

Newsletter



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***Ledcor v. Northbridge*: Changing the standard of appellate review applicable to interpretation of standard form contracts and its application to builder's risk insurance policy exclusions**

In *Ledcor Construction Ltd v. Northbridge Indemnity Insurance Co.*, 2016 SCC 37, the Supreme Court of Canada ruled on two hot topics in insurance law. Firstly, the Court clarified its ruling in *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, which pertained to the appropriate standard of review for standard form contracts. Subject to certain conditions, the Court in *Ledcor* held that the interpretation of standard form contracts, such as insurance contracts, was subject to the correctness standard of review.

The Court also discussed the interpretation of the faulty workmanship exclusion contained in a builder's risk insurance policy. The Court held that "the cost of making good faulty workmanship" was excluded from the policy but the "damages resulting" from said faulty workmanship were covered.

The present case was on appeal from the Alberta Court of Appeal. Respondent Northbridge insured a construction project for an office building in Edmonton, Alberta. During construction, a subcontractor scratched the windows of the building insured by Northbridge when washing the windows by using inappropriate methods and tools. The windows had to be replaced. The owner and general contractor claimed the replacement cost of the windows from Northbridge. The latter denied coverage alleging that replacement of the windows was excluded under the policy's terms, because Northbridge considered the damages corresponded to faulty workmanship.

The Court had to interpret the following exclusion:



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4 (A) Exclusion

This policy section does not insure:

[...]

(b) the cost of making good faulty workmanship, construction materials or design unless physical damage not otherwise excluded by the policy results, in which event this policy shall ensure such resulting damage [Court's emphasis].

The Alberta Court of Appeal reversed the trial judge's holding and granted Northbridge's coverage denial. The Court of Appeal held that the appropriate standard of review was correctness. Therefore, the trial judge's application of the doctrine of *contra proferentem* was inappropriate, because the exclusion language was not ambiguous and thus did not give rise to this doctrine. Instead, the Court of Appeal developed a test of physical damage or systemic connectedness to determine whether physical damage was excluded as the "cost of making good faulty workmanship" or covered as "resulting damage". The Court of Appeal concluded that the damages caused to the windows had to be excluded because they were not accidental or fortuitous, but rather caused by scraping and wiping during the subcontractor's work. Therefore, the subcontractor intentionally applied these motions to the windows. The damages were not only foreseeable, but probable.

The majority of the Supreme Court, led by Wagner J., allowed the appeal and reversed the Alberta Court of Appeal's decision. The Court clarified

Sattva, wherein Rothstein J. held that the interpretation of contracts was a question of mixed fact and law requiring a palpable and overriding error to review a Court's interpretation of a contract. In *Ledcor*, Wagner J. held that the interpretation of standard form contracts, such as insurance policies, should be recognized as an exception to the Court's holding in *Sattva*. According to the Court in *Ledcor*, interpretation of clauses in standard form contracts is a question of law, which is subject to the appellate review standard of correctness. The Court states that this will promote consistency and coherence in interpretation of such clauses in order to create precedent.

The Court bases its reasoning on the fact that the factual matrix underpinning entering into such a contract has little or no bearing on the parties' intentions or expectations. A standard form contract such as a builder's risk insurance policy should be interpreted upon such factors as the purpose of the contract, the nature of the relationship it creates and the market or industry in which it operates instead of the facts underpinning its signature; said facts will usually be the same for any part entering into such a contract.

Based on the above reasoning, the Supreme Court held that the Alberta Court of Appeal had no reason to develop the physical or systemic connectedness test. Instead, Wagner J. held that the language of the exclusion was ambiguous. Using the general principles of contractual interpretation, the Court is led to the conclusion that the exclusion clause serves to exclude from coverage only

the cost of redoing the faulty work, which, in the present case, corresponded to the cost of recleaning the windows, whereas the damage to the windows was covered. The Court supports its conclusion on the fact that the reasonable expectation of the parties corresponds to a broad coverage provided by the builder's risk insurance policy, considering the commercial nature in which this policy is taken. The Court explains that the purpose of the builder's risk insurance policy is to offer broad coverage to contractors and owners in order to protect them from construction projects grinding

to a halt because of disputes and potential litigation about liability for replacement or repair amongst various contractors involved. In light of the underlying objective of this broad coverage, the appropriate interpretation of such contracts should favor coverage for damages caused to the construction project, but which excludes the cost of redoing faulty work.

The Supreme Court therefore reversed the Court of Appeal's decision and reinstated the conclusion rendered by the trial judge.

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