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THE INTERACTION OF "OTHER INSURANCE" CLAUSES IN GENERAL LIABILITY POLICIES

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I. INTRODUCTION:

The intersection of a wrap-up liability and general liability policies is a common phenomenon in the construction industry. This paper will discuss the interaction of these types of liability policies in the construction setting. In particular, we will look at several unique issues that arise on a wrap-up policy, and how the different types of "other insurance" clauses contained in wrap-up and general liability policies affect each insurers' defence and indemnity duties.

II. WRAP-UP BASICS:

A. THE "WHO":

Originally referred to as an "owner controlled insurance program", the wrap-up policy is typically purchased by the owner, developer or lead contractor of a construction project. The intent of the coverage is to protect all the participants in the construction project from third party liability arising from work on that construction site. The wrap-up policy will typically define the insureds as:

> *[The Developer], All Contractors, Sub-contractors, Architects and Engineers*

This broad definition of the insured can, and often is, limited by an endorsement directed at excluding coverage for specific professional services. An example of a limitation is such:

> *This policy shall not apply to any liability arising out of any professional services performed by or for the insured including:*
>
> *(a) the preparation or approval of maps, plans, opinions, reports, surveys, designs or specifications; and*
>
> *(b) supervisory inspection or engineering services.*

The significance of this provision is that the wrap-up policy, like the general liability policy, only covers non-professional exposures.

B. THE "WHAT":

The wrap-up liability policy is intended to reduce the gaps between general liability policies in the construction setting by providing blanket third party liability coverage to most participants on a project. As a result, when a loss occurs and a claim is made against all the trades remotely involved with the loss, both their individual general liability and the project wrap-up liability policy may be triggered. The general liability and wrap-up liability insurers become co-insurers for any indemnity exposure, and determining what the defence and indemnity duties of each insurer is often contentious.

Each policy that is on risk will have its defence and indemnity obligations determined by the collective wordings of the policies. A wrap-up policy may state that it is primary. More often though, whether one of the policies is ultimately primary or excess in nature will depend on the combined effect of the "other insurance" clauses contained in each policy.

Like a general liability policy written for construction contractors, the wrap-up is only intended to respond to true third party losses for injury to persons or damage to property. It is not intended to respond to loss involving the insured's own work product, and any liability assumed in contract. In *Alie v. Bertrand & Frere Construction Co.*, at paragraph 165,[1] the Ontario Superior Court quoted from *Normart Management Ltd. v. West Hill Redevelopment Company Ltd.* (1998), 37 O.R. (3d) 97 (C.A.):

> *"It is a well established principle of Canadian insurance law that comprehensive general liability policies are intended to protect the insured from liability for injury or damage to persons or property of others; they are not intended to pay for costs associated with repairing or replacing the insured's defective work and products, which are pure economic loss."*

The comments of the Court in *Normart Management,* as approved in *Alie*, are equally applicable to wrap-up policies.

C. THE "WHERE":

Perhaps the most defining characteristic of a wrap-up policy is that coverage afforded under a wrap-up is limited to losses that arise on the work site, and losses arising off the work site that are a direct result of the construction project itself (such as the building toppling onto an adjacent building).[2] In other words, losses that arise indirectly as a result of the construction, such as bodily injury caused while fabricating building

[1] (2000), 30 C.C.L.I. (3d) 297.

[2] Some wrap-ups may include an endorsement that provides coverage for losses arising from a contractor's work off the work site, provided the work being undertaken relates directly to the project itself (such as fabricators of girders). These policies, referred to as "rolling wrap-ups", are relatively uncommon.

components off-site, are not covered by the wrap-up. By contrast, each contractor's general liability policy will provide coverage for qualifying losses, *regardless of location*.

D. THE "WHEN":

The typical wrap-up is limited to the duration of the construction of the project, and either twelve or twenty-four months completed operations coverage. The wrap-up is often criticized for providing completed operations coverage that is too short.

III. ISSUES THAT ARISE ON A WRAP-UP LIABILITY POLICY:

A. INTRODUCTION:

The wrap-up was created with the intent of:

a. reducing the overall premium costs; and

b. avoiding any gaps in liability coverage left by overlapping general liability policies on the construction site.

