Insurance for Construction Projects

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The purpose of this paper is to discuss the most common forms of construction insurance and to outline some recent developments of interest to contractors. The paper also discusses aspects of professional errors and omissions policies and outlines principles of interpretation for insurance contracts. It also briefly describes new innovative types of insurance for complicated projects.

I. COMMERCIAL GENERAL LIABILITY POLICY (“CGL”)

Nearly every party involved in a construction project will carry a CGL policy. This is the most common liability policy issued by insurers for the construction industry. The typical CGL policy protects insureds against loss arising out of “bodily injury” or “property damage” caused by an occurrence during the policy period. This insurance is most often taken out by contractors and subcontractors.

The purpose of a CGL policy is to indemnify the insureds for liability at law arising out of claims made against them by third parties (hence it is
referred to as third party insurance). CGL insurance is placed on a yearly basis and covers all of the operations of the contractors, subcontractors, owners, etc.

There are two fundamental insuring agreements contained in a CGL policy. The first indemnifies the insured for liability that it may have for bodily injury or property damage caused by an accident or an occurrence during the term of the policy. The second insuring agreement provides that the insurer must provide a defence to an insured in respect of any claim which, if successful, may result in liability under the policy.

The purpose of the CGL policy is to protect the insured from a wide range of liability exposures that it may have arising from accidents which occur in the construction process. It is not intended to indemnify the insured for defective or shoddy work. Like most insurance policies, a typical CGL policy contains numerous exclusions which must be understood. In this paper, I will touch upon the scope of coverage provided by the policy and some of the typical significant exclusions.

**Coverage**

The typical CGL policy indemnifies an insured from claims arising from bodily injury or property damage. Bodily injury is easily understood, but property damage is not.

Property damage does not include poor workmanship. Property damage is typically defined to mean physical injury to property (sometimes
tangible property), including resultant loss of use of that property or loss of use of property that is not physically injured. Generally speaking, property damage arising from the use of automobiles, watercraft and aircraft is excluded by the policy.

Where there has been a substantial collapse of a building or part of a building during construction, property damage is self evident. The difficulty arises where the claim is for the cost of remedying defects in materials or workmanship and the effect of such defects on a building project. Historically, CGL insurers have argued that claims of this nature are economic loss and are not covered by liability policies. Until recently, it was thought that such claims were not property damage or were excluded by the “work” or “product” exclusion.

The leading decision on economic loss and property damage was *Privest Ltd. v. Foundation Company of Canada* (1991), 57 B.C.L.R. (2d) 88, a decision of the British Columbia Supreme Court. *Privest* dealt with a claim by a building owner for the cost of removing asbestos containing materials from the building. The liability insurers of the contractor argued that the cost of removing asbestos containing materials did not constitute physical injury to or destruction of tangible property. Unfortunately, there were a number of liability insurers on the risk over the years who had different definitions of “property damage” in their insurance contracts. The court found that although there was no actual physical damage to the building, the presence of the asbestos containing materials prevented the building from functioning properly as a building and as such the
presence of such materials could constitute damage to or destruction of property within the definition of “property damage” in some of the policies. However, the court also found that the presence of such materials was not physical injury to or destruction of tangible property which was the definition found in two of the other policies before the court. Those policies which did not include the words “tangible” were sufficiently broad to permit a finding that there was damage to property.

In British Columbia, this issue has arisen in a number of cases involving leaky condos. In the two cases decided to date, *AXA Pacific Insurance Co. v. Guildford Marquis Towers Ltd.*, [2000] I.L.R. 1-3801 and *F.W. Hearn/Actes v. Commonwealth Insurance Company*, [2000] I.L.R. 1-3870, the courts have had no difficulty in concluding that damage internal to the structure itself consisting of cracks, water leakage, internal rot, etc. constitutes property damage under a CGL policy.

In the AXA case, the court was faced with an application by the contractor, Metrocan Construction (GM) Ltd. for a determination of whether or not AXA had an obligation to defend the claim brought against it by the Strata Corporation. The Strata Corporation alleged that Metrocan was liable for construction defects in performing their work under the construction contract.

