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Building Envelope Failures-Litigation and Insurance Industry Responses

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A. The Problem

In British Columbia and elsewhere, over the last 15 years, the building technology adopted the "face seal" system of building envelope construction. At some risk of oversimplification, a "face seal" design is typically comprised of an exterior surface acrylic stucco, underlain by substrata and a water impermeable membrane. Its design intent is to prevent water from entering into a building's exterior wall assembly and its proper functioning is wholly dependent upon surface continuity, proper workmanship and materials.

The "face seal" building envelope system evolved in parallel with the R 2000 criteria which sought to promote more energy efficient buildings by preventing the movement of air through external wall systems. The combined result of these face seal and air barrier systems was to inhibit any drying out of building envelope materials that became wetted as a result of water ingress through discontinuities in the face seal system. The buildings do not "breathe". So if water ingressed into the wall system, it could not escape, nor was air movement through the wall available to assist in drying out wetted building materials.

As a direct result of moisture "trapped" within the "face seal" exterior wall assembly, water ingress into habitable portions of the building, the corrosion of metal fastening and other structural wall components and the development of dry-rot and mold growth in wood frame structures, combines to diminish the structural integrity and safety of building components.

Paradoxically, the more traditional building technology employing the "rain screen" or cavity wall design, is much less susceptible to damage due to water ingress. This system, which was used predominantly in construction in British Columbia until the late 1980's, assumed that water would in fact penetrate the outermost layer of the wall system. Accordingly, adequate provision was made for ventilation through the cavities in the wall and for pathways where water could exit out of the wall system before it could cause damage.

Following the Barrett Commission Inquiries, it is now generally accepted that losses due to building envelope failures in British Columbia are in the hundreds of millions of dollars. The news accounts are redolent with unhappy accounts of "leaky condo" owners, serious deficiencies in subsidized housing projects, and at-risk schools and residential buildings – both low and high-rise. It is estimated that there are now in excess of several hundred law suits by building owners and occupiers in British Columbia arising out of building envelope failures.

B. Building Envelope Litigation

Legal claims for building envelope failures are typically made against developers, property management corporations, contractors, architects, engineers, building trades and government authorities. Invariably, the cost of litigation, combined with mandatory mediation provisions in the regulations to the *Homeowner Protection Act*, S.B.C. 1998, c. 31 have resulted in mediated settlements of claims at between 40% - 60% of the claimed lost values.

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That there is less than complete compensation for aggrieved building owners is a product of insurance industry responses, insolvent contractors and development corporations, exhausted insurance benefits in the case of serial defendants, and the uncertainties of full economic recovery.

The growth in building envelope failure claims is directly related to the evolution of the law of recovery for pure economic loss. In most cases, save and except claims by original owners against developers and vendors arising out of contractual relations and related proximity, claims for building envelope failures, are advanced by strata corporations or "subsequent owners", i.e. non-privity owners having no contractual relations with the potentially responsible parties. Their claims, of necessity, are couched in negligence, failure to warn, negligent misrepresentation, and breach of statutory duty in the case of local governments. Indeed it is not unusual to find between 10 – 15 defendants implicated in a building envelope failure claim, most of whom had no contractual relations directly with the claimants.

Traditionally, the Courts have considered costs incurred in repairing a defective building as an "economic loss" on the basis that the costs of repairs did not arise from any actual injury to a person or damage to property apart from the defective building itself.[1]

Heeding the Cardozon admonishment against expanding a general duty of care in such a way as to give rise to indeterminate liability[2], remedial costs in the nature of "pure economic loss" were held unrecoverable in the absence of a statutory duty, breach of contract, or some special reliance-based relationship of proximity. Pure economic loss was distinguished from physical injury or damage to other property, where, in the latter type of case, actionability is based on the principles in *Donohue v. Stevenson*[3]

However, in 1995, the Supreme Court of Canada in *Winnipeg Condominium Corporation No. 36 v. Bird Construction Co.* [4], created an important exception to the rule of non-recovery for pure economic losses in the case of negligent building construction. In that case, it was held that where the remediation costs were incurred to remedy a defect which posed a "real and substantial danger" to persons or other property than the defective building itself, a non-privity party could be liable for remediation costs required to return the defective building to a non-dangerous condition. In that case, subsequent owners of a building in which brick cladding had fallen away, were held entitled to claim damages against a contractor for the costs to repair the dangerous structure. The cost of remedying mere shoddy workmanship and materials would nevertheless remain unrecoverable in negligence, as these claims are properly the subject of contract claims and to recognize them would yield a "transmissible warranty".