Although the wrap-up make take a relatively standard from, many underwriters have tailored wrap-up wordings to accord to only those risks that are acceptable to the underwriters given the particular characteristics of a specific construction project. As such, wrap-up underwriters have employed some common, and some uncommon, provisions in their wrap-ups in an effort to make the policy both acceptable to themselves and to the market. Following is a discussion of two mechanisms employed to adapt coverage to particular applications, these being the inclusion in the wrap-up of a "project exclusion", and the approach of removing the requirement to prove an "occurrence".

B. THE PROJECT EXCLUSION:

The thrust of the wrap-up policy is to provide broad liability coverage specific to participants of a particular construction project. It was never intended that liability policies would afford coverage for a construction site participant's work on the project since that "business risk" can be regulated by means of contract and to afford coverage for improper workmanship was akin to turning the liability policy into a performance bond.

However, during the 1980's and 1990's insureds were creative in attempting to find coverage in respect of work done on a construction site. In the case of the general contractor this entailed seeking coverage for work done by sub-trades notwithstanding the absence of completed operations coverage, and in the case of sub-trades this entailed confining their "work product" so as to obtain indemnification for damage caused to another trade.

So many "inroads" were made on coverage that the insurance industry began to introduce, in the late 1980's and early 1990's, what is known as a "project exclusion". It purports to exclude coverage for any damage to the project itself. In other words, the liability policy is only intended to respond if work on the project itself causes damage to a nearby building, or, for example, injures a passing pedestrian or a visitor to the site. It does not afford coverage for loss or damage to the building that is the subject of the insurance.

A typical project exclusion may read as follows:

> ***Damage to Project Exclusion:***
> *It is agreed that coverage under this policy shall not apply to "Property Damage" to the Insured Project described in the Declaration including all materials, parts and supplies forming part or to form part thereof. This exclusion does not apply after the date the Insured Project is physically completed and accepted by or on behalf of the owner.*

Another example of a "project exclusion" is:

> *A. Excluding damage to project*
>
> *(1) Property of every kind and description either forming part or to form part of the Project described under "Business Description" Item 2 of the Declarations and any material or supplies used in the construction of the Project described under "Business Description" Item 2 of the Declarations or work completed by or for the Named Insured.*
>
> *(2) With respect only to the "Product Hazard" and "Completed Operations Hazard" as defined and only with respect to the claims occurring after completion and acceptance of the entire Projects described in the Declarations, the above Exclusion (1) is deleted and replaced by the following exclusions:*
>
> *(a) Any personal property or any fixtures as a result or any work performed thereon by or for the Insured, or anyone on behalf of the Insured.*

(b) Any goods or products manufactured, sold, handled or distributed or work completed by or for the Insured.

These exclusions make clear that any loss to the construction project itself is excluded from coverage. Although the "project itself" exclusion serves to remove the obligation to indemnify where the loss relates to the project itself, this does not eliminate the insurer's duty to defend if the pleadings of a claim allege facts that could give rise to indemnity. For example, where the pleadings allege damage to the project in general, but there is a possibility that the damage may relate to the property of a third party and not that as specifically defined as part of the "project" in the policy, the insurer must respond with a defence. It will however, be open to the insurer to demonstrate at the indemnity stage whether, and to what extent, the loss is properly excluded by the project exclusion.

C. REMOVING THE REQUIREMENT OF AN "OCCURRENCE":

A further issue that arises with respect to a wrap-up policy is that some wrap-up policies remove the requirement that the loss arise as a result of an "occurrence". An example of an insuring agreement that has removed the requirement for an "occurrence" is as follows:

Insuring Agreements:
To pay on behalf of the Insured all sums which the Insured shall become legally obligated to pay as damages because of:

(a) Bodily injury, shock, sickness or disease sustained by any person which occurs during the policy period, including death at any time resulting therefrom.

(b) Physical injury to or destruction of tangible property which occurs during the policy period, including the loss of use thereof at any time resulting therefrom, or loss of use of tangible property which has not been physically injured or destroyed provided such loss is caused by an occurrence during the policy period.

The effect of removing the requirement of an occurrence is to broaden coverage. The consequence of replacing the traditional trigger of an "occurrence" is that the insurer loses the potential to argue that the loss did not arise out of an "accident". Despite some jurisdictions finding that the results of faulty workmanship can be said to be expected, this defence would not be available to an insurer under a policy that has removed the requirement that the loss arise from an "occurrence", or, replaces the wording with a broader trigger.

