

BULLETIN 26

Coverage for Existing Fixed Structures Under Builders' Risk Policy

November 2022

This bulletin is with respect to the Builders' Risk Broad Form Property Insurance policy scope of the property insured, more particularly concerning resulting damages to "existing fixed structures". This bulletin is intended to highlight the issue concerning insurance coverage given conflicting interpretation of policy wording by the courts; it is strongly recommended the contents be discussed with your insurance representative.

All construction work is susceptible to damage from a wide range of causes (known as "perils" in insurance terminology). The most common perils include fire, collapse, windstorm, vehicle impact, theft, vandalism, water damage, and flooding. Construction projects can be protected against such perils through Builders' Risk Broad Form Property (Builders' Risk) insurance (also known as course of construction insurance).

While the term "all risks" is used to describe a relatively broad form of insurance, such policies are subject to specific exclusions contained in the policy. The insurance industry has adopted the term "broad form" instead of "all risks" as a better way to describe the coverage provided by such policies, including Builders' Risk Broad Form Policy IBC 4042, which is specified in the CCDC standard contract form.

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The Builders' Risk policy insures direct physical loss or damage to the work in the course of construction and at the risk of the builder. It indemnifies the interested parties for physical loss or damage to all permanent construction and temporary works necessary to facilitate construction, provided their value is included in the amount insured as required by the policy. While the insurance provided is termed "Builders' Risk Broad Form," the exclusions, as well as the description of the insured property and the amount of insurance, determine the scope of coverage. Further details are described in *CCDC 21 A Guide to Construction Insurance*.

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Where interpretation of the intended coverage for existing fixed structures has been in question, whether the broader interpretation where the Builders' Risk policy should insure existing fixed structures, or the narrower interpretation where the Builders' Risk policy should insure only the permanent construction and temporary works, the courts considered the following:

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- the purpose of the Builders' Risk policy is to provide a builder with sufficient insurance to repurchase new materials to be incorporated into a project and complete its work in the event of an unforeseen physical loss or damage

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- whether each trade and sub-trade has an insurable interest in the entire project where a new structure was being constructed, and not merely the new addition being worked on
- whether it makes commercial sense for a builder to purchase insurance to cover an entire existing structure when the insurance costs more than the total profit for the project
- whether it is commercially viable to require a builder to obtain builders’ risk insurance to cover an entire building while working on only one part

The following cases will demonstrate both broader and narrower interpretations of Builders’ Risk insurance policy scope of property insured.

Case: Pre-Eng v. Intact, 2019 ONSC 1700

The Ontario Superior Court considered whether losses caused by the negligent work of a builder hired to renovate the roof of an existing school, resulting in rain damage to the wooden floor of a gym below, were covered by the Builders’ Risk.

Property Insured/Excluded:

The Builder’s Risk Insurance policy described the insured property, in part, as follows:

- At the “project site”, provided that the value of the described property, whether owned by the Insured or by others, is included in the amount of insurance
- Property in course of construction, installation, renovation, reconstruction or repair other than property described in 3.a) ii), all to enter into and form part of the completed project including expendable materials and supplies, not otherwise excluded, necessary to complete the project.

The General Liabilities policy excluded property damage coverage, in part, as follows:

- To that particular part of real property on which the Named Insured or any builder or subcontractor working directly or indirectly on the Named Insured’s behalf are performing operations, if the property damage arises out of those operations; or
- To that particular part of any property that must be restored, repaired or replaced because the Named Insured’s work was incorrectly performed on it.

Insurer’s Positions:

- The Builder’s Risk Policy insurer took the position that its policy covered only the portion of the property actively under construction, renovation or repair. The insurer argued that the property under construction was the school roof, not the gym floor.
- The CGL insurer took the position that the Builder’s Risk Insurance policy covered all damage caused at the “Project Site”, which included the entire school.

Court’s Position:

It concluded that these damages were not covered by the Builder’s Risk Policy as the court adopted a narrow interpretation of the property insured. There was also a Commercial General Liability (“CGL”) policy in place and the court described the two policies as “complementary”, despite the fact that a Builders’ Risk policy provides first party coverage and a CGL policy covers third party liability. The Court noted that the Builders’ Risk and CGL insurance served different purposes, with the purpose of the Builders’ Risk policy being to ensure that a builder had sufficient insurance to repurchase new materials incorporated into a project and complete its work in the event of an unforeseen physical loss or damage. According to the Court, this purpose did not require a builder to “insure the entire structure before undertaking his small task”. **Builders’ risk policy NOT to provide coverage for resulting damage to existing fixed structures.**

Conflicting Decisions:

In *Medicine Hat College v. Starks Plumbing & Heating Ltd.*, 2007 ABQB 691, the Alberta Court of Queen’s Bench held that damage to a penthouse mechanical room through an explosion caused by improper reconnection of a gas line was covered under a builders’ risk insurance policy as “property in the course of construction”, although the contractor had not been hired to do any work on the penthouse. The Court reasoned that each trade and sub-trade had an insurable interest in the entire project where a new structure was being constructed, that trades and sub-trades also had an insurable interest in the entire interconnected structure (and not merely the new addition being worked on) where an addition to an existing structure was being constructed. **Broader interpretation; Builders’ risk policy to provide coverage for resulting damage to otherwise not insured existing fixed structures.**

