Court File No. CV-21-00658423-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF 14487893 CANADA INC.

Applicant

BOOK OF AUTHORITIES OF THE INSURERS
(Prior Acts Exclusion)

Dated July 22, 2024

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CITATION: Omarali v. Just Energy, 2016 ONSC 4094
COURT FILE NO.: CV-15-527493-CP
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SUPERIOR COURT OF JUSTICE - ONTARIO

RE: Haidar Omarali / Plaintiff

AND:

Just Energy Group Inc., Just Energy Corp., and Just Energy Ontario LP / Defendants

BEFORE: Justice Edward P. Belobaba

COUNSEL: *David Rosenfeld and Jody Brown* for the Plaintiff / Moving Party

Paul J. Martin, Laura F. Cooper and Janna L. Young for the Defendants / Responding Parties

HEARD: June 21 and June 28, 2016

Proceeding under the *Class Proceedings Act, 1992*

CERTIFICATION DECISION

Introduction

[1] This is a motion to certify a proposed class action of some 7000 sales agents who were hired by the defendants as independent contractors and worked door-to-door selling their products. The plaintiff says the sales agents were misclassified - that they are not independent contractors but employees and are therefore entitled to the benefits and protections of the *Employment Standards Act*[1] such as minimum wage, overtime pay, and vacation and public holiday pay.

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[1] *Employment Standards Act, 2000*, S.O. 2000, c. 41 ("ESA").

[2] Class counsel says this is "the archetypal misclassification case." He says this to suggest that the proposed class action should be easily certified. The reality, of course, is otherwise. Misclassification cases are generally difficult to certify because individualized assessments are often required and commonality cannot be established.[2]

[3] Misclassification cases have been certified in two situations: one, where the issue was job function but the class was carefully defined to ensure class-wide job function similarity;[3] and two, where the common issues were focused on the systemic nature of the defendant company's policies and practices rather than on class member entitlements.[4] Otherwise, most misclassification cases that ask whether the class member is an employee (rather than say a manager) collapse under the weight of an "it depends" reality.[5] I am not saying that an "archetypal misclassification case" can never be certified,[6] only that the challenge in doing so should not be underestimated.

[4] That is why the defendants in this action argue that the determination whether the sales agents herein are independent contractors or employees can only be made on an individualized basis and, because there is no commonality, the matter cannot proceed as a class action. The defendants submit that the motion for certification must therefore be dismissed.

[5] When I first reviewed the parties' submissions, I was inclined to agree with the defendants. However, as I considered the matter further, and reviewed the applicable case law and the actual record before me, I realized that the evidence in this case was quite different from what was before the court in *Brown*[7] and *McCracken*[8]. More specifically, I realized that the defendants really had little in the way of "it depends" evidence and the

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[2] See, for example, *McCracken v. Canadian National Railway*, 2012 ONCA 445, and *Brown v. Canadian Imperial Bank of Commerce*, 2014 ONCA 677.

[3] *Rosen v. BMO Nesbitt Burns Inc.*, 2013 ONSC 2144.

[4] *Baroch v. Canada Cartage*, 2015 ONSC 40. Also see *Fulawka v. Bank of Nova Scotia*, 2012 ONCA 443 and *Fresco v. Canadian Bank of Commerce*, 2012 ONCA 444.

[5] *Brown v. Canadian Imperial Bank of Commerce*, 2012 ONSC 2377, at para. 175.

[6] Indeed, in *McCracken, supra*, note 2, at para. 44, the Court of Appeal agreed that "there is no rule that misclassification cases are automatically incapable of raising common issues." As in every certification motion, it depends on the evidence.

[7] *Brown, supra*, note 2.

[8] *McCracken, supra*, note 2.

plaintiff, on the other hand, had significant evidence of systemic commonality. I therefore came to the conclusion that the plaintiff has satisfied the commonality as well as the other requirements under s. 5(1) of the *Class Proceedings Act*[9] and that the proposed action should be certified as a class proceeding.

[6] The defendants may well prevail on the merits whether by way of summary judgment or a common issues trial. But overall merits are not relevant at certification. On a motion for certification, which is primarily a procedural decision, the plaintiff simply has to show a cause of action and some basis in fact for the four remaining s. 5(1) requirements: an identifiable class, common issues that will advance the litigation, procedural preferability and a suitable representative plaintiff.

[7] In my view, for the reasons set out below, the plaintiff has satisfied each of these requirements. The motion for certification is granted. The common issues, as proposed and certified, are attached in the Appendix.

Outline of decision

[8] To explain why this "archetypal misclassification case" has been certified as a class action on the evidence herein, I will proceed as follows. First, I will describe the defendants' 'independent contractor' sales structure. Next, I will provide a brief overview of how the law decides who is an "employee" and a summary of the key provisions of the *Employment Standards Act* as they apply here. I will then discuss the commonality requirement in detail because this is the core issue on the motion. I will end by considering the certification requirements in s. 5(1) of the CPA.

Background

Just Energy's sales structure

[9] Just Energy is a "family of companies" that provide electricity and natural gas supply to residential and commercial customers across North America. They commenced operations in Ontario in 1997, initially marketing fixed price natural gas contracts. After the provincial market for electricity was deregulated in 2002, Just Energy began to market electricity in addition to natural gas. Just Energy currently carries on business in six provinces and fifteen American states.

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[9] *Class Proceedings Act*, 1992, S.O. 1992, c.6 ("CPA").

[10] From the time it began operating in Ontario, Just Energy has hired what it believes are independent sales agents to solicit customer contracts for natural gas and electricity. The sales agents work door-to-door and are paid entirely by commission. In 2009 about 95 per cent of the company's sales revenues came from door-to-door selling. Today, on-line sales generate most of the company's revenue and about 21 per cent of the revenue comes from door-to-door selling. Nonetheless, even at 21 per cent, door-to-door selling remains a significant component of the defendants' business. As the company's vice president explained in his affidavit, "Our success has been built one door at a time."

[11] Just Energy has about 130 sales agents working in Ontario as independent contractors ("ICs"). However, because of the high turn-over rate in the door-to-door workforce (close to 18 times a year) the defined class over the four-year class period includes some 7000 former and current sales agents.

[12] Each of these putative class members work or worked in a team or "crew" supervised by a crew coordinator. The crew coordinators are supervised, in turn, by regional distributors who run the regional sales office. The crew coordinators and regional distributors are also IC's and are also paid on commission, drawing "over-rides" from the commissions earned by the door-to-door sales agents under their supervision. The sales agents can become crew coordinators and regional distributors. Some of the latter have been be hired by Just Energy as senior employees.

[13] The regional distributors are trained by Just Energy and report to the national distributors employed by the company. Every regional distributor signs an agreement with Just Energy which provides that the sales agents are ICs working for Just Energy, that the regional distributor must recruit, educate, motivate and guide the activities of the ICs, solicit customer contracts using forms and solicitation material approved and supplied by Just Energy, implement the compliance materials provided by Just Energy and generally comply with "all directions" provided by the company. Every sales agent is recruited and hired by Just Energy. All sales agents must wear a Just Energy identification badge.

[14] As an independent energy retailer, Just Energy is regulated by the Ontario Energy Board ("OEB"). Just Energy is responsible for the training, monitoring and conduct of its sales agents and must ensure that all sales agents adhere to internal and external codes of conduct.

The independent contractor agreement

[15] Every sales agent is required to execute an IC agreement. The plaintiff signed his IC agreement in July, 2012 and worked as a sales agent until December, 2013.

[16] In their submissions, the defendants go to great lengths to identify the many provisions in the IC agreement that assert that the sales agents are not employees. Let me simplify this part of the analysis by agreeing with the defendants that, except for clause 2 of the agreement (which requires the sales agents to "follow all instructions or directions" provided by Just Energy), there is no doubt, based on the IC agreement alone, that the defendants intended to hire the sales agents as ICs and not as employees.

[17] The IC agreement provides that the sales agents are generally on their own to do as they please. They must, of course, comply with applicable provincial regulations, such as the codes of conduct promulgated by the OEB and they are required to wear the prescribed identification badge and not engage in any misleading or deceptive sales practices. Otherwise, they can pursue sales as they wish.

[18] According to the IC agreement, there is no requirement to attend the morning meetings at the regional office or wear the defendants' clothing or use the defendants' suggested sales scripts or work door-to-door in any particular location. The IC agreement provides that the sales agents are free to choose when, where and how they will solicit contracts. Thus, I say again, if the IC agreement alone was determinative, it is reasonably clear (except for clause 2) that sales agents were being hired as ICs and not as employees.

[19] But the hiring agreement alone is not determinative.[10]

Who is an employee - the "economic realities" test

[20] Little weight is given by courts as to how the parties describe their relationship in the contractual agreement because this is often self-serving.[11] Nor does the ESA provide any assistance in this regard. The ESA applies to employees.[12] But "employee" is not defined. Thus, both courts and administrative adjudicators have had to look beyond the labels and examine the "economic realities" of the parties' relationship in practice.[13] It is in the common law that one finds the factors that must be considered. A leading Canadian text summarizes the key factors as follows:

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[10] England, *Individual Employment Law* (2008) at 22.

[11] *Ibid*.

[12] ESA, s. 3.

[13] England, *supra*, note 10, at 22.

> Canadian courts and administrative tribunals use various formulations of the test for determining employee status, but three elements are common: (1) the employer must exercise a relatively high degree of bureaucratic control over the when and the where of employment; (2) the worker must be economically dependent on the employer; and (3) the worker must not be an entrepreneur operating a business as a going concern but must form part of the employer's business.[14]

[21] The application of this common law test is invariably fact-specific and more often than not requires a nuanced analysis. Different courts or agencies in different regulatory contexts can come to different conclusions. A worker can simultaneously be an employee under the ESA and an IC under, say, the *Income Tax Act*.[15] Rulings by the CRA or the WSIB or other administrative agencies that the Just Energy sales agents are ICs and not employees are interesting and to a point relevant, but they are not determinative.[16] What counts, and the only thing that counts here, is whether the ICs are employees under the ESA as determined by the application of the common law test set out above.

[22] I pause here to note that of the three primary factors that are typically considered, the one that is the most determinative on the facts herein is the "control" factor, that is, the degree of control over the how, when and where of what's being sold.

[23] The other two factors are not seriously contested by the defendants:

- There is no serious dispute about the fact that the sales agents are economically dependent on Just Energy. Other than one example of a sales agent in the Ottawa area who also tries to sell LED lights while going door-to-door, the bulk of the evidence is that the sales agents sell only Just Energy products and are economically dependent on the defendants.

- There is also no serious dispute about the fact that the sales agents are not operating stand-alone businesses that service Just Energy as just one of several clients. The evidence is uncontroverted that the sales agents put in full days working exclusively for Just Energy and in doing so form a significant part of the defendants' business. (Recall the fact that door-to-door sales account for more than 20 per cent of Just Energy's total revenues.)

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[14] *Ibid*., at 19.

[15] England, *supra*, note 10, at 18 and cases cited therein.

[16] *Ibid*.

[24] Thus, when we come to consider whether there is "some basis in fact" or "some evidence" for the proposed common issues - for example, whether the sales agents are employees rather than ICs - the question will really be whether the plaintiff has presented some evidence that Just Energy exercises a degree of control over the how, where and when of the sales agent's job – because, as discussed, this is the determinant factor on the facts herein.

[25] I recognize that the Court of Appeal listed five factors in *Belton*[17] not three. The two that were added were these: whether the sales agent is limited exclusively to the service of the principal; and the cost and ownership of any tools required for the job. Neither factor, on the facts herein, is significant. In practice, virtually all of the sales agents work exclusively for Just Energy (except for the individual working out of the Ottawa office who also sells LED lights); and both sides agree that no special tools are needed to do door-to-door sales. Thus, the three-factor test outlined above is more than sufficient.

[26] A final point before turning to the applicable ESA provisions. "Control" is not defined either in the ESA or in the case law. One must therefore resort to the definition of "control" that can be found in most on-line and in-print dictionaries: "the power to influence or direct people's behavior." Note that "control" does not mean 'compel at gunpoint' but simply *"influence or direct"* people's behavior. I will return to this definition later in these reasons.

The applicable ESA provisions

[27] As already noted, because the ESA does not define "employee" it is necessary to apply the "economic realities" test described above. If the IC sales agents are found to be employees, then (unless they fall within a statutory exemption) they are entitled to a range of benefits and protections as set out in Parts VII to XI of the Act, such as minimum hourly wages, overtime pay and vacation and public holiday pay. These benefits and protections, as already noted, cannot be waived. One cannot contract out of the ESA.[18]

[28] A number of exemptions are set out in the legislation The exemption that applies here is found in s. 2(1)(h) of O. Reg. 285/01:

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[17] *Belton v. Liberty Insurance Co. of Canada*, [2004] O.J. No. 3358 (C.A.)

[18] ESA, s. 5(1).

> *Exemptions from Parts VII to XI of Act*
>
> 2. (1) Parts VII, VIII, IX, X and XI of the Act do not apply to a person employed…
>
> (h) as a salesperson, other than a route salesperson, who is entitled to receive all or any part of his or her remuneration as commissions in respect of offers to purchase or sales that,
>
> (i) relate to goods or services, and
>
> (ii) are normally made away from the employer's place of business.

[29] In other words, a sales agent who is found to be an "employee" under the common law test is exempted from receiving ESA benefits if she is a sales person who is paid in commission and works outside the employer's place of business. Thus, because Just Energy's door-to-door sales agents are outside salespersons they would fall within this exemption[19] and would not be entitled to minimum wage, overtime pay, or vacation or public holiday pay, *unless* they were found to be "route salespersons". If they come within the "route salesperson" exception to the general exemption, then they would be entitled to minimum wage and related benefits already noted.

[30] The ESA does not define "route salesperson." However, according to the Act's interpretation manual and related case law, the key consideration is the degree of control exercised by the employee relative to the employer.[20] Whether the "routes" are determined by the employer or the employee, the chance of profit or risk of loss and the level of entrepreneurial activity by the employee are also relevant questions.[21]

[31] The case law follows suit. "The key characteristics driving the conclusion that a person is either a salesperson or a route salesperson are the degree of control the employer exercises over the scheduling and order of sales calls and the degree of entrepreneurial initiative the employee at issue exercises."[22] The adjudicator typically

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[19] The plaintiff argues that the sales agents do not fall within the exemption because they are not paid commissions with respect to "offers to purchase or sales." I explain below why this is not a reasonable interpretation of the s. 2(1)(h) provision.

[20] *Employment Standards Act 2000 Policy and Interpretation Manual*, at 31-18.2.

[21] *Ibid*.

[22] *VanGrootel v. Advance Beauty Supply Limited*, 2016 CanLII 17209 (OLRB).

considers such facts as whether the employees were given scripts, were pre-assigned work locations, were driven to the assigned locations, were given direction and coaching on how to perform sales, wore a uniform provided by the employer and were subjected to supervisory phone calls.[23]

[32] It is important to remember as we begin to consider whether there is some evidence of commonality for the two key issues – that is, whether there is some evidence that the sales agent is an employee or route salesperson – that the most important evidence for each of these determinations is evidence about the defendants' degree of control over the how, when and where of what is being sold.

Commonality

[33] As already noted, this motion for certification turns on commonality – whether the proposed common issues can be answered on a class-wide basis. In *Brown* and *McCracken*, the defendant adduced extensive evidence to show that individualized inquiries were needed (to decide whether the employee was also a manager). And the plaintiff, in turn was unable to adduce sufficient evidence of systemic, class-wide commonality. Here however, the defendants' "individualized inquiries" evidence was surprisingly weak and the plaintiff's "systemic commonality" evidence was quite compelling.

[34] The proposed common issues ("PCIs") are set out in the attached Appendix. The key issues are PCI No. 1 (are the sales agents employees?) and PCI No. 4 (are they route salespersons?). In both cases, as already noted, the most relevant evidence is evidence about the degree of control that Just Energy has over the how, when and where of what is being sold.

[35] I will therefore take some time discussing the s. 5(1)(c) commonality requirement. I will set out the reasons why in my view commonality has been established for PCI Nos. 1 and 4, and I will then go on to consider the other certification requirements and the remaining PCIs.

[36] The law of commonality is well established. Under s. 5(1)(c) of the CPA, the plaintiff must show that his claim raises common issues. In order to satisfy the commonality requirement, the plaintiff only needs to adduce some basis in fact for the

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[23] *Schiller v. P & L Corporation Ltd*, 2012 CanLII 12611 (OLRB); *Kognitive Marketing Inc. v. Director of Employment Standards*, 2015 CanLII 61657 (OLRB); and *Orlov v. Amato*, 2003 CanLII 2984 (OLRB).

existence of the common issue.[24] This has been generally interpreted in the case law as involving two-steps - some evidence that the proposed common issue actually exists and some evidence that the proposed issue can be answered in common on a class-wide basis.[25] This must be coupled with the over-arching proposition that an issue cannot be common if its resolution is dependent upon individual findings of fact that have to be made with respect to each individual claimant.[26]

Step one: Some evidence that the "employee" and "route salesperson" issues exist

[37] The first step, some evidence that the proposed common issue actually exists, is typically satisfied with affidavit evidence from the plaintiff about his or her own experience. Here the plaintiff has adduced more than enough evidence to show that PCI Nos. 1 and 4 exist – that is, some evidence that Just Energy controls the how, where and when of the door-to-door sales and that the questions about whether the sales agents are "employees" and "route salespersons" are legitimate questions.

[38] I refer specifically to the evidence presented by sales agents Omarali, Awal, Nazerally and Filipovic. They make the following points. They work twelve-hour days, the morning portion dedicated to meetings and role-playing, and the balance of the day, 12 noon to 9 p.m., to door-to-door selling. They are required to wear Just Energy clothing. They are given sales scripts. They are driven in vans to pre-assigned locations, picked up at day's end and returned to the regional sales office. They cannot change their pre-assigned work areas without explicit permission. They are reprimanded if they take time off work and sanctioned if they breach internal or external codes of concduct. In short, say the affiants, they are told how, when and where to sell the defendants' products.