The potentially responsible parties in every building envelope failure action include developers and their related corporations and principals, architectural and engineering consultants (design and field review services), general and trade contractors, material suppliers and local government.

Apart from claims for breach of an implied warranty of habitability[5], in the case of pre-sales of yet to be constructed buildings, claims by subsequent owners against developers are typically made on the basis of remediation of dangerous defects, misrepresentation through marketing materials and failure to warn of defects. Judgment has been awarded against a developer where water ingress adversely affected the structural integrity of a residential building[6]. In the context of claims against the developer's related corporations and principals resort to corporate "alter ego" principles, agency and the "common enterprise" theory[7] may be made. Typically, allegations are made against related corporations which coordinate and supervise the conduct of the developer or contractor, where the developer and associated defendants share common directorships, profits and common offices[8].

Contractors and trades implicated in building envelope failure litigation generally include stucco applicators, window suppliers and installers, trades responsible for flashing and caulking and waterproofing trades. In each case the action by the Strata Corporation and the individual subsequent owners is based on the *Winnipeg Condominium* case, and failure of a duty to warn.

It is settled law that a local government responsible for enforcing its construction and permitting bylaws may be held liable for acts or omissions which result in pure economic losses to non-privity building owners and occupiers[9].

In one of the rare building envelope failure cases that has actually gone to trial, *Strata Plan NW3341 v. Delta (Corporation)*[10], the B.C. Court of Appeal upheld a trial judgment imposing liability on the Municipality of Delta for failing, at an operational level, to exercise reasonable care in ensuring that Part 5 of the Building Code was adhered to in the construction of a condominium project, and in ensuring that the project design professional provided adequately detailed drawings for the purpose of approval of the development under the supervision of a party licensed under the *Architects' Act.*

There are, however, statutory provisions that may operate, limit, or even negate local government liability in similar cases. In 1990, the predecessor to the *Local Government Act* R.S.B.C. 1996 c. 323 was amended to protect municipal authorities from negligence claims where building plans were certified by a Registered Professional (architect or engineer) with whom responsibility was placed by the municipal building authority. This reflects the Certified Professional Program and the utilization of Letters of Assurance provided by Registered Professionals upon which Local Governments place responsibility and reliance (for design and building code compliance in plan checking, inspections and permitting).

Earlier, in 1987, the *Vancouver Charter* was amended to immunize the City of Vancouver from actions for negligent plan checking and inspection[11]. Although claims under s. 294(8) of the Vancouver Charter may be excluded respecting negligent plan approval inspection, inspection and the resulting issuance of a building permit, the protection may not extend to a claim for failure to warn[12].

Where no statutory protection exists, the Supreme Court of Canada has held that a Municipal Government, having a policy of building inspections during construction involving building elements which posed significant risk of harm to the building itself or its occupants, cannot merely rely on a contractor's assurances as to the work, but it's inspectors must make their own reasonable efforts to determine whether the building codes and bylaws have been complied with[13]. Local government liability rests on the application of the modified two-stage analysis in *Anns v. Merton London Borough Council*[14] and the "policy" vs. "operations" dichotomy which may, or may not, yield an actionable private law duty.

