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Insurance Bulletin

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PROGRESSIVE HOMES LTD. V. LOMBARD GENERAL INSURANCE CO. OF CANADA, 2010 SCC 33

David R. Mackenzie

This morning the Supreme Court of Canada released its decision in *Progressive Homes Ltd. v. Lombard General Insurance Co.*, on review from the British Columbia Court of Appeal (the decision may be found online at http://scc.lexum.umontreal.ca/en/2010/2010scc33/2010scc33.html). The Supreme Court has overturned the decision of the BC Court of Appeal, and has ruled that Lombard owed a duty to defend to its insured, Progressive Homes Ltd.

This decision is of critical importance for liability insurers in Canada, as it resolves divergent lines of case law which have emerged across the country in respect of coverage for claims alleging construction deficiencies.

The Action arose out of a denial of coverage to Progressive Homes, who was being sued for having acted as the general contractor in the construction of four buildings alleged to have deficient building envelopes. Progressive Homes' CGL insurer denied coverage for the claim, asserting that all of the damages alleged were the normal expected consequences of faulty workmanship, and therefore the alleged damage was not caused by an "accident" or an "occurrence", nor did it constitute "property damage" as required by the policies.

In the decision below, the BC Court of Appeal sided with the insurer, ruling that the claim made against the general contractor did not allege fortuitous "property damage", as defined in Progressive Homes' liability policies, and therefore did not fall within the ambit of the coverage provided. The rulings of the BC courts stood in contrast to those of courts in Ontario (*Bridgewood Building Corp. v. Lombard General Insurance Co. of Canada*) and Saskatchewan (*Westridge Construction Ltd. v. Zurich Insurance Co.*) which each employed a broader reading of the coverage grant in similar liability policies.

This morning's decision of the Supreme Court of Canada has overruled the BC Court of Appeal, with Justice Rothstein writing for a unanimous court, as summarized in the Court's headnote:

> The duty to defend only requires a possibility of coverage, and that possibility is made out in this case. The pleadings reveal a possibility of "property damage". The pleadings describe water leaking in through windows and walls and allege deterioration of the building components resulting from water ingress and infiltration. The pleadings also describe defective

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property. The pleadings also sufficiently allege an "accident" for the purpose of deciding whether Lombard owes a duty to defend. There is no reference to intentional conduct by Progressive which would suggest that the property damage was expected or intended. The pleadings allege negligence, which, on its face, suggests that the damage was fortuitous. In addition, it is clear from the pleadings that the damage alleged is the result of "continuous or repeated exposure to conditions", which squarely fits within the definition.

The Issues in Contention

It was alleged in the underlying action against Progressive Homes that it, as the general contractor in the construction of the four buildings in issue, was liable to the building owners because the owners had suffered damages as the result of the failure of, and water leakage through each of the building envelopes. The claim was submitted to Progressive Homes' insurer, which ultimately denied coverage on the basis that the damage alleged pertained only to structural elements which formed part of the general contractor's obligations under its construction contract (and did not allege damage to third party property). The insurer further denied coverage on the basis that damage was the natural result of the alleged faulty workmanship, and therefore did not arise as the result of an "accident" or "occurrence". The denial of coverage was upheld in the BC Supreme Court in a decision found at 2007 BCSC 439.

The trial court's decision was affirmed by a 2-1 majority in the BC Court of Appeal. The analysis of the majority affirmed important aspects of a line of reasoning which was begun in the BC Supreme Court decisions in *Swagger Construction Ltd. v. ING Insurance Company of Canada* 2005 BCSC 1269, and *GCAN Insurance Company v. Concord Pacific Group Inc. et al*, 2007 BCSC 241. Each of these decisions concerned coverage for claims alleging defective construction, and in each the determination was made that requisite elements of the insuring agreement were not satisfied. The BC courts consistently found that allegations of construction defect were not the result of an accident or occurrence, as the alleged damage was the natural consequence of faulty workmanship. Further, they found that the damages alleged pertained to the buildings themselves rather than to third party property and, accordingly, they determined that no "property damage" was being alleged. While not wholly adopting all aspects of the analysis found in *Swagger* and *GCAN*, the Court of Appeal in *Progressive Homes* ruled that the requirements of the insuring agreement were not met and no coverage was owed. Justice Ryan, for the majority, ruled that "the expected consequences of poor workmanship can hardly be classified as fortuitous".

Standing in contrast to the BC decisions were decisions from Courts of Appeal of Ontario and Saskatchewan. In both *Bridgewood Building Corp. v. Lombard General Insurance Co. of Canada* (2006), 266 D.L.R. (4th) 182, 79 O.R. (3d) 494 (C.A.) and *Westridge Construction Ltd. v. Zurich Insurance Co.* 2005 SKCA 81, an expansive coverage obligation was found to be owed to a general contractor facing allegations of construction defect. In both of those decisions the courts determined that the insuring agreement found in the Broad Form Property Damage Endorsement (variations of which were present in all policies in issue) was intended to provide

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coverage to a general contractor where the defect in construction was the result of the negligence of a subcontractor.

Thus the battle lines in the Supreme Court of Canada were drawn between the narrow construction given to insuring agreements in British Columbia and the expansive construction given by courts in other provinces.

The Supreme Court of Canada

The Supreme Court's reading of the insuring agreement was expansive, and focused on the specific policy wording in issue rather than on "general principles". In this respect the Supreme Court's analysis differed from the fortuity analysis provided in the British Columbia court.

The Supreme Court's focus on the specific language used mandated a departure from the British Columbia analysis in a number of important respects, particularly with respect to the nature of an "accident" or "occurrence", and with respect to the scope of the term "property damage".

