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Prior to 2013, Mr. Heintzman practiced with McCarthy Tétrault LLP for over 40 years with an emphasis in commercial disputes relating to securities law and shareholders' rights, government contracts, insurance, broadcasting and telecommunications, construction and environmental law. He has acted in trials, appeals and arbitrations in Ontario, Newfoundland, Manitoba, British Columbia, Nova Scotia and New Brunswick and has made numerous appearances before the Supreme Court of Canada. He was an elected bencher of the Law Society of Canada for 8 years and is an elected Fellow of the American College of Trial Lawyers and of the International Academy of Trial Lawyers.

Thomas Heintzman is the author of *Heintzman & Goldsmith on Canadian Building Contracts,* 5th Edition which provides an analysis of the law of contracts as it applies to building contracts in Canada.

Damage To The Rebar And The Deflection Of Floor Slabs Are Covered Under Builders' Risk Policy: B.C. Court Of Appeal

The extent of coverage under Builders' Risk policies is a matter of continuing debate in Canada. Insurers try to draft policies which do not cover the poor workmanship of contractors, and contractors continue to insist that they have bought and paid for insurance which covers damage to the work in progress. And so the debate continues to rage with neither party apparently able to draft a policy which is clear to both parties.

The latest chapter in the ongoing saga is the decision of the British Columbia Court of Appeal in

Acciona Infrastructure Canada Inc. v. Allianz Global Risks US Insurance Co.. In this case, the over-deflection of the concrete floor slabs caused damage to reinforcing bar in the floor, cracking of the floor and a sloped floor that had to be sanded down, all involving an expense of $14 million. The insurer argued that this was a clear case of poor workmanship not covered by the policy. The trial judge held that these costs were covered by the policy and his decision was upheld by the Court of Appeal.

Those concerned with insurance coverage in the construction industry are well advised to consider whether this result was due to the peculiar facts, or to the wording of the policy.

Background

Acciona entered into a contract to design and build a reinforced concrete structure as an addition to the existing hospital and hired Campbell Construction as the principal subcontractor to design and build the concrete framework and slabs.

The slabs were designed with an upward camber or crown of 30 mm in the centre of the slab. The camber was part of the design of the slabs so that, with the curing of the slabs and during their normal life, the slabs would be level. The camber was to be achieved by the particular formwork to be used for making the floors, the wedges inserted into those forms, and plywood sheathing into which the concrete was placed. Re-enforcing bars ("rebars") were placed in the forms and then concrete poured into the forms.

When the pouring of the concrete was completed, some of the slabs over-deflected, resulting in the rebars being over-stretched and cracking of the slabs. While the testing of the slabs showed that they met applicable design criteria and standards, the uneven floors were unacceptable from a hospital-use standard. The only solution was to grind down the slabs to make them flat. That resulted in isolation of the building, extensive work, and cleaning.

Under its Builders' Risk policy with Allianz, Acciona claimed $14.9 million including subcontractor costs of $4,050,949, indirect costs of $1.6 million, management fees of $550,000 and a profit margin of $1.6 million.

As the Court of Appeal noted, the crucial finding of the trial judge was that "the over-deflection and cracking of the slabs and bending of the rebar was *not* caused by defective design, but by defective formwork and re-shoring procedures during construction …. The over-deflection, bending and cracking were caused by the failure of the formwork and re-shoring procedures to account for the thin design" of the slabs.

Decision of the Court of Appeal

1. **Initial Coverage**

Clause 3 of the policy insured against ALL RISKS of direct physical loss of or damage to the property insured. The trial judge found that the cracks in the slab and the damage to the rebar

due to over-deflections were not merely defects in the slabs themselves, but rather constituted damage. The trial judge found that:

> "the slabs were not defective as designed and built but were damaged as a result of inadequate support while they cured. In particular, because of the inadequate shoring procedures, the slabs over-deflected and cracked, and the rebar inside the slabs was damaged irreparably."

Relying on that finding, the Court of Appeal said:

> "The Insurers' argument - that the over-deflection, bending and cracking was a manifestation of faulty workmanship and therefore not damage to property - is inconsistent with the trial judge's finding of fact that the defect was a state of affairs (faulty or defective shoring) and the damage was the result of an occurrence (over-deflection)."

The insurers also argued that the slabs could only be "damaged" if they were once in a satisfactory state but no longer, and the slabs were never in an initially satisfactory state. The Court of Appeal rejected that argument, saying:

> "To accept that argument would be to deprive the Contractor of any insurance coverage for unfinished work during construction, which cannot be what the parties intended. The Policy, a course of construction policy, was clearly intended to afford coverage for damage to property that was in a partially finished state. In any event, the rebar that was damaged was installed correctly and undamaged before the faulty shoring caused it to become deformed."

2. **Exclusion**

The policy excluded:

> "all costs rendered necessary by defects of material workmanship, design, plan, or specification and should damage occur to any portion of the Insured Property containing any of the said defects the cost of replacement or rectification which is hereby excluded is that cost which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage."

The policy also went on to said that "any portion of the Insured Property shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship, design, plan or specification."

The insurers argued that this exclusion was very different than the usual exclusion in a Builders' Risk policy which excludes damage to the insured's own work but not "resulting damage." The insurers said that the whole of the work was excluded from coverage because the over-

deflection, bending and cracking was a manifestation of a defective design. The contractor argued that the exclusion required a sequential analysis:
first, there must be a finding of damage under the policy;
second, the total cost to repair and rectify the damage must be determined; and then
third, from that recoverable cost, the policy excludes only those costs of repair that would have remedied the defect immediately prior to the occurrence of the damage.

