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COURT OF APPEAL FOR ONTARIO

DOHERTY, CHARRON and FELDMAN JJ.A.

B E T W E E N:

BERNARD ALIE and OTHERS

Plaintiffs

- and -

BERTRAND & FRERE CONSTRUCTION COMPANY LIMITED, LARFARGE CANADA INC. and OTHERS

Defendants/Lafarge Canada Inc.-Appellant

- and -

BOREAL INSURANCE INC., KANSA GENERAL INTERNATIONAL INSURANCE COMPANY LTD., SCOTTISH & YORK INSURANCE CO. LIMITED, CHUBB INSURANCE COMPANY OF CANADA, AMERICAN HOME INSURANCE COMPANY, GUARDIAN INSURANCE COMPANY OF CANADA, CIGNA INSURANCE COMPANY OF CANADA, NATIONAL

Glenn A. Smith and Eleni Maroudas for Lafarge Canada Inc. and Cigna Ins. Co.

John S. McNeil, Q.C. for Boreal Ins. Co.
Don H. Rogers, Q.C. and Allyn Abbott for Kansa General Int'l. Ins. Co.
Geoffrey D. E. Adair, Q.C. for Scottish & York Ins., American Home Ins. and Guardian Ins. Cos.
Jamieson Halfnight for Chubb Ins. Co.
Robert J. Clayton for National Union Fire Ins.
Richard D. McLean and D.G. Martin, Q.C. for First State Ins. Co. and Hartford Ins. Co.
Ruth Henneberry for Westchester Fire Ins. Co.
Crawford MacIntyre, Q.C. for Reliance Ins. Co.
Graeme Mew for Royal Indemnity
Crystal O'Donnell for Pacific Employers Ins. Co. and California Union Ins. Co.
Marina Stefanovic for Harbor Ins. Co.

P. Donald Rasmussen for Bertrand & Frere Construction Co. Ltd.

UNION FIRE INSURANCE COMPANY OF PITTSBURGH, P.A., FIRST STATE INSURANCE COMPANY, WESTCHESTER FIRE INSURANCE COMPANY, RELIANCE INSURANCE COMPANY, HARTFORD CASUALTY INSURANCE COMPANY, HARBOR INSURANCE COMPANY, PACIFIC EMPLOYERS INSURANCE COMPANY, FEDERAL INSURANCE COMPANY, ROYAL INDEMNITY COMPANY and CALIFORNIA UNION INSURANCE COMPANY	)	Garth MacDonald for Chubb Ins. Co. of Canada Vernol I. Rogers and Thomas J. Donnelly for Guardian Ins. Co. Wayne B. Spooner and Melanie L. Griffin for Canadian General Ins. Co. Brian Elkin for General Accident Assurance Co. Keith N. Batten and Donald L. Macdonald, Q.C. for Royal Insurance Co.
Third or Subsequent Parties (Respondents)	)	Heard: June 24, 25, 26 and 27, 2002

On appeal from the judgment of Mr. Justice Albert Roy dated April 17, 2000 and supplementary judgment dated December 15, 2000.

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BY THE COURT:

A. Introduction

[1] Bertrand & Frère Construction Company Limited ("Bertrand") supplied concrete for the construction of about 140 homes in 1986, 1987 and 1988. Bertrand used material known as type C fly ash supplied by Lafarge Canada Inc. ("Lafarge") as one ingredient in its ready-mix concrete. The concrete used in the foundations of the homes proved defective and in 1992 it was determined that the foundations needed total replacement. The defect was traced to the use of Lafarge's fly ash.

[2] One hundred and thirty seven homeowners (plaintiffs) sued Bertrand & Lafarge. Bertrand third partied five of its insurers (Bertrand insurers) claiming they were obliged to indemnify Bertrand for any damages it owed to the plaintiff. Lafarge third partied 18 of its insurers (Lafarge insurers) on the same basis. After a trial of some 150 days, the trial judge found that both Bertrand and Lafarge were negligent. He found Lafarge 80% liable for the plaintiffs' damages and Bertrand 20% liable. That result was upheld on appeal. The quantum of damages owed to the plaintiffs is also no longer in issue.[1]

[3] This appeal concerns issues arising out of the proceedings against the insurers. Broadly speaking, the issues may be divided into three groups:

- Which, if any, of the insurers were obliged to indemnify Bertrand or Lafarge for damages suffered by the plaintiffs? [the coverage issues]
- Which, if any, of the Lafarge insurers were obligated to contribute to Lafarge's defence costs, and in what proportion should they be required to contribute to those costs? [the defence costs issues]
- Which, if any, of the Lafarge insurers were obligated to pay the costs of the plaintiffs and Bertrand for which Lafarge had been held liable in the main action and in what proportion should they be obliged to contribute to those costs? [the third party costs issue]

[4] Some of the parties also seek leave to appeal aspects of the costs order in proceedings brought against the Lafarge insurers.

[1] The court was advised that in July of 2001, payments totalling some $19,550,000 were made to the plaintiffs.

B. Summary of the Main Action

[5] Lafarge is the second largest cement producer and the second largest supplier of concrete in the world. Bertrand, a concrete supplier, had purchased cement powder from Lafarge for a number of years. In April 1986, Bertrand started to use Lafarge's fly ash as a partial replacement for portland cement in its ready-mix concrete. Bertrand supplied concrete for the construction of a number of homes.

[6] Bertrand had no role in the actual construction of the homes. All work necessary to construct the footings, foundations and other components of the homes was done entirely by others. The contractors who undertook the construction of the footings and foundation walls excavated, built forms, inserted any embedded items such as anchor bolts, and placed and cured the concrete. Subsequently, waterproofing was applied to the exterior foundation walls below grade and, in most cases, parging was installed on the exterior walls above grade. Many of the homes had interior finishes applied either directly to the foundation walls or immediately adjacent to and touching them. The balance of each house was built above, resting upon and attached to the foundation by anchor bolts. The excavation was backfilled, following which either hard or soft landscaping was installed. Each of these items of work was a component in the construction of the homes of which the foundations comprised an integral part.

[7] The homeowners started to experience problems with their homes shortly after the construction. These included white powder (efflorescence) on the walls, cracking and delaminating parging, and excessive moisture in the basements. When Bertrand began receiving complaints from its customers, within a year of the pouring of the concrete, it called in Lafarge, which had previously provided it with technical and scientific advice, to investigate. Lafarge's technical representatives advised that the observed problems related to improper parging application or poor workmanship on the part of those responsible for placing and curing the foundations. Lafarge consistently told Bertrand that there was nothing wrong with the concrete it had supplied.

[8] To maintain goodwill, Lafarge and Bertrand jointly spent approximately $36,000 between 1988 and 1991 replacing parging on certain foundations. Ultimately, the repairs failed. In some cases, the signs of deterioration had increased to include mildew and mould on interior walls and crumbling surface concrete on both the interior and exterior of the foundations. Lafarge had no other reasonable repair recommendations.

[9] In the summer of 1992, experts retained by the Ontario New Home Warranty Program concluded that the homes they had investigated were suffering from a "major structural defect"; that there was something seriously wrong with the concrete Bertrand

had supplied for the foundation walls and possibly the footings of many of these homes (since both the walls and footings were constructed with concrete containing fly ash), and that their replacement was required. The remedial work necessary to deal with the foundation problems included:

> (a) lifting the house structure off of the foundation, which required that the anchor bolts be detached, plumbing and utility lines be cut, and many interior finishes in the basement be disturbed or removed;
>
> (b) excavation around the perimeter of the building to afford access to the foundation walls and footings and removal of the drainage tile;
>
> (c) saw cutting of the basement floor parallel to the innermost edge of the footings to allow their removal;
>
> (d) the removal of the foundation walls and footings, including any interior finishes or partitions;
>
> (e) the forming and replacement of the footings, foundation walls and that portion of the basement floor that had been removed;
>
> (f) reinstallation of the dampproofing and the weeping tile system;
>
> (g) lowering of the house onto the new foundation and re-attaching it to the new anchor bolts cast into the new foundation walls;
>
> (h) reconnection of any plumbing and utility lines;
>
> (i) restoration of all interior finishes that had been disturbed;
>
> (j) backfilling of the excavation and reinstatement of all hard and soft landscaping, including patios, decks, porches, steps, driveways, gardens and the like; and
>
> (k) repairs to any elements of the house structure above the foundation level which were damaged by the movement of the building which included in some cases replacement of brick cladding, drywall and other repairs.

[10] In 1992, about 137 homeowners brought a number of suits against Bertrand and, in some cases, Lafarge, for the costs of repairing their homes and the surrounding landscaping. Where necessary, Bertrand brought third party proceedings against Lafarge. Eventually all of the actions were consolidated, with Bertrand and Lafarge as defendants.

[11] The trial judge concluded that the high levels of sulphates and alkalies in the fly ash supplied by Lafarge caused the concrete to deteriorate, leading to the damages suffered by the plaintiffs and the need for complete replacement of the footings and foundation walls. He concluded that the deterioration of the foundations resulted from chemical reactions originating in whole or in part from components of the fly ash. The deterioration took place over time, with exposure to wetting and drying and, in some cases, freezing and thawing. It began shortly after the concrete was placed. The trial judge found that the plaintiffs had been prevented from fully enjoying their homes and using their basements because of the high humidity resulting in the growth of mildew and toxic moulds that were hazardous to the occupants' health. In addition to recovery of all of the costs of replacing the foundation walls and footings, the trial judge awarded alternative accommodation costs, an amount for hardship and inconvenience and, in one case, damages for mental distress.

[12] Liability was apportioned 80% to Lafarge and 20% to Bertrand. Costs were allocated 90% to Lafarge and 10% to Bertrand. This order was made on the basis that the trial judge found that Lafarge had needlessly extended the trial and at times conducted its defence in a reprehensible manner. The damages totalled approximately $20,000,000. The legal costs are estimated to be in the same range.

C. Summary of the actions against the insurers

[13] The insurance actions were against the insurers who issued comprehensive general liability ("CGL") policies to Bertrand and to Lafarge for the years 1986 through 1992, inclusive. They were heard at the same time as the main action. Both Bertrand and Lafarge had a primary insurer and one or more excess[2] or umbrella insurers for each of the 7 years in question. The insurers of Bertrand and Lafarge for each policy period, the amount of the coverage and the position of that coverage in the total coverage, are illustrated on the charts attached as Appendix A and B to this judgment. All insurers took the position that the CGL policy did not cover the facts of this case, and refused to provide a defence. The issue of Bertrand's insurers' duty to defend was ultimately settled. All others issues remained outstanding at trial.

[14] The trial judge held that the Bertrand insurers were obligated to indemnify Bertrand for damages owed to the plaintiffs. He further held that the damages occurred throughout the period from 1986, when the first foundations were poured, to 1992 when it was determined that the foundations had to be replaced, and that policies in effect for any of the one-year periods between 1986 and 1992 were triggered. Damages suffered

[2] We use the term excess insurer here in the broad sense to refer to any insurer who provided a level of insurance above the primary level.

by the plaintiffs whose foundations were poured in 1986 were spread equally over the seven policy periods from 1986 to 1992. Damages suffered by those whose foundations were poured in 1987 were spread equally over the six policy periods running from 1987 to 1992 and damages referable to the houses whose foundations were poured in 1988 were spread equally over the five policy periods from 1988 to 1992. Canadian General was Bertrand's primary insurer for the years 1986 to 1989 and Royal was the primary insurer from 1990 to 1992. The trial judge held that to the extent that Bertrand's claims for indemnification exceeded the limits of the Canadian General policy, Bertrand could look to its excess insurers for the years 1986 to 1989 (Guardian, General Accident and Chubb) for indemnification. There was no need for a similar order with respect to the years 1990 to 1992 since Royal was both the primary and excess insurer.

[15] The trial judge next found that some of the Lafarge insurers were obligated to indemnify Lafarge for the damages suffered by the plaintiffs. He quantified the liability of the individual insurers using the same *pro rata* approach that he used to quantify the liability of the Bertrand insurers. On this approach, five of the Lafarge insurers were ultimately held liable to indemnify Lafarge. They were:

- Boreal [primary insurer 1986, 1987]
- Cigna [primary insurer 1988-1992]
- Scottish & York [first excess insurer 1987]
- Reliance [first excess insurer 1988]
- National Union [first excess insurer 1989-1992]

[16] The trial judge further held that the five insurers listed above and three others (Kansa, American Home and Guardian Insurance) were responsible for Lafarge's reasonable defence costs and for most of the costs Lafarge was ordered to pay to Bertrand and the plaintiffs in the main action (third party costs).

[17] Lafarge's actions against its remaining insurers were dismissed.

D. Proceedings in this court

[18] As indicated earlier, the appeals concerning the trial judge's findings of liability against Bertrand and Lafarge have been dismissed by this court: see *Ontario New Home Warranty Program v. Bertrand & Frere Construction Co.* (2001), 30 C.C.L.I. (3d) 159, leave to appeal to S.C.C. refused [2001] S.C.C.A. No. 418. This proceeding consists of nine appeals and three cross-appeals that were heard together, all related to insurance coverage.

[19] Five appeals are brought by Bertrand insurers: Chubb, Royal, Canadian General, General Accident and Guardian. Three other appeals are brought by Lafarge insurers: National Union, Kansa and Boreal. Common to most of these appeals are the issues of whether there was property damage in this case that attracted coverage by these insurers, whether exclusionary clauses voided coverage, and the determination of the appropriate trigger for coverage. Some of Lafarge's insurers also raise issues related to the duty to defend and to indemnify for third-party costs.

[20] Lafarge and Cigna appeal the trial judge's finding that the "Rip and Tear" exclusion clauses in two of the polices provided by Chubb and Scottish & York excluded coverage. Lafarge and Cigna also appeal various aspects of the trial judge's ruling with respect to defence costs and third party costs. Finally, Lafarge seeks leave to appeal the costs order made at trial.

[21] Three cross-appeals were brought by five of Lafarge's insurers (Scottish & York, American Home, Guardian, Chubb, and Reliance). These costs appeals relate to coverage issues, liability for defence costs, and liability for third party costs.

E. The coverage issues

[22] The trial judge correctly noted that there is a two-step process in the interpretation of an insurance policy. First, it is for the insured to demonstrate that the claim advanced comes within the insuring agreement. If the insured satisfies this burden, then it is for the insurer to establish that a claim that would otherwise be covered is excluded by some term in the policy. The trial judge also properly instructed himself on the general principles of contract interpretation. No issue is raised in this proceeding in respect of those general principles. We will therefore deal solely with the issues raised on appeal following the same two-step process.

1. Do the claims fall within the coverage under the various CGL Policies?

(a) Does the loss to the plaintiffs constitute property damage?

[23] The material provisions were very similar in all of the insurance policies. Under each policy, the insurer agreed to pay those sums that the insured would become legally obligated to pay as compensatory damages because of property damage occurring during the policy period. "Property damage" was defined as "physical injury to or destruction of tangible property" in most policies and as "injury to or destruction of tangible property" in some others. The different wording is not significant in the result in this case.

Property damage in the various policies also included the “loss of use of tangible property that is not physically injured.”

[24] It is common ground between the parties that CGL policies are not performance bonds. They are not intended to cover the costs of repairing or replacing the insured’s defective work or product. They are intended, rather, to cover tort liability for injury to other persons or damage to their property. This general intent is expressed in the language used in the various policies to define both the coverage and the exclusions.

[25] Some of the argument on appeal with respect to this general intent underlying the CGL policies was framed in terms of the distinction between property damage and economic loss. It was argued that while property damage is covered under the CGL policy, economic loss is not. It may be useful to comment briefly on this distinction at the outset.

[26] Traditionally the courts have characterized the cost of repairing or replacing defective work and products as “economic loss” on the ground that such cost does not arise from injury to persons or damage to property, apart from the defective work or product itself. LaForest J., in writing for the court in *Winnipeg Condominium Corporation No. 36 v. Bird Construction Co.,* [1995] 1 S.C.R. 85 at 97, makes reference to this usual classification. *Winnipeg Condominium* was not an insurance case but one dealing with a contractor’s tortious liability for negligence in the absence of privity of contract with the plaintiff. In that context, LaForest J. noted at para. 13, with respect to this traditional distinction between property damage and economic loss, that he “would find it more congenial to deal directly with the policy considerations underlying that classification”. More will be said about the decision in *Winnipeg Condominium* later in this judgment. At this point, however, we note that we share LaForest J.’s view and find, in this context as well, that the classification of the insured’s own work or product as economic loss is not particularly instructive. Rather, the focus should be on the language of the insuring agreements and their interpretation.

[27] As indicated, the CGL policies are generally intended to cover an insured’s tortious liability to third parties, but not including the cost of repairing or replacing the insured’s own defective work or product. This intent is manifest by the language usually found in CGL policies and the interpretation generally given by the courts to such policies. The policy reason underlying this interpretation is set out succinctly in *Privest Properties Ltd. v. Foundation Co. of Canada Ltd.* (1992), 57 B.C.L.R. (2d) 88 (S.C.) at 131 as follows:

> If the insurance proceeds could be used to pay for the repairing or replacing of defective work and products, a

> contractor or subcontractor could receive initial payment for its work and then receive further payment from the insurer to repair or replace it. Equally repugnant on policy grounds is the notion that the presence of insurance obviates the obligation to perform the job initially in a good and workmanlike manner [citation omitted].

[28] Hence Bertrand has conceded that it could not be indemnified for the concrete that it supplied and, consequently, the actual cost of the concrete used to replace the deteriorating foundations has been excluded from the damage award. The question that arose, however, is whether the damage that occurred in this case consisted entirely of Bertrand's defective product and, as such, whether it fell outside the scope of the CGL policies. The trial judge found that the damage to the foundations and, in turn, to the houses themselves went beyond Bertrand's own product and constituted property damage within the meaning of the policies. All of Bertrand's insurers and four of Lafarge's insurers (Boreal, Scottish & York, Guardian and American Home) appeal from this finding.

[29] In a nutshell, Bertrand's insurers submit that their insured's product is not simply the ready-mix that it provided to the various contractors but the defective foundations themselves. They submit that there was no evidence that there was anything other than Bertrand's ready-mix in the foundations and that the product did not cease to be Bertrand's product for the purpose of the policy simply because it had been worked on by others. They submit further that the resulting structural defect to the homes is but a threat of future harm and that it does not constitute "physical injury", or in Canadian General's case, "injury" to property. They submit that the trial judge's finding that there was property damage to the homes is, in essence, a finding that there was damage to the structure as a whole because of a defect in one of its parts, and that this finding runs contrary to established jurisprudence. Hence, Bertrand's insurers take the position that since no property other than Bertrand's product was damaged[3], there is no coverage under the CGL policies.

