

COURT OF APPEAL UPHOLDS NO INSURANCE FOR FAULTY WORKMANSHIP OR MATERIALS

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In its recent decision, *Progressive Homes Ltd. v. Lombard General Insurance Company*, the British Columbia Court of Appeal has endorsed the conclusion reached in three earlier B.C. Supreme Court decisions: general liability insurance does not extend to cover a general contractor's liability for the cost of remedying faulty workmanship, material or finished product for which the general contractor was contractually responsible. It is the first endorsement by the B.C. Court of Appeal of three earlier Supreme Court decisions: *Privest* (1991); *Swagger* (2005); and *GCAN* (2007). The decision is another brick in the wall guarding against claims which would otherwise turn general liability policies into performance bonds.

The principles to be taken from all these cases are as follows:

- Comprehensive general liability (CGL) insurance policies are designed to protect the insured from liability for injury or damage to the persons or property of others, not to pay for repairing or replacing the insured's defective work and products. To suggest otherwise would encourage shoddy workmanship.
- CGL insurance policies covering the insured's liability for physical injury to tangible property do not divide construction work into component parts for the purpose of establishing resultant damage, unless that is the clear intention of the entire wording in the policy.
- The insured's faulty workmanship, materials or product cannot constitute an "occurrence" that triggers coverage under a general liability policy. Nor can an insured claim for the cost of repairing the same.
- A CGL policy only covers losses that are fortuitous or contingent. It does not cover losses attributable to the inherent nature of the property insured or to an intentional act on the part of the insured.

In short, a general contractor or subcontractor generally cannot find coverage under its CGL policy for remedying faulty workmanship, material or work product supplied by them. But, as the *Progressive* judgment states, coverage might exist elsewhere in a policy if it is supported by clear wording or evidence of well-known industry practice. Significantly, the court in *Progressive* says the entire policy, including the exclusions, can be assessed for coverage, even if there is none available under the basic insuring agreements. Specifically, coverage might be found in an exception to an exclusion.

Over and above these findings, the balance of the Court's judgment in *Progressive* wrestles with the work product exclusion found in general liability policies, both as originally written and as amended by "the subcontractor exception" wording. The work product exclusion in CGL policies typically used to read something like: "This insurance does not apply to property damage to work performed by or on behalf of the named insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith."

Historically, courts have interpreted this exclusion to mean that there is no coverage under a CGL policy if claiming for the cost of remedying faulty workmanship, materials or work product. With the courts in *Privest*, *Swagger*, *GCAN* and, now, *Progressive* finding this to be the effect of the basic coverage grant under a CGL policy, a question arose in the *Progressive* case: Why was this exclusion required at all? Did it have a purpose or was it merely a redundancy?

Such an exclusion would, of course, be required in some instances. For example, if a building owner brought a claim against a general contractor for damage caused to interior suites because of defects in the workmanship and materials supplied for the building envelope, there would be coverage under the basic coverage grant. There would be physical damage to property resulting from an occurrence or accident.

But the insurers would want to make sure that, in indemnifying the contractor for its liability to the claimant for the damage in the suites, they were not paying for the cost of remedying faulty workmanship and material applying to the building envelope. In such circumstances, there would be a substantial reason for the exclusion in the policy. It seems unrealistic to expect that the exclusion could be written in such a way that it was not redundant under any circumstance.

The Court in *Progressive*, however, concluded that the work product exclusion was unnecessary except for the "subcontractor exception" written into CGL policies starting in 1986. This, as amended, typically reads as follows: "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." Similar wording was considered by the Ontario Court of Appeal in the 2006 case, *Bridgewood Building Corp. v. Lombard General Insurance Company* (see *Letter of the Law*, Fall 2008) to grant coverage to a

general contractor where a subcontractor had damaged work that was the general contractor's responsibility.

But the B.C. Court of Appeal in *Progressive* did not adopt that reasoning and chose to distinguish the *Bridgewood* case on its facts and the evidence before the Ontario court. Instead, it interpreted the subcontractor exception clause to apply if, and only if, the defective subcontractor work was external to the faulty building component. In *Progressive*, this meant that the subcontractor's work should have been external to the building envelope—the court gave the example of a faulty boiler or electrical wiring damaging the envelope. Subcontracted work within the building envelope that damaged other parts of the building envelope would not trigger coverage.

The *Progressive* Court reasoned that this would satisfy the Supreme Court of Canada's (SCC) "complex building theory" outlined in the 1995 *Winnipeg Condominium* case. In that case, the SCC said that a faulty part of a larger building component could not be viewed as causing damage to the latter. A claim for the cost of remedying the failed part would not be a claim for physical damage to property but for pure economic loss—and therefore incapable of triggering coverage under a CGL policy.

Applying the same reasoning to the subcontractor exception in the work-product exclusion, the *Progressive* Court found that the exception applies if, and only if, the defect in the subcontractor's work is external to the building component for which remedial costs are sought—taking a different tack than the Ontario courts in *Bridgewood*.

In *Progressive*, the Court found that there was no evidence before it to establish an industry pattern of granting coverage in similar circumstances, nor were there defects external to the faulty building envelope resulting in damage to the envelope. On both accounts, under the basic coverage grant and under the coverage which might have been found under the subcontractor exception, *Progressive Homes* failed to make its case.