[39] The plaintiff has therefore satisfied the first step of the commonality analysis by showing some basis in fact that the "employee" and "route salesperson" issues exist.

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[24] *Fulawka v. Bank of Nova Scotia,* 2012 ONCA 443, at para. 79 ("…some evidentiary basis indicating that a common issue *exists* beyond a bare assertion in the pleadings.")

[25] *Dine v Biomet,* 2015 ONSC 7050 at paras. 15-19; affd, 2016 ONSC 4039 (Div.Ct.).

[26] *Fehringer v. Sun Media Corp.*, [2002] O.J. No. 4110 (S.C.J.), aff'd, [2003] O.J. No. 3918 (Div. Ct.).

Step two: Some evidence of systemic or class-wide commonality

[40] This is always the more difficult challenge in misclassification cases. The plaintiff may well have some evidence that the PCI exists at least for one or more class members. But now, under the second step of the analysis, he must present some evidence that the PCI is common to the entire class. To do this, the plaintiff typically must find evidence of systemic commonality, ideally in the defendants' own practices and policies.

[41] Here the plaintiff does just that. He relies not only on the defendants' own documentation (such as Just Energy's training materials) but also on the representations made on behalf of the company to the OEB. The plaintiff provides the following evidentiary support for the proposition that the defendants influence or direct (that is, control) the sales agents' behavior on a class-wide basis.

[42] There is evidence in the company's own documentation that the completion of the sales agent's five-part training program is not optional but "must" be completed in its entirety. There is evidence that the morning meetings provide an opportunity "to practice the sales presentation and receive coaching and suggestions from the crew coordinator." There is evidence that a detailed sales script is provided and that the sales agents are trained in "what must and must not be said at each door."

[43] There is evidence in the defendants' documentation that the sales agents "will be dropped off by the crew coordinator at the location you will be working in for the day." The sales agents "will work from early afternoon to early evening in one area, contacting customers." There is evidence that they are provided with "do not solicit" lists for the assigned area and must "use only current and approved Just Energy sales and marketing materials."

[44] Customer contracts are finalized by Just Energy. All customer complaints are handled by Just Energy. There is evidence of ongoing quality-control supervision on the part of Just Energy with daily and weekly reports detailing sales agent productivity and customer complaints. The OEB was told by the defendants' legal counsel that "… Just Energy's Ontario operations and compliance teams commit more than 80 person hours per week on quality assurance and monitoring activities."

[45] There is evidence that the sales agents must comply with the company's internal Code of Business Conduct. Just Energy advises its sales agents that it "may discipline and/or terminate its relationship or affiliation with any representative who breaches this Code or related policies." There is evidence that violations of either the OEB or the Just Energy code of conduct can result in "progressive discipline" - from warning letters to monetary penalties, suspensions and terminations.

[46] Last but not least, Clause 2 of the IC agreement (executed by every sales agent) requires every IC to "follow all instructions or directions provided by JEC from time to time." Note the language: all "instructions and directions."

[47] In sum, I have no difficulty concluding that the plaintiff has presented some evidence that the defendants control (that is, influence or direct) the "how, when and where" behavior of the sales agents and do so on a class-wide basis.

Why this is not *Brown* or *McCracken*

[48] In *Brown* and *McCracken*, the plaintiff failed to provide some evidence that the job functions of class members were "sufficiently similar" that the misclassification claim could be resolved without considering the individual circumstances of class members.[27] In both cases, the defendants presented extensive evidence showing a "wide variability"[28] in the duties and responsibilities of employees having the same job title or classification. Some had managerial duties; other did not. The court concluded that individual inquiries were required and thus there was no commonality.[29]

[49] Here, however, the issue is not whether the job functions of class members are "sufficiently similar" but whether the level or degree of control over the how, when and where of what is being sold is "sufficiently similar" that the misclassification claim can be resolved without considering the individual circumstances of class members.

[50] Here, the defendants did not present any evidence of wide variation in the nature or extent of control over the sales agents. The defendants pointed to the IC agreement which, as I have already noted, is not determinative. They pointed to several broad assertions in their affidavit evidence that the sales agents were under no obligation to attend the morning meetings, were not required to wear Just Energy branded clothing and were "at liberty" to work "at any time and at any location." But these highly generalized assertions are akin to the "bald, sweeping and conclusory assertions" that were rejected by the Court of Appeal in *McCracken*.[30]

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[27] *McCracken, supra*, note 2, at para. 104.

[28] *Brown, supra*, note 2, at para. 44.

[29] *McCracken, supra*, note 2, at para. 128.

[30] *McCracken, supra*, note 2, at para. 104.

[51] The defendants also tried to suggest there were variations in job functions and related degrees of control by noting that not all of the class members worked door-to-door selling energy supply contracts to first-time residential customers. Some of the sales agents sometimes worked on residential "renewal" sales and others on commercial customers, both new and renewal.[31]

[52] However, the defendants presented no evidence showing any variation in the level of control relating to the residential renewal sales, or commercial new or renewal sales. There was no evidence, for example, that sales agents selling to commercial customers worked their own hours, used their own sales scripts, wore their own clothing, drove their own cars or finalized their own contracts.

[53] Instead, there is evidence to the contrary. Every sales agent was hired to perform just one job: door-to-door selling. Indeed, Just Energy instructed its recruiters that, "We can't tell people we have multiple positions as multiple positions imply different jobs. We have *one job* with multiple openings."

[54] Also, the company's VP noted in his affidavit that the sales agents working the residential renewal or the commercial customers were still selling 'door-to-door':

> While these sales agents may sell different products to differing customer bases, the one constant is that each and every door-to-door sales person is an Independent Contractor and it is this business model that has remained constant at Just Energy since 1997.

[55] In short, unlike in *Brown* and *McCracken*, here the evidence adduced by the defendants does not show a "wide variability"[32] or "lack of core commonality"[33] in the nature or extent of control exercised by the company over its door-to-door sales agents.

[56] I am satisfied that there is some basis in fact for both the existence and the commonality of the key common issues, "employee" and "route salesperson."

Certification requirements

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[31] I note that some of the sales agents also sold water heaters at one time. However, no further information has been provided about the water heater sales.

[32] *Brown*, *supra*, note 2, at para. 44.

[33] *Ibid*.

[57] I can now turn to the certification requirements as set out in s. 5(1) of the CPA - cause of action, identifiable class, common issues, preferable procedure and a suitable representative plaintiff. I will consider each of these in turn.

(1) Cause of action

[58] Section 5(1)(a) requires that the pleadings disclose a cause of action. I am satisfied that the pleadings disclose the following causes of action: breach of the ESA, breach of contract and the duty of good faith, negligence, and unjust enrichment.

[59] The defendants' complain that more facts should have been pleaded. However, Rule 25.06(1) requires "a concise statement of the material facts but not the evidence by which those facts are to be proved." In my view, there is nothing deficient or improper about the pleadings.

[60] The defendants also argue that because the pleadings refer to the IC agreement, and the IC agreement is clear that the sales agents were independent contractors, it follows that no cause of action is disclosed in the pleadings. However, as already noted, the contractual agreement is not determinative. The application of the so-called *Belton* factors may well result in a finding that the sales agents were actually employees even though they signed an IC agreement. The primary issue in this analysis is "control" and that issue is not decided by the content of the IC agreement but the "economic realities" of the parties' relationship in practice.[34] The fact that the pleadings refer to the IC agreement is simply not determinative.

[61] In short, the pleadings disclose the causes of action as noted above. The first requirement under s. 5(1)(a) is satisfied.

(2) Identifiable class

[62] The plaintiff, Haidar Omarali, signed the Just Energy IC agreement in July, 2012 and worked in Toronto as a Just Energy door-to-door sales agent from approximately August 2012 to December 2013. In his first month of employment, the plaintiff worked about 288 hours and made $956.40 or the equivalent of $3.32 per hour. The plaintiff's commission income in 2012 was $8,851 and in 2013 it was $23,515.

[63] To satisfy the section 5(1)(b) requirement of the CPA, there must be an identifiable class of two or more persons. The class must also be objectively defined and

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[34] *Supra*, note 13.

limited by rational criteria bearing a relationship to the common issues.[35] In my view, this second requirement has been satisfied.

[64] The plaintiff proposes the following class definition:

> Any person, since 2012, who worked or continues to work for Just Energy in Ontario as a Sales Agent pursuant to an independent contractor agreement.

[65] The defendants say the class definition should be narrowed to exclude claims that are, on the face of the pleadings, statute-barred. The statement of claim was issued on May 4, 2015. Therefore, all claims in respect of services provided prior to May 4, 2013 (or services for which commission payments were made prior to May 4, 2013) are barred by the two-year limitation period set out in the *Limitations Act, 2002*.[36] Every class member, say the defendants, would have known upon the receipt of his or her first commission payment, if not sooner, that he or she was not being paid a minimum wage or receiving any other benefits under the ESA. In other words, the class period should begin on May 4, 2013 not January 1, 2012.

[66] I am not persuaded that the class should be narrowed at this stage of the proceeding. The defendants may well prevail on the limitations point but more evidence on the issue of reasonable discoverability is needed, particularly where the defendants themselves were continually representing to the sales agents through words and actions (e.g. pay slips) that they were ICs and not employees. On these facts, I prefer to follow the case law as summarized in the leading text on class actions, that "the limitations issue should not be resolved on a pleadings motion or on a motion for certification."[37]

[67] The better approach, in my view, is to allow the defendants to add the limitations question as a common issue[38] and I have done so herein. On the defendants' motion, I have added Common Issue 15 to deal with the limitations argument.

[68] Returning then to the s. 5(1)(b) requirement. The class consists of an identifiable group of door-to-door sales agents who are recruited and trained in common, have the

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[35] *Western Canadian Shopping Centres Inc. v. Dutton*, 2001 SCC 46, at para. 38.

[36] S.O. 2002, c. 24, Sch. B, ss. 4-5.

[37] Winkler, Perell, Kalajdzic and Warner, *The Law of Class Actions in Canada* (2014) at 294.

[38] *Ibid*.

same job, and are all classified as independent contractors. The term "sales agent" is an objective term that is used by Just Energy and readily understood by the class members. The class definition is rationally connected to the common issues because the class members were allegedly misclassified as independent contractors in violation of the ESA.

[69] The "identifiable class" requirement is satisfied.

(3) Common issues

[70] I will now consider each of the PCIs in turn and decide whether the PCI should be certified as a common issue.

PCI No.1: Are the class members employees?

[71] PCI No. 1 asks if the class members are employees under the ESA. I have already found in my discussion of the commonality question[39] that there is some basis in fact that the issue exists and has class-wide commonality.

[72] PCI No. 1 is certified as a common issue.

PCI Nos. 2, 3 and 9: CPP and EI contributions

[73] PCI Nos. 2 and 3 ask about CPP and EI contributions. PCI No. 9 asks if the defendants failed to make these contributions on behalf of the class members. There is certainly some evidence that the issues exist and, because they focus on the defendants' conduct, they can be answered on a class-wide and common basis.

[74] I suggested to the plaintiff that because the answers to these PCIs were self-evident (obviously no such contributions were made) there was little to be gained in having these questions certified as common issues. But counsel on both sides insisted that there was value in doing so. I will yield to their joint request.

[75] PCI Nos. 2, 3 and 9 are certified as common issues.

PCI No. 4: Are the class members route salespersons?

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[39] See above, at paras. 37-47.

[76] This is the second core common issue. If the answer to PCI No. 1 is "yes" and the class members are found to be employees, PCI No. 4 asks whether they are exempt from Parts VII, VIII, IX, X and XI of the ESA as outside salespersons or fall within the exception to this exemption as route salespersons? I have already found in my discussion of commonality above,[40] that there is evidence in the plaintiff's affidavit material that the issue exists and has class-wide commonality.

[77] There is one problem, however, with this common issue as drafted by the plaintiff. The first dozen or so words of PCI No. 4 suggest that s. 2(1)(h) of O. Reg. 285/01 should be interpreted as meaning that "class members are making offers to purchase" rather than the customer.[41] In my view, it is plain from the language in the Regulation that it is the customer that is making the offer to purchase not the sales agent. I therefore agree with the defendants that the opening language in PCI No. 4 should be revised to simply read, "If the answer to (1) is "yes", are the class members ... [etc]."

[78] With this revision, PCI No. 4 is certified as a common issue.

PCI No. 5: ESA requirements as express or implied terms

[79] PCI No. 5 asks the following: if the class members are employees and route salespersons, do the ESA requirements regarding minimum pay and related benefits form express or implied terms of the class members' contracts?

[80] Here again, I suggested to the plaintiff that very little would be gained by adding this question to the common issues list. The answer is self-evident. If the ESA applies, and one cannot contract out of the ESA, then it follows that the ESA benefits and protections are payable and these requirements can be characterized as an implied term of the class member employment contracts.

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[40] Recall above at paras.37-47.

[41] The plaintiff's PCI No. 4 reads as follows: "*If the Class Members are making offers to purchase or sales pursuant to s. 2(1)(h) of O. Reg. 285/01*, are the class members exempt from Parts VII, VIII, IX, X and XI of the *ESA*, or do the Class Members fall within the exception to this exemption as route salespersons?

[81] But here again, counsel for both sides requested that this question be added as a common issue. And here again, as I did with PCI Nos. 2, 3 and 9, I acceded to the joint request. I note that a similar issue was certified in *Rosen*, *Fulawka* and *Fresco*.

[82] PCI No. 5 is certified as a common issue.

PCI Nos. 6 and 7: Breach of contractual and good faith duties

[83] PCI No. 6 asks if the defendants owed contractual duties or a duty of good faith to ensure that the class members paid the minimum wage, that the hours of work were monitored and accurately recorded, that the class members were properly classified and advised of their rights to overtime pay and that they were compensated with vacation and public holiday pay.

[84] There is certainly some evidence that none of this was done and that the questions posed can be answered on a class-wide basis. The basis of the duties alleged are informed by the requirements of the ESA and the Supreme Court's decision in *Bhasin v Hrynew*[42] that requires honesty in contractual performance. I also note that similar questions have been certified in other employment class actions, including *Rosen, Fulawka, Fresco* and *Baroch*.

[85] PCI No. 7 is certified as a common issue.

PCI No. 8: Failure to comply with ESA requirements

[86] If the class members are found to be employees and route salespersons, PCI No. 8 asks if the defendants failed to pay minimum wage, overtime pay, and vacation and public holiday pay. Here again, the answer is self-evident. But here again, because both sides requested that this issue be added, I will accede to the joint request.

[87] PCI No. 8 is certified as a common issue.

PCI Nos. 10 and 11: Negligence

[88] PCI Nos. 10 and 11 ask, in the alternative, if the various failures alleged under the contractual claim in PCI Nos. 6 and 7 can constitute breaches of a duty of care in negligence and if so, whether the defendants breached such a duty. As with PCI Nos. 6

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[42] *Bhasin v Hrynew*, [2014] S.C.R. 494.

and 7, there is sufficient evidence for PCI Nos. 10 and 11. I also note that negligence as a common issue was certified in other ESA cases such as *Fresco, Fulawka* and *Baroch*.

[89] PCI Nos. 10 and 11 are certified as common issues.

PCI No. 12: Unjust enrichment

[90] PCI No. 12 asks if the defendants were unjustly enriched by failing to make the payments required under the ESA or the contributions required under the CPP and EI legislation.

[91] I agree with the plaintiff that unjust enrichment is well suited to certification as a common issue because the focus is on the defendant's actions and not on the actions of individual class members. An unjust enrichment issue has been certified by the court in numerous employment class actions, such as *Rosen, Fulawka, Fresco* and *Baroch*.

[92] PCI No. 12 is certified as common issue

PCI No. 13: Aggregate damages

[93] PCI No. 13 asks if the damages sustained by class members should be assessed on an aggregate basis. Aggregate damages under s. 24(1) of the CPA may be certified as a common issue if there is a reasonable likelihood that the damages can be determined without proof by individual class members.

[94] If the class members are found to be employees and route salespersons, the bulk of the loss would consist of the unpaid ESA benefits, in particular minimum hourly wages and overtime pay. But the defendants kept no records of hours worked. Therefore, these losses cannot be determined without proof by individual class members. Aggregate damages are not appropriate.

[95] Further, to properly assess each sales agent's "loss" the court would likely have to subtract the 'commissions received' amount from the 'ESA benefits that should have been paid' amount – again, requiring individualized inquiries.

[96] I therefore conclude that for the bulk of the damages sustained, an aggregate damages common issue should not be certified. However, I recognize that the Court of Appeal in *Good* [43] concluded that aggregate damages can be certified as a common issue

[43] *Good v. Toronto (Police Services Board)*, 2016 ONCA 250.

where it can be established that the class members are entitled to "a base amount" that does not depend on individualized proof.[44] Here, says the plaintiff, the amounts owing for CPP and EI contributions can be determined by reviewing the income records in the defendants' possession.

[97] I accept the plaintiff's submission about the CPP and EI amounts. But this action is not about CPP and EI. So, on balance, I prefer to leave the entire aggregate damages question to the common issues trial judge who will be able to decide on his or her own whether aggregate damages can or should be awarded.

[98] PCI No. 13 is not certified as a common issue.

PCI No. 14: Punitive damages

[99] PCI No. 14 asks if the class members are entitled to an award of aggravated, exemplary or punitive damages based on the defendants' conduct.

[100] A punitive damages common issue (asking about entitlement rather than amount[45]) is often certified because the focus is on the defendants' conduct and thus the commonality requirement is satisfied. But one still needs to adduce some evidence that the issue exists - that there is conduct that would justify a punitive damages question.[46]

[101] Punitive damages are awarded when the defendant's wrongful acts are "harsh, vindictive, reprehensible and malicious", indeed "so malicious and outrageous that they are deserving of punishment on their own."[47] There is no evidence in the record that the defendants' conduct in classifying and hiring sales agents as ICs rather than as employees was in any way "harsh, vindictive, reprehensible and malicious."