Following completion of the project, the building developed leaks which were traced to defects in both the construction and the materials supplied and in the design by the project architect. The construction defects included
improper application of caulking and stucco/concrete interfaces, improper application of elastomeric coatings over the stucco and the improper preparation of the substrata upon which the stucco was placed. These defects were the cause of water infiltration, penetrating behind the stucco and eventually into the building. The claim advanced was for the costs of replacing the stucco, refurbishing damaged building elements and replacing the caulking in exterior finishes.

The policy issued by AXA provided an indemnity for the insureds’ liability for damages arising from injury to or destruction of property due to an accident or occurrence.

AXA argued that the claim was essentially for pure economic loss and that there was no injury to or destruction of property. The court reviewed the Privest decision and determined that the definition in the AXA policy was similar to that found in those policies in the Privest decision where the court held that there was damage to or injury of property in the sense of an infringement of intangible property or an incorporeal right.

In the Hearn/Actes case, the general contractor, Hearn/Actes, had commenced proceedings against UBC claiming delay damages arising out of the completion of a student housing project. UBC filed a counterclaim for the costs of remedying deficiencies in the building made by Hearn/Actes. These deficiencies included the standard allegations for a leaky condo claim such as improper installation of roof flashings, roof membranes, sealants at windows,
absence of control joints and installation of an inadequate or improper face seal system. Hearn/Actes requested Commonwealth to defend it in the counterclaim. Commonwealth denied it had a duty to defend and an application was brought by Hearn/Actes for a declaration that Commonwealth was obliged to defend the claim. Commonwealth’s first position was that there was no damage within the terms of the policy as its policy was limited to legal liability “because of damage to or destruction of or loss of use of tangible property caused by an occurrence”. Commonwealth argued that the reference to “tangible property” distinguished its policy from the AXA policy and that in essence the claims of UBC were for pure economic loss not covered by the policy. The court did not agree and based on the reasoning of the Privest decision concluded that the claims advanced by UBC were in fact claims for damage to property. The effect of this decision is that with respect to leaky condos the cost of remedying building defects and their consequences to the building are properly considered to be claims for damage to property.

The Requirement for an Accident or Occurrence During the Policy Period

The standard CGL policy requires that there be an accident or occurrence during the policy period. Intentional conduct is not covered by the policy. Similarly, poor workmanship per se is not covered.

The words “accident” or “occurrence” have received a great deal of judicial scrutiny. It is generally accepted to mean something fortuitous,
unexpected, an unanticipated or unlooked for mishap. To this point in time, the courts have had no difficulty in determining that water penetrating into condominium units through defective caulking, improperly applied stucco or defective flashings and membranes constitutes an accident. Although the work performed was performed defectively, it was not intended that water would penetrate to living units and that damage would occur.

Problems however arise with respect to the timing of the accident. CGL policies cover accidents which occur during the policy period. They are generally renewed on a yearly basis. Often contractors and subcontractors change liability insurers over the years. Water penetrating buildings does not happen only once. It is a progressive event which occurs over time. Issues arise as to which policies should respond to a claim for damages for repairing defects in construction causing water penetration. In the United States, the general principle is that all policies in place from the time of construction through to and including the completion of repairs are on the risk. In Canada, this issue has not been definitively decided. In *Surrey (District) v. General Accident Assurance Co. of Canada* (1996), 19 B.C.L.R. (3d) 186, the B.C. Court of Appeal indicated that policies in force at the time the actual damage occurred to the property should respond to the loss. This is very difficult to prove where there is rot as it is a progressive damage. In these circumstances, it is argued that all policies on the risk as the rot progresses are required to respond to the claim. In British Columbia, the liability insurers generally agree among themselves to share the
claim proportionately to the number of years that each policy was on the risk.
There has been no definitive litigation of this issue and it remains open for
debate.

Exclusions

Each policy differs with respect to exclusions. Insurers have changed their own exclusions over the years to expand them or restrict them based upon competitive market forces. This creates difficulties when assessing liability for progressive damage. Under some CGL policies, there may be coverage for some loss, under other CGL policies coverage may be expressly excluded. There are some instances where contractors have had a number of different policies over the years, some of the policies cover the loss and others exclude it. Additionally, some contractors change the scope of their CGL insurance over the years. Sometimes, they have a comprehensive policy applicable to all of their work, in other years, they have specific policies applicable only to identified locations. In these examples, there will be some years where progressive damage has occurred and the contractor has no insurance because of a reduction in the scope of its policy or the application of an exclusion in a policy. This is referred to as “going bare”.

