CITATION: PCL Constructors Canada Inc. v. Allianz Global Risks US Insurance Company, 2014 ONSC 7480
COURT FILE NO.: CV-12-450943
DATE: 20141230

ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N:	
PCL CONSTRUCTORS CANADA INC. AND FLYNN CANADA LTD. Plaintiffs	*Jamieson Halfnight* and *Anne Thompson* for the plaintiffs
- and -	
ALLIANZ GLOBAL RISKS US INSURANCE COMPANY, COMMONWEALTH INSURANCE COMPANY AND AVIVA INSURANCE COMPANY OF CANADA Defendants	*Murray Stieber* and *Grace Leung*, for the defendants
	HEARD: December 19, 2014

F.L. Myers J.

REASONS FOR DECISION

Background

[1] The parties move consensually under rule 22 of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194, to resolve this action by way of a Special Case. They have agreed upon the facts and the issues for resolution. While they are to be commended for their effort and ingenuity in bringing this matter forward in the most expeditious, affordable, and proportionate way, the mechanism that they have chosen may not quite fit their purpose. Rule 22 provides for a Special Case to be used to determine an issue of law that might "dispose of all or part of the proceeding,

substantially shorten the hearing or result in a substantial saving of costs". The problem here is that the issues that the parties have identified for resolution include an issue of fact or mixed fact and law rather than a question of law alone. As discussed below, the court does not have all of the facts needed to answer one of the questions that arises in the Special Case. The court has the authority to draw reasonable inferences of fact under rule 22.05(1). Counsel were clear and resolute in oral argument that the clients do not want a trial and they are content for the court to draw inferences as required. The practical question for the court is whether there is a fair and just basis upon to do so on the facts as agreed.

[2] The issue in this Special Case is whether the defendant insurers are liable to reimburse the plaintiffs for the sum of $512,346 that the plaintiffs spent to repair damage to their construction project. For the reasons set out below, the court finds that the insurance policy does apply to require the defendants to indemnity the plaintiffs for the loss in the agreed upon amount subject to one uncertain deduction that remains to be resolved.

The Basic Facts

[3] The following facts are summarized from the parties' Special Case as filed.

[4] The plaintiffs are the contractor and a subcontractor, respectively, on a construction project located at Maple Leaf Square in downtown Toronto. The plaintiff Flynn Canada Ltd. was retained by the contractor PCL Constructors Canada Inc. to construct and install an aluminium frame to support the outer wall of the building that was under construction. The outer wall was to be comprised mostly of windows. The aluminium frame pieces in which windows were to sit are called "mullions". The mullions are roughly "U" shaped so that glass panes can fit into them. In this case the mullions became corroded due to exposure to a corrosive liquid (water containing salt and urea used for snow and ice melting) that became trapped in sealed mullions. The plaintiffs spent $512,346 opening, cleaning, and re-facing damaged mullions.

[5] The plaintiffs claim that they are entitled to be indemnified for the cost to repair the damage under the terms of an AON Builder's Risk Policy (No. 14190) for which the defendants are the current insurers. The defendants deny liability under the policy due to exclusions from coverage of loss or damage caused by corrosion and faulty workmanship.

The Insurance Policy

[6] The defendants accept that the plaintiffs are additional insureds who are entitled to coverage under the insurance policy if it applies on the facts.

[7] The insuring agreement provides that the property as described (which term includes the mullions) is insured against "all risks of direct loss or damage …except as hereinafter excluded".

[8] There is no issue in this case of consequential or resultant loss as was the issue in the seminal authority relied upon by both parties *Consolidated-Bathurst Export Limited v. Mutual Boiler and Machinery Insurance Company*, 1979 CanLII 10 (SCC). In the case at bar, the sole damage is to the mullions themselves. There is no indemnity claimed for damage to other building elements caused by the damage to the mullions.

[9] There is no real issue but that the damage in this case falls within the insuring agreement and that the defendants must reimbursthe plaintiffs for the damage to the mullions unless the loss is excluded elsewhere in the policy. The parties also accept that the loss was fortuitous in the sense that it is the kind of loss captured within the intent of an all risks policy.

