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THE APPLICATION OF THE GENERAL LIABILITY EXCLUSIONS IN THE CONSTRUCTION SETTING

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I. INTRODUCTION

Comprehensive or Commercial General Liability policies (commonly known as “CGL” policies) are widespread in the commercial world, including in the construction setting. While the particular wording of CGL policies may differ from insurer to insurer, generally the insurance industry follows one of the formats adopted by the Insurance Bureau of Canada (“IBC”). A CGL is designed to respond when claims are brought by others against the policyholder who has allegedly suffered damage as a result of some event or course of action allegedly involving the policyholder. In the construction context, CGL policies often respond to claims in negligence brought against developers, general contractors, subcontractors, engineers, architects and others involved on construction projects for property damage arising from defects and deficiencies in construction.

This paper is written primarily for insurers as a guide to recent judicial developments in Canada that impact on the exclusions found in the CGL policy. We will examine how four of the most common exclusions in a CGL policy operate to manage the risks inherent to construction activity.

The four common CGL exclusions addressed in this paper are:

- (a) The “*Work Performed*” Exclusion;
- (b) The “*Product Itself*” Exclusion;
- (c) The “*Contractual Liability*” Exclusion; and
- (d) The “*Care, Custody and Control*” Exclusion.

As well, this paper will discuss the Broad Form Property Endorsement (“BFPE”), which if purchased by the insured will act as an extension of coverage to a CGL policy.¹

The cornerstone Canadian case on CGL exclusions is the 1991 decision of the B.C. Supreme Court in *Privest Properties Ltd. et al v. Foundation Co. of Canada Ltd. et al.*² This case set an important precedent for both the insurer and insured. The insured, a

¹ The author gratefully acknowledges the discussion on the BFPE in G. Hilliker’s *Liability Insurance Law in Canada*, 2d ed. (Vancouver: Butterworths 1996) at 193-96.

² (1991), 6 CCLI(2d) 23, [1991] BCJ No. 2213 (QL).

general contractor, sought the Court's review of six different liability policies and a declaration that the insurers owed it a duty to defend. The claim in the underlying action was for damages arising from the installation and later removal from a downtown office building of fireproofing material containing asbestos.

The Court reviewed the common exclusions in the CGL policies and eventually dismissed the application for coverage by Foundation, the general contractor. As Mr. Justice Drost began his discussion in *Privest*, a review of exclusion clauses must begin with the fact that exclusion clauses operate to take a risk event out of coverage:

While the obligation of an insurer to defend is separate from its duty to indemnify, there is no duty to defend an action against its insured if there is clearly no liability to indemnify under the terms of the policy when read as a whole. Therefore, when determining whether a duty exists, consideration must be given to the exclusion clauses whose function it is to restrict and shape the coverage otherwise afforded. Any claim clearly within such a clause will not require a defence [*Opron Maritimes Construction Ltd. v. Canadian Indemnity Co.* (1986), 73 N.B.R. (2d) 388 (C.A.), [1986] N.B.J. No. 111 (QL), leave to appeal to the Supreme Court of Canada refused, (1987), 21 C.E.L.I. XXXV (note) (SCC)]. Any doubt as to coverage must be resolved in favour of the insured.³

Any building construction project poses a variety of risks that are potentially the subject matter of insurance. In general, these risks are of four types:

- (a) The owner has the risk that the contractor will fail to properly perform his contractual obligations. That risk can be shifted from the owner by means of a performance bond. If the contractor defaults the owner can look to the surety for indemnification of the cost of repair or of completion of the project. Ultimate responsibility remains with the contractor who is liable to the surety who has completed the work.
- (b) The owner or the contractor bears the risk that the project may be destroyed by fire or explosion during construction. Who bears that risk depends upon the terms of the contract. That risk is guarded against by means of a Builders' All Risk policy or "course of construction" coverage.
- (c) The owner and the contractor bear the risk of third party claims that entail property damage or personal injury as a result of the project

³ *Privest, supra*, at 32.

being defectively constructed. That risk can be shifted to an insurer by means of the CGL policy.

- (d) The contractor bears the "business" risk that it may be liable to the owner resulting from the contractor's failure to properly complete the project in a manner that does not cause damage to it. That risk is one that the general contractor can control and which the insurer does not assume.

Each of the "work performed", "product itself", and "care, custody or control" exclusions typically contained in the CGL policy and discussed in this paper are intended to ensure that the contractor, and not the insurer, bears the "business risks" associated with the project.

II. THE SCOPE OF THE "WORK PERFORMED" EXCLUSION IN THE CONSTRUCTION SETTING

The CGL policy does not indemnify the insured from the consequences of poor workmanship. Such consequences are treated as a business risk to be regulated by contract through contractual warranties and "hold harmless" provisions. Like the "product itself" exclusion described below, the "work performed" or "your work" exclusion is intended to prevent the insured from obtaining indemnity for repair costs due to the insured's defective or deficient work. To do otherwise would convert the CGL into a performance bond. The "work performed" exclusion, therefore, serves as an effective means of encouraging contractors to perform their work in a diligent, careful and professional manner, knowing that if they do not, then they have potential indemnity exposure to plaintiffs outside of coverage. The IBC Form 2100 wording thus contains an exclusion that is worded as follows:

This insurance does not apply to:

- (j) *"property damage" to "your work" arising out of it or any part of it and included in the "products-completed operations hazard". This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.*

The IBC Form 2100 contains the following defined terms that are relevant with reference to the "work performed" exclusion:

"Property damage" means:

- a. Physical injury to tangible property, including all resulting loss of use of that property; or

- b. Loss of use of tangible property that is not physically injured.

“Your work” means:

- a. Work or operations performed by you or on your behalf; and
- b. Materials, parts or equipment furnished in connection with such work or operations.

“Your work” includes warranties or representations made at any time with respect to the fitness, quality, durability or performance of any of the items included in a. or b. above.

“Products-completed operations hazard” includes all “bodily injury” and “property damage” occurring away from premises you own or rent and arising out of “your product” or “your work” except:

- 1) Products that are still in your physical possession; or
- 2) Work that has not yet been completed or abandoned.

The rationale for the “work-performed” exclusion was made clear in *Privest, supra*, when Drost, J. cited as a leading judgment in the area the American case of *Weedo v. Stone-E-Brick Inc.*⁴ In that case, the contractor sought to obtain a defence in light of a lawsuit brought by a dissatisfied property owner. The New Jersey Supreme Court concluded that the CGL policy “does not cover an accident of faulty workmanship but rather faulty workmanship which causes an accident”.⁵ In distinguishing between these two types of risks the New Jersey Court provided an example:

When a craftsman applies stucco to an exterior wall of a home in a faulty manner and discolouration, peeling and chipping result, the poorly performed work will perforce have to be replaced or repaired by the tradesman or by a surety. On the other hand, should the stucco peel and fall from the wall, and thereby cause injury to the homeowner or his neighbour standing below or to a passing automobile, an occurrence of harm arises which is the proper subject of risk-sharing as provided by the type of policy before us in this case. The happenstance and extent of the latter liability is entirely unpredictable - the neighbour could suffer a scratched arm or a fatal blow to the skull from the peeling stonework. Whether the liability of the businessman is predicated upon warranty theory or, preferably and more accurately, upon tort concepts, injury to persons and damage to other property constitute the risks intended to be covered under the CGL.⁶

The “work performed” exclusion has historically been a topic of uncertainty in the construction insurance context. Various courts across Canada had interpreted this

⁴ 81 N.J. 233, 405 A. 2d 788, [1979] NJ-QL 469

⁵ *Weedo, supra*, at para. 36 (QL)

⁶ *Weedo, supra*, at para. 15 (QL)

exclusion differently, leading to confusion as to whether or not the exclusion operated to negate coverage to contractors for damage relating to deficiencies in their own work, as well as for damage resulting from those deficiencies and causing damage to other parts of the project (commonly referred to as “resultant damage”). As we describe below, the Supreme Court of Canada finally clarified the uncertainty regarding the effect of this exclusion in the seminal decision in *Progressive Homes v. Lombard General Insurance Co. of Canada*.⁷

At the time that *Progressive Homes* was decided by the Supreme Court of Canada in 2010, there existed two distinct trends in Canada regarding faulty construction work:

1. Faulty work *did not* constitute an “occurrence” or did not involve “property damage”, as those terms are defined in the CGL policy (this was the view in British Columbia, for example).
2. Faulty work *may* constitute an “occurrence” or involve “property damage”, but this was to be decided on a case-by-case approach (Ontario, for example, had adopted this position).

In the Ontario case of *Privest, supra*, for example, the Court concluded that the work and/or product exclusions clause found in each of the CGL policies relieved the insurers from the duty to defend the general contractor against the claims for the removal and replacement of the asbestos material, which was found to be part of the insured’s work or product. However, the Court would not extend the exclusion to apply to any damage to other property.⁸

Another illustration is the Ontario case of *Bridgewood Building Corp. (Riverfield) v. Lombard General Insurance Co. of Canada*.⁹ In that case, the insured builder had constructed new homes containing defective concrete supplied by subcontractors. The faulty concrete caused damage to the homes such that the footings and foundation walls would not support the weight of the structures. As a result, foundations shifted causing exterior cracking to the exterior walls, as well as damaging the framing and drywall of the homes affected. At issue was whether or not the insured builder was to be indemnified for the cost of repairing the homes by its insurer under a CGL policy. Lombard argued, in part, that the CGL policy at issue was only intended to cover the insured’s tortious liability to third parties, but not the cost of repairing or replacing the insured’s own defective work or

⁷ [2010] 2 SCR 245.

⁸ *Privest, supra*, at 80, where the Court stated that until the nature and extent of the damage was established at trial, the work/product exclusion could not be said to cover all of the plaintiff’s claims.

⁹ [2005] O.J. No. 2083 (Ont. SCJ), *afid* 266 DLR (4th) 182 (C.A.).

product. The Court disagreed with Lombard on this issue, ruling that coverage determinations could not be made solely on the basis of general principles; instead, the Court noted that the proper approach was to review the particular policy wordings in the context of a particular claim in order to make a coverage determination. On the facts of this case, the Court looked at the policy wordings and determined that there was coverage.

This approach was also adopted by the Saskatchewan Court of Appeal in *Westridge Construction Ltd. v. Zurich Insurance Co.*¹⁰ In that case, Westridge sought a declaration that its insurers had a duty to defend it in an action against it relating to the alleged defective construction of a barn. In finding that there was coverage under the subject CGL policies for Westridge, the Court of Appeal noted that the “work performed” exclusions in the policies were not applicable, in part because the work that was alleged to have been faulty was actually performed by subcontractors retained by Westridge.

By contrast, up until the Supreme Court of Canada decision in *Progressive Homes*, the British Columbia Courts took a different view. In a series of decisions arising out of building defect claims relating to “leaky condos”, these Courts favoured a general principle that faulty work did not constitute an “occurrence” or did not involve “property damage”.

