Toronto Law Journal

Case Analysis: *Ledcor Construction Ltd v Northbridge Indemnity Insurance Co.*, 2016 SCC 37; Standard Form Contracts & Faulty Workmanship

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The Supreme Court of Canada recently released its long awaited decision in *Ledcor Construction Ltd v Northbridge Indemnity Insurance Co.*, 2016 SCC 37 ("*Ledcor*"). The case is important for at least two reasons: first, the case is a significant decision concerning the proper standard of review for courts asked to interpret standard form contracts. In this decision, the SCC confirmed that interpretation of standard form contracts is often a question of law, and so the standard of review of standard form contracts ought to be correctness. In this manner the SCC endorses the precedential value that a consistent interpretation presents, while suggesting that the "factual matrix" surrounding the particular usage of standard form contracts will generally be less impactful.

Second, the case provides commentary on the appropriate approach to the faulty workmanship exclusion. Comparing the SCC *Ledcor* decision with that of the trial decision and the appellate court decision affirms the SCC's interest in promoting a consistent and efficient approach to applying the "faulty workmanship" exclusion, which is often found in insurance policies. The majority judgment also attempts to avoid a potential risk underlying the Alberta Court of Appeal's decision, which could have injected an additional level of analysis into "faulty workmanship" coverage assessments. In the simplest terms, as noted in the SCC's decision, "making good faulty workmanship" means only the cost of redoing the faulty work.

Underlying Facts

In *Ledcor,* the property owner, Station Lands Ltd., had retained Ledcor Construction Limited as construction manager over the EPCOR tower in Edmonton. A window cleaning company, Bristol Cleaning, was hired to wash construction debris off the windows of the tower as it neared the end of construction.

As is common with projects of this size, there were various sub-trades, suppliers and installers involved. Station had a builders' all risks policy covering all "direct physical loss or damage except as hereinafter provided." Station and Ledcor were both named insureds and the subcontractors, architects, engineers etc., were additional insureds.

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In the process of cleaning the windows of the post-construction dirt and grit, Bristol caused damage. Bristol was found to have used improper tools and methods, dull, dirty or inappropriate blades to scrape off the dirt, and a "non uni-directional" cleaning method, contrary the manufacturer's cleaning instructions. The window glass had to be replaced and Station estimated the replacement to cost $2.5 million. Ledcor and Station claimed the cost of replacing the windows under the builders risk policy. The insurers denied coverage under the "cost of making good faulty workmanship" exclusion.

Guidance on Standard Form Contract Interpretation

Ledcor gave the SCC an opportunity to comment on its ruling in *Sattva Capital Corp. v Creston Moly Corp.*, 2014 SCC 53 ("*Sattva*"). *Sattva* dealt with a complex commercial agreement between two sophisticated parties.[2] The Court observed that in many contract interpretation cases, the intention of the parties would play an important role, and could be impactful to the contract's interpretation.

In *Sattva* the SCC concluded that contract interpretation is a question of mixed fact and law since it involves applying legal principles of contractual interpretation to a particular set of facts.[3] From that decision, when an appeal involves the interpretation of a contract, the interpretation would be characterized as a question of mixed fact and law.

Following *Sattva*, some appellate courts had attempted to apply the "mixed law and fact" approach to contractual interpretation for standard form contracts. Others had held this approach would not apply for standard form contracts, and so instead approached the interpretation of standard form contracts as a question of law, and therefore applied a correctness standard of review.[4]

In *Ledcor* the SCC acknowledged this inconsistent application of *Sattva,* and expressly carved out an exception in the manner of judicial review for standard form contracts. The *Sattva* decision acknowledged that a particular interpretation of a contract in a particular situation would have little precedential value beyond the immediate parties because the intentions would differ from one case to the next.[5]

In *Ledcor* the SCC distinguished standard form contracts from other contracts and held that the interpretation of standard form contracts may constitute a question of law. As the facts are often similar when standard form contracts are used, the task for reviewing courts ought to be ensuring the correct legal principle is applied, which should foster consistency of interpretation of standard form contracts. Since the factual matrix and the terms of the standard form contract are sufficiently similar amongst cases, the consistent interpretation of standard form contacts will be of significant precedential value to future parties and courts.