One of the invariable "targets" in building envelope failure litigation are design professionals. They include architects responsible for the preparation of design and construction drawings, as well as the provision of field review services as a registered professional, or otherwise, and consulting engineers, e.g. structural and mechanical engineers. Claims by Strata Corporations and subsequent owners against design professionals are typically advanced under the rubric of liability propounded in *Winnipeg Condominium, supra.*

Thus far, claims against CMHC, which administers a federal rent subsidy program on social housing projects, and acts as a mortgage insurer, have been unsuccessful. Allegations have been made that CMHC acts as a developer and "supervisor" of construction insofar as it requires that design drawings be in compliance with standards for approval of mortgage advances and that construction

proceed in accordance with the plans. To date no claims on this basis have been judicially determined on the merits, and a proposed class proceeding was not certified[15].

Defences to building envelope failure claims typically include: (1) compliance with the appropriate standard of care; (2) lack of causation; (3) failure to mitigate; (4) betterment; and (5) limitations of actions. Invariably expert evidence is necessary to assessing the first four of these defences. With respect to betterment, the B.C. Court of Appeal, in *Strata Plan NW3341 v. Delta (Corp.),* rejected the argument that a substitution of a more expensive “rain screen” building envelope system for a defective “face seal” stucco cladding, did not constitute a betterment but was, instead, essential to the proper functioning of the wall system[16]. This is significant in relation to building envelope remediation in Vancouver where, by virtue of amendments to the building bylaws, all remediation must provide for a “rain screen” or cavity wall padding system.

It is now determined that the applicable limitation in respect of pure economic losses in building envelope failure claims is six years from the discovery of defects in the design and/or construction of the building envelope, and that a limitation period is subject to the postponement provisions of s. 6(3) of the *Limitations Act*[17]*.*

Generally, the limitation period for claims against a local government is six months, pursuant to s. 285 of the *Local Government Act*. It has been held, however, that s. 285 only applies in cases in which there is a breach in the enabling statute and not merely a breach of a common law duty for which the limitation period is the general limitation under the *Limitation Act*[18]. In either event of a claim against a Municipality or private parties, the Court will consider whether the knowledge was that of a Strata Corporation or its constituent owners. Time limits for claims by individual owners commence to run when that owner became aware of the cause of action and the identity of the defendants, i.e. where a claimant is aware of facts that would put a reasonable person on inquiry leading to knowledge of claims against a defendant.

Interesting limitation issues can arise where individual members of the Strata Corporations, in a claim for remediation of defects to common property (exterior walls, underground parking structures, etc.) have knowledge of those deficiencies, and whether the Strata Corporation is deemed to have this knowledge. In the case of Strata owners whose claims are restricted to their individual units, their knowledge of defects in construction and resulting damage, triggers the limitation period.

Damages in building envelope failure claims typically include remediation costs, diminution in market value, aggravated damages, loss of rental revenues, additional living costs during remediation, and damages for inconvenience and upset, and physical damage to building contents. An interesting question arises in relation to claims for the diminished market value of a fully repaired building, where the “stigma” of having been a “leaky condo” reduces its marketability, even though it is fully remediated.

C. Insurance Industry Responses

Legislative responses in the nature of warranty protection under the *Homeowner Protection Act* are beyond the scope of this article. So too is the failure of the New Home Warranty Program and the various claims arising in related C.C.A.A. proceedings. For present purposes, the focus will remain on the private insurance industry and claims on errors and omissions (“E & O”) policies covering professional and design services, comprehensive general liability (“CGL”) policies and Wrap-Up Liability Policies, etc. covering developers, contractors, trades.

Errors and Omissions Insurance

When claims against architects and engineers initially evolved, there were only a few E & O insurers providing coverage for building envelope failures. With the growth and multiplicity of E & O claims for building envelope failures, the reaction of the lead insurers has been to leave the markets, exclude coverage for water ingress claims or otherwise reduce coverages while increasing premiums. Insofar as the E & O insurance policies, these responses have significantly effected prospective claims for faulty design and field review services. As a principle insurer, the Encon Group, moved out of coverage for water ingress claims in renewal and replacement policies, and other insurers came into the market at substantially higher premiums and deductibles, the result has been that a significant number of design professionals now "go bare" and are without fully responsive E & O insurance coverages.