[102] Instead, the evidence shows that over the years the 'independent contractor' issue was adjudicated before various administrative agencies including the CRA, the WSIB,

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[44] *Ibid.*, at para. 75.

[45] See the discussion in *Dine v Biomet, supra,* note 25, at paras. 58-60.

[46] *Ibid.*, at para. 55.

[47] See the case law as discussed most recently by the Court of Appeal in *Strudwick v. Applied Consumer & Clinical Evaluations Inc.*, 2016 ONCA 520 at paras. 110-112.

and on at least one occasion, before an employment officer of the ESA. With each decision the defendants were reassured that their sales agents were indeed ICs not employees. This does not mean that the same result will necessarily follow in this case. But it does mean that the defendants' actions in the design and implementation of their IC sales structure cannot be characterized as "so malicious and outrageous that they are deserving of punishment on their own." In any event, and to repeat, there is no evidence of conduct that would support a punitive damages issue.

[103] PCI No. 14 is not certified as a common issue.

PCI No. 15: Limitations period

[104] As I have already explained in my discussion of the "identifiable class" requirement, I will add and certify a common issue dealing with the limitations question. There is some evidence that the class definition should be narrowed to confine the class period to the two years preceding the issuance of the statement of claim. The resolution of the limitations issue will have a common impact on all those affected.

[105] I will therefore add and certify the following issue:

> Are the claims that relate to services provided before May 4, 2013 (or services for which commission payments were made before May 4, 2013) barred by the two-year limitation period set out in the *Limitations Act, 2002*?

[106] This completes my analysis of the proposed common issues. In sum, for the reasons set out above, PCI Nos. 1 to 12 are certified, PCI Nos. 13 and 14 are not certified, and a new PCI No. 15 has been added.

(4) Preferability

[107] Section 5(1)(d) of the CPA requires that a class proceeding be the preferable procedure for the resolution of the common issues in the context of the claim as a whole.[48] Preferability is meant to capture two ideas: (i) whether the class proceeding would be a fair, efficient and manageable method of advancing the claim; and (ii)

[48] *Pearson v. Inco Ltd.* (2005), 78 O.R. (3d) 641 (C.A.) at para. 67.

whether a class proceeding would be preferable to other procedures such as joinder, test cases, consolidation or any other means of resolving the dispute.[49]

[108] Here, in my view, a class proceeding is the preferable procedure and would provide a fair, efficient and manageable method of advancing the claim. The individual claims of the class members may be small and not warrant the commencement of individual lawsuits. A common determination in a class proceeding about their employment status will significantly advance the litigation and provide meaningful access to justice some 7000 class members.

[109] One would still need individual damage assessments if the common issues are resolved in favour of the class members. However, this does not detract from the overall preferability of the class action. In any event, s. 6(1) of the CPA makes clear that the court shall not refuse certification just because individual damage assessments will be required after the conclusion of the common issues trial.

(5) Suitable representative plaintiff

[110] Finally, under s. 5(1)(e) of the CPA, the court must be satisfied that there is a representative plaintiff who (i) will fairly and adequately represent the interests of the class, (ii) has produced a workable litigation plan and (iii) does not have a conflict of interest with any of the other class members. The proposed representative need not be 'typical' of the class, but must be 'adequate' in the sense that he or she will vigorously prosecute the claim.[50]

[111] Mr. Omarali has proven to be a conscientious representative plaintiff by retaining and instructing class counsel, reviewing the evidence filed to date, providing his own evidence, being cross-examined and attending in court for the certification hearing. He shares interests in common with the other class members and has produced a workable litigation plan. He is more than suitable as a representative plaintiff.

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[49] *Hollick v. Metropolitan Toronto (Municipality)*, 2001 SCC 68 at paras. 28-31; *Fischer v. IG Investment Management Ltd.*, 2013 SCC 69, at paras. 16 and 22.

[50] *Campbell v. Flexwatt*, 98 B.C.A.C. 22 (C.A.) at paras. 75-76, leave to appeal to S.C.C. refused [1998] S.C.C.A. No. 13.

Conclusion

[112] For the reasons set out above, I find that the requirements in s. 5(1) of the CPA have been satisfied. The proposed action is certified as a class proceeding.[51]

[113] As noted in the attached Appendix, proposed common issues Nos. 1 to 12 are certified; Nos. 13 and 14 are not certified; and a new common issue dealing with limitations has been added. I would ask that counsel prepare a draft Order in the form contemplated by s. 8 of the CPA.

[114] If the parties are unable to agree on the costs, I would be pleased to receive brief written submissions from the plaintiff within 14 days and from the defendants within 14 days thereafter. Counsel are urged to review my costs awards in previous certification cases.[52]

[115] My thanks to counsel for their co-operation and for their additional written submissions.

_____

Belobaba J.

Date: July 27, 2016

[51] I note that a similar class action was certified in 2013 by the U.S. District Court for the Northern District of Ohio: see, *Hurt et al v. Commerce Energy Inc.*, (Case No. 1:12-CV-00758). The defendant Commerce Energy is a Just Energy company. I also note that when another similar class action was litigated on the merits, the U.S. District Court for the Northern District of California granted Just Energy's motion for summary judgment finding that the IC's were "outside sales persons" under the California Labour Code and thus fell within the exemption: see *Dailey v. Just Energy Marketing Corp.*, (Case No. 14-CV-02012-HSG).

[52] See any of *Dugal v Manulife Financial*, 2013 ONSC 4083; *Rosen v BMO Nesbitt Burns*, 2013 ONSC 2144; *Crisante v DePuy Orthopaedics*, 2013 ONSC 5186; *Brown v. Canada (Attorney General)* 2013 ONSC 5637; or *Sankar v Bell Mobility*, 2013 ONSC 5916.

Appendix

Revised Proposed Common Issues

[Issues 1 to 12 are certified. Issues 13 and 14 are not certified. Issue 15 dealing with Limitation Periods has been added and certified.]

Statutory Claim

1. Are the Class Members "employees" of the Defendants pursuant to the *Employment Standards Act, 2000* ("*ESA*")?

2. If the answer to (1) is "yes", are the Class Members in "pensionable employment" of the Defendants pursuant to the *Canada Pension Plan* ("CPP")?

3. If the answer to (1) is "yes", are the Class Members in "insurable employment" of the Defendants pursuant to the *Employment Insurance Act* ("EI")?

4. If the answer to (1) is "yes", are the Class Members exempt from Parts VII, VIII, IX, X and XI of the *ESA*, or do the Class Members fall within the exception to this exemption as route salespersons?

5. If the answers to (1) and (4) are "yes", do the minimum requirements of the *ESA* with regard to minimum wage, overtime pay, vacation pay, and public holiday and premium pay form express or implied terms of the contracts with the Class Members?

Breach of Contract

6. If the answers to questions (1) and (4) are "yes", do the Defendants owe contractual duties and/or a duty of good faith to:

    a. Ensure that the Class Members were compensated with the minimum wage?

    b. Ensure that the Class Members' hours of work were monitored and accurately recorded?

c. Properly classify and advise Class Members of their entitlement to overtime pay for hours worked in excess of 44 hours per week which the employer required or permitted?

d. Ensure that the Class Members were compensated with vacation pay?

e. Ensure that the Class Members were compensated with and public holiday and premium pay?

7. Did the Defendants breach any of their contractual duties and/or a duty of good faith? If so, how?

8. If the answers to (1) and (4) are "yes", did the Defendants fail to pay the Class Members minimum wage, overtime pay, vacation pay, and/or public holiday and premium pay as required by the *ESA*?

9. If the answers to (2) and/or (3) are "yes", did the Defendants fail to make the prescribed employer CPP and/or EI contributions on behalf of the Class Members?

Negligence

10. Alternatively, did the Defendant owe a duty of care to the Class Members to:

a. ensure that Class Members are properly classified as employees;

b. advise Class Members of their entitlement to the minimum wage, overtime pay, vacation pay and public holiday and premium pay;

c. ensure that the Class Members hours of work are monitored and accurately recorded; and

d. ensure that Class Members are appropriately compensated with minimum wage, overtime pay, vacation pay and public holiday and premium pay.

11. Did the Defendants breach any of the duties of care found to exist above? If so, how?

Unjust Enrichment

12. Were the Defendants unjustly enriched by failing to compensate Class Members with minimum wages, overtime pay, vacation pay and public holiday and premium pay owed to them, in accordance with the *ESA*, and/or failing to make the prescribed employer CPP and/or EI contributions on behalf of the Class Members?

Aggregate Damages

13. If the Defendants breached the *ESA*, or its contracts with Class Members, or its duties of good faith or duties of care owed to the Class Members, or was unjustly enriched, should damages be assessed on an aggregate basis?

Punitive Damages

14. Are the Class Members entitled to an award of aggravated, exemplary, or punitive damages based on the Defendants' conduct?

Limitation Period Issue (added at the request of the defendants)

15. Are the claims that relate to services provided before May 4, 2013 (or services for which commission payments were made before May 4, 2013) barred by the two-year limitation period set out in the *Limitations Act, 2002*?

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CITATION: Omarali v. Just Energy, 2019 ONSC 3734
COURT FILE NO.: CV-15-527493-CP
DATE: 20190621

SUPERIOR COURT OF JUSTICE - ONTARIO

RE: Haidar Omarali / Plaintiff

AND:

Just Energy Group Inc., Just Energy Corp., and Just Energy Ontario LP / Defendants

BEFORE: Justice Edward P. Belobaba

COUNSEL: *David Rosenfeld and Garth Myers* for the Plaintiff / Moving Party

Paul J. Martin and Anastasia Reklitis for the Defendants / Responding Parties

HEARD: June 11 and 12, 2019

Proceeding under the *Class Proceedings Act, 1992*

Summary Judgment Decision

[1] A motion for summary judgment on certified common issues that ask in essence whether the defendants' sales agents were independent contractors or employees will not always work.

[2] If there are serious credibility issues, or the court finds that the evidence needs substantial clarification, and recourse to a "mini-trial" is precluded by a provision in the *Class Proceedings Act*,[1] the motion for summary judgment may well be dismissed.

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[1] *Class Proceedings Act, 1992*, S.O. 1992, c. 6.

[3] That's what happened here.

Background

[4] In this class action, the plaintiff alleged that the defendants' 8000 sales agents were misclassified - that they were not independent contractors but employees and were therefore entitled to the benefits and protections of the *Employment Standards Act*[2] such as minimum wage, overtime pay, and vacation and public holiday pay. The defendants argued that the determination whether the defendants' sales agents were independent contractors or employees could only be made on an individualized basis. Because commonality could not be established on the evidence before the court, argued the defendants, the matter could not proceed as a class action and the motion for certification should be dismissed.

[5] In 2016, I certified this action as a class proceeding.[3.] I found there was some evidence of commonality for each of the 13 certified common issues that are attached in the Appendix.

The motion for summary judgment

[6] The plaintiffs now move for summary judgment on the 13 common issues. The key issues are Common Issue Nos. 1 and 4:

- CI No. 1: Are the Class Members "employees" of the Defendants pursuant to the *Employment Standards Act, 2000* ("*ESA*")?

- CI No. 4: If the answer to (1) is "yes", are the Class Members exempt from Parts VII, VIII, IX, X and XI of the *ESA*, or do the Class Members fall within the exception to this exemption as route salespersons?

[7] The outside sales agent exemption and the route sales person exception are set out in s. 2(1)(h) of O. Reg. 285/01:

Exemptions from Parts VII to XI of Act

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[2] *Employment Standards Act, 2000*, S.O. 2000, c. 41 ("ESA").

[3] *Omarali v. Just Energy*, 2016 ONSC 4094.

> 2. (1) Parts VII, VIII, IX, X and XI of the Act do not apply to a person employed…
>
> (h) as a salesperson, other than a route salesperson, who is entitled to receive all or any part of his or her remuneration as commissions in respect of offers to purchase or sales that,
>
> (i) relate to goods or services, and
>
> (ii) are normally made away from the employer's place of business.

[8] In other words, if a worker is found to be an employee, he is entitled to the range of benefits and protections set out in Parts VII to XI of the Act, such as minimum wage, overtime pay, and vacation and public holiday pay. However, if the employee is an outside door to door sales agent who works on commission, he falls within the exemption and the ESA benefits and protections are not available, *unless* the outside sales agent is a "route salesperson." In other words, on the facts of this case, the ESA provisions in question only apply if the defendants' door to door sales agents are both employees *and* route salespersons.

[9] At the certification stage, I found there was some basis in fact for each of the 13 certified common issues, including the all-important employee and route salesperson determinations. But that was at the certification stage. We are now at the merits stage where the overall evidence may well point to a very different determination.

[10] The plaintiff says the evidence on this summary judgment motion requires a finding that the defendants' sales agents were employees and route salespersons.[4] The defendants refer to their evidence and argue that the sales agents were not employees but independent contractors and if they were employees, they cannot reasonably be characterized as route salespersons – and instead fall within the outdoor sales agent exemption.

The "control" factor

[4] I say "were" because the defendants' residential door to door sales practices ended five years into the class period. As of January 1, 2017, Just Energy no longer engages individuals for door-to-door energy solicitation as a result of legislative amendments to the *Energy Consumer Protection Act*, 2009, S.O. 2010, c. 8, which came into force on that date. These amendments provide, in part, that the sale or offer of sale of electricity or natural gas to a consumer in person at the consumer's home is prohibited, and that such sales or offers of sale cannot be based on a commission or value of volume sales basis.

[11] Neither "employee" nor "route salesperson" is defined in the ESA – hence the need to rely on judicial interpretation. The case law is clear that one of the factors in the analysis that decides both the "employee" and "route sales person" determinations is the defendants' degree of control over the how, where and when of what is being sold.[5]

[12] The courts have identified five or six factors that are relevant to the "employee" determination.[6] The central question is "whether the person who has been engaged to perform the services is performing them as a person in business on his own account"[7] – in other words, "whose business is it?"[8] The various factors may be weighed differently depending on the evidence before the court, but as the Supreme Court noted in *Sagaz,* "the level of control the employer has over the worker's activities will always be a factor."[9]

[13] The focus on the level of control over the how, when and where of what is being sold – important as it is for deciding the threshold "employee" question - is even more important in deciding whether the employee/outside sales agent is a "route sales person." The evidence that is relevant to the "route salesperson" determination is evidence about the degree of control exercised by the employer over the selection of the marketing locations, whether the employees are driven to and from the pre-assigned locations, are given sales scripts or direction or coaching on how to perform sales calls, wear uniforms provided by the employer and are generally subject to employer monitoring or supervision.[10]

[14] In short, evidence about the level of control that is exercised by the employer is always relevant (to some degree) when deciding the "employee" question and pretty

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[5] *Omarali, supra,* note 3, at para. 32.

[6] *671122 Ontario Ltd. v. Sagaz Industries Canada,* 2001 SCC 59, at para. 47. The Supreme Court set out a list of non-exhaustive factors that should be considered: (1) the level of control the employer has over the worker's activities; (2) whether the worker provides his or her own equipment; (3) whether the worker hires his or her own helpers; (4) the degree of financial risk taken by the worker; (5) the degree of responsibility for investment and management held by the worker; and (6) the worker's opportunity for profit in the performance of his or her risks. Also see *Belton v. Liberty Insurance Co. of Canada*, [2004] O.J. No. 3358 (C.A.) at para. 11 and *Braiden v. La-Z-Boy Canada Limited,* 2008 ONCA 464 at paras. 33-35

[7] *Sagaz, supra,* note 6, at para. 47.

[8] *Braiden, supra,* note 6, at para. 34.

[9] *Sagaz, supra,* note 6, at para. 47.

[10] *Omarali, supra,* note 3, at para. 31 and case law cited therein.

much determinative when deciding whether the employee/outside sales agent is a "route salesperson."

[15] Both sides, not surprisingly, provided compelling affidavit evidence about the level of control over the how, when and where Just Energy products were sold by the class member sales agents – the plaintiffs saying the level of control was extensive; the defendants the exact opposite.

[16] In the certification decision, I noted that "control" is conventionally defined as "the power to influence or direct people's behaviour."[11] On this motion, counsel on both sides focused more on the "power to direct" the sales agents' behaviour than on "the power to influence" the sales agents' behaviour. (This may change as the case proceeds.)

Mini-trial or trial?

[17] The difficulty that I face on this motion for summary judgment is that there is diametrically conflicting evidence about the level of control over the how, when and where question. The plaintiff says I can decide the common issues more directly by simply considering the "organizational structure" evidence and finding that Just Energy's organizational structure is "inconsistent" with the sales agents being independent contractors. Not surprisingly, the defendants refer to the same organizational structure to make the opposite point.

[18] In any event, even if I were to focus on the defendants' organizational structure, I would still have to consider the relevant factors that are set out in the case law. Given that "the level of control the employer has over the worker's activities will always be a factor"[12] I would be obliged to consider the extent to which Just Energy exercised control over the how, where and when of what was being sold.

[19] The plaintiffs filed six affidavits (all quite similar in format and content) that describe a high level of control. The affidavits say, in essence, that the morning sales meetings were mandatory, the sales agents were driven to and from pre-selected sales locations, were required to wear the defendants' uniform, used a pre-approved sales script, and worked a mandatory number of hours, all under the defendants' supervision. In other words, the defendants' level of control over the how, when and where was extensive.

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[11] *Ibid.* at para. 26.

[12] *Sagaz, supra,* note 6, at para. 47.

[20] The defendants filed three affidavits from equally knowledgeable witnesses swearing the exact opposite - that the outside sales agents were independent contractors that were "free to market anywhere they wanted." The defendants' affiants swore that the morning sales meetings were completely optional, the sales locations or hours of work were not imposed on the sales agents, they weren't required to wear a Just Energy uniform or accept van rides from the crew co-ordinators and they didn't only sell Just Energy products. There were sales scripts but they were imposed primarily because of regulatory requirements. The sales agents were neither monitored nor supervised. According to the defendants' affiants, the sales agents were free to come and go as independent contractors and work wherever and whenever they pleased.

