“GETTING A LEG UP”

RECENT DEVELOPMENTS IN CONNECTION WITH THE FAULTY DESIGN AND WORKMANSHIP EXCLUSION

These materials were prepared by Gregory J. Tucker of Owen Bird Law Corporation, Vancouver, BC, for the Continuing Legal Education Society of British Columbia, September 2015.
# TABLE OF CONTENTS

I. Introduction .............................................................................................................................................. 1  
II. Wordings .................................................................................................................................................. 1  
   A. Facts and Policy Wording .................................................................................................................. 2  
   B. Trial Decision ...................................................................................................................................... 2  
   C. Court of Appeal Decision .................................................................................................................. 4  
   D. Commentary on the Appeal Decision ................................................................................................. 7  
   A. Facts and Policy Wording .................................................................................................................. 8  
   B. Trial Decision ...................................................................................................................................... 9  
   C. Commentary on the Trial Decision .................................................................................................. 10  
V. *Acciona Infrastructure Canada Inc. v. Allianz Global Risks US Insurance Company*, 2015 BCCA 347 .................................................................................................................................................. 10  
   A. Facts and Policy Wording .................................................................................................................. 10  
   B. Trial Decision ...................................................................................................................................... 12  
   C. Court of Appeal Decision .................................................................................................................. 13  
   D. Commentary on the Appeal Decision in Acciona ............................................................................. 15  
      1. Is LEG2 an Exclusion, or a “Deeming Clause”? ............................................................................. 15  
      2. What is ‘Property Containing a Defect’ Within the Meaning of the LEG2 Wording? ..................... 16  
      3. What Are the ‘Costs That Would Have Been Incurred’ to Repair or Rectify the Defect Just Prior to the Damage? ................................................................................................................................. 18  
      4. What is the ‘Moral Hazard’ Addressed by the Exclusion? ............................................................. 19  
VI. Conclusion .............................................................................................................................................. 20  

Appendix A – Primary Wordings
“GETTING A LEG UP”
RECENT DEVELOPMENTS IN CONNECTION WITH THE FAULTY DESIGN AND WORKMANSHIP EXCLUSION

I. Introduction

The faulty design and workmanship exclusion was the subject of a paper at the September 2014 Insurance Law Conference. ¹ The 2014 paper considered: (1) various wordings; (2) what constitutes “cost of making good”; (3) when design or workmanship is “faulty”; and (4) the “state of the art” standard. The paper also discussed two then recent trial decisions considering the exclusion: Ledcor Construction Limited v. Northbridge Indemnity Insurance Company et al, 2013 ABQB 585, [2013] I.L.R. 1-5495² and Acciona Infrastructure Canada Inc. v. Allianz Global Risks US Insurance Company, 2014 BCSC 1568. Over the past 12 months both the Ledcor³ and Acciona⁴ appeals have been decided. This paper discusses the appeal decisions in both cases, discusses PCL Constructors Canada Inc. v. Allianz Global Risks US Insurance Co., [2014] O.J. No. 6210, 2014 ONSC 7480, another recent decision considering the exclusion, and comments on the significance of the three decisions.

II. Wordings

The various faulty design and workmanship wordings are set out in “Not My Fault”. The primary wordings are attached as Appendix “A” to this paper. They include:

1. The “cost of making good” wording. This is what might be termed the “traditional” Canadian wording. This wording, with minor variations, excludes “cost of making good” or “damage caused by” faulty design or workmanship, subject to an exception for “resulting damage”. The “cost of making good” wording has been considered many times by Canadian courts. Ledcor involved “cost of making good” wording.

2. The “DE” and LEG” wordings. These are a series of graduated wordings, developed by London underwriting groups. These wordings provide, across the range of DE and LEG wordings, greater flexibility to insurers and insureds in terms of scope and application of the exclusion. Both Acciona and PCL involve LEG2 wording.

² The author is counsel for insurers on the Ledcor matter in the Alberta Court of Appeal and in connection with the currently outstanding application for leave to appeal to the Supreme Court of Canada.
³ 2015 ABCA 121.
⁴ 2015 BCCA 347.

A. Facts and Policy Wording

*Ledcor* concerned a builders risk policy issued in connection with construction of the Epcor Tower in Edmonton. The named insureds were Station Lands Ltd. (“Station Lands”), the project owner, and Ledcor Construction Limited (“Ledcor”), the construction manager. A sub-contractor, Bristol Cleaning Ltd. (“Bristol”), was retained to carry out the final construction clean of the exterior glass. The construction clean was a requirement, under the project specifications, for substantial completion. Bristol did not carry out the work properly. Bristol’s workers did not adhere to contractual specifications and they used improper techniques and tools. As a result, some of the exterior glass was scratched. Station Lands and Ledcor made a claim under the policy for the costs potentially to be incurred in remedying the exterior glass. Insurers denied cover on the basis of the faulty workmanship exclusion. The exclusion provided:

This policy section does not insure:

. . .

(b) The cost of making good faulty workmanship, construction materials or design unless physical damage not otherwise excluded by this policy results, in which event this policy shall insure such resulting damage.

Insurers argued that the poor cleaning constituted faulty workmanship and that cost of repair of the glass constituted “cost of making good”. Station Lands and Ledcor argued that the poor cleaning did not amount to faulty workmanship, and argued that “cost of making good” was restricted to cost of a proper cleaning (or the cost of “doing the job right”). Station Lands and Ledcor argued that, if the exclusion applied, cost of repair of scratching to the exterior glass would constitute “resulting damage”.

B. Trial Decision

The matter was heard by Clackson J. as trial of an issue, on the basis of an agreed statement of facts. Clackson J. held that the poor cleaning constituted faulty workmanship, and went on to consider what would constitute “cost of making good”. Clackson J. summarized the issue as follows:

14 It is plausible that excluding the cost of “making good” faulty cleaning simply excludes the cost of having someone else do it right. That is the plaintiffs’ position. It is also plausible that “making good” faulty cleaning
extends to the damage done by the faulty cleaning. That is the defendants’ position.

Clackson J. then referred to *Ontario Hydro and Combustion Engineering – Superheater Ltd. v. Royal Insurance*, [1981] O.J. No. 215. That case involved acid wash of boiler tubes during commissioning of the boiler. The acid wash resulted in damage to the tubes. No other part of the boiler suffered damage. The insurer argued that the exclusion was restricted to cost of properly carrying out the acid wash. The insurer argued that the exclusion applied to the cost of repair of the damaged tubes. The court accepted the insurer’s argument, holding that “the cost of making good the improper workmanship is the cost of replacing the tubing which was the object of this procedure.”

