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Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co., 2016 SCC 37

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On September 15, 2016, the Supreme Court of Canada released the highly anticipated *Ledcor* decision. In its reasons, the Court assessed the scope of the faulty workmanship exclusion found in a Builders Risk policy, and clarified the standard of review appellate courts should give to standard form contracts. The decision will be of considerable concern to insurers.

Facts

Station Lands Ltd. retained Ledcor Construction as a construction manager to coordinate construction of Edmonton's EPCOR Tower. Station Lands then entered into contracts with various trade contractors to supply and install the goods and services needed to construct the building.

At the very early stages of the project, Station Lands purchased a "Builders Risk" policy, which covered "all risks of direct physical loss or damage…". The named insureds on the policy were Station Lands and Ledcor, while additional insureds included the owners, contractors, sub-contractors, architects, engineers, consultants, and all individuals or firms providing services or materials to or for the named insureds. The policy, however, excluded "The cost of making good faulty workmanship … unless physical damage … results, in which event this policy shall insure such resulting damage".

The building's windows were supplied and installed by a trade contractor. As construction neared completion, concrete splatter, paint specs, and other construction dirt remained on the windows. Another trade contractor, Bristol Cleaning, was retained by Station Lands to "[p]rovide all necessary equipment, manpower, [and] materials required to complete a construction clean" of the building's windows.

During the cleaning process, Bristol Cleaning caused damage to the windows by using inappropriate tools and methods. The glass had to be replaced at considerable expense.

Bristol Cleaning was obliged under the construction contract to pay the cost of replacing the glass it had damaged. Bristol Cleaning sought coverage under the Builders Risk policy. The insurers denied coverage, asserting that the damage to the windows was excluded through operation of the “making good faulty workmanship” exclusion.

The Trial and Appellate Decisions

The Alberta Court of Queen’s Bench concluded Bristol Cleaning’s work constituted “workmanship” and that it had been faulty, but that the exclusion clause did not exclude the damage to the windows from coverage. In coming to this determination, the exclusion clause was deemed ambiguous and the interpretations of “making good” advanced by the insureds and insurers were equally plausible. *Contra proferentem* was found to apply, resulting in a ruling against the insurers.

The Alberta Court of Appeal reversed the trial judge’s decision and declared that the damage to the tower’s windows was excluded from coverage. Applying a correctness standard of review to the interpretation of the policy, the Court held that the trial judge had improperly applied the rule of *contra proferentem* because the exclusion was not ambiguous.

The Court of Appeal proceeded from the premise that, because the base coverage under the policy was for “physical loss or damage”, the exclusion clause had to exclude physical damage of some kind, or else it would be redundant. Under this analysis, the key determination was how to separate excluded physical damage falling within the “cost of making good faulty workmanship” and other physical damage that would be covered as “resulting damage”.

The Court of Appeal concluded that the damage to the windows was physical loss excluded as the “cost of making good faulty workmanship” because it was neither accidental nor fortuitous but was directly caused by the scraping and wiping motions involved in Bristol Cleaning’s work. According to the appellate court, the windows themselves formed a core part of the work to be undertaken, and, therefore, damage to them fell within the scope of the faulty workmanship exclusion.

The Supreme Court of Canada’s Decision

Ledcor appealed the decision to the Supreme Court of Canada, both in respect of the standard of review to be applied by an appellate court to a standard form insurance policy and with regard to the proper interpretation of the “making good faulty workmanship” exclusion contained in Builders Risk insurance policies.

1. Standard of Review

The standard of review issue arises from the Court’s previous holding in *Sattva Capital Corp. v. Creston Moly Corp.*. In *Sattva*, the Court had held that contractual interpretation is a question of

mixed fact and law subject to deferential review on appeal. The question before the Supreme Court here was whether or not the “standard form” nature of the insurance policy created an exception to the *Sattva* rule, such that appellate review should be undertaken on a “correctness” standard, rather than a deferential standard.

The *Ledcor* Court arrived at this finding for two reasons. First, while a proper understanding of the factual matrix is crucial to the interpretation of many contracts, it is often less relevant for standard form contracts because “the parties do not negotiate terms and the contract is put to the receiving party as a take-it-or-leave-it proposition”. While the parties to an insurance contract may negotiate over matters like the cost of premiums, the actual conditions of the insurance coverage are generally determined by the standard form contract.

Second, because standard form contracts are highly specialized contracts that are sold widely to customers and even industries without negotiation of their terms, their interpretation could affect a large number of people. As a result, it would be undesirable for courts to interpret identical or very similar standard form provisions inconsistently. Consistency is particularly important in the interpretation of standard form insurance and, because the interpretation of these contracts has precedential value, questions relating to their interpretation are “pure questions of law”.

The Court acknowledged that there may be circumstances in which a standard form contract will attract the deferential standard. For example, a deferential standard may apply where the standard form contract is specific to the particular parties or where changes to the standard form were negotiated by the parties.

In the insurance context it is not difficult to foresee circumstances in which different standards of review may apply to the same policy. Standard form provisions may be reviewed on a correctness standard, but manuscript endorsements negotiated between the insurer and insured may be subject to the Court’s ruling in *Sattva,* such that the particular circumstances in which the endorsement was drafted are relevant to its interpretation. If such circumstances are properly taken into account in assessing the endorsement, a standard of review that is deferential to the trier of fact may be appropriate. A key question for determination going forward may be whether the policy provision in issue is “standard form” or not.

