Waiver of Subrogation in Builders Risk Policies

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An insurer cannot subrogate against its own insured[1]. Litigants have tested this well-known bar to subrogation since the *s.s. Fitzmaurice* struck and sunk the *s.s. Dunluce Castle*, and the latter's underwriters tried to recover against the former's owner, although he owned both vessels.[2] Despite a long history, cases still arise that explore its limits. In particular, actions involving construction projects often address subrogation given the involvement of insured owners, contractors, subcontractors, builders risk policies and property insurers.

Recently, in *Maio v. Mer Mechanical Inc.*, the Ontario Superior Court considered whether a waiver of subrogation ought to bar an action involving property damage, a responding property insurance, and builders risk insurance.[3] The Court distinguished between two different definitions of a single policy term, and ultimately found there was no waiver of subrogation. Although the decision largely turns on the policy wording, the case touches several issues central to subrogation, and specifically, the waiver of subrogation between insureds. This article addresses *Maio*, and other jurisprudence that may offer further support for the conclusion that the Maio insurer was not running afoul of the subrogation bar.

Maio v. Mer Mechanical Inc.

The plaintiff Joe Maio acted as his own general contractor while building his luxury home. During its construction, Maio had a policy that included residential builders all risk coverage (the "builders risk policy" or "BRP"). The BRP had a waiver of subrogation and expired September 1, 2009, upon the project's completion. A homeowner's property policy covered the home after completion.

Shortly after the project was finished and Maio moved in, a faucet failed. The water caused extensive damage to the house. Maio's property insurer honoured the claim and then started a subrogated action against some trades involved in the construction. Mer Mechanical Inc. was the plumber who had installed the faucet. Mer produced an expert who theorized the faucet failure arose from a "creep/stress relaxation" present from shortly after the faucet's installation.

Mer then brought a summary judgment motion asserting the waiver of subrogation in the BRP barred the property insurer's subrogated claim against it. In essence, Mer asked the Court to bar Maio's action based on a waiver of subrogation in an expired builders risk policy that had not responded to the loss.

Mer asserted the BRP covered any "occurrence" during the coverage period so long as the "inception of the event" was before the project's completion date. Mer argued the "occurrence" was within the BRP's coverage period because (according to its expert) the "creep/stress relaxation" was present from shortly after the faucet's installation. Mer also contended Maio ought to have claimed under the BRP, not the

property policy. In either case, Mer claimed the BRP's waiver of subrogation should have barred the claim against it.

In response, the plaintiffs argued:

1. the "occurrence" was the separation of the faucet after the project was completed, not anything at installation;
2. a builders risk policy insures construction operations, not completed property;
3. no claim was made against the BRP so subrogation issues ought not to arise;
4. the BRP's waiver of subrogation cannot waive another's claim; and
5. the facts were in dispute, so the summary judgment motion was inappropriate.

The Court denied Mer's motion based on the definition of occurrence in the RBAR policy and, aside from a brief comment on builders risk policies, did not need to explore the other issues.

Maio's BRP defined "occurrence" as:

> *"… loss… arising out of one event. If the inception of the event causing the loss occurs prior to the estimated completion date of the project, then the Insurer shall be liable for any loss incurred after the estimated completion date of the project, a s a result of the event".*

Mer cited two cases involving pipes rupturing after builders risk policies had expired, but where problems tied the occurrence to the original installation.[4] However, both policies defined "occurrence" as "… an accident, including continuous or repeated exposure to substantially the same harmful conditions…". Mer asserted the "inception of the event" was the "creep/stress relaxation".

The Court noted the BRP definition of "occurrence" did not reference accident, and ruled the "inception of the event" is merely the beginning of an event, which is distinct from its cause. The "event" was the detachment of the water supply, not the installation of the faucet, and so no event fell within the builders risk policy period.[5] The loss was not an "occurrence" within the BRP, the defendant was not an insured under the property policy and there was no bar to any subrogated claim by that insurer. The Court added that the purpose of a builders risk policy is to protect common insurable interests of contractor and subcontractors while completing a project, not afterwards when insurable interests cease to exist.