After referring to *Ontario Hydro*, and to the general principles of interpretation applicable to insurance policies as reiterated by the Supreme Court of Canada in *Progressive Homes v. Lombard Gen. Ins. Co.*, 2010, S.C.C. 33 [2010] 2 S.C.R. 245, Clackson J. continued:

15 However, while the result in *Ontario Hydro* is defensible, the reasoning that led to the conclusion reached is not provided. In the end, the result reached was simply one of two plausible alternatives, and why one was chosen over the other is not readily apparent.

16 In my view, either of the proffered interpretations presented by the parties in this case appears on its face to be reasonable. The policy does not clearly suggest one alternative in preference to the other. Returning to the Supreme Court of Canada’s guidance in *Progressive Homes*, it appears, therefore, that the language of the exclusion is ambiguous. In the context of what is an all risk or builders policy stipulating coverage for virtually any event which might occur by way of negligence, third party action or act of God, one could conclude that an exclusion as suggested by the defendants is inconsistent. Additionally, Bristol, as a sub-contractor is an additional insured under the policy. Subrogation by the insurers against Bristol can be waived at the option of the plaintiffs. Again, all of that suggests broad coverage inconsistent with what the defendants say is the effect of the exclusion.

On that basis the Clackson J. held that the “cost of making good” the faulty workmanship was restricted to the cost of properly carrying out the construction clean of the exterior glass, and did not apply to costs incurred to repair the scratching.

---

5 The exclusion in *Ontario Hydro* was on “caused by” wording, rather than “cost of making good” wording. This should, as explained elsewhere (see “Not My Fault, 2014, Section IV.C) make no difference. The Court in *Ontario Hydro* was right to equate “caused by” with “cost of making good” in connection with cost of repair of the insured property.
C. Court of Appeal Decision


“Resulting damage” was damage to a separate part of the property insured. While other facts could legitimately engage the border between cost of making good and resultant damage, that issue, insurers argued, did not arise on the facts in Ledcor. The only damage was scratching of the windows. The windows were the specific part of the property being worked on by Bristol, and Bristol’s faulty work led directly to the scratching. Insurers argued that, on any reasonable interpretation, cost of repair of the windows was “cost of making good” the faulty workmanship.

The primary argument made by Station Lands and Ledcor on the appeal was that the exclusion could have no application where the work of more than one party was involved. In other words, because Bristol’s work was restricted to cleaning the windows, and because the windows had been manufactured, supplied and installed by parties other than Bristol, any damage to the windows arising from Bristol’s work would necessarily constitute “resulting damage”. Station Lands and Ledcor also sought to uphold the trial decision on the basis Clackson J. decided the case (that “cost of making good” is generally restricted to cost of re-doing the work in question). But that was very much a secondary argument.

The Court of Appeal overturned the trial decision. The judgment was written by Côté J.A., concurred in by Watson J.A. and Slatter J.A.

The Court first considered standard of review to be applied to interpretation of the exclusion, in light of Sattva Capital Corp. v. Creston Moly Corp., 2014 SCC 53 (paras 12-19). The Court concluded that, as the exclusion was on wording that commonly appeared in builders risk policies, and required consistency of interpretation, correctness was the appropriate standard of review.

The Court gave some consideration to the purpose and intent of the exclusion. The Court noted the observation, from prior cases (including Plutos, supra and Poole, supra) that an overly narrow interpretation of the exclusion would be inappropriate as it would give the insured carte
*blanche* to cut corners by utilizing faulty workmanship, materials or design, and require the insurers to pay for any repairs (para 24). Having said that, the Court pointed out that the cardinal rule of interpretation was to look first to the words of the policy (para 26). The Court also noted that “truisms” could be of limited assistance in interpreting the words of the policy (para. 21). The Court pointed out that, in order to trigger cover under the Policy there must be physical loss or damage. Therefore, the exclusion must apply to some element of the cost of repair of physical loss or damage. Otherwise, the exclusion would be irrelevant (paras 27-29). This echoes prior cases considering the exclusion, including the decision of the BC Court of Appeal in *BC Rail v American Home Assurance Co*, (1991) 54 B.C.L.R. (2d) 228 (C.A.).

After reviewing those matters the Court considered whether Bristol’s improper cleaning amounted to faulty workmanship. Station Lands and Ledcor argued that “workmanship” referred to only to acts which resulted directly in the creation of a “faulty product”. This interpretation of the exclusion is based on a line of US cases. Those cases are very much in the minority in the US, and are inconsistent with Canadian caselaw considering the exclusion. Canadian caselaw on the exclusion makes it clear that “workmanship” encompasses any activity involving application of care and skill and related to construction. Thus, in Canada faulty workmanship has been held to include poor procedures used in connection with acceptance testing of a tank which collapsed during testing and was damaged (*Pentagon Const. v U.S. Fidelity and Guarantee Co.* (1977) 77 DLR (3d) 189 (BCCA)); careless handling of a truss which was dropped during installation and damaged (*Bird Construction Co. Ltd v U.S. Fire Ins. Co.* (1985) 24 DLR (4th) 104 (Sask. CA)); and failure to take proper measures to protect equipment from the elements (*Sayers & Assoc. Ltd. v Ins. Co. of Ireland Ltd.* (1981) 126 DLR (3d) 681 (Ont. CA)). Most US cases reach a similar result; see, for example, *L.F. Driscoll Company v. American Protection Ins. Co.*, 930 F. Supp. 184 (E.D. Pa. 1996); *BSI Constructors Inc. v. Hartford Fire Insurance Co.*, 705 F. 3d 330 (U.S.C.A., 8th Circuit, 2013) and see *Couch on Insurance*, 3d, 2006, §153:79. In US jurisdictions which adopt the “faulty product” interpretation of the exclusion, such matters as failure to protect property being constructed from the elements has been found not to constitute workmanship. These cases generally concern facts indistinguishable from those on which Canadian courts have held that the exclusion applies.

The Court considered this issue fairly briefly (paras. 30 to 32). The Court found, consistent with Canadian caselaw the “workmanship” encompasses any activity involving application of care and skill, and would include provision of a service such as a pre-acceptance construction.