The question then becomes, how does this type of wrap-up policy intersect with a general liability policy that <u>is</u> occurrence based? The answer is that in cases where the general liability insurer can maintain that there was no "occurrence", that is the loss was not caused by an "accident", then coverage may be shifted entirely onto to the wrap-up insurer, and the general liability insurer potentially avoids coverage.

IV. IS A WRAP-UP "PRIMARY" BY NATURE?

When a wrap-up liability policy and a general liability policy overlap a determination must be made as to which policy is primary and which is excess, or whether they are both primary. There is nothing inherent about the nature of a wrap-up liability policy that makes it a primary layer of insurance. This determination will depend on the wording of the wrap-up and the opposing general liability policy.

There are two ways in which a wrap-up comes to function as the primary level of insurance. The first way is that the wrap-up policy explicitly states it is primary. An example of policy wording is:

> ***Other Insurance***
> *The insurance afforded by this policy is primary insurance.*

Where the policies are silent on being primary or excess, which is unlikely, general liability insurers in the past have employed an approach of arguing that the wrap-up is primary in nature by virtue of being "closer to the risk". It has been argued that a policy is "closer to the risk" when the loss that has arisen is more specifically addressed by the coverage of that policy than by another. In other words, because a general liability policy insures all third party liability risks faced by a contractor, regardless of location, and the wrap-up coverage is specific to the work-site on which the loss arose and only provides coverage for participants on the work site, the general liability may argue that the wrap-up is "closer to the risk" from a spatial and temporal standpoint.

Indeed, this approach of deciding which policy is primary has been followed by some Canadian Courts. However, the recent Supreme Court of Canada decision in *Family Insurance Corporation v. Lombard Canada Ltd.*, [2002] S.C.J. No 49 (Q.L.), rejected the approach that the policy that is specific to the risk is *necessarily* primary.

In *Family v. Lombard*, the Supreme Court of Canada was asked to decide which of two liability policies was primary when both had near identical "other insurance" clauses declaring themselves policies providing excess coverage. The British Columbia Court of Appeal found the clauses to be ambiguous and resolved the dispute by looking to the surrounding circumstances to determine the intent of the insurers. This approach, which is used in determining which of the policies is closer to the risk, has been referred to as the "Minnesota Approach".

The "Minnesota", or, "closest to the risk" approach, has been criticized in several decisions. In *Wawanesa Mutual Insurance Co. v. Co-Operative Fire and Casualty Co.*[3] the Saskatchewan Court of Queen's Bench described the approach as an exception to the ordinary rule. In *Marchand v. Dominion of Canada General Insurance Co.*,[4] the Ontario Court of Appeal stated that there was no indication in Canadian jurisprudence that the "closest to the risk" approach should be embraced.

In the *Family v. Lombard* case, Family Insurance had written a general liability policy covering a horse-rental business, while Lombard's policy was written to cover members of an equestrian association and was specific to "horse riders". Family Insurance, having lost on appeal and found liable for the full amount of the plaintiff's damages appealed to the Supreme Court of Canada. The Supreme Court explicitly rejected the "closest to the risk" approach, and stated at paragraph 27:

> *In effect, the Minnesota approach to resolution of overlapping coverage disputes results in the preference and endorsement of the intentions of one insurer over another. The result does not accord with the principles of equitable contribution nor does it respect the intentions of both insurers.*

Importantly, the S.C.C. went on to state at Paragraph 28:

> *The better approach is one that recognizes that the principles of contract interpretation must be applied here in light of the fact that the parties involved have not contracted with one another. Although the intentions of the insurers govern the interpretation exercise, the focus of the examination is to determine whether the insurers intended to limit their obligation to contribute, by what method, and in what circumstances vis-à-vis the insured. In the absence of such limiting intentions or where those intentions cannot be reconciled, principles of equitable contribution demand that parties under a co-ordinate obligation to make good the loss must share the burden equally.*
>
> *Once the interest of the insured is no longer at stake, that is, where the contest is only between the insurers, there is simply no basis for looking*

[3] (1980), 119 D.L.R. (3d) 188
[4] [1999] O.J. No. 329 (Q.L.)(C.A.)

> *outside the policy. In the absence of privity of contract between the parties the unilateral and subjective intentions of the insurers, unaware of one another at the time the contracts were made, are simply irrelevant.*

The Court found that where the intentions of the insurers was irreconcilable, the principles of equitable contribution required that the clauses be treated as mutually repugnant and void. The court concluded that parties under a co-ordinate obligation to share in the loss must do so equally.