Mer's Challenges

Mer's motion failed on the BRP wording. However, jurisprudence suggests it may also have failed because it ran counter to principles of subrogation: there was no prior determination of coverage under the BRP, no payment made under the BRP and no common insurable interest.

The importance of underlying coverage was an issue in *Winnipeg Regional Health*

Authority Inc. v. Bockstael Construction (1979) Ltd.[6], which also involved a property insurer indemnifying an insured for a loss and then commencing a subrogated claim. Like Mer, the defendant, Bockstael, moved for summary judgment asserting a builders risk policy contained a waiver of subrogation barring the claim.

The Manitoba Court of Queen's Bench rejected Bockstael's motion, stating:

> *There is no doubt that there is an equitable proposition of insurance law that an insurance company, after having paid out a loss, may not pursue a subrogated action against an insured under its policy. But the precondition to such a discussion is that the insurance company must have responded to, and paid out, the loss. In this case, the builders risk insurer, Royal & SunAlliance, refused payment of the claim, for reasons unknown. As argued by the plaintiffs, if Royal & SunAlliance had paid out the claim to the plaintiffs, there is no question that it could not then pursue subrogation against the defendant, given its status as a named insured under the builders' risk policy.* **[Emphasis added.]**

The Manitoba Court highlighted that Bockstael's motion would have required the Court to conclude the builders risk policy would have covered the loss. Parties knew the builders risk insurer had already denied the claim, but the Court was not privy to the reasons for the denial and the insurer was not a party.

Determining whether the builder's risk policy ought to have responded to the loss required that insurer's involvement and knowledge of its reasons for the denial. The Court was unwilling to treat the summary judgment motion as a coverage assessment of the builders risk policy and expressly refused to consider whether the builder's risk policy ought to have responded to the loss. Bockstael's motion did not support a *prima facie* conclusion that the property insurer's claim would fail, and the Court dismissed the summary judgment motion.

As in *Maio*, the builders risk insurer did not respond to the loss in that the BRP did not pay out any loss. Thus, drawing from *Winnipeg Regional Health Authority*, Maio's BRP had no role in Maio's loss and so did not meet the "precondition" necessary to initiate any discussion on limits to subrogation.[7]

In *Condominium Corp. No. 9813678 v. Statesman Corp*[8] a condominium corporation had bought all-risk insurance for two completed towers, while two other towers remained under construction. The condominium's developer, Statesman, had a builders risk policy for the uncompleted towers. Statesman was also an owner of certain units and common area in the completed towers, and thus subject to the condominium corporation's actions, by-laws, shared common expenses, and all risk insurance. The by-laws also had a waiver of subrogation extending to unit owners.

A fire allegedly started by a subtrade working on the unfinished towers extensively damaged the completed towers. The all-risk insurer paid the losses for unit holders in the completed towers, and started a subrogated action against Statesman. Statesman alleged that it was an insured under the all-risk insurance and that the by-law's waiver of subrogation also applied.

The condominium corporation was successful in the first instance. However, the Court of Appeal ruled that the waiver of subrogation barred the action. The Court of Appeal stated:

> *The law is well settled that the insurer has no subrogation rights against an insured. In other words, it cannot sue any of its insured for losses paid out under the same policy, no matter how negligent they were in causing the loss (barring arson or other deliberate cause).* **[Emphasis added.]**

Unlike in *Maio*, the developer Statesman, while named as a defendant, was also an insured under the very same policy that paid the claim that the insurer was advancing. The fact Statesman held nominal interests in the completed towers meant it had an insurable interest under the subrogating policy. While subrogation is a derivative right (in this case derived from the insured unit holders), an ongoing mutual insurable interest can engage the waiver of subrogation.