[30] Bertrand submits that its product consists solely of the ready-mix that it provided to the various sites and that this product cannot be equated to the footings and foundations walls done by others. Bertrand argues further that the trial judge's finding that there was damage, not only to the foundations, but to the plaintiffs' homes themselves, is amply supported by the evidence and not contrary to law.

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[3] It is conceded that there was evidence of damage to the parging but the insurers submit that the cost of repairing it would be minimal.

[31] Lafarge's insurers submit that the fly ash supplied by their insured did not damage any property that was in existence, but rather was used to create a product (Bertrand's concrete) which, because of its own inherent propensities, would eventually not perform its intended function. They submit further that the resulting need to replace the foundations is not because the foundations were not actually performing their function but because they would not do so in the future and that, as such, this future danger, in law, is economic loss and not property damage.

[32] The appeals taken by the Lafarge insurers on this issue can be disposed of summarily. We see no merit to the position taken by Lafarge's insurers. It is quite clear on the findings of the trial judge that the fly ash supplied by Lafarge caused damage to the property of a third person, Bertrand, and in turn, the property of the plaintiffs. This constitutes property damage within the meaning of all of the policies. The trial judge so found and there is no reason to interfere with this finding.

[33] The trial judge did not accept the position taken by the Bertrand insurers either. After reviewing a number of decisions that illustrate the type of property damage that is and is not covered by the CGL policies, he held that the damage was not solely to Bertrand's product but to third-party property. The trial judge reviewed the following cases where coverage was denied: *Privest Properties*, *supra*; *Bird Construction Co. v. Allstate Insurance Co. of Canada* (1996), 36 C.C.L.I. (2d) 29 (Man. C.A.) and *Carleton Iron Works Ltd. v. Ellis Don Construction Ltd*, [1996] 1 I.L.R. I-3373 (Ont. Gen. Div.). He then reviewed other cases where courts have found that the damage to property was covered by the CGL policies: *Ontario (Attorney General) v. Fatehi*, [1984] 2 S.C.R. 536; *Gulf Plastics Ltd. v. Cornhill Insurance Co. Ltd.*, [1990] I.L.R. 1-2644 (B.C.S.C.) aff'd (1991), 3 C.C.L.I. (2d) 203 (B.C.C.A.); and (*Carwold) Concrete and Gravel Ltd. v. General Security Insurance Co. of Canada* (1984), 17 C.C.L.I. 241 (Alta. C.A.). The trial judge concluded that the damage, to the foundations and, in turn, to the structural integrity of the homes, resulting from the incorporation of Bertrand's concrete, did constitute property damage within the meaning of the CGL policies.

[34] Counsel for the insurers on appeal argued at length that the trial judge erred in failing to recognize that the situation here, on the one hand, was akin to those cases where coverage was denied and, on the other hand, unlike the other cases where property damage was found. Bertrand's submissions were to the contrary. Each side relied on further cases in support of their respective positions.

[35] In our view, little would be gained in reviewing the submissions of counsel on the relevant case law. The principle that a CGL policy is not intended to cover the insured's own defective product or work is well-established and not disputed in this case. It is its

application that is in issue. The ultimate determination of whether the damage was to the insured's own product, or to the property of a third party, is largely a question of fact. The trial judge's conclusion that the damage went beyond Bertrand's product was essentially based on the following evidence.

[36] At the time the plaintiffs' homes were constructed, Bertrand ran a ready-mix concrete operation. It also constructed roads, sewers and watermains, rented equipment and owned three quarries. Its products and operations were described in the primary polices in issue as follows:

> **Canadian General** – *Products (Including Completed Operations):*
>
> Construction of Roads, Sewers and Watermains, Equipment Rentals, Repair Garage Operations, and Sales of Stone, Gravel and Ready Mix.
>
> **Royal** – *Business Description:*
>
> 1) Contractor in ready mix, stone, asphalt and gravel inclu. ownership and operation of quarries
>
> 2) Construction roads, sewer, watermains incl. equipment rental.

[37] The excess insurance policies all made reference to the underlying primary policies and did not otherwise describe the insured's products. The product in this case, beyond dispute, was the ready-mix. This product was incorporated by the forming contractors into the footings and foundation walls of the plaintiffs' homes. Over time, because of the phenomenon identified as sulphate attack which was caused by the fly ash in the concrete, physical damage was caused to the footings, foundations walls, parging, interior finishes, where any, and to the structural integrity of the houses themselves. The damage impaired the plaintiffs' ability to fully enjoy their homes and use their basements. As indicated earlier, experts retained by the Ontario New Home Warranty Program ultimately concluded that the homes were suffering from a "major structural defect". That term is defined in s.1 of Regulation 892 R.R.O. 1990 under the *Ontario New Home Warranties Plan Act*, R.S.O. 1990, c. O.31 as follows:

> "major structural defect" means, for the purposes of clause 13 (1) (b) of the Act, any defect in work or materials,
>
> (a) that results in failure of the load-bearing portion of any building or materially and adversely affects its load-bearing function, or

> (b) that materially and adversely affects the use of such building for the purpose for which it was intended,
>
> including significant damage due to soil movement, major cracks in basement walls, collapse or serious distortion of joints or roof structure and chemical failure of materials, but excluding flood damage, dampness not arising from failure of a load-bearing portion of the building, damage to drains or services, damage to finishes and damage arising from acts of God, acts of the owners and their tenants, licensees and invitees, acts of civil and military authorities, acts of war, riot, insurrection or civil commotion and malicious damage; ("vice de construction important")

[38] We do not agree that this major structural defect to the homes is but a threat of future harm and not "physical injury" or "injury" to property. The fact that the injury is expected to get worse over time and to ultimately result in the total collapse of the home does not change its present character. In our view, any interpretation of the policy that would lead to the conclusion that there is no coverage for a defect to the plaintiffs' houses until the houses themselves collapse as a result of this defect should be rejected as contrary to the true intention of the parties.

[39] Therefore, on this evidence, it is our view that the trial judge's conclusion that there was property damage going beyond Bertrand's own product was entirely supported in fact.

[40] Further, we are not persuaded that the trial judge's conclusion runs contrary to any principle of law as contended. The insurers argument on this point is based on the Supreme Court of Canada's decision in *Winnipeg Condominium, supra*.

[41] In that case, the stonework cladding of a condominium building was falling off, creating a safety hazard. The condominium corporation sued the building's general contractor in negligence for the cost of replacing the cladding. The question raised was whether a general contractor, responsible for the construction of a building, could be held liable in tort for negligence to a subsequent purchaser, who was not in contractual privity with the contractor. For the purpose of the analysis, the Supreme Court noted, as indicated earlier, the traditional characterization of the costs incurred by a plaintiff in repairing a chattel or a building as "economic loss". This characterization was adopted by the parties on the usual grounds that those costs "do not arise from injury to persons or damage to property apart from the defective chattel or building itself": *supra*, at para. 13. Hence, the characterization of the damage to the building as "economic loss" is of no

moment to our case. Nor is this argument advanced. Indeed, in a CGL insurance context with the contractor as the insured, the entire condominium building would be the insured's work and product. The insurers, rather, rely on the following part of the Supreme Court's analysis in support of their argument that the trial judge's analysis constituted error at law.

[42] In the course of its analysis, the Supreme Court discussed the dichotomy between property damage and pure economic loss that had traditionally marked the limits of liability in tort, and, in that context, referred to a theory known in some American cases as the "complex structure" theory. This theory had been developed in defective construction cases in an attempt to obtain recovery in the absence of personal injury or property damage beyond the defective product itself. The argument underlying this theory proceeded on the basis that any component part of a complex structure (such as a building) was such an indivisible part of the whole, that any defect in one of the component parts, in and of itself, represented damage to the whole structure.

[43] LaForest J., in writing for the Court, noted that the complex structure theory had been criticized in subsequent American jurisprudence and he expressed full agreement with that criticism. He stated as follows at paras. 15-16:

> In cases involving the recoverability of economic loss in tort, it is preferable for the courts to weigh the relevant policy issues openly. Since the use of this theory serves mainly to circumvent and obscure the underlying policy questions, I reject the use of the "complex structure" theory in cases involving the liability of contractors for the cost of repairing defective buildings.
>
> Proceeding on the assumption, then, that the losses claimed in this case are purely economic, the sole issue before this Court is whether the losses claimed…are the type of economic losses that should be recoverable in tort.

[44] In the result, the Supreme Court extended the contractor's liability in tort to those economic losses consisting of the costs of repair of dangerous defects.

[45] The insurers argue that the Supreme Court of Canada's unequivocal rejection of the complex structure theory precludes any finding in this case that the structural defect to the plaintiffs' homes occasioned by the defective foundations constitutes property damage. We do not agree. In our view, the Supreme Court has simply rejected, as unhelpful, any artificial characterization of the nature of the loss as the basis for determining the extent of tortious liability. The Court favoured a more principled

approach based on relevant policy considerations. Further, the rejection of the complex structure theory does not assist the insurers. Their argument on this point still rests on the assumption that the defective foundations are Bertrand’s product and that they constitute the entirety of the loss. As we have stated earlier, it is our view that the trial judge’s finding that the damage went beyond Bertrand’s ready-mix concrete is supported on the evidence.

[46] Consequently, we would not give effect to this ground of appeal. In our view, there is no basis to interfere with the trial judge’s finding that there was property damage within the meaning of all the CGL policies.

(b) Are the claims covered by the “rip and tear” coverage found in some of the policies?

[47] A further issue, related to the question of property damage, was raised by some of the insurers with respect to the availability of what is known as “rip and tear coverage.” Insurance policies may specifically include rip and tear coverage, may specifically exclude rip and tear coverage or may make no reference to rip and tear coverage. The insurers submit that rip and tear coverage is triggered in circumstances where there is no property damage caused by the insured’s product, but, due to a defect in the product, the product must be removed. If, in removing the product, other property is damaged, coverage is afforded under the rip and tear section of the policy for this damage. It is submitted that rip and tear coverage is purchased by the insured at an increased premium because it is intended to respond to a loss not usually covered under the standard wording of a CGL policy.

[48] None of the Bertrand policies contained an endorsement for rip and tear coverage. All of Bertrand’s insurers took the position at trial that their policies would have granted Bertrand coverage to respond to the plaintiffs’ damages had there been a rip and tear endorsement. Bertrand was made aware of the availability of this coverage in 1984 but did not purchase it. The insurers therefore argued that Bertrand’s policies, not having that endorsement, did not afford coverage for the plaintiffs’ damages. It was acknowledged, however, that there was no standard rip and tear endorsement and that the scope of any such coverage was dependent on the provisions of the policy as a whole.

[49] The trial judge disposed of this issue as follows at 127:

> Given the limited facts on this issue, the relevancy of the insurers’ argument is somewhat tenuous. To accept the insurers’ argument, I would have to conclude that the policies without the rip and tear endorsement do not afford Bertrand

> coverage. Further, there is no standard rip and tear endorsement and I have no idea what type of endorsement was being offered to Bertrand back in 1984, and whether such endorsement would have extended Bertrand's coverage. Would a rip and tear endorsement in the policies be affected by the exclusionary clauses? To accept the insurers' proposition the Court would have to enter the realm of speculation. The issue of coverage has to be decided on the agreement between the parties and the evidence before the Court. I, therefore, cannot accept the insurers' proposition on this issue.

[50] Bertrand's insurers argue that the trial judge erred in failing to appreciate the relevance of the available rip and tear coverage.

[51] We find no merit to this argument. We agree with the trial judge's conclusion on the evidence before him that the availability to Bertrand of some form of additional unspecified coverage that was not part of the insuring agreement was irrelevant. The issue of coverage for property damage was properly decided on the agreement between the parties and the evidence before the court.

[52] Lafarge did have rip and tear coverage in some of its policies and one of its insurers submits that coverage should have been found under that endorsement. Boreal was Lafarge's primary insurer from April 1986 to April 1988. In addition to the coverage for "injury to or destruction of property" already discussed, Boreal's policies provided for rip and tear coverage. The provision for property damage liability, including the coverage for rip and tear under clause (iii), read as follows:

> THE INSURING AGREEMENT:
>
> To pay on behalf of the insured all sums which the insured shall become obligated to pay as damages, by reason of the liability imposed by law upon the insured… because of an occurrence as herein defined during the policy period because of:
>
> …
>
> <u>Coverage B – Property Damage Liability</u>
>
> (i) injury to or destruction of property which occurs during the policy period, including loss of use thereof at any time resulting therefrom;

> (ii) loss of use of property which has not been injured or destroyed provided such loss of use is caused by an occurrence during the policy period;
>
> (iii) the cost of removing, replacing or repairing any property including loss of use of such property as a result of the introduction into it of concrete, cement, sand or aggregate, concrete blocks, other concrete products or other products manufactured, sold, handled or distributed by or on behalf of the insured which is or are defective or which is not or are not as specified or required.

[53] As discussed under the previous ground of appeal, the trial judge, having determined that there was property damage, found that there was coverage under clauses (i) and (ii). Boreal contended at trial that the claims against its insured Lafarge fell, rather, under clause (iii), the rip and tear coverage. Boreal further argued that if coverage was to be found solely under the rip and tear provisions of the policy, the occurrence that triggered the policy was at that point in time when the need to replace the foundations became reasonably apparent. Since that point in time was after its policies had expired, Boreal submitted that there was no coverage.

[54] The trial judge rejected this argument. He did not make any finding whether there was coverage under clause (iii) but simply held that, whatever additional coverage may have been provided under Boreal’s policies, it did not affect his finding that there was coverage under clauses (i) and (ii).

[55] Boreal submits that there is a presumption against absurdity and a presumption against tautology that operate against the suggestion that the insurer has extended coverage for the same kinds of losses twice in the policy. Boreal therefore contends that the trial judge’s failure to read the policy as a whole and to ascribe an interpretation to it that would give effect to all of the language in the policy constitutes reversible error.

[56] We see no error in the trial judge’s interpretation of Boreal’s policies. There is nothing in clause (iii) that would change the meaning that was ascribed to clauses (i) and (ii). Once the trial judge had determined that Lafarge’s liability for the plaintiffs’ loss was covered under clauses (i) and (ii), he made no error in failing to determine whether there was also coverage under clause (iii).

[57] For these reasons, we would not give effect to this ground of appeal with respect to any of the insurers.

(c) Did the loss result from an occurrence?

[58] All of the policies in question were occurrence-based. The property damage that was found to exist by the trial judge was only covered by any given policy if it resulted from an occurrence, if any, during the policy period. Quite apart from the issue of timing, which will be discussed later, the insurers contended that the loss to the plaintiffs did not result from an occurrence at all within the meaning of each policy.

[59] Although the wording was somewhat different from policy to policy, "occurrence" was generally defined to mean "an accident including continuous or repeated exposures to conditions neither expected nor intended by the insurer." The trial judge held that the damage did result from an occurrence. He stated as follows at 126:

> On the facts here, I do not think there can be any doubt that what took place was an occurrence within the meaning of the policy. The product that was inserted into Bertrand's concrete was not inherently bad. I have already made a finding that Lafarge and Bertrand were both negligent, but I could hardly conclude that they deliberately sold an inferior product to the plaintiffs. The damage that took place to the plaintiffs' foundations was certainly not expected or intended by the defendants. My earlier findings on the evidence leads me to conclude that the damage caused to the plaintiffs' property was the result of an occurrence within the meaning of the policies.

[60] Bertrand's insurers have appealed from this finding. Their appeal is essentially founded on the contention that the loss to the plaintiffs consisted solely of Bertrand's defective product. They submit that neither the simple failure of an insured's product to function properly nor the damage caused by the intentional process of repair of an insured's defective product constitutes an occurrence.

[61] In our view, the position advanced on this ground of appeal stands or falls on the correctness of the trial judge's findings on the issue of property damage. Having correctly found, as we have concluded, that the loss to the plaintiffs went beyond a simple failure of the insured's product, and that the damage to their property was caused by the defective product, the trial judge was correct in finding that the loss resulted from an occurrence.

[62] General Accident advanced an additional argument based on the trial judge's finding that Bertrand had been wilfully blind in its reliance on Lafarge's expertise with respect to the use of fly ash. General Accident submits that this finding is tantamount to a finding that the damage resulted from Bertrand's intentional act and, as such, is inconsistent with the finding that it resulted from an occurrence.

[63] We see no merit to this argument. When the reasons for judgment are considered in context, it is clear that the trial judge, in finding that Bertrand had been wilfully blind, was explaining why he was of the view that Bertrand's conduct had been negligent. On any reasonable interpretation of the reasons for judgment, the trial judge's finding of wilful blindness cannot be equated to a finding that Bertrand acted intentionally. Indeed, the trial judge specifically held that the damage was not intended by either Bertrand or Lafarge.

2. Are the claims excluded under any of the policies?

[64] After finding that both Bertrand and Lafarge were covered for their respective liability to the plaintiffs under the various CGL policies, the trial judge proceeded to determine whether the claims were otherwise excluded by any of the individual policies. A number of grounds of appeal relate to particular exclusionary clauses and their applicability to the facts of this case.

[65] The trial judge found that none of the exclusionary clauses contained in the Bertrand policies applied to exclude the coverage for property damage. All Bertrand insurers appeal from this conclusion with respect to one or more of the clauses. Their appeals on this issue can be disposed of summarily.

[66] There were four types of exclusionary clauses described by the trial judge as follows: a) the own product exclusion; b) the faulty workmanship or performance exclusion; c) the business risk exclusion; and d) the impaired property exclusion. The latter was found only in Royal's policies.

[67] The own product exclusionary clauses basically removed all insurance coverage for the insured's own product. This clause was the basis of Bertrand's concession that there was no coverage for the cost associated with the supply of new ready-mix to the plaintiffs. The insurers' arguments with respect to this clause were based on their contention that Bertrand's own product consisted of the foundations themselves. Their arguments were defeated by the trial judge's finding that the damage to the foundations and other parts of the houses went beyond Bertrand's own product and constituted

damage to the property of others. In light of our conclusion on the issue of property damage, the arguments on appeal are likewise defeated.

[68] We see no reason to interfere with the trial judge's conclusions with respect to the other exclusionary clauses in the Bertrand policies. We agree with his finding that the faulty workmanship would only have applied if Bertrand's faulty workmanship was the cause of the defective concrete. No appeal is taken with respect to the business risk exclusion. Finally, Royal's impaired property exclusion and its performance exclusion would only apply with respect to property that had not been physically injured. They have no application given the trial judge's finding on the nature and extent of damage to third-party property.