The Court then turned to the question of whether the exclusion would apply where more than one party had involvement with the damaged property. The Court termed this the “multiple contractors” argument. The Court rejected that argument for several reasons:

(a) It would be artificial, the Court concluded, to draw a dividing line between the work of other parties involved in the exterior glass and that of Bristol. In this context the Court noted that Bristol’s scope of work expressly included a

---

requirement that Bristol repair any damage caused by its work to the exterior glass (para. 35).

(b) The Court pointed out that, in many faulty design or workmanship cases, the damage was caused to work carried out by other contractors or parties, and this did not prevent application of the exclusion (para 36).

(c) The Court pointed out that the policy, as a typical builders risk policy, covered the entire project and all property. It would make no sense, in the context of such a policy, that the exclusion would apply if one party or contractor was solely involved in the damaged portion of the project, but would not apply if more than one party happened to be involved in that part of the project (para 37).

(d) In the context of a multi-year blanket course of construction policy it could not make any difference that there was a time lapse from initial installation of the windows to the window cleaning that resulted in the damage (para 38).

(e) The exclusion must be interpreted based on the nature of the damage, not on the specific contractual relationships between the parties or whether more than one contractor is involved (para 39).

(f) None of the cases on the exclusion support an interpretation which turns on the number of parties involved in the part of the project at issue. Nor is there support for that interpretation in the wording (para 39).

(g) The “multiple contractor” approach would lead to arbitrary and unreasonable results. Whether cost of repair of scratching due to faulty cleaning is excluded should not turn on whether the contractor who scratched the windows also happened to have installed the windows at some earlier stage of the project. In this context the Court cited prior caselaw, including Ontario Hydro (paras. 40-42).

(h) The Court also pointed out that the “multiple contractor” approach would provide an incentive to artificially divide the work as finely as possible among multiple contractors, to avoid application of the exclusion. This would make no sense (para 40).

After rejecting the “multiple contractor” approach the Court proposed a test, which the Court referred to as the “physical or systemic connectedness” test. The Court said:

[50] …The proper test can more properly be described as a test of the connectedness between the work, the damage and the physical object or system being worked on. The application of the test will depend on an examination of the factual context, but the primary considerations will be:
(a) The extent or degree to which the damage was to a portion of the project actually being worked on at the time, or was collateral damage to other areas. The test will be relatively easy to apply when the damage is caused directly by the work to the very object being worked on. There may be cases where several parts of the project work together as one system. Work on one part of the system may cause damage to another part, but repairing that damage might still properly be characterized as the cost of making good faulty workmanship if there is sufficient systemic connectedness;

(b) The nature of the work being done, how the damage related to the way that work is normally done, and the extent to which the damage is a natural or foreseeable consequence of the work itself. If the damage is a foreseeable consequence of an error in the ordinary incidents of the work, then it presumptively results from bad workmanship; and

(c) Whether the damage was within the purview of normal risks of poor workmanship, or whether it was unexpected and fortuitous.

The degree of physical or systemic connectedness is the key to determining the boundary between “making good faulty workmanship” and “resulting damage”.

The Court then considered application of the physical and systemic connectedness test to the facts. The damage here was restricted to the windows, the very part of the project being worked upon. The Court noted that scratching was highly likely, even, perhaps, inevitable, if the work was done in a faulty way (para 56). On that basis the exclusion applied.

Ledcor and Station Lands have applied for leave to appeal to the Supreme Court of Canada.

D. Commentary on the Appeal Decision

The Appeal decision in Ledcor confirms and is consistent with prior caselaw on the “cost of making good” wording. Had the trial decision been upheld on appeal, this would have resulted in a very significant narrowing of the exclusion. The physical and systemic connectedness test is new. However, the three elements of the test are the key matters that have always been looked to in connection with the exclusion.

Considering the first part of the test, where the damage is to the specific part of the structure which was the subject of faulty design or workmanship (as in Ledcor or Ontario Hydro) or is to part of an integrated structure which, for example, relies for support on the damaged part (as in Algonquin, Poole, Simcoe & Erie or Greene (all cited in “Not My Fault”), the exclusion applies.
On the other hand, where damage is caused to a separate part of the structure (as in *BC v Royal*) the exclusion does not apply.

Considering the second and third parts of the test, where the damage arises directly from the faulty mode of work (as in *Ledcor*), the exclusion will apply. Where the damage is remote, and not a direct result of the faulty mode of the work, the exclusion will not apply. Few, if any, Canadian cases have considered the type of conduct that would be too removed from a faulty mode of work to fall outside the exclusion, but factual scenarios that raise this issue are easy to envisage. Where a worker, smoking on his or her lunch break, drops a cigarette and starts a fire, the exclusion would presumably not apply. On the other hand, where (as in *Ledcor*) the worker fails to follow specifications designed to avoid scratching, and as a result the surface being worked on is scratched, the conduct is foreseeable, directly related to the work, and is a normal incident of faulty workmanship. Cases between these two ends of the spectrum will have to be assessed individually. But the test propounded by the Court of Appeal, in the author’s view, provides a useful and accurate means to assess those scenarios.


A. **Facts and Policy Wording**

*PCL* involved a claim under a builders risk policy for damage to mullions (window frame components) installed in the Maple Leaf Square project in Toronto. The mullions suffered corrosion damage and required repair. The cause of the corrosion was the presence of excessive liquid, specifically urea and sea salt, which became trapped within the mullions during construction. The corrosive liquid came from exposure during construction to road spray and de-icing salt used on the adjacent Gardiner Expressway; use of a urea-based snow melting product on parts of the project during construction; as well as general exposure to the elements. The method of installation involved caulking that made it difficult for corrosive liquid trapped within the mullions to escape. It was alleged that the caulking methods, and failure to either protect or clean the building components during construction, amounted to faulty workmanship.

The policy contained a faulty design and workmanship exclusion which was essentially on LEG2 wording, as follows:

> 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

---

7 For example, replace the cigarette in the hypothetical above with a welding torch, and the result is potentially different.
loss or damage shall be deemed to be Resultant Damage as Defined in Clause 38 of Section I of this policy.

The definition of resultant damage from clause 38, section 1 of the policy is not quoted in the judgment. That definition was likely the definition contained in the Builders Risk CCDC Endorsement from Insurance Bureau of Canada Form 4047:

“RESULTANT DAMAGE” shall mean physical damage to the insured property other than the cost or rectifying the defect or fault that caused the physical damage. The cost of rectifying the defect or fault (cost of making good) shall be the cost which the Insured would have incurred to do so had such defect or fault been discovered immediately before the physical damage occurred and rectified at that time.