There is a difference of opinion as to the liability for damage for those years where the contractor has no insurance. Clearly, the contractor itself is liable for the lack of insurance but what of the circumstances where the contractor is a single purpose company and has no assets? In those
circumstances, it is argued that the insurers on the risk for the years where coverage was in place are jointly and severally liable for the totality of the loss and must bear the full liability for the loss vis-à-vis the plaintiff. Those insurers are free to seek contribution and indemnity from the insolvent contractor for the years that it went bare. As is typical with insurance issues, there are authorities in the United States on both sides. There is no decision in Canada yet which definitively answers this question. Contractors should make sure that even where they are single purpose companies, all such companies are listed on their general liability policy every year. Contractors should also be very careful not to change liability insurers as differences in policies may create gaps in coverage which may leave them bare.

**The Product Exclusion**

There are a number of different exclusions to the standard CGL insurance policy. They include intentional conduct, Workers’ Compensation liability, bodily injury arising out of the use of automobiles, watercraft, etc., liability for damage to property owned by the insured, pollution liability, product recall, nuclear risk, professional services and professional liability and liability for blasting, pile driving and collapse or caisson work. Separate insurance by way of an endorsement is required for blasting, pile driving and collapse or caisson work.

The most often referred to exclusion is the contractor’s “product” and contractor’s completed “work” exclusions. In my view, these exclusions have
received much wider support from the courts than originally intended. The contractor’s product exclusion is intended to exclude goods or products manufactured, sold, handled, distributed or disposed of by the insured. U.S. authorities initially held that a building constituted the contractor’s “product” as it was transferred from the contractor to the owner during construction. Following this line of reasoning, the U.S. courts excluded all claims involving damage to the building from the policy. This left very little area for coverage.

More recent U.S. authorities have concluded that the contractor’s product could not possibly include the building as there is no “sale” or “transfer” of title to the building to the owner during the course of the work. The contractor merely constructs the building; the building is owned at all times by the owner. To confuse the issue even further, there was a substantial change to this exclusion in the United States between the 1973 form and the 1986 form of CGL insurance. The 1986 form made it clear that the contractor’s product did not include real property so it could not apply to a building.

The AXA case addresses this issue in British Columbia. In denying liability, AXA relied upon an exclusion which excluded coverage for injury to or destruction or loss of use of goods or products manufactured by the insured. The court found that this exclusion did not apply to a building. It accepted the reasoning that a building could not be considered “goods” or “product” of a contractor as to do so would essentially exclude from coverage all of the work done by or on behalf of the insured. Similarly, in the Hearn/Actes case,
Commonwealth sought to rely upon its exclusion for damage to “that particular part of the insured’s products out of which an accident arises”. The court found that this exclusion did not apply as the claim involved damage to other portions of the project other than that particular part of the insured’s products which were defective.

The Work Exclusion – Broad Form Coverage

Some forms of CGL policies contain an exclusion which excludes coverage with respect to damage to property arising out of the insured’s work or any part of it. On a typical construction site, work is performed by a general contractor’s own forces or by subtrades. The effect of this exclusion is to exclude all liability for property damage where such damage arises out of the general contractor’s work under the head contract, including the work of subcontractors. As you can see, this is a fairly onerous exclusion which substantially limits a CGL insurer’s obligations to indemnify the insured general contractor.

Contractors can purchase what is referred to as Broad Form Property coverage which modifies the exclusion so that the exclusion does not apply where work is performed by or on behalf of the general contractor by a subcontractor.

The “work performed” exclusion is often raised by insurers in connection with claims against contractors for defective work. It is a common refrain within the insurance industry that insurance is not intended to pay the cost
of repairing a contractor’s poor workmanship. The insurance industry does not intend to cover contractors for the cost of making good their own bad work as this is a risk of doing business rather than insurance. The Broad Form Property coverage substantially diminishes the impact of this exclusion.

