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FAULTY WORKMANSHIP – WHAT'S EXCLUDED?
Exclusion Clauses in All-Risk Homeowners' Insurance Policies Following the Decision in *Monk v. Farmers' Mutual*

A recent decision in *Monk v Farmers' Mutual Insurance Company*[1] saw the Honourable Justice Koke revisit the general principles of insurance policy interpretation as articulated by the Supreme Court of Canada in *Progressive Homes v. Lombard*, and consider the application of these principles in the context of a uniquely worded "faulty workmanship" exclusion in an all-risk homeowners' policy.

1. The Faulty Workmanship Exclusion

Monk involved a summary judgment motion brought by Farmers' Mutual Insurance Company (the "Insurer"), seeking dismissal of a homeowner's action for coverage in connection with property damage arising from her contractor's negligence.

It was the Insurer's primary position on the motion that the plaintiff's claim was excluded from coverage as it constituted the cost of making good "faulty workmanship". The plaintiff's argument in response was that the property damage was in fact incidental or corollary damage *resulting from* the faulty workmanship (i.e. damage to windows, doors, fixtures and carpets caused by a contractor who was retained to perform restoration of exterior logs at the home). Since the damage was properly characterized as "resulting damage", this argument went, it fell outside the scope of the exclusion.

Although there is a wealth of jurisprudence in Canada interpreting the meaning of the standard "faulty workmanship" exclusion, the vast majority of cases in this area involve clauses that contain express exceptions for damages *resulting from* the faulty workmanship. *Monk* is unique in that it appears to be the first Canadian authority dealing with a first party claim in the context of a faulty workmanship exclusion that is entirely unqualified. The relevant wording of the plaintiff's policy of in *Monk* was as follows:

> Losses Excluded
>
> We do not insure…
>
> 2. The cost of making good faulty material or workmanship.

The insured took the position that, in an all-risk policy, where something is not specifically excluded, it is included in coverage. Since the aforementioned provision did not expressly exclude "resulting damage", the insured asserted that it had to be covered.

Justice Koke rejected this argument and accepted the Insurer's position that the insured's entire claim flowed from the contractor's faulty workmanship and therefore fell within the broad and unqualified scope of this exclusion. His well-articulated reasons for this conclusion were five-fold:

1. **Policy Rationale:** For policy reasons, contractors should be discouraged from cutting corners by being careless and then passing the risk and the cost of

[1] *Monk v. Farmers' Mutual Insurance Company et. al.* 2014 ONSC 39; [2014] O.J. No. 3509 (S.C.J.).

that carelessness to the homeowners' insurer. Rather, contractors should be held responsible for the costs of making good both the direct and indirect damages flowing from their faulty workmanship, including resulting damage. An all-perils property insurance policy should not be viewed as a de-facto performance bond for the work of third-party contractors, or as a commercial general liability policy.

2. **Greater Certainty:** Historically, the line between faulty workmanship and resulting damage has been difficult to establish, spawning a significant amount of litigation. By removing the exception, parties to an insurance contract are provided with greater certainty as to what is excluded from coverage under the policy.

3. **Principles of Interpretation – Comparison to Other Policies:** Most homeowners' policies contain a specific exception within the faulty workmanship exclusion for resulting damage. If, as argued by the plaintiff, it was plain and obvious from the faulty workmanship exclusion that resulting damage was excepted, it would have been unnecessary to include a resulting damage exception in these other policies.

4. **Principles of Interpretation – Intentional Omission:** Since *most* home owners' policies include a resulting damage exception, the absence of this exception in the *plaintiff's* policy indicated that this omission was intentional. This interpretation is bolstered by the wording of the "Property While Being Worked On" exclusion in the plaintiff's policy, which, in contrast to the faulty workmanship exclusion, did include a specific exception for resulting damage. In this way, Justice Koke accepted the argument advanced on behalf of the Insurer that the absence of an exception for resulting damage in the faulty workmanship exclusion is best understood as an intention by the insurer ***not*** to limit the scope of the exclusion.

5. **Exception Should Not Be Read-In:** The unambiguous wording of the faulty workmanship exclusion in this case should be given its plain and simple meaning. The resulting damage exception should not be either inferred or read into the clear language of the policy.