Comprehensive General Liability Insurance

A CGL Policy is intended to cover claims against an insured for damages arising out of bodily injury or damage to property of others. "Typical" CGL policies variously cover "physical injury to or destruction of tangible property", "damage to or destruction of property", "damage to or destruction of…tangible property", or "injury to or destruction of property". Various coverage wordings have evolved as the North American insurance industry has struggled to deal with, and limit, coverage for economic losses.

These "typical" CGL Policies incorporate exclusions for damages to the insured's own product or work. Other exclusions include claims based on the insured's contractual liability (e.g. warranty claims), damage to property owned by an insured and "impaired property"[19]. Without an own work/product exclusion the insurer would, it is argued, become a guarantor of contractual performance – the protection otherwise purchased by the contractor in the forum of a performance bond.

In *AXA Pacific Insurance Company v. Guildford Marquis Towers Ltd.*[20], the importance of pleadings in a building envelope failure, so as to attract insurance coverages, was underscored. At issue in two Petitions before the Court, was coverage under a CGL Policy issued to the developer and the contractor for two high-rise residential buildings in Surrey, B.C. The insurer denied both defence and coverage on the grounds that the claims in the underlying building envelope action against the insured were claims for "pure economic loss" and were not accordingly covered under the CGL Policy which only covered physical damage to property. The insurer asserted that the damages claimed in the underlying building envelope failure action against the insureds were *not* in respect of "injury to or destruction of property" and argued the exclusion of coverage for injury to, destruction or loss of use of goods or products sold by the insured or work done on its behalf "where the cause of the occurrence is a defect in such work". At issue was whether the pleadings in the underlying action, which touched minimally on resultant damage to property (to resident-installed wallpaper in one unit) was in the nature of "pure economic loss" or were in the nature of injury to the insured's own work or product for which there was no coverage. The Court considered the "complex structure theory" by which the entire building was said in *Bird Construction Co. Ltd. v. Allstate Insurance Company of Canada*[21], to comprise the contractor insureds own work/product. In such case losses were held to be other than "physical injury or destruction of tangible property" and not "resultant damage" insofar as the building itself was "a single indivisible unit" comprising the work or product of the insured.

Considering *Pier Mac Petroleum Installation Ltd. v. AXA Pacific Insurance Co.*[22] and *Privest Properties Ltd. v. Foundation Co. of Canada*[23], the Court in *AXA Pacific* distinguished the latter on the basis of ambiguity in policy terms, and found that the own work/product exclusion did not extend to claims involving damage to something other than the building itself. Since this type of damage was alleged in the underlying action against the insureds, albeit ancillary to claims for damage to the

building itself, AXA was held to a duty to defend the underlying action in respect of claims which may be argued to fall under the policy[24]. It was considered by the Court to be premature to apportion defence costs between covered and uncovered claims prior to completion of the trial in the underlying action[25].

In a related case, *F.W. Hearns/Actes – A Joint Venture Ltd. v. Commonwealth Insurance Company and others*[26], the insurer was held also liable to defend the underlying claims against the insured. In *F.W. Hearns/Actes* the insured had paid an additional premium for Completed Operations Coverage for property damage arising out of "operations on the project, but only if the…property damage occurs after such operations have been completed". After comparing provisions of the policy which gave rise to "confusion and ambiguity with respect to coverage", the ambiguity was resolved in accordance with the insured's reasonable expectation of coverage and the insurer was held to owe a duty to provide a defence. Again, apportionment of defence costs for claims falling within, and without, coverage was deferred to completion of the trial of the underlying building envelope litigation.

Coverage under an E & O is coterminous with the term of the policy. An E & O insurance policy is a "claims made" policy. It is immaterial when the alleged error or omission was made or when the damage manifested itself, so long as the claim is advanced against the insured during the policy period. CGL and Wrap-Up coverages are "occurrence" coverages. Coverage is determined not with reference to when the claim was advanced under a CGL policy, but when the condition which gives rise to injury to property arises.

