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# Multiparty Construction Litigation: The Game has Changed

**Presented by:** Alexandre Maltas
**Prepared by:** Alexandre Maltas & May Allingham

Whitelaw—Twining

The 1980s and 1990s saw a large spike in multi-party construction cases making their way to litigation in this country. What is now the infamous Leaky Condo Crisis of British Columbia exposed a flawed system where new home owners were being left with deficient homes, scrambling to sue whichever contractor or consultant was still around in hopes that they had insurance or the ability to compensate them for their losses.

Changes were inevitable, and the result of the leaky condo crisis was ultimately the introduction of the *Homeowner Protection Act,* SBC 1998, c 31 (the **"BC Act"**) which not only provided owners with more consumer protection, but also led to major changes in the way multi-party construction litigation is conducted. The predictability and apportionment which the major players (owner/developer, general contractor, design professional, municipality) had become accustomed to were no more and there was a new major player at the table with deep pockets.

In addition to the new mandatory warranty which was now available to homeowners, there have been other fundamental changes that affected multi-party construction defect litigation as well. As more claims made their way to litigation, the courts clarified the role of certain types of insurance policies and in doing so extended coverage to damages which were previously thought to be unrecoverable.

## *The Leaky Condo Crisis*

In the 1980s, the public, swayed by popular culture, desired California style homes, and developers were more than willing to adopt the style and give the homeowners what they demanded. Unfortunately, the one factor they could not mimic was Californian climate, and the materials used in carrying out the design of the homes, while suitable for California, were not suitable in preventing water damage in the West Coast environment[1] and with that the leaky condo crisis as we know it was set in motion.

In addressing the leaky condo crisis, the Commission of Inquiry into the Quality of Condominium Construction in British Columbia (the **"Commission"**) reported that it had been presented with a vast range of problems which included:

> …single family homes, whose foundations were sliding; expensive townhouse complexes with water rushing through the walls; concrete high-rise apartment condominiums with cracking foundations; older wood frame conversions, which required extensive renovations; equity co-ops with extensive construction over runs; and many, many wood-frame condominium apartment complexes requiring extensive repairs.[2]

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[1] Waldron, Mary Anne. How T-Rex Ate Vancouver: The Leaky Condo Problem *Symposium: The Leaky Condo Problem on the West Coast* Canadian Business Law Journal 31 Can. Bus. L. J. (1999) at 335

[2] Dave Barrett, *The Renewal of Trust in Residential Construction – Commission of Inquiry into the Quality of Condominium Construction in British Columbia,* June 1998, online: Government of the Province of British Columbia <www.qp.gov.bc.ca/condo/>

The Commission criticized the litigation system for not serving either the homeowner or members of the residential construction industries and recognized delays in the legal system and legal expenses as being detrimental to both plaintiffs and defendants. It went on to state in its report:

> "The public deserves a more effective system of quality control and consumer protection than is currently available through court action. The first step is to focus responsibility where it belongs – on the developer – then create a legal, administrative and market-based framework which allows quality developers to succeed, and irresponsible developers to leave BC's economy."[3]

In trying to provide this more effective system of quality control and consumer protection, the BC Act was born establishing three essential approaches to protect the home buyer: making warranty mandatory on all new homes that are not owner-built homes; providing for compulsory licencing of residential builders; and it establishing a Homeowner Protection Office.

## *Mandatory New Home Warranty*

With the pronouncement of the BC Act in British Columbia[4] and more recently the *New Home Buyer Protection Act,* SA 2012, c N-3.2 (the **"Alberta Act"**), in Alberta[5] third-party home warranty insurance was made mandatory in both for new home construction. The warranty specified coverage requirements for defects in materials and labour, building envelope and structural defects which guaranteed that homeowners who reported their claims for same within the specified coverage period had remedies available to them.