In *Swagger Construction Ltd. v. ING Insurance Co. of Canada*,¹¹ the petitioner, Swagger, was the general contractor for the construction of a building at the University of British Columbia in Vancouver. Initially, Swagger commenced an action against the University seeking compensation for extra work and delays; in response, the University brought a counterclaim against Swagger for damages relating to construction deficiencies relating to the fact that the building leaked. Swagger then brought a Petition seeking an order that three liability insurers had a duty to defend it in respect of the counterclaim under CGL policies that were issued in the course of the project. In denying coverage, the CGL insurers took the position that the claims against Swagger were, in essence, claims for deficiencies in Swagger’s own work as Swagger was the general contractor for the project and therefore responsible for the construction of the building as a whole. As a result, the insurers took the position that the counterclaim was not covered by the policies.

The B.C. Supreme Court cited *Privest, supra*, as a leading authority on the duty to defend under a CGL policy and referenced Drost, J., where at paragraph 208, he described the general purpose of CGL policies:

¹⁰ [2005] S.J. No. 396.

¹¹ [2005] BCJ No. 1964 (QL).

Comprehensive general liability policies ... are intended to protect the insured from liability for injury or damage to the persons or property of others; they are not intended to pay the costs associated with repairing or replacing the insured's defective work and products ...

In its reasons, the Court emphasized that the damage alleged was "damage to the very building that Swagger was contracted to build". The Court further noted that there was no allegation of personal injury to anyone, or any allegation of damage to property other than the building at issue. Ultimately, the Court held that the claims against Swagger did not even fall within the insuring agreement clause because, in the Court's view, physical damage did not occur to something other than the building, which the Court viewed as Swagger's "own work". As a result, the CGL insurers did not have any duty to defend Swagger in relation to the claims brought against it.

The British Columbia Supreme Court revisited this issue again in *GCAN Insurance Co. v. Concord Pacific Group Inc.*¹² In that case, GCAN applied for a declaration that it had no duty to defend certain defendants under wrap-up policies which it had issued to them with respect to claims against those defendants brought in two separate "leaky condo" actions by two strata corporations for defective workmanship and resultant damage. The defendants seeking coverage were the general contractor, construction manager, owner and developer for the projects at issue.

In the petition, GCAN argued that the Court's decision in *Swagger, supra*, was determinative of the issue and therefore it had no duty to defend the underlying actions. In essence, GCAN argued that for insureds whose "work" is the production of an entire project, any construction defects and resultant damage to the projects could not constitute an "accident", as that term was defined in the subject policies.

The Court reviewed *Swagger, supra*, and provided two basic interpretations of that decision:¹³

I would interpret *Swagger* as authority for the proposition that a liability insurance policy covering physical injury to tangible property does not contemplate the artificial division of the work of the party responsible for that work into component parts for the purpose of establishing Resultant Damage, unless that is the clear intention of the entirety of the policy.

...

¹² [2007] BCJ No. 443.

¹³ *Ibid.* at para. 42.

...Swagger is also authority for the proposition that in the context of an insurance policy covering physical injury to tangible property, defective construction is not an “accident” unless there is damage to the property of a third person.”

Following the reasoning in *Swagger, supra*, the Court concluded that the “own work” exclusion in the policies precluded coverage for the general contractor. However, the Court also held that there was a possibility of coverage for the other insured defendants (the construction manager, owner and developer of the projects at issue) and that the “own work” exclusion was therefore restricted in application to the general contractor.

The uncertainty regarding the effect of the “work performed” exclusion was finally addressed by the Supreme Court of Canada in *Progressive Homes, supra*. In that case, Progressive had been retained as a general contractor to build four housing complexes. The owner who retained Progressive on the projects initiated four actions against Progressive alleging significant damage caused by water leaking into each of the four buildings. Lombard had issued five successive CGL policies. At issue was whether Lombard owed Progressive a duty to defend the claims in the underlying actions.

Progressive initially brought an application in the B.C. Supreme Court for a declaration that Lombard was under a duty to defend in the four actions. Following the reasoning in *Swagger, supra*, the lower Court upheld the proposition that defective construction was not an “accident” unless it caused damage to the property of a third property. The lower Court further held that it could not artificially divide Progressive’s work into its components parts for the purpose of establishing resulting damage. As a result, the lower Court followed *Swagger* and *GCAN, supra*, and held that Lombard did not owe Progressive a duty to defend.

On appeal before the British Columbia Court of Appeal, the majority of the Court of Appeal dismissed the appeal. With reference to the “work performed” exclusions in the subject policies, the Court of Appeal noted that the pleadings alleged that integral parts of the buildings, themselves, failed to function properly. As the buildings, themselves, constituted Progressive’s work on the projects, the Court of Appeal determined that the “work performed” exclusions in the policies applied and that there was no duty to defend.

The Supreme Court of Canada, however, disagreed and found that Lombard *did owe* a duty to defend. In doing so, the Supreme Court of Canada rejected the rigid approach earlier relied upon by the British Columbia Courts which had precluded any possibility of coverage to a contractor for deficient work, and instead preferred an approach involving a close review of the language of the subject insurance policy to determine whether there was coverage for a particular claim.

In its reasons, the Supreme Court of Canada found that “property damage” was not limited only to damage to third party property, as insurers had argued. Rather, the Court found that the definition of “property damage” could encompass damage to the property on which the insured was actually performing its work. The Court went so far as to say that defective property may, itself, constitute “property damage” depending on the policy wordings, although the Court did not have to decide that issue in this case.

The Supreme Court of Canada further rejected the insurer’s contention that faulty workmanship could not be an “accident”, and therefore did not satisfy the “occurrence” requirement for coverage. Instead, the Court noted that whether or not faulty workmanship constitutes an “accident” must be determined on a case-by-case basis, depending on both the circumstances of the defective workmanship alleged in the pleadings and the way “accident” is defined in the policy.

The Supreme Court of Canada also addressed the “work performed” exclusions contained in the subject policies. There were three versions of the exclusion, depending on the policy in question.

In the first version, the original “work performed” exclusion was modified by a General Liability Broad Form Endorsement. The original policy excluded “*property damage to work performed by or on behalf of the Named Insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith [Emphasis added].*” That clause was replaced by clause (z) in the endorsement, which excluded “*property damage to work performed by the Named Insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith.*” The Supreme Court of Canada found that the modified exclusion in the endorsement (which was narrower in scope than the original exclusion) operated to exclude coverage for property damage caused by the insured contractor to its *own work*, but did not exclude coverage for property damage caused by a subcontractor’s work or damage to the subcontractor’s work, even if the insured contractor caused the damage.

With respect to the second version, it excluded “*property damage to that particular part of your work arising out of it or any part of it and included in the products-completed operations hazard.*” The Supreme Court of Canada noted that this version expressly contemplated the division of the insured’s work into its component parts by the use of the phrase “that particular part of your work”. This meant that coverage for repairing defective components would be excluded, while coverage for resulting damage would not.

Finally, with respect to the third version, it excluded coverage for “*property damage to that particular part of your work arising out of it or any part of it and included in the products-*

completed operations hazard". However, an exception to the exclusion provided that the "exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor". In interpreting this version of the "work performed" exclusion, the Supreme Court of Canada noted this version did not eliminate the possibility of coverage; in particular, the subcontractor exception would allow for coverage of defective work if the work was completed by a subcontractor.

The Supreme Court of Canada in *Progressive Homes* therefore determined that Lombard owed Progressive a duty to defend the claims against it under each of the policies considered. In doing so, the Court has clarified that a determination of coverage depends on the policy wordings, and not on the "general principles" earlier favoured by some Courts in Canada, such as British Columbia. As *Progressive Homes* demonstrated, an insured may have coverage in relation to claims arising from deficiencies in construction notwithstanding the existence of a work-performed exclusion in the policy. Whether there is coverage is to be decided on a case-by-case basis.

In the recent decision in *Co-operators General Insurance Co. v. Wawanese Mutual Insurance Co.*,¹⁴ the Nova Scotia Supreme Court applied *Progressive Homes* in deciding whether the Co-operators owed its insured a duty to defend an action alleging damages caused by the insured's defective work. The insured had performed plumbing work and it was alleged that the insured had negligently installed an expansion tank for the hot water heating system, which resulted in damage. The Co-operators argued, in part, that there was no duty to defend because the property damage must have related to the work of the insured, which triggered the operation of the "work performed" exclusion. However, the pleadings not only alleged deficiencies in the insured's work, but also resultant damage. The Court was satisfied that the Co-operators had not satisfied its onus of proving that the exclusion clearly applied, therefore the Court determined that there was a duty to defend.

In the context of the "work performed" exclusion, the fundamental question arises as to what properly constitutes the insured's "work". In the New Brunswick case of *Greenan v. R.J. Maber Construction Co.*¹⁵ the defendant contractor/insured sought an order that its insurer defend and indemnify it in an action brought by dissatisfied homeowners. The policy contained a "work performed" exclusion. The Court summed up its position in upholding the exclusion:

My reading of the terms of the policy in question is that coverage is provided only to cover claims of personal injury or damage caused by defective workmanship and

¹⁴ [2014] NSJ No. 111 (QL).

¹⁵ (1992), 123 NBR (2d) 271, [1992] NBJ No. 7 (QL) upheld on appeal (1992), 127 NBR (2d) 124, [1992] NBJ 552 (QL)

not to cover claims for deficiencies or flaws in the workmanship itself. [To do so]...would effectively translate this policy into a full performance bond or guarantee of its total workmanship under its building contract with the plaintiffs. In my view, that is not the intent of this policy...¹⁶

The case of *Ray Electric Ltd. v. Zurich Insurance Co.*¹⁷ demonstrates that a Court will not always have to review the application of the exclusionary clauses. In this case the insurer argued that the product itself and the work performed exclusions applied to release it from its duty to defend an underlying claim against it for the supply and installation of a heating system. The Court ruled that the loss was actually a claim for breach of contract, not for property damage, and so it did not fall within coverage at all. This case reminds us a policyholder first has to prove that a claim is covered before the burden shifts to the insurer to prove that an exclusion applies.

In another Canadian case, the 1994 decision of the Ontario Court in *J.N.A. Distributors v. Permacool Mechanical Systems Inc.*,¹⁸ the Court carefully considered what constitutes "work" for the purposes of a "work performed" exclusion. In that case, the defendant worked on the plaintiff's cooling and heating system. Part of the refrigeration system was damaged by the insured's negligent installation of a condenser. The insured argued that it had worked on the system as a whole, not only on the components it installed. The plaintiff argued that the insured had not worked at all on the actual component that was damaged, so that the exclusion did not apply. The Court found that the insured's contractual duty to the plaintiff was to modify the entire cooling system and that any damage that arose fell within the "work performed" exclusion, and no coverage from the policy was available.

In *Great West Development Marine Corp. v. Canadian Surety Co.*,¹⁹ the Court reviewed a wrap-up liability policy issued with respect to the demolition of a condominium project. In an action brought by the insured to compel the wrap-up liability insurer to defend an underlying tort action for improper dumping of excavation waste, the Court decided that waste being removed from the construction site was not part of the work product of the insured, and that the "work product" was merely the condominium project. This follows the result in *Privest, supra*, where the B.C. Supreme Court decided that the general contractor's "work" was the entire building.

