of insurance coverage for property damage caused to third parties. Applying the principle from *Weston Ornamental Iron Works*, I would not apply the Your Product exclusion."

Perell stated at Paragraph 71 his second reason for finding the Your Product Exclusion did not apply. This reason, he added, was "mutually exclusive of the *Weston Ornamental Iron Works* factor."

According to Perell, the "real property" exemption contained within the definition of Your Product saves the coverage. The court noted that under this exemption, "when the insured's product becomes part of the real property, then the Your Product Exclusion does not apply.



Ani-Wall's footings and foundations are real property, and the definition of 'your product' does not include real property."

The court observed that Canadian and American courts have "recognized that products incorporated into buildings are 'real property' and therefore do not fall within the definition of 'your product.'" The court continued: "The exemption for 'real property,' in effect, redresses any problem of the insurance coverage being more apparent than real when the insured's defective product is incorporated into the property of a third party."

COMMENT

This decision has potentially far-reaching implications because of the effect it

has on what has become understood practice — although coverage might be available for the damage resulting from an insured's defective product, the cost of repairing or replacing the product itself is not covered. In light of *Ani-Wall*, depending on the particular facts, the court has indicated that if the product is such that it is the foundation, so to speak, of the overall product, then the common understanding is no longer operative and the Your Product Exclusion will have no effect whatsoever.

The consequences of this decision for both construction claims and other types of claims — for example, product liability cases — are obvious. The court's decision demonstrates the potential for the further "whittling away" of what was left of the Your Product Exclusion.

It was arguably unnecessary for the court to go as far as it did, given the finding made in respect of the "real property" exemption in the Your Product definition, which would have addressed the particular circumstances.

This decision is under appeal and it will be interesting to see how the Court of Appeal addresses it. ☐