2. What is the scope of the “making good faulty workmanship” exclusion?

Having determined that that standard of review was correctness, the Court turned to the specific provisions found in the policy. The insurer did not dispute that the terms of the insuring agreement were satisfied. Rather, the term in issue was the exclusion for “the cost of making good faulty workmanship”. The interpretation given by the Court to that exclusion may be controversial. In short, the Court ruled that Bristol Cleaning’s “work” was limited to the cost of the cleaning itself, and therefore the damage to the windows was covered “resultant damage”. While this ruling marks a shift of risk to insurers from contractors in similar circumstances, the Court’s ruling should be carefully analysed as the Court took note of factors which may limit the

reach of the decision. It is important briefly to outline the factors upon which the Court reached its conclusion.

The Court began its review by reciting basic governing principles of insurance policy interpretation, which are well known and settled:

i. where the language of the insurance policy is unambiguous, effect should be given to that clear language, reading the contract as a whole;

ii. where the policy's language is ambiguous, general rules of contract construction must be employed to resolve that ambiguity; and

iii. if ambiguity still remains after the above principles are applied, the *contra proferentem* rule be employed to construe the policy against the insurer.

While both parties asserted that the exclusion was unambiguous, they took diametrically opposed positions on what the exclusion meant. Accordingly, the Court disagreed with both parties and ruled that the exclusion was ambiguous. Having made that ruling, it engaged in the policy interpretation analysis set out in prior rulings and reaffirmed in *Ledcor*.

The Court first reviewed the reasonable expectations of the parties in entering into what it acknowledged was a standard form contract. As the parties entered into a standard form contract, the Court found it inappropriate to assess their individual motivations. Rather, their purpose is found in the general purpose of the contract itself in the marketplace. Here the Court found that the purpose of a Builders Risk insurance policy had been ruled on in the Court's prior judgment in *Commonwealth Construction Co. v. Imperial Oil Ltd*.

As set out in *Commonwealth Construction,* the purpose of a Builders Risk policy is to provide broad coverage for construction projects and certainty and stability by granting coverage that reduces the need for private law litigation. Builders Risk policies are widely used in Canada and, in purchasing these policies, contractors believe that indemnity will be available in the event of an accident or damage on the construction site arising as a result of a party's carelessness or negligent acts. Consequently, an interpretation of the exclusion clause that precludes coverage for any and all damage resulting from a contractor's faulty workmanship merely because the damage results to that part of the project on which the contractor was working would, in the Court's view, undermine the purpose behind such policies and would essentially deprive insureds of the coverage for which they contracted. The reasonable expectations of the parties here, as found by the Court, was that Bristol Cleaning and others would be covered broadly against accidents and errors arising out of the construction project, subject only to narrow exclusions.

The Court did not stop its analysis there. It acknowledged that, in discussing the interpretation of insurance policies, there is a need to avoid interpretations that would bring about unrealistic results or results that would not have been contemplated by the parties. It took note of the admonition found in the *Consolidated Bathurst* case that neither party should receive a windfall

as the result of judicial interpretation of the policy. In its assessment, though, because of the broad coverage objective underlying Builders' Risk policies and significant premiums charged, no such windfall would result here if the damage to the windows fell within cover.

Finally, the Court reviewed the jurisprudence in which the exclusion had been previously interpreted. It disagreed with the insurers' assertion that the case-law supported the insurer's position. Rather, it concluded that "many of these faulty workmanship and faulty design decisions can be read as limiting the faulty workmanship exclusion to only the cost of redoing the faulty work". It addressed a number of the cases cited by the parties and carefully assessed the scope of the policyholder's work in each. In the *Sayers* decision of the Ontario Court of Appeal, the policyholder's work extended not merely to installing equipment, but also to keeping it dry. Damage to the equipment as the result of getting wet was properly excluded from coverage, as keeping the equipment dry was part of the policyholder's work. In the *Bird Construction* decision of the Saskatchewan Court of Appeal the policyholder was responsible for fabrication and erection of a truss that had collapsed. The exclusion applied not simply to the cost of erecting a truss again but also to the cost of repairing the truss itself, as the truss formed a part of the insured's work. The Court acknowledged that had Bristol Cleaning been responsible for installing the windows in good condition, and not merely cleaning them, damage to the windows themselves would have been excluded. One wonders whether Bristol Cleaning would have been covered had it contractually agreed to "clean the windows without scratching them". Careful analysis of the scope of the insured's work will be required going forward, and will likely be the source of dispute.

Bristol Cleaning was covered against the cost of the damaged windows because its work was limited to cleaning the windows only: the cost of re-doing the cleaning itself was excluded. However, the analysis of the case-law provided by the Court suggests that the ruling may not wholly be to the benefit of policyholders. Additional considered analysis of the Court's decision will be required, particularly where insurers have denied or limited coverage based on the exclusion in issue.

One final note should be made. The Court's analysis may have reach beyond the construction/Builders Risk context. Particular attention should be paid to paragraph 83 of the Court's decision in which it stated:

I also note that interpreting the Exclusion Clause as precluding from coverage only the cost of redoing the faulty work breaks no new ground in the world of insurance, as it mirrors the approach courts have adopted when construing similar exclusions to comprehensive general liability insurance policies. These policies cover the risk that the insured's work might cause bodily injury or property damage. However, they generally contain a "work product" or "business risk" exception, which excludes from coverage the cost of redoing the insured's work

The implication of this passage is that the Court's view of what constitutes the insured's "workmanship", "work", or "work product" in other forms of coverage (particularly CGL, but also potentially E&O and other forms) will be consistent with the Court's ruling here.

Insurers will wish to re-evaluate existing coverage positions under such policies in light of this decision, and may also wish to re-evaluate the wording of their forms, premiums charged, and deductibles.