Experience shows that damage caused to buildings due to water ingress through defective building envelopes, can occur over a number of years. Thus, damage may occur during periods covered by different insurers and policies. One of the questions in these circumstances is which CGL insurance policy will respond to the claim. The Courts have considered four "trigger" theories in order to determine whether one or more serial insurers must respond to building envelope failure claims. The four "trigger" theories include: (1) the exposure theory, where coverage is triggered at the date upon which exposure to the condition which causes property damage, first occurs; (2) the manifestation theory, where "property damage" is held to occur where the claimant first becomes aware of it; (3) the "injury – in – fact" theory, where the date that property damage actually occurs is equated to the actual date of "occurrence"; and (4) the continuous or "triple trigger" theory. Under the continuous or triple trigger theory, property damage is said to have occurred throughout the period from initial exposure to the condition giving rise to it and the manifestation and discovery of physical damage.

In building envelope failure litigation there is some judicial support for the continuous or triple trigger theory[27] which can in the case of long-term continuing damage in a progressive building envelope failure is justified on policy grounds. The insurance industry itself appears to have acknowledged, in the drafting of standard occurrence-based policies, that the term "occurrence" may include "an accident or exposure to injurious conditions resulting in the occurrence of damage or injury during the policy period"[28].

Under the continuous, or triple trigger theory, "injury or damage to property is said to occur from the time of the initial exposure to the harmful substance to the time that injury is discovered"[29]. Thus, in the case of a building envelope failure where it is not generally possible to determine when or how much of the damage occurred during any particular policy period, the application of the continuous, or triple trigger theory, is best suited to allow the Courts to apportion damage on a pro rata basis throughout periods covered by different policies. Indeed, in British Columbia most CGL carriers which insure contractors and trades, have adopted, as between themselves, a "time on risk" risk sharing formula. The insurers divide responsibility for defence costs between the numbers of

insurers on risk between the substantial completion date for the project and the earliest of the start of remediation or service of a Writ of Summons on the insured.

D. Conclusion

Given the multiplicity of parties, the time and expense associated with a building envelope failure claim, and the relatively limited resources of a typical Strata Corporation and its members, it is no surprise that litigation of this kind is often settled through mediation. Mediations are typically attended by counsel and clients, including E & O and CGL insurance representatives, who are well familiar with the ordinary dynamics of multiparty building envelope failure mediation. On mediation, the insurers continue to assert all available defences and in the case of CGL or Wrap-Up Completed Operations Hazards coverage the “time on risk” following substantial completion is a focal point of their position on coverage.

In my experience, Plaintiff’s counsel in building envelope failure litigation, in laying the groundwork for a successful mediation or trial, must take considerable care in the drafting of pleadings having regard to underlying insurance coverage issues and the relevant law. The unfortunate “leaky condo crisis” has reshaped not only the construction industry but the insurance industry as well. On the basis that an “ounce of prevention is worth a pound of cure”, the mandatory warranty requirements under the *Homeowner Protection Act* may yet serve to be the most effective tools with which to ensure that compensation is recovered by the unfortunate owner of an affected building.

ENDNOTES

[1] *Rivtow Marine v. Washington Iron Works*, [1974] S.C.R. 1189.

[2] *Ultramares v. Touche Niven & Co.* (1931), 255 N.Y. Supp. 170.

[3] *Donohue v. Stevenson* [1932] A.C. 562 (H.L.).

[4] [1995] 1 S.C.R. 85 (S.C.C.).

[5] *Strata Plan NW2294 v. Oak Tree Construction Inc*. (1994) 93 B.C.L.R. (2d) 50 (C.A.).

[6] *Strata Plan VR1534 v. Regent Development Corp*. [1996] B.C.J. No. 6 (S.C.).

[7] *Rafiki Properties Ltd. v. Integrated Housing Development Ltd.* [2002] B.C.J. No. 1061 (S.C.); *Jams International Ventures et al v. Westbank Holdings et al* [2002] B.C.J. No. 891 (S.C.).

[8] *Owners, Strata Plan LMS 2064 v. Noel Developments Ltd.* (1999) 50 C.L.R. (2d) 117 (B.C.S.C.).

[9] *Rothfield v. Manolakas* [1989] 2 S.C.R. 1259; *Kamloops v. Nielson* [1984] 2 S.C.R. 2; and *Just v. B.C.* [1989] 2 S.C.R. 1228.

