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Case Analysis: *Ledcor Construction Ltd v Northbridge Indemnity Insurance Co.*, 2016 SCC 37; Standard Form Contracts & Faulty Workmanship

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The Supreme Court of Canada recently released its long awaited decision in *Ledcor Construction Ltd v Northbridge Indemnity Insurance Co.*, 2016 SCC 37 ("*Ledcor*"). The case is important for at least two reasons: first, the case is a significant decision concerning the proper standard of review for courts asked to interpret standard form contracts. In this decision, the SCC confirmed that interpretation of standard form contracts is often a question of law, and so the standard of review of standard form contracts ought to be correctness. In this manner the SCC endorses the precedential value that a consistent interpretation presents, while suggesting that the "factual matrix" surrounding the particular usage of standard form contracts will generally be less impactful.

Second, the case provides commentary on the appropriate approach to the faulty workmanship exclusion. Comparing the SCC *Ledcor* decision with that of the trial decision and the appellate court decision affirms the SCC's interest in promoting a consistent and efficient approach to applying the "faulty workmanship" exclusion, which is often found in insurance policies. The majority judgment also attempts to avoid a potential risk underlying the Alberta Court of Appeal's decision, which could have injected an additional level of analysis into "faulty workmanship" coverage assessments. In the simplest terms, as noted in the SCC's decision, "making good faulty workmanship" means only the cost of redoing the faulty work.

Underlying Facts

In *Ledcor,* the property owner, Station Lands Ltd., had retained Ledcor Construction Limited as construction manager over the EPCOR tower in Edmonton. A window cleaning company, Bristol Cleaning, was hired to wash construction debris off the windows of the tower as it neared the end of construction.

As is common with projects of this size, there were various sub-trades, suppliers and installers involved. Station had a builders' all risks policy covering all "direct physical loss or damage except as hereinafter provided." Station and Ledcor were both named insureds and the subcontractors, architects, engineers etc., were additional insureds.

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In the process of cleaning the windows of the post-construction dirt and grit, Bristol caused damage. Bristol was found to have used improper tools and methods, dull, dirty or inappropriate blades to scrape off the dirt, and a "non uni-directional" cleaning method, contrary the manufacturer's cleaning instructions. The window glass had to be replaced and Station estimated the replacement to cost $2.5 million. Ledcor and Station claimed the cost of replacing the windows under the builders risk policy. The insurers denied coverage under the "cost of making good faulty workmanship" exclusion.

Guidance on Standard Form Contract Interpretation

Ledcor gave the SCC an opportunity to comment on its ruling in *Sattva Capital Corp. v Creston Moly Corp.*, 2014 SCC 53 ("*Sattva*"). *Sattva* dealt with a complex commercial agreement between two sophisticated parties.[2] The Court observed that in many contract interpretation cases, the intention of the parties would play an important role, and could be impactful to the contract's interpretation.

In *Sattva* the SCC concluded that contract interpretation is a question of mixed fact and law since it involves applying legal principles of contractual interpretation to a particular set of facts.[3] From that decision, when an appeal involves the interpretation of a contract, the interpretation would be characterized as a question of mixed fact and law.

Following *Sattva*, some appellate courts had attempted to apply the "mixed law and fact" approach to contractual interpretation for standard form contracts. Others had held this approach would not apply for standard form contracts, and so instead approached the interpretation of standard form contracts as a question of law, and therefore applied a correctness standard of review.[4]

In *Ledcor* the SCC acknowledged this inconsistent application of *Sattva,* and expressly carved out an exception in the manner of judicial review for standard form contracts. The *Sattva* decision acknowledged that a particular interpretation of a contract in a particular situation would have little precedential value beyond the immediate parties because the intentions would differ from one case to the next.[5]

In *Ledcor* the SCC distinguished standard form contracts from other contracts and held that the interpretation of standard form contracts may constitute a question of law. As the facts are often similar when standard form contracts are used, the task for reviewing courts ought to be ensuring the correct legal principle is applied, which should foster consistency of interpretation of standard form contracts. Since the factual matrix and the terms of the standard form contract are sufficiently similar amongst cases, the consistent interpretation of standard form contacts will be of significant precedential value to future parties and courts.

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[2] *Ledcor Construction Ltd. v Northbridge Indemnity Insurance Co.*, 2016 SCC 37 ("Ledcor") at para 25.
[3] *Ledcor* at para 33.
[4] For instance, see discussion in *Precision Plating Ltd. v. Axa Pacific Insurance Company*, 2015 BCCA 277 (CanLII), paras. 22-30.
[5] *Ledcor* at paras 37- 38.

