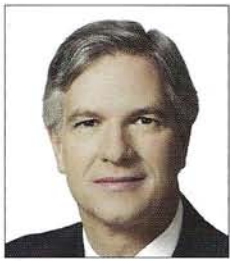


The Invisible Insureds



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Policy drafters should beware of including unnamed insureds in their builders' risk policies

Drafting an insurance policy is undoubtedly a daunting and challenging task at the best of times. Insurance companies often rely upon standard policy language. For some readers of such policy language, however, the intended meaning may not be obvious. We recall the critical observation made by former Ontario Superior Court justice James Farley in the 1994 case of *Esagonal Construction Limited v. Traina et al.*, in which Farley, after considering the wording of a builders' risk policy, stated: "I think it fair to observe that the insurance industry has its own form of relatively incomprehensible jargon which at least rivals that of the legal profession."

One might not expect any controversy or ambiguity under an insurance policy, for example, when it comes to something as relatively straightforward as identifying an "insured." But an exception arises when the notion of an "unnamed insured" comes into play. A notable example is the question of whether subcontractors for a construction project are to be covered under a builder's risk policy, in which the subcontractors have not been expressly designated by name in the Declarations Page or by category (i.e. "all subcontractors having contracted with the named insured for the insured project").

The courts have consistently inferred from policy language and extrinsic considerations that certain categories of parties, such as subcontractors — and even on occasion, suppliers of materials — are to be considered as insureds even though that might not necessarily have been the intent of the drafter of the policy. Accordingly, those who have the task of defining the parameters of coverage under a builders' risk policy should take note of the factors the courts consider, as discussed below.

It might be argued that, in light of a series of decisions emanating from the common law provinces, the status of subcontractors as unnamed insureds under a builders' risk policy is settled law.¹ But the issue has received scant judicial consideration in the province of Quebec until recently.

There have been a few decisions by the Quebec Courts over the past year in which the Canadian common law decisions on the notion of unnamed insured have been considered and, thus far, followed.² Such cases deal with a number of issues that are not only of interest to underwriters in respect of policy wording but also to claims examiners, insurance brokers and counsel for insurers and insureds, among others. These issues are important factors in considering whether a subrogation action may validly be brought against a party that participated in a construction project covered by a builders' risk policy.

Here is an overview of the principle issues the courts have examined in determining whether or not a party is an unnamed insured under a builders' risk policy. They include:

- the significance of the phrase "property owned by others," often found in the insuring agreements;
- how "intention" of the parties is to be dealt with;
- the consequences of a "covenant to insure" benefiting parties that are not named or additional insureds; and
- the "necessary implication" principle.

The courts have observed that the mere fact an insuring agreement provides for a policy to insure property in the course of construction, installation, reconstruction or repair that is owned by others than the named insured implies the insurer contemplated providing coverage to such other entities. At the very least, the reference to property "owned by others" gives rise to an ambiguity that is to be decided in favour of the insured, assuming the court applies the *contra proferentum* rule (in which ambiguity is resolved contrary to the interests of the party that drafted the contract — in this case, the insurer). In the *Esagonal Construction Ltd.* case noted above, it was held the party seeking the status of an unnamed insured under a policy, a supplier of materials, could invoke the *contra proferentum* rule.

On the other hand, it might be argued the mere fact a policy specifically designates one or more named insureds necessarily reflects the intention of the parties to the insurance contract that coverage is to be restricted to those entities.

The courts have often noted that when interpreting an insurance contract, as with any contract in general, one must look to the nature of the contract and the circumstances in which it was concluded. This principle is incorporated in article 1426 of the *Civil Code of Quebec* and has been invoked by some of the Canadian common law courts (i.e. *Sylvan Industries Ltd. v. Fairview Sheet Metal Works Ltd.*). In the specific context of a builders' risk policy, this rule of interpretation supports the argument that, in addition to the policy wording, one must necessarily take into account the underlying construction contracts to determine which entities the parties "intended" to be the insureds. The courts expect underwriters are or should be aware of their named insured's contracts and subcontracts, because the insurer's rights may be affected by them (such as where there is an express or implicit waiver of subrogation).