[10] [2001] B.J.C. No. 1723 (S.C.), suppl. reasons [2001] B.J.C. No. 2661, aff'd. on appeal [2002] B.J.C. No. 2142 (C.A.).

[11] *Vancouver Charter*, R.S.B.C. 1987, c. 52; See also, *Strata Plan LMS1400 v. Objekt Properties Corp*. [2002] B.C.J. No. 2305 (S.C.); *Wilson v. Robertson* [1991] B.C.J. No. 1351; and *Kaiser v. Bufton's Flowers Ltd.* [1994] B.C.J. No. 1976 app dismissed [1995] B.C.J. No. 309.

[12] *Supra*.

[13] *Inglis v. Tutkaluk Construction Ltd*. [2000] S.C.J. No. 13.

[14] [1978] A.C. 728; and see *Cooper v. Hobart* [2001] 3 S.C.R. 531. A putative class action against Canada, British Columbia and the National Research Council was not certified because a private law duty could not be established on the pleadings: *Kimpton v. Canada (A.G.) and British Columbia (HMTQ)* 2004 B.C.C.A. 72.

[15] *Sapperton Terrace Housing Cooperative v. Budding Construction Ltd*. [2000] B.C.J. No 14 (S.C.).

[16] *Ibid;* see also *Nan v. Black Pine Manufacturing Ltd.*(1991) 55 B.C.L.R. (2d) 241 (C.A.).

[17] *Limitation Act*, R.S.B.C. 1996, c. 266, ss. 3 and 6(3); *Owners, Strata Plan VR1720 v. Bart Developments Ltd.* [1998] B.C.J. No. 224 (S.C.) aff'd [1999] B.C.J. No. 2399 (C.A.); *Owners, Strata Plan 2000 v. Shaw* [1998] B.C.J. No. 1190 (S.C.). See also *Workers' Compensation Board v. Genstar Corp.* (1986) 24 B.C.L.R. (2d) 157 (C.A.).

[18] *Pausche v. Maple Ridge [District]* [2002] B.C.J. No. 196 (S.C.); *Gringmuth v. North Vancouver (District)* (2002) B.C.C.A. 61.

[19] see for example *Insurance Bureau of Canada, IBC 2100*. In the 1980's the "own product" exclusion from coverage excepted that part of such work which is defective and damages arising from work performed on the insured's behalf by a subcontractor. Some CGL Policies of that era excepted "real property" from the own products exclusion.

[20] [2000] B.C.J. No. 208 (S.C.).

[21] (1996) 110 Man.R. (2d) 305 (C.A.). See also, in a non-construction context, *M. Hasegawa and Co. v. Pepsi Bottling Group (Canada) Co.* [2002] B.C.J. No. 1125 (C.A.).

[22] (1997) 41 B.C.L.R. (3d) 326 (S.C.).

[23] (1991), 57 B.C.L.R. (2d) 88 (S.C.).

[24] *Nichols v. American Home Assurance Co.* [1990] 1 S.C.R. 801. See also, *Monenco Ltd. v. Commonwealth Insurance Co.* [2001] 2 S.C.R. 699.

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[25] *Surrey (District) v. General Accident Assurance Co. of Canada* (1994) 92 B.C.L.R. (2d) 115 (S.C.); and *Continental Insurance Co. v. Dia Met Minerals Ltd.* (1996) 20 B.C.L.R. (3d) 331 (C.A.).

[26] [2000] B.C.J. No. 964.

[27] *Alie v. Bertrand* (2000) O.J. 1361 (S.C.). See also *Zurich Insurance Co. v. Trans-America Insurance Co.* 34 Cal. Rptr. 2d 913 (Cal. App. 4th Dist. 1994).

[28] *Montrose Chemical Corporation of California v. Admiral Insurance Co.* 913 P. No. 2d 878 (Cal. 1995) at P. 908.

[29] *Alie v. Bertrand, Ibid, at para 344.*

*denotes a Personal Law Corporation