Thomas G. Heintzman, O.C., Q.C., FCIArb
Heintzman ADR
Arbitration Place
Toronto, Ontario
www.arbitrationplace.com

416-848-0203

tgh@heintzmanadr.com

www.constructionlawcanada.com

www.heintzmanadr.com

Thomas Heintzman specializes in alternative dispute resolution. 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.

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 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,*** 4th Edition which provides an analysis of the law of contracts as it applies to building contracts in Canada.

What Are "Making Good", "Faulty Workmanship" And "Resulting Damage" Under A Builders' Risk Policy?

The decision in ***Ledcor Construction Ltd. v. Nortbridge Indemnity Insurance Company*** is another attempt by a Canadian court to deal with the ambiguity in the Builders' risk insurance policy. The wonder is that insurers and builders do not eliminate the exclusion for faulty workmanship, or clarify what the words "making good", faulty workmanship" and "resulting damage" mean in this policy. Instead they leave it up to courts to settle the issue on an *ad hoc* basis. And it's no wonder that, in that situation, the courts must find that these ambiguous words provide, and do not exclude, coverage.

Coverage In A Builders' Risk Policy

There are three elements in the coverage clause of a standard Builders' Risk policy.

The first element is the "coverage wording". This element defines, at its broadest, what the policy covers. The policy in the ***Ledcor*** case provided very broad coverage for property involved in construction. The policy said that there was coverage for property "undergoing site preparation, demolition, construction, reconstruction, fabrication, insulation, erection, repair or testing…". The case law makes it clear that this sort of coverage wording includes coverage for property damage arising from the negligence of the insured unless the policy says otherwise.

The second element of the coverage clause in a Builders' Risk policy is the "exclusion wording". In the ***Ledcor*** case, the wording took coverage away for "making good faulty workmanship, construction or design." So the "exclusion wording" is apparently intended to exclude the repair of negligent workmanship. The insurers justify the inclusion of this exclusion on the basis that a property damage policy is not a professional liability policy, and that if coverage for negligence is to be obtained, it should be obtained in a separate policy, or by a further premium and amended wording in the Builders' Risk policy.

The third element in the coverage clause in a Builders' Risk policy is the "exemption wording." This wording in the policy in the ***Ledcor*** case exempted the exclusion if "physical damage not otherwise excluded by this this policy results." In this event, the exemption wording said that "this policy shall cover such resulting damage."

What is one to make of this "wheels within wheels"? It's like peeling an onion, or taking a Russian doll apart, layer by layer. Except that these layers are words, not physical layers. How does one know where one layer ends and the next begins? The answer to that question is very important because the insured could make a decision to buy other coverage if it knew where the gap is in the Builders' Risk policy. Since the insurer doesn't tell the insured, the insured has to figure it out by reading the cases. And since the insurers don't tell the insured, the courts inevitably decide the cases in favour of the insureds in case of doubt, of which there is almost always a lot.

Background To The *Ledcor* Case

Ledcor was the general contractor on a construction project. In the concluding portion of the project, Ledcor retained Bristol to clean the outside of the building. During the cleaning, Bristol scratched and damaged the windows of the building. The windows had to be replaced at considerable cost. Ledcor and the owner made a claim under the policy.

There did not seem to be any dispute that the damage fell within the coverage element of the policy. There were two issues:

Did the exclusion wording apply? The insurer said Yes, because the scratching of the windows was due to faulty work. The insured said No because the exclusion clause is intended to apply

to the costs of having the faulty work re-done, but not to the resultant damage of the faulty workmanship.

Second, did the exemption wording apply? Yes said the insured because the claim was based on resulting physical damage. No said the insurer because the damage in this case was not resulting physical damage, but damage caused directly by the window cleaner.

Decision of the Court

The Alberta Court of Queen's Bench concluded that the work done by the window cleaning company, Bristol, fell within the words "faulty workmanship" in the exclusion wording. The court compared the present situation to the facts in another case in which the acid cleaning of a boiler was held to fall within the words "faulty workmanship" and the court in the ***Ledcor*** case agreed that both cleaning exercises amounted to "faulty workmanship".