In contrast, the subcontractor's or supplier's work product is the component part that it constructed or furnished to the site. The contrast in the position of the contractor and

¹⁶ *Greenan, supra* at para. 14 (QL)

¹⁷ [1993] ILR 1-2989 at 2535 (Ont.Gen Div.)

¹⁸ [1994] ILR 1-3018 at 2667 (Ont.Gen Div.)

¹⁹ (2000), 19 CCLI (3d) 52, [2000] BCJ No. 939 (QL)(SC)

subcontractor is best illustrated by a 1980 appellate decision of the Indiana Supreme Court, *Indiana Insurance Co. v. DeZutti*,²⁰ which has been cited with approval in Canadian cases such as *Privest, supra*.

In *DeZutti*, the general contractor built a home. Seven years later, the owners discovered cracks in its bricks. The owners sued, contending that the loss was due to settlement caused by improper construction of the footings. The general contractor argued that the exclusion only applied to the defective component of the project which constituted the defective "work". In rejecting that submission the Indiana court stated:

[The insured in this case] is a general contractor and his product or work must be the entire project or house which he built and sold. The exclusion for damages to his work arising from the product or work itself will necessarily be broader than a subcontractor's exclusion. A subcontractor's product or work is merely a component part of a larger work or product. Thus, a subcontractor's exclusion would be less encompassing and any damage to the larger work or item caused by his product or work would be damage to the other property which would fall outside exclusions (n) or (o) and be covered. In both situations the exclusion applies to what the insured or those on his behalf worked upon or produced.²¹

The issue regarding what properly constitutes an insured's "work" was addressed in *B.C. Master Blasters Inc. v. Aviva Insurance Co. of Canada*.²² In that case, the insured inadvertently damaged pipes as it was removing smelt which had accumulated in the pipes of a large boiler at a mill. The British Columbia Supreme Court examined whether there was any coverage to the insured in light of a "work performed" exclusion in the policy. The insurer argued that the insured's "work" involved cleaning the pipes in the boiler. Given that the damage was caused while the insured was working on the pipes, the insurer argued that the "work performed" exclusion was applicable. Conversely, the insured argued that its "work" was restricted to the removal of smelt and denied performing work on the pipes; given did not apply. The Court held in favour of the insurer, finding that the damage at issue was a direct result of the work being performed, which was the removal of smelt from pipes:²³

While I do not disagree with the proposition that it is possible to say that Master Blasters [the insured] was working on the smelt, I think to do so is artificial. It ignores the entire purpose of their work as well as the fact that the entire way in which the work was structured and performed was governed by the fact that the

²⁰ 408 N.E. 2d 1275 (Ind. S.C. 1980).

²¹ *DeZutti, supra* at 1280.

²² [2006] BCJ No. 2620 (QL).

²³ *Supra* at para. 41

smelt was covering the pipes. It is apparent to me that, in ordinary language, Master Blasters was working on the boiler and in particular on the floor of the boiler and the pipes that made up that floor. They were clearing the pipes of smelt so that inspections of the pipes could take place. While it is true that they were not required to remove all smelt down to the bare metal of the pipes, this does not justify the view that they were working on the smelt as opposed to the pipes.

The scope of the "work performed" exclusion has significant implications for the insured performing the role of a construction manager. Many contractors operate construction management divisions that perform no actual construction work but, instead, supervise the work of the subtrades for an agreed fee. In such circumstances it could be argued that no portion of the physical project constitutes its "work performed" and as a consequence the exclusion would have no application. This position would appear to be supported by the IBC Form 2100 wording, which excludes indemnity for property damage arising out of an insured's work, but contains an exception to the exclusion providing that the exclusion *"does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor."*

III. JUDICIAL TREATMENT OF THE BROAD FORM PROPERTY DAMAGE ENDORSEMENT

A) GENERAL

In the construction setting the insurance industry has traditionally viewed both the performance bond and property coverage as being the primary means for correcting property damage that occurs within the confines of the project site. In contrast, the CGL was viewed as the vehicle which indemnified for the losses of third parties who sustained bodily injury or property damage consequential to the work under construction.

That traditional dichotomy has been rendered illusory by the introduction of the Broad Form Property Damage Endorsement ("BFPE") as a supplement to the CGL. The BFPE, as an addition to a policy of liability insurance, often provides first party insurance for the insured's work, including loss attributable to the risk of defective workmanship. In that sense, the BFPE performs a role not unlike a performance bond or policy of property insurance and acts to "blur" the traditional distinctions between on one hand, the CGL, and on the other hand, property insurance and the performance bond.

B) THE SCOPE OF CONTRACTOR COVERAGE UNDER THE BFPE

Contractors have traditionally sought to rely upon the BFPE as first party insurance for work done "by or on behalf of the insured". This has occurred notwithstanding that the CGL was never intended to reimburse the contractor for damage caused to his work by his own or a subcontractor's defective workmanship.

The question as to whether a BFPE provided coverage for a contractor's own work was specifically addressed by the Supreme Court of Canada in *Progressive Homes, supra*. In that case, the Court examined a "work performed" exclusion which had been modified by the BFPE issued to the insured. The modified exclusion in the BFPE provided as follows:

This insurance does not apply to:

(Z) With respect to the completed operations hazard to property damage to work performed by the Named Insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith.

In interpreting this exclusion, the Court in *Progressive Homes* noted that this exclusion was limited to work performed *by* the insured, and did not apply to work performed *on behalf* of the insured, for example by subcontractors retained by the insured. The Court held that the exclusion in the BFPE did not exclude property damage caused by the subcontractor's work or property damage to the subcontractor's work, even if such damage was caused by the insured. The Court also noted that coverage for work completed by subcontractors appeared to be the purpose of upgrading to the BFPE, as the "work performed" exclusion in the underlying CGL policy excluded coverage for property damage to work performed by or *on behalf* of the insured.²⁴

The jurisprudence that exists in the United States suggests that in respect of losses arising following substantial completion, and falling within the CGL's "completed operations hazard", the BFPE will not allow the contractor to recover repair costs associated with the remedying of its own work, but will allow recovery of repair costs needed to correct the subcontractor's "work" (which is consistent with the result in *Progressive Homes, supra*). This is so notwithstanding that the general contractor had contractual responsibility for the entire work.

²⁴ *Supra* at para. 56.

One general warning about the “completed operations hazard”, and exclusions in general, comes from the British Columbia case of *F.W. Hearn/Actes – A Joint Venture Ltd. v. Commonwealth Insurance Co.*²⁵ In that case, the insured was a general contractor and had the benefit of a construction wrap-up policy with numerous exclusions and exceptions and completed operations coverage. The Court reviewed the policy and additional coverage and stated that:

At best, the co-existence of the Completed Operations Hazard as defined in Clause 5 of the Definitions section of the Policy; the exception for Completed Operations coverage to the exclusion in Clause 11 of the Policy; and the Work/Product Exclusion within the same policy leads to confusion and ambiguity with respect to coverage.²⁶

Relying on an American case which concluded that the message of broad protection sent by the title of a policy (“general liability insurance”), the definition of the Completed Operations Hazard (included with the coverage by endorsement), and the exceptions to the exclusions all led to inherent ambiguity, Edwards J. of the B.C. Supreme Court resolved the ambiguity in the insured’s favour.

(i) The Contractor's Ability to Recover Construction Losses Involving Its Own Work

*C.D. Walters Construction Co. v. Fireman's Ins. Co.*²⁷ is one of the few American cases that examines the scope of the BFPE in the context of a loss that arose during construction operations. The insured had been hired to clear a road on 6 acres of land and it was alleged that during operations the insured removed some trees and dug a trench, contrary to the owner's instructions. The insured sought coverage relying upon the BFPE. The South Carolina Court of Appeal concluded that the BFPE did not allow indemnity for the contractor's own work and faulty workmanship flowing therefrom.

(ii) The Contractor's Ability to Recover for Post-Construction Losses Involving Its Own Work

Illustrative of cases in which the general contractor has sought indemnity for repair costs for its own work arising after completion of the project is *Taylor-McDonnell Construction Co. v. Commercial Union Insurance Co.*²⁸ This decision of the Montana Supreme Court examined the right of a contractor to rely upon the BFPE for indemnity as a result of a loss arising after substantial completion. The insured had been hired to construct a museum

²⁵ (2000), 75 BCLR (3d) 272 (S.C.)

²⁶ *F.W. Hearn/Actes, supra* at 281.

²⁷ 316 S.E. 2d 709 (S.C. App. 1984).

²⁸ 744 P. 2d 892 (Mon. S.C. 1987).

roof. Two years after the work was completed the roof began to leak. An action was commenced against the insured claiming damages for poor workmanship and materials, negligence, and breach of contract. The damages included the cost of repairs and replacement of the roof.

The insured had obtained, as a supplement to the CGL, a BFPE, expressed to be in substitution for the "work performed" exclusion, worded as follows:

"With respect to the completed operations hazard and with respect to any classification stated above as 'including completed operations', to property damage to work performed by the named insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith."

Noting that the only property damage being complained of was that part of the property upon which operations were being performed by the insured, and not "other property", the Court, without much analysis, concluded that the BFPE did not afford coverage.

(iii) The Contractor's Ability to Recover for Post-Construction Losses Involving the Subcontractor's Work

Not unlike the judicial treatment of the "product itself" exclusion, decisions concerning the proper scope of the BFPE are divided. It is instructive to examine these divergent lines of authority.

The more compelling United States authorities reflect a restrictive approach in the treatment of the BFPE in the context of losses arising during the "completed operations" phase. Reflective of this restrictive approach is the decision of the Supreme Court of Minnesota in *Knutson Construction Company v. St. Paul Fire & Marine Insurance Co.*, *supra*. In *Knutson*, the Minnesota Court of Appeal opined that the BFPE does not act to provide indemnity for the general contractor's completed building following substantial completion. In the Court's view, to hold otherwise would serve to convert the CGL into a type of performance bond that would compensate the general contractor for its failure to exercise proper workmanship. That, in the Court's view, is tantamount to imposing upon a liability insurer a business risk that is entirely within the control of the contractor.

In *Knutson*, *supra*, the insured obtained a liability policy that included "completed operations" coverage and a BFPE in connection with the construction of an apartment building. The insured had agreed to construct the apartment building according to plans and specifications prepared by architects and engineers and, also, to correct any defects due to faulty materials or workmanship for a period of one year following the date of substantial completion. Before commencing work, the contractor had subcontracted much

of the work, including the installation of windows, prefabricated brick masonry panels, plumbing, heating, and ventilation. Four years following completion of the building the owner detected cracks, staining and chipping on the exterior brick of the building. The owner commenced action to recover its repair costs, claiming both negligence and breach of contract against the insured.