[10] The perils that are excluded from coverage are set out in Clause 5 of Section II of the policy and include the following:

> 5(d) This Policy does not insure against faulty or improper workmanship…; however, in the event of loss or damage caused in whole or in part by…faulty workmanship…this exclusion shall apply only to the direct costs that would have reasonably been incurred to rectify such fault(s) immediately prior to the commencement of such loss or damage [. S]uch loss or damage shall be deemed to be Resultant Damage as Defined in Clause 38 of Section I of this policy.[1]
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> ***
>
> 5(j) Loss or damage caused directly or indirectly by rust or corrosion, frost or freezing, pollution or contamination unless caused directly by a peril not otherwise excluded herein.

[11] Each of these exclusions has its own internal limitations that need to be considered in order to determine whether the exclusion applies and, if it does, to what extent.

The Cause of the Corrosion of the Mullions

[12] The following facts are also summarized from the Special Case as filed.

[13] The corrosion of the mullions was caused by the presence of urea and salt in the liquid within the mullions. It is normal to expect that a certain amount of liquid will enter mullions during the construction process. However, the volume and composition of the liquid in this case was "unusual". The unusual and corrosive condition was brought on by:

(a) The exposure of the mullions to road spray of de-icing salt used on the Gardiner Expressway that was adjacent to the construction site;

(b) PCL used a mixture of water and urea to melt snow and ice on upper slabs of the building under construction. The corrosive liquid was drained through pipes and washed over the outer wall of the building while it was under construction;

(c) During the construction generally, the mullions were exposed to the elements including de-icing liquid and road spray;

[1] I have inserted a period ["."] and a capital "S" with the consent of the parties who agree that there is no other sensible grammatical reading to this clause.

(d) Where horizontal mullions met vertical mullions, Flynn caulked the joints on most or on all four sides which prevented accumulated corrosive liquid from draining out of the horizontal mullions; and

(e) The salt and urea corroded the mullions from the inside out.

Analysis

[14] The majority of the Supreme Court of Canada in *Consolidated-Bathurst, supra,* set out the basic principles applicable to the construction of an insurance policy. First, the contract is interpreted as any other contract would be to determine the intention of the parties from the words they used in the surrounding circumstances objectively assessed. Then, if ambiguity is found – that is, if there are two or more clear alternative interpretations open - then the rule of *contra proferentem* leads the court to adopt the interpretation that is contrary to the interests of the drafter of the policy. It is assumed that the drafter has the burden to clearly exclude perils that it undertakes in the insuring agreement.

[15] There is no ambiguity in the corrosion exclusion of this policy. The exclusion at Clause 5(j) uses the precise format to clearly exclude a risk that was suggested by the majority of the Supreme Court of Canada in *Consolidated-Bathurst, supra,* at pp. 898-899. Accordingly, it effectively excludes from coverage loss or damage caused by corrosion.

[16] The exclusion for rust and corrosion is generally understood in the law to relate to the normal risk of wear and tear of property left exposed to the elements. Such natural processes are not considered to be "fortuitous" events of the type encompassed by an all risks policy. *University of Saskatchewan v. Fireman's Fund Insurance Company of Canada*, 1997 CanLII 9789 (SK CA) at para. 7. That may explain why Clause 5(j) also excludes losses caused by frost, freezing, and pollution.

[17] Absent another interpretative aid, an issue might arise as to whether the *ejusdem generis* rule of construction might limit the meaning of "corrosion" to only "naturally occurring corrosion" rather than corrosion brought on by untimely exposure to corrosive liquid as occurred in this case. However, there is no need to resort to such uncertain interpretive questions in this Special Case. The drafters of the policy have provided an answer by excepting from the exclusion for corrosion, damage or loss that is "caused directly by a peril not otherwise excluded herein". That is, where corrosion is caused by a peril that is covered within the insuring agreement and is not otherwise excluded by another exclusion, then the corrosion damage is not excluded; it is covered by the insurance policy.

