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The Risk Management Committee of the Canadian Design-Build Institute (CDBI) is pleased to provide this paper which discusses a recent court ruling on a difficult (but common) insurance exclusion that design build contractors can face when they are managing their risks on design build projects. As you will find in this article, the Canadian Courts are taking a much broader interpretation of insurance clauses to the benefit of the design builders.

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.

BC SUPREME COURT ADDRESSES INTERESTING AND NOVEL COC POLICY ISSUES

By R. Glen Boswall

In the recently decided case of *Acciona Infrastructure Canada Inc. v. Allianz Global Risks US Insurance Co.*, the BC Supreme Court addressed some interesting and novel issues concerning Course of Construction (COC) insurance. Particularly, the Court,

- clarified the distinction between excluded defects and covered resulting physical damage within a building component;
- dealt with a novel argument that fortuity was not required to trigger coverage under typical COC policy wording; and
- was the first in Canada to interpret a design and workmanship exclusion wording that is becoming more common in COC policies.

The case concerned sagging and cracking of cast-in-place floor slabs during construction of a 500 bed patient care facility. In 2008, ISL Health (Victoria) Partnership ("ISL") entered into a P3 agreement with the Vancouver Island Health Authority to finance, design, build and operate the project. ISL in turn subcontracted the design and build obligations to Acciona Lark Joint Venture ("Acciona").

Under the terms of Acciona's contract, the concrete floor slabs were to be constructed with an upward camber or "crown" of 30 millimetres in the center of each one. The camber was designed to accommodate the expected downward deflection of the slabs as the concrete cured and as would occur naturally over the life of the slab, with the intent of achieving an almost-level surface to meet functionality requirements. Unfortunately, the formwork and shoring procedures employed did not properly account for the unusually thin design of the slabs, resulting in excessive downward deflection and flexural yield cracks in the first through seventh floor slabs. Although testing showed the slabs to be safe for use, they did not meet the Health Authority's functional requirements and so Acciona was compelled to carry out excessive repairs costing over $14 million. Acciona sued its COC underwriters after they refused to cover the cost.

The Insuring Agreement Issues

The main insuring agreement issues were whether the slab deflections and cracking were defects rather than physical damage and, if it was physical damage, was fortuity required?

The insurers asserted that the deflections and cracking constituted defects in the slab as distinct from physical damage and so they were not covered by the insuring agreement. The insurers argued that the slabs were not damaged in the sense that their essential state was altered because they continued to function as slabs and their safety was confirmed by load tests. The Court rejected the argument, finding instead that the excessive deflection and cracking were physical damage because they left the slabs in an altered physical state which rendered the facility unfit for its intended purpose.

Regarding fortuity, Acciona's COC policy contained a fairly standard inuring agreement in which neither the "all risks" clause nor the description of "occurrence" expressly stated that losses must be accidental in order to trigger coverage. Acciona's lawyers made the novel argument that fortuity was not necessary because the interpretive approach mandated by the 2010 Supreme Court of Canada decision in *Progressive Homes Ltd. v. Lombard General Insurance Company of Canada* required that courts adhere to the specific language of the insurance policy and not rely on historical insurance "truisms" like the requirement of fortuity. Given that fortuity has long been a fundamental principle of insurance law, it was perhaps not surprising that the Court did not accept the argument. Mr. Justice Skolrood wrote at paragraph 122 of his decision,

> *I agree with the Insurers that the concept of fortuity is, in any event, built into the Policy here. Again, the "Perils Insured" include "all risks" of direct physical loss or damage. Use of the term "risk" underscores that the Policy is intended to insure against possible occurrences, as distinct from certain events or intended consequences.*

The Court subsequently concluded that the deflections and cracking were fortuitous and so fell within the protection of the Policy insuring agreement.

The Design & Workmanship Exclusion Issues

Acciona's COC policy contained a defective design and workmanship exclusion based on standard wording created by the London Engineering Group (LEG). The wording, labelled LEG 2/96, is designed to separate and exclude the cost of repairing defective design and workmanship from the covered cost to repair resultant damage. The exclusion states,

> This Policy does not insure:
>
> (b) all costs rendered necessary by defects of material workmanship, design, plan or specification, and should damage occur to any portion of the Insured Property containing any of the said defects, the cost of replacement or rectification which is hereby excluded is that cost which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage.
>
> For the purpose of this policy and not merely this exclusion it is understood and agreed that any portion of the Insured Property shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship, design, plan or specification.

Acciona's insurers focused on the first phrase which removed cover for "all costs rendered necessary by defects …". They argued that all of the costs claimed by Acciona related to the defective work and so were excluded. However, the Court noted that the conjunctive word "and" connected the first phrase of the exclusion to the second phrase, beginning with the words "and should damage occur …" In the result, the two components of the exclusion must be read together. Otherwise, to read the first phrase as a distinct exclusion would result in any and all costs relating to the defect being excluded and would completely nullify the second phrase.

The Court concluded that the covered "damage" was the cracking and over deflection of the concrete slabs. The excluded "defect in material workmanship" was the improper formwork and shoring/reshoring procedures that resulted in the damage. The excluded costs were those that would have remedied the defect before the cracking and over deflections occurred, i.e. the costs of implementing proper formwork and shoring/reshoring procedures. There was no evidence before the Court to quantify these excluded costs except to say that they would have been minimal.

This case clarifies the law on some interesting COC policy coverage issues.

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