II. WRAP-UP LIABILITY INSURANCE

Most construction contracts require a contractor to have liability insurance in specified amounts and to include the owner and its consultants as well as subcontractors in the policy. This is effected usually by adding the owner and its consultants and the others as additional insureds to the contractor’s standard CGL policy or by the purchase of a wrap-up liability policy.

Care should be taken when adding others to a standard contractor’s CGL policy to ensure that the others are added as “additional insureds” in their own right and are not added only as “additional insureds” with respect to vicarious liability arising out of the contractor’s acts or omissions. This issue often involves a question of costs. There is virtually no additional cost to add the owner or others as insureds to a standard CGL policy if the coverage is limited to vicarious liability only. An additional premium will likely be charged where the additional risks arising out of the owner’s work or the consultant’s work are included in the contractor’s policy.

Care should be taken to determine what additional insurance is required under the construction contract before this insurance is placed. The
standard CCDC2 requires the contractor to place insurance for itself as well as for the benefit of the owner and the consultant. Rather than adding the owner and its consultant as “additional insureds” to the contractor’s standard insurance policy, the contractor may take out one policy covering the liability of all parties directly involved in the construction project. This is referred to as a wrap-up liability policy. This policy typically insures the owner, the contractor and the consultants as named insureds and extends coverage to all subcontractors and consultants as additional insureds for liability arising out of their work on the project.

A number of issues arise with respect to wrap-up policies. These issues must be understood before deciding to place wrap-up insurance or to add “additional insureds” to the contractor’s CGL policy. Generally speaking, a standard CGL policy provides that it has no application where a wrap-up policy is in place. Typically, wrap-up policies are placed for the period of time when construction of the project is ongoing and for a few years thereafter until completion of the warranty period. Disputes often arise between wrap-up insurers and liability insurers as to who is responsible for a claim for progressive damage. Standard CGL insurers claim that there was an accident or occurrence during the wrap-up policy period and it should respond to the claim. Wrap-up insurers say that their liability is limited to the few years that the policy was in effect and that the bulk of the obligation to respond lies with the CGL insurers who are on the risk while the progressive damage occurred.
Generally speaking, wrap-up liability policies exclude coverage for damage to the project during construction. They also provide coverage for Completed Operations for a number of years after the work is completed. They traditionally do not include the Broad Form property coverage found in the standard CGL policy. The wrap-up policy exclusion for damage to the project often does not apply after the construction operations are completed. This may result in a lack of coverage for damage to property while construction is ongoing.

The existence of a wrap-up policy is generally not known to subtrades who are provided coverage by its terms. This can often result in claims being advanced against subtrades and processed by the subtrades and its CGL insurers long before it has realized that a wrap-up policy was placed.

As standard CGL policies do not apply when wrap-up policies are in effect, there will only be one limit under the wrap-up policy available for any claim. In circumstances where each party held its own CGL insurance, and an accident arises which was caused or contributed to by a number of parties, there will be a stacking of limits available under the CGL policies to respond to the claim which could be greater than the single limit under the wrap-up policy.

A wrap-up policy however does have some benefits. As it applies to all parties on the construction site, it limits the possibility of disputes of who is at fault. In addition, all contractors usually enjoy the benefits of higher policy limits than they could normally purchase. Lastly, the Completed Operations coverage is of benefit to the owner as it ensures that liability insurance will be in
place for a number of years after the project has been completed whether or not the general contractor and the subcontractors maintain their own CGL insurance. Essentially, the owner is able to control the contracting parties’ liability policies rather than be at the whim of a contractor maintaining its own insurance.

The contractor should continue its CGL insurance on a yearly basis to cover project risks after the wrap-up policy terminates in order to ensure it is fully protected.

Wrap-up policies were originally intended for large projects where premium volume would be attractive to insurers and where insureds would benefit from corresponding premium reductions. Recently however these policies have been used on projects of all sizes.

III. PROPERTY INSURANCE

Property insurance on construction projects is usually referred to as “Builder’s Risk Insurance” or less frequently “All Risks Insurance”.

As the risks of damage to property is significantly different in nature when a project is undergoing construction, the standard property insurance policy coverages usually will not cover loss associated with buildings under construction. A Builder’s Risk policy is the main vehicle for providing property coverage for structures under construction.
Builder’s Risk policies typically contain exclusions for any type of consequential or indirect loss. This would include losses due to delays in construction caused by the structure being damaged by an insured. Owners can incur significant damages if the project is delayed. These time element or soft cost damages can be covered under loss of use insurance which can be purchased by way of an endorsement to the Builder’s Risk policy.

