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Résumé de l'article

Le but de cet article est d'examiner les plus récents développements en matière d'assurance construction. Une couverture globale et adaptée aux besoins exige les efforts et la maîtrise de différentes disciplines, notamment dans les domaines juridique et technique. L'auteur tente de démontrer comment le milieu de l'assurance peut répondre aux problèmes les plus particularisés par une analyse exhaustive des principales clauses et conditions en vertu de l'assurance des biens et de l'assurance des responsabilités. La troisième partie de cet article a été publiée dans le numéro précédent.

Insuring Conflicts on the Construction Site*

by

Eric A. Dolden**

Le but de cet article est d'examiner les plus récents développements en matière d'assurance construction. Une couverture globale et adaptée aux besoins exige les efforts et la maîtrise de différentes disciplines, notamment dans les domaines juridique et technique. L'auteur tente de démontrer comment le milieu de l'assurance peut répondre aux problèmes les plus particularisés par une analyse exhaustive des principales clauses et conditions en vertu de l'assurance des biens et de l'assurance des responsabilités.

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PART FOUR OF FOUR

I. The Scope of the "Contractual Liability Assumed" Exclusion in the CCDC Form 101 CGL

The IBC Form 2000 wording contains a "contractual liability" exclusion that provides:

> This insurance does not apply to:
>
> *a)* **liability assumed** by the insured under any contract or agreement except an **incidental contract**, but this exclusion does not apply to a warranty of fitness or qualifications of the named insured's products or a warranty that work performed by or an behalf of the

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> named insured will be done in a workmanlike manner. (emphasis added)

For an insured confronting losses on the construction site it is noteworthy that the term "incidental contract" is defined as follows:

> ...incidental contract means any written agreement which is a lease of premises, easement agreement, agreement required by municipal ordinance, sidetrack agreement or elevator maintenance agreement.

In the context of a construction loss the use of the term "liability assumed" in the exclusion could potentially refer to one or more of the following:

1. an express obligation undertaken pursuant to a construction contract;
2. any liability that stems from a party's tort obligations which forms an implied term of the construction contract;
3. an express provision which assumes the liability for one's own fault or the fault of a third party.

The U.S. jurisprudence has given a narrow scope to the "contractual liability" exclusion and concluded that the exclusion only bars indemnity if the insured would not be liable to a third party but for the fact that it assumed that liability pursuant to its contract. Conversely, the insurer cannot rely upon the exclusion when the liability assumed under the construction contract, with a third party, is co-extensive with the insured's liability imposed as a matter of tort law. This is borne out by the comments of the U.S. District Court in *Lebow Associates Inc.* v. *Avemco Insurance Company*:[1]

> A major rationale underlying the principle that assumed liability exclusion clauses are inoperative when the liability assumed is coextensive with the insured's liability imposed by law is that the insured's assumption of liability does not

[1] F. Supp. 1288 (1977).

> expand the insurance company 's element of risk, upon which the insured's premium amounts are predicated, beyond the original contractual agreement of the parties. To allow an insurance company to avoid payment of its insured's liability to a third party, which otherwise exists by operation of law, merely because the insured contractually assumed the same liability to the third party would be to judicially condone a unilateral alteration of the substantive terms of the contract in favour of the insurance company on grounds which are not even relevant to the element or risk which underlies each party's bargaining position. Such a result would undoubtedly be contrary to the reasonable expectations of the insured.[2]

That, however, is not the position in Canada. The Canadian experience has been to broaden the scope of the "contractual liability" exclusion to a degree that contractors are practically compelled to obtain a wording wider in its scope than the current IBC wording to ensure that the CGL coverage is more than illusory in guarding against losses on the construction site.

The origin of this approach lies in the decision in *Foundation of Canada Engineering Corporation Ltd.* v Canadian *Indemnity Company*.[3] The insured, a construction manager, was hired to build a cement plant. The plant collapsed following completion; a collapse caused by what the Court characterized as a "gross under design"of the metal connectors that linked the ends of a roof beam with two columns.

