

## Recovering From Subcontractors Under Builders' Risk Policies: Ontario Court Of Appeal Opens The Door For Subrogation

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### A. INTRODUCTION

Until recently, the general rule of thumb in Canada has been that builder's risk insurers are unable to maintain subrogated actions against subcontractors who have caused a loss. In Canada, builders' risk policies have traditionally been treated as a unique species of insurance contract whose practical purpose can only be served if subcontractors are considered to be unnamed insureds.<sup>1</sup> Since an insurance company cannot bring a subrogated action against its own insureds, subcontractors are generally protected from subrogated actions.

Never assume that all subcontractors will automatically obtain the status of unnamed insured under a builder's risk policy. A recent decision of the Ontario Court of Appeal has 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" defense.

### B. WHEN IS A SUBCONTRACTOR AN UNNAMED INSURED?

In any construction project, there is always a risk that a subcontractor will damage the property of another or the construction project as a whole. Canadian courts have tended to regard the primary purpose of builder's risk policies as being to ensure that funds are available for the completion of construction, without the various sub-trades having to resort to protracted litigation in the event of negligence by anyone connected with the construction. In other words, the practical purpose of extending insurance to cover all the subcontractors who are working to complete the construction is that they are spared the necessity of fighting

between themselves. Courts have held that this is a risk accepted by the insurers at the outset.<sup>2</sup>

Ultimately, however, the issue of whether subcontractors are included as insureds in a policy that does not expressly name them is one of contractual interpretation; courts will look at the wording of both the **construction contract** and the **insurance policy** in order to make this assessment. (In fact, it is largely irrelevant whether a contractor has agreed to obtain the insurance for the benefit of the subcontractor. 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 appear to give rise to the unnamed insured defence:

#### i) "Property Owned by Others"

Where an insurance policy insures an entire construction project, including "**property owned by others**," Canadian courts have interpreted the policy as inferring that it actually insures parties *other than* just the named insureds.<sup>4</sup> In the context of construction contracts, subcontractors are seen

<sup>1</sup> *Sylvan Industries Ltd. v. Fairview Sheet Metal Works Ltd.*, [1994] B.C.J. No. 468 at para. 6. (B.C.C.A.) ["Sylvan"].

<sup>2</sup> 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."

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

<sup>4</sup> *Madison Developments Ltd. v. Plan Electric Co.*, [1997] O.J. No. 4249 (Ont. C.A.) ["Madison"].

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.

In this regard, 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 defense may not apply. In other words, 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>

#### ii) 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, having regard to the special nature of builder’s risk policies, judicial pronouncements on the commercial necessity for including subcontractors; and the language of the clause itself, subcontractors must be taken to be unnamed insureds by necessary implication.<sup>7</sup> Any doubt on this issue is resolved against the insurance company.<sup>8</sup>

#### C. BROOKFIELD HOMES V. NOVA PLUMBING<sup>9</sup>

In May of 2010, the Ontario Supreme Court of Justice was asked to decide 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 this decision is only binding in Ontario, it is significant as it presents a persuasive new basis for advancing subrogated claims against negligent subcontractors in all provinces.

In *Brookfield*, a home builder had contracted a plumber to provide plumbing services for a new subdivision that was undergoing construction. Significantly, although the construction contract contained a hold harmless clause in favor of the home builder 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 part of the home builder to obtain insurance of any kind or provide any subrogation waivers.

The home builder 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 take out liability insurance. The subcontractor described the policy as a builder’s risk policy.

#### **The court, in finding that the subcontractor was not an unnamed insured, made the following findings:**

- The label of the policy, be it “builder’s risk”, “all-risks,” or “all perils,” is not determinative. Rather, it is the policy language that matters.
- In this case, 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.**” In other words, the subcontractor was insured only to the extent that the home builder was found legally liable for the loss or damage.

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<sup>5</sup> 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.

<sup>6</sup> *Brookfield Homes v. Nova Plumbing*, 2010 ONSC 2131 (CanLII).

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

<sup>8</sup> *Ibid*.

<sup>9</sup> *Supra*, note 6.

Although the court's decision did not set out the wording of the policy's subrogation clause, the policy provided that the insurer's right of subrogation was preserved and required the home builder to cooperate in any subrogation proceeding.

The court concluded, based on the considerations set forth above, that both the construction agreement and the policy allocated the risk of loss caused by a contractor to the contractor, rather than the home builder. 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 that provide 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 both the construction contract and the policy in question. Significantly, as noted in the recent case of *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.