The court held, however, that the words "making good" are ambiguous. They could refer only to re-doing the work that was faulty, which is what the insured asserted. Or they could refer to the damage done by the faulty workmanship, which is what the insurer asserted. In the boiler case, the cleaning was part of the very installation of the boiler, and therefore arguably part of "making good" the work if that meant re-doing the work, including installing a new boiler. But "re-doing the work" in the present case did not include installing new windows.

The court also considered the words "resultant damage" in the exemption wording and reasoned that these words must have been intended to complement the words "making good" in the exemption wording, so that the exclusion referred to "direct damage of the faulty workmanship as opposed to the indirect consequences."

The court concluded that both of the interpretations advanced by the parties were reasonable. On balance the one suggested by the insured was somewhat more logical for two reasons.

First, since Builders' Risk policies are intended "provide coverage for virtually any event which might occur by way of negligence, third party action or act of God, one could conclude that an exclusion as suggested by the [insurers] is inconsistent.

Second, "Bristol, as a sub-contractor, is an additional insured under the policy. Subrogation by the insurers against Bristol can be waived at the option of the [insureds]. Again, all of that suggests broad coverage inconsistent with what the [insurers] say is the effect of the exclusion."

The Alberta Court of Queen's Bench held that, at best, the clause was ambiguous and should be interpreted *contra proferentem* against the insurer. Therefore, there was coverage under the policy.

Discussion

This decision illustrates the need for insurers and insureds to refine the meaning of the coverage, exclusion and exemption wording of Builders' Risk policies, or the futility of doing so. The ***Ledcor*** decision means that the policy exclusion does not apply in two situations.

First, if the person who did the faulty work installed something, and whatever was installed caused damage to some other part of the construction, then the damage to that other part is not excluded. That sort of damage is "resultant damage" and not "direct damage" and therefore falls within the exception to the exclusion. One only has to review the decided cases to know how difficult it can be to determine in that sort of situation whether the damage is "direct" or "resultant".

Second, and this is the nub of the ***Ledcor*** decision, if the person who did the faulty work did not construct or install anything, then the claim does not arise from "making good" that work, or is "resultant damage" and not "direct damage."

However, if the person who did the faulty work also constructed or installed something upon which it did the faulty work (as in the boiler case), then if the "making good" requires the property to be re-installed, then there may be no coverage due to the exclusion.

Two further points can be made about this decision:

First, this decision is a very good example of the rule of interpretation that the words, and all the words, in a contract must be given meaning. Here the key words were "making good". What do those words mean and why were they used? The insurer really wanted to read the exemption to read as follows: "physical damage arising from faulty workmanship…." instead of "making good faulty workmanship…." After all, the policy covered "physical damage" and the exemption referred to "physical damage". But for some reason, the exemption doesn't. It refers to "making good". So the parties must have meant something different by those words than "physical damage." The court concluded that they can't and don't mean "physical damage" because the parties didn't use those words. Rather, in that context, the words must mean re-doing the work, not repairing the damaged property, at least in the absence of any other or better explanation of what the words mean.

Second, this decision perhaps demonstrates the futility of the exemption for faulty workmanship. Surely contractors and their advisors do not go through the mental gymnastics to figure out all these permutations and combinations involved in coverage. And should they have to, especially when all the parties to the construction project are intended to be covered by the policy? Would it not be better simply to eliminate the exemption for faulty workmanship? Since the policy covers all the sub-contractors on the project, would there really be much, if any, additional risk or premium?

Ledcor Construction Ltd. v. Nortbridge Indemnity Insurance Company, **2013 ABQB 585**

Builders'Risk Policy - Construction - Sub-Contractors - Contractors - Damages – Insurance – Exclusion Clauses

Thomas G. Heintzman O.C., Q.C., FCIArb **December 27, 2013**

www.heintzmanadr.com
www.constructionlawcanada.com