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THE SCC GRANTS LEAVE TO APPEAL THE PROGRESSIVE HOMES DECISION AND WILL ADDRESS THE DUTY TO DEFEND ON A CGL POLICY

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October 2009

Background

The Supreme Court of Canada has granted leave to appeal the case *Progressive Homes Ltd. v. Lombard General Insurance Company of Canada*. This is an appeal from the BC Court of Appeal which held that a general contractor was not covered under a CGL policy for damage caused to a leaky building, and was not covered for damage caused by its subcontractors. The Supreme Court's decision is much anticipated as it is expected to resolve what are perceived to be conflicting case authorities in British Columbia and several other provinces. The decision should have important implications to the insurance industry in connection with CGL policies and construction insurance generally. It is hoped that the SCC will address the broader issues raised by the cases surrounding *Progressive*, namely: (1) what constitutes an accident under a policy; and (2) what should a court consider when interpreting insurance policies.

Progressive is an appeal of the third in a series of three recent BC cases denying coverage to general contractors in leaky building litigation, starting with *Swagger Construction Ltd v. ING Insurance Company of Canada*. The *Swagger* case departed from previous interpretations of CGL policies that found there was defence cost coverage for general contractors.

Swagger

In *Swagger*, the general contractor brought an action against UBC for amounts it alleged were owing for extra work and delay in the construction of the Forest Science Centre. UBC counterclaimed for deficiencies in the work. After a series of amendments, UBC's allegations against Swagger included claims for building envelope deficiencies and resultant damage to the building, and a range of other claims. Swagger sought a declaratory order that three liability insurers had a duty to defend, and for reimbursement of defence costs already spent.

In *Swagger*, the court decided that because Swagger was the general contractor responsible for the construction of the entire building, its work product could not be divided into the component parts of the building. The court found 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. Since Swagger was responsible for the construction of the entire building, any damage caused to the building as a result of Swagger's workmanship was effectively a workmanship issue and could not be accidental damage to the property of a third person. The court therefore concluded that damage within the building caused by water ingress could not be considered damage to tangible property. It is notable that the court reached this conclusion independent of the exclusions in the policy for own work and own product. This conclusion is directly contrary to the ruling of the same court in *F.W. Hearn/Actes v. Commonwealth Insurance Company*, and the court expressly declined to follow the earlier case.

An appeal of *Swagger* was settled. The subsequent trial decisions of *GCAN Insurance Company v. Concord Pacific Group Inc.* and *Progressive* followed the *Swagger* decision and held that it stands for the following proposition:

1. liability insurance policies governing physical injury to tangible property do not contemplate the artificial division of 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 entirety of the policy; and

2. defective construction is not an “accident” unless there is damage to the property of a third party.

Progressive trial decision

In *Progressive*, the general contractor was responsible for building a number of residential buildings for the BC Housing Management Commission, which suffered from alleged water ingress defects. The trial judge determined he was bound by *Swagger* and denied coverage on the basis that coverage never came into existence. In doing so, the court rejected an interesting argument brought by the general contractor, which had not been addressed by the previous decisions. The general contractor referred to an apparent contradiction within the exclusions of the policy. The standard form CGL wording contained an exclusion for work performed “by or on behalf of a named insured”, where the broad form addition referred only to “work performed by the Named insured”. Since the second exclusion did not refer to work performed “on behalf” of the named insured, which would mean work by a subcontractor, it was argued that the policy intended there to be no subcontractor work exclusion. In other words, the insurance policy covered the general contractor for work performed by its subcontractors.

The trial judge rejected this argument, deeming it would be improper to look to the exclusions and exceptions to exclusions to find coverage where none existed in the first place.

The Appeal of Progressive

The British Columbia Court of Appeal split two to one in favour of the insurer, and held that the general contractor, in the circumstances, is not covered for the defence of the claims in a leaky condo action.