The insured argued that the BFPE, by deleting the words "*or on behalf of*", suggested that the general contractor was entitled to indemnity for those losses attributable to the workmanship of the sub-contractor. The Minnesota Court of Appeal rejected this argument, stating that notwithstanding that the general contractor had subcontracted much of the work, the completed structure became the contractor's "product" at the moment the completed building was turned over to the owner. Regardless of who was to bear immediate responsibility for the work during construction, upon the project being completed all of the work performed and materials supplied by the various sub-contractors in effect "merged" into the completed building, which the general contractor turned over to the owner. The general contractor, by reason of its contract, assumed the business risk inherent in any loss that ensued by virtue of its contractual promise that the building would be constructed in a "good and workmanlike" manner. Since the entire completed building fell within the scope of the "work performed" exclusion there was, in the Court's view, no basis for the BFPE to afford indemnity.

It is noteworthy that the Minnesota Court adopted, with approval, comments made some years earlier by the Florida Court of Appeal, in *Tucker Construction Co. v. Michigan Mutual Insurance Co.*,²⁹ in which that Court had stated:

The deletion of the phrase relating to subcontractors in the exclusion in the completed operations policy makes sense because the insured contractor has presumably accepted the subcontractor's work as his own (at least so far as its potential tort liability is concerned), and has turned the completed work over to the owner by the time such a completed operations policy is operative.

In effect the applicable exclusion provides that the 'completed operations' hazard coverage does not apply 'to property damage to work performed by the named insured arising out of such work or any portion thereof'. The words 'work performed by' in this context in the policy mean the same as 'the restaurant constructed by' the insured and was intended to exclude coverage of the insured's contractual liability for damages to the 'work' caused by the insured's neglect or failure to complete and deliver the completed 'work' in accordance with his contractual undertaking with the owner.³⁰

²⁹ 423 So. 2d 525 (Fla. App. 1982)

³⁰ *Tucker, supra*, at 528

Whether in the context of the "product itself" exclusion or of the BFPE, the obligation to repair defective work or to replace defective materials is not a matter for indemnity pursuant to the CGL, with or without a BFPE.

Judicial response to the BFPE has not been uniform. There exists a distinct line of cases which adopt the view that the insurance industry, by replacing the "work performed" and "care, custody or control" exclusions with a narrower exclusion, usually for an additional premium, intended to confer upon contractors a form of additional coverage in instances involving loss to the subcontractor's work.

Illustrative of this alternate line of cases is the decision in *Southwest Louisiana Grain, Inc. v. Howard A. Duncan, Inc.*,³¹ in which the Louisiana courts concluded that BFPE, when read together with the "work performed" exclusion, created an ambiguity, and therefore ought to be construed in a manner favourable to the insured by treating the BFPE as conferring a form of coverage.

In *Southwest Louisiana Grain, Inc., supra*, the general contractor had been retained to design and construct a grain elevator and storage facility for the owner. The only portion of the work actually performed by the general contractor was to design the buildings and provide site supervision. The work of actually constructing the structure was undertaken by a subcontractor. That fact figured prominently in the Court's reasoning. Following substantial completion, the foundation of the grain elevator and storage facility began to crack. The owner brought an action against the general contractor seeking damages for property damage and loss of income. The primary coverage included both "completed operations" and a BFPE that extended to "completed operations". The effect of the BFPE was that the exclusion:

This insurance does not apply:

(o) to property damage to work performed *by or on behalf of the named insured* arising out of the work or any portion thereof, or out of materials, part, or equipment furnished in connection therewith

was replaced by an exclusion that read:

This insurance does not apply:

³¹ 438 So. 2d 215 (La. Ct. App., cert. denied, 441 So. 2d 1224)

(z) with respect to the completed operations hazard, to property damage to work performed *by the named insured* arising out of the work or any portion thereof, or out of materials, part or equipment furnished in connection therewith." (emphasis added)

Whereas the "work performed" exclusion purported to exclude the insured's entire building, the BFPE only excluded work undertaken by the insured and not work performed at the direction of the insured, including that of a sub-contractor. That caused the Court to consider whether the BFPE was available to indemnify the general contractor for the loss caused to the subcontractor's work product.

In the Court's view the term "work performed" as utilized in the BFPE must entail some form of permanent and tangible structure. So, for example, if the general contractor's work merely consisted of a service, for instance, surveying the site or preparation of its design, then any damage to the tangible portion of the completed structure, being outside the definition of "work performed", would not be excluded by reason of the BFPE. Viewed that way, the BFPE retains the exclusion for property damage to work performed by the insured arising out of the work, but eliminates coverage for damage to work performed on behalf of the insured. So, if the sub-contractor's work sustained damage attributable to an unstable foundation, the sub-contracted work should be covered.

The Court acknowledged that the "product itself" exclusion conflicts with this interpretation of the "work performed" exclusion, but, given the ambiguity in its wording, any doubt as to the proper interpretation of these clauses ought to be resolved in favour of the insured. It is apparent from the decision of the Court that it was not prepared to treat each exclusion as being read separately and independently. In effect, the exclusions were to be read together to identify the scope of indemnity.

The practical effect was that the general contractor, whose only task it was to design the building and survey the site, gained indemnity for damage caused to the building itself since the structure had been erected by the sub-contractor.

Consistent with the decision in *Southwest Louisiana Grain, Inc., supra*, is the decision of the Texas Court of Appeal in *Mid-United Contractors, Inc. v. Providence Lloyds Insurance Co.*³² *Mid-United Contractors*, when read together with *Southwest Louisiana Grain, Inc., supra*, is completely at variance with the decisions in *Knutson, supra*, and *Tucker, supra*.

³² 754 S.W. 2d 824 (Tex. App. 1988)

In *Mid-United Contractors, supra*, the insured had been hired to construct an office building for the owner. Following substantial completion the owner alleged that various prefabricated brick panels were improperly installed. The issue was whether the insured was entitled to a defence by reason of the BFPE. The BFPE in issue in that case provided:

The insurance for property damage liability applies, subject to the following additional provisions:

- (A) Exclusions (k) and (o) are replaced by the following:
 - (2) except with respect to liability under a written sidetrack agreement or the use of elevators...
 - (d) to that particular part of any property not on premises owned by or rented to the insured.....
 - (iii) the restoration, repair, or replacement of which has been made or is necessary by reason of faulty workmanship thereon by or on behalf of the insured
 - (3) with respect to the completed operations hazard and with respect to any classification stated in the policy or in the company's manual as 'including completed operations' to property damage to work performed by the named insured arising out of such work or any portion thereof, or out of such materials, parts of equipment furnished in connection therewith.

The insured's position was that the BFPE replaced some of the exclusions contained in the liability policy and thereby extended coverage to property damage resulting from the actions of any sub-contractors.

The Court acknowledged that the purpose of the BFPE was to replace the "care, custody or control" and the "work performed" exclusions. Commenting upon the effect of the BFPE, the Court remarked:

The endorsement narrows the application of the two exclusions to the particular part of the property with which the insured or its subcontractor had contact in causing the loss...the insured is protected by the endorsement's completed operation coverage when the insured is legally liable for property damage to the work of a subcontractor, to the work of the insured or other subcontractors arising from the work of a subcontractor of the insured. *In other words, although [the general contractor] would have no insurance coverage for damage to its work or arising out of its work, [the general contractor] was covered for damage to its work arising out of a subcontractor's work. By contrast, absent any endorsement, under*

exclusions (k) and (o), any property damage to work completed by [the general contractor] or on behalf of the appellant by its subcontractors would be excluded [Emphasis added].

IV. THE "PRODUCT ITSELF" EXCLUSION IN THE CONSTRUCTION SETTING

CGL policies typically contain a "product itself" or "your product" exclusion clause. The IBC Form 2100 contains the following "product itself" exclusion:

This insurance does not apply to ...

- (i) "property damage" to "your product" arising out of it or any part of it.

The IBC Form 2100 contains the following defined terms that are relevant with reference to the "product itself" exclusion:

"Property damage" means:

- a. Physical injury to tangible property, including all resulting loss of use of that property; or
- b. Loss of use of tangible property that is not physically injured.

"Your product" means:

- a. Any goods or products, other than real property, manufactured, sold, handled, distributed or disposed of by:
 - 1) You;
 - 2) Others trading under your name; or
 - 3) A person or organization whose business or assets you have acquired; and
- b. Containers (other than vehicles), materials, parts or equipment furnished in connection with such goods or products.

"Your product" includes warranties or representations made at any time with respect to the fitness, quality, durability or performance of any of the items included in a. and b. above.

"Your product" does not include vending machines or other property rented or located for the use of others but not sold.

The "product itself" exclusion (like the related "work performed" exclusion discussed above) was intended to eliminate coverage for business risks which the contractor undertakes and which can be governed as a matter of contract. Risk allocation of this type

lies solely with the contractor and can be governed by means of contractual conditions and warranties. To provide the general contractor with indemnity for matters which are a matter of contract as between the contractor and the owner would amount to a license for the contractor to engage in faulty workmanship and, secondly, would furnish a disincentive for the parties to properly address how and in what manner such risk ought to be allocated.

Accepting this as the rationale for the exclusion, what is interesting is the extent to which that same exclusion alleviates the underlying tension that can arise over those risks that, in many respects, the general contractor cannot control. The most pronounced of these uncontrolled risks is the risk that a subcontractor will cause loss or damage to that portion of the construction project that the general contractor did not in fact construct.

While generally the contractor will be contractually bound to supervise and direct all of the subtrades, the contractor cannot possibly guard against every contingency that can occur on the construction site. That reality raises the question as to whether, assuming that a general contractor covenants to construct the entire building and yet only constructs a portion of the building, the general contractor can obtain indemnity for loss to those portions of the building built by other parties including the subcontractor. The Courts must thus decide what the actual “product” is in the “product itself” exclusion.

It is important to note that there is a distinction between “product” and “work” as those terms are recognized in the context of CGL policies. In *Indiana Insurance Co. v. DeZutti*,³³ the Court stated:

... the term “work” refers to the negligent or incorrect manner in which the job was done, whereas “product” means that the item made or sold is somehow defective or deficient in itself.

The “product itself” exclusion is intended to preclude coverage only for damage to the product itself; it does not exclude from coverage bodily injury or property damage that is caused by the faulty or deficient product.³⁴

A study of the Canadian case law on the “product itself” exclusion begins with the words of Mr. Justice Spencer in *Quintette Coal Ltd. v. Bow Valley Resource Services Ltd.*,³⁵ who summed up the Court’s unwillingness to allow a CGL policy to be converted into a type of performance bond for the completed project:

³³ 408 N.E. 2d 1275 (Ind. 1980) at p. 1280.

³⁴ As per Lichty M. and Snowden M. in *Annotated Commercial General Liability Policy* (Aurora: Canada Law Book Inc., updated to December 2014) at 21-4.

