

# Subrogating Against Subcontractors

## Recovering from subcontractors under a builders' risk policy: Ontario Court of Appeal opens the door for subrogation



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Until recently, Canadian builders' risk insurers have been unable to maintain subrogated actions against subcontractors who have caused a loss. Builders' risk policies have traditionally been treated as a unique insurance contract whose practical purpose can only be served if subcontractors are considered unnamed insureds.<sup>1</sup> Since an insurance company cannot bring a subrogated action against its own insureds, subcontractors are usually protected from subrogated actions.

Nevertheless, it is incorrect to assume all subcontractors automatically obtain the unnamed insured status under a builder's risk policy. A recent Ontario Court of Appeal decision created an important exception to this rule. Subrogation professionals should be alert to the circumstances in which it may be possible to challenge the "unnamed insured" defence.

### When a subcontractor is an unnamed insured

In any construction project, there is always a risk that a subcontractor will damage another's property or the project as a whole. Canadian courts often regard the purpose of builders' risk policies to ensure available funds for a construction's completion, without various sub-trades resorting to protracted litigation upon negligence by anyone involved. The practical purpose of extending insurance to cover all subcontractors is that they are spared the necessity of fighting between themselves. Courts have held that this is a risk accepted by insurers at the outset.<sup>2</sup>

However, the issue of whether subcontractors are included as insureds in a policy, which does not expressly name them is one of contractual interpretation. Courts look at the wording of the construction contract and the insurance policy to make this assessment. In fact, it is largely irrelevant whether a contractor has agreed to obtain insurance for the subcontractor's benefit. The intention of the contractor to insure the subcontractor under the builder's risk policy is not determinative of how an insurance policy will be interpreted.<sup>3</sup> There are two features of builder's risk policies that give rise to the unnamed insured defence:

#### 1. Property owned by others

Where an insurance policy insures an entire construction project, including "property owned by others," Canadian courts have interpreted this as insuring parties other than just the named insureds.<sup>4</sup> In construction contracts, subcontractors are seen as having such an "identity of interest" with the general contractor (in that it will stand to

gain from the project's existence and will lose from any damage to it), that they are considered unnamed insureds by necessary implication.<sup>5</sup> Thus, a subcontractor's interest in the project may be considered insured even when he is not named as an insured on the policy and his interest is not disclosed.

However, there has been an important new development. In May 2010, the B.C. Court opined, in *Brookfield Homes v. Nova Plumbing*, that where property damage coverage for contractors and subcontractors is limited "to the extent of the insured's legal liability for insured physical loss or damage to such property," the unnamed insured defence may not apply. Where a subcontractor is insured only to the extent that the named insured is found legally liable for the loss or damage, it may be that a subcontractor cannot be regarded as an unnamed insured, even in the context of a builder's risk policy.<sup>6</sup>

#### 2. Waivers of subrogation for any "interest with respect to which insurance is provided by this policy"

Where a policy provides that no subrogation lies against a "corporation, firm, individual, or other interest with respect to which insurance is provided by this policy," courts have held that, in regard to the special nature of builder's risk policies, judicial pronouncements on the commercial necessity for including subcontractors; and the clause language itself, subcontractors must be unnamed insureds by necessary implication.<sup>7</sup> Any doubt on this issue is resolved against the insurance company.<sup>8</sup>

#### Case examples

Two cases illustrate the application of these principles:

##### *Janeland Developments Inc. v. Michelin Masonry Inc.*<sup>9</sup>

A general contractor's insurer brought a subrogated action against a defendant masonry subcontractor who negligently caused the collapse of a building's wall. The construction contract contained a hold harmless clause in favor of the homebuilder and required that a subcontractor must obtain its own comprehensive general liability insurance. There was no corresponding obligation on the general contractor to attain insurance of any kind. The general contractor had obtained a Builder's Risk Broad Form policy, which contained "property insured" and "waiver of subrogation" wording referred to above. The Ontario court found that the subcontractor was an unnamed insured under the policy:

- The policy wording, stating that it covered "property owned by others," extended coverage to the masonry subcontractor as an unnamed insured.