The Court of Appeal was split on how to interpret the language of the Broad Form Property damage endorsement Progressive purchased to expand coverage after completion of the project. As stated above, this endorsement specified only that the policy would not cover work performed by the Named Insured. In other words, it had

altered the exclusion language contained in the standard policy and appeared to now allow coverage for subcontractors after completion of the contract.

Madam Justice Ryan writing for the majority held that the exception language was not sufficiently clear to overcome the implied assumption that insurance is designed to transfer *fortuitous contingent risk*. A fortuitous contingent risk is another way of explaining that the policy is only intended to cover “accidents”. Madam Justice Ryan interpreted the insuring agreement of the policy by considering the intentions of the parties when entering into the insurance agreement. She explains that it is important to keep in mind the underlying economic rationale for insurance. The underlying assumption is that insurance is designed to provide protection from fortuitous underlying risk. Although she does not specify what constitutes a fortuitous risk, she says that the expected consequence of poor workmanship can hardly be classified as fortuitous. She then reviewed the claim and determined that water damage is the expected consequence of defective workmanship and therefore does not constitute a fortuitous risk.

Madam Justice Ryan then deals with the apparent ambiguity in the exception clause language. This is where her explanation becomes problematic. She finds that the first exclusion clause operates to exclude coverage for damage to other parts of the building caused by a true fortuitous risk, such as a faulty boiler that explodes, if it was installed by the insured or a subcontractor and the explosion occurs during construction. The Broad Form Property endorsement, on the other hand, is designed to cover the project once the project is complete. So the exclusion would not exclude fortuitous risks, such as a post completion boiler explosion, installed by a sub trade. She says that this makes some commercial sense, because the general contractor has the ability to observe the work of the subcontractor and to check for obvious problems during construction, but the general contractor cannot be expected to find latent defects which can cause damage after the work is completed. She was therefore satisfied that the exclusion clauses did not conflict with the proper interpretation of the policy. One might question the rationale of this interpretation. Does it make sense that a general contractor

is in a better position to prevent a boiler explosion caused by the defective workmanship of its subcontractor simply because the explosion occurred during construction?

In a dissenting opinion, Madam Justice Huddard determined that defence coverage should be afforded. Madam Justice Huddard first began with the principle that the insurance policy must be interpreted in reference to the entire agreement. The exclusion clause therefore must be interpreted in a way that gives meaning to the entire policy. If the policy specifically excludes coverage to work performed “on behalf of the insured” and then that language is modified to delete the words “on behalf of the insured”, the only reasonable meaning that can be attributed to that modification is that the parties intended there to be coverage for liability arising out of work performed “on behalf of the insured” by subcontractors. In this respect, the Court was persuaded by the Ontario Court of Appeal decision in *Bridgewood Building Corp (Roverfield)*. *Lombard General Insurance Company of Canada*, which came to the same interpretation when interpreting a policy with similar wording that included a Broad Form modification of the exclusion cause.

In dissent, Madam Justice Huddard held that in reading the policy as a whole, one had to find that the intention of the parties was to insure for property damage resulting from the work product of subcontractors and the insurer should defend the claim until it can be determined what work was performed by Progressive and what work was performed by its subcontractors.

Conclusion

The result is a non-unanimous Court of Appeal decision in British Columbia where a three member panel of the Court Appeal held two to one in favour of there being no defence coverage to a general contractor for liability arising out of a subcontractor’s work, whereas in Ontario, the Court of Appeal came to the exact opposite result. This has made the decision suitable for an appeal to the Supreme Court of Canada to ensure uniformity of the law relating to insurance coverage across Canada. We are hopeful that the Supreme Court of Canada will not restrict its review of the law to the

proper interpretation of the Progressive policy where there are conflicting exclusion clauses. It would serve both the construction and insurance industry if there was a further review of the conflicting decisions in *Swagger* and *Hearne/Actes*. We expect the SCC will continue to adopt the principle that each insurance policy should be interpreted individually, although clarification of the definition of accident and what constitutes a fortuitous risk within a CGL policy would be welcomed.