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[2] *Ledcor Construction Ltd. v Northbridge Indemnity Insurance Co.*, 2016 SCC 37 ("Ledcor") at para 25.
[3] *Ledcor* at para 33.
[4] For instance, see discussion in *Precision Plating Ltd. v. Axa Pacific Insurance Company*, 2015 BCCA 277 (CanLII), paras. 22-30.
[5] *Ledcor* at paras 37- 38.

As such, the *Ledcor* ruling suggests that appeals interpreting standard form contracts and absent a meaningful factual matrix, ought to be addressed as questions of law. From that, the interpretation of the standard form contract should be reviewed against a standard of correctness. Rather than strictly follows *Sattva's* "mixed fact and law" approach, a standard form contract's interpretation would be a question of law if (1) the appeal involved the interpretation of a standard form contract; (2) the interpretation at issue is of precedential value; and (3) there is no meaningful factual matrix specific to the particular parties to assist the interpretation process.[6]

Of course the question of law approach is not automatic. The SCC also referenced a non-exhaustive list of when deference will be warranted when interpreting standard form contracts. For instance, deference may be warranted "if the factual matrix of a standard form contract that is specific to the particular parties assists in the interpretation" or "if the parties negotiated and modified what was initially a standard form contract, because the interpretation will likely be of little or no precedential value". [7]

Faulty Workmanship Exclusion

While much of the case discusses the standard of review for standard form contracts, the central issue of the factual matrix was whether the cost of the window replacement was insured. The builders' risk policy exclusion pertained to the cost of making good faulty workmanship, construction materials or design, but excepted physical damage arising from the faulty workmanship.

The trial judge had determined that the damage was covered. The trial judge agreed with the insureds' position that the cost of making good faulty workmanship was only the cost of redoing the cleaning work, whereas the damaged windows were a separate thing that Bristol had performed the work on.

The Alberta Court of Appeal ("ABCA") reversed the decision. It ruled the exclusion was not ambiguous and therefore the principle of *contra proferentem* did not apply. The ABCA's decision attempted to meld a variety of interpretative aids as it considered (a) the distinguishing line between the physically damaged items being worked on at the time and the physical damage collateral to that thing, (b) the work being done and the foreseeable consequence of that work, and (c) whether the damage in question was [to an unspecified degree] unexpected and fortuitous.

The SCC overturned the appellate decision using a more traditional approach to the coverage analysis. When reviewing the policy itself, the SCC restated the frequently-cited principles that apply to interpreting insurance policies, and the usual, orderly approach for applying a coverage interpretation.

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[6] *Ledcor* at para 4.
[7] *Ledcor* at para 48.

The SCC noted that the ABCA approach was flawed (partially) due to its effort to match the exclusion clause with the initial grant of coverage. Because the coverage grant applied only to physical loss or damage, the ABCA considered the exclusion as needing to equally apply to physical loss or damage. In applying the exclusion, the ABCA sought to identify something other than the faulty workmanship itself, and thereafter distinguish between some physical damage that could be excluded from the physical damage that would be excepted from the exclusion. The ABCA crafted a new "physical or systemic connectedness" test to delineate such a boundary. The SCC rejected this methodology.

The SCC found that the faulty workmanship exclusion need not be triggered by physical damage. Rather, while cognizant that "exclusions should be read in light of the initial grant of coverage" the SCC noted that the exclusions and coverage grants do not require perfect mutual exclusivity, and cited other instances within the Policy where exclusions or conditions addressed topics distinct from the physical damage contemplated in the coverage grant.

The SCC reviewed various cases that had previously considered the faulty workmanship exclusion. In each instance, the Court highlighted the actual work that was originally intended, and distinguished between that affected work versus resulting damage to elements outside of the original scope. It concluded that the exclusion meant the fault within the intended work would be excluded, while resulting damage to elements outside the original scope would be exempted from the exclusion, and therefore covered.