The mandatory coverage requirements are summarized in the chart below:

| Defect | British Columbia | Alberta |
|---|---|---|
| **Materials and Labour** | Defects in materials and labour must be covered for a period of at least 2 years[6]:<br>• Other than the common property, common facilities and other | Defects in materials and labour must be covered for a period of at least one year, but defects in materials and labour related to delivery and distribution systems |

[3] *ibid.*
[4] *Homeowner Protection Act,* SBC 1998, c 31, s. 22(1)
[5] *New Home Buyer Protection Act,* SA 2012, c N-3.2, s. 3(1)
[6] *BC Act,* SBC 1998, c 31, s. 22(2) and *Homeowner Protection Act Regulation,* BC Reg 29/99, Schedule 3 s. 1(1)

| | | |
|---|---|---|
| | assets of a strata corporation, there must be coverage for any defect in materials and labour and for any violation of the building code for the first 12 months.<br><br>• For the common property, common facilities and other assets of a strata there must be coverage for any defect in materials and labour and for violation of the building code for the first 15 months<br><br>• For the first 24 months there must be coverage for any defect in: materials and labour supplied for the electrical, plumbing, heating, ventilation and air conditioning delivery and distribution systems; any defect in materials and labour supplied for the exterior cladding, caulking, windows and doors that may lead to detachment or material damage to the new home; any defect in materials and labour which renders the new home unfit to live in; and, any violation of the building code.<br><br>*Non-compliance with the building | must be covered for a period of at least 2 years.[7] |

[7] *New Home Buyer Protection Act,* SA 2012, c N-3.2, s. 3(6)

| | | |
|---|---|---|
| | code is only considered a defect if it constitutes an unreasonable health or safety risk, or if it has resulted in, or is likely to result in, material damage to the new home. | |
| **Building Envelope** | Defects in the building envelope, including defects resulting in water penetration, must be covered for a period of at least 5 years[8] | Defects in the building envelope must be covered for a period of at least 5 years[9] |
| **Structural** | Structural defects must be covered for a period of at least 10 years[10] | Structural defects must be covered for a period of at least 10 years[11] |

The Alberta Act contains a further requirement that a warranty provider must offer the option to purchase, at an additional premium, additional coverage covering defects in the building envelope for a prescribed period and for defects in other prescribed components of the new home for a prescribed period.[12]

Aside from mandatory coverage provisions, both the Alberta Act and British Columbia Act also attempt to prevent problems from arising in the first place by imposing stricter standards on builders and providing dispute resolution options for the issues which inevitably will arise. In British Columbia for example, requirements such as education and professional development, disclosure requirements, undertakings to comply with regulations etc. have been implemented to weed out inferior builders who in the past could have easily obtained a building permit and constructed a home.

Further, both provinces require that provisions for dispute resolution be included on warranties. In British Columbia, dispute resolution is only required if the homeowner elects to proceed with it.[13] However, in Alberta, it is mandatory that disagreements are sent to dispute resolution.[14]

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[8] *BC Act,* SBC 1998, c 31, s. 22(2) and *Homeowner Protection Act Regulation,* BC Reg 29/99, Schedule 3 s. 2
[9] *New Home Buyer Protection Act,* SA 2012, c N-3.2, s. 3(6)(c)
[10] *BC Act,* SBC 1998, c 31, s. 22(2) and *Homeowner Protection Act Regulation,* BC Reg 29/99, Schedule 3 s. 3
[11] *New Home Buyer Protection Act,* SA 2012, c N-3.2, s. 3(6)(d)
[12] *New Home Buyer Protection Act,* SA 2012, c N-3.2, s. 3(7)
[13] *Homeowner Protection Act Regulation,* BC Reg 29/99, Schedule 2 s. 1(2)
[14] s. 5, *Home Warranty Insurance Regulation*, Alberta Regulation 225/2013

These provisions, particularly the mandatory coverage provisions, provide homeowners with some comfort and peace of mind, in knowing that they no longer have to pursue a bankrupt builder or shell company. They now only have to make a claim to their warranty provider who then has the obligation to push the builder to complete repairs for covered defects or alternatively if the builder does not do so the warranty provider arranges for same. In terms of pursuing the actual wrongdoer, that burden has been somewhat passed from the owners to the warranty providers. What we have begun to see more of in recent years is the warranty provider agreeing to undertake certain repairs and then relying on indemnity agreements with the builder and/or subrogation rights to pursue the builders, guarantors, architects, engineers and/or subcontractors.

