Blaney McMurtry LLP

PUBLICATION

The Correct Approach to the Interpretation of Boilerplate Policy Wording in Canada

Date: November 02, 2016
Co-Author: Anna Casemore

Original Newsletter(s) this article was published in: Blaneys' Coffee House: November 2016

On September 15, 2016, the Supreme Court of Canada released its highly anticipated decision in *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.*, 2016 SCC 37 (CanLII), ruling on (a) the standard of review on appeals relating to boilerplate contracts, (b) the principles of insurance policy interpretation, and (c) the scope of the faulty-workmanship exclusion in a builder's risk policy. This decision is critically important to insurers who underwrite property and construction-related risks in Canada.

The Facts in *Ledcor*

Station Lands Ltd. owns the EPCOR Tower in Edmonton, Alberta. Ledcor Construction Ltd. was the general contractor with respect to the construction of the Tower.

During construction, Station Lands hired Bristol Cleaning to clean the windows of the Tower. Bristol scratched and permanently damaged the surface of the windows. The estimated replacement cost was CDN$2.5 million.

The project was covered by a builder's risk insurance policy, with Ledcor and Station Lands being the named insureds. The policy covered all contractors, including Bristol, for physical damage occurring on the project, subject to the following exclusion:

4(A) Exclusions

This policy section does not insure:

…

(b) The cost of making good faulty workmanship, construction materials or design unless physical damage not otherwise

> excluded by this policy results, in which event this policy shall insure such resulting damage.

Coverage for “the cost of making good faulty workmanship” was excluded, but there was an exception for “resulting damage”.

Station Lands and Ledcor sought indemnification under the policy for the damaged windows. The insurers[1] denied coverage in reliance on the exclusion. Station Lands and Ledcor commenced proceedings against the insurers for coverage.

Decision of the Lower Court

The insureds argued that the phrase “cost of making good” limited the exclusion to barring coverage for redoing Bristol’s work (approximately CDN$45,000). Conversely, the insurers took the position that the “cost of making good” included the cost of redoing the cleaning work, as well as the damage to the windows, given that Bristol had performed the work on the windows.

The Alberta Court of Queen’s Bench concluded that the exclusion clause was ambiguous (both the insureds and the insurers had advanced reasonable interpretations of the “cost of making good” the improper work, which informed the phrase “resulting damage”), and applied the principle of *contra proferentem* (see below) to conclude that only the cost of redoing the cleaning was excluded. The insurers appealed.

Decision of the Court of Appeal

In applying a ‘correctness’ standard (the least deferential standard of appellate review), the Court of Appeal reversed the decision of the lower court, holding that the faulty-workmanship exclusion barred indemnification for damage to the windows. It also concluded that since the exclusion clause was unambiguous, the principle of *contra proferentem* did not apply.

Once again, the Court had to distinguish between the physical damage, intended to be excluded, and the resulting damage, to which the exclusion was not intended to apply. To do this, the Court devised the following test:

> (1) whether the damage was part of the work in question, or was “collateral damage”,
>
> (2) whether the damage was a “natural or foreseeable consequence of the work”, and
>
> (3) whether the damage was “unexpected and fortuitous”.

The Court held that the damage was excluded because it was caused by Bristol’s improper cleaning of the windows and, therefore, was foreseeable. The insureds appealed.

Decision of the Supreme Court of Canada

The Supreme Court of Canada reversed the appellate decision, holding that the faulty-workmanship exclusion barred indemnification for only the cost of redoing the cleaning.

This decision is important for three reasons:

1. the Court addressed the standard of review applicable to boilerplate or standard-form contracts;

2. it reaffirmed the interpretive principles applicable to insurance contracts, expressed, six years earlier, by the Supreme Court in *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, 2010 SCC 33 (CanLII); and

3. it clarified the meaning of "resulting damage".

Standard of Appellate Review: Boilerplate Contracts

In distinguishing one of its own decisions (*Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53 (CanLII)), the Court ruled that the standard of appellate review for standard-form contracts is correctness (the least deferential standard), which is applicable to pure questions of law.

In *Sattva*, the Supreme Court had held that a more deferential standard (i.e. palpable and overriding error) would apply to a negotiated contract because there would have to be a determination of the reasonable expectations of the parties considered in light of the contract's wording and the surrounding circumstances. However, it was noted that there may be rare cases whereby the standard of appellate review in respect of a contract is correctness. The standard form insurance policy at issue in *Ledcor* was such a case.

