

Insuring Against Loss at the Construction Site

A. Introduction

The typical construction project, if there is such a beast, presents insurable risks of two kinds. There is the risk of damage to property itself, and the risk of liability for injury to persons or other property as a result of the construction activities. The insurance industry has developed a myriad of products to insure against these risks. Traditionally, there were three standard types of policies that would respond to a given risk: property insurance, general liability insurance, and errors and omissions insurance. The prevailing assumption was that a loss would trigger only one policy coverage to the exclusion of the other coverages. However, with the lines between contractor and designer blurring, the insurance industry is scrambling to create new products to insure against these new types of risk. This paper will look at the types of coverage available for the construction project.

Occurrence and Claims-Made Policies

For coverage to be afforded under a policy of insurance, a specified event must take place during the policy period. How that event is defined will dictate whether the policy is an “occurrence-based” policy or is written on a “claims-made” basis.

With occurrence-based policies, the *accident or condition* that causes the bodily injury or property damage must have occurred during the policy period. In contrast, claims-made policies require that the claim be first made against any insured during the policy period.

An occurrence policy obligates the insurance company to pay for claims arising out of occurrences during the policy period regardless of when the claim is reported. The policyholder is covered for any incident that occurs during the term of the policy regardless of when the claim arising from the incident is reported. In some situations the claim might be made many years after the incident occurred. This leads to uncertainty for both the insured and the insurer.

A claims-made policy protects an insured against claims or incidents that are reported while the policy is in force. A claims made policy provides coverage for acts occurring prior to, or during, the claims-made policy period.

B. Property Insurance

Property insurance often referred to as builder's risk or all-risk coverage, is insurance on the property which is in the course of construction against damage during construction. Both the owner and the contractor are named insureds (although additional parties may be added for an additional premium). The policy period starts with the commencement of construction and continues at least until the building is complete and accepted by the owner. Property policies may be written on a claim's-made or occurrence basis.

The approach to property, or first party, coverage is either to insure against specific perils, such as fire, collapse, windstorm, theft and vandalism, or to insure against all risks with stated exclusions. Under the former, the insured must show that a loss was caused by a peril insured, while under the latter, in the event of a loss, the insurer may only escape liability if a stated exclusion applies. Under either approach, the term "all-risk" is potentially misleading and most certainly a misnomer.

Although the exact scope of coverage varies, an all-risk policy generally covers direct physical loss or damage to property which is in the course of construction, including works and materials connected with the construction and removal of debris resulting from the destruction of covered property. It will not cover other costs such as those resulting from delay in completion of the work. The classes of property excluded from coverage vary substantially between policies. However, exclusions almost always include:

- a. contractor's equipment and tools;
- b. motor vehicles;
- c. aircraft and watercraft;
- d. contractors' portable or temporary buildings, and
- e. boiler and machinery.

Property excluded from coverage under a Builder's Risk policy can often be covered by other insurance. It is important to carefully review the exclusions in the proposed insurance policy to ensure that they do not result in unacceptable gaps in coverage, and if they do, to arrange for additional coverage by modifying the all-risk policy itself or by purchasing separate insurance.

Perils usually excluded from coverage include:

- a. the cost of making good faulty or improper material, workmanship or design;
- b. mechanical or electrical breakdown;
- c. theft or dishonest act of the insured's employees, officers or agents;
- d. war, insurrection;
- e. loss of use or occupancy;

The faulty workmanship exclusion has given rise to extensive litigation. Its purpose serves to avoid a situation where insurers must pay for work that has to be done twice because there was something wrong with the way it was done the first time. While the elimination of coverage for the cost of making good the faulty workmanship, material or design is excluded, ensuing loss caused to other parts of the property insured is often not. An example is illustrative of the distinction.

In *B.C. v. Royal Ins. Co. of Canada* [1992] C.I.L.R. (B.C.C.A.), the Crown contracted for the channelization of a creek. The project required a diversion of the creek so that the bed and the banks could be reshaped by concrete. The project was insured under a policy which excluded damages resulting from faulty or improper design but covered resultant damage to insured property from an excluded peril. While the project was under way, there was heavy rain and the creek water started to rise. The diversion pipe could not handle the water flow and heavy flow of water rushed down the creek bed, causing substantial damage to the diversion pipe and to the work in progress. The Crown claimed under the policy for the costs of restoring the damaged work in progress but not for the cost of replacing the diversion pipe. The insurer denied liability and appealed a decision finding for the Crown. The issues on appeal were whether the damage was from "faulty or improper design"; whether the damage was "resultant damage to the property"; and whether the damage was from "flood" as to set in the deductible clause.