Two terms of the contract are of relevance for the purpose of the contractual liability exclusion:

> [The insured] does hereby agree to indemnify and save harmless (the owner) of, from and against any and all claims, demands, actions, causes of actions, losses, damages and things of any nature, whatsoever arising out of or resulting from the breach, non compliance, or wrongful

[2] *supra* at page 1291.

[3] [1978] 1 SCR 84.

compliance by (the owner or the contractor) with any of its covenants hereunder.[4]

The contractor also agreed to:

"..inspect all workmanship carried out on the Project, it being understood and agreed that it is the duty and responsibility of [the cantractor] to reject such workmanship which is not of good and adequate quality and which does not meet specifications.[5]

The Supreme Court of Canada indicated that the "contractual liability" exclusion withdrew any obligation to indemnify not only with respect to the hold harmless agreement, but as well, liability predicated on the failure to inspect the work. The result is that, at least in Canada, the "contractual liability" exclusion removes from indemnity all contractually assumed liability that one incurs by reason of contract.

The related question for Canadian courts was whether that same exclusion could bar tort liability merely because that tort liability arose as a term of the contract. In other words, if the insured would be liable in tort without the contract, as happened in *Lebow Associates Inc.* (supra), does the exclusion apply? That question was canvassed in an earlier decision of the Supreme Court of Canada, *Dominion Bridge* v. *Toronto General Insurance Company*.[6] In *Dominion Bridge* (supra) the contractor entered into a contract to erect the steel superstructure for the Second Narrows Bridge. The contract provided:

...if there is evidence of any fault, defect or injury, from any cause whatever, which may prejudicially affect the strength, durability, or appearance of any section of the structure, the contractor shall, at his own expense, satisfactorily correct such faults or, if required, shall replace so much of said

[4] *supra* at page 86.

[5] *supra* at page 86.

[6] [1963] SCR 362.

> section as the engineer may deem necessary even to the extent of rebuilding the entire section.[7]

The contract contained a provision whereby the insured also guaranteed that its agents, workmen and all other persons in its employment and under its control would perform their common law duties. The completed work buckled due to faulty design causing portions of the bridge to fall onto and damage the third party's piers.

In the British Columbia Court of Appeal the issue was whether, assuming the insured is liable in tort for damage to another, and the insured has assumed that same liability in a contract, that liability is excluded by reason of the "contractual liability" exclusion though the insured would be liable in tort if the contract had not been in place.

Both the Court of Appeal and the Supreme Court of Canada agreed that the exclusion did preclude liability and the insurer in that situation had no obligation to indemnify. In the Supreme Court of Canada it was stated:

> The trial judge held that the first exclusion clause only excluded liability arising from contract and not claims arising out of concurrent liability in tort. The Court of Appeal held that the liability in question had been assumed by (the insured) under its contract (with the third party) and that it came squarely within the first exclusion clause and that it was immaterial that such liability was tortuous liability independently of contract. "Liability imposed by law', and "liability assumed under contract" were for one and the same loss. That being so, liability, even though imposed by law, was excluded from the coverage.[8]

When one reviews *Foundation of Canada Engineering* (supra) and *Dominion Bridge* (supra) it is apparent that the standard IBC wording is completely inadequate in guarding

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[7] *supra* at page 264.

[8] *supra* at page 264.

against contractual liabilities commonly found in the construction setting. It is for that reason that many contractors have moved to the CCDC Form 101 wording which provides:

> This insurance does not apply to:
>
> *a)* liability assumed by the insured under any contract or agreement except in an incidental contact. This exclusion does not apply to a warranty of fitness or quality of the named insured's products or a warranty that work performed by or on behalf of the named insured will be done in a workmanlike manner.

It is noteworthy that "incidental contract" is defined to mean:

> any written agreement
>
> *a)* which is a lease of premises, easement, agreement, agreement required by municipal ordinance, sidetrack agreement, elevator maintenance agreement, or
>
> *b)* **which assumes the liability of others, except agreements wherein the insured has assumed liability for the sole negligence of his indemnitee**
>
> (emphasis added)

This expanded definition of "incidental contract", based as it is upon the nature of the legal liability assumed and not the activity involved in the incidental contract, broadens the scope for indemnity. The only circumstance in which the insured would not gain indemnity is if the insured stipulated that it would bear liability for the sole negligence of another party. That rarely occurs in the context of a construction contract.

