

Ledcor v. Northbridge: the Supreme Court of Canada Clarifies the "Faulty Workmanship" Exclusion

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The Supreme Court of Canada recently released one of the more important insurance law decisions in recent memory. In *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.*¹ the Supreme Court weighed in on the distinction between “faulty workmanship”, which is typically excluded under a builder’s risk policy, or “resultant damage”, which is typically covered.

Ledcor was a general contractor hired to construct the EPCOR building in Edmonton, Alberta. As the general contractor, they hired a window cleaner to clean the exterior windows of the building near the end of the project. The insurer, Northbridge, had issued an “all-risks” builder’s risk policy for the project. The insuring agreement read:

1. Property Insured

(a) Property undergoing site preparation, demolition, construction, reconstruction, fabrication, installation, erection, repair or testing (hereinafter called the “Construction Operations”) while at the risk of the insured and while at the location of the insured project(s), provided the value thereof is included in the declared estimated value of construction operations;

...

2. Perils Insured and Territorial Limits

This policy section insures against “All Risks” of direct physical loss or damage except as hereinafter provided.

Ledcor and the developer, Station Lands, submitted a claim to Northbridge seeking indemnity under the policy for the \$2.5 million in damage to the windows. Northbridge denied, and relied on the faulty workmanship exclusion, which read:

4(A) Exclusions

This policy section does not insure:

¹ [2016] SCJ No 37.

- (a) Any loss of use or occupancy or consequential loss of any nature howsoever caused including penalties for non-completion of or delay in completion of contract or non-compliance with contract conditions;
- (b) The cost of making good faulty workmanship, construction materials or design unless physical damage not otherwise excluded by this policy results, in which event this policy shall insure such resulting damage.

The trial judge initially found in favor of Ledcor, but the decision was overturned by the Alberta Court of Appeal. On appeal, it was held that the cleaning service was “faulty workmanship” as defined by the policy, and that the cost to repair the windows was not “resultant damage”, but rather the direct result of the faulty work.

The Supreme Court disagreed. In coming into their decision, the Supreme Court made two important findings. The first was that, as a standard form insurance contract, the standard of review that should be applied on appeal is one of correctness. This is important, because in *Sattva Capital Corp. v. Creston Moly Corp.*², the Supreme Court had said that appeals that involve contractual interpretation require findings of fact that attract a higher standard of review. Until *Ledcor*, it had been understood that appeals involving interpretation of insurance policies were subject to a higher standard of review and, therefore, harder to appeal. However, the Supreme Court carved out an exception to *Sattva Capital* where the contract is a “standard form” contract. In those cases, the factual matrix in which the contract arises is not as important, and the interpretation of such an insurance policy is much closer to a pure question of law rather than a question of mixed law and fact. As a result, when faced with the interpretation of a standard form insurance policy, the standard of review is one of correctness. Part of the reasoning behind this is that consistency in how standard form contracts are interpreted is important, and appeal courts must ensure that decisions interpreting standard form contracts have precedential value.

A second important finding involved the scope of the “faulty workmanship” exclusion itself. The Court began by looking at the broad purpose of builder’s risk insurance, as well as the high premiums charged, which is intended to cover accidents or damage that occur during the course of construction. The Court found that, notwithstanding the exclusion, the insurer agreed to cover physical damage that results from faulty workmanship using language that was clear and unambiguous. Instead, the “faulty workmanship” exclusion was meant only to exclude the cost of redoing the faulty work. This is true even where the “resultant damage” and “faulty work” overlap. To allow otherwise would undermine the purpose of the coverage, which is to provide peace of mind and ensure construction projects do not grind to a halt over disputes such as these. The result was a successful appeal by the insured.

² [2014] 2 SCR 6 33

This interpretation of the faulty workmanship is exclusion will have an impact beyond builder's risk policies. While the Court certainly relied on the specific nature of builder's risk coverage in its decision, the analysis of the exclusion itself has precedential value for any case involving a policy with a similar exclusion, such as in a typical CGL policy.

Guidance on the "faulty workmanship" exclusion is very welcome. The Supreme Court of Canada has stated clearly that the faulty workmanship exclusion pertains only to the cost of redoing the faulty work. Damage caused by faulty workmanship, even when the damage is to the very property where the faulty work is performed, is covered. Here, the cost of re-cleaning the windows is excluded, while the damage caused to the windows by the faulty work is covered.

While the interpretation of the faulty workmanship exclusion is key, the more important take away from *Ledcor* may in fact be the court's finding on the standard of review. By establishing a standard of review of correctness for the interpretation of standard form insurance policies, the court has effectively made it easier to appeal any decision involving interpretation of an insurance policy. It is quite possible that *Ledcor* will become cited much more frequently for this issue than for faulty workmanship.