In *William Osler Health Centre v. Compass Construction et al.*, 2015 ONSC 3959, the Ontario Superior Court of Justice declined to follow *Medicine Hat College*. The Court held that the builders’ risk insurance policy at issue covered only flooding damage to a hospital kitchen under renovation which was caused by negligent plumbing work carried out in the kitchen, but did not cover flooding damage to other areas of the hospital. The Court held that it would be commercially unreasonable to expect a contractor or subcontractor to obtain insurance coverage for the entire hospital in order to carry out work in one area. The Hospital insured itself to a limit of \$162.5 million for a premium of \$122,000. Compass’ total profit for the job is likely to be around \$60,000. It would make no commercial sense to expect Compass to obtain \$122,000 worth of insurance to insure the entire hospital in these circumstances.

The court held that the wording of the builders’ risk insurance policy at issue stipulated that only the insured’s actual interest in the property insured would be covered by the policy. In other words, a contractor’s “insurable interest” in an existing structure as a whole, as referenced in *Medicine Hat College*, merely permitted the contractor to obtain insurance on the property as a whole and did not determine the scope of coverage for a given insurance policy. The Court held that any insurable interest of the contractor in the Project Site as a whole was not in fact insured by the specific policy at issue in *William Osler Health Centre*. **Builders’ risk policy NOT to provide coverage for resulting damage to existing fixed structures.**

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In *Team Mechanical Construction Limited v. Viking Fire Protection Inc.*, 2017 Carswell Nfld 370, the Newfoundland and Labrador Supreme Court (Trial Division) rejected the reasoning in *William Osler Health Centre* and adopted the reasoning in *Medicine Hat College*. The Court held that damage caused throughout a health sciences complex by the negligent installation of a water treatment system was covered by a builders’ risk insurance policy. In particular, the Court held that “an insurer issuing a Builders’ Risk Insurance Policy for an existing structure undergoing renovation, must be clear if “Property Insured” is limited to specific areas of the building, or is limited to new work only.” According to the Court, a plain reading of “property in the course of construction, installation, reconstruction or repair” insured by the policy included the entire complex and was not limited to any specific area, though works were occurring only in certain areas of the complex.

However, the Newfoundland and Labrador Court of Appeal reversed the trial decision in *Team Mechanical* and adopted the reasoning in *William Osler Health Centre*, holding that the term “property insured” covered “loss or damage to new property related to the construction project only, and did not cover loss or damage to pre-existing property not directly involved in the project. In the Court of Appeal’s view, the interpretation in *William Osler Health Centre* accorded more with the parties’ reasonable expectations and produced a commercially realistic result. **Due to Court of Appeal decision, Builders’ risk policy NOT to provide coverage for resulting damage to existing fixed structures.**

In *Pre-Eng*, the Ontario Superior Court of Justice noted that there was no factual basis to distinguish *William Osler Health Centre*, and held that it was not commercially viable to require a contractor to obtain builders’ risk insurance to cover an entire building while working on only one part, nor was this necessary in order to fulfil the purpose of builders’ risk insurance. Further, the Court followed the Newfoundland and Labrador Court of Appeal’s reasoning in holding that there was no ambiguity regarding property “under construction” in the Builders’ Risk Insurance policy at issue, such that property damaged as a result of construction, but not under construction, was not covered.

Conclusion

Pre-Eng is one of a growing number of cases which have moved away from the broader interpretive approach in *Medicine Hat College*. The courts have instead adopted the narrower interpretation applied in *William Osler Health Centre*. Owners, general contractors and subcontractors should be aware of this judicial trend and not only review the scope of the property covered under the builders’ risk policy at issue but also ensure the construction contract is clear as to whether the Builders’ Risk Insurance Policy is expected to insure the existing structure undergoing renovation, is limited to specific areas of the building, or is limited to new work only.

Such clarification in a contract could be managed as follows:

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- The Contractor can expressly agree to insure damages also resulting to the fixed structures, whether limited to specific areas or applicable to all areas. This would require the insurer to be informed of the agreement to insure all or a portion of the existing structure damages as the case may be, obtain values and price the builders’ risk policy accordingly; the Owner may be willing to pay all or a portion of the increased premium.
- The Owner could agree the risk of the cost of damages to the existing structure is disproportionate to the value of the construction contract for the repairs or construction undertaken by the Contractor and agree in contract:
 - to waive such damage claims against the Contractor and its Subcontractors and release the Contractor and its Subcontractors from any such damage claims; or
 - the Owner could agree to have its property insurer issue a waiver of subrogation in favour of the Contractor and its Subcontractors with respect to any such damage claims

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