The trial judge agreed with the contractor's interpretation of the policy. He held that "the excluded costs are those that would have remedied or rectified the defect before the cracking and over deflections occurred i.e. the costs of implementing proper formwork and shoring/reshoring procedures or incorporating additional camber into the formwork." Since there was no evidence of the cost, he concluded that those costs would have been minimal, and no more than the defective procedures that were in fact implemented.

In the Court of Appeal, the insurers made two attacks on the trial judge's decision.

First, they said that the trial judge had effectively relied upon the "insured's own work v. resulting damage" approach contained in other policies, and that the exclusion in this policy was not such an exclusion.

Second, the insurers argued that the trial judge's interpretation made no commercial sense because it would only exclude minimal amounts of preventative measures, which could not be what the parties intended as it would never address the real and substantial effects of poor workmanship.

The Court of Appeal rejected both arguments of the insurer.

First, the court pointed out that the trial judge had made the "crucial" finding that the defects in the framing and shoring had resulted in the slabs being damaged. On the basis of that fact, the slabs were not a "portion of the insured property containing any of the said defects" within the exclusion.

Second, the trial judge had interpreted and applied the wording in the exclusion, and had not just applied the "resulting damage" analysis.

Third, the fact that the resulting damage falling within the exception in this case was minimal was "coincidental "and in other circumstances the exclusion could result in significant costs being outside the policy."

3. **Subcontractor costs**.

Of the $14.9 million claim, increased subcontractor costs amounted to $4,050,949. The trial judge and the Court of Appeal held that these costs were not direct costs that fell within the

coverage of the policy. Neither court explained exactly what the "increased subcontractor costs" were. The overall repairs were described by the Court of Appeal as follows:

> "the slabs were ground to make them flat. This grinding created silica dust and certain areas had to be shot blasted. As a result, each wing had to be isolated and sealed using polyurethane and negative air pumps. Once the repair work was completed, extensive cleaning was required in order to meet hospital standards."

The Court of appeal said that trial judge had disallowed these costs for the following reason:

> "He agreed with the Insurers that such costs are of a different nature than the direct costs incurred as a result of physical loss of or damage to the property insured. Increased subcontractor costs arose out of the Contractor's contractual obligations to the subcontractors and, therefore, fell outside the scope of coverage."

On this basis, the costs were held not to be direct costs, even though they apparently arose from the rectification of the damaged slabs.

Discussion

The trial court and Court of Appeal did not find that the finished concrete floors were defective floors due to bad workmanship. Rather, they found that the rebar and concrete slabs were damaged by separate elements – defective formwork and wedging. The exclusion clearly demonstrated that coverage was intended to be provided when one part of the work damaged another part.

The real question in these cases is: when are parts of the work different, and when are they the same and part of the same thing? There does not seem to be any clear way to differentiate between the two parts of the work. As ***Heintzman and Goldsmith on Canadian Building Contracts*** says:

> "The idea behind this exception is that only the property to which the exception applies is the property that itself was faulty or improper or the subject of faulty workmanship or design or inherent vices of latent defects, and not any other insured property."

The cases cited in that book show how difficult it is to draw the line. In some cases, the entire building or structure has been held to fall within the exception, and not just the inadequate brace or defective part which led to the damage. In a recent Alberta case, when window cleaners scratched the windows during the final clean-up of the building, the damage to the windows was excluded by the faulty workmanship exclusion: ***Ledcor Construction Limited v Northbridge Indemnity Insurance Company***, 2015 CarswellAlta 511, [2015] 8 W.W.R. 466.

In the present case, however, the court was able to conceptually separate the two elements. In the absence of a definitive line, the ambiguity will likely be interpreted in favour of the insured.

The courts' interpretation of the exclusion is particularly interesting because, by its differently worded exclusion, the insurer was trying to avoid the "resulting damage" line of cases. On the court's interpretation, however, the wording that the insurer came up with only excluded the costs arising from another way of doing the same work properly, a result with which the insurer was not happy. One wonders whether the line between the faulty work and the non-faulty work is too difficult to draw and the insurers would be better off to eliminate the exclusion and re-price the insurance.

The courts' exclusion of the subcontractor's costs is perplexing. There was no real explanation what these costs were and why they were not covered. If the least expensive way to repair the slab was by the subcontractor doing the repair work, then it is hard to understand why these costs were not the direct costs of the damage. If, in order to qualify the costs as the direct costs of the damage and avoid the exemption, it is necessary to bring in another contractor – even if it is more expensive to do so – that does not seem to be a sensible approach. If the present decision requires that approach to be adopted, then in the future the contractor may have to obtain the insurer's agreement that the remedial work can be done by the subcontractor, or if not, retain another firm to do the work, even at a greater cost.

See *Heintzman and Goldsmith on Canadian Building Contracts*, 5th ed. chapter 14, part 3(b)(ii)

***Acciona Infrastructure Canada Inc. v. Allianz Global Risks US Insurance Co.,* 2015 CarswellBC 2210, 2015 BCCA 347**

Building contracts - Builders' risk insurance - interpretation - exclusions and exceptions for defective work and materials

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