Conclusion

The *Ledcor* decision should help provide insurers and insureds with more certainty and predictability in how policies will be applied by the courts. With standard form contracts, like insurance policies, the importance of a correctness standard of review applies because the interpretation of the contract (and legal analysis flowing therefrom) can have direct impact upon parties beyond those immediately subject to a dispute. Given the SCC's extensive commentary on the requirement of correctness for standard form contracts, we are left to wonder if the existing jurisprudence concerning standard form contracts (and particularly insurance contracts) is now that much stronger, as appellate courts are perhaps increasingly encouraged to apply prior principles in the pursuit of consistent results.

This will also give parties and courts an important precedent to follow in future cases interpreting identical or very similarly worded "cost of making good faulty workmanship" exclusions. The SCC discussion highlights once again how themes of broad coverage, and consistency stand behind the interpretation of builders' risk policies.

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CONDUCT OF COUNSEL

Michael Bay, Deputy Judge[1]

I remember, at the age of ten or so, visiting the office of a family friend who was the vice-president of a large manufacturing company. On his wall hung a large plaque that read "Be sure brain is engaged before operating mouth." It might do the profession, and generations of new lawyers, a bit of good if a copy of that plaque were handed out along with the various certificates at the call to the bar ceremony.

Most lawyers who appear before us are ladies and gentlemen who understand their duty to the court and their clients. But there are a few who seem to lose their heads and do and say things that they likely later regret. I am thinking of the lawyer who was incensed that our scheduling officers might actually do some scheduling and faxed a letter to the court berating them for "unilaterally" scheduling a trial. Or the guy who allegedly had to be physically restrained from going after his opposite number outside the courtroom after a motion. Or counsel at a settlement conference who made it clear to me in no uncertain terms how angry he was that I would not let him aggressively dress down the unrepresented party opposite.

All of these examples, and there are lots more, are things that were likely done in the heat of the moment by lawyers who doubtlessly regretted them later. And they are things that are disrespectful to the court, damaging to the interests of the lawyer's client, and potential fodder for disciplinary matters.[2] They can be catastrophic to the lawyer's reputation and, therefore, his or her effectiveness before the court and when dealing one-on-one with colleagues.

But, if truth be told, I am not sure if all of this sort of conduct is attributable to off-the-cuff misbehaviour. There are some young lawyers who seem to have learned advocacy from watching WWF wrestling or, perhaps, parliamentary question period on CPAC. These lawyers need to know that bullying is not advocacy and generally not helpful to their client's cause.

When I was a young lawyer, I was taught to pound the law if the law was on my side, pound the facts if the facts were on my side and pound the table if neither the law nor the facts were in my corner. Good advice. Unfortunately, there is now a class of counsel that skips the first two and belligerently and humourlessly pounds the table and waves their fists in the air, figuratively speaking, at every opportunity. Not only is this sort of behaviour unprofessional, it does little to advance your client's cause and is often a thin veneer unsuccessfully masking shoddy preparation by counsel who has done little to marshal the evidence, research the law

[1] This paper was originally presented at the Toronto Lawyers Association program, "The Small Claims Court - Views from the Bench," on September 28, 2016.
[2] See Law Society of Upper Canada's *Rules of Professional Conduct* (November 1, 2000, as amended October 1, 2014), http://www.lsuc.on.ca/lawyer-conduct-rules/.

or prepare to intelligently argue the case. I admit that the amateur theatrics may initially impress your client but a settlement conference or trial is not your neighbourhood drama club. Besides, the impression you make on the client is not going to last long if your belligerent silliness contributes to a car wreck of a result.

In my experience the most effective advocates before the court are those who are knowledgeable, well prepared, courteous and helpful to the court.

These advocates know their case, their client and the applicable law. Their pleadings are important works of written advocacy that lay the groundwork for a successful resolution of their case. Their clients and witnesses are clearly well prepared.