On that basis the definition would repeat the concept that, on this wording appears in the exclusion itself. The excluded cost, in the event faulty design or workmanship causes physical damage, is the hypothetical cost that would have been incurred to repair or rectify the defect had this work been done just prior to the damage occurring.

Insurers denied cover on the basis of the faulty workmanship exclusion, and on the basis of a separate corrosion exclusion in the policy. The corrosion exclusion applied to loss or damage caused directly or indirectly by corrosion, subject to an exception for corrosion caused directly by a non-excluded peril. Insurers argued that, as faulty workmanship was an excluded peril, the exception to the corrosion exclusion would not apply, and the corrosion exclusion would apply to all loss or damage caused directly or indirectly by corrosion.

B. Trial Decision

The matter was heard as a special case, on an agreed statement of facts, by Myers J. The Court first considered whether there was faulty workmanship. The Court found that there was faulty workmanship, at least in connection with the failure to clean the project components during construction, and found that the faulty workmanship was the cause of the damage.

The Court then went on to consider the exclusions. The Court rejected insurers’ argument on application of the corrosion exclusion. In reaching this conclusion the Court found that faulty workmanship should not be treated an excluded peril for purposes of considering the exception in the corrosion exclusion. The Court made that finding on the basis that the LEG2 exclusion “is not actually an exclusion at all” (para 23). The Court found that the LEG2 wording should be treated, at least for purposes of the exception to the corrosion exclusion, not as an exclusion but as a “deeming” clause “that provides special treatment of losses or damage caused by faulty workmanship” (para. 23). The exclusion was restricted to the hypothetical costs that would have been incurred to rectify the defect prior to commencement of any physical damage (para. 23). Therefore, that loss or damage caused by faulty workmanship was not excluded and was, instead, deemed to be resultant damage covered by the policy.
In connection with application of the LEG2 exclusion itself, the Court left determination of the excluded costs to a further hearing, in the event the parties could not reach agreement. The Court referred to the outstanding question (para 31) as being the amount the parties would have had to spend “to avoid the exposure of the mullions to the corrosive liquid”. Insurers have appealed to the Ontario Court of Appeal.

C. Commentary on the Trial Decision

With the greatest respect to Myers J., in the author’s view, the conclusion that the LEG2 wording is not an exclusion, either generally or for the purpose of considering the exception to the corrosion exclusion, is not correct. The peril of faulty workmanship is excluded. The fact that some or all costs arising from that peril may be covered, under an exception to the exclusion for resultant damage, or because the exclusion requires a calculation of hypothetical costs, should make no difference. The application of a preceding or ensuing perils clause turns on whether the peril is excluded, not on whether all resulting loss or damage is excluded. This issue is also discussed below, in connection with Acciona, which followed PCL on this point.

With regard to the faulty workmanship wording, the Court appears to have framed the question in the same way as the Court in Acciona; not as requiring consideration of the costs that would have been incurred to repair or rectify the defective condition of the property just prior to damage occurring, but as requiring consideration of costs that would have been incurred to avoid creation of the defective condition in the first place. Myers J. referred expressly to costs that would have been incurred to avoid exposure of the mullions to corrosive liquid. It is not clear, from the facts set out in the decision, whether those amounts would be different. This issue is also considered in more detail in connection with Acciona.


A. Facts and Policy Wording

Acciona involved a project to construct an eight storey addition to the Royal Jubilee Hospital in Victoria, BC. To understand the decision, it is necessary to consider the construction process and related facts in some detail. The key facts are as follows:

1. The expansion project involved concrete slab construction. Construction occurred over several months commencing in early 2009. The slab for each floor was poured, using forms and shoring, and with a built-in camber. The camber was intended to accommodate expected downward deflection of the slab during the curing process and during life of the slab. With the built-in camber that deflection was intended to ultimately result in a level or close to level surface. Built-in camber was initially

---

8 See for example, Versacold Corp v Zurich Ins Co et al 2010 BCSC 23.
specified at 40mm but was reduced to 30mm due to concerns that a 40mm camber would result in crowned slabs.

2. Reshoring (vertical or inclined supports resting on the slabs below the slab being poured) were utilized. Reshoring was initially specified for 3 floors below the slab being poured. In May 2009 reshoring was reduced to 2 floors below the slab being poured.

3. The slabs, as designed and poured, were unusually thin.

4. In mid-June, 2009 it was observed that the slabs constructed to that date were losing too much camber. Rather than gradually flattening to become level during the curing process, as expected, the slabs were continuing to deflect past level, resulting in a permanent concave recession in the centre of the slab. In addition, cracking was observed in the slabs.

5. As of July, 2009, procedures were revised to reinstitute the original 40mm camber. By this time however, only a few slabs remained to be poured. It appears that this resolved the issue, in connection with the slabs remaining to be poured, although this is not entirely clear from the trial decision.

6. The cracking and over-deflection raised no structural or safety issue. However, as a result of those conditions the slabs did not meet contractual specifications and were rejected as non-conforming. Substantial remedial work was undertaken, including grinding down portions of the surface of the slabs and raising other portions, and cleaning and filling cracks. This work was carried out at a cost of several million dollars.

The builders risk policy issued in connection with the project included a faulty design and workmanship exclusion on LEG2 wording, as follows:

5. Perils Excluded

This Policy does not insure

…

(b) all costs rendered necessary by defects of material workmanship, design, plan, or specification, and should damage occur to any portion of the Insured Property containing any of the said defects the cost of replacement or rectification which is hereby excluded is that cost which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage.
For the purpose of this policy and not merely this exclusion it is understood and agreed that any portion of the Insured Property shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship, design, plan or specification.

Insurers denied the claim on the basis that there was no physical damage to the slabs and that, if there was physical damage, cost of repair or rectification of the slabs was all caught by the LEG2 exclusion. The insured took the position that there was physical damage, that there was no faulty design or workmanship (as the design and construction procedures met the governing “state of the art” standard) and that, if the exclusion applied, none of the costs incurred fell within the exclusion, on LEG2 wording.