As with a CGL policy, a significant issue under the Builder’s Risk policy is whether or not coverage is provided where the damages were caused in whole or in part by poor workmanship.

Generally speaking, the Builder’s Risk insurance policy compensates the insureds for physical loss or damage to all permanent construction and temporary works necessary to facilitate construction (hence it is referred to as first party insurance). This insurance also covers the costs of the removal of debris following any insured damage.

The limits of the Builder’s Risk insurance should be at least sufficient to cover the replacement costs of the project plus costs for debris removal. The amount of the policy should therefore be in excess of the contract price plus the value of any material supplied by the owner or other parties.

For coverage to apply under a Builder’s Risk policy, there must be physical loss of or damage to property. As with CGL insurance, the term “physical loss” is intended to eliminate coverage for economic loss or diminution
in value. The mere fact that defects exist in property is generally insufficient in and of itself to trigger coverage.

The standard IBC Form 4042 of Builder’s Risk Broad Form insurance contains a cessation of coverage clause which provides that the insurance ceases for the project upon the commencement of use or occupancy of any part or section of the project unless the use or occupancy is for construction purposes, office or habitational purposes or for storing equipment or machinery. This clause would essentially terminate insurance coverage for the entire project where the owner opens an underground parking lot while the building is still under construction, and may possibly terminate coverage where a commercial floor is opened for use prior to the completion of the balance of the project or where a special use such as a health club is put into effect before the completion of the project. Care should be taken to ensure that the owner’s plans for temporary openings and occupancy do not prejudice its insurance.

It is also important to understand that coverage ceases as soon as the building is occupied. Therefore, there is no property insurance in respect of work performed after substantial completion such as remedying deficiencies or warranty work.

Generally speaking, water borne property, air and ocean cargo and contractor’s equipment are excluded from the policy. In addition, no coverage is provided for property in transit or off site. Other typical exclusions include employee dishonesty, inventory shortage, wear and tear, pollution, increased
costs due to the enforcement of by-laws, delay interruption, loss of use, etc.,
flood and earthquake, rust, corrosion, frost and freezing and damage caused by
faulty material, faulty workmanship or faulty design; however, where resultant
damage ensues, then such resultant damage is insured.

Faulty Workmanship, Materials and Design

This exclusion is not well understood and has been the subject of a
great deal of litigation. This exclusion has been broadly interrupted by courts in
Canada. The resultant damage exception to the exclusion has been very
narrowly interrupted. When interpreting this clause, courts have tended to look at
the entire project when assessing what it is that is faulty and repaired rather than
the individual defective component which caused the damage.

It is my experience that where there is damage to property during
construction, it usually arises as a result of faulty material, faulty workmanship or
faulty design. The word “faulty” does not require negligence but connotes a lack
of capacity in performing as it should. There is very little damage to property
caused by perils during construction other than a lack of capacity in materials,
workmanship or design. As a consequence, the scope of coverage provided by
the IBC form Builder’s Risk policy is minimal. The leading cases in Canada such
as *BC Rail Ltd. v. American Home Assurance Co.*, 54 B.C.L.R. (2d) 228, *British
Columbia v. Royal Insurance Co. of Canada* (1991), 60 B.C.L.R. (2d) 109, *Triple
W.W.R. 55 reversed: [1977] 4 W.W.R. 351, and Simcoe & Erie General Insurance Co. v. Royal Assurance Co. of Canada, [1982] 3 W.W.R. 628 have consistently held that the court is to look at the totality of the project when assessing what is faulty. The court is not entitled to look at a component part of the work to determine whether it is faulty but rather must look at whether that component part affects the totality of the project thereby rendering the project faulty. In other words, an undersized defective beam in a roof makes the entire roof defective. The collapse of the roof would be excluded from coverage as it arose from defective workmanship, materials or design. The exclusion would exclude all costs of repairing the roof, not just the beam. Damage to property on the floor which was hit by the collapsing roof would be covered as resultant damage.