However even with the new found comfort for homeowners, uncertainties still remain. Taking building envelope defects for example, Warranty providers have often taken the position that there must have been water ingress within the five year coverage period to trigger coverage under the warranty, on the other hand homeowners have taken the view that actual leaking is likely not required and support this with the argument that coverage extends to all building envelope defects "including" any defect which "permits" unintended water penetration, and that the use of the word "including" suggests that building envelope defects encompass more than water penetration. Further a defect may "permit" water penetration even if leakage is not yet significant.[15] Unfortunately given the high costs associated with proceeding to trial, the reluctance of the courts to answer such questions by way of summary trial, and the real risk faced by both sides in proceeding to actual trial, there is very little guidance by way of caselaw.

## *Cases affecting Coverage*

Beyond the BC Act there are a number of court decisions which have also impacted construction litigation and expanded coverage for defects. Two of the most significant decisions in that regard are *Progressive Homes Ltd. v. Lombard General Insurance Co of Canada,* [2010] 2 SCR 245 and *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.,* 2016 SCC 37.

*Progressive Homes Ltd. supra.* was a seminal leaky condo decision dealing with the application of Commercial General Liability (CGL) policies to construction projects. While the decision dealt with the insurer's duty to defend Progressive Homes, a general contractor, in an action arising out of a subcontractor's defective workmanship, in finding that there was a duty to defend the court provided important guidance on the interpretation of the CGL policies in the construction context.

The CGL policy insured Progressive Homes against "property damage" caused by an "accident" subject to certain exclusions. Property damage was defined in the policy as "physical injury to tangible property". The court emphasized the importance of plain meaning of policy wording and found that the subcontractor's negligent work fell within this definition. In making this finding the court rejected the

[15] John Mendes, Legal Issues Arising from Warranty Reviews & 2-5-10 Warranty Claims January 28, 2010

argument that property damage necessarily included damage to the property of third parties stating that there was "no such restriction in the definition"[16].

Secondly the court opened the door to the possibility that faulty workmanship may be considered an "accident" under a CGL policy. It did however caution that such a finding would be fact dependant and would ultimately depend on whether the event could be "unlooked for, unexpected or not intended by the insured"[17].

Lastly, the court also examined the "Work Performed" exclusion, an exclusion that precludes coverage for damage to the insured's own work once it has been completed. The court examined three versions of the "work performed" exclusion in Progressive's successive CGL policies and found that none of them "clearly and unambiguously excluded coverage"[18].

In the first version of the policy the "work performed" exclusion was modified by an endorsement and read:

> This insurance does not apply to:
>
> …
>
> (i) Property damage to work performed by or on behalf of the Named Insured arising out of the work or any portion thereof, or out of materials, parts of equipment furnished in connection therewith;

Clause (i) was replaced by clause (Z) in the Endorsement which read:

> (Z) With respect to the completed operations hazard to property damage to work performed by the Named Insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith.

The court noted that the clause (Z) exclusion is limited to work performed "*by* the insured" rather than the clause which it replaced which applied to work performed "*on behalf of* the insured". It found that the plain language was unambiguous and only excluded damage caused by Progressive to its own completed work. It did not exclude property damage caused by the subcontractor's work "to the subcontractor's work, regardless of whether the damage is caused by the subcontractor itself, another subcontractor, or the insured."[19]

In the second CGL policy the "work performed" exclusion read:

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[16] *Progressive Homes Ltd. supra.* at para 36
[17] *ibid.* at para 37
[18] *ibid.* at para 54
[19] *Progressive Homes Ltd. supra.* at para 56

> J. 'Property damage' to 'that particular part of your work' arising out of it or any part of it and included in the 'products completed operations hazard.'
>
> "Your work" means:
>
> a. Work or operations performed by you or on your behalf; and
>
> b. Materials, parts or equipment furnished in connection with such work or operations.