[21] Cross-examinations were conducted by counsel on both sides but the conflicting evidence about the level of control remained intact.

[22] Following the roadmap in *Hryniak v. Mauldin*,[13] I readily concluded, without using the enhanced fact-finding powers set out in Rule 20.04 (2.1), that there were genuine issues (about the level of control) that required trial.

[23] I then asked the next question - whether the need for a trial could be avoided by using the enhanced fact-finding powers. I was concerned about using the enhanced powers for two reasons: (i) the significance of the credibility issues; and (ii) the insufficiency of the evidence before me. I realized that *viva voce* evidence would be needed. I then had to decide whether resort to a "mini-trial" under Rule 20.01 (2.2) was precluded by an over-arching statutory provision. I will explain each of these points in turn.

[24] ***Credibility.*** As already noted, the evidence about the level of control exercised by the defendants over its door to door sales agents is conflicting. One side swears that the sales agents could come and go and work whenever and wherever they pleased. The other side, the exact opposite.

[25] The Court of Appeal noted in *Gordashevskiy v. Aharon*,[14] that "it is not open to a motion judge to simply prefer one affidavit over another in the absence of explanatory reasons for the preference that permit appellate review."[15] Without hearing *viva voce*

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[13] *Hryniak v Mauldin*, [2014] 1 S.C.R. 87.

[14] *Gordashevskiy v. Aharon*, 2019 ONCA 297.

[15] *Ibid.* at para. 6.

evidence, I would not be able to provide explanatory reasons why I prefer, say, the plaintiffs' affidavit evidence over that of the defendants. All the more so where, as here, the plaintiffs failed on cross-examination to challenge the defendants' affiants on their "no control" evidence. Given the evidentiary conflict in the sworn evidence before me, *viva voce* evidence would be essential, whether via a mini-trial or a trial.

[26] ***Insufficient evidence.*** During the class period, Just Energy had about a dozen offices in Ontario, each run by a regional distributor who was also said to be an independent contractor. The plaintiffs' affiants spoke about their experiences in only three of these offices and only for a portion of the class period. They also limited their evidence to residential door to door sales agents and made no mention of the other two sales agent categories: customer renewal agents and commercial (business) agents.

[27] In order to fairly determine the key Common Issues (Nos. 1 and 4) – that is, whether the class members were "employees" and if so, whether they fell within the "route salesperson" exception - I would need more evidence about the customer renewal agents and the commercial agents. In particular, I would need evidence about the number of sales agents that did renewal and commercial work on a regular basis; the level of control that the defendants exercised in these circumstances; and the number of residential agents that from time to time opted to do this kind of work and how often this happened.

[28] I would also need evidence that would allow this court to draw reasonable inferences that could support a determination of the Common Issues on a class-wide basis for all 8000 class members. To clarify these questions[16] at this stage of the proceeding, I would need to conduct either a mini-trial or a trial.

[29] ***Can't be a mini-trial.*** I say this for three reasons, the first two raising concerns and the third one being determinative. First, I would have to hear from numerous witnesses. Given the number of required witnesses, the mini-trial might arguably be no more efficient or cost-effective than a conventional "hybrid" trial.

[30] Second, I am mindful of the Court of Appeal's admonition in *Baywood Homes*,[17] that "the motion judge's task of assessing credibility and reliability [is] especially

[16] *Hryniak, supra,* note 13, at para. 51: "Often, concerns about credibility or *clarification* of the evidence can be addressed by calling oral evidence on the motion itself." (Emphasis added.)

[17] *Baywood Homes Partnership v. Haditaghi,* 2014 ONCA 450.

difficult in a summary judgment and mini-trial context." [18] I recognize that the Supreme Court in *Hryniak* was less timid, noting that "concerns about credibility or clarification of the evidence" on the summary judgment motion can be addressed by calling oral evidence by way of a mini-trial.[19] However, I also recognize that the Supreme Court added a proviso to this statement that in my view could well apply here:

> However, there may be cases where, given the nature of the issues and the evidence required, the [motion] judge cannot make the necessary findings of fact or apply the legal principles to reach a just and fair determination.[20]

[31] Third, and this reason proved determinative, I am unable to direct a mini-trial that, in essence, approaches the dimensions of a trial because of s. 34(3) of the *Class Proceedings Act.*[21] This provision makes clear that a class actions judge who heard the certification motion and certified the common issues cannot preside over "the trial of the common issues" unless both sides agree. I know that the Supreme Court in *Hryniak* authorized the occasional use of super-sized mini-trials.[22] In my view, however, it would be contrary to the intent of s. 34(3) if I were to direct and preside over a super-sized "mini-trial", unless I did so with the parties' consent.

[32] I am therefore driven to conclude that the next step in this proceeding must be a focused trial, not a mini-trial.

Conclusion

[33] Common Issues Nos. 1 and 4 must proceed to trial.

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[18] *Ibid.* at para. 44.

[19] *Hryniak, supra,* note 13, at para. 51.

[20] *Ibid.*

[21] *Supra,* note 1.

[22] *Hryniak, supra,* note 13, at para .63: "[The mini-trial] should be employed when it allows the judge to reach a fair and just adjudication on the merits and it is the proportionate course of action. While this is more likely to be the case when the oral evidence required is limited, there will be cases where extensive oral evidence can be heard on the motion for summary judgment, avoiding the need for a longer, more complex trial and without compromising the fairness of the procedure."

[34] Because Common Issues Nos. 1 and 4 have not been answered and are going to trial, it follows that Common Issues Nos. 2, 3, 5, 6, 7, 8 9, 12 and 13 must go to trial as well because they depend on affirmative answers to Nos. 1 and 4.

[35] Common Issues Nos. 10 and 11 that ask about duties of care should also proceed to trial for two reasons. One, their answer, and in particular the answer to 10(d) overlaps with the determination of Common Issues Nos. 1 and 4. Two, a partial summary judgment in these circumstances would probably be contrary to the case law. If 11 of the 13 Common Issues are going to trial, the court should not grant partial summary judgment on the other two. As the Court of Appeal noted in *Butera v. Chown, Cairns*:[23]

> A motion for partial summary judgment should be considered to be a rare procedure that is reserved for an issue or issues that may be readily bifurcated from those in the main action and that may be dealt with expeditiously and in a cost-effective manner.[24]

[36] Common Issues Nos. 10 and 11 are not easily detached from the other 11 issues. And even if they could be detached, there is no good reason to do so on the facts herein. It makes more sense if all 13 issues are heard together.

Disposition

[37] The plaintiffs' motion for summary judgment is dismissed. All 13 common issues shall proceed to trial.

[38] If both sides agree, I would be prepared to preside over the trial of the common issues. I would issue directions under Rule 20.05 to ensure that the trial proceeds in a timely, focused and expeditious fashion.

[39] Given that much of the material that was filed on this summary judgment motion can be used at the upcoming trial (whoever hears it) I am inclined to defer the question of costs until after the trial and the court's decision on the common issues. I say this because but for s. 34(1) of the CPA I would seriously have considered the super-sized mini-trial (using s. 12 of the CPA if necessary.) Had this happened, the costs question would not have materialized until the mini-trial was concluded and a decision had been rendered. In

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[23] *Butera v. Chown, Cairns LLP*, 2017 ONCA 783.

[24] *Ibid.* at para. 34.

fairness, the same reasoning should apply here. In other words, the costs award on this motion should be deferred until the conclusion of the trial and a decision on the common issues. If either side disagrees, they should advise forthwith.

[40] I am obliged to counsel on both sides for their co-operation and assistance.

Justice Edward P. Belobaba

Date: June 21, 2019

Appendix

Certified Common Issues

Statutory Claim

1. Are the Class Members "employees" of the Defendants pursuant to the *Employment Standards Act, 2000* ("*ESA*")?

2. If the answer to (1) is "yes", are the Class Members in "pensionable employment" of the Defendants pursuant to the *Canada Pension Plan* ("CPP")?

3. If the answer to (1) is "yes", are the Class Members in "insurable employment" of the Defendants pursuant to the *Employment Insurance Act* ("EI")?

4. If the answer to (1) is "yes", are the Class Members exempt from Parts VII, VIII, IX, X and XI of the *ESA*, or do the Class Members fall within the exception to this exemption as route salespersons?

5. If the answers to (1) and (4) are "yes", do the minimum requirements of the *ESA* with regard to minimum wage, overtime pay, vacation pay, and public holiday and premium pay form express or implied terms of the contracts with the Class Members?

Breach of Contract

6. If the answers to questions (1) and (4) are "yes", do the Defendants owe contractual duties and/or a duty of good faith to:

    a. Ensure that the Class Members were compensated with the minimum wage?

b. Ensure that the Class Members' hours of work were monitored and accurately recorded?

c. Properly classify and advise Class Members of their entitlement to overtime pay for hours worked in excess of 44 hours per week which the employer required or permitted?

d. Ensure that the Class Members were compensated with vacation pay?

e. Ensure that the Class Members were compensated with and public holiday and premium pay?

7. Did the Defendants breach any of their contractual duties and/or a duty of good faith? If so, how?

8. If the answers to (1) and (4) are "yes", did the Defendants fail to pay the Class Members minimum wage, overtime pay, vacation pay, and/or public holiday and premium pay as required by the *ESA*?

9. If the answers to (2) and/or (3) are "yes", did the Defendants fail to make the prescribed employer CPP and/or EI contributions on behalf of the Class Members?

Negligence

10. Alternatively, did the Defendant owe a duty of care to the Class Members to:

a. ensure that Class Members are properly classified as employees;

b. advise Class Members of their entitlement to the minimum wage, overtime pay, vacation pay and public holiday and premium pay;

c. ensure that the Class Members hours of work are monitored and accurately recorded; and

d. ensure that Class Members are appropriately compensated with minimum wage, overtime pay, vacation pay and public holiday and premium pay.

11. Did the Defendants breach any of the duties of care found to exist above? If so, how?

Unjust Enrichment

12. Were the Defendants unjustly enriched by failing to compensate Class Members with minimum wages, overtime pay, vacation pay and public holiday and premium pay owed to them, in accordance with the *ESA*, and/or failing to make the prescribed employer CPP and/or EI contributions on behalf of the Class Members?

Limitation Period

13. Are the claims that relate to services provided before May 4, 2013 (or services for which commission payments were made before May 4, 2013) barred by the two-year limitation period set out in the *Limitations Act, 2002*?

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Court File No. 05-CL-5880
Date: 20061228

SUPERIOR COURT OF JUSTICE
ONTARIO
(Commercial List)

IN THE MATTER OF AN APPLICATION UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C., 1985, c. C-36

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF THE WAREHOUSE DRUG STORE LTD. AND THE COMPANIES LISTED IN SCHEDULE "A" HERETO

HEARD: December 12, 2006

BEFORE: C. CAMPBELL J.

COUNSEL: *Raymond M. Slattery, Tracy A. Kay* for McKesson Canada Corporation
Frank Spizzirri for the Applicants

E N D O R S E M E N T

[1] This is an appeal from the disallowance by the interim receiver of Warehouse Drugs of a claim brought by a former director of the Company for indemnity against the directors charge in respect of non-union employees' claims in respect of vacation pay.

[2] To put the matter in context, as the Company sought relief under the *Companies' Creditors Arrangement Act*, R.S.C., 1985, c. C-36 (the "CCAA"), the order of this Court provided for a charge to which the directors could look for indemnity for failure of the Company to make payments for enumerated items.

[3] The assets of Warehouse Drugs was transferred to a new company owned and operated on the same principles as Warehouse under a Plan of Arrangement approved by this Court.

[4] The issue on this appeal is whether Bernard Katz, a former director, can look to the "directors charge" for indemnity in respect of potential claims for vacation pay he brings on behalf of employees of Warehouse who have been transferred to and accepted by the successor corporation of which he is also an officer.

[5] Mr. Spizzirri on his behalf acknowledges that the new corporation, Pharmacy Won, does have legal liability for the vacation pay of transferred employees on the basis of continuing accrual but urges that the former directors of Warehouse also have legal liability given the provisions of the *Employment Standards Act* ("ESA.")

[6] Having heard submissions from counsel, I am satisfied that under the ESA, an employer such as Warehouse and its directors are responsible for wages and indeed vacation pay of employees that is due and payable at the date of transfer, and no liability arises for vacation pay that has only accrued at the time of transfer.

[7] Part IV of the ESA contains a number of provisions that are intended to provide certainty to the employee who is transferred on the sale of a business. Section 13(2) in particular deems the period of employment to be continuous as between former and successor when there is a sale of a business. In this case, the transferred employees did not have their employment terminated for the purposes of entitlement under the ESA.

[8] It is common ground that at the time of the transfer of assets and employees, the amount in issue of $58,213.33 was not due and payable to those employees but rather could only be said to have accrued on the books of Warehouse.

[9] The respondent, which is the secured creditor McKesson Canada Corporation acting in place of the Interim Receiver and which will receive $58,000.00 less if the appeal succeeds, takes the position that since there was no vacation due and payable, it was not a liability of the transferor of the assets nor of any of its directors and officers.

[10] The position put forward on behalf of Mr. Katz is that while the new company Pharmacy Won may have responsibility, this does not relieve him and his fellow directors of legal liabilities to the former employees, as the liability is joint in respect of the old and new companies and the monies should at least be set aside against this contingency.

[11] The following summarizes the obligation of an employer under the Statute in ss. 35, 36 and 38:

(i) An employer shall give an employee a vacation of least 2 weeks after each vacation entitlement year has been completed. A vacation entitlement year is a full 12 months of service.

(ii) Vacation is to be taken no later than 10 months after the end of the vacation entitlement year for which it was given.

(iii) An employer shall pay vacation pay to an employee who is entitled to vacation of at least 4% of wages that the employee has earned during the period for which the vacation is given.

(iv) An employer shall pay vacation pay to an employee in a lump sum before the employee commences his or her vacation unless:

(a) the employee is paid by direct deposit or does not take a full week of vacation then the employer can pay vacation pay on the regular pay day in the period where the vacation is taken;

(b) the employer and the employee have agreed to pay vacation at another time;

(c) the employment ends at a time when vacation pay has accrued. Then, the employer shall pay the vacation pay within the later of 7 days after the employment ends and the day when the employee would have next been paid.

[12] If vacation is not taken within the 10 months following the year in which it was earned, the vacation pay becomes due and payable.

[13] Mr. Spizzirri relies on the provision of s. 81(7) of the ESA:

> The directors of an employer corporation are jointly and severally liable to the employees of the corporation for all debts not exceeding six months' wages, as described in subsection (3), that become payable while they are directors for services performed for the corporation and for the vacation pay accrued while they are directors for not more than 12 months under this Act and the regulations made under it or under any collective agreement made by the corporation. 2000, c. 41, s. 81 (7).

[14] I am satisfied that the purpose of s. 81 of the ESA is to establish the limits of a director's responsibility for unpaid wages, which includes vacation pay that is due and payable.

[15] The scheme of subsections (2), (3) and (4) provides that the employer is primarily responsible and the directors' / director's liability is capped.

[16] I accept the proposition that s. 81 deals with the concept of a "joint and several liability" of directors for responsibility in respect of their time of service. I am unable to conclude, as urged by Mr. Spizzirri, that the responsibility extends beyond amounts that were at any given time due and payable to the employee and extends to accrued amounts that may or may not be payable in the future.

[17] The following comment, contained in the ESA Manual, page 24-21, supports the proposition that the provision of s. 81 is to establish the basis for liability but only for amounts that have become payable while an individual is a director.

> Section 81(7) also indicates that directors will only be liable for wages other than vacation pay that become payable while they are directors of the corporation. Wages become payable on the regular payday of the employer, as established by the practice of the employer. For example, if a director resigns in the middle of a pay period, that director would not be liable for the unpaid wages that because due on the payday following his or her resignation. The section also states that directors will only be liable for vacation pay that accrued while they were on the board of directors. For service-based vacation pay (e.g., 1-1/2 days of vacation for every month of service), a director would only be liable for vacation pay calculated on service that occurred while he or she was a member of the board of directors. For percentage-based vacation pay (e.g., four per cent of earnings), a director would only be liable for vacation pay calculated on wages the employees earned while he or she was a member of the board.

[18] This interpretation is bolstered by at least two decisions of adjudicators dealing with successor employers.

[19] *SIS Cronin, a Division of Urus Industrial Corporation v. Ministry of Labour and John Hurdis*, [1993] O.E.S.A.D. No. 129 and *Metro International Trucks Limited and Metro Leasing Limited v. Ministry of Labour et al.*, [1996] O.E.S.A.D. No. 211 are to this effect and while not binding, make absolute sense.

[20] Mr. Spizzirri submits that those decisions are not inconsistent with the proposition of allowing the employees access to two sources of vacation pay. He asks what if the new company Pharmacy Won does not pay. The answer in my view is that the scheme of the Act is to allow all parties to know with some certainty what it is they are responsible for at the time of transfer. It would not make sense to have the potential for a contingent claim in an uncertain amount against uncertain directors to have to be protected in the event the primary obligator (Pharmacy Won) did not pay to deprive a secured creditor of recovery and bring finalization to the CCAA process.

[21] Section 111 of the ESA, which contains time limits on recovery, provides in subsection 3.1 for the time limit of recovery of vacation pay, which must have become due. (Emphasis added.)

[22] This in my view supports the conclusion that due and payable is the appropriate consideration of time for the ripening of the obligation of Mr. Katz's obligations. There is no evidence of any claim that he has sought recovery for what may be said to be due and payable.

[23] The appeal is therefore dismissed. Mr. Slattery requests costs in the normal course. It is submitted by Mr. Spizziri that since the point of law was novel, there should be no costs.

[24] I disagree. I am of the view that costs should follow the event for among other reasons this is an appeal. I am of the view that $7500 inclusive of fees, disbursements and GST is a fair amount, payable forthwith, and so order.