[18] In this case, the policy wording is clear and unambiguous and can be applied readily on the agreed facts. The parties expressly agree in para. 19 of the Special Case that "[t]he corrosion was caused by the presence of urea and salt in the liquid within the mullions". Moreover, they agree that this was "unusual" and, as noted above, that the events were sufficiently fortuitous to fall within the insuring agreement. That is, the parties agree that this corrosion was not caused naturally but by an insured peril. Thus, they have agreed that the corrosion in this case is indeed covered by the policy unless it is excluded elsewhere. There is no need to distinguish between

direct and indirect losses or to look any further than the plain and ordinary meaning of the words used in the policy to reach these conclusions.

Is there an Exclusion Applicable? Three Issues for Resolution:

[19] The defendants argue that there is another exclusion that applies that prevents the exception from the corrosion exclusion in Clause 5(j) from saving the insurance in this case.

[20] The defendants argue that all of the causes of the corrosion in this case – the (un)fortuitous combination of circumstances that led to the mullions being exposed to corrosive liquid - were the fault of the plaintiffs' workmanship. They say that the plaintiffs ought to have guarded against exposure of the mullions to de-icing liquid and road spray. They say that it was reasonably foreseeable, if not obvious, that PCL's act of pouring corrosive liquid down the sides of the building while under construction might expose building components to the corrosive liquid. Moreover, they say that it was reasonably foreseeable, if not obvious, that when Flynn caulked mullion joints on all four sides, it was preventing any corrosive liquid in the mullions from draining.

[21] The defendants therefore argue that, on the facts as admitted and reasonable inferences drawn from those facts, the corrosion was caused by "faulty workmanship" and is therefore excluded under Clause 5(d).

[22] The court expressed some concern at the hearing about the lack of expert evidence to inform it as to normal, reasonable construction processes. In all however, especially considering the washing of corrosive liquid over the sides of the building, it strikes the court as inescapable that the peril in this case was caused in whole or in part by faulty workmanship. I do not need to go further and find negligence. All of the agreed upon causes of the unusual exposure of the mullions to corrosive liquid were readily preventable by the exercise of foresight and care by one or both of the plaintiffs. Their own acts in handling well understood Toronto winter conditions caused the peril.

[23] But, as quoted above, the "exclusion" for faulty workmanship is not actually an exclusion at all. Rather, it is a deeming clause that provides special treatment of losses or damage caused by faulty workmanship. The loss or damage caused by faulty workmanship is not excluded. To the contrary, it is deemed to be "Resultant Damage" which is covered by the policy. All that is excluded under Clause 5(d) (and the definition of Resultant Damage that is at Clause 38(f) of Section I of the policy) is the direct costs that would have reasonably been incurred to rectify such fault(s) immediately prior to the commencement of such loss or damage.

[24] That is, under the faulty workmanship "exclusion", the insurer does not pay the cost that would have been incurred by the contractor or subcontractor to have done the work right the first time. This protects the insurer from the moral hazard of contractors under-spending on materials or labour and then passing on the risk of their own poor performance to the insurer.

[25] However, despite being called an "exclusion", the damage or loss caused by the faulty workmanship itself is not excluded from coverage as noted above.

[26] Three issues arise on this understanding of the policy:

a. Is the fact that the mullions were exposed to corrosive liquid due to faulty workmanship a basis to prevent the exception from the exclusion for corrosion from applying?

b. If the corrosion exclusion does not apply to prevent the plaintiffs' recovery, does the faulty workmanship exclusion apply to exclude from the plaintiffs' recovery the direct costs that would have reasonably been incurred to rectify such fault(s) immediately prior to the commencement of such loss or damage? and

c. If the faulty workmanship exclusion applies to exclude the cost of proper workmanship as in (b), what would have been the cost to prevent the mullions from being exposed to the corrosive liquid that is to be deducted under the faulty workmanship exclusion?