- The fact that the agreement for masonry services did not require the general contractor to insure the subcontractor was not sufficient to convince the court that the subcontractor was not intended to be an unnamed insured under the policy.
- The waiver of subrogation clause wording constituted a general waiver of all claims by the insurer against the subcontractor, who was an “interest with respect to which insurance is provided by this form.”
- Finding the subcontractor was an unnamed insured was in keeping with the court’s desire to reduce the litigation, which flowed from losses of this type. It also recognized the reality of complex industrial life and provided comfort and security to owners, builders and subcontractors involved in commercial projects.<sup>10</sup>

### **Brookfield Homes v. Nova Plumbing<sup>11</sup>**

The Ontario Supreme Court of Justice was asked to decide in May 2010 whether a subrogated action could be brought by a home builder’s insurer against a plumbing contractor whose negligence with a welding torch caused fire damage to several homes under construction. The Court permitted a subrogated claim against the subcontractor — a decision that was subsequently upheld by the Ontario Court of Appeal. Although only binding in Ontario, the decision is significant as it presents a persuasive new basis for advancing subrogated claims against negligent subcontractors in all provinces.

In *Brookfield*, a homebuilder contracted a plumber to provide services for a new subdivision undergoing construction. Although the construction contract contained a hold harmless clause in the home builder’s favor and required the plumbing subcontractor to obtain liability insurance, and to waive the subrogation rights of its insurers against the home builder, there was no corresponding obligation on the home builder’s part to obtain insurance or provide any subrogation waivers.

The homebuilder argued that it did not take out builder’s risk policies on behalf of its contractors. Rather, it obtained all perils property insurance, and contractually required its contractors to obtain liability insurance. The subcontractor described the policy as a builder’s risk policy.

The Court, determining that the subcontractor was not an unnamed insured, made the following findings:

- The policy label, be it “builder’s risk,” “all-risks” or “all perils,” is not determinative. It is the policy language that matters.
- The “property damage” coverage for contractors was explicitly limited, stating that the policy “also insures the interest of contractors and subcontractors . . . during construction of an insured location . . . to the extent of the insured’s legal liability for insured physical loss or damage to property.” The subcontractor was insured only to the extent that the homebuilder was found legally liable for the loss or damage.

- Although the Court’s decision did not set out the policy’s subrogation clause wording, the policy provided that the insurer’s subrogation right was preserved and required the home builder to cooperate in any subrogation proceeding. The Court concluded that the construction agreement and policy allocated the risk of loss caused by a contractor to the contractor, rather than the homebuilder. As such, the plumbing subcontractor could not be regarded as an unnamed insured.

### **Conclusion**

Although subcontractors may often be regarded as unnamed insureds with respect to property policies providing coverage for construction projects, this is not always the case. The issue of whether a subcontractor can rely on an “unnamed insured” defence to a subrogated action requires an analysis of the construction contract and the policy. As noted in *Brookfield Homes*, a subcontractor may not be able to utilize this defence where the property coverage for subcontractors has been expressly limited to amounts for which the named insured is legally liable. 🍁

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1. *Sylvan Industries Ltd. v. Fairview Sheet Metal Works Ltd.*, [1994] B.C.J. No. 468 at para. 6. (B.C.C.A.) [“Sylvan”].

2. As stated by Grandpre J. in *Commonwealth Construction Company v. Imperial Oil Limited*, [1978] 1 S.C.R. 317 (S.C.C.), at p. 328: “Whatever its label, its function is to provide the owner the promise that the contractors will have the funds to rebuild in case of loss and to the contractors the protection against the crippling cost of starting afresh in such an event, the whole without resort to litigation in case of negligence by anyone connected with the construction, a risk accepted by insurers at the outset. This purpose recognizes the importance of keeping to a minimum the difficulties that are bound to be created by the large number of participants in a major construction project, the complexity of which needs no demonstration. It also recognizes the reality of

industrial life.”

3. See for example, *Sylvan Industries Ltd. v. Fairview Sheet Metal Works Ltd.*, (1994) 89 B.C.L.R. (2d) 19 (C.A.).

4. *Madison Developments Ltd. v. Plan Electric Co.*, [1997] O.J. No. 4249 (Ont. C.A.) [“Madison”].

5. For example, in *Madison, ibid*, the Court of Appeal stated: “. . . the policy insures property owned by others, suggesting that others than those named in the policy are insured. The contractor obtained that insurance, a loss occurred, and payment was made under the policy. The insurer must be taken to be aware of the contractor’s contracts with subcontractors, or to have some control over them if not yet entered, because the insurer’s subrogation rights can be eliminated by such a contract. . . .” The Court concluded that the subcontractor was an unnamed insured by necessary implication.

6. *Brookfield Homes v. Nova Plumbing*, 2010 ONSC 2131 (CanLII).

7. *Sylvan, supra* note 16 at para. 17; *Esagonal, supra* note 21 at p. 9 of 10.

8. *Ibid*.

9. 1996] O.J. No. 513 (Ont. Gen. Div.).

10. *Ibid* at para. 15.

11. *Supra*, note 6.