[69] Lafarge's insurers invoked three kinds of exclusionary clauses at trial: a) the product or work performed exclusion; b) the rip and tear exclusion; and c) the professional liability exclusion. The trial judge found that none of the exclusionary clauses applied, except for the rip and tear exclusion found in the policies of Chubb, Guardian and some of the policies of Scottish & York.

[70] Scottish & York, Guardian and American Home appeal from the trial judge's finding that the professional liability exclusionary clauses in their policies did not apply. We see no error in the trial judge's interpretation of these clauses.

[71] Lafarge appeals from the finding that the rip and tear exclusion applied with respect to the Scottish & York and Chubb policies. No appeal is taken from the similar finding made with respect to Guardian's policy. American Home, Hartford[4] and Reliance appeal from the finding that the coverage was not excluded by their respective rip and tear exclusionary clauses. These appeals on this issue can also be disposed of summarily.

[72] There was no standard rip and tear exclusionary clause. The trial judge dealt with the different policies individually and, in each case, determined whether the language of the specific clause removed Lafarge's claim from coverage.

[4] Although its rip and tear exclusion was found not to be effective in this case, Hartford was one of the "successful insurers" that were held to be not liable to indemnify or contribute to the defence for other reasons.

[73] In most cases, the trial judge found that the rip and tear exclusionary clause did not apply. Some of these clauses were found to apply only in the event that Lafarge was the supplier of the concrete; other clauses were found to be unclear or ambiguous. We agree with the trial judge that the clauses contained in the American Home, Reliance and Hartford policies did not apply to exclude coverage, for the reasons that he gave.

[74] The wording of Scottish & York's rip and tear exclusion was very similar to that found in the Chubb policies. The trial judge found that it applied to exclude from coverage the plaintiffs' damages for which Lafarge had been found to be liable. The clause read as follows:

> It is understood and agreed that this Policy does not apply to any sums which the Insured shall become obligated to pay as damages, by reason of the liability imposed by law upon the Insured or assumed by the Insured under any contract or agreement because of an occurrence as herein defined during the policy period because of:
>
> The cost of removing, replacing or repairing any property including loss of use of such property as the result of the introduction into it of concrete, cement, sand, or aggregate, concrete blocks, other concrete products or other products manufactured, sold, handled or distributed by or on behalf of the Insured which is or are defective or which is not, or are not as specified or required.

[75] The wording of the exclusion in the Scottish & York policy for the year 1987 was similar except for the latter part of the final paragraph where it read:

> …as the result of the introduction into it of products manufactured, sold, handled or distributed by or on behalf of the Insured which is or are defective or which is not or are not as specified or required.

[76] Quite apart from the question of interpretation of the language of the clause, Lafarge submits that the trial judge erred in considering this exclusionary clause at all. On this point, Lafarge argues that, once it is established that the insured is liable to pay compensatory damages for third-party property damage, the rip and tear exclusion becomes irrelevant. Hence, Lafarge takes the position that its coverage under the property damage provisions of the policy cannot be affected by any rip and tear exclusionary clause, regardless of its wording. Any other interpretation, Lafarge argues, would make

the clause repugnant to or inconsistent with the main purpose of the property damage coverage in the policy.

[77] Lafarge argued further that, in any event, the clause did not apply because the plaintiffs' claim was not for "the cost of removing, replacing or repairing" of the damaged property. Rather, the claim was for property damage; the cost of removal and replacement was simply the measure of the compensatory damages.

[78] The trial judge rejected Lafarge's arguments. With respect to the first argument, he stated at 170:

> Lafarge appears to suggest that, even if the parties agree, a rip and tear exclusionary clause cannot limit coverage given by a standard CGL policy for property damage and personal injury. I have a problem with that proposition. I cannot see why two parties in a context of being on equal footing for purposes of negotiation could not limit the risk and coverage of a CGL policy.

[79] The trial judge also noted that, contrary to Lafarge's second argument, a major component of the plaintiffs' damages was the removal and replacement of the damaged property. He went on to interpret the language of the clause and concluded that it applied to exclude coverage for the plaintiffs' damages.

[80] We see no reason to interfere with the trial judge's conclusion on the effect of this clause. We do not agree with Lafarge's first contention that a rip and tear exclusion is, by its very nature, inapplicable to any coverage for third-party property damage. There is nothing in the language of the insurance agreements to support this contention. Nor is there any public policy reason to support that interpretation. The parties are free to limit the coverage for property damage. The clause in question here was not repugnant to or inconsistent with the coverage. It only excluded one type of property damage, that caused by the introduction into it of one of Lafarge's products that proves defective. Indeed, that exclusion is entirely consistent with the general purpose of the CGL policy that was discussed earlier. Further, we are of the view that the trial judge's interpretation of the language of the clause was reasonable.

[81] In light of our denial of Lafarge's appeal against Chubb with respect to the "rip and tear" exclusion, there is no need to deal with Chubb's conditional cross-appeal of the trial judge's ruling regarding the evidence of Chubb's witness on the historical development of the exclusion in the Chubb policy.

[82] For these reasons, we would not give effect to any of the grounds of appeal with respect to the exclusionary clauses.

3. Are the Insurance Policies Vitiated by Misrepresentation by Bertrand?

[83] Two insurers of Bertrand, Chubb and Royal Insurance Company, appeal from the decision of the trial judge that their policies were not vitiated by any misrepresentation by Bertrand. Royal came on cover from December, 1989 through 1990 and 1991. Chubb was an excess insurer of Bertrand for 1988 and 1989. These insurers claim that Bertrand failed to disclose material facts known to it by the time these two insurers issued their policies. An agreed statement of facts details the material facts referred to. The question for the trial judge was whether a reasonable person in Bertrand's position would have disclosed those facts to prospective insurers. His answer was no. Had his answer been yes, it was agreed that the policies would be treated as void.

[84] The trial judge reviewed in detail the facts which the insurers said should have been disclosed, and summarized them in the reasons for judgment. Royal submits in its factum that the trial judge "failed to adequately consider the overwhelming weight of the evidence". This submission is consistent with the articulation of the test to be applied on appeal on the issue of misrepresentation by an insured in its application to an insurer as set out in *Fellows McNeil v. Kansa* (2000), 22 C.C.L.I. (3d) 1 (Ont. C.A.) at para. 20, which is whether the trial judge properly appreciated the evidence. The recent decision of the Supreme Court of Canada in *Housen v. Nikolaisen* 2002 SCC 33 is also instructive on the issue of the standard of review of a question of mixed fact and law and in particular, of a finding of negligence. In *Housen* the Court summarized its discussion of the standard of review at para. 36 as follows:

> To summarize, a finding of negligence by a trial judge involves applying a legal standard to a set of facts, and thus is a question of mixed fact and law. Matters of mixed fact and law lie along a spectrum. Where, for instance, an error with respect to a finding of negligence can be attributed to the application of an incorrect standard, a failure to consider a required element of a legal test, or similar error in principle, such an error can be characterized as an error of law, subject to a standard of correctness. Appellate courts must be cautious, however, in finding that a trial judge erred in law in his or her determination of negligence, as it is often difficult to extricate the legal questions from the factual. It is for this reason that these matters are referred to as questions of "mixed law and fact". Where the legal principle is not readily

> extricable, then the matter is one of "mixed law and fact" and is subject to a more stringent standard. The general rule, as stated in *Jaegli Enterprises*[, [1981] 2 S.C.R. 2] is that, where the issue on appeal involves the trial judge's interpretation of the evidence as a whole, it should not be overturned absent palpable and overriding error.

[85] In our view, it is clear that the trial judge did appreciate the weight of the evidence. He fixed Bertrand with knowledge of many of the facts that the insurers allege should have been disclosed. These included in summary, numerous homeowner complaints, consultations with Lafarge, payments totalling $36,000 by 1991 for attempted repairs, discontinuing the use of fly ash, engineering reports from customers and letters from homeowners threatening litigation. However, the trial judge found that Bertrand did not know the seriousness of the problem until 1992. He stated that: “I have to judge Bertrand’s conduct under the circumstances and in the context of the situation existing from 1987 to 1991 when it first purchased insurance and renewed the policies of these insurers” (at 145). Those circumstances included that there was nothing about fly ash itself, nor about the parging, which warranted disclosure. Lafarge, “one of the most important cement producers in the world”, (at 146) was telling Bertrand that there was nothing wrong with the concrete. The trial judge concluded that although Bertrand may have been too trusting of Lafarge or waited too long to conduct its own investigations of the problems, “in the context of 1987 to 1991, I cannot conclude that a reasonable person in Bertrand’s position would have disclosed those facts to the insurers” (at 147).

[86] In our view, the trial judge made no reviewable error in coming to his conclusion and we would not give effect to this ground of appeal by Royal.

[87] Chubb has accepted the trial judge’s overall finding on this issue and limits its appeal to the failure of the trial judge to find that Bertrand made a misrepresentation on its Chubb application by failing to identify ready-mix containing fly ash as a “new product.”

[88] Chubb relies on an answer given by Bertrand’s representative at the examination for discovery. Mr. Cliff was asked:

> Q. Then question 20: “Have any New Products been introduced in the last 5 years or contemplated?” Answer no. Is that information Correct?
>
> A. The only thing that I can recall would be the use of a new product which had been contemplated, let’s say the slag

> cement as a Portland cement replacement." Mr. Starr: But your product is ready-mix. The Witness: That's correct.
>
> Q. So I take it from that answer that you exclude fly ash as a new product?
>
> A. See, we don't manufacture those products. Being introduced in the last five years. That's been introduced by ourselves, I take that to be.
>
> Q. Fly ash is not a new product? (interruption by counsel)
>
> A. I would say it is not a new product, no.

[89] Chubb's argument is that because the witness considered ready-mix with slag cement to be a new product, ready-mix with fly ash should be in the same category, and the trial judge erred in not so finding.

[90] We would not give effect to this argument. This was a finding of the trial judge based on the evidence, including his assessment of the witnesses and the inferences he drew. It was open to him to accept that Bertrand's product was ready-mix and that a new ingredient in its composition did not necessarily make it a new product. The question on the application was a specific one and could have been asked in a different manner if the introduction of new ingredients was the information sought by the insurer.

4. Which Policies Were "Triggered" to Respond to the Claims?

a) Overview

[91] Bertrand and Lafarge both had primary and excess insurance policies in place for each of the policy periods from 1986 to 1992. Once having found that the plaintiffs had suffered a loss because of property damage caused by an occurrence, in order for any particular insurance policy to be required to respond and cover the loss on behalf of the insured, the property damage must have taken place during the policy period. The policies are "triggered" to respond to the claim only when there is an occurrence resulting in property damage suffered during the policy period, no matter the timing of the initial precipitating cause or event. The issue, therefore, is when did the property damage occur in this case?

[92] That question is easily answered when the precipitating event and the damage are effectively simultaneous, for example, where property is destroyed by fire. However, where the precipitating event is the introduction of a defective product into a structure, together with the ongoing deterioration of the product, acted on by outside forces over

time, the timing of the damage to property, as defined, may not be clear, or even determinable with precision.

[93] Four approaches have been developed in the U.S. and Canadian jurisprudence for determining the timing of property damage which is latent, or developing over time, and which does not become apparent immediately. The “Exposure Theory”, the “Manifestation Theory”, the “Injury in Fact Theory” and the “Continuous Trigger or Triple Trigger Theory” are often referred to as the “four trigger theories”. The word “trigger” is not a term of art, nor is it used in the policy language. It is rather a term used in the jurisprudence to signify that the coverage afforded by a particular policy has been effectively called upon or activated and that the policy will respond to the loss.

[94] Although the four formulations are referred to as “theories”, we do not endorse that nomenclature as it may imply an arbitrary or conceptual basis rather than an evidentiary basis for triggering coverage under a policy. As will be evident, the trigger theories are, in effect, four ways of interpreting the often-complex evidence of how and when the damage occurred, then labelling the approach. Upon close analysis, each theory is effectively an application of the “injury in fact” theory where the court determines, on the evidence, at what point or continuum of points in the process, the property damage in fact occurred.

[95] The first trigger theory is referred to as the Exposure Theory. On this theory, from the first exposure to the condition or conditions which ultimately cause the property damage, that damage is inevitable, a certainty. As a result, the property damage is considered to have occurred on that first exposure so that the deterioration following that exposure is merely the manifestation of the damage that has already occurred requiring repair or replacement. Consequently, only the insurance policy in effect at the date of the first exposure is triggered to respond to the loss.

[96] The second is the Manifestation Theory. On this theory, damage only occurs when it becomes known (on one formulation, to the insured, and on another, to the third party whose property is affected). Therefore, coverage is triggered when the insured or third party first becomes or could have become aware of the damage. Again, the result is that only the insurance policy in effect on the date of manifestation of the damage is triggered to respond to the loss.

[97] The third approach is referred to as the Injury in Fact Theory. A policy responds if in fact there was damage which actually occurred during the policy period, whether or not anyone was aware of it or could have been aware of it. Where property damage is ongoing or continuous, every policy in effect while the damage continues to occur is triggered to respond to the loss.

[98] The fourth approach is the Continuous Trigger or Triple Trigger Theory. Under this theory, the property damage is effectively deemed to have occurred from the initial exposure to the time when the damage became manifest or ought to have become manifest to the plaintiffs, and if alerted, to the insured. In that case, all policies in effect over that period are called upon to respond to the loss.

[99] A couple of matters should be noted with respect to these theories and their development. The first is that the issue of the appropriate trigger is not viewed as a matter of principle by the insurance community. Rather, insurers (and insureds) generally advocate the application of the theory that will, in the case of an insurer, absolve it from liability, and in the case of an insured, provide coverage. This is well-demonstrated in this case, where two of the insurers, Chubb and Guardian, each insure both Bertrand and Lafarge. As insurer for Bertrand, Chubb asserts the exposure theory, while as insurer for Lafarge, it asserts the manifestation or triple trigger theory. In Guardian's case, as insurer for Bertrand, it advocates the triple trigger theory, while as insurer for Lafarge, it seeks the manifestation theory.

[100] This approach is not necessarily disingenuous. Whether the policy language has been triggered is determined by making findings of fact, or drawing inferences from the established facts, and applying those findings to that language; in other words, the issue of whether property damage occurred during the policy period is a question of fact, or mixed fact and law, but is not a question of law alone. As a result, different trigger nomenclature may be applicable in different cases depending on the factual findings, although as noted above, the use of the term "theories" or "deeming" is misleading.

[101] The second question is whether the type of insurance policy should be determinative of which trigger is applicable. This issue has arisen both in the American and Canadian case law because courts have applied different triggers when dealing with first party indemnity policies and third party liability policies.

[102] The California Supreme Court has held that for first party property damage cases involving more than one insurer where there is latent damage and therefore an undiscovered loss occurs over several policy periods, it is the manifestation theory which applies, making the insurer at the time of the discovery of the extent of the damage solely responsible for indemnity: *Prudential-LMI Com. Insurance v. Superior Court of San Diego County* 274 Cal. Rptr. 387 (1990). The court reserved for a later case, whether the same trigger would apply for CGL policies. In 1995 in *Montrose Chemical Corporation of California v. Admiral Insurance Co.* 42 Cal. Rptr. 2d 324, the court contrasted the requirements of the two types of policies and concluded that for third party liability

(CGL) policies, the triple trigger theory applies, making all insurers on cover over the full period while the damage was developing responsible for the loss.

[103] In the leading first party insurance case in Canada, *University of Saskatchewan v. Fireman's Fund Insurance Co. of Canada*, [1998] 5 W.W.R. 276 (Sask. C.A.), the Court of Appeal reversed the trial judge who had applied the manifestation theory. As will be discussed in further detail below, the court only considered two theories, the manifestation and exposure theories. The court determined that as all of the damage had occurred before it was discovered, the exposure theory should be applied.

[104] This divergence of view on the applicable trigger for first party policies suggests that it is not the type of policy which dictates the appropriate trigger, but rather, the requirements of the policy language together with the facts of the specific case, including the evidence of when the injury actually occurred, when it was manifest and how many insurance policies are potentially available and liable to respond.

b) The Findings of the Trial Judge

[105] The trial judge analyzed all four theories. He first considered and rejected the exposure theory. He did so because he had found that the damage occurred over time. He stated at 134:

> I am of the view that the plain wording of the policies provide that there will be coverage for property damage occurring during the policy period. The evidence before me clearly indicates that the property damage did not all occur during the first year or two after pouring the foundations. The damage occurred over several years, was continuous and progressive to a point where tests showed in 1992, that the foundations would have to be replaced.

[106] He noted that the exposure theory had developed in the U.S. to accommodate asbestos bodily injury claims, where the courts were considering only two theories, either the exposure or the manifestation theory. On the exposure theory, every time a person breathed in an asbestos fibre, that amounted to a new exposure causing further deterioration of the lungs. As a result, long-term exposure meant that insurance coverage was maximized. Had the manifestation theory been applied, only one insurer would have been called on to respond.

[107] He noted that authors and subsequent judgments have been critical of extending the application of the exposure theory from bodily injury to property damage cases, and

as well commented that the exposure theory may be applicable only in cases of first party indemnity insurance, such as *University of Saskatchewan, supra.*

[108] He concluded that the application of the exposure theory to trigger coverage would be inconsistent with the wording of the policies.

[109] The trial judge next dealt with the manifestation theory, which would put the entire burden of response on the insurer whose policy was in place when the damage was manifested. The proper date of manifestation of the damage was also in dispute. Canadian General, which insured Bertrand from 1986 to 1989, argued that the date of manifestation was 1992 when the Ontario Home Warranty Plan experts determined that the concrete contained a major structural defect and that the foundations would have to be removed and replaced. Royal, which insured Bertrand for the years ending 1991 and 1992 argued against the manifestation theory, but in the alternative, submitted that manifestation occurred when a number of the plaintiff homeowners and some of the experts first observed deterioration, before 1989, when Canadian General was the covering insurer.

[110] The trial judge observed that where damage is cumulative and progressive, it is easier to determine the date the damage is manifested than the date it actually occurred. Also, the manifestation theory in effect parallels the discoverability concept for the determination of the running of a limitation period and in that way, is equitable to the insured. However, the trial judge concluded that he must reject the manifestation theory, again because it is inconsistent with the wording of the policies, and he went on to say, the intentions of the parties to the contracts.

[111] In rejecting the manifestation theory, the trial judge reiterated certain of his factual findings which findings are key to the proper approach to determining the correct trigger of coverage. These two findings were, first, that "the cumulative evidence before me demonstrates that the damage to these foundations took place between the years 1986 and 1992"; and second: "…to conclude that all the damage had taken place prior to December 1, 1989 is not supported by the evidence" (at 137). From these two findings the trial judge concluded that as damage occurred between 1986 and 1992, and because coverage is triggered by the occurrence of damage during the policy period, he could not exonerate those insurers on cover during those periods. Also, although there was manifestation of damage before 1989, the evidence did not support the argument that all the damage had occurred by that time requiring replacement of the foundations. Therefore, the cut-off date was not 1989, but 1992.