³⁵ (1987), 21 BCLR (2d) 203, [1987] BCJ No. 2412 (QL) (SC)

I am hesitant to think that a comprehensive general liability policy covers a contractor for the cost of having to repair or replace his own negligently done work as opposed to the cost of redressing damages caused to others through the contractor's carelessness. Were that the case a contractor could bid a job for \$1 million, do it carelessly at minimal cost to itself, and then claim from the insurer the cost of redoing the work as it should have been done in the first place for \$1 million. I respectfully adopt that view from the judgment in *Poole Const. Ltd. v. Guardian Assur. Co.*, [1977] I.L.R. 1-879 at 635, 4 A.R. 417 [T.D.].³⁶

Canadian cases, including *Privest, supra*, have relied heavily on American cases in this area of law. Decisions on this question are divided as Courts attempt to reconcile three underlying sources of conflict:

- (1) Judicial unwillingness to allow a CGL to be converted into a type of performance bond for the completed project;
- (2) Even greater judicial unwillingness to allow the contractor's own carelessness to constitute a basis for indemnity if the loss relates solely to the bargain contracted for;
- (3) Judicial willingness to allow recovery where the policy is ambiguous.

Some American Courts have concluded that the general contractor's completed building does not constitute a "product". That conclusion allows the general contractor to obtain indemnity for what would otherwise be characterized as a loss that arose from a "business risk". In effect, the CGL is converted into a form of performance bond.³⁷

A significant Minnesota case that reaches this conclusion, cited with approval in *Privest, supra*, is *Knutson Construction Company v. St. Paul Fire and Marine Insurance Company et al.*³⁸ In *Knutson*, the Court concluded that if a contractor has effective control over all project work and materials, building damage caused by faulty workmanship or the use of defective materials constitutes a contractual business risk to be borne by the general contractor and not by the contractor's CGL insurer. The Court reasoned that allowing indemnity in these circumstances would encourage sloppy workmanship. Outlining its concerns, the Court stated:

³⁶ *Quintette, supra*, at 8 (QL)

³⁷ Representative of this line of authority are decisions such as *Kisell v. Aetna Casualty and Surety Co* 380 S.W. 2d 497 (1964), and *Kammeyer et al. v. Concordia Telephone Co. et al* 446 S.W. 2d (486) (Mo. App. 1969) and *Mid-United Contractors, Inc. v. Providence Lloyds Insurance Co.* 754 S.W. 2d 824.

³⁸ 396 N.W. 2d 229 (Minn. S.C. 1986)

... undoubtedly it would present the opportunity or incentive for the insured general contractor to be less than optimally diligent in these regards in the performance of his contractual obligations to complete a project in a good workmanlike manner. To accept the [general contractor's] contention would be to provide the contractor with assurance that notwithstanding shoddy workmanship, the construction project would be properly completed by indemnification paid to the owner by the comprehensive general liability insurer. In and of itself, the incentive for the contractor to fairly and accurately bid a contract in order to secure the job would be removed. Even if such a result would not always be inevitable, the possibility of such consequences, in our view, is incompatible with the general public policy concerning the relationship between owners and contractors.³⁹

Mr. Justice Drost summed up the American authorities in *Privest, supra*, as follows:

All of the [American] authorities to which I have referred thus far, were cases in which the contractor had built an entirely new building. In those circumstances courts have generally found that the entire structure was the work/product of the contractor.⁴⁰

The Court concluded that the Canadian authorities came to the same conclusion:

The Canadian authorities...also support the proposition that the work or product of a general contractor, such as Foundation, is the project for which the contractor was engaged.⁴¹

In *Privest, supra*, the Court concluded, following its review of the differing policies, that the “product” of a general contractor was the “...structure erected or [the] improvements made pursuant to its contract with the owner”.⁴² It is important to note that *Privest* merely involved renovation work, not the construction of an entirely new building. After carefully examining the wording of all of the “product itself” exclusions, the Court found that the removal of asbestos products was excluded under the “product itself” exclusions for all of the policies considered in the case. However, the Court went on to find that resultant damage to other property was not within the exclusion clauses.

When the Court reviews the “product itself” exclusion to determine if there is coverage, it must first ask whether the claim asserted is for damage to the insured’s product, or for

³⁹ *Knutson, supra* at 21.

⁴⁰ *Privest, supra* at 78.

⁴¹ *Privest, supra* at 79.

⁴² *Privest, supra* at 74.

resulting damage to the property of others. Under the usual wording, damage to the insured's own product is clearly excluded from coverage under the policy. There is no coverage when the claim is for costs associated with repairing or replacing the insured's defective work and product.⁴³ The CGL policy is intended to cover tort liability for damage to others – not contractual liability for economic loss because the product or work is not what the claimant bargained for.⁴⁴

This principle was demonstrated in the Ontario decision in *Bothwell Accurate Co. v. Royal Insurance Co. of Canada*.⁴⁵ In that case, Bothwell was retained to construct a roof and used phenolic foam to insulate it. The foam reacted with the steel deck, causing its deterioration. Bothwell was not responsible for installing the steel deck. Although the parties agreed that the damage to the steel deck was covered because it was not part of Bothwell's product, at issue was whether the costs of other repairs to the roof, necessitated by the damage to the steel deck, were covered. In finding that there was a duty to defend, the Court found that the "product itself" exclusion could not apply because the claim only alleged property damage to the steel roof deck which was not part of Bothwell's work product.

The New Brunswick Court of Appeal also recently looked at the effect of the "product itself" exclusion in a construction context in *Beaverdam Pools Ltd. v. Wawanesa Mutual Insurance Co.*⁴⁶ In that case, Beaverdam had installed an above-ground pool. After the pool was installed, the owner of the property where the pool was installed constructed a deck level with the top of the pool. Later, the pool began to fall apart and attempts to repair it were unsuccessful. The owner therefore brought a claim for damages primarily relating to the costs to repair the pool, but also in relation to raising the deck to make it level with the pool (Beaverdam had no involvement in the construction of the deck). The issue before the New Brunswick Court of Appeal was whether Wawanesa owed Beaverdam a duty to defend the claims in the underlying action. Although the Court found that there was no coverage for claims relating to repairing deficiencies in the pool (i.e. the insured's own product), there was still a duty to defend because the pleadings alleged consequential damage:

As the application judge correctly pointed out, the exclusionary clauses contained in this Commercial General Liability policy exclude coverage or indemnity to the insured for the cost of repairing or replacing "the work" or "work product" of the insured. For example, the policy does not provide

⁴³ *Carleton Iron Works Ltd. v. Ellis Don Construction Ltd.* (1996), 8 OTC 287 (Ont.Gen.Div.), [1996] OJ No. 2427 (QL).

⁴⁴ *Century I Joint v. United States Fidelity* 493 A 2d 370 (Md. App. 1985).

⁴⁵ [2001] O.J. No. 453.

⁴⁶ [2010] N.B.J. No. 4.

indemnity to the insured for the cost of repairs to or replacement of the pool. But the construction of the deck surrounding the pool was Mr. Brewer's responsibility and had nothing to do with Beaverdam. For that reason, it is difficult to understand Wawanesa's contention that "there is no allegation in the Statement of Claim regarding anything other than [Beaverdam's work or work product."⁴⁷

In *Alie v. Bertrand & Frere Construction Co.*,⁴⁸ the Ontario Superior Court addressed the "product itself" exclusion in a claim arising from defective concrete used in house foundations across Ontario. The Court distinguished *Privest, supra*, stating:

This situation is much different than the cases cited dealing with insulation containing asbestos...The structural integrity of the buildings in those cases was never threatened. In this case, the faulty concrete became incorporated in the foundation and the faulty foundation was incorporated into the home...If the foundations are not replaced they will collapse...⁴⁹

In *Alie*, the Court had to grapple with the distinction between pure product defect replacement and situations that involved the incorporation of the product into that of another party working on the project. The Court concluded that:

Whether there is or is not coverage will depend on the facts of each case. Clearly if the defective product becomes a part of the whole of a third party product, or is incorporated in a third party's product and can't be removed or repaired without either rendering the third party's product useless or damaging it, the Courts have concluded that that is property damage and coverage will follow.⁵⁰

The Court found (and the insured conceded) that it could not recover from its insurer for replacing the defective concrete itself. The Court stated that the exclusionary clause only emphasizes again that there was no insurance coverage for the cost associated with the insured supplying new concrete. The Court went on to find that the damage to the houses' foundations would not be caught by the exclusionary clause because the property damaged belonged to others, not the insured.

In *ING Insurance Co. of Canada v. A.M.L. Painting Ltd.*,⁵¹ the plaintiff in the underlying action brought an action against A.M.L. and others alleging the premature widespread failure of paint systems on drilling platforms, pipelines and onshore plants and facilities.

⁴⁷ *Ibid.* at para. 12.

⁴⁸ (2000), 30 CCLI (3d) 166, [2000] O.J. No. 1360 (QL)

⁴⁹ *Alie, supra* at para. 311 (QL).

⁵⁰ *Alie, supra*, at para. 308 (QL).

⁵¹ [2006] NSJ No. 268 (QL).

A.M.L. painted the equipment. The Court reviewed a “product itself” exclusion in the subject CGL policy and concluded that there could be no indemnity for damages arising from the replacement or repair of the faulty paint system that was A.M.L.’s product; however, certain other allegations in the pleadings including that the structures, themselves, were defective and claims for loss of profits were potentially covered. The allegations in the pleadings were therefore sufficient to trigger a duty to defend.

Other cases on the “product itself” exclusion from British Columbia are also worth examining. In the 1997 case of *Pier Mac Petroleum Installation Ltd. v. Axa Pacific Insurance Co.*,⁵² the insurer successfully avoided coverage under a CGL policy for repairs to a gas bar, in part because of an exclusion equivalent to the “product itself” exclusion. The insured argued that the “products” exclusion did not include the gas bar it had manufactured. The Court reviewed the plain and normal meaning of the words “products” and “products manufactured” and the parties’ intention that the policy was a general liability policy, not a performance bond. It concluded from the construction and interpretation of the policy’s terms that the exclusion applied.

In *Axa Pacific Insurance Co. v. Guildford Marquis Towers Ltd.*,⁵³ the Court reached a rather different conclusion. In that case, the developer and general contractor were involved in “leaky condo” litigation and applied to the Court for coverage and a declaration that Axa had a duty to defend the underlying action pursuant to a CGL policy. The insurer argued that the claims were expressly excluded from coverage because of a two-part exclusionary clause, relying on *Pier Mac*. However, the Court found that the two-part clause was irreconcilable and ambiguous. The Court reviewed extrinsic evidence, namely an internal bulletin published by Axa, to find against the insurer. The developer and contractor were thus covered for claims relating to the “work done by or on [their] behalf”, and the argument that the building was their “product” within the meaning of the exclusion was rejected.⁵⁴

Although not a construction case, the British Columbia Court of Appeal recently addressed a “product itself” exclusion in the context of a CGL policy in *Bulldog Bag Ltd. v. Axa Pacific Insurance Co.*. In that case, Bulldog manufactured defective printed plastic packaging for one of its customers which was used in the sale of manure and soil products. The defect related to the fact that moisture would cause ink to come off the packaging, making the labelling partly illegible. As a result, the customer could not sell its product packaged in the defective packaging and sustained damages. Bulldog was able to

⁵² (1997), 41 BCLR (3d) 326, [1997] BCJ No. 1611 (QL) (S.C.).