C. CAMPBELL J.

Released:

Suit No. AI 94-30-02020

IN THE COURT OF APPEAL OF MANITOBA

Coram: Huband. Philp and Kroft JJ.A.

BETWEEN:

SCOTT BROWN

(Plaintiff) Appellant

- and -

DUNCAN SHEARER, KEITH VAN BEEK and RICHARD FOX

(Defendants) Respondents

N. A. Cuddy and D. G. Joynt for the Appellant

D. G. Douglas for the Respondents

Appeal heard: March 23, 1995

Judgment delivered: May 8, 1995

HUBAND J.A.

The plaintiff Scott Brown, whose employment at a company, MacLeod-Stedman Inc. (MSI), came to an end as a result of a receivership, has sued the defendants who were directors of MSI claiming severance pay and vacation pay. Brown contends that the directors are liable by virtue of s. 119(1) of the *Canada Business Corporations Act, R.S.C.,* 1985, c. C-44.

[Page 2]

The defendants answer that there is no liability because they had resigned as directors over two months before Brown's employment was terminated and, in any event, the claims advanced do not fall within the ambit of s. 119(1), in that they are not "debts ... for services performed for the corporation."

The plaintiff Brown joined the staff of MSI at a high level position on October 1, 1990. There is no secret that the company was experiencing serious financial difficulties and it was hoped

that Brown would be able to improve the situation. He was induced to accept the position as vice-president and general manager with a generous employment offer from MSI contained in a letter dated August 21, 1990. The letter specified a salary of $150,000 per annum. Benefits included four-weeks' vacation starting in 1991, a company car, club membership, and possible bonuses. The letter specified that the contract was for a three-year term to be extended annually unless notice was given by either party ninety days prior to the concluding date of the contract. The letter then contained this additional provision:

> Twelve months of your current salary will be paid to you as severance under any one of the following three conditions:
>
> a) Your employment is terminated at any time for reasons other than just cause;
>
> b) You lose your job due to the sale of the company; or
>
> c) You do not have a position because the company ceases its operations.

[Page 3]

The latter contingency occurred. Brown had worked 66.6 weeks when the receivership was imposed and his employment terminated on January 10, 1992.

It is agreed by the parties that during the course of his employment Brown had not taken his full vacation entitlement. As of January 10, 1992 he was entitled to accrued vacation pay of $7,437.51.

There is no doubt that as against NISI Brown would be entitled to his severance pay of $150,000, plus the accumulated vacation pay. The company went into bankruptcy and Brown filed a claim as an unsecured creditor in bankruptcy, but the indications from the trustee in bankruptcy are that all of the assets will be used up to pay the claims of secured creditors. Thus Brown attempts to effect collection of his claim, or at least a substantial part of it, from the three defendant directors. Section 119(1) of the *Canada Business Corporations Act* reads as follows:

> Directors of a corporation are jointly and severally liable to employees of the corporation for all debts not exceeding six months wages payable to each such employee for services performed for the corporation while they are such directors respectively.

The maximum exposure under s. 119 with respect to the plaintiff Brown is $75,000.

As noted, the defendant directors deny the claim for severance pay on the basis that it does not relate to "services performed" and they

[Page 4]

deny liability for both the severance pay and the vacation pay because they had resigned as directors some two months prior to the receivership.

Kennedy J. of the Court of Queen's Bench disallowed the claim for severance pay, and the plaintiff Brown appeals. Kennedy J. allowed the claim for vacation pay in the full amount of $7,437.51, and the defendant directors cross-appeal.

I agree entirely with the conclusion of Kennedy J. that the claim for severance pay is not a claim for a debt in respect of "services performed." It is unlike salary or vacation pay which relate to work performed over a period of time. The severance pay is in the nature of a payment which MSI was entitled to make at any time to relieve itself of the burden of the employment contract. The amount payable would be precisely the same if MSI had terminated the plaintiff Brown's employment, without cause, on the day after it had begun, or on the day before his contract was about to expire. The amount was unrelated to the quality or duration of his service to the company.

The disposition of this aspect of the claim is consistent with the decision of the Supreme Court of Canada in *Barrette v. Crabtree Estate,* [1993] 1 S.C.R. 1027, in which a claim for damages in lieu of notice, as compensation for wrongful dismissal, was not considered as a debt for the performance of services for the corporation.

I would dismiss the appeal of the plaintiff Brown.

[Page 5]

I turn now to the cross-appeal by the defendants with respect to the award of vacation pay in favour of the plaintiff Brown.

The defendants claim that the debt with respect to vacation pay did not crystallize until the termination of the plaintiff Brown's employment on January 10, 1992, and at that time each of the defendants had long since ceased to be a director of MSI.

The validity of the defendants' position depends on two things: firstly, that there was no "debt" with respect to vacation pay until January 10, 1992; and, secondly, that the resignations of the directors were effective when tendered some two months earlier on November 6, 1991.

There is support for the first position in the case of *Vopni v. Groenewald* (1991), 84 D.L.R. (4th) 366, a decision of McKeown J. of the Ontario Court (General Division). In that case an employee whose employment had been terminated sued a director for vacation pay. The director had resigned his position some five months earlier. While it was true that the obligation to allow the employee a vacation had gradually accrued during the time the defendant served as director, it was said that the right to a vacation had not been transformed into a debt for vacation pay until the actual termination of employment (at 370-71):

> ... Mr. Vopni did not have an absolute right to take his vacation, except that he could have demanded his first year's entitlement within 10 months after the completion of the first year. While *Mills-Hughes v. Raynor* [(1988), 47 D.L.R. (4th) 381] stated that upon termination, vacation pay is *a* debt due to employees for

[Page 6]

> services performed, I am of the view that the debt did not crystallize until Mr. Vopni was terminated, and this was five months subsequent to Mr. Groenewald's resignation as a director. The purpose of s. 119 is to urge directors to keep payments to the employees current. In this case, all the company's obligations to Mr. Vopni were current while Mr. Groenewald was a director. There are no debts which crystallized at the time Mr. Groenewald ceased to be a director and thus he had no liability under s. 119.

With respect, I think McKeown J. was wrong in making his determination on the basis that the claim had not crystallized. There is a contractual obligation on the part of MSI not only to allow the plaintiff Brown an earned annual vacation, but to pay him his regular wage during that vacation time. As the employee earns his vacation entitlement by his work, week by week and month by month, so too he earns the right to be paid during his vacation time. At any given time the obligation with respect to vacation pay can be determined just as the obligation to pay wages can be determined. This is the thrust of *The Vacations with Pay Act,* R.S.M. 1987, c. V20, and in particular secs. 11(2), 13(1) and 13(3).

With respect to wages, the liability of a director under s. 119 cannot be avoided on the plea that the wages claim had not crystallized. To take an example, if the employee was being paid on a monthly basis, and the director resigned his position half way through the month, the director cannot escape liability which otherwise might arise under s. 119 by asserting that the debt for wages would not crystallize until the end of the month. The obligation to pay the employee his wages arises when the work is done. There is indeed a debt.

[Page 7]

Similarly, there is a debt with respect to vacation pay which has accumulated due to the work performed by the employee, and the existence of the indebtedness does not hinge on whether the employee has completed the whole measure of work to entitle him to an annual vacation or whether the employee has demanded his vacation rights.

The extent of the contractual obligation has in fact been calculated by the parties in the present case. The accumulated vacation pay up to the date of the resignations of the defendant directors on November 6, 1991 was $5,377.10, and *a* further $2,060.41 accrued between then and January 10, 1992.

The plaintiff Brown is therefore entitled to the sum of $5,377.10 from the defendant directors, since that debt arose while they were occupying their positions as directors.

Counsel for the defendant directors claims that his clients are not liable for vacation pay accruing after their resignations, namely, the remaining $2,060.41. That question is to be decided on the basis of whether the directors' resignations were effective.

The plaintiff Brown argues that the three directors could not validly resign on November 6th because it would have left the company with no directors, and a company cannot function in the absence of directors. It is argued that, if need be, the resignations should be set aside by the Court exercising its authority under s. 241 of the *Canada Business Corporations Act*

[Page 8]

on the grounds that the tendering of the resignations, without the knowledge of the plaintiff Brown, constituted oppressive conduct which the Court can remedy.

It would seem that the defendant directors tendered their resignations for proper reasons. MSI was in financial difficulty. In the fall of 1991 attempts were made to dispose of certain real property owned by MSI in the hope that the proceeds of sale would keep creditors at bay. When a sale of the real property could not be concluded, the principal secured creditors arranged that the accounting firm of Ernst & Young Inc. become involved in the management, with the intent that the business of MSI should be sold. Cotter & Co. was identified by Ernst & Young Inc. as a potential purchaser. All of the directors of MSI, save for the three defendants, resigned on October 28th and the three defendants resigned nine days later. The three defendants said they resigned because effective control was being exercised by Ernst & Young Inc. on behalf of the secured creditors. They thought a sale of the business would be

successfully consummated. Two of the three remained as officers of MSI, and were compensated as such, after their resignations as directors.

Section 108(1) of the *Canada Business Corporations Act* states that a director ceases to hold office when he dies or resigns, and 108(2) specifies that a resignation becomes effective at the time that the written resignation is sent to the corporation, or at the time specified in the resignation, whichever is later. There is nothing in the *Act* which limits the right of a director to resign. (This is in contrast to the Ontario

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Business Corporations Act, as an example, which specifies that a director is not permitted to resign unless a successor is available.)

Counsel for the plaintiff Brown suggests that it is impossible to conceive of a corporation continuing to operate without directors, but the *Canada Business Corporations Act,* under s. 111(2), contemplates that very situation. It provides that if there is no quorum of directors, or if there has been a failure to elect the required number of directors, the directors then in office shall call a special meeting of shareholders to fill the vacancy and if they fail to call a meeting, or if there are no directors then in office, the meeting may be called by any shareholder.

Apart from a statutory limitation, no authority was cited to us to support the proposition that a director of a company must continue to serve as a director against his will after having tendered his resignation.

Counsel for the plaintiff Brown argues that this Court can provide a remedy under the broad authority of s. 241 of the *Canada Business Corporations Act.* The resignations, it is argued, give rise to oppression and as a remedy it is suggested that the resignations can be retroactively annulled.

It was not, however, the resignations that caused oppression but rather the receivership and bankruptcy of MSI. In any event, even the broad remedial powers under s. 241 do not include the authority to

[Page 10]

retroactively cancel the resignations and reinstate the defendants against their will.

In my view the resignations were effective as of November 6, 1992, with the consequence that the claim for vacation pay is limited to $5,377.10 which had accumulated while the defendants served as directors. The appeal by the plaintiff Brown is dismissed. The cross-appeal by the defendant directors is allowed in part. The defendants are entitled to costs of the appeal.

[S] J.A.

I Agree:

[S] J.A.

I Agree:

[S] J.A.

COURT FILE NO.: 04-CV-271540CM 2
DATE: 20060329

ONTARIO

SUPERIOR COURT OF JUSTICE

B E T W E E N:	)	
	)	
THOMAS ENGLEFIELD, on his own behalf and on behalf of all former employees of Dylex Limited, in bankruptcy	)	***Andrew J. Hatnay***, for the Plaintiff
Plaintiff	)	
- and -	)	
HARDOF WOLF	)	No appearance by, or on behalf, of the defendant.
Defendant	)	
	)	**HEARD:** March 8, 2006

PROCEEDINGS UNDER THE CLASS PROCEEDINGS ACT, 1992

SUPPLEMENTARY REASONS FOR DECISION

CULLITY J.

[1] For reasons released on November 18, 2005 ([2005] O.J. No. 4895) I indicated that, pursuant to section 119 (1) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C - 44 ("CBCA"), I would grant default judgment against the defendant for debts in respect of unpaid wages, holiday pay and expense reimbursements. I indicated, however, that I would require further evidence and submissions in order to determine the quantum of the amounts for which Mr Wolf would be liable. I stated that the plain meaning of the words of section 119 (1) required that his liability would be limited to the part of the total amount of $286,089.68 claimed that should be considered to be for services performed

for the corporation in the three-month period that commenced with his election as a director in May, 2001 and terminated on the employees' dismissal on August 7 - 8, 2001. In support of this conclusion, I referred to the reasoning of McKeown J. in *Vopni v. Groenwald*, [1991] O.J. No. 3577 (G.D.) and of the Manitoba Court of Appeal in *Brown v. Shearer,* [1995] 6 W.W.R. 68.

[2] Mr Hatnay has since informed me that he has no evidence that would assist in allocating, or attributing, parts of the total unpaid amount to the three months' directorship of Mr Wolf. In his further submission, such an inquiry is neither necessary nor relevant. He argued strongly that my preferred interpretation of section 119 (1) of the CBCA was not correct and was not supported by the authorities I had cited. As the question had not been addressed at the earlier hearing, I indicated that I would revisit it in the light of the submissions he has now made.

[3] Section 119 (1) provides that directors are jointly and severally liable to employees of the corporation

> "for all debts not exceeding six months wages payable to each such employee for services performed for the corporation while they are such directors respectively."

[4] In Mr Hatnay's submission, the only interpretation that is consistent with the plain reading and purpose of the section, and with previous decisions, is that the individuals who are directors at the time of the termination of employment are liable for all amounts then owing to the employees in respect of unpaid wages, vacation pay and expense reimbursements. He submitted that the date of the termination of the employment was when the debts "crystallized" and that was the material time for establishing a director's liability.

[5] Mr Hatnay made his learned submissions with great confidence and I mean no criticism or disrespect to him when I say that I regret having to decide this question - and the others previously dealt with - on a motion for default judgment without hearing opposing submissions.

[6] I am, however, not persuaded that the interpretation Mr Hatnay urged me to accept represents the plain meaning of section 119 (1). In effect, it would require the provision to be read as if it referred to "debts payable, <u>while they are such directors</u>, for services performed for the corporation ". This does not appear to me to be either a literal or a grammatical interpretation of the words of the provision. Nor does it appear to attribute any meaning to the word "respectively" which I understand to reflect the possibility that the periods in which different individuals were directors, and in which the services were performed by the employees, may not be the same. Mr Hatnay’s intepretation would also assume that debts for unpaid wages would not become payable - or “crystallize” in some material sense - until the employee’s employment terminated.

[7] As far as the authorities are concerned, I adhere to the opinion that the decision of the Manitoba Court of Appeal in *Brown v. Shearer,* [1995] M.J. No. 182 supports what I consider to be the plain meaning of section 119 (1). There it was held that directors who had resigned two months before the termination of the plaintiff's employment were liable for vacation pay that accrued before the date of their resignations but not for pay that accrued subsequently. If Mr Hatnay's submissions are correct, liability for the whole amount would have fallen on the directors in place at the time of the plaintiff's termination even if they had been elected following the resignation of the earlier directors. The latter would have no liability. The Court of Appeal, however, expressly rejected an argument that the former directors incurred no liability as the debts had not crystallized at the time they resigned. In delivering the judgment of the court, Huband J.A. stated:

> There is a contractual obligation on the part of [the corporation] not only to allow the plaintiff Brown an earned vacation, but to pay him his regular wage during that vacation time. As the employee earns his vacation entitlement by his work, week-by-week and month-by-month, so to he earns the right to be paid during his vacation time. At any given time the obligation with respect to vacation pay can be determined just as the obligation to pay wages can be determined. ...
>
> With respect to wages, the liability of a director under s. 119 cannot be avoided on the plea that the wages claim had not crystallized. To take an example, if the employee was being paid on a monthly basis, and the director resigned his position halfway through the month, the director cannot escape liability which otherwise might arise under s. 119 by asserting that the debt for wages would not crystallise until the end of the month. The obligation to pay the employee's wages arises when the work is done. This is indeed a debt.
>
> Similarly, there is a debt with respect to vacation pay which has accumulated due to work performed by the employee, and the existence of the indebtedness does not hinge on whether the employee has completed the whole measure of work to entitle him to an annual vacation or whether the employee has demanded his vacation rights.

[8] While the decision in *Brown* was distinguished by the Court of Appeal of British Columbia in *Bell v. British Columbia (Director of Employment Standards),* [1996] B.C.J. No. 1372 on the different wording of an applicable provincial statute, the court (at paras 28 and 36) expressly agreed with the interpretation placed on section 119 (1) in *Brown*:

> On appeal, Huband J.A. stated that a director's liability for wages under s.119 cannot be avoided on the plea that the wages had not "crystallized". He stated further that, just as an obligation to pay an employee wages arises as work is done, a corporation incurs a debt for accrued vacation pay as the work is performed by the employee. ...
>
> In my view, Brown is distinguishable from the case at bar because the language of the "director liability" section in the CBCA differs markedly from that found in the ESA. In s. 119 of the CBCA, the key words are "are... payable to each such employee for services performed for the corporation while they are such directors respectively". I agree with counsel for [an intervenor] that section 119 creates an "earned " test, since the debts "payable" are for "services performed", that is, for wages earned. On the other hand, s.19 (1) of the ESA imposes liability for wages which "should have been paid".

[9] None of the cases cited by Mr Hatnay involved facts that raised the question that is now in issue, or contain any consideration of it. In *Mills-Hughes v. Raynor* (1988), 63 O.R. (2d) 343 (C.A.) and *Barrette v. Crabtree Estate*, [1993] 1 S.C.R. 1027, for example, there is no suggestion that that any of the directors had resigned, or been recently appointed, before the termination of the employment and I see no justification for attributing significance to the court's failure in those cases to refer to the question. I note, moreover, that, in para 31, Heureux-Dube J. quoted with apparent approval a passage from the *Meredith Memorial Lectures 1985* in which the learned author states:

> ... the mere fact of having been a director at the time the services were rendered by the employees renders the directors jointly and severally liable ...