Virtually none of the 1982 CCDC construction contract provisions would be beyond the parameters of an "incidental contract" as defined in the CCDC Form 101. It is worth reviewing the provisions in the standard CCDC documentation which do give rise to indemnity or contractual liability for damages.

1. General Condition 4.1 states that if the contractor is delayed in the performance of the work "by an act or omission of the

owner consultant, or other contractor or anyone employed or engaged by them directly or indirectly" then the "contractor shall be reimbursed by the owner for reasonable costs".

2. General Condition 4.2 states that if a contractor is delayed in the performance of the work by a stop work order then the "contractor shall be reimbursed by the owner for reasonable costs incurred by the contractor as a result of such delays».

3. General Condition 19.1 provides that the contractor "...shall indemnify and hold harmless the owner and the consultant, their agents and employees from and against claims, demands, losses, costs, damages, actions, suits or proceedings" by third parties provided two conditions are met:

   a) the claim is attributable to bodily injury or death, or injury to or destruction of tangible property;

   b) the claim is caused by the negligent act or omission of the contractor;

   and provided the claim is made within six years from the date of substantial performance.

4. General Condition 19.3 states that the owner shall indemnify and hold harmless the contractor from and against all claims demands, loss or costs which are attributable to a lack or defect in title or alleged lack or defect in title.

5. General Condition 21.1 states that the contractor shall protect the work and the owner's property on the work and adjacent to the place of work and "shall be responsible for damage which may arise as a result of his operations under the contract except damage which occurs as a result of errors in the contract documents or acts or omissions by the owner, the consultant and other contractors or their agents". This is supplemented by General Condition 21.2 which stipulates that the contractor shall "be responsible for making good such damage at his expense".

6. General Condition 22.1 provides that "...if either party to this contract shall suffer damage in any manner because of any wrongful act or neglect of any other party or of anyone for whom he is responsible in loss then he shall be reimbursed by the other party for such damage",. This right to recover exists provides that the notice is provided in writing and is provided as soon as reasonably practicable.

Each of these provisions, when combined with the operation of the *Negligence Act*, R.S.B.C., would fall within the definition
280 of "incidental contract" as contained in the CCDC wording.

While there exists a dearth of Canadian jurisprudence on this subject, in the United States it is clear that hold harmless language worded similar to General Condition 19.1 could give rise to indemnity in circumstances that would not otherwise be the case if liability rested merely in negligence. That result would not necessarily offend against the definition of "incidental contract" as provided in the CCDC wording.

Illustrative of the problems confronting a contractor that agrees t indemnify an owner is the decision in *Bartak* v. *Bell-Gallyardt & Wells Inc.*[9] The contractor undertook to indemnify the owner and architect on the following terms:

> The contractor shall **indemnify and hold harmless** the owner and architect and their agents and employees from and against all claims, damages, losses and expenses, including attorneys' fees arising out of or resulting fro the performance of the work provided that any such claim, damage, loss, or expense (1) is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (other than the work itself) including the loss of use resulting therefrom, and (2) is caused in whole or in part by any negligent act or omission of the contractor, any subcontractor, anyone directly or indirectly employed by any of them or anyone for whose act any of

[9] 473 F. Supp. 737 (1979).

> them may be liable, regardless of whether or not it is caused in part by a party indemnified hereunder.[10]

At trial it was determined that the general contractor was liable for 65% of the loss and the architect responsible for 35% with the latter's negligence being solely attributable to its preparation and approval of drawings for which it was not liable pursuant to the terms of the indemnity. Acknowledging that the indemnity was clear in its terms the contractor was held obligated to indemnify and hold harmless the architect for any claim or damage arising fro the work notwithstanding that it was caused only in part by the negligence of the contractor.

