IN FACT AND IN LAW

General and
Damage Insurance

**March 2001**

# An **All-Risk Builder's Insurance** does not cover costs which should have been expended from the beginning

By Daniel Alain Dagenais

On February 19, 2001, the Quebec Court of Appeal affirmed the trial judgment dismissing the action of *Canadian Pacific* against its insurers *American Home* and *Château*[1] in a claim in the amount of $4,700,000 for the additional construction costs of a ventilation shaft in the Rogers Pass Tunnel in British Columbia.

It was introduced in evidence that, during the preliminary studies, one of the consultants had indicated that the only effective construction method required the freezing of the ground while CP favoured dewatering, a much less costly method. In the call for tenders, CP had indicated dewatering in its specifications and all tenderers, except one, had provided a price for this element. CP had made no reference to the expert report favouring freezing of the ground. The other tenderer was in fact the consultant who recommended this freezing method; he had suggested this alternative method and did not tender a price for dewatering.

CP granted the contract to Cemco and during construction, Cemco encountered, between October 1985 and February 1986, enormous seepage problems resulting in sloughing and sinking to the bottom of the well. On February 14, 1986, during a job meeting, CP asked Cemco to provide a proposal for continuation of the work and freezing of the ground. On February 24, CP instructed Cemco to proceed with freezing.

It was admitted that CP's claim to the insurers was for the cost for freezing of $4,200,000 and $500,000 for associated costs claimed within the "*Expediting and Extra Expenses Clause*".

Cemco filed a separate claim of $1,563,660.53 for repairs to the concrete lining of the shaft; this claim which was settled at 25 % with the agreement that Cemco would not voluntarily assist CP in its claim and a commitment to collaborate with the insurers.

The only issues submitted to the Court of Appeal were the following:

- Is the "faulty design" exclusion applicable?
- Is the claim covered under the "Expediting or Extra Expense Clause"?

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[1] *Canadian Pacific Limited* v. *American Home Assurance Company* and *Chateau Insurance Company*, 500-09-005227-970;

Justice Otis reviews the nature of the all-risk builder's insurance and quotes Justice de Granpré's comments in *Commonwealth Construction*[2], according to which the purpose of this insurance is to guarantee "*the necessary funds for the reconstruction in case of loss*". The insurance only covers material damages caused to the insured property and not the economical losses caused by delays.

As to the exclusion clause for faulty design, Justice Otis states that it specifically covers:

> **"... the error resulting from the inadequacy in the design of the plans or from faulty designs without having to demonstrate the existence of a civil fault (negligence) by the designers." (para. 55) (translation)**

It is also interesting to note that Justice Otis takes into consideration that these policies are negotiated between knowledgeable parties.

> **"In this instance, the exclusion clauses in contention are part of all-risks builder's insurance contracts opposing contracting parties (holder and insurers) which fully command - by their status and business acumen - the ability to substantially negotiate the terms and conditions involved in damage insurance and, more specifically, the contingent part of the contract which is the risk. This consensual situation allows us to conclude that the boundaries of the exclusion clauses of the risk have been explained and understood within the general framework of the contract and the consent given by the holder was informed. Under these same circumstances, I believe that the scope of the exclusion clauses was sufficiently specific. We are not in the presence, in this case, of a holder without actual power to negotiate who - confronted with the same clauses - would only have the ability to acquiesce to them without being able to really measure and level off, in a global manner, the extent of the guarantee contained in the insurance policy in order to balance the proceeds." (translation)**

She confirms the trial judge's decision to the effect that the dewatering method was an integral part of the design and that this method was inadequate, therefore the exclusion was applicable,

[2] *Commonwealth Construction Co. Ltd.* v. *Imperial Oil Co. Ltd.*, [1978] 1 R.C.S. 317, p. 328 - 329;

all the more so as CP knew from the beginning of the work that freezing was the best method. In essence, she conludes, CP is asking the insurers "to be compensated for the normal cost of the work it should have spent if it and its subcontractor had simply taken into consideration the predictable risks." (para. 74).

CP also argued the exception to the exclusion, namely that it was "*resulting damages*" or alternately that the exclusion was "*limited to the work directly affected*", but Justice Otis believes that this only extends to a property other than that affected by the defect of construction and that in this case, the ventilation shaft is excluded.

As to the "*Expediting or Extra Expense*" coverage, it does not apply since it only extends to the additional operating costs other than the costs of repair, subject to the latter being covered.

In a brief additional statement, Justice Delisle reiterates that the "*faulty design*" exclusion clause must be applied even in the absence of fault at the time of the design but that it evidently does apply when there is obvious negligence:

**"Otherwise, the client would wish, even organize, neglect from its tenderers, in order to have its insurers assume part of the costs of the work." (para. 91) (translation).**

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