In the event a general contractor undertakes to obtain insurance coverage for the benefit of a subcontractor, that covenant is consistently construed as constituting a waiver of subrogation in favour of the beneficiary subcontractor. Such a waiver is opposable to the builders' risk insurer, since the insurer can have no greater rights than that of its insured.

In situations in which the underlying construction contracts are silent on the issue of insurance, and the evidence shows there was no particular discussion of that topic between, for example, the contractor and the subcontractor, such "silence" may be considered to be a factor indicative of the parties' intentions in the circumstances.

Courts have long considered the particular nature of a builders' risk policy and the commercial policy considerations that favour the principle. In doing so,

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they have frequently found that, by "necessary implication," a subcontractor or other party that participates in the construction project should be considered an unnamed insured. For example, case law in the United States on this issue goes back at least to the 1940s.³ These policy considerations include:

- the avoidance of a severe conflict of interest that would arise if an insurer were permitted to recover from one of its own insureds. The conflict arises because an insured is under a duty to cooperate fully with its insurer in the investigation of any loss covered by the policy;
- the reduction of litigation; and
- the potential financial burden placed on subcontractors if a builders' risk insurer were permitted to recover against its own insured, since each subcontractor would be required to obtain separate liability insurance to cover the full value of the insured project.

The courts have stated on many occasions that such concerns can be addressed by recognizing all of the participants in the construction project have an insurable interest in the entire project. They have also noted the aforementioned objectives and policy considerations are best fulfilled by recognizing the status of such participants as unnamed insureds under the builders' risk policy.

Even so, despite various judicial pronouncements that subcontractors should

be considered unnamed insureds by necessary implication, it is nevertheless acknowledged that under any particular policy a different conclusion may be reached if there is sufficiently clear and concise exclusionary language to that effect.⁴ In *Esagonal Construction Ltd.*, Justice Farley stated: "While I would observe that a builders' risk policy can be worded in such way as to eliminate both direct coverage of unnamed insureds — i.e., neither specifically named or named by category — and indirect protection from a subrogation clause exception, the insurer did not do so in this case."

However, caution should be exercised in the drafting of the exclusionary language. The choice of words should take into account other clauses in the insurance contract, such as the "property owned by others" provision in an insuring agreement, which may suggest a broader group of insureds than what is desired from the underwriter's perspective. Hence, our admonition: drafter beware! ≡

1. *Commonwealth Construction Co. v. Imperial Oil Limited*, (1978), *Sylvan Industries Ltd. v. Fairview Sheet Metalworks* (1994) and *Madison Developments Ltd. v. Plan Electric Co.* (1997).

2. *Optimum Société d'Assurance Inc. v. Plomberie Raymond Lemelin Inc.*, Superior Court of Montreal 500-17-020901-040 Superior Court, in appeal; *Promutuelle Lévisienne-Orléans v. Ville de Lévis*, (2007)

Q.C.C.S. 4587 (Quebec Superior Court; conf'd by 2008 Q.C.C.A. 618); *Axa Assurances Inc. and Construction de la Croisette Inc. v. Valko Electric Inc.*, *ING Assurances, Regulvar Inc. and Lombard du Canada Ltée*, 2007 Q.C.C.S. 5449 (Superior Court; in appeal)

3. (e.g., *Louisiana Fire Ins. Co. v. Royal Indemnity Co. et al.*, *Lexsee 38 So. 2D 807*, (Court of Appeal of Louisiana (1949).

4. *Trans-America Ins. Co. v. Gage Plumbing & Heating Co., Inc.*, *Lexsee 433 F. 2D 1051* (U.S. Court of Appeals for the Tenth Circuit, (1970)); *Esagonal Construction Ltd. v. Triana et al* (supra).