As such, the *Ledcor* ruling suggests that appeals interpreting standard form contracts and absent a meaningful factual matrix, ought to be addressed as questions of law. From that, the interpretation of the standard form contract should be reviewed against a standard of correctness. Rather than strictly follows *Sattva's* "mixed fact and law" approach, a standard form contract's interpretation would be a question of law if (1) the appeal involved the interpretation of a standard form contract; (2) the interpretation at issue is of precedential value; and (3) there is no meaningful factual matrix specific to the particular parties to assist the interpretation process.[6]

Of course the question of law approach is not automatic. The SCC also referenced a non-exhaustive list of when deference will be warranted when interpreting standard form contracts. For instance, deference may be warranted "if the factual matrix of a standard form contract that is specific to the particular parties assists in the interpretation" or "if the parties negotiated and modified what was initially a standard form contract, because the interpretation will likely be of little or no precedential value". [7]

Faulty Workmanship Exclusion

While much of the case discusses the standard of review for standard form contracts, the central issue of the factual matrix was whether the cost of the window replacement was insured. The builders' risk policy exclusion pertained to the cost of making good faulty workmanship, construction materials or design, but excepted physical damage arising from the faulty workmanship.

The trial judge had determined that the damage was covered. The trial judge agreed with the insureds' position that the cost of making good faulty workmanship was only the cost of redoing the cleaning work, whereas the damaged windows were a separate thing that Bristol had performed the work on.

The Alberta Court of Appeal ("ABCA") reversed the decision. It ruled the exclusion was not ambiguous and therefore the principle of *contra proferentem* did not apply. The ABCA's decision attempted to meld a variety of interpretative aids as it considered (a) the distinguishing line between the physically damaged items being worked on at the time and the physical damage collateral to that thing, (b) the work being done and the foreseeable consequence of that work, and (c) whether the damage in question was [to an unspecified degree] unexpected and fortuitous.

The SCC overturned the appellate decision using a more traditional approach to the coverage analysis. When reviewing the policy itself, the SCC restated the frequently-cited principles that apply to interpreting insurance policies, and the usual, orderly approach for applying a coverage interpretation.

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[6] *Ledcor* at para 4.
[7] *Ledcor* at para 48.

The SCC noted that the ABCA approach was flawed (partially) due to its effort to match the exclusion clause with the initial grant of coverage. Because the coverage grant applied only to physical loss or damage, the ABCA considered the exclusion as needing to equally apply to physical loss or damage. In applying the exclusion, the ABCA sought to identify something other than the faulty workmanship itself, and thereafter distinguish between some physical damage that could be excluded from the physical damage that would be excepted from the exclusion. The ABCA crafted a new "physical or systemic connectedness" test to delineate such a boundary. The SCC rejected this methodology.

The SCC found that the faulty workmanship exclusion need not be triggered by physical damage. Rather, while cognizant that "exclusions should be read in light of the initial grant of coverage" the SCC noted that the exclusions and coverage grants do not require perfect mutual exclusivity, and cited other instances within the Policy where exclusions or conditions addressed topics distinct from the physical damage contemplated in the coverage grant.

The SCC reviewed various cases that had previously considered the faulty workmanship exclusion. In each instance, the Court highlighted the actual work that was originally intended, and distinguished between that affected work versus resulting damage to elements outside of the original scope. It concluded that the exclusion meant the fault within the intended work would be excluded, while resulting damage to elements outside the original scope would be exempted from the exclusion, and therefore covered.

Conclusion

The *Ledcor* decision should help provide insurers and insureds with more certainty and predictability in how policies will be applied by the courts. With standard form contracts, like insurance policies, the importance of a correctness standard of review applies because the interpretation of the contract (and legal analysis flowing therefrom) can have direct impact upon parties beyond those immediately subject to a dispute. Given the SCC's extensive commentary on the requirement of correctness for standard form contracts, we are left to wonder if the existing jurisprudence concerning standard form contracts (and particularly insurance contracts) is now that much stronger, as appellate courts are perhaps increasingly encouraged to apply prior principles in the pursuit of consistent results.

This will also give parties and courts an important precedent to follow in future cases interpreting identical or very similarly worded "cost of making good faulty workmanship" exclusions. The SCC discussion highlights once again how themes of broad coverage, and consistency stand behind the interpretation of builders' risk policies.