The decision in *Family v. Lombard* has effectively taken an arrow from the general liability insurers quiver, eliminating their ability to argue that the wrap-up is primary as a result of being more specific to the risk. Indeed, the wrap-up is not deemed the primary level of insurance simply because it is more specific to the loss. It is, in fact, the wording of the individual competing policies and particularly their "other insurance" clauses, that determine which policy is primary and which is excess.

V. THE INTERSECTION OF VARIOUS "OTHER INSURANCE" CLAUSES

When more than one insurance policy must respond to a loss, the manner in which the policies interact is governed by their individual wordings. In this regard, wrap-up and general liability policies typically contain different "other insurance" clauses that are intended to govern the relationship as between the policies, despite the fact there is no privity between the underwriters.

The Supreme Court of Canada has provided some significant guidance in this regard in the *Family v. Lombard* decision. Although there is no privity of contract between the liability insurers, Courts have held that the wording of the contract between the insurer and the insured (the policy) reflects the intent of the insurer in determining their relationship with other insurers. The question then becomes, based on the interaction of these "other insurance" clauses, which policy is primary and which is excess?

A. FORMS OF OTHER INSURANCE CLAUSES:

This section of the paper will describe the various forms of "other insurance" clauses and their basic intended purposes. "Other insurance" clauses come in the following forms:

1. Pro-rata clause;
2. Excess clause;
3. Super Excess clause;
4. Escape clause;
5. Super Escape clause:

6. Excess Escape clause; and
7. Custom "Other Insurance" clause.

1. Pro-rata clause

Pro-rata clauses typically utilize out one of two methods for setting the respective shares of two insurers on risk. The first method provides that each insurer will pay its share of the loss proportionate to its policy limits as compared to all collectible policy limits. The second approach is that each insurer will pay equally until its limits are reached. This second approach is used when all the policies provide for equal apportionment, or both policies are. A policy may specify which approach it uses, or it may incorporate both. Following is an example of a policy that provides for alternate methods of apportionment:[5]

> *When both this insurance and other insurance apply to the loss on the same basis, whether primary, excess or contingent, the company shall not be liable under this policy for a greater proportion of the loss than that stated in the applicable contribution provisions below:*
>
> *(a)* ***Contribution by equal shares.*** *If all of such other valid and collectible insurance provides for contribution by equal shares, the company shall not be liable for a greater proportion of such loss than would be payable if each insurer contributes an equal share until the share of each insurer equals the lowest applicable limit of liability under any one policy or the full amount of the loss is paid, and with respect to any amount of the loss not so paid the remaining insurers then continue to contribute equal shares of the remaining amount of the loss until each such insurer has paid its limit in full or the full amount of the loss is paid.*
>
> *(b)* ***Contribution by Limits.*** *If any such other insurance does not provide for contribution by equal shares, the company shall not be liable for a greater proportion of such loss than the applicable limit of liability under this policy for such loss bears to the total applicable limit of liability of all valid and collectible insurance against such loss.*

2. The Excess Clause

Excess clauses attempt to limit the insurer's contribution to only that amount in excess of the limits of any other insurance coverage. An example of an excess clause is:

[5] *Holyoke Mutual Insurance Co. v. Cherokee Insurance Co*., [1989] 386 S.E. 2d 524 (Georgia Appeal Court)

If the insured has or places any other insurance against a claim for loss or damage covered by this policy, the Insurer shall be liable for only that part of such loss that is in excess of the amount recoverable from the other insurance"

3. Super Excess Clause

Courts have been willing to recognize that super-excess clauses, clauses that purport to be excess even to excess clauses, are indeed excess to all other insurance.[6] A typical super-excess clause reads as follows:

This insurance is excess over any other insurance, whether primary, excess, contingent or on any other basis.

However, Courts have been less willing to find that a primary policy, even with a super excess clause, is excess to a true excess policy.[7] For example, when one policy states in its insuring agreement that the coverage it affords is primary and the same policy contains a super excess "other insurance" clause, regardless of this super excess clause the policy will still be primary if a competing policy is clear in its intent to provide only excess coverage. A true excess policy is one that contains policy wording such as:

The insurance afforded by this policy is excess insurance only.