The more interesting and yet largely unconsidered issue in Canada is whether, assuming that a contractual obligation falls within the CCDC Form 101 definition of "incidental contract", indemnity is necessarily extended to all of the obligations contained in the "incidental contract". However, U.S. courts have examined this issued including whether a breach of a covenant to insure, similar to that contained in General Condition 320, can be characterized as an "incidental contract" sufficient to trigger indemnity. In *Olympic, Inc.* v. *Providence Washington Insurance Co. of Alaska*,[11] a fire had arisen in the tenant's premises and a firefighter was killed attempting to extinguish the flames. It was alleged in the wrongful death action that the landlord had been negligent in failing to install a sprinkler system. Having settled the tort action the landlord's insurer sought indemnity from the tenant's insurer on the basis of a provision in the lease which stated:

> The [tenant] shall provide and maintain public liability insurance in a minimum amount of $300,000, naming the [landlord] as a named insured, which insurance will save the [landlord] harmless fro liability from any injuries or losses

[10] *supra* at page 739-740.

[11] Alaska, 648 P.2d 1008.

> which may be sustained by any persons or property while in or about the aid premises.[12]

The tenant had obtained a CGL but omitted to have the landlord included as a named insured with the result that the landlord did not have the third party limits available to it for utilization as a portion of the settlement proceeds.

In seeking reimbursement of the settlement amounts the landlord's insurer argued that the lease, being an "incidental contract", in combination with a breach of the lease covenant to
282 obtain $300,000 in third party liability insurance, dictated indemnity. The Alaska Court noted, however, the language of the "contractual liability" exclusion which provided:

> This insurance does not apply:
>
> (*a*) to liability assumed by the insured under any contract or agreement except an incidental contract..."

While the lease was an "incidental contract" the obligation upon which indemnity was being sought was not in the nature of a "...liability under any contract or agreement". The obligation entailed a promise to indemnify or hold harmless another and did not include liability arising from a breach of contract. the former, unlike the latter, the insured is merely assuming liability for another person's negligence, not liability for breach of contract. The covenant in the lease did not constitute a hold harmless contract or indemnification agreement that resulted in policy coverage.

J. The "Care, Custody and Control" Exclusion in the Construction Setting

For the contractor the risk of loss of property handled in the course of one's own work is greater than the risk of damaging other property. In excluding damage to property directly handled by the contractor and limiting liability to losses occurring on

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[12] *supra* at page 1009.

property not under the "care, custody, or control" of the contractor, liability insurance can be obtained at reasonable rates.

In the IBC Form 2003 the "care, custody or control" exclusion provides:

> This insurance does not apply to
>
> (*h*) property damage to
>
> (3) property in the **care, custody or control** of the insured or property as to which the insured is for any purpose exercising physical control"

In contrast, the CCDC Form 101 CGL wording provides:

> This insurance does not apply to:
>
> (*h*) property damage to
>
> 2 (c) property in the **custody** of the insured which is to be installed, erected or used in construction by the insured"

It will be immediately noted that the CCDC wording is narrower in scope than the comparable IBC wording and the CCDC exclusion, drawn from the wording of the BFPE, provides a significant degree of coverage to a contractor or subcontractor when one of those parties causes property damage to the other. those circumstances, the CCDC wording covers repair costs and converts the wording into first party insurance not uniike a Builders~ All Risk policy. That is why the exclusion contains a reference in the "Other Insurance" clause to this coverage being "excess insurance ...over property insurance."

Since many contractors are issued the IBC wording it is instructive to examine what American authorities exist which have considered the IBC wording in the context of a construction loss. These cases suggest the existence of two general principles in the interpretation of the IBC "care, custody or control" exclusion:

1. "care, custody or control" presupposes the owner's permission. Tacit or implicit permission is not sufficient (Home Indemnity Co. v. Fuller)[13]

2. A mere right of access to the owner's premises, without the right to exercise control, is not sufficient to invoke the exclusion. (Gibson v. Glenn Falls Ins. Co.)[14]

1. The scope of the "care, custody or control" exclusion for general contractors

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In determining whether the construction site is within the "care, custody or control" of the general contractor the courts will examine, firstly, the contract between the owner and contractor to determine which of the two maintains control over the work site. Second, the courts will look to the degree of control which has been delegated to the contractor when the damage occurred.