Faulty Workmanship is not an Exclusion that allows the Corrosion Exclusion to Apply

[27] Under Clue 5(j), the corrosion exclusion excludes from coverage loss or damage caused by corrosion "unless caused directly by a peril not otherwise excluded herein." The insurers argue that regardless of how one interprets the effect of the faulty workmanship exclusion, the fact that it applies is enough to prevent the exception from the exclusion for corrosion from saving this claim. They argue that damage caused by faulty workmanship is excluded from coverage and that therefore the corrosion of the mullions was not caused by "a peril not otherwise excluded herein". Therefore it is excluded by the corrosion exclusion.

[28] But is the peril of faulty workmanship "otherwise excluded herein"? In looking at the words used, I do not read the corrosion exclusion as having the effect of enlarging the faulty workmanship exclusion. Notwithstanding being called an "exclusion" the faulty workmanship provision does not exclude from coverage loss or damage caused by faulty workmanship. In fact, it expressly preserves coverage for that damage by deeming it to be "Resultant Damage". The "peril" is not "excluded" at all. Instead a deduction is required based upon a substitute calculation designed to prevent the moral hazard of underperformance by the insured.

[29] On this reading of the faulty workmanship provision, the exposure of the mullions to corrosive liquid was "caused directly by a peril not otherwise excluded herein" because loss or damage caused by faulty workmanship is *not* excluded from coverage by the policy. However, even if I am incorrect in this reading of the policy on its plain wording, given that two clear alternative meanings of the policy are arguable, the doctrine of *contra proferentem* applies to reject the reading that favours the drafter. Accordingly, for both of these reasons, the corrosion exclusion does not apply to the exposure of the mullions to the corrosive liquid in this case.

The Faulty Workmanship Provision applies on its own Terms

[30] The second question then is whether the faulty workmanship provision nevertheless requires the deduction from the plaintiffs' recovery of the direct costs that would have reasonably been incurred to rectify the exposure of the mullions to corrosive liquid immediately prior to the corrosion. Although the corrosion exclusion does not apply because loss or damage

from faulty workmanship is not excluded from coverage, that does not mean that faulty workmanship has not occurred or has no effect. Under the terms of Clause 5(d), where faulty workmanship causes loss or damage, in whole or in part, then a deduction is required of the direct costs that would have reasonably been incurred to rectify such fault(s) immediately prior to the commencement of such loss or damage.

What was the Cost of Proper Workmanship?

[31] This brings to the fore the third issue listed above. How much would PCL and Flynn have had to spend to avoid the exposure of the mullions to corrosive liquid? That is a factual question on which the Special Case is silent. It is not a question of law. Can the court reasonably draw an inference on the facts that would help resolve the issue?

[32] In *Glassman v. Honda Canada Inc.*, 1998 CanLII 7192 (ON CA), Weiler J.A. wrote:

> An inference is the drawing of a conclusion from a proposition. There must be a rational basis or connection between the evidence proving or establishing certain facts and the proposition before the conclusion can be drawn: see generally W. Little, ed., Shorter Oxford English Dictionary: On Historical Principles (Oxford: Oxford University Press, 1973); R. J. Delisle, Evidence: Principles and Problems, 4th ed. (Scarborough: Carswell, 1996) at p. 23; Jeffs v. Matheson, 1951 CanLII 107 (ON CA), [1951] O.R. 743 (C.A.).

[33] She also noted:

> Where the inference drawn by the judge of first instance is unsupported, improperly drawn and unreasonable, an appellate court has a duty to intervene: Jengle v. Keetch (1992), 1992 CanLII 7496 (ON CA), 7 O.R. (3d) 187 at pp. 191-92, 89 D.L.R. (4th) 15 (C.A.).

[34] While the court could muse as to various possible steps that might have been taken by PCL and Flynn to pre-empt the listed causes of the corrosion, there is no evidence before the court that could prove or provide even a basis to infer that one step or another might have been effective in preventing the corrosion from occurring or the cost of performing any such work. The court has little hesitation in assuming that the lowest cost effective alternative would have been chosen by the plaintiffs to avoid the corrosion of the mullions (See by analogy, *Hamilton v. Open Window Bakery Ltd.*, 2004 SCC 9 at para. 20). The problem is that there is simply no evidence in the Special Case to allow the court to make this determination or on which to base a reasonable inference.