[10] Similarly, in *Jonah v. Quinte Transport (1986) Ltd.*, [1994] O.J. No. 1507 (G.D.) while Epstein J., on a motion for summary judgment, referred to the date of termination of the employee as "the material time", the learned judge (at para 39) held that the question of the identity of the directors of a corporation and “over what period of time" they were directors should be tried. The learned judge referred also to statements in *Barrette* with respect to the exceptional nature of the liability imposed on directors by section 119 (1) and the need for a legislative intention to do this to be indicated expressly and clearly.

[11] Mr Hatnay was, I believe, on firmer ground when, in his written submissions, he stated that the decision in *Vopni* does not support "the notion that directors are only liable for amounts owing to employees from the date the person became a director to the date of termination of employment."

[12] In *Vopni* it was held by McKeown J. that a director who had resigned five months before the dismissal of the plaintiff was not liable for vacation pay that had accrued prior to his resignation. The learned judge stated:

> While *Mills-Hughes v. Raynor*, supra, stated that upon termination, vacation pay is a debt due to employees for services performed, I am of the view that the debt did not crystallise until Mr Vopni was terminated, and this was five months subsequent to Mr Groenwald's resignation as a director. The purpose of s. 119 (1) is to urge directors to keep payments to the employees current. In this case, all of the company's obligations to Mr Vopni were current while Mr Groenwald was a director. There are no debts which crystallized at the time Mr Groenwald ceased to be a director and thus he had no liability under s.119.

[13] The court in *Vopni* was not called upon to consider whether directors in place at the time of an employee's dismissal would be liable for all vacation pay then owing irrespective of their length of tenure, but this appears to be implicit in the reasoning of the learned judge. It is, perhaps, not so clear that debts for unpaid wages and expense reimbursements should be considered to "crystallize" only on the termination of employment.

[14] It is clear that, if *Vopni* was correctly decided, the interpretation of section 119 (1) that I would otherwise wish to accept would create a gap in the legislation or, at least, significantly limit the rights it confers on employees where all the directors had been replaced shortly before the termination of employment. If, however, the contrary view adopted in *Brown* is correct, there would be no such gap.

[15] The difficulty I am faced with is that the reasoning in *Vopni* was not followed and described as "wrong" by the Manitoba Court of Appeal in *Brown* and the decision in *Brown* was clearly preferred by the British Columbia Court of Appeal in *Bell*. While ordinarily - and despite my own preference for the reasoning in those decisions - I would consider myself bound to follow *Vopni*, I would do so with the knowledge that the issue would very likely be dealt with on an appeal from my decision. In this case, the defendant has no right of appeal but I have Mr Hatnay's assurance that a notice of appeal from my decisions with respect to termination and severance pay has been filed. In these circumstances, and as the importance of the question of statutory interpretation extends

beyond the facts of this case, I intend to follow the reasoning of the appellate courts in Manitoba and British Columbia rather than that in *Vopni*.

[16] Accordingly, as there is no evidence of the amounts owing for unpaid wages, vacation pay and unreimbursed expenses that are referable to the period while Mr Wolf was a director, the motion for judgment is dismissed.

_____

CULLITY J.

Released: March 29, 2006

COURT FILE NO.: 04-CV-271540CM 2
DATE: 20060329

ONTARIO

SUPERIOR COURT OF JUSTICE

B E T W E E N:

THOMAS ENGLEFIELD, on his own behalf and on behalf of all former employees of Dylex Limited, in bankruptcy

Plaintiffs

- and -

HARDOF WOLF

Defendant

SUPPLEMENTARY REASONS FOR DECISION

CULLITY J.

Released: March 29, 2006

Andrew Sabean *Appellant*

v.

Portage La Prairie Mutual Insurance Company *Respondent*

Indexed as: Sabean *v.* Portage La Prairie Mutual Insurance Co.

2017 SCC 7

File No.: 36575.

2016: October 5; 2017: January 27.

Present: McLachlin C.J. and Moldaver, Karakatsanis, Wagner, Gascon, Côté and Brown JJ.

ON APPEAL FROM THE COURT OF APPEAL FOR NOVA SCOTIA

Insurance — Automobile insurance — Excess insurance policy — SEF 44 Endorsement — Deductions — Insured awarded damages for injuries sustained in motor vehicle accident — Tortfeasor's insurance coverage inadequate to cover quantum of jury award — Clause of insured's Endorsement stipulating that amounts recoverable under "any policy of insurance providing disability benefits or loss of income benefits or medical expense or rehabilitation benefits" must be deducted from shortfall of damages award in determining amount payable by insurer — Whether Canada Pension Plan is a "policy of insurance providing disability benefits" within meaning of Endorsement.

S, who was injured in a motor vehicle accident was awarded damages of $465,400 by a jury. The tortfeasor's insurer paid S approximately $382,000, leaving a shortfall of more than $83,000. S claimed that amount from his own insurer under the provisions of his SEF 44 Endorsement. The insurer sought to deduct S's future Canada Pension Plan ("CPP") disability benefits under cl. 4(b)(vii) of his SEF 44 Endorsement. The trial judge found that CPP benefits were not benefits from a "policy of insurance" under the Endorsement and thus would not be deducted from the amount payable. The Nova Scotia Court of

Andrew Sabean *Appelant*

c.

Portage La Prairie Mutual Insurance Company *Intimée*

Répertorié : Sabean *c.* Portage La Prairie Mutual Insurance Co.

2017 CSC 7

N° du greffe : 36575.

2016 : 5 octobre; 2017 : 27 janvier.

Présents : La juge en chef McLachlin et les juges Moldaver, Karakatsanis, Wagner, Gascon, Côté et Brown.

EN APPEL DE LA COUR D'APPEL DE LA NOUVELLE-ÉCOSSE

Assurances — Assurance automobile — Police de garantie complémentaire — Avenant SEF 44 — Déductions — Jugement accordant à l'assuré des dommages-intérêts pour des blessures subies dans un accident d'automobile — Couverture d'assurance de l'auteur du délit insuffisante pour payer le montant des dommages accordés par le jury — Clause de l'avenant de l'assuré prévoyant que, pour l'établissement du montant payable par l'assureur, les montants recouvrables aux termes « de toute police d'assurance stipulant une indemnité d'invalidité ou de réadaptation, ou une indemnité pour manque à gagner ou frais médicaux » doivent être déduits de la somme manquante des dommages-intérêts accordés — Le Régime de pensions du Canada constitue-t-il une « police d'assurance stipulant une indemnité d'invalidité » au sens de l'avenant?

Un jury a accordé à S, qui a été blessé dans un accident d'automobile, la somme de 465 400 $ à titre de dommages-intérêts. S a reçu environ 382 000 $ de l'assureur de l'auteur du délit, ce qui laissait une somme manquante de plus de 83 000 $. S a réclamé ce montant à son propre assureur aux termes des dispositions de son avenant SEF 44. L'assureur a cherché à déduire, en vertu de la cl. 4(b)(vii) de l'avenant SEF 44, le montant des futures prestations d'invalidité du Régime de pensions du Canada (« RPC ») versées à S. Le juge de première instance a conclu que les prestations du RPC ne constituaient pas des

Appeal disagreed, concluding that the CPP was a "policy of insurance" under the Endorsement.

Held: The appeal should be allowed.

The clear language of cl. 4(b)(vii) of the SEF 44 Endorsement, reading the contract as a whole, is unambiguous. Future CPP disability benefits are not disability benefits from a "policy of insurance" within the meaning of the provision and are not deductible from the amounts payable by the insurer. The overarching purpose of the Endorsement is to provide the "excess" coverage that arises where an underinsured motorist cannot pay the full amount of a court judgment. The Endorsement indemnifies insureds for any shortfall in the payment of a judgment for damages against an underinsured tortfeasor, subject to specified deductions. With respect to amounts that the eligible claimant is "entitled to recover", cl. 4 (b) specifies nine sources that give rise to deductions from the amount payable by the insurer, none of which include the CPP. The ordinary meaning of a "policy of insurance" in cl. 4(b)(vii) is clear. It refers to a private insurance policy purchased by the insured. An average person applying for this additional insurance coverage would understand a "policy of insurance" to mean an optional, private insurance contract and not a mandatory, statutory scheme such as the CPP.

The insurer cannot rely on its specialized knowledge of the jurisprudence to advance an interpretation that goes beyond the clear words of the policy. The overriding principle for the interpretation of standard form insurance contracts is that where the language of the disputed clause is unambiguous, reading the contract as a whole, effect should be given to that clear language. The words used must be given their ordinary meaning, as they would be understood by the average person applying for insurance, and not as they might be perceived by persons versed in the niceties of insurance law. This Court's decision in *Canadian Pacific Ltd. v. Gill*, [1973] S.C.R. 654, does not support an alternative reasonable interpretation of the disputed words. The reasoning in *Gill* is confined to a distinct interpretive context, far removed from the Endorsement at issue. Thus the ordinary meaning of the words "policy of insurance" in cl. 4(b)(vii) does not include the CPP regime.

prestations au titre d'une « police d'assurance » en application de l'avenant, et qu'elles ne seraient donc pas déduites du montant payable. Par contre, la Cour d'appel de la Nouvelle-Écosse a conclu que le RPC constituait une « police d'assurance » aux termes de l'avenant.

Arrêt : Le pourvoi est accueilli.

Compte tenu du contrat dans son ensemble, le texte clair de la cl. 4(b)(vii) de l'avenant SEF 44 n'est pas ambigu. Les futures prestations d'invalidité du RPC ne sont pas des prestations d'invalidité au titre d'une « police d'assurance » au sens de la disposition et elles ne sont pas déductibles des montants payables par l'assureur. L'objet prépondérant de l'avenant est de fournir la protection « complémentaire » qui s'applique lorsqu'un automobiliste sous-assuré ne peut payer la totalité du montant constaté par jugement. L'avenant donne aux assurés droit à une indemnisation pour toute somme manquante pour acquitter un jugement condamnant l'auteur sous-assuré d'un délit à des dommages-intérêts, sous réserve de certaines déductions. En ce qui a trait aux montants que le demandeur admissible a « le droit de recouvrer », la cl. 4(b) précise neuf sources qui donnent lieu à des déductions du montant payable par l'assureur, et aucune ne comprend le RPC. Le sens ordinaire des mots « police d'assurance » à la cl. 4(b)(vii) est clair. Il désigne une police d'assurance privée achetée par l'assuré. Une personne ordinaire qui présente une demande en vue d'obtenir une telle garantie supplémentaire comprendrait qu'une « police d'assurance » s'entend d'un contrat d'assurance privé facultatif et non d'un régime obligatoire établi par la loi tel le RPC.

L'assureur ne peut se fonder sur sa connaissance spécialisée de la jurisprudence pour proposer une interprétation qui va au-delà du libellé clair de la police. Le principe prépondérant pour l'interprétation des contrats types d'assurance veut que, lorsque le texte de la clause contestée n'est pas ambigu, compte tenu du contrat dans son ensemble, le tribunal doit donner effet à ce texte clair. Les mots utilisés doivent être interprétés selon leur sens ordinaire et de la manière dont ils seraient compris par la personne ordinaire qui fait une demande d'assurance et non de la manière dont ils pourraient être perçus par des personnes versées dans les subtilités du droit des assurances. L'arrêt de la Cour *Canadian Pacific Ltd. c. Gill*, [1973] R.C.S. 654, n'étaye pas une autre interprétation raisonnable des mots contestés. Le raisonnement dans *Gill* se limite à un contexte d'interprétation distinct très éloigné de l'avenant dont il est question. Ainsi, le sens ordinaire des mots « police d'assurance » à la cl. 4(b)(vii) ne comprend pas le RPC.

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Jurisprudence

Distinction d'avec l'arrêt : *Canadian Pacific Ltd. c. Gill*, [1973] R.C.S. 654; *Gignac c. Neufeld* (1999), 43 O.R. (3d) 741; **arrêts mentionnés :** *Economical Mutual Insurance Co. c. Lapalme*, 2010 NBCA 87, 366 R.N.-B. (2e) 199; *Ledcor Construction Ltd. c. Société d'assurance d'indemnisation Northbridge*, 2016 CSC 37, [2016] 2 R.C.S. 23; *Progressive Homes Ltd. c. Cie canadienne d'assurances générales Lombard*, 2010 CSC 33, [2010] 2 R.C.S. 245; *Non-Marine Underwriters, Lloyd's of London c. Scalera*, 2000 CSC 24, [2000] 1 R.C.S. 551; *Co-operators Compagnie d'assurance vie c. Gibbens,* 2009 CSC 59, [2009] 3 R.C.S. 605; *MacDonald c. Chicago Title Insurance Co. of Canada*, 2015 ONCA 842, 127 O.R. (3d) 663; *Somersall c. Friedman*, 2002 CSC 59, [2002] 3 R.C.S. 109; *Ratych c. Bloomer*, [1990] 1 R.C.S. 940; *Parry c. Cleaver*, [1970] A.C. 1; *Bradburn c. Great Western Railway Co.* (1874), L.R. 10 Ex. 1; *Cunningham c. Wheeler*, [1994] 1 R.C.S. 359; *Chilton c. Co-Operators General Insurance Co.* (1997), 32 O.R. (3d) 161.

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[2013] N.S.J. No. 656 (QL), 2013 CarswellNS 944 (WL Can.). Appeal allowed.

Derrick J. Kimball and *Sharon L. Cochrane*, for the appellant.

Scott R. Campbell and *Scott C. Norton*, *Q.C.*, for the respondent.

The judgment of the Court was delivered by

Karakatsanis J. —

I. Introduction

[1] This case involves the interpretation of the Nova Scotia SEF 44 Endorsement, an excess insurance policy. This Endorsement is a standard form contract that exists in similar terms across the country. Canadians purchase these policies, sometimes called Special or Family Protection Endorsements, in addition to their existing automobile insurance coverage. These endorsements indemnify insureds for any shortfall in the payment of a judgment for damages against an underinsured tortfeasor, subject to the deductions set out in the Endorsement. The scope of one such deduction is at issue in this appeal.

[2] The Endorsement stipulates that future benefits from a "policy of insurance providing disability benefits" are deducted from the shortfall in determining the amount payable by the insurer (cl. 4(b)(vii)). The issue in this appeal is whether the Canada Pension Plan (CPP) is a "policy of insurance" for that purpose.

[3] The trial judge in this case found that CPP benefits were not benefits from a "policy of insurance" under the Endorsement and thus would not be deducted from the amount payable by the insurer. The Nova Scotia Court of Appeal disagreed, concluding

[2013] N.S.J. No. 656 (QL), 2013 CarswellNS 944 (WL Can.). Pourvoi accueilli.

Derrick J. Kimball et *Sharon L. Cochrane*, pour l'appelant.

Scott R. Campbell et *Scott C. Norton*, *c.r.*, pour l'intimée.

Version française du jugement de la Cour rendu par

La juge Karakatsanis —

I. Introduction

[1] La présente affaire porte sur l'interprétation de l'avenant SEF 44 utilisé en Nouvelle-Écosse, une police de garantie complémentaire. Cet avenant est un contrat type, et des avenants au libellé similaire existent partout au pays. Les Canadiens achètent de telles polices, parfois appelées avenants de protection familiale ou spéciale, en sus de leur assurance automobile. Ces avenants donnent aux assurés droit à une indemnisation pour toute somme manquante pour acquitter un jugement condamnant l'auteur sous-assuré d'un délit à des dommages-intérêts, sous réserve des déductions indiquées dans l'avenant. La portée de l'une de ces déductions est en cause dans le présent pourvoi.

[2] L'avenant prévoit que les prestations futures au titre d'une [TRADUCTION] « police d'assurance stipulant une indemnité d'invalidité » sont déduites de la somme manquante pour déterminer le montant payable par l'assureur (cl. 4(b)(vii)). La question en litige dans le présent pourvoi est de savoir si le Régime de pensions du Canada (RPC) constitue une « police d'assurance » à cette fin.

[3] Le juge de première instance a conclu que les prestations du RPC ne constituaient pas des prestations au titre d'une « police d'assurance » en application de l'avenant, et qu'elles ne seraient donc pas déduites du montant payable par l'assureur. La Cour

that the CPP was a "policy of insurance" under the Endorsement.[1]

[4] I agree with the trial judge. The ordinary meaning of the words at issue is clear, reading this Endorsement as a whole. An insurer cannot rely on its specialized knowledge of the jurisprudence to advance an interpretation that goes beyond the clear words of the policy. An average person applying for this additional insurance coverage would understand a "policy of insurance" to mean an optional, private insurance contract and not a mandatory statutory scheme such as the CPP. Thus, future CPP disability benefits do not reduce the amount payable by the insurer under the Endorsement.

[5] I would allow the appeal.

II. Background

[6] The appellant, Andrew Sabean, was injured in a motor vehicle accident in 2004. In May 2013, a jury awarded Mr. Sabean damages for his injuries in the amount of $465,400. The amount he received from the tortfeasor's insurer was about $382,000, leaving a shortfall of more than $83,000. Mr. Sabean claimed under the excess coverage provisions of his SEF 44 Endorsement with the respondent, Portage La Prairie Mutual Insurance Company (Portage).

[7] Clause 4(b)(vii) of the Endorsement stipulates that amounts recoverable under "any policy of insurance providing disability benefits or loss of income benefits or medical expense or rehabilitation benefits" are to be deducted from the shortfall of the

[1] The New Brunswick and Nova Scotia Courts of Appeal each came to different conclusions on this point. The New Brunswick Court of Appeal in *Economical Mutual Insurance Co. v. Lapalme*, 2010 NBCA 87, 366 N.B.R. (2d) 199, found that CPP benefits were not a "policy of insurance" under the New Brunswick equivalent of the Endorsement.

d'appel de la Nouvelle-Écosse n'était pas de cet avis. Elle a conclu que le RPC constituait une « police d'assurance » aux termes de l'avenant[1].