Whether the general contractor has "care, custody or control" of the site during construction can be discerned from the terms of the contract. Usually, the general contractor's right to control the activities on the construction site is sufficient to trigger the exclusion. This is best illustrated by the decision of the Missouri Court of Appeals in *Estrin Construction Company* v. *The Aetna Casualty and Surety Company*.[15] The general contractor, hired to construct a warehouse, obtained both a CGL and Builders' All Risk as required pursuant to the terms of the contract. During construction a heavy wind toppled an unfinished wall.

The loss was paid on the All Risk policy. The All Risk insurer then subrogated against the architect, and in turn, the architect sought indemnity, pursuant to the terms of the contract, from the general contractor. The terms of the contract required the general contractor to:

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[13] 427 S.W. 2d 97 (Tex. Civ. App.).

[14] 128 S.E. 2d157 (S.C. 1962).

[15] 612 S.W. 2d 413 (Mo. App. 1981).

1. protect the work from damage and the property of the owner from injury

2. supervise the progress of the work and to 'keep on his work... a competent supervisor and any necessary assistants"

Commenting on the approach to be taken in respect of the exclusion the Court stated:

> The general contractor usually performs under a written contract which defines the party to control the property at any given stage of the work — usually the general contractor, itself. That allocation of control, as in the case of [the general cantractor], also impinges on the obligation to insure and determines the cost of the premium. The terms of a written contract which delineates the control of an insured over the construction, therefore, bear on the determination of care, custody or control by the contractor over the real property at any given stage of work.[16]

In the Court's view the duty to supervise, a duty which continued during non-working hours, reflected a right of control which was paramount to any dominion the subcontractors, architects or other personnel on the job could assert under the contract. For that reason the general contractor's loss fell within the exclusion.

2. The scope of the "care, custody or control" exclusion for sub-contractors

Sub-contractors are not generally a party to any contract with the owner and as a consequence the exclusion is of lesser application for the reason that mere access to, or

handling of, property as a mean to accomplish one's work will not fall within the exclusion. Commenting on the scope of the

[16] *supra* at page 429.

exclusion in the context of a subcontractor's loss, in *Goswick* v. *Employer's Casualty Co.*[17], the Texas courts have stated:

> This is the language of the traditional manufacturers' and contractors comprehensive liability policy form. If the insured under such a policy is repairing or installing item #1 adjacent to item #2 and within the premises of a building, when his negligence causes damage to items #1 and #2, as well as the building, the exclusion denies coverage only as that property damaged which was within his possessory control. The cases have limited this 'control' to the particular object of the insured's work, usually, personally, and to other property which he totally and physically manipulates... [18]

If the property damaged is merely incidental to the property upon which the work is being performed by the insured it is not considered to be in the 'care, custody or control' of the insured". Numerous examples of this rule exist. For example, in *Boston Insurance Co.* v. *Gable*[19] the subcontractor was granted permission by the general contractor to refinish the floors of a residential home. The loss arose as a result of the negligence of the subcontractor's employees. In concluding that the exclusion did not apply, as "care, custody or control" was vested with the general contractor, the Court stated:

> [care], custody or control of the house itself was retained...by the general contractor. Defendant Gable was given temporary access to the house in order to perform work under his subcontract. The house itself was merely incidental to the floors upon which work was to be performed...[20]

The Canadian courts have taken an approach which "mirrors" the American authorities. *Interprovincial Pipeline* v.

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[17] 440 S.W. 2d 287 (Tex. 1969).

[18] *supra* at page 289-290.

[19] 352 F. 2d 368 (5th Cir. 1965).

[20] *supra* at page 368.

