

## **THE INSURING AGREEMENT - KEY DETERMINATIONS FOR COVERAGE FOR PROPERTY AND LIABILITY**

### **I. Introduction**

The aim of this paper is to provide a framework for establishing key determinations of coverage for liability and property losses. Of course, the same insurance policy, such as a home owner's policy, might contain coverage for both liability and property.

The key determinations to be made to determine coverage in the first instance can be analyzed by comparing and contrasting the grant of coverage in basic property and liability protections.

It is useful to be reminded of the restatement of the basic method of interpreting an insurance policy in *Progressive Homes*.<sup>1</sup> The focus is on the words of the policy interpreted from the whole of the contract that promotes the parties' true intent at the time of entering into the contract. Effect should be given to clear language where the language of the policy is unambiguous, reading the contract as a whole.

Where the language is ambiguous, certain rules can be applied to assist in resolving the ambiguity:

- (1) interpretations that are consistent with the parties' reasonable expectations are preferred, provided such expectations can be supported by the words of the contract;
- (2) interpretations that would give rise to an unrealistic result should be avoided; and
- (3) similar insurance policies should be construed similarly.

Where these rules do not resolve the ambiguity, the policy is read against the interests of the party who imposed it – usually the insurer – this is known by fans of latin phrases as the *contra proferentem* rule.

Coverage provisions are interpreted broadly and exclusion clauses narrowly.

### **II. Property Policies vs. Liability Policies – the similarities and differences**

Both property and liability policies are, of course, contracts of insurance. That is, the insured pays a premium and the insurer takes on a risk of payment if an event happens. The event has to be uncertain and adverse to the insured. For a person to make a successful claim under a policy, they must be a named or unnamed insured under that policy.

Policies can be occurrence based or claims made based. If the policy is occurrence based, an act or occurrence must take place during the policy period. If the policy is claims made based, the claim must be made during the policy period.

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<sup>1</sup> *Progressive Homes Ltd v. Lombard General Insurance Co. of Canada*, 2010 SCC 33, [2010] 2 S.C.R. 245

A property policy is first party insurance that protects tangible property owned by the insured from damage. Associated income streams may also be covered. The policy may also compensate the insured for certain expenses incurred due to a property loss. The insured property might be a house and contents, building, stock, equipment or tenant's improvements. Business interruption is an optional part of such policies along with extra expenses including professional fees.

A liability policy is third party insurance granting the insured a defence and indemnity for liability caused by an insured's operations. This can include business operations, product liability, defamation, non-owned automobiles and tenant's liability. The essence of a liability policy is that loss is caused to a third party, by a claim or an accident or occurrence, during the policy period.

It must be remembered that claims made under the liability coverage will often be for property damage. The grant of coverage may be different because the words used in the policy differ. However, one event may trigger both property and liability coverage, just in different policies. If a tree from your neighbour's backyard falls and damages your house you may be covered by your own household insurance. If your insurer seeks to subrogate against your neighbour, it will be your neighbour's liability coverage that is engaged for the property loss you have suffered.

Therefore a key difference between whether a property or liability policy responds to a claim is often who is claiming the loss and how, rather than the nature of the loss.

### **III. Key Determinations for Coverage in the First Instance**

The first question is whether the loss falls within coverage. It is for the insured to demonstrate that a claim has occurred within the grant of coverage. This requires certain key determinations to be made: Was there an act or occurrence? Was it an accident or an uncertain event? Is the person claiming under the policy an insured person? Is the thing damaged property?

The grant of coverage and the words of the policy are paramount. It is vital to understand how the policy is written and structured. It is often necessary and always useful to begin with what type of policy you are dealing with and what risks the insured has attempted to cover. Looking just at the grant of coverage will not be sufficient to allow you to make the key determinations. The declarations page, the exclusions and any exceptions to the exclusions should also be considered.

In *Buchanan v. Wawanesa Mutual Insurance Co*<sup>2</sup> a house was damaged by a leaking water main that caused the house to settle. The homeowner was granted coverage against "all risks of physical loss or damage" to their property. There was an exclusion for settling. There was also an exclusion for flood and other water damage, but that exclusion contained an exception: "if the loss or damage is the result of the escape of water from a swimming pool or attached equipment or a public water main, you are insured."