**B. Trial Decision**

At trial, Skolrood J. found that the cracking and over-deflection amounted to physical damage to the slabs. That finding, upheld on appeal, raises the question of the border between physical manifestation of a defect and “physical damage” within the meaning of a property insurance policy. This paper is restricted to the scope of the exclusion, and consideration of the physical damage question is beyond its scope.

There was substantial factual and expert evidence at trial relevant to application of the exclusion. Skolrood J. found that the thin slabs, combined with the construction procedures utilized, were the cause of the over-deflection and cracking. The thin slabs would have been acceptable had different construction procedures been utilized. Conversely, the construction procedures utilized would have been acceptable with a more conventional slab design. The combination of thin slabs and the specific procedures utilized resulted in a situation in which the reshoring applied excessive forces to the slabs supporting the reshoring. Those forces caused the lower slabs, while still in the process of curing, to deform. This caused loss of the intended camber in the top slab being poured (as the top slab was supported by, and its shape determined by, the shoring and reshoring). A variety of alternatives would have been available to avoid this result. The slabs could have been poured with additional camber, or different shoring and reshoring procedures could have been used. But on the combination of thin slab design and construction procedures adopted, over-deflection was inevitable.

Skolrood J. found, on those facts, that the design was not faulty, but that there was faulty workmanship. Skolrood J. rejected the insured’s argument that the construction procedures met a “state of the art” standard. Skolrood J. then considered the question of what costs would be within the exclusion. Skolrood J, in considering the scope of the exclusion, said this, at para. 221:

> Read in its entirety, I find that the intent of clause 5(b) is to exclude those costs rendered necessary by one of the named defects, but is limited to costs “which would have been incurred if replacement or rectification of the Insured Property had been put in hand immediately prior to the said damage.” In other words, the excluded costs are only those costs that
would have remedied or rectified the defect immediately before any consequential or resulting damage occurred, but the exclusion does not extend to exclude the cost of rectifying or replacing the damaged property itself; the excluded costs crystallize immediately prior to the damage occurring and are thus limited to those costs that would have prevented the damage from happening.

The “damage” in issue here is the cracking and over deflection of the concrete slabs. The “defect in material workmanship” is the improper formwork and shoring/reshoring procedures adopted that resulted in the damage to the slabs. Applying clause 5(b), the excluded costs are those that would have remedied or rectified the defect before the cracking and over deflections occurred i.e. the costs of implementing proper formwork and shoring/reshoring procedures or incorporating additional camber into the formwork.

There was no evidence on which to quantify these costs except to say that they would have been minimal. [emphasis added]

The author, in “Not My Fault”, criticized this aspect of the decision on the basis that Skolrood J. treated the exclusion as applying only to the costs that would have been incurred during initial construction to avoid the creation of a defective condition in the slabs in the first place. In the author’s view the exclusion could not be restricted to the incremental cost that would have been incurred to avoid construction of slabs subject to inevitable over-deflection; the exclusion had to be applied to the cost that would have been incurred, after construction of the slabs but just prior to physical damage occurring. In other words, hypothetical costs had to be assessed at a point after each slab was completed, but before the deflection of the slabs reached a point that would constitute physical damage.

C. Court of Appeal Decision

The judgment in the appeal on Acciona was issued August 5, 2015. The decision was written by Willcock J.A., concurred in by Neilson J.A. and Garson J.A.

The Court first dealt with standard of review. The Court said that the issue was not primarily a question of policy interpretation, but was essentially a factual question, or a question of mixed law and fact, specifically, determining what costs would have been incurred in rectification of the property just prior to the physical damage occurring. On that basis, the Court held that the standard of review was palpable and overriding error.

On the proper interpretation of the LEG2 exclusion, Willcock J.A. characterized insurers’ argument as follows:
The Insurers say a conceptual error coloured the trial judge’s interpretation of this clause. Although the trial judge quoted the words of the policy, the appellant says he erroneously imported the concept of avoidance costs into the analysis. They say the judge adopted the approach of the “resulting damage” cases, which grapple with the distinction between defects in an insured’s own work, usually excluded, and damage resulting from those defects, often covered. They say the inquiry mandated by the Defects Exclusion is temporal rather than causative. It is not concerned with drawing distinctions between defects and resulting or consequential damage. Rather, the proper inquiry excludes the costs that would have been incurred if the defect had been recognized and repaired or replaced before it caused any property damage.

The Court of Appeal did not agree with insurers that the trial judge misinterpreted the exclusion to exclude only “avoidance costs”. Willcock J.A. referred to the passage quoted above from the trial decision (paras. 221-224), and said this (para 61-62):

I discern no error in the trial judge’s reasoning. The trial judge interpreted the Defects Exclusion to exclude from coverage the costs that would have been necessary to rectify a defect in workmanship immediately before that defect caused damage to the insured property. His critical finding that defects in the framing and shoring workmanship resulted in damage to the slabs was not challenged on appeal. Given that finding, the floor slabs cannot be considered to be a “portion of the insured property containing any of the said defects” within the meaning of the Defects Exclusion.

In other words, there was no defect in the slabs that could have been rectified in order to prevent the over-deflection, bending and cracking. The defect was in the workmanship. The judge found that if the defect in the workmanship had been identified early enough, there would have been no material additional costs to implementing appropriate workmanship. There was no evidence of such costs. It was a coincidence, in this case, that the necessary rectification costs were equivalent to the avoidance costs – but this does not mean the judge misinterpreted the Defects Exclusion to generally exclude only avoidance costs.

[Emphasis added by Court of Appeal.]

Willcock J.A. then referred to PCL, supra. Willcock J.A. adopted the reasoning from PCL (para. 64) that the LEG2 exclusion is “not actually an exclusion at all”, but a “deeming clause that provides special treatment of losses or damage caused by faulty workmanship”.

Willcock J.A. said (para. 66) that insurers’ argument did not give adequate weight to the fact that the defects exclusion refers to cost of replacement or rectification. In Willcock J.A.’s view the
trial judge did not err in describing the costs necessarily incurred to rectify faulty work.
Willcock J.A. said this:

[66] … In my view, the trial judge did not err in describing the costs necessarily incurred to rectify faulty work as “those that would have remedied or rectified the defect before the cracking and over-deflections occurred i.e. the costs of implementing proper formwork and shoring/reshoring procedures” (at para. 223). Such costs, the costs of doing the job right, represent the moral hazard the Insurers intended to avoid by the Defects Exclusion.

[Emphasis added by Court of Appeal.]