⁵³ (2000), 74 BCLR (3d) 194, [2000] BCJ No. 208 (QL) (SC).

⁵⁴ As per Lichty M. and Snowden M. in *Annotated Commercial General Liability Policy* (Aurora: Canada Law Book Inc. January 2001) at 21-13.

settle the claims, and then sought indemnity from its CGL insurer, Axa. The Court held that although the “product itself” exclusion operated to exclude indemnity for the claims for damage to the Insured’s bags (Bulldog’s own product), it could not be extended to resultant damage (for example, the costs incurred by the customer to repackage the product in non-defective bags). In its reasons, the Court of Appeal followed closely the Supreme Court of Canada’s decision in *Progressive Homes, supra*, in which the Court had considered various “work performed” exclusions and determined that they did not preclude coverage for resultant damages.

In New Brunswick, the Court very recently looked at the application of the “product itself” exclusion in the context of a construction project. In *Ultimate Windows Doors Ltd. v. Aviva Insurance Co. of Canada*,⁵⁵ Ultimate had sold 179 pieces of siding to a couple who owned a residential property and were building a home. Several years after the supply of the siding, the owners noticed that the siding was starting to blister and peel, and it was determined that the siding needed to be replaced. The owners started an action against Ultimate and others. Ultimate’s CGL insurer, Aviva, took the position that there was no coverage because, in essence, it was a claim that the siding sold by Ultimate was defective. Aviva was of the view that it covered damage *by* faulty products, but not damage *to* faulty products. In finding that there was coverage, the Court agreed with Ultimate’s position that the amount claimed by the owners was so great that it must involve more than removal and replacement of siding on the house:

While in this case there is no allegation of negligence against Ultimate, if the need to remove and replace the allegedly defective siding it supplied made it necessary to repair or replace other property such as insulation, vapour barrier, landscaping or even a deck, then, in my view, Aviva would be obliged to pay that portion of the damages that, in turn, would trigger the duty to defend.⁵⁶

It follows from the case law described above that damage to the policyholder’s own product is likely excluded from coverage by operation of the “product itself” exclusion; however, resultant damage to the property of others is not excluded from coverage.

⁵⁵ [2014] NBJ No. 182 (QL).

⁵⁶ *Ibid.* at para. 19.

V. THE SCOPE OF THE "CONTRACTUAL LIABILITY" EXCLUSION IN THE CONSTRUCTION SETTING

The IBC Form 2001 wording contains a "contractual liability" exclusion that provides:

This insurance does not apply to:

- a) "Bodily injury" or "property damage" for which the insured is obligated to pay compensatory damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for compensatory damages:
 - 1) Assumed in a contract or agreement that is an "insured contract"; or
 - 2) That the insured would have in the absence of the contract or agreement.

The IBC Form 2100 wording also contains the following defined terms that are relevant with reference to the "contractual liability" exclusion:

"Insured contract" means:

- 1. A lease of premises;
- 2. A sidetrack agreement;
- 3. And easement or license agreement in connection with vehicle or pedestrian private railroad crossings at grade;
- 4. Any other easement agreement;
- 5. An indemnification of a municipality as required by ordinance, except in connection with work for a municipality;
- 6. An elevator maintenance agreement; or
- 7. That part of any contract or agreement pertaining to your business under which you assume the tort liability of another to pay compensatory damages because of "bodily injury" or "property damage" to a third person or organization, if the contract or agreement is made prior to the "bodily injury" or "property damage". Tort liability means a liability that would be imposed by law in the absence of any contract or agreement.

An "insured contract" doesn't include that part of any contract or agreement that indemnifies an architect, engineer or surveyor for injury or damage arising out of:

- 1) Preparing, approving or failing to prepare or approve maps, drawings, opinions, reports, surveys, change orders, designs or specifications; or
- 2) Giving directions or instructions, or failing to give them, if that is the primary cause of the injury or damage.

In general, and subject to the exceptions built into the exclusion, the effect of the exclusion is that the insurer declines to provide coverage where bodily injury or property damage arises out of the assumption of liability by the insured in a contract or agreement.

The predecessor of IBC Form 2100 contained similar wording, and provided as follows:

This insurance does not apply to:

- (a) liability assumed by the Insured under any contractor agreement except an incidental contract ...

In the context of a construction loss, the use of the terms "liability assumed" in the predecessor of IBC Form 2100 and "assumption of liability" in the IBC Form 2100 potentially refers to one or more of the following:

- (i) an express obligation undertaken pursuant to a construction contract;
- (ii) any liability that stems from a party's tort obligations which form an implied term of the construction contract;
- (iii) an express provision which assumes the liability for one party's own fault or the fault of a third party.

This particular exclusion clause has received much judicial attention, both in Canada and the United States. The American jurisprudence has given a narrow scope to the "contractual liability" exclusion and concluded that the exclusion only bars indemnity if the insured would not be liable to a third party but for the fact that it assumed that liability pursuant to its contract. Conversely, the insurer cannot rely upon the exclusion when the liability assumed under the construction contract, with a third party, is co-extensive with the insured's liability imposed as a matter of tort law. This is borne out by the comments of the U.S. District Court in *Lebow Associates Inc. v. Avemco Insurance Company*:⁵⁷

A major rationale underlying the principle that assumed liability exclusion clauses are inoperative when the liability assumed is coextensive with the insured's liability imposed by law is that the insured's assumption of liability does not expand the insurance company's element of risk, upon which the insured's premium amounts are predicated, beyond the original contractual agreement of the parties. To allow an insurance company to avoid payment of its insured's liability to a third party, which otherwise exists by operation of law, merely because the insured contractually assumed the same liability to the third party would be to judicially condone a unilateral alteration of the substantive terms of the contract in favour of

⁵⁷ F. Supp. 1288 (1977).

the insurance company on grounds which are not even relevant to the element or risk which underlies each party's bargaining position. Such a result would undoubtedly be contrary to the reasonable expectations of the insured.⁵⁸

That, however, has not been the position in Canada. The Canadian experience in the past has been to broaden the scope of the "contractual liability" exclusion to such a degree that contractors are practically compelled to obtain wording wider in scope than the current IBC wording to ensure that the CGL coverage is more than illusory in guarding against losses on the construction site.

The origin of this approach lies in the decision in *Foundation of Canada Engineering Corporation Ltd. v. Canadian Indemnity Company*.⁵⁹ The insured, a construction manager, was hired to build a cement plant. The plant later collapsed due to the "gross under design" of the metal connectors that linked the ends of a roof beam with two columns.

Two terms of the contract in that case are relevant to the contractual liability exclusion:

[The insured] does hereby agree to indemnify and save harmless (the owner) of, from and against any and all claims, demands, actions, causes of actions, losses, damages and things of any nature, whatsoever arising out of or resulting from the breach, non compliance, or wrongful compliance by (the owner or the contractor) with any of its covenants hereunder.⁶⁰

The contractor also agreed to:

... inspect all workmanship carried out on the Project, it being understood and agreed that it is the duty and responsibility of [the contractor] to reject such workmanship which is not of good and adequate quality and which does not meet specifications.⁶¹

The Supreme Court of Canada found that the "contractual liability" exclusion withdrew any obligation to indemnify, not only under the hold harmless agreement but also for any liability predicated on a failure to inspect the work. In the result, at least in Canada, the "contractual liability" exclusion removes from indemnity all contractually assumed liability that a party incurs by reason of contract (subject only to the types of contracts described in the exception clause as an "insured contract", as defined in the IBC Form 2100).

⁵⁸ *Lebow, supra* at 1291.

⁵⁹ [1978] 1 SCR 84.

⁶⁰ *Foundation, supra*, at 86.

⁶¹ *Foundation, supra*, at 86.

While the Courts have traditionally applied a broad interpretation to this exclusion, the recent British Columbia decision in *Westaqua Commodity Group Ltd. v. Sovereign General Insurance Co.*⁶² suggests that they may be moving away from the narrow approach towards a broader interpretation of the exclusion. In that case, Westaqua had supplied ingredients used for the production of fish food to one of its customers, which were later discovered to be contaminated. The customer had to destroy the contaminated product and commenced an action against Westaqua for damages. Westaqua then brought an action against its insurer for the disposal costs. The insurer argued that the claims against Westaqua related to an unpaid refund arrangement for disposal costs, which created an obligation that was within the scope of the “contractual liability” exclusion. However, the Court disagreed and held that the facts did not support a contractual liability exclusion as the exclusion applied to a “liability” rather than an “obligation”.

Another issue relating to the “contractual liability” exclusion that has been addressed by the Courts is whether that exclusion could bar tort liability merely because that tort liability arose as a term of the contract. In other words, if the insured would be liable in tort without the contract, as happened in *Lebow, supra*, does the exclusion apply? That question was canvassed in an earlier decision of the Supreme Court of Canada, *Dominion Bridge v. Toronto General Insurance Company*.⁶³ In that case, the contractor entered into a contract to erect the steel superstructure for the Second Narrows Bridge in Vancouver. The contract provided:

If there is evidence of any fault, defect or injury, from any cause whatever, which may prejudicially affect the strength, durability, or appearance of any section of the structure, the contractor shall, at his own expense, satisfactorily correct such faults or, if required, shall replace so much of said section as the engineer may deem necessary even to the extent of rebuilding the entire section.⁶⁴

The contract contained a provision whereby the insured also guaranteed that its agents, workmen, and all other persons in its employment and under its control would perform their common law duties. The completed work buckled due to faulty design causing portions of the bridge to fall onto and damage the third party's piers.

The issue before the British Columbia Court of Appeal was whether an insurer could escape liability by reason of a “contractual liability” exclusion in its policy in a case where the insured is found to be concurrently liable both in tort and in contract for the same act or omission.

⁶² [2014] BCJ No. 284. (QL).

⁶³ [1963] SCR 362.

⁶⁴ (1962), 32 DLR (2d) 374 (CA) at 377

Both the Court of Appeal and the Supreme Court of Canada agreed that the exclusion precluded liability, and the insurer in that situation had no obligation to indemnify. The Supreme Court of Canada found that:

The trial judge held that the first exclusion clause only excluded liability arising from contract and not claims arising out of concurrent liability in tort. The Court of Appeal held that the liability in question had been assumed by [the insured] under its contract [with the third party] and that it came squarely within the first exclusion clause and that it was immaterial that such liability was tortious liability independently of contract. "Liability imposed by law" and "liability assumed under contract" were for one and the same loss. That being so, liability, even though imposed by law, was excluded from the coverage.⁶⁵

As noted above, the IBC Form 2100 contains an exception which provides that the "contractual liability" clause cannot be permitted to stand where the insured would have liability for the loss arising from other than contract. This principle was demonstrated in the recent Alberta case in *Canalta Construction Co. Ltd. v. Dominion of Canada General Insurance Co.*⁶⁶ In that decision, Canalta acted as a general contractor and developer for a condominium project. The Condominium Corporation sued Canalta for breach of contract and negligence in relation to alleged deficiencies in design and construction. The CGL policy issued by Dominion contained the same "contractual liability" exclusion as in the IBC Form 2100. Dominion argued that the exclusion applied such that it did not have a duty to defend because the claims against Canalta were in essence claims for breach of contract, which meant that Canalta would be "legally obligated to pay" these damages by reason of the assumption of liability in a contract. The Alberta Court of Queen's Bench disagreed, and held that the exclusion did not apply because it could not be said that the alleged deficiencies due to negligence were simply a derivative of the breach of contract.