4. An "Escape" Clause

The escape clause attempts to remove the insurer from <u>any liability</u> (not simply limit coverage to amounts in excess of another policy) where any other insurance covers the loss. An example of an escape clause is:

If other valid insurance exists and protects the insured or any person or organization entitled to protection from liability, this policy shall be null and void in respect of such specific hazards that are otherwise covered by the other policy, whether the insured is specifically named in that policy or not.

Courts generally give effect to escape clauses.

5. A Super "Escape" Clause

The super escape clause attempts to broaden the number of situations in which the policy can avoid liability. The typical super-escape clause reads as follows:

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[6] *Maryland Casualty Co. v. Horace Mann Insurance* Co., [1982] 5551 Fed Supp 907 (W.D. Pa)
[7] *Illinois Emcasco Insurance Co. v. Continental Casualty Co*., [1985] 139 Ill. Appeal 3d 130

> *If other valid insurance, whether primary, excess, contingent or on any other basis, exists and protects the insured or any person or organization entitled to protection from liability, this policy shall be null and void in respect of such specific hazards that are otherwise covered by the other policy, whether the insured is specifically named in that policy or not.*

The important wording above is "*whether primary, excess, contingent or on any other basis*". This wording broadens the simply escape clause by stating that no coverage is provided even where a competing policy states it is excess. Obviously, insureds and excess insurers will be wary of this clause because of its effect of eliminating any primary level of insurance.

6. Excess "Escape" Clause

This clause attempts to have the policy avoid liability, except where the loss exceeds the limits of all other policies, in which case it will respond as excess. It is, in effect, one step back from the super escape clause. The typical excess escape clause reads as follows:[8]

> *If other valid insurance exists and protects the insured or any person or organization entitled to protection from liability, this policy shall be null and void in respect of such specific hazards that are otherwise covered by the other policy, whether the insured is specifically named in that policy or not, provided, however, that if the applicable limit of liability of this policy exceeds the applicable limit of liability of such other valid insurance, then this policy shall apply as excess insurance against such hazard in an amount equal to the applicable limit of this policy minus the applicable limit of liability of such other valid insurance.*

7. Customized "Other insurance" Clause

There are some "other insurance" clauses that are developed as hybrids of the above clauses, and defy classification as pro-rata, excess, escape or one of the derivatives thereof. An example of such a tailor-made "other insurance" clause is as follows:

> *If the insured has other insurance against a loss covered by this policy, the insurer shall not be liable under this policy for a greater portion of such loss that the applicable limit of liability stated in the declarations bears to the total applicable limit of all valid and collectible insurance against such loss; provided, however, the insurance with respect to*

[8] *Automobile Underwriters, Inc. v. Fireman's Fund Insurance Companies*, [1989] 874 Fed 2d 188

> *non-owned automobile shall be excess over any valid and collectible insurance.*

Provided the hybrid clause is drafted specifically, it poses no inherent conflict with other insurance clauses. However, if a custom clause comes up against an identical clause in another competing policy, the two will cancel each other out and the insurers will share equally in the loss up to the limits of each policy.

B. COMPETING OTHER INSURANCE CLAUSES:

This section of the paper will describe the substantive results when "other insurance" clauses from two or more competing policies intersect.

When two or more "other insurance" clauses intersect, it may be possible to reconcile them, and it may not. The Supreme Court of Canada in *Family v. Lombard* concluded that where it is not possible to reconcile two conflicting "other insurance" clauses the clauses cancel each other out and the insurers share in the loss equally until the loss is paid out in full or until a lower policy limit is reached, in which case the policy with the higher limit continues to pay until it is exhausted.

In cases where there are two primary insurance policies and both do not have an "other insurance" clause of any kind, the rule is that any loss should be apportioned among the co-insurers in the proportion that the indemnity limit of each policy bears to the aggregate limits of all available insurance up to their respective limits.[9]

1. Pro-rata v. Pro-rata:

Where two pro-rata clauses are irreconcilable, the Court will likely choose to apportion by equal shares. Where the pro-rata clauses are compatible, the court will seek to give effect to both. If these clauses both have alternative pro-rata clauses, the Courts have held that the language of the policy usually favours allocation by equal shares.[10]

2. Excess v. Excess:

Where the two excess clauses are mutually repugnant the rule in *Family v. Lombard* will apply and the insurers will share equally.

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[9] *United States Services Automobile Association v. American Interinsurance Exchange* [1981] 416 N.E. 2d 875

[10] *Aviles v. Burgos*, [1986] 783 Fed 2d 270.