Willcock J.A. then referred to “Not My Fault” and the criticism of the trial decision, on the basis that the trial decision treated the exclusion as restricted to the costs that would have been incurred in avoiding creation of the defect, rather than cost of rectification of the defect. Wilcock J.A. found (para 73) that this was not what the trial judge did. Willcock J.A. quoted from “Not My Fault” with regard to examples of proper application of LEG2, in connection with situations in which cost of avoidance and cost or rectification would be similar. “Not My Fault” gave an example of a situation in which a building was constructed with 80 trusses, when it should have had 100 trusses. Sometime after completion the building collapses as a result of the insufficient trusses. Any time up to the moment of the collapse, the defective condition in the building could have been rectified by adding another 20 trusses. Costs within the exclusion would be approximately the same, on this scenario, under both an “avoidance” and “rectification” interpretation of the exclusion. Willcock J.A. concluded that the facts in Acciona were similar to those in the truss example, stating that, up to the moment of over-deflection, the “defect in the workmanship” could have been “repaired” by adjusting or supplementing the support structures. Accordingly, those additional construction costs would be the only costs to fall within the exclusion.

D. Commentary on the Appeal Decision in Acciona

In the author’s view, and with the greatest respect to the panel, the decision of the Court of Appeal leaves real uncertainty in connection with scope of the LEG2 exclusion, and, potentially, in connection with some of the other DE and LEG wordings. The following issues arise.

1. Is LEG2 an Exclusion, or a “Deeming Clause”? 

Wilcock J.A. adopted the conclusion, from PCL Constructors that the LEG2 wording is not an exclusion, but is a “deeming” clause. As noted above, this conclusion, in the author’s respectful view, is not correct. The LEG2 wording in the Acciona policy was contained in the exclusions section of the policy, and is drafted as an exclusion. In the author’s view, the LEG2 exclusion must be treated as excluding the peril of faulty workmanship. The Court is certainly correct that there is a “deeming” aspect to the exclusion. However, faulty workmanship surely remains an
excluded peril, even if most or all physical damage arising from that excluded peril is, by virtue of the “deeming” aspect of the clause, treated as covered.

Exclusions in property policies often contain what could be termed a “deeming” aspect, generally in connection with exceptions or limitations on the exclusion. The normal “resulting damage” exception to the exclusion on the “cost of making good” wording could be termed “deeming” language, in that it causes an aspect of the physical damage that results from the excluded peril of faulty design or workmanship to be covered. The same could be said for ensuing or preceding perils language commonly found in property policy exclusions, for latent defect, corrosion, and many other matters. Such clauses are nonetheless exclusions. The LEG2 wording is unusual, in the sense of requiring a hypothetical calculation of costs that would have been incurred in order to apply the exclusion, as opposed to a calculation of a portion of costs actually incurred. However, that is surely a difference of degree rather than kind.

It is not clear whether the Court’s conclusion that the LEG2 wording is a deeming clause rather than an exclusion affected the result in Acciona. It is however, an issue that could arise in future cases.

2. What is ‘Property Containing a Defect’ Within the Meaning of the LEG2 Wording?

The Court of Appeal found that, because this was a case involving faulty workmanship rather than faulty design, and because it was found that the slabs suffered physical damage, the slabs could not be characterized as property containing a defect within the meaning of the exclusion.

This finding, in the author’s view, is problematic. In the author’s respectful view, it is difficult to see how the slabs could be characterized as not containing a defect. On the findings of fact made by the trial judge, each slab, by the time it was poured and the forms removed, did not have the intended camber, necessary to avoid over-deflection. The intended camber was not present because of the inadequate shoring/reshoring procedures (in combination with the use of thin slabs). As a result, the slab would, over a period of time, over-deflect and become concave. As the higher floors were laid that slab would be over-loaded by the reshoring placed on it, contributing, in turn to the loss of camber in the slab then being poured. No external loads or forces were involved. As a result of faulty workmanship, in the creation of the slabs themselves, the slabs were doomed to fail.

The Court of Appeal appears to have treated the finding of Skolrood J. that the slabs suffered physical damage as incompatible with a finding that the slabs contained a defect. The two conditions are not incompatible. It is, of course, possible for property which is perfectly sound and not defective in any way to suffer damage from an external source. Many faulty workmanship cases on the “cost of making good” wording consider damage from an external source. This may be the case where, for example, where the faulty workmanship involves failure to take proper steps to protect the insured property from the elements (see, for example, Sayers, supra). It is also possible for property to suffer damage because the property is defective or contains a defect. Many faulty workmanship cases and many faulty design cases on the “cost of making good” wording, consider damage caused by the defective condition of insured property.
This is the case, for example, where a structure collapses or fails because, due to either faulty design or faulty workmanship, it does not have the ability to support expected loads (for example, Poole Construction, supra).

On the “cost of making good” wording it is irrelevant whether the source of the damage is external or internal. On either scenario the exclusion applies to the cost of repair of the physical damage caused to that portion of the insured property which was subject to the faulty design or workmanship. On the DE wordings, other than DE1, the result is different. The exclusion applies only where there is property “in a defective condition” (on DE 2, 3, 4 or 5). In the case of the LEG wordings, apart from LEG1, the exclusion applies, in the case of physical damage, to property “containing” a defect (on LEG2 or 3). Assuming, for the moment, that the requirement that the property “contain” a defect is comparable to the requirement that the property be in a “defective condition”, damage from a purely external source would not trigger the exclusion.

The distinction between treatment of internal and external damage on a wording requiring property in a defective condition can be seen by reviewing two cases: an Australian case, Rickards Constructors & Anor v Rickard Hails Moretti & Ors [2004] NSWSC 1041, upheld on appeal [2006] NSWCA 356; and an English case C.A. Blackwell (Contractors) Ltd. v. Gerling Allegemeine Verischerungs AG, [2007] EWCA Civ 1450, both involving faulty workmanship in connection with paving.

In Rickards the insured was contracted to pave a container terminal. The insured took certain steps in connection with the paving while areas of lower layers were still wet. The paving failed, and sections collapsed, within a few days of the paving being put to use. The exclusion was on wording similar to LEG2 wording. The exclusion applied to property “in which there is” a defect rather than property “containing” a defect. That distinction in the wording would not appear to be material. Cost of repair or rectification of physical damage was covered, less the costs that would have been incurred in rectifying the defect just prior to the damage. The Court found that there was no faulty design, but that there was faulty workmanship. Accordingly, the exclusion applied to the costs that would have been incurred in rectifying the pavement just prior to physical damage occurring. The condition could not have been rectified, except by undertaking repair similar to that undertaken after the collapse. Accordingly, the exclusion applied to the full cost of repair.