In *Westridge Construction Ltd. v. Zurich Insurance Co.*,⁶⁷ the Saskatchewan Court of Appeal confirmed the principal that the "contractual liability" exclusion will only apply to pleadings which allege damages arising from breach of contract. As was noted by the court in that case:

Insofar as the claims in this case are claims in contract for faulty workmanship or materials, the exclusions apply. However, as noted previously, the pleadings support not only a cause of action in contract, but also a separate cause of action

⁶⁵ *Dominion Bridge, supra* (SCC) at 364

⁶⁶ [2013] A.J. No. 592.

⁶⁷ [2005] S.J. No. 396

in tort for negligent misrepresentation, a cause of action to which these exclusions would not apply since they do not necessarily involve allegations of faulty workmanship or materials.⁶⁸

From *Foundation* and *Dominion Bridge*, *supra*, it is apparent that the standard IBC wording in the CGL Form 2005 is completely inadequate as a guard against contractual liabilities commonly found in the construction setting. Many contractors have thus moved to the CCDC Form 101 wording, which provides:

This insurance does not apply to:

- a) liability assumed by the insured under any contract or agreement except in an incidental contract. This exclusion does not apply to a warranty of fitness or quality of the named insured's products or a warranty that work performed by or on behalf of the named insured will be done in a workmanlike manner.

It is noteworthy that "incidental contract" is defined to mean:

... any written agreement

- a) which is a lease of premises, easement, agreement, agreement required by municipal ordinance, sidetrack agreement, elevator maintenance agreement, or
- b) which assumes the liability of others, except agreements wherein the insured has assumed liability for the sole negligence of his indemnitee.

This expanded definition of "incidental contract", based as it is upon the nature of the assumed legal liability and not the activity involved in the incidental contract, broadens the scope for indemnity. The only circumstances in which the insured would not gain indemnity are where the insured stipulates that it would bear liability for the *sole* negligence of another party. That rarely occurs in the context of a construction contract.

Virtually none of the 1982 CCDC construction contract provisions would be beyond the parameters of an "incidental contract" as defined in the CCDC Form 101. It is worth reviewing the provisions in the standard CCDC documentation that do give rise to indemnity or contractual liability for damages.

- General Condition 4.1 states that if the contractor is delayed in the performance of the work "by an act or omission of the owner consultant, or

⁶⁸ *Ibid.* at para. 48

other contractor or anyone employed or engaged by them directly or indirectly" then the "contractor shall be reimbursed by the owner for reasonable costs".

- General Condition 4.2 states that if a contractor is delayed in the performance of the work by a stop work order then the "contractor shall be reimbursed by the owner for reasonable costs incurred by the contractor as a result of such delays".
- General Condition 19.1 provides that the contractor "... shall indemnify and hold harmless the owner and the consultant, their agents and employees from and against claims, demands, losses, costs, damages, actions, suits or proceedings" by third parties provided two conditions are met:
 - a) the claim is attributable to bodily injury or death, or injury to or destruction of tangible property;
 - b) the claim is caused by the negligent act or omission of the contractor;

and provided the claim is made within six years from the date of substantial performance.

- General Condition 19.3 states that the owner shall indemnify and hold harmless the contractor from and against all claims demands, loss or costs which are attributable to a lack or defect in title or alleged lack or defect in title.
- General Condition 21.1 states that the contractor shall protect the work and the owner's property on the work and adjacent to the place of work and "shall be responsible for damage which may arise as a result of his operations under the contract except damage which occurs as a result of errors in the contract documents or acts or omissions by the owner, the consultant and other contractors or their agents". This is supplemented by General Condition 21.2, which stipulates that the contractor shall "be responsible for making good such damage at his expense".
- General Condition 22.1 provides that "... if either party to this contract shall suffer damage in any manner because of any wrongful act or neglect of any other party or of anyone for whom he is responsible in

loss then he shall be reimbursed by the other party for such damage". This right to recover exists provides that the notice is provided in writing and is provided as soon as reasonably practicable.

Each of these provisions, when combined with the operation of the *Negligence Act*, R.S.B.C. 1996, c. 333, could fall within the definition of "incidental contract" as contained in the CCDC wording.

While there is little Canadian jurisprudence on this subject, in the United States it is clear that hold harmless language worded similarly to General Condition 19.1 could give rise to indemnity in circumstances that would not otherwise be the case if liability rested merely in negligence. That result would not necessarily offend against the definition of "incidental contract" as provided in the CCDC wording.

Illustrative of the problems confronting a contractor who agrees to indemnify an owner is the decision in *Bartak v. Bell-Gallyardt & Wells Inc.*⁶⁹ The contractor undertook to indemnify the owner and architect on the following terms:

The contractor shall *indemnify and hold harmless* the owner and architect and their agents and employees from and against all claims, damages, losses and expenses, including attorneys' fees arising out of or resulting from the performance of the work provided that any such claim, damage, loss, or expense (1) is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (other than the work itself) including the loss of use resulting therefrom, and (2) is caused in whole or in part by any negligent act or omission of the contractor, any subcontractor, anyone directly or indirectly employed by any of them or anyone for whose act any of them may be liable, regardless of whether or not it is caused in part by a party indemnified hereunder.⁷⁰

At trial it was determined that the general contractor was liable for 65% of the loss and the architect was responsible for 35%, with the latter's negligence being solely attributable to its preparation and approval of drawings for which it was not liable after all pursuant to the terms of the indemnity. Acknowledging that the indemnity was clear in its terms, the Court found that the contractor was obligated to indemnify and hold harmless the architect for any claim or damage arising from the work, notwithstanding that it was caused only in part by the negligence of the contractor.

The more interesting and yet largely unconsidered issue in Canada is whether, assuming that a contractual obligation falls within the CCDC Form 101 definition of "incidental

⁶⁹ 473 F. Supp. 737 (1979)

⁷⁰ *Bartak*, *supra* at 739-40

contract", indemnity is necessarily extended to all of the obligations contained in the "incidental contract". However, U.S. courts have already examined this issue, including whether a breach of a covenant to insure, similar to that contained in General Condition 20, can be characterized as an "incidental contract" sufficient to trigger indemnity. In *Olympic, Inc. v. Providence Washington Insurance Co. of Alaska*,⁷¹ a fire had arisen in the tenant's premises and a fire fighter was killed attempting to extinguish the flames. It was alleged in the wrongful death action that the landlord had been negligent in failing to install a sprinkler system. Having settled the tort action, the landlord's insurer sought indemnity from the tenant's insurer on the basis of a provision in the lease that stated:

The [tenant] shall provide and maintain public liability insurance in a minimum amount of \$300,0000, naming the [landlord] as a named insured, which insurance will save the [landlord] harmless from liability from any injuries or losses which may be sustained by any persons or property while in or about the said premises.⁷²

The tenant had obtained a CGL policy but had omitted to have the landlord included as a named insured. In the result, the landlord did not have the third party limits available to it for a contribution towards the settlement proceeds.

In seeking reimbursement of the settlement amounts, the landlord's insurer argued that the lease, being an "incidental contract", and in combination with a breach of the lease covenant to obtain \$300,000 in third party liability insurance, dictated indemnity. The Alaska Court noted, however, the language of the "contractual liability" exclusion, which provided:

This insurance does not apply:

- (a) to liability assumed by the insured under any contract or agreement except an incidental contract...

While the lease was an "incidental contract", the obligation upon which indemnity was being sought was not in the nature of a "... liability under any contract or agreement". The obligation entailed a promise to indemnify or hold harmless another and did not include liability arising from a breach of contract. In the former, unlike the latter, the insured is merely assuming liability for another person's negligence, not liability for breach of contract. The covenant in the lease in *Olympic* did not constitute a hold harmless contract or indemnification agreement that resulted in policy coverage.

⁷¹ 648 P. 2d 1008 (Alaska S.C. 1982).

⁷² *Olympic, supra*, at 1009.

With reference to the newer IBC Form 2100 contractual liability exclusion, an “insured contract” is defined in seven different ways and does not include a contract which indemnifies an architect, engineer or surveyor for specific tasks (including planning, reports, and surveys), which thus excludes from coverage any claim under a professional’s errors and omissions policy. As one commentator has stated:

... [E]xception clause 2 ... specifically brings back into coverage situations where the policyholder would have common law liability in any event without the contract. Accordingly where a claim arises in both tort and contract, the newer form does not exclude it.⁷³

One recent Canadian case again shows the importance of examining the particular coverage language and policy definitions to determine whether contractual claims come within coverage as a matter of stated insuring intent.⁷⁴ In *Yacht Harbour Pointe Development Corp. v. Architectura Waisman et al.*,⁷⁵ an insurer issued a CGL policy to a general contractor that listed the plaintiff, the owner of a residential apartment building, as an insured. The relevant policy coverage stated:

1. The insurer agrees to pay on behalf of the insured all sums ... which the Insured shall become legally obligated to pay by reason of the liability imposed by law upon the Insured or assumed by the Insured under contract ... for damages.

“Contract” means

- (a) a warranty of fitness or quality of the Insured’s products or a warranty that work performed by or on behalf of the Insured will be done in a workmanlike manner.

In the contracts of purchase and sale between the owner and the unit purchasers, the owner agreed to repair major structural defects for one year after substantial completion. The owner/insured paid for the repair of certain problems that developed with the balconies of various units pursuant to this contractual obligation, and claimed it under the CGL policy as a liability imposed by law.

The insurer argued that there had been no tortious liability imposed by law, and the policy did not cover the claimed cost of repairs. It premised its argument on the fact

⁷³ See Snowden M. and Lichty M. *Annotated Commercial General Liability Policy*, *supra* at page 15-3.

⁷⁴ See Snowden M. and Lichty M. *Annotated Commercial General Liability Policy*, *supra* at page 15-3 .

⁷⁵ (1999), 69 BCLR (3d) 334, [1999] BCJ No. 675 (QL)(SC).

that “damages” as interpreted in a number of cases meant damages that flowed from tortious liability. The Court looked for the plain meaning of the policy at issue, including the definition in the policy of a “contract”, which included “... a warranty of fitness”, and stated that coverage extended to the liability assumed by the owner under its contract with the unit owners. However, pursuant to a “no action” provision in the general conditions of the policy, the owner’s application for judgment was dismissed and the claim against the insurer was dismissed. The unit owners had never commenced any action against the insured. It must be remembered that the specific language in the policy, including the definition of “contract”, and the fact that liability was assumed by the insured under contract, led to the Court’s decision.