3. Escape v. Escape Clause

Where the two escape clauses are mutually repugnant the rule in *Family v. Lombard* will apply and the insurers will share equally.

4. Pro-rata v. Excess:

In this case the excess clause trumps the pro-rata clause, and the policy with the pro-rata clause must respond as primary.[11] The policy with the excess clause will respond only after the other policy has exhausted its limits. This relationship reflects a compromise of intents of the insurers, wherein the excess insurer intended for the coverage to be excess where other insurance exists, whereas the pro-rata insurer intended sharing primary coverage where the other policy also contemplated being primary (which the excess insurer did not).

5. Pro-rata v. Escape:

These two clauses are typically reconcilable. The escape clause will trump the pro-rata clause so that only the policy with the pro-rata clause will respond. This is because the pro-rata clause only operates to apportion coverage where there is another insurance policy in effect, while the escape clause dictates that where there is other insurance in place its own policy is null and void.

6. Excess v. Escape:

In most cases, the excess clause will trump the escape clause, forcing the escape policy to pay to its limits before the excess policy will be called on.[12] The reasoning for this is that the policy with the excess clause does not provide for coverage that would trigger the escape clause. In other words, the excess policy does not compete with the policy containing the escape clause, so it does not trigger the escape provision. Thus the policy with the escape clause becomes primary.

VI. CAN THE WRAP-UP ALWAYS CALL ON THE GENERAL LIABILITY INSURER FOR CONTRIBUTION?

American courts have wrestled with the issue of whether a general liability insurer, which adds a party as an "additional insured" to its policy, can seek equitable

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[11] *Seagate Hotel Ltd. v. Simcoe & Erie Insurance Co.*, [1981] B.C.J. No. 439 (Q.L.)(C.A.); *State Farm Fire & Casualty Co. v. Royal Insurance of Canada*, [1997] O.J. No. 3401 (Q.L.)

[12] *Contrans, Inc. v. Ryder Truck Rental Inc*. [1987] 836 Fed 2d 163

contribution from the "additional insured's" general liability insurer. At present, there are no decided cases in Canada concerning this issue.

Even though the wordings of a wrap-up and competing general liability policy provide that each policy is on risk, it is not always possible for a wrap-up insurer to call on the general liability insurer for contribution.

A situation may arise where, subsequent to a loss, a contractor is named as a defendant to an action and, being unaware of the coverage afforded by the wrap-up, the contractor tenders its defence to its general liability insurer. The issue becomes, can the wrap-up insurer compel insured to tender its defence to the general liability insurer and then share pro-rat in the exposure?

As well, the premium-conscious contractor may call on the project wrap-up to defend and indemnify even though its own general liability policy provides coverage. In such as case, does the wrap-up insurer have the right to call on the general liability insurer for contribution?

This issue was dealt with in a case called *Institute of London Underwriters v. The Hartford Fire Insurance Company* in which the Court posed the following issue:[13]

> "[W]*here two insurance policies potentially apply to a loss, may an insured elect which of its insurers is to defend and indemnify the claim by tendering its defense to one insurer and not the other and thereby foreclose the settling insurer from obtaining contribution from the non-settling insurer? The trial court found that it could. This is a question of first impression. For the following reasons we affirm."*

In essence, the Court concluded that if the "additional insured" does <u>not</u> tender the defence to its general liability insurer then the wrap-up insurer is <u>not</u> entitled to seek equitable contribution from the general liability insurer. The fact that that step might result in a premium increase to the insured was at the root of the Court's concern, stating, at page 1316:

> *"[the additional insured] may well have feared that if the loss were attributed to its [general liability] policy the result might be rise in premiums or cancellation of its policy. This factor alone suggests the insured ought to have the right to seek or not to seek an insurer's participation in a claim as the insured chooses when more than one carrier's policy covers the loss."*

[13] 599 N.E. 2d 1311 (Ill App. Crt. 1992)

This general principle has been subsequently followed in other cases.

However, in 1998, in *American Country Insurance Co. v. Kraemer Brothers Inc.* this principle was not followed when two general liability policies had an identical or similar "other insurance" clauses. The Court pointed out that in *Institute of London Underwriters* the policy issued by the wrap-up insurer had no "other insurance" clause. This decision is at odds with the line of cases that have concluded an insured can "choose" the general liability insurer it wishes to have defend the lawsuit, and is an exception to the general rule that it is within the insured's discretion as to whom it will tender its defence.