[4] Je souscris à l'opinion du juge de première instance. Le sens ordinaire des mots en cause est clair, compte tenu de l'avenant dans son ensemble. Un assureur ne peut se fonder sur sa connaissance spécialisée de la jurisprudence pour proposer une interprétation qui va au-delà du libellé clair de la police. Une personne ordinaire qui présente une demande en vue d'obtenir une telle garantie supplémentaire comprendrait qu'une « police d'assurance » s'entend d'un contrat d'assurance privé facultatif et non d'un régime obligatoire établi par la loi tel le RPC. Ainsi, les futures prestations d'invalidité au titre du RPC ne réduisent pas le montant payable par l'assureur aux termes de l'avenant.

[5] Je suis d'avis d'accueillir le pourvoi.

II. Contexte

[6] L'appelant, Andrew Sabean, a été blessé dans un accident d'automobile en 2004. En mai 2013, un jury lui a accordé la somme de 465 400 $ à titre de dommages-intérêts pour ses blessures. Il a reçu la somme d'environ 382 000 $ de l'assureur de l'auteur du délit, ce qui laissait une somme manquante de plus de 83 000 $. M. Sabean a présenté à l'intimée, Portage La Prairie Mutual Insurance Company (Portage), une réclamation fondée sur les dispositions en matière de garantie complémentaire de son avenant SEF 44.

[7] La clause 4(b)(vii) de l'avenant prévoit que, pour l'établissement du montant payable par l'assureur au demandeur admissible, les montants recouvrables aux termes [TRADUCTION] « de toute police d'assurance stipulant une indemnité d'invalidité ou

[1] La Cour d'appel du Nouveau-Brunswick et la Cour d'appel de la Nouvelle-Écosse sont arrivées à des conclusions différentes sur ce point. Dans *Economical Mutual Insurance Co. c. Lapalme*, 2010 NBCA 87, 366 R.N.-B. (2e) 199, la Cour d'appel du Nouveau-Brunswick a conclu que les prestations du RPC n'étaient pas des prestations versées au titre d'une « police d'assurance » en vertu de l'équivalent néo-brunswickois de l'avenant.

damages award in determining the amount payable by the insurer to the eligible claimant.

[8] Mr. Sabean is entitled to receive future CPP disability benefits. Portage took the position that those amounts were to be deducted as recoverable benefits from a "policy of insurance" under cl. 4(b)(vii) in determining the amount payable by Portage. Mr. Sabean disagreed.

[9] Justice Murray of the Nova Scotia Supreme Court held that future CPP disability benefits did not fall within the meaning of "any policy of insurance providing disability benefits" in cl. 4(b)(vii) of the Endorsement and therefore were not to be deducted from the amount payable by the insurer: 2013 NSSC 306, 338 N.S.R. (2d) 14. The trial judge relied upon the New Brunswick Court of Appeal's reasoning in *Economical Mutual Insurance Co. v. Lapalme*, 2010 NBCA 87, 366 N.B.R. (2d) 199, at paras. 89-94, that the language and larger context of the New Brunswick equivalent to the SEF 44 Endorsement supported its interpretation of cl. 4(b)(vii) to mean that a "policy of insurance providing disability benefits" did not include CPP disability benefits.

[10] Justice Scanlan of the Nova Scotia Court of Appeal, writing for Justices Beveridge and Hamilton, allowed the appeal on that issue: 2015 NSCA 53, 359 N.S.R. (2d) 392. Relying in part on this Court's decision in *Canadian Pacific Ltd. v. Gill*, [1973] S.C.R. 654, the Court of Appeal concluded that future CPP disability benefits were to be treated as disability benefits recoverable under a "policy of insurance". It reasoned that cl. 4(b)(vii) clearly included CPP disability benefits as a "policy of insurance" after considering the drafting history of the SEF 44 Endorsement following *Gill* and the principle against double recovery in the context of the Endorsement as an excess insurance provision.

de réadaptation, ou une indemnité pour manque à gagner ou frais médicaux » doivent être déduits de la somme manquante des dommages-intérêts accordés.

[8] M. Sabean a le droit de toucher de futures prestations d'invalidité du RPC. Portage a soutenu que, pour l'établissement du montant payable par Portage, la valeur des futures prestations d'invalidité du RPC doit être déduite puisqu'il s'agit de prestations recouvrables d'une « police d'assurance » au titre de la cl. 4(b)(vii). M. Sabean n'était pas de cet avis.

[9] Le juge Murray de la Cour suprême de la Nouvelle-Écosse a conclu que les futures prestations d'invalidité du RPC ne sont pas visées par l'expression [TRADUCTION] « toute police d'assurance stipulant une indemnité d'invalidité » figurant dans la cl. 4(b)(vii) de l'avenant, et qu'elles ne doivent donc pas être déduites du montant payable par l'assureur : 2013 NSSC 306, 338 N.S.R. (2d) 14. Le juge de première instance s'est fondé sur le raisonnement de la Cour d'appel du Nouveau-Brunswick dans *Economical Mutual Insurance Co. c. Lapalme*, 2010 NBCA 87, 366 R.N.-B. (2e) 199, par. 89-94, selon lequel le libellé et le contexte général de l'équivalent néo-brunswickois de l'avenant SEF 44 appuie son interprétation de la cl. 4(b)(vii), voulant qu'une « police d'assurance stipulant une indemnité d'invalidité » ne comprend pas les prestations d'invalidité du RPC.

[10] Le juge Scanlan de la Cour d'appel de la Nouvelle-Écosse, s'exprimant au nom des juges Beveridge et Hamilton, a accueilli l'appel sur cette question : 2015 NSCA 53, 359 N.S.R. (2d) 392. Se fondant en partie sur l'arrêt de notre Cour *Canadian Pacific Ltd. c. Gill*, [1973] R.C.S. 654, la Cour d'appel a conclu que les futures prestations d'invalidité du RPC devaient être considérées comme des prestations d'invalidité recouvrables aux termes d'une « police d'assurance ». Après avoir examiné l'historique de la rédaction de l'avenant SEF 44 qui a suivi l'arrêt *Gill* et le principe interdisant la double indemnisation dans le contexte où l'avenant constitue une garantie complémentaire, la Cour a expliqué que la cl. 4(b)(vii) visait manifestement les prestations d'invalidité du RPC en tant que [TRADUCTION] « police d'assurance ».

III. Issue

[11] Is the Canada Pension Plan a "policy of insurance providing disability benefits" within the meaning of cl. 4(b)(vii) of the SEF 44 Endorsement?

IV. Analysis

[12] In *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.*, 2016 SCC 37, [2016] 2 S.C.R. 23, this Court confirmed the principles of contract interpretation applicable to standard form insurance contracts. The overriding principle is that where the language of the disputed clause is unambiguous, reading the contract as a whole, effect should be given to that clear language: *Ledcor*, at para. 49; *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, 2010 SCC 33, [2010] 2 S.C.R. 245, at para. 22; *Non-Marine Underwriters, Lloyd's of London v. Scalera*, 2000 SCC 24, [2000] 1 S.C.R. 551, at para. 71. Only where the disputed language in the policy is found to be ambiguous, should general rules of contract construction be employed to resolve that ambiguity: *Ledcor*, at para. 50. Finally, if these general rules of construction fail to resolve the ambiguity, courts will construe the contract *contra proferentem*, and interpret coverage provisions broadly and exclusion clauses narrowly: *Ledcor*, at para. 51.

[13] At the first step of the analysis for standard form contracts of insurance, the words used must be given their ordinary meaning, "as they would be understood by the average person applying for insurance, and not as they might be perceived by persons versed in the niceties of insurance law": *Co-operators Life Insurance Co. v. Gibbens*, 2009 SCC 59, [2009] 3 S.C.R. 605, at para. 21; see also *Ledcor*, at para. 27.

[14] The SEF 44 Endorsement is a standard form contract. Sometimes called Special or Family Protection Endorsements, these excess insurance policies are purchased in addition to existing automobile

III. Question en litige

[11] Le Régime de pensions du Canada constitue-t-il une [TRADUCTION] « police d'assurance stipulant une indemnité d'invalidité » au sens de la cl. 4(b)(vii) de l'avenant SEF 44?

IV. Analyse

[12] Dans l'arrêt *Ledcor Construction Ltd. c. Société d'assurance d'indemnisation Northbridge*, 2016 CSC 37, [2016] 2 R.C.S. 23, la Cour a confirmé les principes d'interprétation des contrats applicables aux contrats types d'assurance. Le principe prépondérant veut que lorsque le texte de la clause contestée n'est pas ambigu, compte tenu du contrat dans son ensemble, le tribunal doit donner effet à ce texte clair : *Ledcor*, par. 49; *Progressive Homes Ltd. c. Cie canadienne d'assurances générales Lombard*, 2010 CSC 33, [2010] 2 R.C.S. 245, par. 22; *Non-Marine Underwriters, Lloyd's of London c. Scalera*, 2000 CSC 24, [2000] 1 R.C.S. 551, par. 71. Ce n'est que lorsque le texte contesté de la police est jugé ambigu que l'on doit recourir aux règles générales d'interprétation des contrats pour résoudre cette ambiguïté : *Ledcor*, par. 50. Finalement, si ces règles générales d'interprétation ne permettent pas de dissiper l'ambiguïté, les tribunaux recourront à la règle *contra proferentem* pour interpréter le contrat; les dispositions relatives à la garantie recevront une interprétation large, et les clauses d'exclusion, une interprétation étroite : *Ledcor*, par. 51.

[13] À la première étape de l'analyse relative aux contrats type d'assurance, les mots utilisés doivent être interprétés selon leur sens ordinaire, « de la manière dont ils seraient compris par la personne ordinaire qui fait une demande d'assurance et non de la manière dont ils pourraient être perçus par des personnes versées dans les subtilités du droit des assurances » : *Co-operators Compagnie d'assurance vie c. Gibbens*, 2009 CSC 59, [2009] 3 R.C.S. 605, par. 21; voir également *Ledcor*, par. 27.

[14] L'avenant SEF 44 est un contrat type. Parfois appelées avenants de protection familiale ou spéciale, ces polices de garantie complémentaire sont achetées en sus de l'assurance automobile existante.

insurance coverage. The terms of these endorsements are not negotiated. In this context, the Endorsement is a "take-it-or-leave-it" proposition: *Ledcor*, at para. 28, quoting *MacDonald v. Chicago Title Insurance Co. of Canada*, 2015 ONCA 842, 127 O.R. (3d) 663, at para. 33.

[15] An insured pays an additional premium for the protection of the excess coverage provided under the Endorsement, which indemnifies the insured for any shortfall in the payment of a judgment for damages against an underinsured tortfeasor: *Somersall v. Friedman*, 2002 SCC 59, [2002] 3 S.C.R. 109, at paras. 16-19. However, the amount owed under the Endorsement is not necessarily the full amount of the shortfall owed by the underinsured tortfeasor. The terms of the Endorsement provide for specific deductions from the shortfall in order to determine the amount payable by the insurer to the eligible claimant. This appeal is about the scope of one of the deductions.

[16] Clause 2 of the Endorsement describes the purpose of the insuring agreement:

> In consideration of the premium charged and subject to the provisions hereof, it is understood and agreed that the insurer shall indemnify each eligible claimant for the amount that such eligible claimant is legally entitled to recover from an inadequately insured motorist as compensatory damages in respect of bodily injury or death sustained by an insured person by accident arising out of the use or operation of an automobile.

[17] Clause 4(a) of the Endorsement stipulates the formula for determining the amount payable by the insurer to the eligible claimant:

> The amount payable under this endorsement to any eligible claimant shall be ascertained by determining the amount of damages the eligible claimant is legally entitled to recover from the inadequately insured motorist and deducting from that amount the aggregate of the amounts referred to in paragraph 4(b) . . . .

Les modalités de ces avenants ne sont pas négociées. Dans un tel contexte, l'avenant est une proposition « à prendre ou à laisser » : *Ledcor*, par. 28, citant *MacDonald c. Chicago Title Insurance Co. of Canada*, 2015 ONCA 842, 127 O.R. (3d) 663, par. 33.

[15] L'assuré paye une prime additionnelle pour la garantie complémentaire prévue par l'avenant, qui assure l'indemnisation de l'assuré pour toute somme manquante pour acquitter un jugement condamnant l'auteur sous-assuré du délit à des dommages-intérêts : *Somersall c. Friedman*, 2002 CSC 59, [2002] 3 R.C.S. 109, par. 16-19. Cependant, le montant dû aux termes de l'avenant n'est pas nécessairement la totalité de la somme manquante due par l'auteur sous-assuré du délit. Les modalités de l'avenant prévoient que certains montants doivent être déduits de la somme manquante pour que soit déterminé le montant payable par l'assureur au demandeur admissible. La portée de l'une de ces déductions est en cause dans le présent pourvoi.

[16] La clause 2 de l'avenant décrit l'objet de la convention d'assurance :

> [TRADUCTION] En contrepartie de la prime exigée et sous réserve des dispositions des présentes, il est entendu et convenu que l'assureur indemnisera chaque demandeur admissible du montant que ce dernier a le droit de recouvrer d'un automobiliste sous-assuré à titre de dommages-intérêts compensatoires pour les lésions corporelles subies par une personne assurée ou pour son décès par suite d'un accident découlant de l'usage ou de la conduite d'une automobile.

[17] La clause 4(a) de l'avenant prévoit la formule servant à fixer le montant payable par l'assureur au demandeur admissible :

> [TRADUCTION] Le montant payable en conformité avec le présent avenant à tout demandeur admissible correspond au montant des dommages-intérêts que le demandeur admissible a le droit de recouvrer de l'automobiliste sous-assuré, déduction faite du total des montants visés à la clause 4(b) . . .

[18] The amounts to be deducted from the amount payable are set out in cl. 4(b) of the Endorsement:

The amount payable under this endorsement to any eligible claimant is excess to any amount actually recovered by the eligible claimant from any source (other than money payable on death under a policy of insurance) and is excess to any amounts the eligible claimant is entitled to recover (whether such entitlement is pursued or not) from:

(i) the insurers of the inadequately insured motorist, and from bonds, cash deposits or other financial guarantees given on behalf of the inadequately insured motorist;

(ii) the insurers of any person jointly liable with the inadequately insured motorist for the damages sustained by an insured person;

(iii) the Société de l'assurance automobile du Québec;

(iv) an unsatisfied judgment fund or similar plan or which would have been payable by such fund or plan had this endorsement not been in effect;

(v) the uninsured motorist coverage of a motor vehicle liability policy;

(vi) any automobile accident benefits plan applicable in the jurisdiction in which the accident occurred;

(vii) any policy of insurance providing disability benefits or loss of income benefits or medical expense or rehabilitation benefits;

(viii) any Worker's Compensation Act or similar law of the jurisdiction applicable to the injury or death sustained;

(ix) any Family Protection Coverage of a motor vehicle liability policy; [Emphasis added.]

[19] The insurer submits that it is the overarching purpose of the Endorsement to prohibit overcompensation or double recovery because it is in the nature of "excess insurance". However, an excess insurance policy provides coverage in excess to losses covered by a primary insurance policy. "Excess" for the purposes of an excess insurance policy does not

[18] Les montants devant être déduits du montant payable sont indiqués à la cl. 4(b) de l'avenant :

[TRADUCTION]

Le montant payable en application du présent avenant à tout demandeur admissible est complémentaire au montant effectivement recouvré par ce dernier de toute source (sauf les sommes payables au décès en vertu d'une police d'assurance) et à tout montant que le demandeur admissible a le droit de recouvrer (qu'il fasse valoir ce droit ou non) :

(i) des assureurs de l'automobiliste sous-assuré et des cautionnements, dépôts en espèces ou autres cautionnements financiers fournis au nom de l'automobiliste sous-assuré;

(ii) des assureurs de toute personne responsable conjointement avec l'automobiliste sous-assuré du dommage subi par une personne assurée;

(iii) de la Société de l'assurance automobile du Québec;

(iv) d'une caisse d'indemnisation des créanciers de jugements inexécutés ou d'un régime semblable ou qu'une telle caisse ou un tel régime aurait dû verser n'eût été le présent avenant;

(v) de la garantie relative aux automobilistes non assurés prévue par une police d'assurance responsabilité civile automobile;

(vi) de tout régime d'indemnisation des victimes d'accidents d'automobiles applicable dans le ressort où l'accident s'est produit;

(vii) de toute police d'assurance stipulant une indemnité d'invalidité ou de réadaptation, ou une indemnité pour manque à gagner ou frais médicaux;

(viii) de tout régime d'indemnisation des accidents de travail ou régime semblable du ressort, applicable aux lésions corporelles subies ou au décès;

(ix) de toute garantie de protection familiale d'une police d'assurance responsabilité civile automobile; [Je souligne.]

[19] L'assureur soutient que, de par sa nature même à titre de « garantie complémentaire », l'avenant a pour objet prépondérant d'interdire l'indemnisation excessive ou la double indemnisation. Cependant, une police de garantie complémentaire offre une protection complémentaire aux sinistres couverts par une police d'assurance principale. Le

mean that the purpose of the Endorsement is to preclude "overcompensation". The "excess" coverage is defined by the terms of the contract.

[20] By the terms of the contract, the overarching purpose of the Endorsement is to provide the "excess" coverage that arises where an underinsured motorist cannot pay the full amount of a court judgment. The insurer indemnifies eligible claimants against the shortfall arising from a damages award (cl. 2). The amount that the claimant is entitled to receive in damages has already been determined by the court in accordance with relevant legal principles — here, tort principles. The Endorsement designates this amount — the judgment — as the scheme's starting point for calculating the amount payable (cl. 2).

[21] However, the Endorsement only indemnifies part of the shortfall. The amount payable by the insurer to the eligible claimant under the Endorsement is not the full amount of the shortfall that an underinsured motorist is unable to pay. Clause 4(a) establishes the formula for determining the amount payable by the insurer to the eligible claimant. Clause 4(a) provides that coverage is the amount of damages the eligible claimant is entitled to recover, subject to the deductions in cl. 4(b) (and subject to the overall limit of coverage in cl. 3). Deductions stipulated under the Endorsement are therefore subtracted from the shortfall. Thus, it falls to the language of the contract to determine the extent of the indemnification — the limits of the excess coverage — under the Endorsement.

