IN FACT AND IN LAW

Product Liability

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Do the costs of a correcting manufacturing defect result from an accident?

By Louis Charette

Can the cost of remedying a manufacturing defect be considered as damage resulting from an "accident" covered under a liability insurance policy? This is the question the Quebec Court of Appeal considered in CGU, Compagnie d'Assurance du Canada v. Soprema Inc., [2007] QCCA 113. Its judgement is of interest not only as regards to the Court of Appeal's answer but also for its extra-provincial implications, as the underlying litigation is pending before the Newfoundland Supreme Court.

The Facts

In the early 1990's, the Newfoundland municipalities of Grand Falls-Windsor and Bishop's Falls formed the Expert Regional Services Board (the "Regional Board") for the purpose of the construction of a water treatment plant in central Newfoundland. The Regional Board retained the services of Newfoundland Design Associates Limited ("NDAL"), a consultant and engineering firm, as project manager, and those of Eco-Zone Engineering Limited ("Eco-Zone") for the construction of the plant.

During construction, waterproofing membranes manufactured and sold by Soprema Inc. ("Soprema") were installed by subcontractors approved by Soprema. Shortly thereafter, the membranes proved to be defective, and NDAL decided that they should be removed, and the work was performed by a subcontractor retained by Eco-Zone.

Relations between the parties took a turn for the worse, resulting in protracted litigation pending before the Newfoundland Supreme Court. What is of interest in relation to the coverage issue raised in the Quebec Superior Court and Court of Appeal is that Eco-Zone claimed from the Regional Board and NDAL damages for the termination of its contract, for the unpaid costs of the work performed in accordance with the contract and for the additional work not covered by the contract but performed at the request of the Regional Board and NDAL, including the removal of the Soprema waterproofing membranes. NDAL sued Soprema as a third party defendant in the proceedings arguing that Soprema should be held liable for the damages alleged by Eco-Zone because they result from Soprima's defective product, faulty installation and inspection, and misleading representations regarding the quality of its product.

The Superior Court's Judgement

In August 2002, Soprema filed a motion (commonly known as a "Wellington motion") in the Quebec Superior Court requesting that its insurer, CGU, be ordered to take up its defence in the proceedings pending in the Newfoundland Supreme Court.

On September 2, 2004, the Honourable Justice Rodolphe Bilodeau ordered CGU to take up the defence of Soprema. He concluded that the term "*sinistre*" ("occurrence"), as used in the insurance policy, should be interpreted as an event that puts the insured's liability in issue, within the limits of the lawfulness of the insured's actions and the scope of its contract. (paragraphe 29)

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The Court of Appeal's Judgement

The Quebec Court of Appeal did not share this opinion. It granted CGU's appeal and dismissed Soprema's proceedings against CGU.

The issue to be decided by the Court of Appeal was whether the alleged damages resulting from the loss of enjoyment of tangible property which was not damage resulted from a "sinistre" (occurrence) as defined in the insurance policy. The policy defined "sinistre" as "an accident, including continuous or repeated exposure to risks of essentially the same nature" [our translation].

Without getting into an exhaustive analysis of the relationships between the various parties involved, the Honourable Justice Pierrette Rayle concluded that the alleged damages claimed in the Newfoundland Supreme Court proceedings concerned the economic losses suffered by Eco-Zone. She noted that there was no evidence of material damage to property or loss of enjoyment of property.

Justice Rayle found that the purely economic losses alleged resulted from the inadequate performance of Soprema's waterproofing membrane, which, in her view, constitutes a normal, and even foreseeable incident which may arise in the normal course of business. She thus concluded that they did not arise out of an accident.

In support of her conclusions, Justice Rayle referred to two precedents. First, she considered the decision of the Ontario Court of Appeal in *Celestica Inc.* v. *ACE INA Insurance*, [2003] O.J. No 2820, in which Justice Armstrong held that the costs of remedial action to correct a safety defect affecting the insured's product were not covered by the insurance policy. Justice Armstrong stated that he could not conclude that "the event which triggered the alleged notional damage was anything other than defective manufacture, which the courts have held is not an occurrence or accident within the meaning of an insurance policy of the kind under consideration here."

Secondly, Justice Rayle referred to a previous decision of the Quebec Court of Appeal in *Géodex Inc.* v. *Zurich Insurance Company,* 2006 QCCA 558. Following the partial collapse of the rooftop parking structure in a real-estate complex, the experts retained by the co-owners' association concluded that the structure had not been built in accordance with the requirements of the *Building Code*. The association instituted proceedings against the various parties involved in the construction seeking compensation for the damages resulting from the collapse of the slab in question (the costs of demolition and reconstruction), the cost of complying with the *Building Code* standards and correcting related deficiencies, and damages for the trouble and inconvenience that resulted from the continuation of the situation.

Géodex Inc., faced with the association's lawsuit, appealed from a judgement of the Superior Court that dismissed its motion to force its insurer, Zurich, to take over its defence. The Honourable Justice Dalphond, for the Court of Appeal, concluded that the damages claimed for the costs of complying with the *Building Code* standards and correcting the deficiencies did not result from an event in the nature of an accident within the meaning of the policy.

Conclusion

The Quebec Court of Appeal has thus maintained the majority opinion in Quebec and in Ontario with regard to insurance coverage for the cost of correcting deficiencies. The inherent costs of correcting a defect in manufacturing or in construction which does not result from an accident or which has not caused physical damage or loss of enjoyment of property are not covered under a liability insurance policy.

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