The case of *Daishowa-Marubeni International Ltd. v. Toshiba International Corp.*[9] involved a plant shut down four years after construction had ended. In this case the Alberta Court of Appeal considered the end of the insurable interest and refused to bar a subrogated claim based on waiver. Subcontractors who had worked on the project during its build did not maintain an insurable interest in it thereafter. The Court of Appeal expressly rejected the defendants' assertions that the insurer was barred from subrogating against a party who previously had been a co-insured with an insurable interest in the property.

The defendants had fully completed all contracts for the installation and maintenance, and parties had been fully paid for all work. There was no evidence that the failure in question stemmed from physical damage that occurred during the construction. The fact that the defendants had been contractors with a prior insurable interest in the project was insufficient to bar subrogation. The Court noted that "[t]he relevant date to assess the issue of insurable interest under a property insurance policy is the date of the loss", and concluded the date of "loss" was well after the construction ended.

Conclusion

Maio and the other cases suggest certain factors are indicia of whether a waiver of subrogation could apply. Such factors include (but are not necessarily limited to):

1. coverage owed under a policy;
2. indemnity paid under that policy;
3. the presence of parties with insurable interests under the responding policy;
4. the presence of a waiver of subrogation clause; and
5. an intent (or attempt) to subrogate by one insured against a co-insured under the same responding policy.

An insurer's subrogated claim is wholly derived from the insured's claim, and the insurer can be in no better position as against third parties than the insured.[10] But an insurer's

subrogation rights only arise after an insurer indemnifies an insured. Accordingly, the waiver of subrogation must also be derivative, rather than creating a distinct contract formed between two insureds. The mere fact that two parties may have been insured under a policy containing a waiver of subrogation does not equate that insurance policy to a contract that the parties will not sue each another.[11] *Maio* and the referenced cases remind us, once again, that it is the particular policy wordings and underlying events that dictate outcomes, rather than general concepts.

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1 See *Commonwealth Construction Co. Ltd. v. Imperial Oil Ltd. et al*., [1978] 1 SCR 317 at para. 23:
"The courts have consistently held, in the builder's risk cases, that the insurance company — having paid a loss to one insured — cannot, as subrogee, recover from another of the parties for whose benefit the insurance was written even though his negligence may have occasioned the loss, there being no design or fraud on his part."
2 *Simpson & Co. v. Thomson,* (1877) 3 App. Cas. 279.
3 2018 ONSC 4426.
4 *Royal & SunAlliance Insurance Company of Canada v. Meridian Construction Inc*, 2012 NSCA 84, 320 N.S.R. (2d) 267, and *Co-Operators General Insurance Co. v. Wawanesa Mutual Insurance Co.,* 2014 NSSC 23, 339 N.S.R. (2d) 367.
5 See also *Kapsimallis v. Allstate Insurance Company* 104 Cal.App.4th 667, 673 (Cal. Ct. App. 2002), adopting *Prudential-LMI Com. Insurance v. Superior Court* (1990), 51 Cal.3d 674, where "inception of the loss" was referenced as the point in time when appreciable damage is or should be known to an insured.
6 2012 CarswellMan 218, 2012 MBQB 116, 216 A.C.W.S. (3d) 462, 278 Man. R. (2d) 179.
7 As an additional point, the subrogation clause in the BRP stated the insurer could only receive a subrogated interest "…upon making payment or assuming liability therefor under this policy…". No payment or assumption of liability occurred. As there was no 'uptake' of a subrogation interest, there similarly ought to have been no application of its waiver.
8 2007 ABCA 216, 2007 CarswellAlta 857.
9 2003 ABCA 257 (CanLII).
10 *Douglas v. Stan Fergusson Fuels Ltd*. 2015 ONSC 65 at
11 In comparison, construction contracts can contain waivers of claims between contracting parties but there was no such contract between Maio and Mer. Absent such a contract, and absent an insurer's receipt of a subrogation interest under the policy, there ought to have been no basis to contend a contractual waiver of subrogation would apply.