They prepare properly for settlement conferences and make all disclosures in a timely fashion. They come to the conference ready to talk turkey unless there are valid reasons not to settle. They use their problem-solving and advocacy skills in an attempt to make the settlement conference work. And they settle most of their cases.

At trial, their examinations-in-chief are well prepared and skillfully done. Their cross-examinations avoid areas that are best left alone and carefully explore the areas that need exploring. They never cross examine by script because the questions asked depend on the examination in chief. They never waste the court's time by calling unnecessary witnesses, examining on issues that don't matter or repeatedly asking the same question.

When making submissions, they summarize the evidence accurately and can be relied upon never to mislead the court. When they put law before the court, their brief includes the leading cases whether helpful to their case or not for to fail to do so is deceptive and a violation of the rules of professional conduct. It is then their job, of course, to distinguish the unhelpful cases.

They don't insult and abuse the court by not bothering to inform it when a scheduled attendance will not be necessary because an action has been settled or discontinued.

These advocates are unfailingly polite and respectful to all of the parties, advocates, witnesses and the court. They never rise to the bait from opposing counsel, witnesses or the party opposite. And these advocates are devastatingly effective.

The advocate's duty of professionalism encompasses both the duty of zealous advocacy and the duty of courtesy and civility. Lord Reid's famous statement in *Rondel v. Worsley*[3] is apt:

> Every counsel has a duty to his client fearlessly to raise every issue, advance every argument and ask every question, however distasteful, which he thinks will help his client's case. But, as an officer of the Court concerned in the administration of justice, he has an overriding duty to the Court, to the standards of his profession, and to the public, which may and often does lead to a conflict with his client's wishes or with

[3] (1967), [1969] 1 A.C. 191 at pp. 227-28 (U.K. H.L.).

> what the client thinks are his personal interests. Counsel must not mislead the Court, he must not lend himself to casting aspersions on the other party or witnesses for which there is no sufficient basis in the information in his possession...

These obligations are owed by all advocates and due to all participants in the justice system. An advocate's duties are owed not only to the client, but also to the public and, hence, to the justice system itself and all its participants.[4]Common courtesy does not mean that you do not fight for your client's cause but it does mean that you don't do stupid, useless and time-consuming things like churning the water with useless motions or noting pleadings closed without warning your opposite number. I will never forget the old reported case of *Coady v. Coady* in which two lawyers engaged in an acrimonious marriage breakup each spent many thousands of dollars fighting several motions to determine the proper venue for another motion.

In summary, if your reputation and the success of your cases matters to you, develop your advocacy and negotiating skills and be respectful of the court and parties opposite instead of trying to bludgeon your way to the top.

[4] *R. v. Lyttle*, 2004 SCC 5 at para. 66, quoting the above passage from *Rondel*, *Doré c. Québec (Tribunal des professions)*, 2012 SCC 12 at para. 68, cited in *Groia v. Law Society of Upper Canada*, 2016 ONCA 471 at para 134, leave to appeal to SCC filed July 29, 2016.

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"Active Employment" Conditions on Bonus Eligibility over the Notice Period: A Reminder to Review your Policies Regularly

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The Ontario Court of Appeal recently held that an employee was entitled to the bonuses that he would have received over the notice period, despite the fact that his employer's bonus plan required its employees to be "actively employed" on the date of bonus payout.

In *Paquette v. TeraGo Networks Inc.*, 2016 ONCA 618, the appellant employee worked for the respondent tech company for almost 14 years, until his employment was terminated on a without cause basis. At the time of dismissal, he served as a Director, Billing and Operations Support, reporting to the company's vice-presidents and senior executives. He was 49 years old.

The employee brought a motion for summary judgment in his wrongful dismissal action. The motion judge fixed the notice period at 17 months. However, no monies were awarded in respect of the employee's bonus over the notice period, despite the finding that such bonuses were an integral part of his compensation.