Boilerplate contracts (or contracts of adhesion, as they are sometimes called) are typically not negotiated, and are offered on a take-it-or-leave-it basis. As boilerplate wording has much broader implications - it would apply to a greater number of parties - its interpretation has precedential value, so it is worthy of more stringent judicial intervention. Furthermore, the surrounding circumstances would play a limited role. As recently noted by the Ontario Court of Appeal, while premiums and policy periods may be negotiated in circumstances where insureds accept boilerplate wording, the terms and conditions themselves are not (*MacDonald v. Chicago Title Insurance Co. of Canada*, 2015 ONCA 842 (CanLII)). In such circumstances, the interpretation of the contract is a pure question of law, so correctness would be the proper standard of review.

The Court in *Ledcor* left open, however, the possibility that certain boilerplate contracts could be subject to a more deferential standard of review. For instance, some standard-form contracts may be applicable to only certain parties, or, in some cases, some of the wording may have been negotiated.

Determining whether a contract is true boilerplate, or is somehow more specific to the parties involved, would be a question of fact. So, in the case of a hybrid contract, both standards of review could apply.

Interpretation of Insurance Contracts

In deciding that the faulty-workmanship exclusion only barred indemnification for redoing the cleaning, the Supreme Court affirmed the interpretive principles to be applied when analysing insurance policies:

1. to give effect to the clear, unambiguous language, reading the contract in its entirety;

2. when ambiguity exists, general rules of contract interpretation would apply. For example, courts should give effect to the reasonable expectations of the parties by looking at the surrounding circumstances (or "factual matrix") of contract formation, and consider the objective evidence of what the parties intended the words to mean (provided that such an interpretation is supported by the words of the contract). In considering the commercial context in which the policy was created, the correct interpretation should not be unrealistic, and ought to be consistent with the interpretation of similar wording contained in similar insurance policies; and

3. if ambiguity still exists, the rule of *contra proferentem* (i.e. the wording should be construed against the drafter (the insurer in this case)) should be applied.

A corollary to this principle is that insurance clauses are interpreted broadly, and exclusionary / limitation clauses narrowly.

The Meaning and Application of the Faulty-Workmanship Exclusion

In applying the rules of interpretation, the Court reasoned that the faulty-workmanship exclusion was ambiguous. It was a boilerplate exclusion, and there was no evidence that the parties had given any consideration to how it would apply in the context of window cleaning, or at all. Thus, there was no evidence of the parties' reasonable expectations. In the circumstances, the relevant factors that ought to be considered were:

1. the purpose of the contract;

2. the market or industry involved; and

3. the nature of the relationship it creates.

The Court reasoned that the purpose of a builder's risk policy is to provide "broad coverage for construction projects". They are "all risk" policies, designed to cover fortuitous and contingent accidents or errors in construction projects, and they operate by providing "peace of mind" to the parties involved, so that construction need not be stopped for every dispute or potential claim.

Bristol had been retained only to clean the windows, not install them. Bearing in mind that exclusions are to be interpreted narrowly, the Court held that the damage to the windows was "resulting damage", not the result of faulty work. The cost of replacing the windows (CDN$2.5 million) therefore fell within coverage, and only the cost of cleaning (CDN$45,000) was excluded.

Discussion

The determinative factor for the Supreme Court seems to be that Bristol did not install the windows, so the damage to the windows could not fall within "faulty workmanship". Thus, the contractor's scope of work played a key role in determining the scope of the resultant damage.

The *Ledcor* decision also has implications for the drafting of insurance contracts, generally. Insurers will need to carefully consider the objective factors that the Court relied on to interpret the boilerplate language. For instance, marketing material that is used to sell policies may be relevant in the interpretation of standard-form wording, as it could notionally speak to the nature of the relationship between the insurer and the insured. Accordingly, insurers may want to ensure that policies are not marketed in a manner that is inconsistent with the underwriter's intent as to the purpose and scope of the contract.

---

[1] The policy was underwritten by Commonwealth Insurance Company, GCAN Insurance Company and American Home Assurance Company. Between the date the policy was issued, and the date of judgment at trial, the insurers became Northbridge Indemnity Insurance Company, Royal & Sun Alliance Insurance Company of Canada, and Chartis Insurance Company of Canada, respectively.