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GENERAL LIABILITY INSURERS IN BRITISH COLUMBIA MAY NOT HAVE TO DEFEND ON "LEAKY BUILDING LAWSUITS" IF THE INSURED IS A GENERAL CONTRACTOR: THE SHIFTING JUDICIAL TIDE

In what can be characterized as a dramatic shift in judicial direction a British Columbia Supreme Court Judge has concluded that the general liability insurer and wrap up liability insurer of a general contractor are not obligated to defend when the lawsuit concerns "water ingress" to the very building the general contractor constructed.

Since 1998 over 600 "leaky building" lawsuits have proceeded to mediation in the belief that the liability insurer for a general contractor had a "duty to defend" if the lawsuit concerned solely "water ingress" and merely damage to the building the general contractor agreed to construct. In agreeing to contribute to mediated settlements liability insurers were relying principally upon two earlier British Columbia Supreme Court decisions, *AXA Pacific Insurance Co.* v. *Guildford Marquis Towers* and *F. W. Hearn /Actes – A Joint Venture Ltd.* v. *Commonwealth Insurance Co*, in which it had been concluded that the liability insurer of the general contractor did owe a "duty to defend".

In *Swagger Construction Ltd.* v. *ING Insurance Company Canada et al*, a decision issued September 9, 2005, the B.C. Supreme Court reached the complete opposite result by concluding that if the damage being complained of related solely to the building the general contractor was under obligation to complete there could be no potential "duty to defend". This decision is clearly going to cause the Canadian insurance industry to pause and seriously consider its ongoing obligations in these cases. The need to pause is particularly acute as the province braces for a vast number of yet to be litigated claims involving "leaky glass curtain wall highrise buildings" and potentially hundreds of "leaky schools".

The facts are very simple. The insured had been the general contractor for the new Forestry Building at the University of British Columbia. The University claimed damages by reason of the fact that there were "water ingress" problems that resulted in the entrapment of moisture in the building wall.

The "trigger" for coverage was *"physical injury to tangible property"* or *"loss of use of "tangible"* property. The Court concluded that when examining the defence obligation in relation to a general contractor there must be an allegation of damage to property other than the very object the insured

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has constructed. So, to "trigger" a defence there would need to be, for example, an allegation that the general contractor's work on the building caused damage to an adjacent building, or, potentially, chattels inside the building which were not part of the building construction.

In reaching this conclusion the Court elected not to follow the earlier British Columbia cases that reached an opposite conclusion in view of the fact that the earlier cases entailed a grant of coverage that was potentially wider by the use of the words *"damage to property"* rather than *"damage to tangible property"*. That potentially broader grant of coverage, often seen in policy wordings pre-dating 1985, could attract a "duty to defend" since *"damage to property"* can embrace claims such as "diminution in value" to the building.

The Court's decision made clear that to reach any differing conclusion had the practical effect of turning a general contractor's liability policy into a "first party warranty coverage" for the building construction. That is not the purpose of a general liability policy which is premised, in large measure, upon the emergence of damage to third party property other than the insured's "work" or "product".

The practical result of this decision is to bring the case law in British Columbia more in line with Ontario decisions that have adopted a similar approach; particularly the Ontario decisions in *Celestica Inc.* v. *ACE INA Insurance Company* and *A.R.G. Construction Corp.* v. *Allstate Insurance Company of Canada.*

Equally important as the result is a recognition of the circumstances in which this case will have no application and a "duty to defend" may still exist:

1. it does not alter the "duty to defend" issue if your insured is a sub-contractor as opposed to a general contractor. In the context of a sub-trade the spectre of one sub-trade causing damage to another sub-trade's work can attract a "duty to defend";

2. the decision does not apply to older liability wordings that use a broader grant of coverage than *"physical injury to tangible property";*

3. the decision likely does not apply if the liability policy includes a Broad Form Property Endorsement which has the practical effect of "liberalizing" coverage for general contractors in respect of portions of the construction that entail damage by one of the insured's sub-trades; and

4. the decision only applies when only the building itself is damaged. If there is damage to chattels inside the building, or, to an adjacent building that is "true third party damage" such a claim will attract a "duty to defend".

The practical effect of this decision, assuming the Court of Appeal agrees with this reasoning, is that general liability insurers will be more hesitant to participate in a mediation process when the insured is a general contractor and the damage is confined solely to the building structure that the insured was entrusted to construct to completion.

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