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<sup>2</sup> *Buchanan v. Wawanesa Mutual Insurance Co.* 2010 BCCA 333 [2010] B.C.J. No. 1281

A plain reading of the grant of coverage, the exclusions and the exceptions led to a contradictory result. The court applied the *contra proferentem* rule, the narrow interpretation of exclusions, the primacy of the specific over the general and also the commercial expectations of the parties. It determined that any damage resulting from the escape of water from a public water main was covered as such coverage was specifically mentioned in an exception to an exclusion, and coverage was therefore granted.

This is a key example of why it is important to look beyond the mere grant of coverage and read the entire policy to determine whether the loss might be covered.

### A. Property Coverage

A typical property damage policy states that if property insured is lost or damaged by the perils insured against, the insurer will indemnify the insured against any direct losses caused. The maximum or agreed amount will usually be specified.

Property policies are either specified perils or all perils policies. A specified perils policy will set out which causes of damage are covered: fire, burglary, terrorism, flood, earthquake or accident. In specified perils policies, it is incumbent upon the insured to establish that the loss was caused by a specified peril. An all perils policy will cover damage caused by all perils, except for those that are listed as exclusions. Separate from the requirement to prove that the loss falls within coverage, the insured has no such duty to establish the loss was caused by a specified peril, instead the onus shifts to the insurer to prove that an excluded peril caused the loss.

In *Hanlon v. ING*<sup>3</sup> the British Columbia Court of Appeal interpreted a landlord and tenant policy where damage to a house in Salmon Arm had been caused by a marijuana grow operation. The damage included damp, stained and burned carpets, removal of bathroom faucets replaced with outdoor hose bibs, holes punched in bathroom walls for hoses to pass through them, lifting and stained wallpaper, lifting square tiles, mould and what the unfortunate property owner called “a strange smell”.

The policy covered direct loss or damage caused by specified perils including vandalism or malicious acts. The property owner established that the tenants’ acts were vandalism: they showed a wanton disregard for her rights.

The insurer conceded that vandalism had caused some of the damage, but argued that moisture and mould caused much of the damage and was not directly caused by the vandalism. The tenants were preparing for, or interested in, growing marijuana. They did not deliberately set out to elevate the moisture levels and thereby cause mould.

The court rejected that argument, finding that the word “direct” described the damage or loss, and that the insured proved that the mould was direct damage or loss, caused by vandalism. The court found that the word “direct” did not describe the cause of the loss. The insured did not have to show that the loss or damage was directly caused by vandalism.

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<sup>3</sup> *Hanlon v. ING Insurance Co. of Canada* [2011] B.C.J. No. 84 2011 BCSC 73

It is by applying such fine distinctions that it can be seen how broadly a grant of coverage can be interpreted.

It may also be necessary to examine the policy and any extension or endorsement in it to determine coverage. In *Wingtat Game Bird Packers v Aviva Insurance*<sup>4</sup> the grant of coverage read:

“In the event that any of the property insured be lost or damaged by the perils insured against, the Insurer will indemnify the Insured against the direct loss so caused to an amount not exceeding whichever is the least of (certain amounts).”

The key portions of the policy for the determination of coverage in that case were clauses 2.A and 2.B which relevantly read:

“2. PROPERTY INSURED

- A) This form insures the following property but only those items for which an amount of insurance is specified on the "Declarations Page":

"BUILDING", "EQUIPMENT", "STOCK", "ALL PROPERTY", "CONTENTS"

The insurance in this Clause 2.A. applies only while at the location(s) specified on the "Declarations Page".

- B) This form also insures "Building", "Equipment", "Stock" and "Contents" but only those items for which an amount of insurance is specified on the "Declarations Page".

TEMPORARY LOCATIONS: "Building", "Equipment", "Stock" and "Contents" other than at a specified location except while in transit, but there shall be no liability under this item at any location owned, rented or controlled in whole or in part by the Insured.”

The insured had separate policies written for its office in Surrey and a cold storage facility in Richmond. The office policy covered a building, equipment and stock, consequential loss, limited business income and burglary damage to buildings, all up to limits specified in the declarations. The cold storage policy covered only equipment and stock (contents) up to a limit of a little over one million dollars.

There was a multi-peril extension endorsement in both policies. This endorsement stated certain extensions “to be added, without increasing the amount of insurance, and only as a result of a peril insured against”. The limit applicable under that endorsement to stock and equipment while at temporary locations was a \$25,000 limit for any one occurrence.