[112] The trial judge also noted that the manifestation theory had been rejected in the case law, and referred to in the *University of Saskatchewan*, *supra*, case.

[113] The third theory is injury in fact. Having found that the damage began the same year the foundations were poured, 1986, 1987 and 1988, that it was continuous and progressive, and that in 1992 the experts determined that all of the plaintiff homeowners' foundations would have to be replaced, the trial judge concluded that the policies for each policy period between 1986 and 1992 would have to respond to the claims. However, he also found that because it was impossible to determine what percentage of the damage took place in each policy year, using the injury in fact theory he was not able to apportion the liability to the various policy periods. Consequently he concluded that the injury in fact theory alone could not respond to the facts of the case, and that the triple trigger theory was best suited to those facts.

[114] Under the triple trigger theory, where damage is continuous and progressive, is caused by exposure to a harmful or defective substance, and in some cases by further exposure to exacerbating conditions, then only manifests itself while the damage is progressing or after it has fully developed, the damage is said to occur from the first exposure to the date of discovery of the extent of the damage (or the date when it could reasonably have been discovered). Because all of the relevant policies are called upon to respond to the loss, by applying the triple trigger or continuous trigger theory, the court can apportion the liability equitably among the insurers. To the extent that the amount of deterioration during each policy period cannot be determined, the court is in this case using a "theory" to fill an evidentiary gap.

[115] The trial judge also made reference to the California Supreme Court decision in *Montrose Chemical Corporation of California*, *supra*, where the court heard evidence of the drafting history of the standard C.G.L. policy, including evidence that the industry rejected language which would establish a manifestation or discovery of damage trigger, and favoured the continuous injury trigger.

[116] The trial judge concluded that the combination of the injury in fact together with the continuous or triple trigger theory should be applied for three reasons:

(a) they are the most consistent with the language of the policies and the intention of the parties;

(b) they are the most equitable to the insured and the insurers;

(c) they are the theories intended by the insurance industry in drafting the wording of the policies, and in particular, the definitions of "occurrence" and "accident".

[117] Using the injury in fact and the triple trigger theories together, the trial judge found that all insurers whose policy periods were between 1986 and 1992 were required

to indemnify Bertrand. He apportioned liability *pro rata* based on the policy periods as well as the number of foundations poured in 1986, 1987 and 1988.

c) Submissions as to the Applicability of the Exposure Trigger

[118] Both Chubb and Royal took the position at trial and on this appeal that the proper theory is either exposure or injury in fact. The basis of their analysis and submission is that the trial judge found that once the concrete containing the fly ash was poured into the foundations for the homes, the damage was inevitable and occurred at that time and shortly thereafter. Therefore, by the time the two insurers came on cover in late 1987 and after, all of the damage had already occurred.

[119] The key to this argument is the concept that upon exposure or shortly thereafter, the entire damage was a certainty and inevitable. This was the basis for decisions such as *University of Saskatchewan, supra*. That case involved first-party insurance which covered “all risks of direct physical loss or damage from any cause”. The subject of the claim was the stone cladding on the university Education Building, constructed in the 1960’s. In 1985 a piece of the cladding fell off the façade. It was determined that all of the cladding would eventually fall off, due to the fact that the galvanized steel pins used to hold the stone in place were corroding from moisture. The insurance policy period was 1984-5. The damage was manifested during that period. The trial judge held that the loss occurred upon discovery of the first fallen stone and that the policy should therefore respond and cover the loss.

[120] The Court of Appeal noted that there were four recognized trigger theories, but that no court had applied the manifestation theory in circumstances where there was a significant lapse of time between exposure to the peril and manifestation of the loss. The court declined to consider the continuous trigger theory, effectively limiting itself to choosing between the manifestation and exposure theories. This was because there was only one available insurance policy which either covered the loss or did not, depending upon whether the damage occurred before June 30, 1984, the effective date of the policy. The court referred to the finding of the trial judge that by the time the damage was discovered, all of the panels were unsafe and required replacement. The court therefore concluded that “application of either the exposure theory or the injury-in-fact theory would place the occurrence of the loss before the date of commencement of the coverage”: *University of Saskatchewan*, *supra*, at 288.

[121] The court rejected the manifestation theory on the basis that it conflicts with two fundamental insurance concepts, risk and indemnity. If the damage has already occurred before the commencement of the policy, then there is no longer risk as the damage is a certainty. The trial judge had found that the use of galvanized steel pins was a design

error because their exposure to moisture was inevitable as was their resulting corrosion, and he found that the damage process began with the wetting of the pins. The Court of Appeal concluded that "upon the wetting of the pins, there was no longer a risk of the stone eventually falling prematurely, it was a certainty." Furthermore, if the building was already damaged by design error before the insurer came on the risk, then effectively, the insurer would be insuring a damaged building. However, the insurer did not warrant that the building would be free of damage; rather it would provide insurance against the risk of future damage, and indemnity if such damage occurred.

[122] The appellants rely heavily on this case as being very factually similar to the case at bar and they are correct. However, upon analysis, the result reached is the same as well. Because in the *University of Saskatchewan* case there was only one potential insurer to consider and one policy period, the only issue was whether the damage was complete before 1984 when the policy period commenced. The court was not concerned with when the damage commenced or over what period it occurred. The relevant "exposure" occurred when the defective design using galvanized steel pins was installed and then exposed to moisture sometime thereafter. Had there been other insurers on cover for earlier policy periods, the court may well have turned to the injury in fact and possibly the triple trigger theory in order to determine which policies would respond to the loss.

[123] In the case at bar there are numerous insurers with policy periods from 1986 to 1992. Therefore there are three timing issues: when the damage commenced, whether it continued through the policy periods, and when it was complete. In the context of long-latent damage, which requires replacement rather than just repair, the damage is complete when it has progressed to the level where replacement is required because further deterioration without replacement is a certainty. Another way to describe the concept is the point at which the loss is no longer contingent.

[124] In *Zurich Insurance Co. v. Trans-America Insurance Co.* 34 Cal. Rptr. 2d 913 (Cal. App. 4 Dist. 1994), the court defined which policies are obliged to respond applying the triple trigger theory this way at 922:

> …the loss could still be deemed contingent so long as it was unknown when the insurance was issued whether the insured's activity would result in a claim for property damage that occurred within the policy period.

[125] Following this principle, the trial judge found at 141 that after the Ontario New Home Warranty experts completed their testing in 1992, the loss was no longer contingent. He also found that the damage commenced upon or shortly after the foundations were poured and continued through to 1992. He did not find that the damage

was a certainty once the fly ash was used in the concrete mix, nor when the foundations were poured. In fact, some of the foundations poured from the same mix did not suffer any damage.

[126] The United States Court of Appeals for the District of Columbia undertook a similar analysis and reached a similar conclusion in *Young Women's Christian Association of the National Capital Area Inc. v. Allstate et. al.* 275 F. 3d 1145 (C.A.D.C. 2002), a case involving the liability to indemnify for the failure of precast concrete panels on the YWCA building. The court referred to the policy definitions of "occurrence" and "accident" including continuous or repeated exposure to conditions resulting in damage, and to the requirement that the exposure result in damage during the policy period. The court rejected the exposure theory stating at 1151-52:

> The plain terms of these policies support application of the continuous trigger where, as here, the exposure to the damaging excessive chloride ions was continuous in nature. Although the Insurers, like the district court, take the position that there was only a single exposure that caused continuous damage, this characterization of the nature of the damage is belied by undisputed evidence describing the damage. That evidence showed that the damage was the result of continued exposure to excessive chloride ions that migrate through the concrete, and that the initial exposure to the chloride ions thus resulted in continuous exposure to those same ions as they migrated through the concrete and slowly corroded the steel.

And further:

> The district court interpreted this language as setting forth an exposure trigger. Yet the language provides that it is the property damage and not the exposure to it that must occur during the policy period. The language is thus consistent with the continuous trigger theory, which defines damage broadly to include the entire process of damage from exposure to manifestation when the damage is of a continuous and progressive nature.

[127] The trial judge also rejected the submission that because the foundations were not all immediately replaced in 1992, therefore the damage continued after that time. Although the visible deterioration may have progressed, the major defect requiring replacement of the foundations was full-blown by that time (at 153). The same argument

was the subject of the decision in *Home Insurance v. Landmark*, 293 Cal. Rptr. 277 (Cal. App. 4 Dist, 1988) discussed below.

[128] The trial judge also specifically rejected the submission of Royal Insurance that all of the damage had occurred before 1989 and noted that the evidence did not support that conclusion at 134 and 137:

> The evidence before me clearly indicates that the property damage did not all occur during the first year or two after pouring of the foundations. The damage occurred over several years, was continuous and progressive to a point where tests showed in 1992, that the foundations would have to be replaced.
>
> …
>
> The cumulative evidence before me demonstrates that the damage to these foundations took place between the years 1986 and 1992. …to conclude that all the damage had taken place prior to Dec. 31st, 1989 is not supported by the evidence.

[129] In this context, the trial judge made an important observation which reflects on the significance of manifestation of the damage as part of the continuous trigger theory. He noted at 154 that: “It may be that with proper testing, the experts could have concluded prior to 1992 that the foundations would have to be replaced”. The trial judge was correct to treat this as an evidentiary matter. Had there been evidence accepted by the trial judge, that could fix the point in time when the foundations required replacement, and if that point was before 1992, the trial judge would have been obliged to give effect to that finding, no matter when the full extent of the damage was actually discovered or manifested. This is because the policy covers damage during the policy period. Under the triple trigger or continuous trigger theory, the use of manifestation of the injury is a device to establish the latest time when the damage is complete. However, if the timing of the completion of the damage can be established after the fact, and it is earlier than when the damage was discovered, then the application of this device is no longer necessary.

[130] Therefore, Chubb and Royal are correct that had the trial judge found that the injury in fact occurred and was complete before they came on cover, their policies would not be called on to respond. However, those were not the findings of the trial judge on the evidence.

d) Submissions as to the Applicability of the Manifestation Trigger

[131] Three insurers of Lafarge, Chubb, Guardian and Kansa, maintain the position that the manifestation of damage theory is the appropriate theory to apply to trigger coverage. These three insurers insured Lafarge for the early years of exposure and continuous damage, so that application of the manifestation theory would mean their policies would not be triggered.

[132] The manifestation theory was applied by the Quebec Superior Court in the case of *Allstate du Canada Cie. D'Assurance c. Assurance Royale du Canada*, [1994] R.J.Q. 2045 (C.S.) aff'd [1999] R.J.Q. 2827 (C.A.) and that case is relied on by these appellants. That case involved the supply of concrete railway ties between 1974 and 1980. Royal provided primary insurance coverage to the supplier from 1974 to 1982. Allstate provided excess coverage from 1978 to 1982. Various of the railway ties began to show cracking and spalling over the years. In 1980, experts concluded that all of the ties were defective and all would eventually fail and have to be replaced.

[133] The court held that the damage consisted of the cost of removing and replacing the defective concrete but not the cost of the concrete itself, which was excluded. The court went on to hold that the point in time when the insured could reasonably have foreseen the need to replace the concrete was the date of the damage and therefore of the occurrence and consequently, the date for the trigger of coverage. The court took the view that neither the damage nor the occurrence was continuous and progressive, and in that way distinguished the American cases which had applied the triple trigger theory, such as *Montrose Chemical of California, supra*.

[134] Instead the court relied on two other American authorities, *United States Fidelity and Guarantee Company v. American Insurance Co.* 345 N.E. 2d 267 (Ind. App. 2 Dist. 1976), and *Home Insurance*, *supra*, where the courts endorsed the theory that coverage is triggered "when the deterioration is severe enough to put a reasonable insured on notice of a potential loss" (at 2058).

[135] In the *Home Insurance* case, which followed the *U.S.F.&G.* case, there were seven years between the design and construction defects in 1973, and the first visible manifestations of concrete spalling in 1980. The dispute in the case was between two insurers, Home, which was on cover for the policy period from 1980 to 1981, and Landmark, which was on from 1981 until the claim was made in 1983. The California Court of Appeal (4 District, Div. 1) noted that it was not called on to consider the "interesting question" of the possibility of coverage during the period when the loss was not observable during the seven years, but was limited to deciding which of two

successive insurers is liable once the damage has become apparent. In other words, the court was not rejecting the triple trigger theory or even considering it in *Home Insurance*, but only deciding that where there is ongoing damage after first manifestation, the policy in place at the date of manifestation of the loss is responsible for the entire loss and any subsequent policy is not triggered. This is necessary because once the need for replacement is known, the full loss has been crystallized at that time and any further deterioration is caused by delay in proceeding with the necessary replacement.

[136] We agree with the result in *Home Insurance*, according to the issue that was being decided in that case. The *Home Insurance* case does not, however, purport to prefer the manifestation theory to the continuous trigger theory on the issue of coverage for continuous but undiscovered damage.

[137] We agree with the conclusion of the trial judge that in this case the manifestation theory, making only the insurer on cover at the date of manifestation responsible for the entire loss, is not consistent with the policy language. In making that statement, the trial judge relied on his conclusion that damage was progressive and ongoing during the period leading up to manifestation of the extent of the loss. In contrast, in *Allstate, supra*, the court concluded that the loss was not continuous up to that point, because until the magnitude of the loss was known, all that was occurring was deterioration of the concrete railway ties themselves, which were the product not covered by the insurance. A recognition and examination of this difference of view and approach is essential to the analysis of the proper trigger.

[138] The court's analysis in *Allstate* is correct and also applies to this case, because here, the gradual deterioration of the concrete itself is not the damage that is covered by the policies. What is covered is the ongoing process of deterioration caused by the moisture's effect on the defective concrete which, together with the initial defect caused by the inclusion of the fly ash, eventually made the foundations unsafe, thereby causing the damage to the houses. It is that process of ongoing deterioration culminating in the need for total replacement which is covered by the policies. As a result, all policies in effect from the beginning to the end of that process must respond to the loss.

e) Summary on Trigger Theories

[139] The four trigger theories are misnamed as theories. Rather they are descriptive of the finding of the trial judge, on the evidence, of the point in time when the relevant damage occurred. Consequently, there is no rule that a particular "theory" will always apply. Rather, the findings of fact will dictate the appropriate description of the trigger in any particular case.

[140] The conditions and timing of the trigger of any insurance policy to cover and respond to a loss are governed by the language of the policy. In this case, the policy language in the CGL third party liability policies in issue will trigger coverage, from the timing point of view, when damage is suffered within the policy period. As a result, the injury in fact theory is the one that corresponds with that language. This is also the conclusion of G. Hilliker, *Liability Insurance Law in Canada*, 2nd ed. (Toronto: Butterworths, 1996) who stated at 155:

> The only one of these trigger theories which is entirely consistent with the CGL policy wording is, of course, the injury-in-fact theory. If it is possible, in retrospect, to pinpoint the date or dates when the injury or damage actually took place, then the other theories become irrelevant, for the wording of the CGL policy is clear – it refers to bodily injury or property damage during the policy period. An exposure to a hazard within the policy period which causes damage outside the policy period does not fit this wording. Nor should the manifestation of damage in one policy period relieve the previous insurer when the damage actually took place while that previous policy was in force.

[141] If the injury in fact is found to have occurred at the date of exposure to the hazard, at the date of manifestation of the damage, or on a continuous and progressive basis, one might refer to the application of the exposure, manifestation or continuous trigger theories as descriptive of the timing of the damage as it actually occurred. However, the most straightforward and accurate nomenclature in each case is injury in fact.

[142] If the full extent of the damage has become a certainty at a point in time before it is discovered, the injury in fact has occurred by that point in time. Consequently, the fact that there may be further deterioration after that point does not trigger any policies in place after that point, because the damage is already complete. It will be a matter of evidence at the trial as to when the damage became complete. The point when the full extent of the damage becomes known is the manifestation date. In this case, there was no evidence acceptable to the trial judge that the damage was complete before the experts did conclusive testing in 1992. Therefore that date was accepted as the date when the damage became complete.

[143] Because it was not possible on the evidence to determine how much of the damage occurred during any particular policy period, the application of the continuous trigger

theory was appropriate in order to allow the trial judge to apportion the damage on a *pro rata* basis through the affected policy periods.

f) Is Lafarge Estopped from Asserting a Trigger other than Manifestation as a Result of Certain Decisions Made in the U.S. Case of *Nationwide Mutual Insurance Co. v. Lafarge Corp. et al.*, (D.Md., August 21, 1995)?

[144] Both at trial and on appeal certain insurers of Lafarge took the position that Lafarge was bound by the doctrine of issue estoppel in respect of the applicable trigger theory as a result of litigation in the United States between Lafarge and some of its insurers known as the *Nationwide Mutual Insurance Co. v. Lafarge Corp. et al., supra*, litigation. In that case, Lafarge was held partly responsible for concrete it had supplied to Lonestar for the production of concrete railway ties, which later cracked and deteriorated. Nationwide was one of Lafarge's insurers and sought a declaration as to its responsibility to indemnify Lafarge. Other Lafarge insurers were also involved.

[145] In the course of the action, several orders were made on summary judgment motions by Judge Harvey of the Maryland District Court. One of those orders was that in the case of Kansa and two other insurers not involved in the Bertrand litigation, Quebec law should apply to the interpretation of the insuring agreement. Another order provided that under Quebec law, the manifestation trigger theory was applicable, following *Allstate v. Royal, supra*, referred to above. It appears from Judge Harvey's reasons that Lafarge did not oppose the ruling regarding the applicability of Quebec law to the Kansa and two other insurance contracts, because it was relying on a public policy exception which would require the imposition of Maryland law on the particular issue on the first motion, which was late notice of claim.

[146] In the Maryland litigation, Lafarge also took the position that the manifestation trigger was the proper trigger according to Quebec law. This allowed Kansa and two other insurers out of the action, but Lafarge sought to have the manifestation theory apply to another insurer, National Union, which would then have been liable to indemnify Lafarge. Ultimately the court did not apply the manifestation trigger to the National Union policy.

[147] In this case, the trial judge determined that the doctrine of issue estoppel did not apply to Kansa or any other Lafarge insurers. He went to hold that he would also exercise his residual discretion against the application of the doctrine. We find no error in the disposition made by the trial judge.