In recent years, insurers have taken steps to market a narrow form of this exclusion. One attempt provides an expansive definition of resultant damage which includes damage to the insured property except for the cost of repairing or replacing the part or component of the insured property which was faulty. Another attempt at providing expansive coverage has been to limit the exclusion to the component part or individual item that is defective.

In summary, owners should be cautious to review their Builder’s Risk policy to determine what it covers. They should attempt to obtain a more limited faulty workmanship exclusion and should take steps to ensure that there
is no occupancy of a project prior to its completion which may bring about a termination of the insurance coverage.

In addition, to Builder’s Risk insurance, owners usually also purchase Boiler and Machinery insurance which provides coverage for loss resulting from sudden and accidental breakdown of insured equipment. It is usually required because of the standard exclusions contained in most Builder’s Risk property policies.

IV. BOILER AND MACHINERY INSURANCE

The purpose of this insurance is to provide coverage for all pressure vessels and mechanical and electrical equipment relating to heating or power systems. It is triggered by an accident which is generally defined to be a sudden and accidental breakdown of the object or part thereof which manifests itself at the time of its occurrence by physical damage to the object that necessitates repair or a replacement of the object or part thereof. Typically, damage is caused by cracking, bursting, electrical arching and mechanical breakdown.

Generally speaking, losses involving objects undergoing testing are not covered. Fire, flood and earthquake and other similar risks are also excluded. Coverage does not start until the objects are connected and ready for use, tested and contractually accepted by the owner. The contractor is often considered as the owner of the equipment until actual acceptance by the owner.
Some difficulties arise where two different insurers are involved; one insuring the Builder’s Risk and the other insuring the Boiler and Machinery. Most insurers in Canada are parties to a joint loss agreement which sets out the protocol for dealing with overlapping coverage where there are two insurers.

V. CONTRACTOR’S EQUIPMENT INSURANCE

This form of insurance provides coverage for direct physical loss of construction machinery and equipment. This type of insurance provides comfort to the owner that the project will not fail because the contractor’s equipment is damaged as a result of an insured loss. Coverage is provided on an all risk basis on all construction machinery and equipment owned or not owned by the contractor and used by the contractor in performing the work. The terms and conditions of these policies vary considerably. Some offer broad coverage while others offer very restrictive coverage. In some cases, claim settlement is based on actual cash value and in other cases settlement is based on replacement cost.

VI. LIABILITY COVERAGE FOR DESIGN PROFESSIONALS

Architects and engineers are insured by professional errors and omissions policies. These policies are indemnity policies which indemnify an architect or an engineer for claims made against them for a professional error by third parties. In other words, they only provide insurance to an owner or contractor where the owner and contractor can prove that the negligence of the
architect or engineer caused loss or damage. The injured party cannot make a
direct claim against the insurance policy. It is only there to protect a professional
if a claim is brought against him by a third party.

These policies contain terms and conditions which may
substantially limit the insurer’s obligations to indemnify third parties. In British
Columbia, most small architectural and engineering firms carry very little
professional E&O insurance. Some carry no insurance at all. Many carry
insurance with limits of only $250,000. Most now carry insurance with a specific
exclusion excluding loss or damage arising from face sealed construction. This
exclusion has been inserted as a result of the leaky condo crisis in British
Columbia.

The typical professional E&O policy is a “claims made” policy. The
limits of the policy will only respond to claims made during its term. The insurer
has no liability when the policy term is over. If a number of different claims are
made during the policy period, then the limits are available to be shared pro rata
among all the claimants. A claim is usually defined to include an action by an
injured party seeking compensation or notification to the insurer by the insured of
a potential error or omission which may give rise to a claim.

There are various types of professional liability insurance available.
There is the typical liability insurance for architects, engineers or other
consultants. In addition, professional liability insurance for contractors who
employ architects or engineers is also available. There is also insurance for joint
venturers for vicarious liability arising out of design errors committed by one of the joint venturers. In addition, some specific policies are applicable to design builders and lastly some policies are written on a professional errors and omissions basis for project managers, construction managers and other consultants.

There are some exclusions. These include the performance of services not usual or customary for professional architects or engineers, express warranties or guarantees given by the architect or engineer, claims arising from the failure to advise or require a form of bond, and claims arising from estimates of probable construction costs, profit, return on capital, etc.