2. The "Property While Being Worked On" Exclusion

Unlike the "faulty workmanship" exclusion described above, the subject "Property While Being Worked On" exclusion in *Monk* did contain a specific exception for resulting damage. It read:

> Property Excluded
>
> We do not insure loss or damage to:
>
> 2. Property...
>
> (ii) while being worked on, where the damage results from such process or work *but resulting damage to other insured property is covered.* [Emphasis added]

Justice Koke quite rightly rejected the plaintiff's alternative argument that her loss was covered by the above "resulting damage" exception in the Property Excluded clause, notwithstanding the wording of the "faulty workmanship" exclusion.

Citing the court's reasoning in *Bremner Farms Ltd. v. Economical Mutual Insurance Co.*,[2] Justice Koke held that that the exception for "resulting damage" in the Property Excluded exclusion could not

[2] *Bremner Farms Ltd. v. Economical Mutual Insurance Co.*, [2006] NBQB 419 at paras 22, 23 and 26.

trump the effect of the "faulty workmanship" exclusion in the policy. Here, Justice Koke found that the clear and unambiguous terms of the "faulty workmanship" exclusion excluded all damages resulting from faulty workmanship without exception and that as a matter of law, "an exception to an exclusion cannot override the clear and unambiguous provisions of another general exclusion clause".

In other words, if the claim is excluded in one clause, it cannot be covered by another.

Justice Koke's conclusions in this regard are consistent with the findings of Lang J. (as she then was) in *Algonquin Power v. Chubb Insurance Co. of Canada*, where she emphasized that a given exception applies only to the specific exclusion where it found in the policy: it does *not* operate on other exclusions in the policy. Moreover, an exclusion is not rendered ambiguous simply because another exclusion in the policy contains an exception.[3]

In the result, given Justice Koke's finding that the plaintiff's claim was excluded, the action against the Insurer was dismissed in its entirety with costs.

3. What does the Monk decision mean for insurers?

(a) General Principles of Interpretation

Although the applicability of the court's decision in *Monk* is somewhat limited by the specific language of the insurance policy under consideration, insurers should take comfort in the court's emphasis on the express language used in the policy, and its simultaneous refusal to find ambiguity where none existed.

A policy of insurance constitutes a contract. Yet there are some significant differences between a contract for insurance and an ordinary commercial contract. The general principles governing the interpretation of insurance policies were most recently clarified in *Progressive Homes*, where the Supreme Court of Canada emphasized that so long as the policy was unambiguous, its plain language would always be the starting point of the interpretation. According to the court:

> The primary interpretive principle is that when the language of the policy is *unambiguous*, the court should give effect to *clear language*, *reading the contract as a whole*.[4]

It is only where the language of the policy is found to be ambiguous that the courts will turn to the general rules of contract construction, including the following:

1. courts will prefer the interpretation that is consistent with the reasonable expectations of the parties, so long as it can be supported by the text of the policy.[5]

2. courts will avoid the interpretation that would give rise to an unrealistic result or that would not have been in the parties' contemplation at the time the policy was concluded; and

[3] *Algonquin Power v. Chubb Insurance Co. of Canada*, 2003 CanLII 44422 at para 165-167 (ON SC).

[4] *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada,* 2010 SCC 33, [2010] 2 SCR 245 at para 22 (S.C.C.).

[5] It is important to note that the principles articulated in *Progressive Homes* and *Monk* represent a departure from the American approach as well as the early Canadian jurisprudence whereby the reasonable intentions of the parties had to be taken into account in the interpretation of the policy, even in the absence of ambiguity. See, for example, *Jesuit Fathers of Upper Canada v. Guardian Insurance Co. of Canada,* [2006] S.C.J. No. 21 at paras 34-43 and *Corbounld v. BCAA Insurance Corp*., [2010] B.C.J. No. 2125 at paras 99-104 (B.C.S.C.) for a summary of the American approach and the evolution of the Canadian jurisprudence in this area.