[148] In *Danyluk v. Ainsworth Technologies Inc*., [2001] 2 S.C.R. 460 at 476, the Supreme Court of Canada reiterated the requirements for the application of the doctrine of issue estoppel. Quoting from the Ontario Court of Appeal decision in *McIntosh v. Parent*, [1924] 4 D.L.R. 420 at 422, the court described the doctrine and its purpose:

> When a question is litigated, the judgment of the Court is a final determination as between the parties and their privies. Any right, question, or fact distinctly put in issue and directly determined by a Court of competent jurisdiction as a ground of recovery, or as an answer to a claim set up, cannot be re-tried in a subsequent suit between the same parties or their privies, though for a different cause of action. The right, question, or fact, once determined, must, as between them, be taken to be conclusively established so long as the judgment remains. [Emphasis added in *Danyluk*.]

[149] The court set out the three criteria for the application of the doctrine referring to *Angle v. Minister of National Revenue*, [1975] 2 S.C.R. 248 at 254:

> (1) that the same question has been decided;
>
> (2) that the judicial decision that is said to create the estoppel is final; and
>
> (3) that the parties to the judicial decision or their privies were the same persons as the parties to the proceedings in which the estoppel is raised or their privies.

[150] Beginning with the third criterion, the only insurer in this litigation which could be bound by the Maryland ruling is Kansa, which was one of the three parties to that litigation. It also appears that the same Kansa insurance policy that was in issue in that proceeding, which applied for the 1986 policy period for world-wide coverage, is the one called on by Lafarge in this action.

[151] However, the same question is not being decided. As we discussed above, the determination of the applicable trigger for an insurance policy to respond to a loss is dependant on both the policy wording and the facts of the case as established in the judicial proceeding. Although the situation in the *Nationwide Mutual Insurance Co.*, *supra*, litigation involving deteriorating concrete railway ties was similar to the one in the Bertrand litigation, it is not the same. Based on the evidence and the findings of fact, the trial judge in this case found it most appropriate to apply the injury in fact together with the continuous trigger theory, which resulted in the triggering of all of the policies in

force during the policy periods from the initial exposure to the date when the full extent of the damage was determined. Had the evidence been different, the trial judge, and this court, may have had to approach the matter in a different way. Consequently, the same policy may be triggered on a different theory, depending on the facts of the particular case.

[152] The issue estoppel argument also requires the conclusion that the parties are bound by the Maryland court's ruling that the law of Quebec is the applicable law to apply to the interpretation of the Kansa policy. That ruling was made applying Maryland law and essentially on Lafarge's consent in the course of two of the summary judgment motions, the late notice motion and trigger theory motion. Assuming, without deciding, that that ruling does comply with the three criteria for the application of issue estoppel, we would not interfere with the trial judge's exercise of his discretion not to apply the doctrine in this case.

[153] First, we are satisfied that the neither the Quebec Superior Court nor the Court of Appeal of Quebec in *Allstate*, *supra*, intended to state a rule that the manifestation trigger will always apply no matter the facts of the case and therefore that Quebec law requires the application of the manifestation theory in every case. As we have found, the proper trigger will depend on the wording of the particular policy and the facts of each case.

[154] Second, as the trial judge noted, it would be unfair to other insurers, as well as to all parties to this proceeding to have a different trigger theory apply to one insurer's obligations. It will affect not only the insured, but could affect the *pro rata* obligations of other insurers. The trial judge also noted that it would be unjust to all the parties having regard to the length of the trial and his finding that the facts required the application of the injury in fact and continuous trigger theories. In *Danyluk*, *supra*, the Supreme Court confirmed at para. 80 that unfairness is a most important criterion for the application of a judge's discretion not to apply issue estoppel.

[155] As a result, we would not give effect to this ground of appeal.

5. Bodily Injury after the Policy Period

[156] Two Lafarge insurers, Reliance and National Union, argue that part of the damages awarded for personal injuries were suffered after their policy periods, yet the *pro rata* distribution of liability for those personal injuries makes them responsible for part of those damages.

[157] There are two aspects to these claims. One is with respect to the global award to all plaintiffs of a sum for hardship and inconvenience suffered by the plaintiffs while

living with unusable basements. The trial judge awarded $7,000 per home for the period 1986 to 1993, and $1,000 per home per year thereafter until the foundations are replaced or the problem corrected.

[158] Reliance and National Union suggest that these are personal injury damages within the policy wording, but suffered outside the policy period. Both policies define “personal injury” to mean: “bodily injury, sickness, disease, including death any time resulting therefrom, shock, fright, mental anguish and mental injury…which occurs during the policy period.”

[159] It would appear that the trial judge viewed the amounts awarded not as personal injury damages, but rather as consequential losses flowing from the damage to property which occurred within the policy periods. We agree with his conclusion. The deteriorating concrete did not cause the plaintiffs to suffer a sickness or disease, either physical or mental. What they suffered was hardship resulting from the loss of use of their property as a result of the property damage. On the timing question, just as the entire property damage was found to have occurred by 1992, requiring replacement of the foundations, so the hardship damage had also crystallized by that point in time, and would necessarily continue to occur until the replacement of the foundations was carried out. At the point in time when the extent of the damage became a certainty, the ongoing hardship resulting from it also became a certainty. As a result, we would not give effect to this part of the argument.

[160] The other aspect of Reliance’s argument is with respect to the personal injury award to one plaintiff, Jacques Marcil. He was awarded general and special damages for mental distress as a result of the problems with the foundations to his house as well as loss of income as a result. As to timing, he first noticed something unusual with his foundations in August, 1989, four months after the termination of the Reliance policy in April, 1989. Furthermore, the trial judge found that his psychiatric problems began in 1995. Reliance points out that this is beyond its policy period. In fact, it is beyond all the relevant policy periods.

[161] However, again, although this head of damage is labelled personal injury, it was not personal injury caused by the defective concrete, the way, for example, asbestosis is caused; rather this was loss consequential on the property damage which occurred within the policy periods, including the April 1988 to April 1989 period. The trial judge found that the damage suffered by Mr. Marcil was reasonably foreseeable as a result of the negligence of the insured, Lafarge. That negligence caused property damage within the Reliance policy period. Any consequential damage which resulted from that negligence and which the trial judge found was compensable (therefore, reasonably foreseeable and not too remote) is also covered. That damage has, in effect, crystallized within the policy

period, even though no particular plaintiff was bound or certain to suffer such damage. Any other analysis would mean that an insured would not be able to protect itself with insurance coverage for such losses which manifest themselves after the insurance policy periods even though all of the property damage which causes such a loss does occur during the periods. As a result we would also not give effect to this second aspect of the argument.

F. Liability for Lafarge's Defence Costs

1. Overview

[162] Lafarge made third party claims against eighteen insurers. These insurers had provided various forms of coverage during one or more of the seven policy periods beginning in April 1986 through to April 1993. We will refer to each of these seven policy periods by the year in which they began. Boreal provided primary coverage by way of a comprehensive general liability policy for 1986 and 1987. Cigna provided similar primary coverage for the years 1988 to 1992. Lafarge had, however, agreed to indemnify Cigna for any amounts paid on the policy. In effect, Lafarge was self-insured at the primary level for the years 1988 to 1992. The other insurers who were sued by Lafarge provided excess insurance in various amounts up to maximums ranging from $20,000,000 to $50,000,000, depending on the year. A chart depicting Lafarge's insurance coverage between April 1986 and April 1993 is attached as Appendix B to these reasons.

[163] All of the Lafarge insurers denied coverage in the main action and Lafarge was obliged to fund its own defence. It looked to recover the costs of that defence from its insurers in the third party actions. The trial judge ultimately held that eight of the Lafarge insurers were obligated to contribute to those costs. These included the primary insurers, Boreal and Cigna, as well as Kansa, Scottish &York, American Home, Guardian, Reliance and National Union, the insurers who provided one or more layers of excess coverage up to the limit of $10,000,000. The Lafarge insurers who provided excess insurance beyond the $10,000,000 limit were not required to contribute to the costs of the defence. For ease of reference, in this part of the reasons we will refer collectively to those excess insurers who were held liable to contribute to defence costs as the excess insurers and those who were not as the successful insurers.

[164] The trial judge apportioned the defence costs by dividing them into seven equal segments, each segment representing one of the seven policy periods. He then apportioned the costs for each policy period equally among the various insurers who were obligated to contribute to costs during that policy period. For example, one-seventh of the defence costs was attributed to the 1992 policy period. Cigna and National Union

were liable for defence costs attributable to that period. Each was obliged to pay one-half of one-seventh of the defence costs. The percentage of defence costs for which each of the various insurers was ultimately held liable is set out as a schedule to the judgment dated April 17, 2000 and is attached as Appendix C to these reasons. On the approach taken by the trial judge, the primary insurers were responsible for about 45 percent of the defence costs and the excess insurers were responsible for the rest.

[165] Boreal did not appeal from this aspect of the trial judgment. Cigna originally appealed, but abandoned that part of its appeal. All of the excess insurers who were held liable for defence costs have appealed. Lafarge, Cigna and Boreal resist those appeals.

[166] Lafarge appeals from the judgment as it relates to liability for defence costs claiming that two of the successful insurers, Chubb and Hartford, should have been required to contribute to defence costs.

2. The Reasons of the Trial Judge

[167] As the trial judge acknowledged, Lafarge's claim for compensation for defence costs from its insurers raised some of the most difficult problems in a trial that was replete with difficult problems. The trial judge's resolution of this claim strikes us as reasonable and fair. That, of course, does not necessarily mean that it is correct in law.

[168] The trial judge began this part of his reasons with the observation that the duty to compensate Lafarge for its defence costs flowed from the insurers' duty to defend the main claim on behalf of Lafarge. If an insurer had such a duty and failed to defend, then that insurer was obliged to compensate Lafarge for the reasonable costs it had incurred in its own defence. The trial judge next observed that the nature and extent of an insurer's duty to defend depended on the terms of the specific contract of insurance. After referring to principles governing the interpretation of those contracts, and considering issues relating to the primary insurers, the trial judge turned his attention to the insurers who provided excess coverage. He said at 189:

> Except for minor variances, most of the excess insurance policies have similar wording. They provide for a duty to defend once the underlying insurance limits have been exhausted. Often this obligation is clearly stated in the policy or at times the excess insurance policy accepts the terms and conditions of the underlying insurance.
>
> Some of the excess insurance policies provide coverage for defence and third party costs in one section of the policy, and appear to remove liability in another section. As stated

> earlier, applying the general principle of interpretation of insurance policies, the insured is entitled to the more favourable interpretation whenever the policy is not clear or unambiguous. …
>
> … Suffice it to say that having reviewed all of the submissions made by counsel for the excess insurers, I would conclude that all of the policies provide coverage for defence costs once the limits of the underlying insurance had been exhausted [emphasis added].

[169] Having found a duty to defend in the policies of the excess insurers, the trial judge next considered when that duty was triggered. He rejected the submission that the duty was not triggered until the limits underlying insurance were paid. Relying on *Broadhurst & Ball v. American Home Assurance Co.* (1990), 1 O.R. (3d) 235 (C.A.), leave to appeal to S.C.C. refused (1991), 79 D.L.R. (4th) vi, the trial judge said:

> In my opinion, it is far more reasonable to apply the reasoning in *Broadhurst & Ball*, *supra*, wherein the court has decided that the duty of an excess insurer to defend is triggered upon the reasonable perception that the claim could pierce into its layer. There are very important practical and policy considerations why such a principle should be applied in our type of action …

[170] Applying the "reasonable perception" of risk test to the facts of this case, the trial judge concluded that those excess insurers who provided insurance up to $10,000,000, were obligated to defend and, therefore, to contribute to Lafarge's defence costs.

[171] Finally, the trial judge turned to the issue of apportionment of defence costs as among those insurers who he had found liable to contribute to that costs. He referred to apportionment as "an exercise in the court's equitable jurisdiction". As indicated above, he divided those costs into seven equal parts representing the policy periods in issue and divided the costs attributable to each of the policy periods equally among the insurers who were obligated to contribute to defence costs in that policy period.

3. The Appeals by the Excess Insurers

[172] The excess insurers have advanced various submissions to support their contention that they should not be required to contribute to Lafarge's defence costs. Some of those arguments are specific to individual excess insurers, however, all of the excess insurers argue that the trial judge misunderstood the holding of this court in *Broadhurst & Ball*,

supra. They maintain that the trial judge misread *Broadhurst & Ball* as imposing a duty to contribute to defence costs on excess insurers whenever there was a reasonable apprehension that the claim, if successful, would reach the level of insurance provided by the excess insurer. The excess insurers submit that properly understood, *Broadhurst & Ball* speaks to the obligation of an excess insurer to contribute to the defence of an action, where under the terms of the excess insurer's policy, it has undertaken a duty to defend that is concurrent to the duty to defend of the primary insurer.

[173] The excess insurers contend that the question of their obligation to contribute to defence costs arises only if under the terms of their policies they had a duty to defend the claim made against Lafarge in the main action. According to the excess insurers, their policies imposed no such duty. They submit that to the extent that any of their policies contain a duty to defend, it is a duty that arises only in clearly specified circumstances, none of which arose in this case. The excess insurers submit that the trial judge's analysis ignores the threshold question of the nature of any duty to defend, if any, imposed on an excess insurer by the terms of its policy and proceeds directly to the questions of which excess insurers should share in defence costs and in what proportion.

[174] We agree that absent a statutory obligation to defend, and none exists here, an insurer's obligation, if any, to contribute to defence costs incurred by an insured in the defence of an action, must be found within the four corners of the controlling policy. That obligation may flow from the duty to defend the action, or it may be a discrete covenant within the policy: *Canadian Indemnity Co. v. Simcoe & Erie Insurance Co.* (1979), 103 D.L.R. (3d) 485 at 489 (N.S.C.A.).

[175] We also agree that *Broadhurst & Ball*, *supra*, does not impose a duty to defend on excess insurers by virtue of the possibility that those insurers will be required to indemnify the insured if the claim is successful. The principle in *Broadhurst & Ball* operates where the primary and excess insurer have a concurrent duty to defend imposed by their respective policies and addresses the question of contribution as between those insurers. *Broadhurst & Ball* instructs that where an excess insurer has a duty to defend and is put at risk by the claim, then that excess insurer should contribute to defence costs. The exact nature of the contribution as between those insurers with a duty to defend will depend upon the equities of the specific case.

[176] Most of the excess insurers' policies contain either an express duty to defend or incorporate by reference a duty to defend contained in an underlying policy. The interpretative problems lies in determining the nature of that duty. Before turning to the language of the specific policies, it is helpful to refer in general terms to the approach to be taken to the interpretation of covenants containing a duty to defend.

[177] The duty to defend is a separate obligation from the duty to indemnify. A duty to indemnify does not automatically impose a duty to defend. Similarly, a duty to defend may exist where in the end there is no duty to indemnify: *Nichols v. American Home Assurance Co.*, [1990] 1 S.C.R. 801 at 808-9. In *Nichols* at 808, McLachlin J. said:

> … The respondent also relies in this connection on the contention that the duty to defend is broader than and independent of the duty to indemnify. This is so, in the sense that the duty to defend arises where the claim <u>alleges</u> acts or omissions falling within the policy coverage, while the duty to indemnify arises only where such allegations are proven at trial. [Emphasis in the original.]

[178] Later in her reasons, at 810-811, McLachlin J. observed:

> Where it is clear from the pleadings that the suit falls outside the coverage of the policy by reason of an exclusionary clause, the duty to defend has been held not to arise [citation omitted].
>
> <u>At the same time it is not necessary to prove that the obligation to indemnify will in fact arise in order to trigger the duty to defend. The mere possibility that a claim within the policy may succeed suffices</u>. In this sense, as noted earlier, the duty to defend is broader than the duty to indemnify. O'Sullivan J.A. wrote in *Prudential Life Insurance Co. v. Manitoba Public Insurance Corp.* (1976), 67 D.L.R. (3d) 521 at 524 (Man. C.A.):
>
>> Furthermore, the duty to indemnify against the costs of an action and to defend does not depend on the judgment obtained in the action. The existence of the duty to defend depends on the nature of the claim made, not on the judgment that results from the claim. The duty to defend is normally much broader than the duty to indemnify against a judgment.
>
> In that case, it was unclear whether the insurer might be liable to indemnify under the policy, so the duty to defend was held to apply. <u>In the court's view, it would have been unjust for the insurers to be able to assert that the "claim is probably groundless or will probably end up falling outside of the</u>

> indemnity coverage. Since we have no proof that we owe an indemnity in this case, we take the position that we owe no duty to defend" [emphasis added].

[179] The policy under consideration in *Nichols* required the insured to defend suits "seeking damages which are or may be payable under the terms of this policy". Based on that language and the general principles relating to the interpretation of the duty to defend in insurance contracts, McLachlin J. concluded at 812:

> I conclude that considerations relating to insurance law and practice, as well as the authorities, overwhelming support the view that the duty to defend, should, unless the contract of insurance indicates otherwise, be confined to the defence of claims which may be argued to fall into policy. That said the widest latitude to be given to the allegations in the pleading in determining whether they raise a claim within the policy [emphasis added].

[180] In *Non-Marine Underwriters, Lloyd's of London v. Scalera*, [2000] 1 S.C.R. 551, the policy provided that the insurer would defend "any suit against you alleging bodily injury or property damage and seeking compensatory damages". The policy then excluded bodily injury or property damage caused by an intentional or criminal act. In discussing the duty to defend in general terms, Iacobucci J. said at 581:

> An insurance company's duty to defend is related to its duty to indemnify. A homeowner's insurance policy entitles the holder to have the insurer indemnify against liability falling within the policy's terms. Since the insurance company will be paying these costs, it has also developed the right – now a duty – to conduct the defence of such claims. However, the duty to defend is not so great that it is presumed to be independent of the duty to indemnify. Absent express language to the contrary, the duty to defend extends only to claims that could potentially trigger indemnity under the policy. Therefore, if an insurance policy, like the one in this case, excludes liability arising from intentionally caused injuries, there will be no duty to defend intentional torts [emphasis added].

[181] Iacobucci J. went on to hold that the claim potentially triggered indemnity under the policy if the allegations in the claim properly construed, could give rise to an obligation to indemnify: *Non-Marine Underwriters, supra*, at 581, 597-602.

[182] As these cases demonstrate, where a policy provides a duty to defend, the operation of that duty will be determined prospectively by reference to the allegations made in the claim unless the policy expressly indicates to the contrary. If the insurer is potentially liable to indemnify under the terms of the policy, the insurer will be obligated to defend. There are sound policy reasons for this approach. A duty to defend determined only after the trial of the claim may come much too late to assist an insured who paid through its premium for that defence, but is unable to fund the litigation itself. The prospective determination of a duty to defend also facilitates the expeditious resolution of claims made against the insured through the early involvement of the insurer who may eventually have to indemnify the insured.

