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SUPREME COURT OF CANADA RULES ON DUTY TO DEFEND GENERAL CONTRACTOR UNDER CGL INSURANCE POLICY

Richards Buell Sutton *Special Edition* Insurance Newsletter

SCC ruling in Progressive Homes v. Lombard

In *Progressive Homes Ltd. v. Lombard General Insurance Company of Canada* 2010 SCC 33, the Supreme Court of Canada rendered its ruling on an insurer's duty to defend a general contractor in the context of a construction deficiency claim. A full panel of nine Supreme Court Justices unanimously held that the insured contractor's commercial general liability insurer had a duty to defend. In making this ruling the SCC allowed the insured's appeal from the British Columbia Court of Appeal's split decision that the insurer had no duty to defend. The SCC ruling effectively settles the divergence of appellate court jurisprudence between British Columbia on one hand and Saskatchewan and Ontario on the other regarding a CGL insurer's duty to defend a general contractor in construction deficiency claims. The SCC also provides guidance on the interpretation of CGL policy definitions of "property damage" and "accident" (including the definition of "occurrence") and the "work performed" exclusion.

Background Progressive appealed a ruling that it was not entitled to a defence under various Lombard CGL policies covering a period from the early 1990's to the mid 2000's. Progressive's claim to coverage was in the context of "leaky building" litigation where the plaintiff in the underlying tort action alleged that Progressive's negligence and breach of contract resulted in numerous types of building defects. The alleged building defects focused on components of the building related to the "building envelope" such as exterior walls, vinyl decking, waterproofing, ventilation, drainage, windows and caulking. There were three sets of policy wordings over the alleged coverage period. Each set of wordings had widely used definitions for "property damage", "occurrence" and the "work performed" exclusion. At trial, Progressive's claim to coverage was denied. The denial was made in the face of evidence that the vast majority of the construction of the subject buildings was done by subcontractors on behalf of Progressive. The Court's ruling was based on previous BC Supreme Court rulings in the *Swagger* and *GCAN* cases and the finding that the allegations did not fall within the meaning of "property damage" or "occurrence" and thus did not fall within the ambit of coverage. In particular, the trial court upheld the proposition that defective construction does not amount to an "accident". A majority of the Court of Appeal dismissed the appeal primarily on the basis that "insurance is designed to provide for fortuitous contingent risk" and that faulty

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workmanship could not be considered fortuitous.

The SCC Ruling

Within the context of well structured reasons, the Supreme Court of Canada underlined the general advisability of interpreting policy coverages (the insuring agreement) first followed thereafter by exclusions and then exceptions to exclusions. In this context the definitions of "property damage" and "accident" were considered. The insurer argued that "property damage" was limited to third-party property and did not include damage to the insured's own work. This argument was based on the distinction between property damage and pure economic loss tort claims and the Supreme Court's prior rejection of the complex structure theory which proposed that buildings are divisible into distinct elements as opposed to standing as a whole. The court disagreed with the insurer's interpretation of "property damage" and based its ruling on the notion that principles of tort law are no substitute for simply interpreting the policy language which did not distinguish between third-party property damage and damage to any tangible property in the definition. Interestingly, the court noted that the definition of property damage may include a claim to repair a defect even though this point was conceded by the insured. The court found support for this potential given the terms "physical injury" and "loss of use" and an exclusion for defects contained in one of the versions of the "work performed" exclusion. The definition of "accident" was held to be essentially the same as the definition of "occurrence" used in other versions of the policy. The insurer argued that faulty workmanship is not an accident. The court held that whether defective workmanship is an accident is necessarily a case-specific determination depending on the circumstances of the defective workmanship and the way "accident" is defined in the policy. Accordingly, faulty workmanship may be an accident based on the specific facts of a case. The court pointed to precedents in this regard. The court also rejected the insurer's argument that equating faulty workmanship to an accident converts a CGL insurance policy into a performance bond. In rejecting this argument the court outlined the distinction between the bond and the policy highlighting the fact that the bond only ensured that the work be brought to completion whereas the CGL policy provides coverage once the work is completed. Having found that the claims in the pleadings fell within the grant of coverage the court dealt extensively with the various versions of the "work performed" exclusions contained in the policy, including the commonly found Broad Form Extension Endorsement, and whether the insurer had met the burden of clearly and unambiguously showing the application of such exclusions. The insurer, though it focused its arguments on the definitions of "property damage" and "occurrence", argued that this exclusion applies to deny coverage since the work performed by the general contractor was the entirety of the four subject housing units. The court found that the Broad Form Extension Endorsement operates to except the work of subcontractors from the "work performed" exclusion. Since the pleadings indicated subcontractor involvement in the construction a duty to defend was triggered. Versions of the policy that included the phrase "that particular part of your work" in the

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exclusion meant that coverage for repairing defective components would be excluded while coverage for resulting damage would not. A determination of which particular part of the work caused the damage would have to be made at trial. Repairs to those defective parts will not be visited upon the insurer but, when allegations are made that the defects lead to resulting damage, a duty to defend is triggered.

Impact for Insurers

This decision illuminates the various levels of potential coverage available to insureds, and general contractors in particular, under various versions of CGL policy wordings. The scope of potential coverage ranges from that for damage to subcontractors' work and damages resulting from their work to all damage resulting from the insured's work to all resultant damage and defective subcontractor work. In the context of this case the most recent CGL policy versions appear to create the greatest scope of coverage. The scope of coverage, and accordingly insurers' risk, will be determined in large measure by the extent of subcontractor use. From an underwriting perspective insurers are well advised to take specific note of the version of the policy being offered to insureds and the insured's service delivery model, in particular the extent of the insured's use of subcontractors. Insurance claims examiners and their coverage counsel, depending again on the particular version of the policy, will have to be particularly cognizant of distinguishing between the cost of repairing the insured's or subcontractor's defective work and the cost of repairing resultant damage. Expert advice from quantity surveyors may be of assistance in this regard but whenever possible third parties effecting the repairs should be implored to make the distinction. Early determination of parties responsible for certain works, notice to third party claimants regarding the distinction and routine follow up are recommended. It would be imprudent to rely upon a court determining the third party claim to distinguish between the various sources of repair costs. Finally, insurers can expect a renewal of "shotgun" pleadings from third party claimants in building deficiency cases and in particular, more allegations of resultant damage and subcontractor defective work claims.

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