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<sup>4</sup> *Wingtat Game Bird Packers (1993) Ltd v Aviva Insurance Co of Canada* 2009 BCCA 343, [2009] B.C.J. No. 1515

\$800,000 worth of the insured's stock was damaged by fire. It had been stored at a different cold storage facility which was owned by a third party, VersaCold. The insurer took the position that the insured was covered but only to the limit of \$25,000 as set out in the endorsement.

On appeal from a decision of a summary trial judge, the British Columbia Court of Appeal found that clause 2.B provided coverage for the entire loss and that the multi-peril extension did not limit the recovery for that loss to \$25,000.

The court found that the wording in clause 2.B did not require the address of a temporary location be specified in the declarations page as a precondition of coverage and it was not to be implied from reading the policy as a whole. The reasoning for this finding was that words should not be implied in a written contract, if express wording in the contract would thereby be rendered meaningless. If the temporary location was specified in the declarations page, then there would be coverage under clause 2.A. There would, therefore, never be any need to refer to clause 2.B.

This highlights the need to consider the entire policy. Arguments can be constructed, and in some circumstances accepted by a court, based on words in the policy which might appear at first glance to have little to do with the loss claimed. It is essential to review the entire policy and to consider the extent of other provisions in order to work out the purpose of the grant of coverage and the losses intended to be covered.

## **B. Liability Coverage**

A typical commercial and general liability grant of coverage covers all sums that the insured is obligated to pay by reason of liability imposed by law, or assumed by the insured under contract, for compensatory damages for various listed losses such as property damage due to an accident or occurrence. Of course the particular grant of coverage will depend upon the precise words of the policy, but there are principles of general application which arise from common phrases and concepts.

Since *Progressive Homes*<sup>5</sup>, the analysis of coverage for liability policies has widened. The Supreme Court of Canada determined that property damage in such policies is not limited to third party property and can include damage from part of a building to another part. Accident might include the consequences of defective workmanship and the own product/work exclusion may be limited to damage cause by the insured to its own work.

A typical grant of coverage would read:

“all sums that the insured is obligated to pay by reason of liability imposed by law, or assumed by the insured under contract, for compensatory damages”

There are liability policies available for the operations of almost any kind of business: manufacturers, landlords, garages, farmers and professionals. The compulsory automobile policy in British Columbia is also a liability policy.

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<sup>5</sup> *Progressive Homes Ltd v. Lombard General Insurance Co. of Canada* 2010 SCC 33, [2010] 2 S.C.R. 245

*Bulldog Bag Ltd. v. AXA Pacific Insurance Co.*<sup>6</sup> involved an insurance claim by Bulldog Bag against its own insurer AXA under a CGL policy which relevantly provided:

The Insurer agrees to pay on behalf of the Insured all sums that the Insured shall become obligated to pay by reason of the liability imposed by law upon the Insured or assumed by the Insured under contract, for compensatory damages because of property damage due to an accident or occurrence.

"Property Damage" means physical injury to or physical destruction of tangible property, including loss of use thereof, or loss of use of tangible property that has not been physically injured or destroyed.

"Occurrence" means a continuous or repeated exposure to conditions that result in property damage neither expected nor intended by the Insured.

All property damage arising out of a continuous or repeated exposure to substantially the same general conditions shall be considered as arising out of one occurrence.

Bulldog Bag sold printed packages to Sure-Gro, who in turn filled some of them with soil and manure intending to sell them to Canadian Tire. The ink printed on the bags was defective and as a result Sure-Gro suffered more than \$800,000 in losses. Sure-Gro sued Bulldog Bag for the costs directly associated with packaging different soil and manure products, removing the raw materials from the defective packaging, disposing of the defective packaging and the loss of 10% of the raw material in the salvaging process. The claim was settled for about \$823,000.

Bulldog Bag deducted the amount related to the initial cost of defective bags that had already been filled and claimed the rest, some \$732,000 from its own insurer AXA.

On summary trial, which occurred before the Supreme Court decision in *Progressive Homes*, the trial judge found<sup>7</sup>:

“The costs incurred by Sure-Gro in removing its product from the defective packaging, disposing of that packaging, and packaging replacement material for sale to Canadian Tire all constitute economic loss flowing from Bulldog's supply of defective packaging in breach of its contract with Sure-Gro. Bulldog was obligated under law and by its contract to compensate Sure-Gro for this loss. However, Bulldog is not entitled to indemnification for the cost of replacing its defective product, unless there was physical injury to or destruction of some tangible property of Sure-Gro....