Specifically, the motion judge stated:

> *"[T]here is no ambiguity in the contract terms of the Bonus Program. Mr. Paquette may be notionally an employee during the reasonable notice period; however, he will not be an "active employee" and, therefore, he does not qualify for a bonus."*

The sole issue on appeal was whether the motion judge erred in denying the employee's claim for compensation for lost bonuses on the basis that the bonus plan required employees to be "actively employed" at the time of payout.

The Court of Appeal stated that the employee's entitlement to bonus payments in the context of the action did not turn on whether he was "actively employed" after his employment was terminated.

In the context of a wrongful dismissal action, the Court reiterated that the employee's damages were comprised of the compensation he would have been entitled but for the termination of his employment. On this point, the Court cited a previous Court of Appeal decision, *Taggart v. Canada Life Assurance Co.* (2006), 50 C.C.P.B. 163, which dealt with the requirement for active service as a prerequisite for the accrual of pension benefits (also a wrongful dismissal action):

> "*The claim is not ... for the [benefits] themselves. Rather, it is for common law contract damages as compensation for the [benefits] the [employee] would have earned had the [employer] not breached the contract of employment. The [employee] had the contractual right to work and to be paid his salary and receive benefits throughout the entire ... notice period.*"

Again, the Court reiterated that in principle, the employee's claim was not for bonus payments, but instead for damages as compensation for the bonus payments he lost as a result of the termination of his employment.

As such, the Court held that its analysis should start from the premise that his common law right to damages was based on his complete compensation package (including any bonus payments that he would have received during the notice period).

From this premise, the analysis should then focus on whether the plan language specifically limits or restricts this right – the key issue being whether the language of the plan unambiguously alters or removes the employee's common law rights.

Ultimately, the Court held that the employee was entitled to compensation for the loss of his bonus payments over the notice period.

In light of this case, employers should be cautious about relying on bonus plans which limit bonus or incentive payment eligibility to "active employment", as this language alone is not a sufficient basis on which to limit an employee's bonus entitlements over the notice period. Where employees are in receipt of regular bonuses, the terms of such plans should expressly and unambiguously limit their common law entitlements to such compensation over the notice period.

Paquette is also a reminder to employers that bonus or incentive payment policies should be regularly reviewed to ensure that they sufficiently and concisely delineate an employee's rights and entitlements over the notice period, and thus mitigate the risk of related costs upon the termination of employment.

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Four Recent Decisions Raise Concern About Parity in Sentencing

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Four recent Ontario Provincial Court sentencing decisions – two under the *Occupational Health & Safety Act* ("OHSA"), and two under the *Environmental Protection Act* ("EPA"), throw into high relief the disparity of sentencing approaches under the two statutes, and suggest that environmental offences may be drawing disproportionately high fines. Consider the following four news releases, issued by Ontario within days of each other:

https://news.ontario.ca/mol/en/2016/09/m-fuda-contracting-inc-fined-60000-after-worker-killed-from-fall-in-trench.html?utm_source=ondemand&utm_medium=email&utm_campaign=p

https://news.ontario.ca/mol/en/2016/09/crane-company-fined-120000-after-worker-permanently-injured.html?utm_source=ondemand&utm_medium=email&utm_campaign=p

https://news.ontario.ca/ene/en/2016/09/sarnia-refinery-and-chemical-plant-fined-650000-for-environmental-protection-act-violations.html

https://news.ontario.ca/ene/en/2016/09/northern-region-companies-fined-150000-for-fly-rock-violations.html

Death. The first news release details sentencing in a recent case in which a contractor was fined $60,000 for the death of a worker. The company had failed to "provide information, instruction and supervision to a worker to protect the health or safety of the worker" contrary to s. 25(2)(a) of the OHSA. Under section 66 of the OHSA, the company faced a maximum potential fine of $500,000.

Permanent Injury. The second news release details sentencing in a recent case in which a crane operator was fined $120,000 for violating precisely the same section of the OHSA, in circumstances where a falling crane caused critical and permanent injuries to a worker.

