LIABILITY INSURANCE AIN'T ENOUGH!

by Bill Preston

A couple of very recent court decisions have prompted knowledgeable construction insurance advisers to complain that the judges are narrowing the availability and utility of liability coverage for "resultant damage" arising out of construction deficiencies. And, given that the usual CCDC General Conditions (DEFECTIVE WORK, GC 2.4.1 and DAMAGES AND MUTUAL RESPONSIBILITY, GC 9.2.1) expect the Builder to cover the cost of "resultant damage," these recent cases should prompt those in the construction pyramid, who rely on these usual General Conditions, to always remind themselves to ask, "Has the Builder given me adequate security for this obligation?" Zurich Insurance Co. (among others in each case) was involved in both these cases, so I'll use its policy terms to report the cases. My purpose in discussing these cases is to rattle the construction industry's all-too-frequent conventional wisdom that trades can work on the project without either performance bonding or being sheltered under an All-Risk property insurance policy.

Swagger Construction v. *Zurich* was decided last October in British Columbia. Swagger was the general contractor for construction of the Forest Science Centre on the UBC campus. Swagger felt that it had completed the project and sued for millions of dollars unpaid on the contract price. In turn, UBC countersued, claiming construction deficiencies and resultant damage in and to the roof, walls and curtain walls, costing millions of dollars to repair. As you might expect, all of these allegations of deficiencies were within the scope of work of various trades who worked for Swagger on the job. So, Swagger went to the BC Supreme Court asking for an order compelling Zurich, its liability insurer, to defend against UBC's allegations. Justice Smith refused. The Court reasoned:

1. Courts should do their damnedest to make insurers responsible for defending possible claims;

2. But, the wording of UBC's claim and the wording of Zurich's policy govern whether there is any possibility of Zurich having to provide coverage.

3. Zurich's policy pays only for property damage (neither expected nor intended0, and arising because of an accident.

4. While, though it may be that the deficiencies were caused by a trade, by the terms of Swagger's Construction Contract this is Swagger's Work, and thus Zurich is not liable to repair this Work;

5. Because, the resultant damage caused by these deficiencies in Swagger's Work was not caused by accident, but rather was caused by Swagger's defective work, which was not accidental, but simply only deficiencies.

So, if Swagger did not have All-Risk property policy coverage for the "resultant damages," and its subtrades didn't have a performance bond for the deficiencies, the UBC claim, if proved, had to be paid out of Swagger's pocket!

Much the same was recently decided by the Saskatchewan Court of Appeal in *Westridge Construction.* v. *Zurich*. In this case, Westridge was the general contractor for construction of an elaborate cutting-edge technology hog barn. Here, the Owner, Genex, alleged that the combination of deficient fabrication of the steel building and faulty installation of the foil-backed insulation and heat recovery systems, had combined to prematurely corrode the walls and roof of the building, thus requiring total replacement. Like Swagger, the Saskatchewan Court ruled that Zurich did not cover claims of faulty construction and resultant damage, though the faulty work may have been done by a subcontractor to Westridge. But, Westridge's situation was a little bit different from Swagger, and to this extent Zurich had to contribute to Westridge's defence costs.

Genex, in addition to claiming faulty workmanship and resultant damages, also claimed that Westridge had misled Genex before the construction contract was awarded to Westridge. When Genex put the hog barn design out for tender, the specs called for a color-printed sheet steel-clad roof. Westridge, on its representation that it was cheaper and yet fit for Genex's purposes, persuaded Genex to permit a cost-saving alternate, being a galvalume steel-cladding roof. Westridge then bid and was awarded this alternate. Eight years later, Genex has sued Westridge alleging that, if its faulty work didn't cause the premature rusting, then the galvalume roof was not as fit as Westridge represented. For this part of Genex's claim, the Saskatchewan Court found that this representation did not clearly fall within Zurich's coverage exclusion, "professional services by an architect or engineer," and thus because this portion of Genex's claim might be successful and within Zurich's coverage, Zurich must contribute a portion of Westridge's defence

costs. The Court didn't say how much. But, likely Zurich would not pay cash; rather it would minimally participate to assure that the eventual trial had available to it evidence that the galvalume steel roof would work as well as the painted steel roof and, in any event, Genex didn't rely on Westridge's opinion of fitness, but rather only authorized the alternate after getting the opinion of its design consultants. So, in the end, Westridge didn't' get much of a win.

What's the lesson from these two cases? I suggest it's the realization that there is a lot of wisdom in the trite comments of a well-known insurance broker: "Liability insurance is to cover third party claims; it ain't performance bonding and it ain't property insurance." So, if you permit a builder onto your project with only liability coverage, they had better have deep pockets.