In the context of construction claims, there are many instances where developers and builders of new projects provide buyers with statutory warranties under the applicable new home warranty legislation which varies from province to province. In these cases, the issue may arise as to whether there is coverage for claims brought against a developer or builder in relation to alleged construction deficiencies in view of the “contractual liability” exclusion. This issue was addressed by the Ontario Superior Court of Justice in *Bridgewood*⁷⁶, *supra*.

In *Bridgewood*, the court dealt with a case involving builders who constructed new homes containing defective concrete in the foundations. The *Ontario New Home Warranties Plan Act*⁷⁷ required builders to provide new home buyers with a 7-year warranty for major structural defects. The policy at issue contained a contractual liability exclusion and the insurer argued that because the Act required builders to extend warranty coverage to purchasers of new homes, this represented a liability “assumed in contract” by the builders which meant that the exclusion operated to preclude coverage. The Court rejected this argument and held that the liabilities imposed upon the builders by the Act were not “assumed in a contract”, but rather were assumed by statute. As a result, the Court held that the exclusion was not applicable.

VI. THE “CUSTODY CARE AND CONTROL” EXCLUSION IN THE CONSTRUCTION SETTING

For a contractor, the risk of loss of property handled in the course of one's own work is greater than the risk of damaging other property. By excluding damage to property directly handled by the contractor and limiting liability to losses occurring on property not under the "care, custody, or control" of the contractor, liability insurance can be obtained at reasonable rates. As well, the exclusion is intended to avoid the normal business risks

⁷⁶ [2005] O.J. No. 2083.

⁷⁷ R.S.O. 1990, c. O.31

that occur to property on a construction site. Limited coverage in respect of this risk is available under other forms, including the Broad Form Property Damage Coverage endorsement discussed earlier.

In the IBC Form 2100, the "care, custody or control" exclusion provides:

This insurance does not apply to:

- (h) property damage to
 - 4) personal property in your care, custody or control;

In contrast, the CCDC Form 101 CGL wording provides:

This insurance does not apply to:

- (h) property damage to
 - (2c) property in the *custody* of the insured which is to be installed, erected or used in construction by the insured

It will be immediately noted that the CCDC wording is narrower in scope than the comparable IBC wording, and that the CCDC exclusion, drawn from the wording of the BFPE, provides a significant degree of coverage to a contractor or subcontractor when one of those parties causes property damage to the other. In those circumstances, the CCDC wording covers repair costs and converts the wording into first party insurance not unlike a Builders' All Risk policy. That is why the exclusion contains a reference in the "Other Insurance" clause to this coverage being "excess insurance ... over property insurance."

It is helpful to begin with a look at the Canadian authorities before briefly reviewing some of the American authorities on this particular exclusion. The leading case, albeit not related to the construction setting, on the care, custody and control exclusion is the Supreme Court of Canada's 1954 decision in *Indemnity Insurance v. Excel Cleaning Service*.⁷⁸ That case decided that the "care custody and control" concept was based on a proprietary interest in the property in question - here the owners of carpets damaged by cleaners were said to have remained in the control of the thing damaged and so the exclusion did not apply against the insured carpet cleaners. However, the case was decided on older wording that is not in use in today.

⁷⁸ [1954] 2 DLR 721, [1954] SCR 169.

Two early cases in Canadian jurisprudence show that the Court's decision will be influenced by the relationship between the parties, particularly between the contractor and the subcontractor. In *Interprovincial Pipeline v. Seller's Oil Fields Service*,⁷⁹ a 1976 decision of the Manitoba Court of Appeal, the subcontractor had been issued a work order by the contractor to clean a tank. The loss occurred while the subcontractor was cleaning the tank and the contractor sued. The insurer sought to rely upon the "care, custody or control" exclusion, without success. The Court indicated that "[the subcontractor] essentially assumed an operating responsibility towards the tank for the purpose of cleaning it. It did not exercise sufficient dominion or control to bring into play the exclusion."⁸⁰

Similarly, in *T.W. Thompson Ltd. v. Simcoe & Erie General Insurance Co.*,⁸¹ a 1976 decision of the Ontario Court of Appeal, the insured was a subcontractor on the construction of a school building. The insured subcontracted a portion of its work to a sub-subcontractor. A negligent employee of that sub-subcontractor started a fire that seriously damaged the building. In concluding that the exclusion could not successfully be invoked, the Court opined that if the exclusion applied in the circumstances "... the policy would be virtually worthless to the plaintiff to protect it against claims arising from its operations as a contractor". That comment typifies the Court's attitude towards the exclusion.

These two older authorities are still good law today. Further, the case of *Aetna Insurance Co. v. Construction ANMB Ltee*,⁸² a 1989 decision of the New Brunswick Court, demonstrates that the Courts will consider which party has responsibility for, as well as possession of, the property. The insurer rested its case for denying coverage on the care custody and control exclusion in a CGL policy. A crane was supplied to a construction firm and was operated by the owner's employee while on site, who also remained responsible throughout the project for its repair and maintenance. The crane in question buckled and was irreparably damaged. The Court held that the operators of the crane had control and custody of it on behalf of its owners at all times, and that the construction firm seeking indemnification for its costs in an underlying action was entitled to have been defended. The Court found that the construction firm had no dominion or control over the property and therefore the exclusion was inapplicable.

⁷⁹ [1976] 3 WWR 31.

⁸⁰ *Interprovincial Pipeline*, *supra*, at 36.

⁸¹ (1976), 68 DLR (3d) 240.

⁸² (1989), 94 NBR (2d) 375, [1989] NBJ No. 368 (QL).

The concept of dominion or control over the property in question is of central importance in determining whether this exclusion is applicable. This was confirmed in *T.W. Thompson Ltd., supra*, where the Court stated as follows:⁸³

The contractual arrangements for responsibility do not of themselves determine the issue of whether or not Thompson [the insured] in fact had the care, custody or control of the works. To have care of the property as envisaged by this exclusion, Thompson would have to have had some dominion or authority over the subject property.

Finally, in *Privest, supra*, the Court reviewed a care, custody and control exclusion as well, this time as applied to a general contractor. The insurer argued that since the project was under the supervision of the general contractor, the entire building was therefore in its care, custody and control when the alleged damage occurred. The Court stated that it was not satisfied that in a situation of renovations being performed to an existing building that control of the project went as far as the insurer argued it did. Mr. Justice Drost required more evidence to be led at a full trial before being able to ascertain the extent to which the general contractor had care, custody and control of the building under renovation.

Since many contractors are issued the IBC wording, it is instructive to examine what persuasive American authorities exist which have considered the IBC wording in the context of a construction loss. These cases suggest the existence of two general principles in the interpretation of the IBC "care, custody or control" exclusion:

Care, custody or control" presupposes the owner's permission. Tacit or implicit permission is not sufficient. (*Home Indemnity Co. v. Fuller*)⁸⁴

A mere right of access to the owner's premises, without the right to exercise control, is not sufficient to invoke the exclusion. (*Gibson v. Glenn Falls Ins. Co.*)⁸⁵

When determining whether the construction site is within the "care, custody or control" of the general contractor, the Courts will examine firstly the contract between the owner and contractor to determine which of the two maintains control over the work site. Secondly, the Courts will look to the *degree* of control which has been delegated to the contractor when the damage occurred.

Whether the general contractor has "care, custody or control" of the site during construction can be discerned from the terms of the contract. Usually, the general

⁸³ *Supra*, at p. 331.

⁸⁴ 427 S.W. 2d 97 (Tex. Civ. App.).

⁸⁵ 128 S.E. 2d 157 (S.C. 1962).

contractor's right to control the activities on the construction site is sufficient to trigger the exclusion. For example, in the Missouri Court of Appeals decision *Estrin Construction Company v. The Aetna Casualty and Surety Company*,⁸⁶ the general contractor, hired to construct a warehouse, obtained both a CGL and Builders' All Risk policy as required by contract. During construction a heavy wind toppled an unfinished wall. The loss was paid on the All Risk policy. The All Risk insurer then subrogated against the architect and, in turn, the architect sought indemnity pursuant to the terms of the contract from the general contractor. The terms of the contract required the general contractor to:

...protect the work from damage and the property of the owner from injury [and]

...supervise the progress of the work and to "keep on his work ... a competent supervisor and any necessary assistants.

Commenting on the approach to be taken in respect of the exclusion, the Court stated:

The general contractor usually performs under a written contract which defines the party to control the property at any given stage of the work usually the general contractor, itself. That allocation of control, as in the case of [the general contractor], also impinges on the obligation to insure and determines the cost of the premium. The terms of a written contract which delineates the control of an insured over the construction, therefore, bear on the determination of care, custody or control by the contractor over the real property at any given stage of work.⁸⁷

In the Court's view, the duty to supervise a duty that continued during non-working hours reflected a right of control that was paramount to any dominion the subcontractors, architects, or other personnel on the job could assert under the contract. For that reason, the general contractor's loss fell within the exclusion.

However, for subcontractors under American law, the case is somewhat different. Subcontractors are not generally party to any contract with the owner and, as a consequence, the exclusion is of lesser application for the reason that mere access to, or handling of, property as a means to accomplish one's work will not fall within the exclusion. Commenting on the scope of the exclusion in the context of a subcontractor's loss, in *Goswick v. Employer's Casualty Co.*,⁸⁸ the Texas Courts have stated:

This is the language of the traditional manufacturers' and contractors' comprehensive liability policy form. If the insured under such a policy is

⁸⁶ 612 S.W. 2d 413 (Mo. App. 1981).

⁸⁷ *Estrin, supra*, at 429.

⁸⁸ 440 S.W. 2d 287 (Tex. 1969).

repairing or installing item #1 adjacent to item #2 and within the premises of a building, when his negligence causes damage to items #1 and #2, as well as the building, the exclusion denies coverage only as that property damaged which was within his possessory control. The cases have limited this 'control' to the particular object of the insured's work, usually, personally, and to other property which he totally and physically manipulates...⁸⁹

If the property damaged is merely incidental to the property upon which the work is being performed by the insured, it is not considered to be in the "care, custody or control" of the insured. Numerous examples of this rule exist. For example, in *Boston Insurance Co. v. Gable*,⁹⁰ the sub-contractor was granted permission by the general contractor to refinish the floors of a residential home. The loss arose as a result of the negligence of the subcontractor's employees. In concluding that the exclusion did not apply, as "care, custody or control" was vested with the general contractor, the Court stated:

[care], custody or control of the house itself was retained ... by the general contractor. [D]efendant Gable was given temporary access to the house in order to perform work under his subcontract. The house itself was merely incidental to the floors upon which work was to be performed...⁹¹

VII. SUMMARY

This paper has surveyed recent Canadian and American judicial developments that affect four of the most common exclusions found in a CGL policy, as well as the extension coverage afforded by the Broad Form Property Endorsement. It shows that the practical effect of those exclusions is that many, if not most, of the "business risks" associated with a construction project are borne by the general contractor, and not the insurer.

⁸⁹ *Goswick, supra*, at 289-90.

⁹⁰ 352 F. 2d 368 (5th Cir. 1965).

⁹¹ *Boston, supra*, at 368.