3. courts will strive to ensure that similar insurance policies are construed consistently.[6]

For greater certainty, the Supreme Court confirmed that the aforementioned rules of construction apply only where it is necessary to *resolve* ambiguity. These rules "do not operate to create ambiguity where there is none in the first place".[7]

It is only when the rules of contract construction fail to resolve the ambiguity that the courts will construe the policy *contra proferentem* – against the insurer. A corollary of this principle is that coverage provisions will generally be construed broadly, and exclusion clauses narrowly.[8]

(b) Clear Language of the Exclusion vs. Subjective Intentions of the Insured

For insurers, the *Monk* decision illustrates:

1. the courts' preparedness to give effect to expressly worded exclusions, where the subject exclusion is clearly stated, and the policy as a whole is unambiguous,

   (a) notwithstanding the insured's objection, post-loss, that the express language of the exclusion does not comport with his or her expectations at the time the policy was taken out;

   (b) despite the fact that there is no known precedent interpreting the subject exclusion;

2. the courts' refusal to be swayed by a typical argument that a strict interpretation of the policy is inconsistent with the policyholders' subjective intentions;

3. the courts' preparedness to distinguish a significant body of cases interpreting a standard exclusion, based on the specific or unique wording of the subject policy;

4. the significance of setting out the insurer's intentions through the use of plain, clear language in the policy; and

5. the critical importance of avoiding ambiguity in the policy as a whole.

In terms of his findings regarding the reasonable expectations of the insured (items 1(a) and (3) above), Justice Koke's reasoning is line both with the principles of interpretation in *Progressive Homes* as well as other Canadian authorities that have interpreted all-risk policy exclusions in a similar manner.

For instance, in *Corbounld v. BCAA Insurance Corp*.[9], the argument before the court was that it was the reasonable expectation of the policyholder that the unintended results of the normal operation of the heating system would be covered by her all-risk policy of insurance. The court rejected this argument and held: (i) that the policy was unambiguous; and (ii) that the plaintiff's loss was excluded by the plain and ordinary meaning of the exclusion for damage caused by "contamination or pollution". After a careful review of the relevant authorities, the court reiterated that, unlike the United States, the current state of the law in Canada is that the reasonable expectations of the parties is a tool used to interpret a policy only in the case of an ambiguity. Where there is no ambiguity, there is no free-standing reasonable expectations doctrine that allows the

[6] *Progressive Homes, supra* at para 23.

[7] *Ibid.*

[8] *Non-Marine Underwriters, Lloyd's of London v. Scalera*, [2000] S.C.J. No. 26 at para 70 (S.C.C.).

[9] *Corbounld v. BCAA Insurance Corp*., [2010] B.C.J. No. 2125 (B.C.S.C.).

insured's reasonable expectations of coverage to trump otherwise clear contractual language.

The court further held that, even if the reasonable expectations doctrine could be applied in the absence of ambiguity, the insured's claim would fail given that the plaintiff's loss in this case was precisely the type of loss which the *insurer* could reasonably expect to be excluded from coverage by the "contamination or pollution" exclusion. The court reasoned as follows:

> [T]he Canadian version of the reasonable expectations doctrine, to the extent that it may be applicable independent of ambiguity, requires, I think, consideration of the expectations of both parties. This was explicitly stated by Binnie J. in *Citadel General Insurance v. Vytlingam*, 2007 SCC 46 at para. 4: "***Insurance policies must be interpreted in a way that gives effect to the reasonable expectations of both insured and insurer***". ***Although the application of the pollution exclusion clause to exclude coverage may not meet the expectations of Mr. Corbould, the same cannot be said for the defendant. A spill of heating oil seems to be exactly the kind of case where the insurer would have expected the clause to apply***.[10]

(c) A Valuable Precedent

Finally, Justice Koke's interpretation of the unqualified "faulty workmanship" exclusion in *Monk* is significant in terms of its precedent value. As the Supreme Court of Canada confirmed in *Co-operators Life Insurance Co. v. Gibbens*:

> ***Courts will normally be reluctant to depart from [authoritative] judicial precedent interpreting the policy in a particular way where the issue arises subsequently in a similar context, and where the policies are similarly framed***. Certainly and predictability are in the interest of both the insurance industry and their customers.[11]

Following *Monk*, it is highly likely that similar provisions will be construed in the same manner.

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[10] *Corbounld v. BCAA Insurance Corp.*, *Supra* at para 107.

[11] *Co-operators Life Insurance Co. v. Gibbens*, [2009] S.C.J. No. 59 at para 27 (S.C.C.).