**Project Specific E&O Insurance**

On major projects, owners may place project specific errors and omissions coverage. This insurance has much higher limits than those maintained by the typical architect and engineer. These policies apply to all professionals who may work on a project. They ensure that there are no gaps in coverage for design for the project. This provides comfort to owners that if there is any error in design committed which results in a loss of any kind, then the consultants on the project will have sufficient insurance available to compensate the owner for the loss.

A project specific policy restricts coverage to claims which arise out of the project. Under the policy, the insurer is required to indemnify the
consultants for claims brought against them, including their defence costs. The policy limit is an annual aggregate. Claims erode the aggregate on an annual basis.

Owners should be careful not to undermine the effect of a project specific E&O policy by entering into a contract with their consultants which contains a limitation of liability clause. In a very recent British Columbia leaky condo case, the owner had in place ample E&O insurance available to its design consultant but was severely limited in what it could recover in a claim brought against the design consultant as the architectural services agreement between the owner and the architect provided for a limitation of liability of $250,000.

A more typical limitation of liability clause which is found in the standard form of contract recommended by the architects and engineers associations serves to limit the liability of architects and engineers to the amount of insurance available. This is a problematic limitation. It depends for its efficacy on the date when the claim is made. As E&O policies are claims made policies, architects and engineers can change the amount of insurance available from year to year. Although the owner may receive a certificate from the architect or engineer indicating that it has insurance limits of $5M at the time of construction of the project, when a claim arises five years later, the limits in place at that time may only be $250,000. The effect of the clause would limit the amount of recovery against the architectural and engineering company to the limits
prevailing at the time the claim is made regardless of the limits available at the time the project is built.

VII. PRINCIPLES OF CONTRACT INTERPRETATION

Insurance contracts are unique forms of contract. They have their own general principles of interpretation, some of which are derived from other general principles of interpretation of contracts generally. The principles of interpretation of insurance contracts are as follows:

(a) Contracts of insurance should be interpreted contra proferentem (i.e. against the insurance company who is the maker of the standard form terms and conditions);

(b) If two opposing interpretations are possible, the one most favourable to the insured should be adopted;

(c) Coverage provisions should be construed broadly and favourably to the insured and exclusion clauses narrowly against the insurer;

(d) Courts should be guided by the reasonable expectation and purpose of ordinary insureds regarding coverage; and

(e) Courts should not construe an insurance policy in such a way as to nullify the purpose for which the insurance was sold.
VIII. DUTY TO DEFEND

Liability policies generally include two types of coverages. The first is an indemnification for the insured for claims made against it for losses or damages suffered by a third party. The other is a duty to provide a legal defence to claims brought against the insured.

Legal authorities have articulated principles applicable to determine whether or not an insurer has a duty to defend. In determining whether or not a duty to defend arises, the following questions must be asked:

1. Do one or more of the claims fall within the insuring agreement?

2. Are the claims excluded by an exclusion clause?

3. Is there a possibility that one or more of the claims may succeed at trial?

Where there are mixed claims, some attracting coverage and some not, the insurer is obligated to defend at least those that may attract coverage. With respect to the balance of the claims where they are unclear or intertwined with covered claims, the insurer is obligated to defend those as well.

The duty to defend arises where an insured faces claims which, if proven, would fall within the policy. An insured bears the burden of establishing only a potential claim.
Because contracts of insurance are generally construed contra proferentem and, more importantly, because the success of the claim that is made in the underlying action is a matter of contingency, any doubt as to whether a claim falls within the coverage of the policy ought to be resolved in favour of the insured.

In determining whether or not a claim falls within the insuring agreement, the court must attempt to identify the substance of the claim. A recent case reviews the law to determine whether or not the substance of the claim must be identified solely from the pleadings filed by the claimant or from other extraneous documentation. In *Monenco Ltd. v. Commonwealth Insurance Co.* (2001) 204 D.L.R. (4th) 14, the Supreme Court of Canada dealt with an application brought by Monenco against its insurer, Commonwealth, for the legal costs incurred by Monenco in defending a claim brought against it arising from a fire which destroyed Suncor’s tar sands plant on October 11, 1987. Suncor commenced proceedings against a number of defendants, including Monenco. In its Statement of Claim, Suncor alleged that Monenco, through a subsidiary, 67669 Alberta Inc., owed a duty to warn Suncor of the dangers of PVC cables which were specified by a joint venture of engineering firms, including Monenco’s subsidiary. Suncor also alleged that Monenco had a duty to exercise proper supervision and control over its subsidiary and that this duty was breached giving rise to the fire.
At the time of the claim, Monenco requested its CGL insurer to defend the claim. The CGL insurer denied its liability to defend the claim because of a turnkey exclusion and a professional services exclusion contained in the CGL policy.