In C.A. Blackwell, the exclusion was on DE3 wording (see Appendix). The insured had a subcontract to complete earthworks in connection with the construction of a road. The road was damaged by rain. It was argued that the road was in a defective condition as sub-layers had been constructed without channels necessary to divert rainwater. Had this been proven, the Court accepted that the road would have been in a defective condition. However, the Court was not prepared to find on the evidence that the channels were missing. The cause of the damage, the court found, was the contractor’s failure to implement protective measures, such as use of pumps and separate drainage works, during construction. For that reason, while there was faulty workmanship, there was “no property in a defective condition”, and the exclusion did not apply.

Here, on the trial judge’s findings, the situation would appear to be analogous to Rickards, not to C.A. Blackwell. As noted above, there is no external source of damage. The faulty workmanship did not result in exposure of sound property to damage from an external source, such as wind,
rain or fire. To the contrary the faulty workmanship resulted in creation of concrete slabs that would, as time passed, over-deflect and crack without intervention of any outside force. On that basis the slabs would appear to qualify as property containing a defect within the meaning of the exclusion.

Whether there is property in a defective condition or property containing a defect is a question that does not arise on the “cost of making good” wording. It is however, a key question in terms of application of all of the DE wordings, and possibly on the LEG wordings (subject to an issue discussed below), apart from DE1 and LEG1. As the DE and LEG wordings become increasingly common, this issue will more often arise. If a structure that suffers damage due to faulty workmanship in its creation, and involving no outside force or source of damage, is treated as not containing a defect, this could be significant, in terms of narrowing the scope of the exclusions.

There is one further issue that should be mentioned. The analysis above assumes that property “containing a defect” within the meaning of LEG2 and 3, is analogous to property “in a defective condition” within the meaning of DE2, 3, 4 and 5. The words could be interpreted differently. In Rickards, supra, as noted above, the exclusion applied to property “in which there is” a defect or fault. The Court said (para 123) that the exclusion encompassed costs of repair or rectification of insured property “in which was, or that was affected by” faulty workmanship. Property may be affected by faulty workmanship without being in a defective condition, and in that sense, could be said to “contain” a defect. On the facts in Rickards this does not appear to have made a difference. It would make a difference on other facts. If property affected by defective workmanship is property “containing” a defect, then LEG2 and LEG3 have, on this issue, a scope similar to the “cost of making good” wording; faulty workmanship which exposes sound insured property to damage from an external source is within the exclusion. If, on the other hand, property must be “in a defective condition” to “contain” a defect, LEG2 and 3 are narrower, on this issue, than the “cost of making good” wording, and are comparable to DE2, 3, 4 and 5.

3. **What Are the ‘Costs That Would Have Been Incurred’ to Repair or Rectify the Defect Just Prior to the Damage?**

The Court of Appeal held that the exclusion applied to the costs that would have been incurred, just prior to the damage, to rectify the faulty workmanship. On that basis the Court of Appeal upheld the trial judge’s decision that the exclusion applied to the costs that would have been incurred to carry out proper reshoring.

The first point to note here is that, if there has been physical damage to insured property, and the property does not contain a defect (as the Court found), the exclusion does not apply at all. Accordingly, if the Court of Appeal is correct in finding that the slabs were not property “containing a defect” then, in the author’s respectful view, the finding that the exclusion would apply to the additional cost that would have been incurred in carrying out the shoring and reshoring work properly is clearly wrong. This error may not have affected the result in Acciona, as the costs of proper reshoring were found to be inconsequential. But this issue will arise in other cases considering the exclusion.
The second point raised is whether incremental costs that could have been incurred in initial construction can ever constitute cost of repair or rectification of property containing a defect. Because the Court of Appeal found that the slabs were not property containing a defect, this question was not considered. This issue will certainly arise in future cases, although, unlike the ‘defective condition’ question, this issue arises only in connection with the LEG2 wording. In the author’s respectful view, this issue has to be considered on the basis of costs that would be incurred after completion and prior to physical damage occurring. In Acciona, on the basis of the findings of fact made by the trial judge, this would involve consideration of costs that would have been incurred to rectify each slab after that slab was complete and before the lack of initial camber and imposition of reshoring loads resulted in the slab exhibiting negative camber in breach of contractual specifications. The cost of proper reshoring cannot be the correct measure of rectification costs. Had proper reshoring been used, the slabs would have had the intended camber, and would not have been subject to excessive loads during construction. Those costs would not have repaired or rectified the defect; they would have avoided it.

It is worth considering Rickards, supra in this context. In that case the insured argued that, after the pavement had been laid, steps could have been taken at minimal cost to dry out the affected portions. The court rejected that argument on the facts, and held that the exclusion had to apply to the full cost of repair. The important point for our purposes, is that there was no consideration of incremental costs that would have been incurred in laying the pavement in the first place to avoid layers with excessive moisture. Cost of instituting proper procedures in connection with initial paving would surely have been minimal. But no argument was put forward based on those costs, no doubt because it was clear that those costs, as part of initial construction, could not be treated as costs of rectification.

As noted in “Not My Fault”, if incremental costs that would have been incurred during initial construction can be considered to constitute rectification costs, this could have a significant impact on the scope of the exclusion.

4. What is the ‘Moral Hazard’ Addressed by the Exclusion?

The Court of Appeal referred to the moral hazard addressed by the exclusion as being “the cost of doing the job right” (para. 66). That finding echoes the finding of the trial judge in Ledcor, and the finding in the few other cases on the “cost of making good” wording that restricted the exclusion to the cost of redoing the work in question. As the Alberta Court of Appeal noted in Ledcor, all of those cases have been found to have been incorrectly decided. The moral hazard addressed by the exclusion, at least on the “traditional” wording, is not to preclude the insured from using poor workmanship and passing on to the insurer the cost of redoing the job properly; it is to preclude the insured from using poor workmanship and passing on to the insurer the resulting costs of rectification or repair of the insured property.

