Thomas G. Heintzman, O.C., Q.C.

McCarthy Tétrault

Toronto, Ontario

www.mccarthy.ca

416-362-1812

theintzm@mccarthy.ca

www.constructionlawcanada.com

www.heintzmanadr.com

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 over 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] 1 S.C.R. 116

Contractor's Construction Errors May Be Covered By A General Liability Policy

In two recent decisions, courts in Ontario and British Columbia have held that negligence during construction (or manufacturing) may be covered by general liability policies even though the damage is part of the construction (or the product sold):
California Kitchens & Bath Ltd. v. AXA Canada Inc. and ***Bulldog Bag Ltd. v. AXA Pacific Insurance Company***

In these decisions, the courts have followed and applied the landmark decision of the Supreme Court of Canada in ***Progressive Homes Ltd. v Lombard General Insurance Company of Canada***, [2010] 2 S.C.R. 245. The *Progressive Homes* decision was discussed in my blog of January 16, 2011.

In *Progressive Homes*, the Supreme Court of Canada rejected the long-standing position of insurers that the claims by owners arising from the negligence in construction by contractors may not be covered by CGL insurance.

The insurance industry asserted that general liability insurance is not designed to be a performance bond and that if contractors wished to be insured against claims by owners for their own negligence during construction, then that would convert the insurance into a performance bond.

'Plain Meaning' In a CGL Policy Defined by Supreme Court

The Supreme Court looked at the plain meaning of the words in a CGL policy and held that, as long as the damages arose from an accident or other non-intended event, then the plain meaning of the policy applied, whether or not the damages arose from the contractor's negligence and even though the damage was to part of the building constructed by the contractor. The Supreme Court held that the insured was arguably covered by the policy, and therefore, Lombard had a duty to defend the contractor.

These principles have now been applied by the Ontario Superior Court in ***California Kitchens*** with respect to the duty to defend, and by the British Columbia Court of Appeal in ***Bulldog Bag*** with respect to the duty to indemnify. In both cases, the courts were dealing with general liability policies issued by the AXA group of insurers.

In ***California Kitchens***, the contractor was sued by a homeowner in respect of the mis-design and installation by the contractor of a kitchen in the plaintiff's home. The contractor asserted that AXA was obliged to defend it under a general liability policy. The policy provided insurance for bodily injury and property damage. 'Occurrence" was defined to mean an "accident". The policy contained exclusions for the Named Insured's work and for loss incurred by the Named Insured for the repair, replacement etc. of the Named Insured's work because of known or suspected defects or deficiencies.

AXA argued that the policy did not include the defective design of the kitchen by the contractor, or otherwise the policy would become a performance bond. This was the standard argument of CGL insurers before the ***Lombard*** decision.

The court held that the plaintiff's claim for loss of use of the plaintiff's home while the kitchen was being repaired was property damage under the policy. The court rejected AXA's argument that the claim was really a contract claim and was therefore not covered by the policy.

The Court said:

"If this argument prevailed, it would eliminate virtually all coverage. What work is not performed pursuant to a contract? It is the negligence in the performance of the work by California Kitchens that is the true nature of the claim. There is no claim in contract in the pleading and no basis for questioning the true nature of the claim."

The court also held that the "Named Insured's work" exclusion did not apply because the claim asserted that the deficient work was performed by sub-contractors, not the Named Insured, the contractor.

In ***Bulldog Bag***, Bulldog Bag sold bags to its customer Sure-Gro. Sure-Gro used the bags to supply bagged soil to Canadian Tire. The bags were printed by a printer for Bulldog. Because of the defective printing, the printing became illegible. Bulldog Bag compensated Sur-Gro for the cost of retrieving and re-bagging the soil being sold to Canadian Tire, and made a claim on its CGL policy for this loss. Bulldog Bag did not make a claim for the cost of replacing its own bags.

The policy defined "Occurrence" as meaning "… property damage neither expected nor intended by the Insured", which is a similar definition to "accidental" in the ***California Kitchens*** case.

The exclusions included property damage to "goods or products manufactured or sold by the Insured"; or "work done by or on behalf of the Insured where the cause of the occurrence is a defect in such work, but this exclusion shall only apply to that part of such work that is defective": or loss of use of property that had not been physically injured or destroyed resulting from "a delay in or lack of performance by or on behalf of the Insured of any contract or agreement."

The reasoning in the *Progressive Homes case*

The B.C. Court of Appeal applied the reasoning in P*rogressive Homes* and held that there was coverage for Bulldog Bag's claim and that the exclusions did not apply. The court started with AXA's concession that Bulldog Bag's claim arose from "property damage" because Bulldog's bags had been 'injured' by the faulty printing and Sure-Gro lost the use of them. AXA also conceded that the faulty workmanship that resulted in the defective bags qualified as an "accident" or "occurrence" within the meaning of the policy.

However, AXA asserted that the costs of removing the soil from the defective packaging and disposing of that packaging fell within the exclusions in the policy. It further asserted that the decision in *Progressive Homes* had not altered the basic nature of CGL policies, which did not include the costs arising from repairing or replacing the insured's defective work and products.

The Appeal Court's Decision

The Court of Appeal rejected AXA's submissions. The Court held that the exceptions in the policy barred a claim for damage to Bulldog Bag's own bags. (In light of the *California Kitchen* case, one may question this conclusion since the damage was caused by Bulldog Bag's sub-contractor, the printer, and not by Bulldog Bag itself). However, the court held that the exclusions did not bar a claim for compensation for the costs which Sure-Gro incurred in separating those bags from its products, repackaging the product in different bags, and salvaging the "old" product some months later.

The Court further held that, in any event, and even before *Progressive Homes*, the "own product" exclusion did not apply to loss incurred by the insured's customer as a result of defects in the insured's own product. In addition, the Court held that the "own work and product" exception in this policy did not apply to resulting damage, but only to property damage to the goods supplied by the insured.

***Progressive Homes* Has Had a Profound Impact on General Liability Policies**

These two decisions are the first evidence of the profound impact on general liability policies of the *Progressive Homes* decision of the Supreme Court of Canada. The Supreme court's decision has meant that the initial coverage under those policies will be read broadly, and may possibly include damage from one part of a building or product to another, and damage arising due to the insured's negligence. As the decision in *California Kitchens* shows, those possibilities are very significant, and almost determinative, when it comes to the duty to defend since all the insured must show is the possibility that the claim falls within the policy.

The impact of the decision in *Progressive Homes* on the coverage for indemnity may be even more significant, as the *Bullfrog Bag* decision demonstrates. By widening the potential interpretation of coverage, and narrowing the potential interpretation of the exceptions, the burden on the insurer is substantially increased. As the drafter of the policy, the insurer will face the *contra proferentem* rule so far as initial coverage is concerned. And if it relies on the exceptions, then the rule that exceptions must be narrowly construed will apply.

Once the Supreme Court held that CGL policies could apply to a contractor's own negligence and could apply to damage from one part of a building or product to another, the whole ambit of a CGL policy was substantially clarified to the benefit of the insured.

Insurance policy – Contracts – Duty to Defend – Duty to Indemnify – Construction Law

***California Kitchens & Bath Ltd. v. AXA Canada Inc.*, 2010 ONSC 6125;**
***Bulldog Bag Ltd. v. AXA Pacific Insurance Company*, 2011 BCCA 178**

Thomas G. Heintzman O.C., Q.C. **October 6, 2011**
www.heintzmanadr.com
www.constructionlawcanada.com