[183] The case law described above concerning a duty to defend deals with primary insurers. We see no reason, however, to depart from the presumption in favour of a prospective determination of a duty to defend based on the nature of the claims made where it is an excess insurer that has undertaken that obligation. It is always open to the excess insurer to alter the nature of the duty to defend by including the appropriate express language in the policy.

[184] The language of the policy giving rise to a duty to defend must be interpreted having regard to the rules of interpretation governing insurance contracts: *Reid Crowther and Partners Limited v. Simcoe & Erie General Insurance Co.*, [1993] 1 S.C.R. 252 at 268-69; *Derkson v. (Litigation Guardian of) 539938 Ontario Ltd.* (2000), 205 D.L.R. (4th) 1 at 15 (S.C.C.). The words in the defence covenant must also be examined in the context of the entire agreement and where excess insurance policies are involved, with an appreciation that each policy forms part of a broad scheme of insurance coverage intended to provide layers of insurance against the same risk: see *Trenton Cold Storage Ltd. v. St. Paul Fire & Marine Insurance Company* (2001), 146 O.A.C. 348 at 350 (C.A.). Of paramount concern among the various guides to interpreting insurance contract in this case, it is the principle that where more than one reasonable interpretation of a defence covenant is open, an interpretation which favours the insured by recognizing a duty to defend will carry the day: *Wisebrod v. American Home Assurance Company* (1997), 35 O.R. (3d) 733 at 735-36 (C.A.).

(a) The 1986 policies

[185] On the trial judge's reasoning, five policies were obligated to contribute to Lafarge's defence costs for the 1986 policy period. The relevant specifics of those policies are as follows:

Boreal [primary]	$2,000,000
Kansa – Policy #2503422 [first excess]	$3,000,000

Scottish & York – Policy #10062 [second excess]	$2,000,000
Kansa – Policy #2503423 [third excess]	$2,000,000
Scottish & York – Policy #10064 [fourth excess]	$1,000,000

[186] The first Kansa excess policy (2503422) was a commercial umbrella liability policy. The relevant terms are set out below:

> Insuring Agreements
>
> I. Coverage – To pay on behalf of the Insured that portion of the ultimate net loss in excess of the retained limit as hereinafter defined, which the Insured shall become legally obligated to pay as damages for liability imposed upon the Insured by law, or liability assumed by the Insured under contract because of (A) personal injury, (B) property damage, or (C) advertising liability, as defined herein caused by an occurrence.
>
> II. Defense, Settlement, Supplementary Payments. (<u>The provisions of this Insuring Agreement apply solely to occurrences covered under this policy but not covered by underlying policies listed in the Schedule of Underlying Insurance or any other underlying insurance providing coverage to the Insured, whether collectible or not. This Insuring Agreement shall also apply to occurrences not covered by any underlying insurance due to exhaustion of any aggregate limits by reason of any losses paid thereunder.)</u>
>
> The Company shall
>
> A. <u>defend any suit against the Insured alleging liability insured under the provisions of this policy and seeking recovery for damages on account thereof even if such suit is groundless, false or fraudulent, but the Company shall have the right to make such investigation and negotiation and settlement of any claim or suit as may be deemed expedient by the Company;</u>
>
> …
>
> C. …
>
> <u>The Company agrees to pay the amounts incurred under this Insuring Agreement II, except in settlement of claims and suits, in addition to limit of liability stated in the Declarations, and such defense and supplementary</u>

> payments shall not be included as part of the ultimate net loss as defined in the policy. …
>
> … Insuring Agreements I and II shall cease to apply after the applicable limit of the Company's liability has been exhausted by payments of judgments or settlements.

Limit of Liability – Retained Limit

A. The Company shall be liable only for that portion of the ultimate net loss excess of the Insured's retained limit defined as either:

1. the total of the applicable limits of the underlying policies listed in the Schedule of Underlying Insurance hereof, and the applicable limits of any other underlying insurance providing coverage to the insured; or
2. the amount stated in Item 3 (A-2) of the Declarations as the result of any one occurrence not covered by such underlying policies of insurance;

and then up to an amount not exceeding the amount as stated in Item 3 (A) of the Declarations as the result of any one occurrence.

…

When used in this policy (including endorsements forming a part hereof) …

H. OCCURRENCE – With respect to Personal Injury and Property Damage, the term "Occurrence" means an event, including continuous or repeated exposure to conditions, which result in Personal Injury or Property Damage during the policy period, neither expected nor intended from the standpoint of the Insured. All Personal Injury or Property Damage arising out of the continuous or repeated exposure to substantially the same general conditions shall be considered as arising out of one occurrence.

I. ULTIMATE NET LOSS – Except as provided in Insuring Agreement II, "Defense", the term "Ultimate Net Loss" shall mean the total sum which the Insured, or any company as its insurer, or both become obligated to pay by reason of personal injury, property damage, or advertising liability claims, either through adjudication or compromise, and shall

> also include hospital, medical, and funeral charges and all sums paid or payable as salaries, wages, compensation, fees, charges, interest, expenses for doctors, nurses, and investigators and other persons, and <u>for settlement, adjustment, investigation and defense of claims</u> and excluding only the salaries of the Insured or any of the underlying Insurer's permanent employees. [Emphasis added.]
>
> The Company shall not be liable for expenses as aforesaid when such are covered by underlying policies of insurance whether collectable or not.

[187] Paragraph A of Insuring Agreement II contains an express undertaking to defend. The duty is described in prospective terms and responds to claims for which Kansa may have to indemnify Lafarge. It does not depend on any finding of an obligation to indemnify. The wording is consistent with the *Nichols* approach to the duty to defend.

[188] Paragraph C of Insuring Agreement II contains a specific undertaking to pay amounts incurred under paragraph A in addition to any amounts payable under the coverage provisions.

[189] The plaintiffs' claims arise out of events that were potentially within the coverage provided by Kansa. It further contained allegations which could potentially result in damages occurring within the time frame of a Kansa policy that were beyond the limits of Boreal's primary policy. Paragraph A would appear to impose a clear duty on Kansa to defend the action brought by Lafarge.

[190] The language in paragraph A is, however, subject to the two conditions precedent found in the opening language of Insuring Agreement II. The duty arises in two circumstances:

- where the occurrence giving rise to liability is covered under the Kansa policy but not covered by an underlying policy; and
- where the occurrence is not covered by an underlying policy by virtue of payment having been made of the aggregate limits of that policy.

[191] Kansa submits that, with respect to the first condition precedent, the occurrence giving rise to Lafarge's alleged liability to the plaintiffs was clearly covered under Boreal's primary policy and that the amount of the damages claimed is irrelevant to the determination of whether the occurrence is covered under that policy. Kansa also contends that the second condition precedent to the duty to defend does not operate in this case. The limits of Boreal's primary policy were not exhausted by payment of the

plaintiffs' claims. Indeed, as Kansa accurately points out, Boreal's liability as determined by the trial judge for the 1986 policy period was less than the $2,000,000 limit of the Boreal policy.

[192] We accept Kansa's interpretation of the second of the two conditions precedent to its duty to defend. That condition expressly refers to "losses paid" and, in our view, negates any imposition of a duty to defend based on a mere claim in excess of the limits of the underlying policy.

[193] The interpretation of the first condition precedent to Kansa's duty to defend is more problematic. Kansa's interpretation is not an unreasonable one. We are, however, satisfied that there is another reasonable interpretation. The definition of occurrence relied on by Kansa is specifically limited to the use of that word "with respect to personal injury and property damage", both of which are defined terms. Occurrence as used in the opening language of the Insuring Agreement II is not tied to either personal injury or property damage, but rather to the phrases "covered under this policy" and "not covered by underlying policies". Occurrence must be interpreted in this context. The language seeks to draw a distinction between insurance policies based on coverage. Coverage has two components. It refers to risks covered and to amounts covered. A claim based on an event covered by a policy, but alleging damages beyond the limits of that policy is not covered by that policy. It is partly covered by that policy.

[194] Given the prospective language in the duty to defend covenant, we see no reason why the first condition precedent to Kansa's duty to defend should not be read prospectively. Where a claim alleges a harm that is covered by both the primary policy and excess policy, but seeks damages in excess of the limits of the primary policy, then that claim may or may not be covered by the primary policy. The potential that the primary policy will not fully cover any damages awarded is, in our view, enough to trigger the excess insurer's duty to defend. That is not to say that this potential is enough to eliminate the primary insurer's duty to defend. There is also the potential that the claim will be entirely covered by the underlying policy. For the same reason, the possibility that the claim will go beyond the first excess insurer's limits does not preclude that insurer's obligation to defend, although it may, depending on the language of the second excess insurer's policy, trigger a third duty to defend.

[195] In interpreting the relevant provisions of the Kansa policy, we have considered the blizzard of American authority provided by counsel. Some of those cases interpret provisions which are virtually identical to those found in the Kansa policy. Some offer support for the interpretation that a claim in excess of the primary insurer's limits is not covered by the primary insurer for the purposes of determining the excess insurer's obligation to defend. Most, however, favour the interpretation put forward by Kansa.

[196] We need refer only to *Azco Hennes Sanco, Ltd. v. Wisconsin Insurance Security Fund* 502 N.W. 2d 667 (Wis. App. 1993), as it is typical of the cases relied on by Kansa and refers to many of the authorities. In *Azco*, the court held that a clause which was virtually identical to paragraph A in Part II of the Kansa policy did not impose a duty to defend on the excess insurer in a case where the claim exceeded the limits of the primary insurer. In so holding, the court relied on four factors. First, it noted that the primary insurer had defended the action. The court suggested that the result may have been different had the primary insurer denied coverage. That is what happened in this case.

[197] Secondly, the court accepted and followed what it called the "majority rule", whereby an excess insurer is not obliged to defend until the primary policy limits are exhausted. It is clear after *Broadhurst & Ball*, *supra*, that there is no such majority rule in Ontario. If the excess insurer has a duty to defend, it may be called upon to provide that defence or to contribute to that defence before it is known whether the primary policy will be exhausted.

[198] Thirdly, the court accepted the argument that the word occurrence should be defined by reference to a specific event. For the reasons set out above, we do not accept that as the only reasonable interpretation of the word occurrence when it is used in conjunction with the phrases "covered by this policy" and "not covered by an underlying policy".

[199] Lastly, the court relied on a definition of "ultimate net loss" in the policy before the court. That definition specifically provided that the excess insurer was not liable for defence costs that were covered by other valid insurance. Given the opening words of the definition of "ultimate net loss" in the Kansa policy as set out above, we do not think that the definition of ultimate net loss can limit the duty to defend found in paragraph A of Part II of Insuring Agreement II.

[200] The American authorities go so far as to demonstrate that the Kansa policy may be open to more than one reasonable interpretation. They do not, however, convince us that the interpretation advanced by Kansa is the only reasonable interpretation. The interpretation which imposes a duty to defend on Kansa where the claim is in excess of the primary insurer's limits is, in our view, also a reasonable interpretation. Lafarge is entitled to the more favourable of these two reasonable interpretations.

[201] We are also satisfied that an interpretation which recognizes Kansa's duty to defend the claim is consistent with policy considerations. Those considerations are discussed in *Broadhurst & Ball*. In cases, and this is certainly a good example, where

several layers of insurance are exposed to potential liability, the full and early participation of all insurers who are potentially liable promotes settlement and expedites the trial process. These policy considerations cannot justify the imposition of a duty to defend where none exists. They can, however, assist in giving meaning to a covenant to defend which is open to more than one reasonable interpretation.

[202] Kansa's policy imposed a duty to defend. We are satisfied that Kansa's duty to defend arose when the plaintiffs made a claim in excess of Boreal's limits for which Kansa was potentially liable to indemnify Lafarge. Kansa's duty to defend was concurrent to that of Boreal.

[203] Since Kansa and Boreal had a concurrent duty to defend, it follows that the trial judge did not err in holding that the principle in *Broadhurst & Ball* had application. *Broadhurst & Ball* does not hold that an excess insurer with a duty to defend will be compelled to contribute to defence costs in each and every case where a claim exceeds the limits of the primary insurer. Robins J.A. recognized that the excess insurer's obligation to contribute, if any, was a "matter of equity" or "fairness" as among the insurers who were under a duty to defend the claim. The determination of the equities depends on the circumstances of the particular case. Those equities include the first in line status of the primary insurer, the nature of the risk insured by each insurer, the potential windfall to an excess insurer who was not obliged to contribute to a defence which potentially benefitted that insurer and the contractual obligation of the excess insurer to the insured. In considering the facts before him, Robins J.A. said at 240:

> While it may be that an excess liability insurer is generally under no duty to participate in the insured's defence until the primary coverage is exhausted, it is manifest here, indeed, it is common ground, that the potential judgment against the insured respondent substantially exceeds the amounts of the limits of the American Home primary policy and, should the action succeed, the primary policy will be exhausted. The excess carrier, Guardian, is plainly at risk. This is not a case in which it can be said that the amount claimed in the action, at least in terms of the insurer's liability, bears no or little relation to the true value of the claim. Furthermore, as I noted earlier, the action is difficult and complex and would involve a lengthy trial. The costs of defending it will undoubtedly run into the many thousands of dollars.

[204] All of the insurers refused to defend on Lafarge's behalf. The trial judge could, therefore, consider the equities described in *Broadhurst & Ball* based on the conduct of the trial and the findings he had made. Viewed from that perspective, the words of

Robins J.A. quoted above had direct application to this case. Although as it turned out, Boreal's limits were not exceeded for the 1986 policy period, there was a very clear and substantial risk that those limits could have been exceeded, depending on the trigger theory adopted by the trial judge. It was equally clear that Lafarge's defence based on a denial of liability potentially benefitted all insurers. Finally, this was a complicated trial in which the costs of the defence ran, not into the thousands of dollars, but into the millions of dollars.

[205] The trial judge did not err in applying *Broadhurst & Ball* to Kansa and requiring Kansa to contribute to the costs of Lafarge's defence.

[206] Scottish & York policy #10062 provided a level of excess insurance immediately above the Kansa policy. The Scottish & York policy contained the following provision:

> The coverage provided by this policy shall, except as herein stated, <u>follow the insuring agreements, conditions and exclusions of the underlying insurance</u> (whether primary or excess) immediately preceding the layer of coverage provided by this policy [emphasis added].

[207] Pursuant to this term, the Scottish & York policy, followed the terms of the Kansa policy. Those terms are analyzed above. Consequently, subject to an express provision to the contrary in its policy, Scottish & York had the same duty to defend as did Kansa.

[208] Scottish & York argues that the definition of ultimate net loss in its policy effectively excludes defence costs. Assuming that interpretation is correct, it is irrelevant to Scottish & York's duty to defend. The phrase "ultimate net loss" in the policy is used to describe the damages for which Scottish & York is required to indemnify Lafarge. The covenant to pay defence costs flowing from a duty to defend is distinct from the covenant to indemnify for damages. A limitation imposed on the latter does not limit the former. As Robins J.A. in *Broadhurst & Ball, supra*, at 233 said in reference to a limit on the amount the excess insurer was obliged to indemnify the insured:

> While the retention clause may limit the amount by which Guardian [the excess insurer] must indemnify the respondents where liability is established, it does not diminish Guardian's clearly stated duty to assume the defence of the insured.

[209] Scottish & York (and some of the excess insurers) also rely on the so called "assistance and co-operation" clause in their policy. Under the terms of that clause, Scottish &York could not be called upon to "assume charge of the settlement or defence of any claim" but did have the right to associate with the insured in the defence and

assume control of the defence. We agree with Scottish & York's submission that the "assistance and co-operation" clause does not assist the insured in establishing a duty to defend. Nor, however, does it preclude the existence of that duty. The "assistance and co-operation" clause must be read together with the incorporated clause in the Scottish & York policy imposing a duty to defend. Read together, they impose a duty to defend on Scottish & York, but give Scottish & York the option as to whether it will assume charge of the conduct of the defence. A decision not to assume charge of the defence will not negate Scottish & York's duty to defend and its consequential obligation to contribute to Lafarge's defence costs. Instead, the clause provided Scottish &York in cases such as this where more than one insurer had a duty to defend, with the option of whether it would assume charge of that defence.

[210] We are satisfied that Scottish & York, under the terms of its policy, was obliged to assume the defence of the action from Lafarge's behalf as did Kansa. The principle in *Broadhurst & Ball* has equal application to Scottish & York.

[211] The third level of excess insurance for the policy period 1986 was provided by Kansa policy #2503423. It contained the following provision:

> It is agreed that this policy, except as herein stated, is subject to all conditions, agreements and limitations and shall follow the primary insurance [in this case, Kansa policy #2503422].

[212] Kansa argues that its definition of loss in the coverage provision of policy #2503423 which excludes "expenses and costs" effectively excludes the incorporation of the duty to defend provision in the underlying Kansa policy. For the reasons set out above, we do not think that a definition of loss for the purposes of indemnification touches on the separate duty to defend undertaken by Kansa through the incorporation of the terms of the underlying Kansa policy. The analysis provided for the first Kansa policy is equally applicable to this policy.

[213] Scottish & York policy #10064 provided the fourth layer of excess insurance for 1986. Its terms were identical with the terms of its policy #10062, which provided the second layer of excess insurance for the same period. The analysis of the duty to defend and, hence, to pay defence costs applicable to policy #10062, apply to this policy. Scottish York had a duty to defend under policy #10064 as well.

(b) The 1987 policies

[214] Boreal was also Lafarge's primary insurer for the 1987 policy period. It provided coverage up to $1,000,000 and undertook to defend claims brought against Lafarge. The layers of excess insurance for the 1987 policy period up to $10,000,000 were as follows:

Scottish & York	$2,000,000
American Home	$4,000,000
Guardian Insurance	$3,000,000

[215] It is not necessary to reproduce the relevant provisions of the Scottish & York policy or the American Home policy. The former, as a first layer of excess insurance, contains an undertaking to defend in the same language found in the first layer of excess insurance provided by Kansa in 1986. The American Home policy follows the terms and conditions of the Scottish & York policy. For the reasons set out above, both had a duty to defend the claim against Lafarge and, according to the principle in *Broadhurst & Ball*, could be required to contribute to Lafarge's defence costs.

[216] Guardian, the third level of excess insurance for the 1987 policy period stands in a different position. Its policy provides:

> This policy is subject to the same warranties, terms and conditions (<u>except as regards to premium, the obligation to investigate and defend, the amount and limits of liability and the renewal agreement,</u> if any, except as otherwise provided herein) as are contained or may be added to
>
> a. the underlying insurance described in item 2 of the declaration.