The Supreme Court of Canada agreed that the CGL carrier had no duty to defend as the claim was covered by an exclusion. The traditional rule was that the pleadings would be examined to determine whether an insurer’s duty to defend had been triggered. Whether an insurer is bound to defend the claim would turn on the allegations made in the pleadings. If the pleadings alleged facts which, if true, would require the insurer to indemnify the insured for the claim, then the insurer is obliged to provide a defence even though the actual facts may differ from the allegations pleaded. The widest latitude is to be given to the allegations in the pleadings in order to determine whether they raise a claim within the policy.

In an earlier decision in Scalera, the court held that bare assertions advanced in the Statement of Claim are not necessarily determinative. To rely upon such bare assertions, the parties to an insurance contract will always be at the mercy of a third party pleader. What really matters is not the labels used by the plaintiff but the true nature of the claim. Based on this, courts were urged to look behind the legal terms of the pleadings in order to assess which of the legal claims put forward by the pleader could be supported by the factual allegations. Accordingly, the proper basis for determining whether a duty to defend existed in
any given situation required an assessment of the pleadings to ascertain the
substance and true nature of the claims.

In *Monenco*, the court considered whether or not extrinsic evidence
such as documents outside of the pleadings could be referred to to determine the
substance and true nature of a claim. It was important in *Monenco* as the insurer
wished to refer to the contract between the joint venture engineers and Suncor to
prove that the project was a turnkey project. There was no specific turnkey
allegation made in the pleadings. In *Monenco*, the court held that it is proper to
refer to documents referenced in the pleadings in order to determine the true
substance and nature of the claim. As Suncor had pleaded a contract and had
pleaded that the work was performed by a joint venture, it permitted the court to
review the contract as well as the joint venture agreement. A review of this
extrinsic evidence was simply held to illuminate the substance of the pleadings.
Based on a review of the documents, the court concluded that the claims were
catched by the turnkey exclusion in the policy.

IX. COST OVERRUN INSURANCE

This is a specialized insurance product that is available for major
projects. It has been used on some Alberta projects and is widely used in
European BOT projects. It insures the project for the cost of overruns. Usually
the contractor retains a substantial deductible. The project is usually subject to
an extensive pre-screening and due diligence by the insurers. The insurance
usually covers claims in excess of the project contingency of approximately 5%.
It insures increased costs above the Target Outturn Costs usually involving increases in engineering, procurement, construction and Project Management Costs. Its typical exclusions include insolvency/financial default, acceleration costs, scope changes or betterment costs due to price inflations above a specified percentage, and liquidated damages and delays.

X. DELAYED COMPLETION – FORCE MAJEURE COVERAGE

This is another highly specialized insurance. It is usually provided by insurers only after a substantial contract-engineering review by an independent consultant. It covers the costs of delay in completion arising from force majeure events. There is usually a 30 day deductible period which is absorbed by the contractor.

If the insurance is triggered, it pays negotiated monthly amounts for a negotiated policy period.

This form of insurance can be coupled with acceleration coverage which pays acceleration costs usually after a 30 day deductible period.

XI. CONCLUSION

Placing the appropriate insurance for a construction project is a very complicated exercise. Traditionally, it is undertaken as an after thought. Boiler plate insurance terms and conditions are adopted from previous contracts without any review or thinking. Obtaining appropriate insurance can mean the
difference between a successful and an unsuccessful project. Often contractors provide very little information to brokers in order to permit them to make proper recommendations for the scope of insurance required. If more care is taken in addressing the proper needs of construction insurance, the total insurance costs on a project will be less and all parties will be comforted by the fact that appropriate insurance is in place to protect their interests.