While this exclusion did not include an exception for subcontractors, the court found that all that was excluded was coverage for defects. Unlike the previous clause (i), the inclusion of the phrase "that particular part of your work" indicates an express contemplation of the division of the insured's work into its component parts. This was interpreted by the court as excluding coverage for repairing defective components but not for resulting damage.[20]

In regard to the final policy's "work performed" exclusion, it read:

> J. "Property damage" to that particular part of "your work" arising out of it or any part of it and included in the "products-completed operations hazard".
>
> This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.[21]

The court found that this was essentially a combination of those in the first and second versions of the policy. Coverage would remain for resulting damage and the incorporation of the "Subcontractor exception" even further expanded coverage to allow for coverage of defective work where it is work completed by a subcontractor.

The "work performed" findings by the court provided much needed guidance on the issue to lower courts, however ultimately whether or not same is covered by a CGL policy will depend on the specific wording of that policy.

The impact of the Supreme Court's decision in *Progressive Homes* on coverage under a CGL policy was nicely summarized by the BC Court of Appeal in the very first paragraph of the *Bulldog Bag Ltd. v. Axa Pacific Insurance Company*, 2011 BCCA 178, decision:

> In its recent decision in *Progressive Homes …* the Supreme Court of Canada reversed a line of insurance cases that had taken a narrow view of the scope of coverage under commercial and general liability ("CGL") policies commonly used in Canada and the U.S… The Court confirmed

[20] *ibid.* at para 62-65
[21] *ibid.* at para 68

> that the "primary interpretive principle" for insurance policies is that "when the language of the policy is unambiguous, the court should give effect to clear language, reading the contract as a whole" (para. 22) This was not a new approach… but on the basis of clear language, the Court determined that "property damage" in such policies is not limited to damage to "third-party property" and can include damage from part of a building to another part, previously regarded as irrecoverable "pure economic loss" (para. 36); that the term "accident" may, depending on the facts of each case, include the consequences of defective workmanship (paras. 39, 46); and that, again depending on context, the "own product/work" exclusion is to be construed narrowly or *contra proferentem*, such that it may be limited to damage caused by the insured to its own work and not extend to "resulting damage".

## *"Faulty Workmanship"*

Up until the *Ledcor supra.* decision, coverage was not usually provided for faulty workmanship in a construction project, but with the pronouncement of this decision the Supreme Court of Canada clarified that exceptions to the "faulty workmanship" exclusion in builders' risk insurance policies had to be broadly interpreted.

The facts in *Ledcor* are as follows: The owner of property in Edmonton where an office tower was being constructed held an all-risk property insurance policy covering all contractors involved in the construction. During construction, a building's windows were scratched by the cleaners hired to clean them. The cleaners had used improper tools and methods in cleaning the windows resulting in the windows having to be replaced. The owner and general contractor claimed the cost of replacing the windows under the policy but coverage was denied on the basis of an exclusion in the policy for the "cost of making good faulty workmanship".

In applying the general principles of contract interpretation the court found that there was only one interpretation of the exclusion clause that was consistent with the reasonable expectations of the parties "as informed by the purpose of builder's risk policies", aligned with "commercial reality" and was consistent with the jurisprudence:

> …the faulty workmanship exclusion serves to exclude from coverage only the cost of redoing the faulty work, as the resulting damage exception covers costs or damages apart from the cost of redoing the faulty work. As such, excluded under the Policy is the cost of recleaning the windows, but the damage to the windows and therefore the cost of their replacement is covered. This is consistent with previous interpretations of similar clauses in the jurisprudence… [22]

[22] *Ledcor supra.* At 63

To leave no room for doubt, Justice Wagner went on to even further confirm this view by stating:

> … an interpretation of the Exclusion Clause that precludes from coverage any and all damage resulting from a contractor's faulty workmanship merely because the damage results to that part of the project on which the contractor was working would, in my view, undermine the purpose behind builder's risk policies. It would essentially deprive insureds of the coverage for which they contracted.[23]

Of course the impact of this decision was to widely expand coverage for faulty workmanship, which had previously been thought to have been excluded under such policies. In light of this decision if insurers want to exclude any damage connected to faulty work they will need to use clear language to that effect in the insurance policy.