Notwithstanding this, the general principle articulated in the *Institute of London Underwriters* case is good law in Canada. For clarity, this point of law is, absent a formal tender by the insured to the general liability insurer, that insurer is not required to respond, even if it is merely a claim for equitable contribution by the wrap-up insurer.

The duty to defend is broader than the duty to indemnify. The duty to defend is triggered when pleadings contain an allegation of damage that would be covered by the policy. Where there is ambiguity between other insurance clauses, or there are no "other insurance" clauses in any policy, then a dispute arises. Although there is a paucity of Canadian case law on point, what cases have been decided appear to favour the equal sharing of the defence costs.[14]

Where one insurer is primary and the other is excess, and there is a reasonable possibility that the loss may fall on the excess layer of insurance, the excess insurer's duty to defend is triggered. In such a case, the primary and excess insurer share the defence costs equally, and not in proportion to their limits or to the portion of the loss for which they are liable.[15]

In the case of continuous property damage, such as water ingress cases, where it is impossible to determine which portion of damage occurred at what time, and consequently under which policy, the court will divide the damage equally among the

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[14] *Skyline Gold Corp. v. American Home Assurance Co.*, [1997] B.C.J. No. 2609 (Q.L.)(S.C.); *Ecclesiastical Insurance Office plc. v. Sun Alliance Insurance Co.*, [1993] N.B.J. No. 149 (Q.L.)(Q.B.); *Wawanesa Mutual Insurance Co. v. Commercial Union Assurance Co.*, [1994] M.J. No. 565 (Q.L.)(Q.B.).

[15] *Alie v. Bertrand & Frere Construction Co.*, [2000] O.J. No. 1360 (Q.L.)(Sup.Ct.). In this case the Court followed *Broadhurst & Ball v. American Home Assurance Co.* (1990), 76 D.L.R. (4th) 80 (Ont.C.A.)

years that the damage is found to have occurred in. This approach was taken in *Alie* where the Court applied the continuous trigger theory.

In the United States there exists a uniform body of law which makes it clear that a liability insurer is not obligated to indemnify for any defence costs incurred prior to the insured's formal tender of the defence. Underlying this doctrine is the view that the insured has the "option" of electing to manage its own defence, unassisted by the insurer, if it so chooses and tender later if it wishes. However, if the insured wishes to avail itself of the right to control the defence in the early stages of the litigation, it is not then open to the insured to claim the related legal costs and expenses; merely the expenses from the date the insured makes a formal tender to the insurer.

However, an insurer is obliged to pay only those defence costs which relate to a claim for which coverage is provided in the insurance policy.[16] In cases involving mixed claims (*i.e.*, claims that potentially fall within the scope of coverage provisions as opposed to claims that clearly fall outside the scope of coverage), an insurer is entitled to have its defence costs responsibility determined objectively.

It is acknowledged that where a Statement of Claim contains allegations, some of which give rise to a duty to defend, and others which do not, the onus lies on the insurer to propose a consistent and rational basis for the allocation of defence costs as between allegations. Moreover, defence costs should only be allocated between covered and uncovered claims where it is "practical" to do so.[17]

VII. APPLYING THE APPROPRIATE TRIGGER THEORY ON CONTINUOUS PROPERTY DAMAGE CASES:

This section of the paper will discuss the current state of the law with respect to determining when continuous property loss triggers a liability policy. The situation of competing coverages can be complicated enough on a discrete loss (like a falling pane of glass), but if the loss is progressive or continuous, such as in leaky building cases where the structural integrity of the building is jeopardized by water ingress and the loss occurs over the periods of numerous insurance policies, it becomes imperative to determine which policy is triggered by a loss.

For the purposes of determining coverage in an "occurrence" based policy, if there is a time lapse between the negligent act and the resulting harm, the "occurrence" is when

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[16] *Continental Insurance Company et al v. Dia Met Minerals Ltd. et al*, [1996] I.L.R. I-3346 (B.C.C.A.).

[17] *Daher v. Economical Mutual Insurance Co.*, [1996] O.J. No. 4394 (Q.L.)(C.A.)

the harm ensues. However, in continuous property damage cases often flowing from construction losses, the issue is whether it is the liability insurer whose policy period was during construction or when the water ingress was noticed, or all of them, that have a responsibility for defence and indemnity costs.

