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Thomas Heintzman is counsel at McCarthy Tétrault in Toronto. His practice specializes in litigation, arbitration and mediation relating to corporate disputes, shareholder's rights, securities law, broadcasting/telecommunications and class actions.

He has been counsel in many important actions, arbitrations, and appeals before all levels of courts in many Canadian provinces as well as the Supreme Court of Canada.

Thomas Heintzman is the author of Goldsmith & Heintzman on Canadian Building Contracts, 4th Edition which provides an analysis of the law of contracts as it applies to building contracts in Canada.

Goldsmith & Heintzman on Canadian Building Contracts has been cited in 183 judicial decisions including the two leading Supreme Court of Canada decisions on the law of tendering:

M.J.B. Enterprises Ltd. v. Defence Construction (1951), [1999] 1 S.C.R. 619 and
Double N Earthmovers Ltd. v. Edmonton (City), 2007 SCC3, [2007] 1 S.C.R. 116-2007-01-25 Supreme Court of Canada

Does An Insurance Clause Preclude The Contractor From Being Sued?

An insurance clause in a building contract usually provides that one of the parties will obtain insurance for the project, and that some or all of the other parties engaged on the project will be covered under that insurance. The issue raised by such a clause is whether the party that agreed to take out that insurance, or that party's insurer, may sue another party which was to be covered by that insurance.

In *Greater Toronto Airport Authority Association v. Foster Wheeler,* the Ontario Superior Court recently held that the insurance clause did preclude such an action against the contractor. In the course of its decision the Ontario court set out some useful principles.

There is always a tension between the liability or indemnity clauses, and the insurance clause, in a building contract. If the contract states that the contractor shall be liable for faulty workmanship, or warrants that the project will be free of defects for a certain period of time, or

agrees to indemnify and hold the owner harmless from certain liabilities, how can the insurance clause over-ride those provisions? Yet, if the owner agrees to take out builders' or other broad insurance policy that would normally cover the contractor in those circumstances, how can the owner's insurer maintain a subrogated action in the owner's name against the contractor?

Foster Wheeler entered into a contract with the GTAA to supply four boilers to the GTAA. One of the boilers exploded during installation, damaging the boiler and other property. The GTAA was compensated by its insurer which brought a subrogated claim against Foster Wheeler.

The contract between GTAA and Foster Wheeler contained a variety of apparently conflicting provisions:

1. GTAA agreed to take out an All Risk Course of Construction insurance policy, and to include Foster Wheeler as an additional insured ("the insurance clause");

2. Foster Wheeler warranted the boilers to be free of defects for 12 months;

3. Foster Wheeler was responsible for damage to GTAA's property that occurred as a result of Foster Wheeler's operations under the contract, except to the extent that the GTAA received proceeds of insurance under the All Risk Course of Construction insurance policy;

4. Foster Wheeler agreed to place all risk insurance on its machinery and equipment and that such insurance was to contain a waiver of subrogation against the GTAA.

5. GTAA agreed to waive any claim for damages against Foster Wheeler in contract or tort "except to the extent that such damage might be recovered under insurance".

During the negotiation of the contract, Foster Wheeler asked that the contact include a waiver of subrogation under the All Risk Course of Construction insurance policy taken out by the owner, but the GTAA refused to agree to such a waiver.

The Court reviewed a number of Canadian cases dealing with the effect of an insurance clause in contracts of this nature and arrived at what it called the "beneficial aspects" of typical course of construction insurance contracts:

(a) on a construction site the possibility of damage by one contractor to the property of another and the construction as a whole is ever present:

(b) there is a common interest in avoiding the necessity to debate issues of negligence and responsibility in court;

(c) parties can focus on the common goal of completing construction instead of fighting amongst themselves;

(d) given the obligation of the owner or general contractor to obtain comprehensive insurance it makes "no business sense for sub-contractors to pay premiums to duplicate that coverage";

(e) the insurer sets the premium recognizing there is no right of subrogation;

(f) the owner purchasing comprehensive insurance on behalf of contractors and subcontractors is less expensive than each party obtaining its own insurance.

The Court then considered the contract and concluded as follows:

1. The All Risk Course of Construction insurance that GTAA had agreed to obtain admittedly provided insurance for Foster Wheeler's negligence in the present circumstances. Accordingly, the insurance clause protected Foster Wheeler from GTAA's claim even in respect of Foster Wheeler's negligence, up to the limits of that policy.

2. The provision in the contract that exempted Foster Wheeler's liability for damages to the GTAA's property up to the limits of the owner's All Risk Course of Construction insurance policy confirmed that conclusion.

3. The insurance that the contract required the owner to obtain was described as "course of construction insurance", which is exactly the sort of insurance that had been held by the Supreme Court of Canada to describe insurance which barred an owner's subrogated claims against contractors and subcontractors.

4. The insurance clause commenced with the words "Without restricting any other responsibility of the Supplier….. However, those words did not over-rule the fundamental impact of the insurance clause.

5. The insurance clause did over-ride the warranty obligations of Foster Wheeler, to the extent of the insurance coverage and that result was "necessarily incidental" to the customary interpretation and effect of an insurance clause.

6. The fact that, during the negotiation of the contract, Foster Wheeler had asked for a waiver of subrogation clause and the GTAA had not agreed to such a clause did not change the meaning and effect of the insurance clause. Foster Wheeler was not relying on an implied waiver of subrogation but rather an express insurance clause and its accepted effect.

7. There was an exception to the release of Foster Wheeler's liability. That exception applied to the extent of damages recoverable under insurance. However, that exception did not over-ride the insurance clause to the extent that the GTAA's claim was covered by and paid out of the All Risk Course of Construction insurance. Rather, it provided for the liability of Foster Wheeler over and above the insurance obtained by the owner.

The fact that these liability/insurance issues are still being debated is remarkable. In 1976, the Supreme Court of Canada established the general principle relating to the issue, and there have been many decisions applying the principle since then. Yet parties to building contracts continue to insert into those contracts provisions which are contradictory and do not clearly apply the principles set out in the decided cases.

In these circumstances this judgment, which has not been appealed, is a helpful guide to resolving the various clauses relating to liability, indemnity and insurance in a building contract.

The conclusion to be drawn is that, if there is an insurance clause in the contract by which one of the parties obligates itself to obtain builders' risk or course of construction insurance for the project and another party is to be an insured under that insurance policy, that clause will likely preclude a claim by the owner (or by its insurer in a subrogated claim) against the contractor unless the contract clearly and expressly states that the contractor's liability to the owner remains outstanding notwithstanding the insurance clause.

If a provision is included in the contract which expressly states that the contractor is liable to the owner notwithstanding the insurance clause, then the contractor will likely have to obtain its own insurance, particularly against claims by the owner.

Limited insurance of that nature may not be available and the net effect may be that the contractor may have to duplicate the owner's entire insurance program for the project.

See **Goldsmith and Heintzman, Canadian Building Contracts (4th ed.)** at Chapter 1, part 3(d); Chapter 5, part 3 and Chapter 6, parts 2(b)(i)(D) and 2(b)(ii)(D).

Construction Law – Insurance – Contractors - Subcontractors
Greater Toronto Airport Authority Association v. Foster Wheeler, 2011 ONSC 1442 (CanLII)

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