[U]nder comprehensive general liability insurance policies that define property damage as physical injury to or destruction of tangible property, the insurer's obligation to indemnify will generally not be triggered where the property damage resulting from the

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<sup>6</sup> *Bulldog Bag Ltd. v. AXA Pacific Insurance Co* [2011] B.C.J. No. 654, 2011 BCCA 178

<sup>7</sup> 2010 BCSC 419 at paragraph 4 et seq. and paragraph 60

insured's defective work is confined to the insured's own property, or to property for which the insured is responsible. In the absence of damage to a third party's property, the insured will not be entitled to indemnity for the cost of replacing or repairing its own defective work, or work product.”

As a result, the trial judge allowed the claim against AXA only for the loss of 10% of Sure-Gro’s raw material, and ruled that the other losses were both pure economic losses and also not damage to a third party’s property and therefore not property damage within the meaning of the policy.

On appeal to the British Columbia Court of Appeal all of Bulldog Bag’s claims were successful. It was insured under its liability policy for the damages suffered by Sure-Gro, including removing its product from the defective packaging, disposing of that packaging, and packaging replacement material for sale. Those losses were consequent upon damage to the insured’s property and were pure economic loss, but were nevertheless property damage and comprised sums that Bulldog Bag were legally obligated to pay.

This case is a prime example of the change in the law wrought by *Progressive Homes*. The focus of a coverage issue is the words of the policy.

### **C. Specific Liability Indemnities**

There are several important indemnities granted in British Columbia which are not created in the same way as the types of policy set out above. The indemnities which grant coverage to school districts, hospitals, foster parents, colleges, universities and midwives are set out in handbooks and policies published by the risk management branch of the Ministry of Finance.

These statutory indemnities are quite different from a standard contractual insurance policy.

The indemnities granted to school boards were originally authorized and funded by an Order in Council in 1987.<sup>8</sup> That order gave approval to the Minister of Education to give indemnities to the boards of every school district. The terms were as set out in the standard comprehensive general liability coverage and for standard crime contained in the school protection program reference manual. A copy of the manual was deposited in the offices of the Ministry of the Provincial Secretary and Government Services.

In addition, Section 30 of the *Financial Administration Act*<sup>9</sup> continued the insurance and risk management account as a special account for the purpose of providing insurance or risk management services to participants such as government bodies, ministries and persons or public authorities designated by regulation. The government was authorized, by that section, to enter into agreements or make arrangements with participants for insurance or risk management. Regulations were authorized designating a person or public authority as a participant, respecting the terms and conditions under which agreements may be made and respecting payments to be made (in the nature of premiums).

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<sup>8</sup> Order in Council No. 1390, approved and ordered July 15, 1987

<sup>9</sup> *Financial Administration Act* RSBC 1996 c. 138

Section 1 of *Guarantees and Indemnities Regulation*,<sup>10</sup> made under the *Financial Administration Act* provides that such an indemnity may only be given in two circumstances: (1) with prior written approval by the Minister of Finance or (2) if the Director of the Risk Management Branch of the Ministry of Finance has given prior written assurance that the indemnity has been reviewed and accepted by that branch.

Clearly these indemnities are differently created and structured than a standard insurance policy. However, the normal rules of construction and interpretation are generally applied to these indemnities. If the actual terms of the policy were set out in legislation, then careful consideration should be given to whether a different set of rules would apply to its interpretation.

#### **IV. Conclusion**

In determining whether coverage is granted in a particular situation, the full terms of the policy are primary and paramount. The grant of coverage, the exclusions and exceptions can all be relevant. The circumstances of the creation of the policy, the operations of the insured and the types of risks that would have been expected to arise are all relevant considerations.

It is generally the insured's obligation to show at first instance that a covered loss has occurred. The onus can shift to the insurer if it contends that an exclusion applies. Coverage is interpreted broadly and exclusions narrowly. Key concepts to keep in mind are the type of peril, whether the insured was covered and whether there was an act or occurrence.

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<sup>10</sup> *Guarantees and Indemnities Regulation* B.C. Reg 365/92