How to Resolve this Factual Issue

[35] The defendants' counsel argued that the burden is on the plaintiffs to establish the applicability of an exception to an exclusion in an insurance policy. While this is a generally correct proposition of law, the court has already determined that the exception to the exclusions in Clause 5(j) applies as matter of interpretation and that the faulty workmanship provision applies as well. The issue remaining is the factual question of how much money is to be deemed excluded or deducted under the faulty workmanship calculation. What would it have cost the plaintiffs to avoid the corrosion at the outset? This is not a question of burden of proof on the

applicability of an exclusion or an exemption from an exclusion. It is a question of fact or perhaps mixed fact and law.

[36] The practical question for the court is what to do when parties submit an agreed upon Special Case that does not provide the facts required to support the outcome sought? The court is in no way critical of the parties or counsel in arriving at this position. It is apparent from the parties' respective *facta* that arguments evolved after the Special Case had been agreed upon. As a result of the evolution of arguments, further facts have become relevant. Whether this might be an issue for costs remains to be seen.

[37] The court is not inclined to dismiss the Special Case. A Special Case was arguably never the correct process inasmuch as the central question for resolution – the interpretation of the insurance contract - was always a mixed question of fact and law and not a question of law (See: *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53 (CanLII) at para. 50). However, the court should strain to support parties' efforts to resolve matters expeditiously where it can do so fairly and in the interests of justice. Had the parties titled their motion as a motion for summary judgment under rule 20 and then brought forward the exact same agreed facts and the exact same issues for resolution, there would have been no difference in process or in substance. The court would have heard the exact same motion and would be facing the exact same question. There is no question of a party seeking a procedural or strategic benefit or leg up through the improper use of the rules. This is a clear case of a *bona fide* and cooperative effort to bring a matter on for hearing expeditiously, affordably and proportionately and the issues shifting to bring a factual question forward that was not initially anticipated. It would be artificial and a triumph of form over substance to dismiss this motion and make the parties start again, go to trial, or bring a different motion. The parties expressly want a summary resolution. While the court cannot find facts absent evidence and requires further assistance, this is no different than finding that there is a triable issue of fact in the context of a summary judgment motion and moving forward toward the resolution of the action by resolving that one issue. That is, in this case, a Special Case is not a fair and just process for the resolution of the action and the court requires evidence in order to do so (See: *Hryniak v, Mauldin*, 2014 SCC 7 at para. 58).

[38] The following questions will be the considered at a telephone case conference to be treated as a motion for directions under rule 1.05 (See: *Hryniak, supra*, at para. 70):

(a) Can the parties agree on the "direct costs that would have reasonably been incurred to rectify such fault(s) immediately prior to the commencement of such loss or damage" that ought to be deducted from the plaintiffs' award? and

(b) If not, by what process ought that issue be determined?

Result

[39] It is in the interests of justice as that term is used in *Hryniak, supra*, that the findings set out above be made so that judgment may issue finding that the insurance policy applies to the subject loss as claimed. The plaintiffs are entitled to be paid the sum of $512,346 less the amount to be determined under Clause 5(d) of the policy. The court does not prejudge the final amount that may be due, if any, noting only that if the deemed costs under Clause 5(d) of the

policy were to exceed the sum of $512,346, the claim amount will be zero as it cannot be negative.

[40] The parties' counsel are to consult with each other to try to resolve the two remaining process issues listed above and to pick a date in January, 2015 at which they are available either at 9:00 a.m. or 4:00 p.m. for a telephone Case Conference. They may then contact my Assistant who will confirm the court's availability and make necessary arrangements.

[41] Costs reserved pending the final outcome of this motion.

F.L. Myers, J.

DATE: December 30, 2014

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REASONS FOR DECISION

F.L. Myers J.

Released: December 30, 2014