Seller's Oil Fields Service,[21] a decision of the Manitoba Court of Appeal, the sub-contractor had been issued a work-order by the contractor to clean a tank. The loss occurred while the subcontractor was cleaning the tank and the contractor sued. The insurer sought to rely upon the "care, custody or control', exclusion, without success. The Court indicated that "[the sub-contractor] essentially assumed an operating responsibility towards the tank for the purpose of cleaning it. It did not exercise sufficient dominion or control to bring into play the exclusion."[22]

Similarly in *T.W. Thompson Ltd.* v *Simcoe & Erie General Insurance Co.*,[23] a decision of the Ontario Court of Appeal, the insured was a subcontractor on the construction of a school building. The insured, in turn, subcontracted a portion of its work to a sub-subcontractor. The negligence of that sub-sub-contractor's employee resulted in a fire which caused serious damage to the building. In concluding that the exclusion could not successfully be invoked the Court opined that to apply the exclusion in the circumstances "...the policy would be virtually worthless to the plaintiff to protect it against claim arising from its operations as a contractor". That comment typifies the Court's attitude towards the exclusion.

K. The CGL Insurer's Responsibility for Past Joint Venture and Partnership Activities

In today's construction setting it is not uncommon for contractors to constitute a joint venture or partnership on an individual project basis. The underlying business rationale is predicated upon the need to introduce a particular technical expertise to the project, or, to ensure a financial strength that would not otherwise be achievable by a single contractor acting alone.

Section III of he CGL, entitled "Persons Insured" states:

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[21] [1976)]3 WWR 31.

[22] *supra* at page 36.

[23] [1976)]68 D.L.R. (3d) 240.

Each of the following is an Insured under this insurance to the extent set forth below:

(2) if the Named Insured is designated in the declarations as a partnership or joint venture, the partnership or joint venture so designated and any partner or member thereof **but only with respect to his liability as such**

The intent of the wording is that if the insured is a partner or member of a partnership or joint venture **other than** the Named
288 Insured, they are not insured for any liability incurred in the course of business of that other partnership or joint venture. Coverage in the CGL is tied to the particular business operations of a particular business organization.

What happens if an insured, during the course of construction, designates that it is operating as a partnership or joint venture, but encounters a loss following construction when the joint venture or partnership is no longer operative? If that partnership or joint venture designation is no longer reflected on the policy in the successive year does there exist coverage for any ensuing loss? That issue was considered in *Austin P. Keller Construction Company, Inc. et al* v. *Commercial Union Insurance Co. et al*[24] The question arose as to whether a CGL insurer was obligated to defend and indemnify a contractor for previous joint venture undertakings which were not disclosed on the declaration page but which gave rise to a claim during the period of the policy.

The general contractor had formed a joint venture in 1970 to construct water and sewer lines. The joint venture was dissolved in 1972. Ten years later, in 1981, an explosion occurred at the site of the completed lines. The parties to the joint venture were joined in the ensuing lawsuit on the basis that their negligence in backfilling the sewer and water lines had caused damage to the adjacent gas lines. The CGL that was in place at the moment of the

[24] 379 N.W. 2d 533 (Minn. 1986).

"occurrence" contained a provision not unlike the IBC Form 2000 which stated:

> "Each of the following is an insured under this insurance to the extent set forth below:
>
> (2) If the Named Insured is designated in the declarations as a partnership or joint venture, the partnership or joint venture so designated and any partner or member thereof but only with respect to his liability as such;
>
> This insurance does not apply to bodily injury or property damage arising out of the conduct of any partnership or joint venture of which the Insured is a partner or member and which is not designated in this policy as a Named Insured."

Notwithstanding that the general contractor had "completed operations" coverage at the time of the loss the insurer argued that it was not obligated to defend and indemnify for losses arising from an undisclosed involvement in the joint venture. While the joint venture was terminated by the date the CGL had been obtained the joint venture did not necessarily terminate for all purposes. Instead, it continued to exist as an entity which could be held liable for past acts and omissions of the joint venture. What obviously troubled the court was whether a CGL insurer should be saddled with the liability 10 years following the termination of the joint venture when the insured had failed to notify the insurer of its involvement in the concluded joint venture.

In deciding that the CGL insurer was not obligated to defend or indemnify, the Court accepted that while from the standpoint of tort responsibility a joint venture continues to exist as long as it can be found liable for damages arising from joint venture activities, having failed to disclose on the policy the existence of the joint venture, the insurer was not obligated to respond.