The analysis as to whether there is property damage during the period of a particular policy involves determining which theory of coverage will apply. When determining the issues, it is open to a court to adopt one or more of the following four trigger theories, only some of which may apply so as to put an insurer "on risk". These trigger theories are as follows:

(a) The "Manifestation" Theory
The damage occurs when it is discovered or becomes "manifest". According to this theory, only insurers with policies in force at the time the problem was discovered will be asked to defend and indemnify;[18]

(b) The "Injury in Fact" Theory
If it can be proven that the injury or damage pre-dated its discovery, then the insurers with policies in effect when the water leakage caused measurable and compensable, albeit unascertained, damage are obligated to respond. This presupposes technical or scientific evidence as to when water leakage reaches a critical stage;[19]

(c) The "Exposure" Theory
The policy in effect while the property was in contact with the cause of the property damage is triggered. Coverage will not attach in any period where there is no exposure to the injurious product;[20] and

(d) The "Continuous Trigger" or "Triple Trigger" Theory
Coverage is extended from the first date the property experienced loss through to and including the date of discovery.[21]

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[18] *Korossy* v. *Sunrise Homes*, 653 So. 2d 1215 (La. App. 5 Cir., 1995)
[19] *Hoechst Celanese Corp* v. *Lloyds* Del. Supr. 673 A. 2d 164 (Del. S.C. 1996)
[20] *Privest Properties v. Foundation Co. of Canada*, *supra.*
[21] *Family Insurance Corp v. Lombard Canada, supra.; Stonewall Ins. Co. v. City of Palos Verdes,* 9 Cal. Rpr. 2d 663 (Cal. App. 2 Dist, 1992)

In *Alie v. Bertrand & Frere Construction Co.*[22] the Court considered each of the afore-mentioned trigger theories in the context of deteriorating residential concrete foundations. *Alie* is the only Canadian case to date in which the issue of continuous property damage has gone to trial and the Court was compelled to determine which of the above trigger theories applied.

The Court concluded that the "Injury in Fact" and "Continuous Trigger" theories were the most appropriate, since they are:

a) the most consistent with the language of the policies and the intention of the parties;
b) the most equitable to both the insured and the insurers; and
c) the remedy that was intended by the insurance industry in drafting general liability policies.

The *Alie* decision was appealed and argument was heard in June of 2002. As of September 23, 2002, the appeal judgment had not been released.

VIII. CONCLUSION:

The wrap-up liability policy evolved to provide blanket liability coverage for contractors and other participants on a construction site. Coverage is restricted to all those participants of the construction project that are not specifically excluded, and is further limited to only losses that arise on the construction site or as a direct result of the construction project. Like a general liability policy, the wrap-up policy is not intended to indemnify the insured for pure economic losses. Despite this, the insurer's duty to defence may be triggered where the pleadings raise the possibility that the loss involves damage to third parties, including the work of sub-contractors.

The respective responsibilities of two competing insurance policies are determined by each policy's expressed intent to be primary or excess, and the nature of each policy's "other insurance" clauses. When it is possible to reconcile two or more "other insurance" the Court will do so. The Supreme Court of Canada in the *Family v. Lombard* decision held that where it is not possible to reconcile two "other insurance" clauses, the clauses cancel each other out and the insurers share in the loss equally (until the loss is paid out in full or until a lower policy limit is reached, in which case the policy with the higher limit continues to pay until it is exhausted).

[22] *Supra*.

Even though the wordings of a wrap-up and competing general liability policy provide that each policy is on risk, it is not always possible for a wrap-up insurer to call on the general liability insurer for contribution. In cases where the insured does <u>not</u> tender its defence to its general liability insurer then the wrap-up insurer is <u>not</u> entitled to seek equitable contribution, for either indemnity or defence costs, from the general liability insurer.

Alie is the only Canadian case to date in which the issue of continuous property damage has gone to trial. In this case, the Ontario Supreme Court concluded that the Injury in Fact and Continuous Trigger theories were most appropriate because: they were the most consistent with the language of the policies and the intention of the parties, they were the most equitable to both the insured and the insurers, and most represented the remedy that was intended by the insurance industry in drafting general liability policies. Although appealed, the appeal decisions on this case have not yet been released. Whether the decision to apply the Injury in Fact and Continuous Trigger theories will be limited to the particular facts of the *Alie* case, or whether they will provide guiding principles in all cases of continuous property damage is a question that will have to be answered by further decisions of the Courts.