---

9 It could be argued, in connection with this issue, that the slabs had already over-deflected and were concave from the moment they were formed. This does not appear consistent with the facts as found by Skolrood, J. But if this were the case, the finding that the slabs suffered “damage”, rather than simply being defective from the moment of their creation, would be difficult to sustain.
The LEG2 wording obviously differs from the “cost of making good” wording in its use of a hypothetical measure of pre-damage repair or rectification costs. Notwithstanding that difference, the moral hazard addressed by the exclusion, whether on LEG2 wording or “cost of making good” wording, is surely the same. The only difference under LEG2 is that, where there has been a collapse or similar event, the additional rectification or repair costs that arise from that event are covered.

VI. Conclusion

*Ledcor* confirms the interpretation given to the “cost of making good” faulty design and workmanship exclusion on prior caselaw. *PCL* and *Acciona* make it clear that the DE and LEG exclusions will, depending on the particular wording used, and the facts, cause the exclusion to have a much narrower scope. These cases also, in the author’s view, indicate that significant issues remain to be worked out in terms of interpretation and application of the DE and LEG wordings in Canada.
APPENDIX “A”

The “Traditional” or “Cost of Making Good” Wording

PERILS EXCLUDED:

(c) cost of making good faulty or defective workmanship, material, construction or design, but this exclusion shall not apply to damage resulting from such faulty or defective workmanship, material, construction or design;

Variations on the “Cost of Making Good” Wording

One variation on the “cost of making good working is:

This policy does not insure:

(a) The cost of making good:

(i) faulty or improper material;

(ii) faulty or improper workmanship;

(iii) faulty or improper design

provided, however, to the extent otherwise insured and not otherwise excluded under this Policy resultant damage to the property shall be insured.¹

Another is:

We will not pay for loss … caused by or resulting from any of the following. But if loss or damage by a Covered Cause of Loss results, we will pay for that resulting loss or damage.

This policy does not insure:

(a) (i) faulty or improper material;

(ii) faulty or improper workmanship;

(iii) faulty or improper design;

provided, however, to the extent otherwise insured and not otherwise excluded under this policy, resultant damage to the property shall be insured.

The “DE” Wordings

- **DE1 (1995): Outright defect exclusion**
  This policy excludes loss of or damage to the Property insured due to defective design plan specification materials or workmanship.

- **DE2 (1995): Extended defective condition exclusion**
  This policy excludes loss of or damage to and the cost necessary to replace repair or rectify:
  
  (i) Property insured which is in a defective condition due to a defect in design, plan, specification, materials or workmanship of such Property insured or any part thereof;

  (ii) Property insured which relies for its support or stability on (i) above;

  (iii) Property insured lost or damaged to enable the replacement repair or rectification of Property insured excluded by (i) and (ii) above.

Exclusions (i) and (ii) above shall not apply to other Property insured which is free of the defective condition but is damaged in consequence thereof.

For the purpose of the Policy and not merely this Exclusion the Property insured shall not be regarded as lost or damaged solely by virtue of the existence of any defect in design, plan, specification, materials or workmanship in the property insured or any part thereof.

  This policy excludes loss of or damage to and the cost necessary to replace repair or rectify:

  (i) Property insured which is in a defective condition due to a defect in design, plan, specification, materials or workmanship of such property insured or any part thereof;

  (ii) Property insured lost or damaged to enable the replacement repair or rectification of Property insured excluded by (i) above.

Exclusion (i) above shall not apply to other Property insured which is free of the defective condition but is damaged in consequence thereof.
For the purpose of the Policy and not merely this Exclusion the Property insured shall not be regarded as lost or damaged solely by virtue of the existence of any defect in design plan specification materials or workmanship in the Property insured or any part thereof.

- **DE4 (1995): Defective part exclusion**
  This Policy excludes loss of or damage to and the cost necessary to replace, repair or rectify:

  (i) Any component part or individual item of the Property insured which is defective in design, plan, specification, materials or workmanship;

  (ii) Property insured lost or damaged to enable the replacement repair or rectification of Property insured excluded by (i) above.

  Exclusion (i) above shall not apply to other parts or items of Property insured which are free from defect but are damaged in consequence thereof.

  For the purpose of the Policy and not merely this Exclusion the Property insured shall not be regarded as lost or damaged solely by virtue of the existence of any defect in design plan specification materials or workmanship in the Property insured or any part thereof.

- **DE5 (1995): Design improvement exclusion**
  This policy excludes:

  (i) The cost necessary to replace repair or rectify any Property insured which is defective in design, plan, specification, materials or workmanship;

  (ii) Loss or damage to the Property insured caused to enable replacement, repair or rectification of such defective Property insured.

  But should damage to the Property insured (other than damage as defined in (ii) above) result from such a defect, this Exclusion shall be limited to the costs of additional work resulting from and the additional costs of improvement to the original design plan specification materials or workmanship.

  For the purpose of the Policy and not merely this Exclusion the Property insured shall not be regarded as lost or damaged solely by virtue of the existence of any defect in design plan specification materials or workmanship in the Property insured or any part thereof.
The “LEG” Wordings

- **LEG1/96 model ‘outright’ defects exclusion**
  The Insurer(s) shall not be liable for Loss or Damage due to defects of material workmanship design plan or specification.

- **LEG2/96 model ‘consequences’ defects exclusion**
  The Insurer(s) shall not be liable in respect of:

  All costs rendered necessary by defects of material workmanship design plan or specification and should damage occur to any portion of the Insured Property (Contract Works) containing any of the said defects the cost of replacement or rectification which is hereby excluded is that cost which would have been incurred if replacement or rectification of the said portion of the Insured Property (Contract Works) had been put in hand immediately prior to the said damage.

  For the purpose of this policy and not merely this exclusion it is understood and agreed that any portion of the Insured Property (Contract Works) shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship design plan or specification.

- **LEG3/06 model ‘improvements’ defects exclusion**
  The Insurer(s) shall not be liable in respect of:

  All costs rendered necessary by defects of material workmanship design plan or specification and should damage (which for the purposes of this exclusion shall include any patent detrimental change in the physical condition of the Insured Property) occur to any portion of the Insured Property (Contract Works) containing any of the said defects the cost of replacement or rectification which is hereby excluded is that cost incurred to improve the original material workmanship design plan or specification.

  For purpose of this policy and not merely this exclusion it is understood and agreed that any portion of the Insured Property shall not be regarded as damaged solely by virtue of the existence of any defect of material workmanship design plan or specification.