With these two decisions defects and deficiencies covered under CGL and Builder's risk policies increased. What constituted property damage now expanded to potentially include things such as damage to your own property and costs arising from faulty workmanship, which were not linked to redoing the faulty work, and were now the insurer's responsibility as well.

## *"Dangerous Defects"*

Another issue that has often been of much debate in all property damage claims is recovery for pure economic loss. In the construction context the court in British Columbia very recently emphasized in *The Owners, Strata Plan KAS 3575 v. Renascence Enterprises (Shannon Lake) Corp.*, 2017 BCSC 1336, that there is no recovery for pure economic loss "for deficiencies or shoddy work that do not pose a danger or a threat to the health or safety of persons." In making that finding the court cited from *Kayne v. Strata Plan LMS 2374,* 2013 BCSC 51 (CanLII) at paragraph 167:

> … with respect to the plaintiff's claim for pure economic loss, in cases such as this involving allegedly defective construction of a residence (i.e. no damage to anything other than the thing itself), the Supreme Court of Canada has made it clear that the builder does not owe a duty of care to a subsequent purchaser unless the alleged defect is more than just shoddy construction. Rather it must pose a "real and substantial danger" to persons or property.

The implications of this decision are important for both builders and warranty providers to realize, as many defects that are covered under the 2 year materials and labour warranty may not actually constitute a dangerous defect and while contractually they must be covered by the warranty provider, difficulties may ensue when the warranty provider decides to try to pursue others by way of a subrogated claim. Additionally, the

[23] *ibid.* at 70

importance of warranty providers, or those bringing a subrogated or indemnity claim, in pleading dangerous defects in the Notice of Civil Claim is highlighted and a failure to do so may result in a dismissal of the claim as a whole as was seen in this decision.

## *Conclusion*

In the past and during the bulk of the leaky condo litigation mediations were often successful in resolving matters. Plaintiffs recognized that they needed to take a sometimes significant deduction on their claim and the uniformity of problems in the leaky condo cases provided design professionals, engineers, consultants etc. guidance as to their likely apportionment of any settlement that was reached.

With increased coverage for construction defects being found in both recent case law and also by way of mandatory legislation, the construction litigation game has changed. Plaintiffs no longer have the same concerns about chasing dry judgments and their expectations on both amount of recovery and items for which they can recover have increased. Consultants are now taking harder positions at mediation. Uncertainty and the addition of the warranty provider to the table has led to many failed mediations as parties struggle to figure out their role and ultimate apportionment of liability. We have also begun to see many more subrogated actions being brought by warranty insurers following pay out or completion of repairs. This has led to multiple actions concerning the same property and players and has resulted in even further complications in mediations whether the matters are heard together or not.

Decisions such as *Ledcor supra.* and *Progressive Homes supra.* have clarified the interpretation of some common exclusion clauses, including “faulty workmanship” and “work performed” exclusions, leading to increased coverage for defects that were typically not covered under insurance policies. Potential coverage for non-dangerous defects under the mandatory materials and labour warranty coverage is also a new development in favour of home owner plaintiffs who typically had to bear the costs of such repairs on their own.

With these changes that have occurred over the past decade we will have to wait and see how construction deficiency claims will be handled moving forward. The recent exclusion clause decisions and legislation do lean towards protecting homeowners and the response of insurers in clarifying exclusion clauses in their policies and warranty insurers specifically in dealing with builders will ultimately dictate how such matters are dealt with over time.