[217] This condition forecloses the incorporation of any obligation to defend found in an underlying policy into the Guardian policy. The definition of ultimate net loss in the Guardian policy also excludes any expenses incurred in connection with the defence of the suit from the indemnity obligation of Guardian. In any event, Guardian was found not liable to indemnify Lafarge under the terms of its policy.

[218] Boreal acknowledges that the Guardian policy does not contain a duty to defend. Boreal submits, however, that even absent an explicit duty to defend, this court should imply that duty unless the excess policy clearly excludes the duty to defend. Guardian's policy does not expressly state that Guardian has no duty to defend. Boreal refers to California authority to support this contention (e.g. *Pacific Indemnity v. Firemen's Fund*

Insurance Company 223 Cal. Rptr. 30 (Cal. App. 2 Dist, 1989); *Interstate Fire & Casualty Company v. Stuntman Inc.* 861 F. 2d 203 (9th Cir. 1988).

[219] This court has vigorously interpreted ambiguities in insurance contracts in favour of the insured. It has, however, stopped short of rewriting those contracts: *Chilton et al. v. Co-operators General Insurance Co.* (1987), 143 D.L.R. (4th) 647 at 652 (Ont. C.A.). An invitation to imply a duty to defend into the Guardian policy is an invitation to rewrite that policy in a dramatic way. None of the limited bases upon which Canadian courts have been prepared to imply terms into a contract operate here: see *G. H. L. Fridman, The Law of Contract in Canada*, 4th ed., (Toronto: Carswell, 1999) at 514-516.

[220] Boreal also argues that, apart from any duty to defend that may be implied into Guardian's policy, it had "an equitable obligation of contribution" to defence costs where a claim threatened the indemnity provisions of Guardian's policy. This submission amounts to the claim that any excess insurer whose layer of insurance is threatened by a claim has a duty to contribute to the costs of the defence. We think this approach is inconsistent with *Broadhurst & Ball*, where Robins J.A. first considered whether the excess insurer had a duty to defend the action. It was only after concluding that such a duty existed that Robins J.A. turned to the question of the allocation of defence costs. He said at 234:

> Accepting that Guardian, as the excess insurer, and American Home, as the primary insurer, are under concurrent obligations to defend the respondents against the claims asserted in the Lumsden Building action, should the costs of defending the action be apportioned between these insurers, as American Home contends, and if so in what proportion.

[221] The principle in *Broadhurst & Ball* which holds that excess insurers may be required to contribute to defence costs is premised on the existence of a duty to defend on the part of the excess insurer. Without that duty, one does not reach the "equities of the matter" as among various insurers with a duty to defend.

[222] Guardian had no duty to defend. The trial judge erred in requiring Guardian to contribute to the costs of the defence.

(c) The 1988 policies

[223] Cigna was the primary insurer for the policy period 1988 and provided up to $1,000,000 in coverage. Reliance, as the first excess insurer provided the next $10,000,000 in coverage. The Reliance policy was virtually identical to Kansa's first excess policy for the 1986 policy period. It imposed a duty to defend in the same terms as set out in the Kansa policy. In addition, the definition of "ultimate net loss" used in setting out Reliance's coverage specifically included defence costs. Reliance had a duty to defend the claim made by the plaintiffs against Lafarge and, under the principle in *Broadhurst & Ball*, could properly be required to contribute to the defence where its layer of insurance was at risk.

(d) The 1989-92 policies

[224] Cigna was the primary insurer for the policy periods 1989-1992. National Union was the first excess insurer for the policy periods 1989 and 1990 and provided $15,000,000 in excess insurance. In the policy periods 1991 and 1992, that amount was increased to $25,000,000.

[225] The provisions governing the duty to defend in the National policy were virtually identical to those found in the 1986 first excess policy of Kansa. However, those terms were amended as of April 1, 1989 by what is referred to as the "Texas Amendatory Endorsement" (Texas Amendment). Prior to the amendment of Insuring Agreement II, under the heading "Defence, Settlement, Supplementary Payments", read as follows:

> The Company shall:
>
> (a) defend any suit against the Insured alleging liability under the provisions of this policy and seeking recovery for damages on account thereof even if such suit is groundless, false or fraudulent, but the Company shall have the right to make such investigation and negotiation and settlement of any claim or suit as may be deemed expedient by the Company;
>
> (b) pay all premiums on bonds to release attachments for an amount not in excess of the applicable limit of liability of this policy, all premiums on appeal bonds required in any such defended suit, but without any obligation to apply for or furnish such bonds, all costs

> taxed against the Insured in any such suit, all expenses incurred by the Company and all interest accruing after entry of judgment until the Company has paid, tendered or deposited in court that part of the judgment as does not exceed the limit of the Company's liability thereon;
>
> (c) reimburse the insured for all reasonable expenses incurred at the Company's request, (Including actual loss of wages or salary, but not loss of other income, not to exceed $75 per day) because of his attendance at hearings or trials at such request.
>
> The Company agrees to pay the amounts under this Insurance Agreement II, except in settlement of claims and suits, in addition to the limit of liability stated in the Declarations, and such defense and supplementary payments shall not be included as part of the ultimate net loss, as defined in the policy.
>
> The Insured shall promptly reimburse the Company (excepting Defense Costs) for any amount of ultimate net loss paid on behalf of the Insured within the retained limit specified in Item 3(A-2) of the Declarations.
>
> Insuring Agreement I and II shall cease to apply after the applicable limits of the Company's liability has been exhausted by payment of judgments or settlements.

[226] The "Texas Amendatory Endorsement" stated:

> In consideration for the payment of premium charged, it is hereby agreed that this policy is amended as follows: …
>
> Under INSURING AGREEMENTS, II, DEFENSE, <u>SETTLEMENT, SUPPLEMENTARY PAYMENTS, the words "The Company shall:" is replaced by: "The Company may:".</u>
>
> Under DEFINITIONS, (I), "ULTIMATE NET LOSS", <u>the words "investigation and defense of claims" are deleted.</u> [Emphasis added.]

[227] National contends that as a sophisticated consumer of multi-layered insurance schemes, Lafarge could only reasonably expect that the replacement of "shall" with

"may" would have the obvious effect of giving National the discretion to defend claims. National contends that Lafarge was in effect self-insured at the primary level given its agreement with Cigna, and was well positioned to assess the respective merits of absorbing its own defence costs at the excess level of insurance as against the costs of insurance which would compensate for those costs. National submits that Lafarge agreed to the terms of the Texas amendment and that there is no reason why this court should allow Lafarge to resile from that agreement.

[228] National's argument rests on the assertion that the Texas amendment unambiguously converts what was a duty to defend to a discretion to defend. That assertion must be tested by an examination of the entirety of the language of Part II of the insuring agreements affected by the amendment. Prior to the amendment, National undertook to:

- Defend suits against Lafarge (paragraph (a)).
- Pay all taxed costs in defended suits (paragraph (b)).
- Pay all expenses incurred by National in the defence of suits (paragraph (b)).
- Pay all post-judgment interest accruing until National paid the judgment or tendered the amount into court (paragraph (b)).
- Reimburse the insured for all reasonable expenses incurred at National's request (paragraph (c)).

[229] If "may" is to be given a permissive meaning, it would follow that National could in its discretion refuse to make any or all of the payments described above. Even where "may" is read as giving the party to an agreement a discretion as to whether it will perform a particular act, that discretion must be exercised reasonably. How could National reasonably refuse to pay costs ordered against Lafarge in a suit defended by National? How could National reasonably refuse to pay expenses incurred by National? How could National reasonably refuse to pay post-judgment interest on an outstanding judgment that it was obligated to satisfy? How could National reasonably refuse to reimburse Lafarge for reasonable expenses Lafarge had incurred on National's behalf? Reading "may" as permissive in respect of at least some of these undertakings by National results in a commercial absurdity. In those contexts, the word "may" must be read as mandatory. An examination of the provisions in the policy directly affected by the amendment suggests uncertainty as to the meaning of "may" in the amendment.

[230] The ambiguity becomes manifest when other parts of the Insuring Agreements are considered. Under the agreement, National:

> Agrees to pay the amounts incurred under this Insurance Agreement II, except in settlement of claims and suits, in addition to the limit of liability stated in the Declarations, and

> such defense in supplementary payments shall not be included as part of the ultimate net loss as defined in the policy.

[231] This commitment to pay is unaffected by the Texas amendment. However, if that amendment has the effect of changing the duty to defend to the discretion to defend, then the agreement to pay quoted above becomes virtually meaningless. In effect, it becomes an agreement to pay if National chooses to defend.

[232] The terms of the Insuring Agreements also provide that National's obligation to defend and pay expenses referred to in the Insuring Agreement "shall cease to apply after the applicable limits of the Company's liability have been exhausted by payment of judgments or settlements". This provision also becomes virtually meaningless and certainly redundant if National never has any duty to defend or pay those expenses but rather only the option to do so in its discretion.

[233] The word "may" is generally given a permissive meaning. It can, however, have a mandatory meaning if the context in which it is used mandates that meaning. Considering the Insuring Agreements in their entirety, we find the use of the word "may" as it relates to the duty to defend to be ambiguous. Applying the principles of construction referred to earlier, we prefer the meaning which favours Lafarge and recognizes a duty to defend. Consequently, we reject the submission that the Texas amendment distinguishes the National policy from the 1986 first excess policy of Kansa. National had a duty to defend that was concurrent to that of Cigna and the trial judge properly applied *Broadhurst & Ball* in requiring National to contribute to the defence of Lafarge for the relevant years.

4. The Apportionment of Defence Costs

[234] The excess insurers also take issue with the allocation of defence costs as among the insurers who were found to have an obligation to contribute to those costs. To some extent, these arguments repeat the claim that various excess insurers had no duty to defend under the terms of their policies. In addition, however, it is argued that the primary insurers bore the more significant risk of loss and should, therefore, be required to assume a larger proportion of the defence costs. Some excess insurers also contend that those costs should have been weighted toward the years which accounted for the bulk of the damages.

[235] As discussed above, *Broadhurst & Ball* holds that the allocation of defence costs as among insurers who have a concurrent obligation to defend is essentially a matter of

fairness as among those insurers. As such, the allocation of costs is not an exact science and a trial judge's determination is owed considerable deference.

[236] The after-the-fact allocation of defence costs in this case was not an easy matter and of necessity was somewhat arbitrary. The liability issues and the nature of the damages were such that there was no realistic way that defence costs could be connected to a specific policy period or an isolated event. The potential liability of the various insurers turned on the resolution of difficult issues which, as the arguments on this appeal demonstrate, remain the subject of strong controversy. Given the nature of the claims and the uncertainty as to which insurers would be required to indemnify, we are satisfied that an equal distribution of defence costs among the seven policy periods and an equal distribution among insurers with a duty to defend was fair and reasonable: see *Broadhurst & Ball*; *Canadian Indemnity Co. v. Simcoe & Erie General Insurance Co., supra*.

5. Lafarge's appeal

[237] Lafarge submits that Chubb and Hartford should have been required to contribute to defence costs. Chubb provided excess insurance beyond the first $10,000,000 for the policy years 1986 and 1987. Hartford provided similar coverage for the policy year 1988. Lafarge submits that under the terms of their policies, that Chubb and Hartford had a duty to defend the claim against Lafarge that arose when the claim was made. Lafarge further contends that as the damages awarded against it exceeded some $15,000,000, there was a real possibility that layers of excess insurance beyond the $10,000,000 limit would have been reached had the trial judge determined that $10,000,000 of the damages occurred in a single policy period.

[238] Chubb and Hartford deny any duty to defend under the terms of their policy. We need not examine those policies. Assuming without deciding that the duty to defend existed, it does not follow that Chubb and Hartford were automatically required to contribute to the costs of the defence. As indicated in *Broadhurst & Ball*, contribution as among the insurers with a duty to defend is a matter of fairness. A crucial consideration is whether the particular insurer was "plainly at risk" to indemnify the insured.

[239] The risk that the claim posed to the coverage provided by Chubb and Hartford was a matter for the trial judge. He had to make a realistic appraisal of the chance that either policy would be required to indemnify Lafarge. As *Broadhurst & Ball* indicates, that realistic appraisal involves more than a mere consideration of whether the claim is for an amount which would reach the policy's of Chubb and Hartford. It also entails an assessment of whether there is any realistic chance that those policies would be reached by the claim. Lafarge has not pointed to any error in the reasons of the trial judge which

would justify interfering with his conclusion that the plain risk to the excess insurers did not go beyond those insurers who provided coverage up to $10,000,000 for any policy period.

6. Conclusion

[240] The trial judge erred in holding that Guardian was responsible for part of the defence costs attributable to the policy period 1987. Guardian had no duty to defend and cannot be required to pay any part of Lafarge's defence costs for 1987. We would, therefore, allow Guardian's appeal against the judgment requiring it to pay a part of the defence costs for the 1987 policy period. Defence costs for that period should be divided equally among Boreal, Scottish & York and American Home. Except as regards to the finding against Guardian, we would dismiss all other appeals and cross-appeals relating to responsibility for defence costs and affirm the judgment of the trial judge.

G. Third Party Costs

1. Overview

[241] Lafarge was found liable for 80 percent of the plaintiffs' damages and Bertrand was found liable for 20 percent of those damages. The trial judge ordered Lafarge to pay 90 percent of the plaintiffs' costs. The additional 10 percent was imposed by the trial judge as a penalty for the manner in which counsel for Lafarge (not counsel on appeal) had conducted the defence. Lafarge was also ordered to pay 80 percent of Bertrand's costs. We will refer to the plaintiffs' and Bertrand's costs as third party costs.

[242] The trial judge held that the insurers who he had found were obligated to contribute to Lafarge's defence were also obligated to indemnify Lafarge for most of the third party costs. The insurers were not required to pay the penalty portion (10%) of the costs order made in favour of the plaintiffs. He apportioned those costs on the same basis that he had apportioned defence costs.

[243] The excess insurers submit that the trial judge erred in law in equating the obligation to pay third party costs with the obligation to pay defence costs. They argue that the obligation to pay defence costs flows from the existence of a duty to defend, but that the obligation to pay third party costs, if any, is part of the insurer's obligation to indemnify. The excess insurers contend that the scope of the obligation to indemnify, if any, depends on the terms of the policy. They maintain that their policies do not provide for the payment of third party costs as part of the obligation to indemnify.

[244] Lafarge and the primary insurers support the trial judge's ruling with respect to third party costs.

[245] Lafarge appeals the order that it pay the penalty portion (10%) of the plaintiffs' costs. Lafarge argues that having correctly held that certain of the insurers were obligated to indemnify Lafarge for third party costs under the terms of their policy, the trial judge erred by limiting that indemnification to exclude part of those costs. Lafarge argues that the trial judge should not have modified the contractual obligation to indemnify for all third party costs. Lafarge also submits that to the extent that its counsel's conduct merited adverse costs consequences, those consequences are properly borne by the insurers who could have and should have defended the action on behalf of Lafarge.

2. The Excess Insurers Appeals

[246] The trial judge's reasons offer some support for the contention that he did not give separate consideration to the obligation to indemnify for third party costs, but instead treated it as part of the obligation to contribute to defence costs. For example, he observed at 183 and 185:

> i. With so many parties advocating different interpretations, it is quite a challenge to determine which of these insurers has a <u>duty to defend and the corresponding obligation to contribute to defence and third party costs</u> …
>
> ii. … When a finding is made that an insurer has a duty to defend, it would follow logically that <u>such insurer would have the corresponding obligation to contribute to the costs of Lafarge's defence and third party costs</u> [emphasis added].

[247] We accept that an insurer's obligation to pay third party costs does not flow automatically from a finding that an insurer has a duty to defend. We do not, however, accept that the obligation to pay third party costs is necessarily part of, and limited to, the obligation to indemnify. The terms of the policy govern. A policy may not provide expressly for any obligation to pay third party costs, it may include payment of those costs as part of the indemnification obligation or the duty to defend obligation; or it may provide for payment of those costs in a separate covenant.

[248] Most of the excess insurers' policies address third party costs in the same covenant which addresses a duty to defend. This may well have led the trial judge to equate the two obligations.

(a) The 1986 Policies

[249] As indicated above, paragraph A of Insuring Agreement II of Kansa's first excess policy (see para. 186) required it to defend certain claims on Lafarge's behalf. We have held that this claim triggered that obligation. Paragraph B of Insuring Agreement II required Kansa to pay various costs and expenses incurred in the defence of those actions. Included among these costs and expenses was the obligation to pay:

> iii. …all costs taxed against the insured in any such suit…

[250] Kansa clearly undertook to pay third party costs and linked that obligation to its duty to defend. It did not link the obligation to its duty to indemnify under the coverage provisions of the policy. It is, therefore, irrelevant to Kansa's obligation to pay third party costs that its layer of coverage was not reached for the 1986 policy period. Nor did Kansa link its obligation to pay third party costs to the obligation of the underlying insurer to pay those costs. Even if Boreal had an unlimited obligation to pay third party costs under the terms of its policy, that obligation would not preclude the obligation on Kansa to pay third party costs where it had a duty to defend. Those concurrent obligations would, however, give rise to a need to equitably apportion third party costs as among the various insurers who had undertaken to pay them.

[251] The trial judge correctly concluded that Kansa was obliged to contribute to third party costs.

[252] Scottish & York policy #10062 provided the second layer of excess insurance for 1986. It followed the form of the Kansa policy and, therefore, like that policy, contained an obligation to pay third party costs which was tied to the obligation to defend and not to the separate obligation to indemnify contained in the policy. There is no basis upon which to distinguish the Scottish & York policy from the Kansa policy in so far as the obligation to pay third party costs is concerned.

[253] The second Kansa policy provided the third layer of excess insurance for 1986. Condition one of that policy provided that except as stated in the policy, it was subject to "all conditions and agreements and limitations" in the primary insurance. The first Kansa excess policy was the primary insurance for the purposes of this policy. Although the second Kansa policy contains a different definition of loss than the first excess policy,

that does not alter Kansa's obligation under this policy to pay third party costs. As indicated previously, that obligation is not tied to the duty to indemnify for damages. Loss is used in connection with the latter obligation. Kansa's obligation to contribute to third party costs under the second Kansa policy was the same as under the first excess policy.

[254] The fourth and final layer of excess insurance for 1986 was provided by the second Scottish & York policy. Counsel concedes that it is to the same effect as the first Scottish & York excess policy. We agree. Like the first policy, it imposed an obligation to pay third party costs that was linked to the obligation to defend the claim.

