

CANADIAN DESIGN-BUILD INSTITUTE

1900-275 Slater Street Ottawa ON K1P 5H9

Tel: 613.236.9455

Fax: 613.236.9526

www.cdbi.org



The Risk Management Committee of the Canadian Design-Build Institute (CDBI) is pleased to provide this paper which discusses a recent decision in the Canadian legal system that has followed the precedent set by the Supreme Court of Canada ruling *Progressive Homes Ltd. v. Lombard General Insurance Company of Canada* decision. The importance of this Supreme Court of Canada ruling is that the decision provides a level of certainty as to what contractors (general or design-build) can expect from its Commercial General Liability (CGL) insurers and insurance policies when dealing with construction defect claims.

The Risk Management Committee of CDBI will continue to circulate articles of this nature to members as they become available. We trust this will be found to be of interest and beneficial to the members.

COVERAGE FOR CONSTRUCTION DEFICIENCIES: BC SUPREME COURT EXAMINES THE “PARTICULAR PART” IN THE CGL WORK EXCLUSION

**By R. Glen Boswall
Clark Wilson LLP**

In an April, 2012 ruling in *Lombard General Insurance v. Canadian Surety Company*, the British Columbia Supreme Court (“BCSC”) analyzed and applied the “particular part” restriction within the typical CGL policy faulty work exclusion (the “particular part work exclusion”). In doing so, the BCSC followed the path set down by the Supreme Court of Canada (SCC) in *Progressive Homes Ltd. v. Lombard General Insurance Company of Canada*.

In the *Progressive* decision, the SCC took a new approach to the particular part work exclusion. Previously, judges treated “that particular part” as a reference to the insured’s entire scope of work. Faulty workmanship on any component of the insured’s work was considered to be faulty workmanship on the entire scope of work. When faulty workmanship on one component of the work injured other components, there was no coverage for this resulting damage because the entire scope of work was excluded. This changed with the *Progressive* decision. The SCC ruled that the phrase “that particular part” expressly contemplated the division of the insured’s work into its component parts and so the exclusion, properly interpreted, meant that coverage for repairing or replacing defective components would be excluded, while coverage for resulting damage would not.



Lombard v. Canadian Surety was a coverage action arising from an underlying lawsuit concerning flaws in a hot water distribution system installed in a residential strata complex called Marina Pointe. Canem Systems Inc. installed the system under subcontract to the developer when Marina Pointe was built in the mid 1990's. Canem had its own liability insurance but was also covered by a project specific wrap up liability policy issued by Canadian Surety.

The water system specifications called for the installation of circuit setters, balancing valves and time clocks to regulate the water flow in order to avoid excessive and premature wear of the system's pipes. The strata corporation learned in 2002 that ball valves had been installed instead of the specified circuit setters. The strata corporation replaced the ball valves in 2004 and then sued the project developer, general contractor, Canem and others to recover the replacement cost plus damages for the alleged premature deterioration of the hot water system.

Canadian Surety refused to defend Canem, relying on its particular part work exclusion which removed coverage for "injury to, or destruction of, or loss of use of ... that particular part of any property ... the restoration, repair or replacement of which has made or is necessary by reason of faulty workmanship thereon or on behalf of the Insured." Canadian Surety said the strata corporation's claim was in relation to damage to the hot water system and this was the property on which Canem worked. The claim related to damage to the system and therefore the exclusion applied.

Canem's own insurers began funding the defence costs and one of them, Lombard, commenced a separate coverage action against Canadian Surety, seeking a declaration that Canadian Surety was obligated to contribute to the costs of defending Canem in the strata corporation lawsuit. Lombard used the SCC's analysis in *Progressive*, arguing that the "particular part" in the Canadian Surety exclusion was not the entire hot water system. Lombard said the trial court in the strata corporation lawsuit might find that Canem's faulty workmanship was confined to a particular part of the water system and that this injured other parts of the system. The particular part work exclusion would not remove coverage for the resulting damage to the other parts of the system in this scenario, and the possibility of this being proven meant Canadian Surety was obliged to contribute to Canem's defence.

Canadian Surety argued that its exclusion was broader than the one analyzed by the SCC in *Progressive*. The *Progressive* exclusion was for " 'property damage' to 'that particular part of your work arising out of it' ..." whereas the Canadian Surety exclusion applied to "that particular part of any property ... 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." But the BCSC noted that this did not address the central issue, which was whether the hot water system could be divided into component parts so that the exclusion would apply only to the ball valves and not to the resulting premature deterioration in the rest of the water system.



Citing the SCC's analysis in *Progressive*, the BCSC concluded that to give meaning to the phrase "that particular part of any property" in the Canadian Surety policy as it applied to Canem, the hot water system had to be considered as comprising component parts with the ball valves being some of those parts. The exclusion therefore did not apply to the alleged premature deterioration in the rest of hot water system. The inapplicability of the exclusion meant there was a possibility that some of the strata corporation's claim would fall within the Canadian Surety wrap up liability coverage and so Canadian Surety was obliged to contribute to the cost of Canem's defence in the strata corporation lawsuit.

The lesson from this case and the *Progressive* decision is that, unless the allegation is that the entirety of an insured's work is faulty, the particular part work exclusion will apply only to the defective components. In the future, expect plaintiffs to be more precise when alleging construction deficiencies and broader when describing resulting damage.

For more information please contact:

Glen Boswall is a partner at Clark Wilson LLP and practices in the areas of construction, insurance, business litigation, and construction. He is also the current chair of the British Columbia Construction Law Subsection of the Canadian Bar Association.

Tel: 604-643-312 or email: rgb@cwilson.com

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