Odour. By contrast, the third news release indicates that Imperial Oil Limited was fined $650,000 for a discharge of pollution, contrary to s. 14 of the EPA, where the discharge caused only discomfort and inconvenience for 3½ hours to some people, but no permanent injury. The company discharged "coker stabilizer thermocracked gas" when a frozen flare line ruptured – apparently accidentally. The gas contained hydrogen sulphide gas. While exposure to very high levels of hydrogen sulphide can cause death, no such exposure occurred here. The news article details that the "foul odour from the gas affected some people in central and north-end Sarnia. Some experienced burning eyes, sore throats, headaches, light-headedness, nausea and dizziness. Some residents were also forced to remain in their homes." In addition, a nearby hospital had to turn off its external air intakes for a brief period of time.

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Fly-rock. In an equally curious case, which indicates how seriously the Ontario Ministry of Environment and Climate Change is now taking s. 14 EPA discharges of "fly-rock" since the decision in *Castonguay Blasting Ltd. v. Ontario (Environment)*, 2013 SCC 52, the fourth news release details a $150,000 fine against two companies involved in blasting at an aggregates quarry. As a result of one blast, "Fly-rock landed on the residential driveway about 25 feet from where the homeowner and an employee from Bruman Construction were standing. There was no property damage and no one was injured." No indication is given of how far the driveway was located from the blast area, or how large (or small) the particles of fly-rock were.

Discussion.

The confluence of the four news releases, and the enormous disparity in sentencing, leaves one scratching one's head. Death and permanent injury warrant only fines of $60,000 and $120,000, while odours and some stones on a driveway warrant fines of $650,000 and $150,000. How can this be?

Part of the answer may lie with the maximum fines available under each statute. As noted above, the maximum corporate fine under the OHSA is $500,000. By contrast, the EPA, s. 187(4), provides for minimum fines of $25,000, $50,000 and $100,000 on first, second and subsequent convictions, as well as much higher maximum fines of $6M, $10M and $10M on first, second and subsequent convictions. The news releases do not tell us whether the offences in question were first, second or subsequent offences for each accused.

Equally, the news releases do not detail what aggravating or mitigating factors were considered by the court in each case. Were the OHSA offences closer to being "accidents" that were not easily foreseen by their respective defendants, while the EPA offences were egregious, reasonably foreseeable and easily preventable? It is possible, but the coincidence seems unlikely.

Parity in Sentencing.

The juxtaposition of the four cases certainly causes one to ask whether prosecutors at the Ontario Ministry of Environment and Climate Change are comparing notes with their colleagues at the Ministry of Labour, before demanding such high fines. It also causes one to ask whether any of the legal counsel involved in these cases asked the court to consider established principles of consistency and parity in sentencing. As noted by Justice Brecknell in *R. v. First Pro Shopping Centres Inc.*:[i]

> I am persuaded … that I must carefully consider the concept of parity in arriving at an appropriate penalty to be imposed.
>
> 134 From the case law I conclude:
>
> (a) the principle of parity applies to environmental offences (see *Sandover-Sly*);

(b) that parity does not require identical sentences to be given to co accused and that different circumstances can justify different sentences (see *Wilson*); and

(c) that if one offender was to be treated substantially different than another offender in the same set of circumstances both the offenders and the community would not perceive the result as fair and that could lead to a lack of respect for the administration of justice (see *Laronde*).

One may also ask whether these principles of consistency and parity in sentencing apply to not only fines under one statute (the EPA), but should also require a consistent approach across many regulatory statutes. According to Justice R. Libman, of the Ontario Court of Justice, they should as a matter of justice, but unfortunately often do not.[ii]

This author believes that regulatory lawyers on both sides of a case need to take off the blinders, and adopt a broader perspective of what statutes and fines are relevant in a given case, if some semblance of justice is to be achieved. The principles of consistency, parity and the fair administration of justice, require it.

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[i] (2006), 22 C.E.L.R. (3d) 80 (B.C. Prov. Ct.), at para. 134.

[ii] The Honourable Mr. Justice Rick Libman, *Sentencing Purposes and Principles For Provincial Offences - The Modernization of the Provincial Offences Act* (Commissioned by the Law Commission of Ontario, June 2010.