Lambert J.A., for the Court, held that the damage to the work was covered, stating:

Damage for faulty or improper design encompasses all the damage to the very thing that was designed faultily or improperly. Resultant damage is damage to some part of the insured property other than the part of the property that was faultily designed. *Simcoe & Erie General Insurance Company v. Royal Insurance Company*, [1983] I.L.R. 1-1597 (Alta. Q.B.) presents a very clear example of the operation of a similar

clause. A bridge was being built. As it reached completion, rails for another bridge were stored on top of it. Because of a design error in the substructure of the bridge, the bridge collapsed. The superstructure had no design error but of course it also collapsed. The stored rails were destroyed. It was decided that the design error was a design error affecting the whole work, namely the bridge; that the bridge was an integral whole; and that it would be improper to separate the bridge into separate items of property, namely, substructure and superstructure, and so regard one of the parts (the substructure) as excluded from coverage through being damaged by faulty design, and the other part (the superstructure) as being excepted from the exclusion as being resultant damage. On the other hand, it was decided that the damage to the stored rails was resultant damage. With respect, I regard that analysis by Mr. Justice Kryczka of the application of a similar clause to the clause in this case as being accurate...

In this case it is my opinion that the piped channel diversion system which was the part of the work that was alleged to be the subject of faulty design was not an integral part of the work being constructed, or, perhaps more accurately, the work being constructed was not an integral part of the diversion system. The diversion system was a necessary but conceptually separate construction device. There are two principal reasons which support my opinion. The first is that the diversion system had no continuing function in the completed channelization works and was not a designed part of them. The second is that the construction contract treated the diversion system as a construction device separate from, and not a part of, the designed project. The fact that the particular diversion system that was adopted was to remain in place after the work was completed does not make a design flaw in the diversion system a design flaw in the channelization work for which damage is claimed. In short, the diversion system was not an integral part of the channelization work even though it was, by later design, incorporated in it.

Obligations of the Insured after a loss

An insured must comply with certain obligations after a loss in order to recover under a builder's risk policy. Failure to do so, could jeopardize coverage.

The obligations of the insured can be found within the policy. As well, the *Insurance Act* sets out obligations of the insured following a loss within the Statutory Conditions. Whether the Statutory Conditions apply depends on how the policy is characterized (that is, whether it is primarily a fire policy, or not) and whether the policy incorporates, by reference, the Statutory Conditions. The issue is largely moot as most builder's risk policies incorporate the Statutory Conditions. A copy of the Statutory Conditions is attached to this paper.

Under Statutory Condition 6, an insured must give notice in writing to the insurer "forthwith" after the occurrence of any loss or damage to the insured property which is covered by the insurance policy.

Under Statutory Condition 6, the insured must deliver to the insurer "as soon as practicable" a proof of loss verified by a Statutory Declaration indicating, among other things, what property was destroyed or damaged, details of the amount claimed, and when and how the loss occurred.

Statutory Condition 8 permits the notice of loss and proof of loss to be given by an agent rather than the insured in some circumstances.

Imperfect compliance with the notice requirements may afford an insurer an opportunity to deny coverage for the loss. While it is open to a court to grant relief for failure to comply with the notice requirements, if an insurer can show that it is prejudiced by the lack of compliance, there will likely be reluctance on the court's behalf to grant relief.

Section 22 of the *Insurance Act*, provides a general limitation period, to commence an action against an insurer, of one year from the furnishing of a "reasonably sufficient proof of loss". Further, if Statutory Condition 14 is applicable (see comments above), then every action or proceeding against the insurer for the recovery of any claim is absolutely barred unless commenced within one year after the loss or damage occurs.

C. General Liability Insurance

The commercial or comprehensive general liability (“CGL”) policy is an insurance product to protect the insured from third party liability for unexpected personal injury or property damage resulting from the insured’s negligent behavior or the behavior of those for whom the insured is responsible. As with property policies, coverage is restricted through the inclusion of policy exclusions. CGL policies are typically written on an occurrence basis, but are available on a claims-made basis as well.

The standard CGL policy creates two fundamental obligations on the insurer:

1. to defend any civil action brought against the insured claiming damages for bodily injury or property damage; and
2. to pay on behalf of the insured all sums which the insured might become legally obligated to pay as compensatory damages because of bodily injury or property damage caused by accident;

It is said that the duty to defend is independent from, and more expansive than, the duty to indemnify. If a claim, as pleaded, potentially gives rise to indemnification, the duty to defend is triggered. In other words, an insurer must defend a claim which could, not will, fall within the indemnification provisions of the policy.

As noted above, CGL policies are typically written on an occurrence basis. Where there are multiple liability policies, or gaps in coverage, it will be necessary to determine the timing of the occurrence of the bodily injury or property damage. For if the loss did not occur within the policy period there can be no indemnification and no duty to defend.

In the writer’s experience, many insurers often deny coverage noting that the loss did not occur within their policy period. With due respect, a determination of when the loss occurred is not for the insurer to make. That is an issue for the trier of fact (the court) only. If there is a mere possibility that the loss occurred during the policy period, the insurer must defend (subject to other coverage exclusions).

There are at least four theories, or rules, employed by our courts to assist in the determination of when the loss occurred. The law remains somewhat unsettled in this area. However, a recent Ontario Court of Appeal decision may go a long way in resolving the ambiguity around trigger theories in the construction context.