(b) The 1987 Policies

[255] The first layer of excess insurance for 1987 was provided by Scottish & York. The policy is virtually identical to the first excess policy provided by Kansa for 1986. The Scottish & York policy, like the Kansa policy, contained an express obligation to pay taxed costs if the insurer was under an obligation to defend the action. We have already held that Scottish & York was under that obligation under the terms of the 1987 policy. We, therefore, conclude that the trial judge properly held that Scottish & York was liable for third party costs for the 1987 policy period.

[256] The second layer of excess insurance for 1987 was provided by American Home. Its policy followed the form of the Scottish & York policy. It is not suggested that there is any relevant distinction between those policies in so far as the obligation to pay third party costs is concerned. We would hold that American Home had the same obligation as Scottish & York to pay third party costs for the 1987 policy period.

[257] The third layer of excess insurance for 1987 was provided by Guardian. As indicated above (see para. 216), Guardian followed the form of the underlying policies, but specifically did not incorporate the obligation to defend found in those underlying policies. There was no obligation to defend in the Guardian policy. Boreal argues, however, that as Guardian did not specifically exclude the obligation to pay third party costs from the provisions of the underlying policies that were incorporated into Guardian's policy, that Guardian had a duty to pay those costs. We cannot agree. The obligation to pay third party costs in the underlying policies was tied to the obligation to defend. Where there was no obligation to defend, there was no obligation to pay third party costs. It was not a freestanding obligation. Consequently, by excluding the obligation to defend provisions from its policy, Guardian effectively excluded the companion obligation to pay third party costs.

[258] Guardian can also not be made responsible for third party costs through its obligation to indemnify Lafarge for damages owed to the plaintiffs. Assuming that the obligation to pay third party costs is included in Guardian's obligation to indemnify, that obligation was never triggered in this case. The limits of Guardian's policy were not reached and Guardian's "rip and tear" exclusion placed the plaintiffs' claims beyond the reach of the Guardian policy.

[259] Guardian should not have been held liable to pay any part of the third party costs.

(c) 1988 Policies

[260] Reliance provided the excess coverage for 1988. The terms of that coverage cannot be distinguished from the coverage provided by Kansa's first excess policy for 1986. Reliance, like Kansa, had an obligation to pay third party costs assessed against Lafarge.

(d) 1989-92 Policies

[261] National provided excess coverage for the policy period 1989 to 1992. In its Insuring Agreements, it had undertaken to pay "all costs taxed against the insured" in any lawsuit in which it had a duty to defend. The duty to defend was described in the same terms as found in the 1986 Kansa policy.

[262] The Insuring Agreements were, however, amended by the Texas Amendment described above (see para. 225). We have held that the endorsement did not convert the duty to defend in the Insuring Agreements to an option to defend at the discretion of National. It would make no commercial sense to hold that while National had a duty to defend in the circumstances described in the policy, it had a discretion to pay costs awarded against the insured in suits that it had a duty to defend. One would wonder when would it ever exercise that discretion in favour of paying those costs. The reasons which led us to conclude that "may" should not be read as permissive as it relates to National's undertaking to defend also leads us to conclude that it should not be read as permissive in relation to National's undertaking to pay third party costs. In our view, the National policy imposed an obligation on National to pay taxed costs in claims to which it had a duty to defend. It had that duty in this case.

3. The Apportionment of Third Party Costs

[263] Our reasoning in respect of the apportionment of defence costs has equal application here and we would not interfere with the trial judge's apportionment of the third party costs.

4. Conclusion

[264] We would affirm the trial judgment as it relates to liability for third party costs and apportionment of those costs, except as it applies to Guardian. We would allow Guardian's appeal, hold that Guardian had no responsibility for third party costs and dismiss this claim as against Guardian. Liability for third party costs in the 1987 policy period should be apportioned equally among the remaining insurers who had a duty to pay such costs for the 1987 period (Boreal, Scottish & York and American Home).

5. Lafarge's Appeal

[265] Although Lafarge was held 80 percent responsible for the plaintiffs' damages, it was required to pay 90 percent of the plaintiffs' costs. Its appeal from that order was dismissed in the earlier judgment of this court dealing with the appeals from the main action.

[266] Lafarge now argues that its insurers should have been required to pay all of its third party costs, including the 10 percent imposed as a penalty to reflect the trial judge's disapproval of the manner in which the trial had been conducted on behalf of Lafarge.

[267] Provisions in an insurance contract cannot bind a trial judge in the exercise of her discretion as to the appropriate costs order: *Darling v. Kay* (1993), 15 O.R. (3d) 299 (Ont. Gen. Div.). Clearly, the existence of an undertaking to indemnify to third party costs, and the insurer's failure to take control of the defence of the action were factors which were relevant to the trial judge's determination of whether the penalty component of the costs order should be tacked on to the insurers. On the other hand, the conduct of Lafarge's counsel which attracted the penalty went well beyond what could reasonably have been expected by the insurers. The placement of the burden of the penalty was ultimately for the trial judge and we cannot disagree with his conclusion that Lafarge should bear that burden.

H. Appeals from costs orders made in proceedings brought against Lafarge's Insurers

[268] Three aspects of the trial judge's costs order are relevant on appeal. He held that the successful insurers should have their costs against Lafarge on a party-and-party basis. He further held that those successful insurers who had made offers to settle should have their costs from Lafarge on a solicitor-and-client basis after the date of the offers. Lastly, the trial judge made a partial *Bullock* order requiring the insurers who were liable to contribute to Lafarge's defence costs to indemnify Lafarge for the costs it owed to the successful insurers up to the start of the trial. Lafarge was responsible for those costs after that date.

[269] Lafarge seeks leave to appeal all three parts of the costs order summarized above. Some of the excess insurers seek leave to appeal the order requiring them to indemnify Lafarge for part of the costs it owed to the successful insurers.

[270] Lafarge submits that it should not have been obliged to pay the costs of the successful insurers. It contends that those insurers had a duty to defend and even though they were not ultimately obliged to contribute to defence costs, they should not be rewarded for having failed to defend the action.

[271] This argument cannot succeed. Lafarge's claim against the successful insurers failed completely. There is no reason not to apply the general rule that a successful party should have its costs on a party and party scale.

[272] Lafarge next argues that the successful insurers who made an offer to settle should not have received solicitor and client costs after the date of the offer. In making that order, the trial judge said, at 22, supplementary reasons:

> For those excess insurers [successful insurers] who have made offers they will be entitled to party/party costs prior to the date of their offer and to solicitor/client costs after the date of the offer <u>in accordance with the rules</u> [emphasis added].

[273] The trial judge's language suggests that he interpreted rule 49.10 which deals with the costs consequences of the failure to accept an offer as dictating that the successful insurers should have solicitor and client costs after the date of the offer. That rule does not address the effect of rejected offers made by defendants where an action is dismissed. This court has held however, that in applying rule 57.01, the rule which addresses the

principles generally applicable to costs awards, a trial judge should consider a defendant's offer to settle, and may where the action is dismissed, order solicitor and client costs from the date of the defence offer: *S & A Strasser Limited v. Richmond Hill (Town)* (1990), 1 O.R. (3d) 243 (C.A.).

[274] The trial judge found that there was no good reason for Lafarge to maintain its action against the successful insurers throughout the trial. This finding combined with the offer made by some of the successful insurers justified an order of solicitor and client costs from the date of the offer. Indeed, counsel for Lafarge in his oral submissions conceded that an order for solicitor and client costs from the date of offers made by some of the successful insurers was "totally reasonable under the rules". We will not interfere with this order.

[275] Lafarge submits that the *Bullock* order should have extended to all costs Lafarge was required to pay to the successful insurers. Most of the insurers who are adversely affected by the *Bullock* order do not challenge it on appeal. Two of the insurers argue that the order should not have been made as each of the claims against the various insurers was independent of the claims against the other insurers.

[276] We cannot say that a *Bullock* order was inappropriate in the circumstances of this case. The claims against the respective insurers were independent of each other, but were closely interrelated. They cannot be described as separate and distinct claims. Applying the principles set down in cases like *Hock (next friend of) v. Hospital for Sick Children* (1998), 79 A.C.W. S. (3d) 464 (Ont. C.A.) and *Mortimer et al. v. Cameron et al.* (1994), 17 O.R. (3d) 1 (C.A.), we are satisfied that it was open to the trial judge to make a *Bullock* order.

[277] The trial judge's conclusion that the *Bullock* order should apply only to costs incurred prior to trial reflected his finding that it was unreasonable for Lafarge to maintain its action against the successful insurers beyond the commencement of the trial when it should have been evident that the claims would not reach the policies of those insurers. This assessment was reasonably open to the trial judge and we see no reason to interfere with that conclusion. Indeed, its reasonableness is perhaps best demonstrated by the fact that most of those adversely affected by the order do not challenge it. We would not interfere with the partial *Bullock* order made by the trial judge.

[278] We would grant leave to appeal on the costs issues but would dismiss those appeals.

<u>Disposition</u>

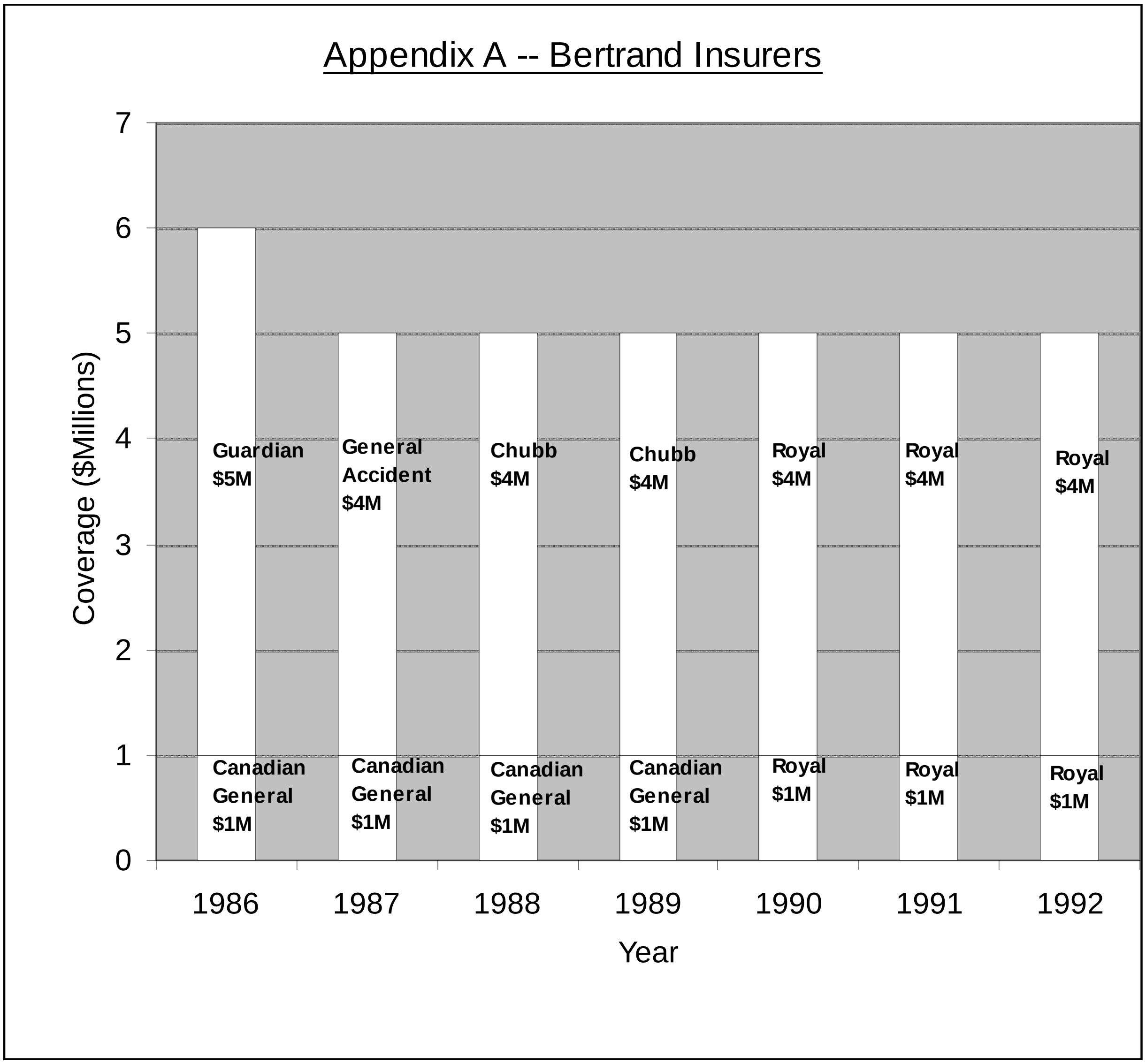
[279] The Appeal by Guardian Insurance Company of Canada against that portion of the judgment requiring it to pay a part of the defence costs for the 1987 policy period is allowed. In all other respects the appeals and cross appeals are dismissed.

[280] Given the disposition of the appeals and cross-appeals, we anticipate that many of the issues relating to the costs of the appeals and cross-appeals can be resolved by counsel. Counsel should discuss matters relating to the costs of the appeals and hopefully arrive at a consensus on at least some of these issues. Once those discussions have gone as far as they usefully can, arrangements should be made for a conference call with Justice Doherty to determine how best to proceed to resolve any outstanding costs issues. The conference call should be arranged no later than forty-five days after the release of these reasons.

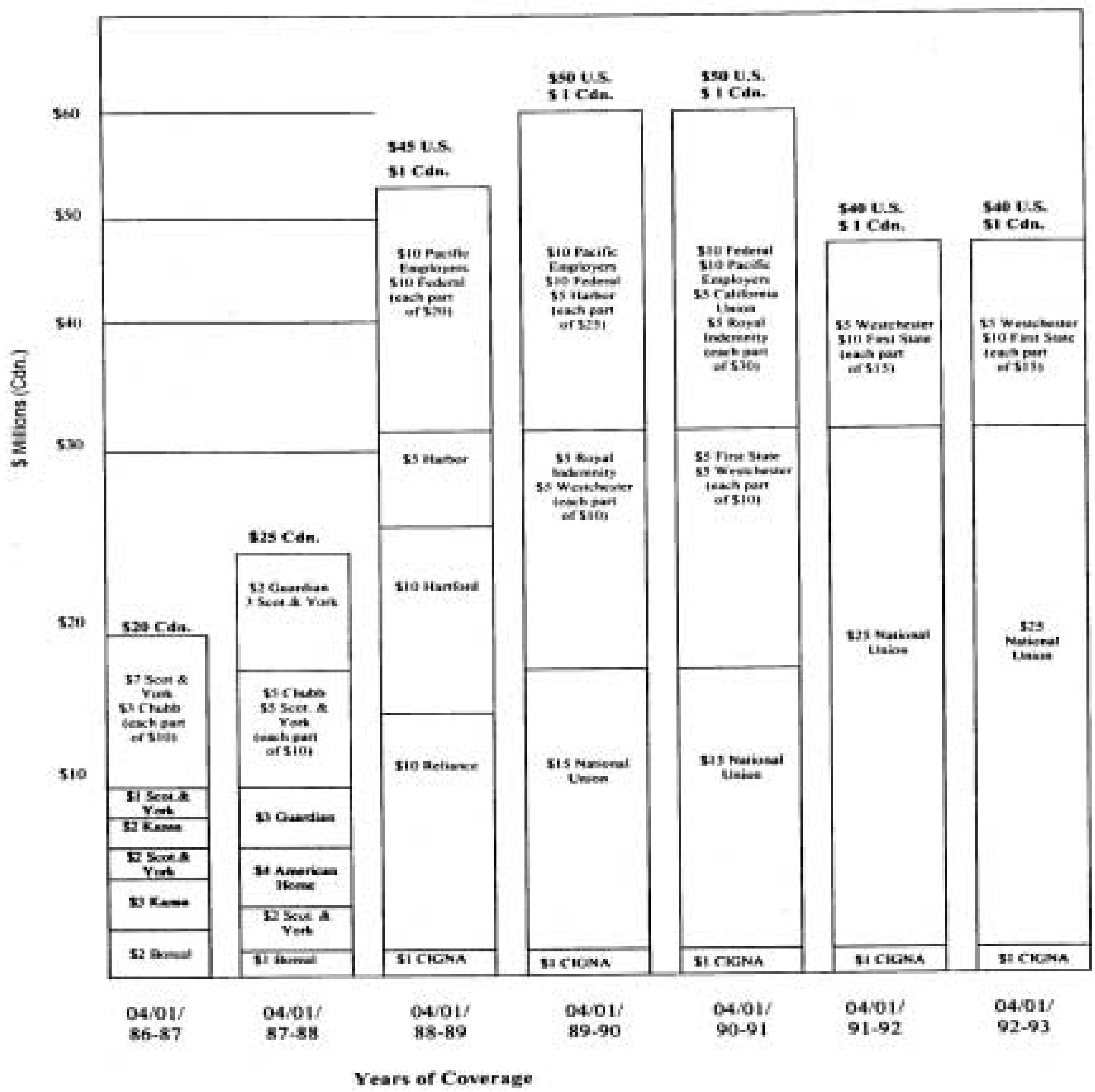
RELEASED: "DEC 06 2002"

"DD"

"Doherty J.A."
"Louise Charron J.A."
"K. Feldman J.A."



Chubb Insurance Company of Canada ("Chubb")
Royal Insurance Company of Canada ("Royal")
Canadian General Insurance Company ("Canadian General")
The General Accident Assurance Company of Canada ("General Accident")
Guardian Insurance Company of Canada ("Guardian")



Appendix B – Lafarge Insurers

Boreal Insurance Inc (“ Boreal”)
CIGNA Insurance Company of Canada (“Cigna”)
Kansa General International Insurance Company Ltd. (“Kansa”)
Scottish & York Insurance Co. Limited (“Scottish & York”)
National Union Fire Insurance Company of Pittsburgh, P.A. (“National Union”)
Reliance Insurance Company (“Reliance”)
American Home Insurance Company (“American Home”)
First State Insurance Company (“First State”)
Westchester Fire Insurance Company (“Westchester”)
Hartford Casualty Insurance Company (“Hartford”)
Harbor Insurance Company (“Harbor”)
Pacific Employers Insurance Company (“Pacific”)
Federal Insurance Company (“Federal”)
Royal Indemnity Company (“Royal Indemnity”)
California Union Insurance Company (“California Union”)
Guardian Insurance Company of Canada (“Guardian”)

APPENDIX C

Name	Proportion (%)
Boreal Insurance Inc.	8.33
Kansa General International Insurance Company Ltd.	4.76
Scottish & York Insurance Co. Limited	8.33
American Home Insurance Company	3.57
Guardian Insurance Company of Canada	3.57
CIGNA Insurance Company of Canada	35.72
Reliance Insurance Company	7.14
National Union Fire Insurance Company of Pittsburgh, P.A.	28.58