The Court has specifically rejected insurers' contention that "property damage" cannot be found where the only damage alleged is to the building itself. Citing to the lower court rulings in *Bridgewood Building Corp. (Riverfield) v. Lombard General Insurance Co. of Canada* (2006), 266 D.L.R. (4th) 182 (Ont. C.A.), at paras. 6-7; and *Westridge Construction Ltd. v. Zurich Insurance Co.*, 2005 SKCA 81, 269 Sask. R. 1, at para. 38., Justice Rothstein found:

> I cannot agree with Lombard's interpretation of "property damage". The focus of insurance policy interpretation should first and foremost be on the language of the policy at issue. General principles of tort law are no substitute for the language of the policy. I see no limitation to third-party property in the definition of "property damage". Nor is the plain and ordinary meaning of the phrase "property damage" limited to damage to another person's property. Indeed, the Ontario and Saskatchewan Courts of Appeal reached the same conclusion with respect to similar definitions of "property damage" in CGL policies.

In this regard, the Court has rejected the analysis undertaken by the BC courts which referenced the "complex structure theory" set out in the Supreme Court's decision in *Winnipeg Condominium Corporation No. 36 v. Bird Construction Co.*, [1995] 1 S.C.R. 85, which was a tort case. The BC courts had employed the "complex structure theory" to ground their rulings that buildings constituted an indivisible whole for insurance coverage purposes. It is now clear that damage caused to one part of a building by another part of the same building can constitute "property damage" under liability policies:

> I would construe the definition of "property damage", according to the plain language of the definition, to include damage to any tangible property. I do not agree with Lombard that the damage must be to third-party property. There is no such restriction in the definition.

The Supreme Court has also rejected the BC Court's fortuity analysis, finding that the concept of fortuity is built into the definition of accident itself:

> I cannot agree with Justice Ryan's conclusion that such an interpretation offends the assumption that insurance provides for fortuitous contingent risk. Fortuity is built into the

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> definition of "accident" itself as the insured is required to show that the damage was "neither expected nor intended from the standpoint of the Insured". This definition is consistent with this Court's core understanding of "accident": "an unlooked-for mishap or an untoward event which is not expected or designed" (*Gibbens*, at para. 22; *Martin v. American International Assurance Life Co.*, 2003 SCC 16, [2003] 1 S.C.R. 158, at para.20; *Canadian Indemnity*, at pp.315-16; originating in *Fenton v. Thorley & Co.*, [1903] A.C. 443, at p. 448). When an event is unlooked for, unexpected or not intended by the insured, it is fortuitous. This is a requirement of coverage; therefore, it cannot be said that this offends any basic assumption of insurance law.

Accordingly, the analysis as to whether or not faulty workmanship constitutes an "accident" must be determined on a case by base basis:

> First, whether defective workmanship is an accident is necessarily a case specific determination. It will depend both on the circumstances of the defective workmanship alleged in the pleadings and the way in which "accident" is defined in the policy. I, therefore, cannot agree with Lombard's view that faulty workmanship is *never* an accident. This Court's jurisprudence shows that there is no categorical bar to concluding in any particular case that defective workmanship is an accident. In *Canadian Indemnity Co. v. Walkem Machinery & Equipment Ltd.*, [1976] 1 S.C.R. 309, at pp. 315-17, the Court found that the negligent repair of a crane constituted an accident. Therefore, I see no impediment to concluding the same in the present case, unless of course it is not supported by the specific language of the policy.

On the basis of the foregoing, the Court determined that the requirements of the insuring agreement were met, and turned its attention to the series of "work performed" exclusions found in the policies. The first exclusion, found in the Broad Form Extension, read:

> 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. [Emphasis added by the Court.]

The Court read the exclusion very narrowly to exclude only "damage caused by Progressive to its own work". The claim made against Progressive Homes was found to allege considerable damage to elements of the building which potentially fell outside the scope of Progressive Homes "own work". Accordingly, the exclusion did not apply to negate coverage.

Turning its attention to the second exclusion, which excluded 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 Court similarly found that this exclusion did not eliminate the possibility of coverage:

> Again, I find there is a possibility of coverage under the second version of the policy. It will have to be determined at trial which "particular parts" of the work caused the damage. Repairs to those defective parts will be excluded from coverage under this version, regardless of whether they were the result of Progressive's own work or the work of subcontractors. If, as Lombard alleges, the buildings are wholly defective, then the exclusion will apply and Lombard will not have to indemnify Progressive. However, the pleadings allege that there was resulting damage: deterioration of the building components resulting from water ingress and infiltration. This is sufficient to trigger the duty to defend under the second version of the policy.

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The last form of exclusion contained what has been called the "subcontractor exception", which provided: "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". As with the first two exclusions, the Court found that the third exclusion did not eliminate the possibility of coverage:

> The third version of the "work performed" exclusion is simply a combination of the first and second versions. The "exclusion" portion of this exclusion clause is identical to the second version of the policy, thus it only excludes coverage for defective property. Coverage would remain for resulting damage. This version of the policy also expressly incorporates the "subcontractor exception", which was previously implicit in the Broad Form Extension Endorsement. The subcontractor exception expands coverage again. It would allow for coverage of defective work where it is work completed by a subcontractor.

The Court clarified that its ruling pertained only to the duty to defend, and that the determination of what damage was actually covered by the insuring agreement, and excluded by the exclusions would have to wait until the evidence was established at trial. However, the Supreme Court ruled that the allegations in the underlying claim triggered Lombard's duty to defend under each of its policies.

This morning's Supreme Court decision will require considerably more consideration and analysis than we have provided here. We will review the decision in more depth, and provide more considered analysis in the coming weeks. ■

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