In *Alie v. Bertrand & Frere Construction Co.* (2003) 222 D.L.R. (4th) 687 (Ont. C.A.), Bertrand supplied concrete for the construction of about 140 homes during 1986 through 1988. Bertrand used fly ash supplied by Lafarge Canada as one ingredient. The concrete proved to be defective, and in 1992 it was determined that the foundations of all of the homes would have to be replaced. The defect was traced to the fly ash supplied by Lafarge. 137 homeowners sued Bertrand and Lafarge.

Following a 150 day trial, Bertrand and Lafarge were found 20% and 80% liable, respectively. Both parties turned to their insurers for defence and indemnification. Both were insured through a succession of liability policies over a 6 year period.

As expected, all insurers argued that coverage was excluded under their respective policies and in any event, the loss did not occur within their policy periods. The trial court considered the four approaches to triggering coverage for progressive damage claims:

- The Exposure theory holds that only the policy in place when the first exposure to the condition or conditions causing the deterioration of the property should respond because, from that point on, damage is a certainty;
- The Manifestation theory holds that the policy in place when the injured third party does or could have become aware of the damage must respond;
- The Injury in Fact theory holds that a policy will respond if damage actually occurred during the policy period, whether or not any one was or could have been aware of it, and regardless of when the negligent act or omission causing the damage actually took place; and
- The Continuous or Triple Trigger theory deems property damage to have occurred from the initial exposure or negligent act, through to the time when damage became manifest, or ought to have been manifest.

Following its review of the four theories, the Court of Appeal held that “upon close analysis, each theory is effectively an application of the “injury in fact” theory where the court determines, on the evidence, at what point or continuum of points in the process, the property damage in fact occurred.”

Having so held, the Court of Appeal endorsed the trial Court’s finding that all insurers who provided coverage were between 1986 and 1992 were required to indemnify Bertrand. The Court of Appeal upheld the trial judge's 'cut-off' date of 1992, noting that that was the point in which the full extent of the damage became known to the homeowners (through the production a report from New Home Warranty).

The *Alie* decision is important for a number of reasons. First, it represents the first comprehensive review of trigger theories in a construction context. Second, the “injury in fact” approach received strong endorsement from the Court. Third, the Court accepted that the cut-off date was the time the owners received evidence on the nature and magnitude of the damage. This is a significant finding insofar that owners who fail to take steps to mitigate their loss in a timely manner following notice, may be exposing contractors to a period of self-insurance, even if otherwise insured. Insurers who come on risk after notice of a claim is given will take the view that the loss is no longer “unexpected” by the insured, and therefore is excluded or falls outside the grant of coverage.

Exclusions

Like builder’s risk policies, the typical CGL policy will include provisions which exclude or limit the grant of coverage. It is beyond the scope of this paper to consider each of these exclusions. However, parties should generally be aware of the usual exclusions and discuss their meaning and reach with their insurance broker. The following represents some of the typical exclusions contained within a CGL policy:

- a. Liability assumed under contract;
- b. Property or work in which insured has interest; and
- c. Work performed, that is property damage to “your work”

d. Extensions of Coverage

Just as there are many exclusions limiting or negating coverage, CGL policies often contain riders or endorsements extending or broadening coverage. They may include:

- a. Wrap-up coverage – where the owner or general contractor arranges for liability insurance insuring the interests of the owner, contractor, consultants and subcontracts under one policy of insurance. Wrap-up policies are usually project specific and usually contain a completed operations coverage component.
- b. Completed Operations coverage – covers claims arising after a project has completed and turned over to the owner. Coverage is typically for 1 to 3 years. Standard policies often exclude all damage to work completed, but cover damage to other property, including parts of the project which were damaged by the defective part.

D. Professional Liability Insurance

Liability for professional services is usually not covered by CGL policies. Rather, the insurance industry has responded to coverage demands of architects and engineers through the errors and omissions policy.

Neither the CGL nor E&O policy define “professional services”. The activities of design professionals are far reaching. Whether a particular activity constitutes a “professional service” is a question of fact. Not all activities of architects and engineers are professional services. As well, non-architects and non-engineers (such as technicians and draftspersons) may carry out activities which would be categorized as a professional service.

The issue is not insignificant. Frequently, there are two or more insurance carriers on any given project (a CGL carrier and E&O carrier), both with competing economic interests. The E&O insurer has an interest in establishing that the activity complained of is not a professional service and therefore is not covered by the policy. While a CGL carrier is interested in proving that the activity is a professional service, and thus excluded under the policy of insurance.

Most E&O policies are written on a claims-made basis. Accordingly, if a policy expires prior to a claim being advanced, there is no coverage. Owners should consider adding a provision to the consulting services contract requiring the consultant to maintain E&O coverage for a stipulated period of time following completion of the project. That period should coincide with the claim period for commencing an action against the design professional. For example, if the design professional's contract provides that all claims against that party must be made within 2 years following completion of the project, the consultant should be required to maintain E&O coverage for the same period. Design professionals should consider the inclusion of a term which limits the requirement to maintain E&O coverage only where such coverage can be reasonably obtained at a reasonable cost.