[22] The introductory words in cl. 4(b) require that amounts "actually recovered . . . from any source" are deductible from the amount payable to the claimant, except amounts from a policy of insurance payable on death. The term "any source" is broad and includes CPP disability benefits. However, with respect to amounts that the eligible claimant is

mot « complémentaire » au sens d'une police de garantie complémentaire ne signifie pas que l'objet de l'avenant est d'empêcher l'« indemnisation excessive ». La garantie « complémentaire » est définie par les termes du contrat.

[20] Selon les termes du contrat, l'objet prépondérant de l'avenant est de fournir la protection « complémentaire » qui s'applique lorsqu'un automobiliste sous-assuré ne peut payer la totalité du montant constaté par jugement. L'assureur indemnise les demandeurs admissibles de la somme manquante des dommages-intérêts adjugés (cl. 2). Le montant de dommages-intérêts que l'appelant a le droit de recevoir a déjà été déterminé par la cour conformément aux principes juridiques pertinents — en l'espèce, les principes de responsabilité délictuelle. L'avenant prend ce montant — constaté par jugement — comme point de départ pour calculer le montant payable (cl. 2).

[21] Cependant, l'avenant ne prévoit l'indemnisation de l'assuré que pour une partie de la somme manquante. Le montant payable par l'assureur au demandeur admissible en application de l'avenant n'est pas la totalité de la somme manquante que l'automobiliste sous-assuré est incapable de payer. La clause 4(a) prévoit la formule servant à établir le montant payable par l'assureur au demandeur admissible. La clause 4(a) prévoit que la protection vise le montant des dommages-intérêts que le demandeur admissible a le droit de recouvrer, déduction faite des montants visés à la cl. 4(b) (et sous réserve de la limite globale de la protection prévue à la cl. 3). Les déductions prévues dans l'avenant doivent donc être soustraites de la somme manquante. Ainsi, le libellé du contrat déterminera la portée de l'indemnisation — les limites de la garantie complémentaire — en application de l'avenant.

[22] L'énoncé liminaire de la cl. 4(b) prévoit que les montants [TRADUCTION] « effectivement recouvrés [. . .] de toute source » sont déductibles du montant payable au demandeur, sauf les sommes payables au décès en vertu d'une police d'assurance. L'expression « de toute source » est générale, et comprend les prestations d'invalidité du RPC.

"entitled to recover", cl. 4(b) specifies nine sources that give rise to deductions.

[23] What then is the correct interpretation of "any policy of insurance providing disability benefits" under cl. 4(b)(vii) of the Endorsement, reading the contract as a whole?

[24] The dictionary meaning of the words "policy of insurance" refers to a private contract purchased as a policy of insurance. In the *Canadian Oxford Dictionary* (2nd ed. 2004), an "insurance policy" has been defined as "a contract of insurance" and "a document detailing such a policy and constituting a contract": p. 783; see also *Collins Canadian Dictionary* (2010), at p. 469. The *Merriam-Webster's Collegiate Dictionary* (11th ed. 2003), defines a "policy" as "a writing whereby a contract of insurance is made": p. 960.

[25] In contrast, CPP benefits are benefits provided under federal legislation: *Canada Pension Plan*, R.S.C. 1985, c. C-8. Under that legislation, contributions are mandatory for all employed Canadians over the age of 18. CPP benefits are payable as a retirement pension, as a disability benefit or as a death benefit.

[26] The use of the word "policy" (i.e. "motor vehicle liability policy") in cl. 4(b), paras. (v) and (ix), clearly indicates a private contract of insurance. Paragraphs (iii) ("the Société de l'assurance automobile du Québec") and (viii) ("any Worker's Compensation Act") clearly refer to amounts provided under legislation. The contract could have included the legislated CPP disability benefits under cl. 4(b)(vii); it referred specifically to legislated amounts in a number of other enumerated sources. Had the contract done so, an average person would have known exactly what they applied for as insurance, and what was and was not covered by the premiums paid under the Endorsement.

Toutefois, en ce qui a trait aux montants que le demandeur admissible « a le droit de recouvrer », la cl. 4(b) précise neuf sources donnant lieu à des déductions.

[23] Quelle est donc l'interprétation correcte de l'expression [TRADUCTION] « toute police d'assurance stipulant une indemnité d'invalidité » au sens de la cl. 4(b)(vii) de l'avenant, compte tenu du contrat dans son ensemble?

[24] Selon leur sens figurant au dictionnaire, les mots « police d'assurance » s'entendent d'un contrat privé acheté à titre de police d'assurance. Le *Canadian Oxford Dictionary* (2e éd. 2004) définit [TRADUCTION] « police d'assurance » comme « un contrat d'assurance » et « un document exposant en détail une telle police et constituant un contrat » : p. 783; voir également le dictionnaire *Collins Canadian Dictionary* (2010), p. 469. Selon le dictionnaire *Merriam-Webster's Collegiate Dictionary* (11e éd. 2003), une [TRADUCTION] « police » est « un écrit par lequel un contrat d'assurance est constitué » : p. 960.

[25] Par contre, les prestations du RPC sont prévues par une loi fédérale : *Régime de pensions du Canada*, L.R.C. 1985, c. C-8. Aux termes de cette loi, les contributions sont obligatoires pour tous les Canadiens salariés âgés de plus de 18 ans. Les prestations du RPC sont payables à titre de pension de retraite, de pension d'invalidité ou de prestation de décès.

[26] L'emploi du mot [TRADUCTION] « police » (c.-à-d. « police d'assurance responsabilité civile automobile ») aux par. (v) et (ix) de la cl. 4(b) indique clairement qu'il s'agit d'un contrat d'assurance privé. Les paragraphes (iii) (« la Société de l'assurance automobile du Québec ») et (viii) (« tout régime d'indemnisation des accidents de travail ») indiquent clairement des montants prévus par une loi. Le contrat aurait pu inclure à la cl. 4(b)(vii) les prestations d'invalidité du RPC prévues par la loi; il précisait des montants prévus par la loi dans plusieurs autres sources énumérées. Si le contrat avait prévu la déduction de ces montants, une personne ordinaire aurait su exactement ce que sa demande d'assurance visait, ainsi que la protection conférée ou non par le paiement des primes dans le cadre de l'avenant.

[27] It also follows that CPP death benefits are not benefits pursuant to a "policy of insurance" payable on death for the purposes of the introductory words in cl. 4(b). Therefore, where the eligible claimant has actually recovered CPP death benefits, the amount of those benefits is deducted from the amount payable under the Endorsement. Obviously, such an interpretation does not work to the advantage of the eligible claimant in the context of death benefits. However, the mere effect of different consequences arising from the meaning of a term used in different places in a contract does not create ambiguity.

[28] In my view, the ordinary meaning of a "policy of insurance" is limited to private contracts of insurance between an insured and a private insurance agency. An average person would not consider benefits provided under a mandatory statutory scheme to be a private insurance contract.

[29] The insurer submits and the Court of Appeal accepted that the meaning of "policy of insurance" under the Endorsement must be understood in the context of this Court's decision in *Gill*. Implicit in the approach urged by the insurer is the suggestion that this Court's decision in *Gill* itself supports an alternative reasonable interpretation of the disputed words at the first stage of the *Ledcor* analysis. As I shall explain, I cannot accept this as a reasonable interpretation of this insurance policy. *Gill* does not interpret or inform the ordinary words of the Endorsement. Nor would the average person applying for this insurance contemplate the distinct tort and statutory context in *Gill* in understanding the words of the Endorsement. The insurer relies on its specialized knowledge of the jurisprudence to advance an interpretation that goes beyond the clear words of the policy.

[30] In *Gill*, this Court dealt with the deductibility of Canada Pension Plan death benefits from a damages award arising from an action initiated under the *Families' Compensation Act*, R.S.B.C. 1960, c. 138. Section 4(4) of the Act provided that "[i]n assessing damages there shall not be taken into account any

[27] Il s'ensuit également que les prestations de décès du RPC ne sont pas des prestations au sens d'une « police d'assurance » payables au décès pour l'application de l'énoncé liminaire de la cl. 4(b). Par conséquent, lorsque le demandeur admissible a effectivement recouvré des prestations de décès du RPC, la somme de ces prestations est déduite du montant payable en application de l'avenant. Évidemment, une telle interprétation ne profite pas au demandeur admissible dans le contexte des prestations de décès. Cependant, le simple fait que différentes conséquences découlent du sens d'un terme utilisé à différents endroits dans un contrat ne crée pas d'ambiguïté.

[28] À mon avis, le sens ordinaire de l'expression « police d'assurance » se limite aux contrats d'assurance privés conclus entre un assuré et un assureur privé. Du point de vue d'une personne ordinaire, les prestations prévues par un régime obligatoire établi par la loi ne constitueraient pas un contrat d'assurance privé.

[29] L'assureur soutient que l'expression [TRADUCTION] « police d'assurance » aux termes de l'avenant doit être interprétée eu égard à l'arrêt *Gill* de la Cour, et la Cour d'appel a retenu cet argument. L'approche préconisée par l'assureur suggère implicitement que l'arrêt *Gill* de la Cour étaye une autre interprétation raisonnable des mots contestés à la première étape du cadre d'analyse énoncé dans *Ledcor*. Comme je l'explique plus loin, je ne peux accepter cela comme une interprétation raisonnable de cette police d'assurance. Dans l'arrêt *Gill*, la Cour n'a pas interprété les mots ordinaires de l'avenant, ni éclairé leur sens. Une personne ordinaire demandant une telle garantie n'aurait pas non plus envisagé les contextes de responsabilité délictuelle et législatif distincts relatifs à l'arrêt *Gill* pour comprendre les mots de l'avenant. L'assureur se fonde sur sa connaissance spécialisée de la jurisprudence pour faire valoir une interprétation qui va au-delà des mots clairs de la police.

[30] Dans *Gill*, la Cour a examiné la possibilité de déduire les prestations de décès du Régime de pensions du Canada du montant des dommages-intérêts adjugés à l'issue d'une poursuite intentée en vertu de la loi intitulée *Families' Compensation Act*, R.S.B.C. 1960, c. 138. Le paragraphe 4(4) de cette loi prévoyait

sum paid or payable on the death of the deceased under any contract of assurance or insurance." The Court held that benefits under the CPP are "so much of the same nature as contracts of insurance" that they should not be deducted from a damages award arising from a successful statutory action under the Act: *Gill*, at p. 670.

[31] However, *Gill* was decided in a very different context. *Gill* was concerned with the interpretation of a remedial statute. This Court applied a broad and liberal interpretation approach to determine whether to deduct CPP survivor death benefits from a damages award arising from a successful statutory action.[2] In doing so, this Court referred to the collateral benefits rule and the assessment of an award of damages in tort to inform its interpretation of the scope of the damages under the statute.

[32] In the tort context, the collateral benefits rule assists in fixing an award of damages. As a general rule, the compensation principle holds that an injured person should be compensated for the full amount of his or her loss but no more: *Ratych v. Bloomer*, [1990] 1 S.C.R. 940, at p. 948. Thus, some benefits received by an injured person as a result of the tort are deducted from a damages award in order to prevent overcompensation. However, the collateral benefits rule is an exception to this general principle. At common law, the collateral benefits rule acknowledges that it would be unfair to allow the tortfeasor to benefit from the insurance held by the plaintiff because he or she has paid premiums for the eventuality: *Parry v. Cleaver*, [1970] A.C. 1 (H.L.); *Bradburn v. Great Western Railway Co.* (1874), L.R. 10 Ex. 1.

ce qui suit : [TRADUCTION] « Dans l'appréciation des dommages, il ne faut tenir compte d'aucune somme versée ou devant être versée au décès du défunt en vertu d'un contrat d'assurance. » La Cour a conclu que les prestations au titre du RPC « présentent un caractère tellement semblable aux contrats d'assurance ordinaires » qu'elles ne devraient pas être déduites du montant des dommages-intérêts adjugés à la personne qui a gain de cause dans une action prévue par la loi en question : *Gill*, p. 670.

[31] Cependant, l'arrêt *Gill* a été rendu dans un contexte très différent. Il y était question de l'interprétation d'une loi réparatrice. La Cour a appliqué une méthode d'interprétation large et libérale pour déterminer si les prestations de décès du RPC versées au survivant devaient être déduites du montant des dommages-intérêts adjugés à la personne qui a gain de cause dans une action prévue par la loi[2]. Ce faisant, la Cour a fait référence à la règle des prestations parallèles et à l'évaluation du montant des dommages-intérêts en responsabilité délictuelle pour faciliter son interprétation de la portée des dommages-intérêts en vertu de la loi.

[32] En matière délictuelle, les tribunaux se fondent sur la règle des prestations parallèles pour établir le montant des dommages-intérêts. Généralement, selon le principe de l'indemnisation, une personne lésée devrait être indemnisée intégralement de sa perte, mais sans plus : *Ratych c. Bloomer*, [1990] 1 R.C.S. 940, p. 948. Ainsi, certaines prestations que touche une personne lésée par suite d'un délit civil sont déduites du montant des dommages-intérêts afin que soit évitée l'indemnisation excessive. Cependant, la règle des prestations parallèles constitue une exception à ce principe général. En common law, la règle des prestations parallèles tient compte du fait qu'il serait injuste de permettre à l'auteur du délit de bénéficier de l'assurance dont le plaignant est détenteur parce que ce dernier a payé des primes dans cette éventualité : *Parry c. Cleaver*, [1970] A.C. 1 (H.L.); *Bradburn c. Great Western Railway Co.* (1874), L.R. 10 Ex. 1.

[2] I note that under cl. 4(b) of the Endorsement, amounts actually recovered from a policy of insurance payable on death are not deductible from the amount owed to the eligible claimant under the Endorsement.

[2] Je fais remarquer que selon la cl. 4(b) de l'avenant, les montants effectivement recouvrés d'une police d'assurance payables au décès ne sont pas déductibles du montant dû au demandeur admissible en application de l'avenant.

[33] This Court concluded in *Gill* that, for the purpose of the collateral benefits rule and the assessment of an award of damages in tort, CPP benefits were "an exact substitute for a privately arranged insurance policy": p. 669. Thus, the Court referred to the collateral benefits rule to inform its interpretation of the statute and concluded that benefits under the CPP are "so much of the same nature as contracts of insurance" that they should not be deducted from a damages award arising from a successful statutory action under the *Families' Compensation Act*.[3]

[34] In my view, the reasoning in *Gill* is not applicable here at the first stage of *Ledcor* and does not assist in interpreting this contract. *Gill* is confined to a distinct interpretive context far removed from the Endorsement at issue.

[35] First, it is wrong to rely on *Gill* to illustrate that insurance companies amended their policies in light of that judgment and thus intended to include CPP benefits. It cannot be assumed that the average person who applies to purchase this excess insurance policy would imbue the words in the Endorsement with knowledge of how they were interpreted by the courts for the purposes of provincial insurance legislation and the collateral benefits rule in tort. In this context, the purchaser is not someone with the specialized knowledge of related jurisprudence or of the objectives of the insurance industry. Thus, the history and intention of the insurance industry in drafting the Endorsement following *Gill* do not assist in the interpretation of this contract.

[3] This Court has also confirmed that similar benefits were not deductible from tort damages pursuant to the collateral benefits rule in tort. In *Cunningham v. Wheeler*, [1994] 1 S.C.R. 359, the Court found that disability benefits received under a collective agreement were not deductible from an award of damages in tort.

[33] Dans *Gill*, la Cour a conclu que, pour l'application de la règle des prestations parallèles et l'évaluation du montant des dommages-intérêts en responsabilité délictuelle, les prestations du RPC « remplace[nt] exactement une police d'assurance qui aurait été contractée [. . .] chez une compagnie d'assurance privée » : p. 669. La Cour a donc fait référence à la règle des prestations parallèles pour faciliter son interprétation de la loi et a conclu que les prestations versées au titre du RPC « présentent un caractère tellement semblable aux contrats d'assurance ordinaires » qu'elles ne devraient pas être déduites du montant des dommages-intérêts adjugés à la personne qui a gain de cause dans une action intentée en vertu de la loi *Families' Compensation Act*[3].

[34] À mon avis, le raisonnement dans *Gill* n'est pas applicable en l'espèce à la première étape du cadre d'analyse énoncé dans *Ledcor* et n'est pas utile à l'interprétation du contrat qui nous intéresse. L'arrêt *Gill* se limite à un contexte d'interprétation distinct très éloigné de l'avenant dont il est question.

[35] Premièrement, on aurait tort de se fonder sur l'arrêt *Gill* pour illustrer le fait que les compagnies d'assurance ont modifié leurs polices eu égard à ce jugement et qu'elles avaient donc l'intention d'inclure les prestations du RPC. On ne peut présumer qu'une personne ordinaire qui présente une demande en vue d'obtenir une telle police de garantie complémentaire comprendrait les mots de l'avenant au sens que leur donnent les tribunaux aux fins de l'application des lois provinciales en matière d'assurance et de la règle des prestations parallèles en matière délictuelle. Dans ce contexte, l'acheteur ne possède pas une connaissance spécialisée de la jurisprudence pertinente ou des objectifs des assureurs. Par conséquent, l'historique de l'avenant et l'intention des assureurs lors de sa rédaction suivant l'arrêt *Gill* ne sont pas utiles à l'interprétation de ce contrat.

[3] La Cour a également confirmé que des prestations semblables n'étaient pas déductibles des dommages-intérêts délictuels selon la règle des prestations parallèles en matière délictuelle. Dans *Cunningham c. Wheeler*, [1994] 1 R.C.S. 359, la Cour a conclu que les prestations d'invalidité perçues dans le cadre d'une convention collective n'étaient pas déductibles du montant des dommages-intérêts accordés en matière délictuelle.

[36] Second, while the rationale and history of the collateral benefits rule is relevant to the determination of an appropriate award of damages, the fixing of the quantum of damages is not at issue in this contract. The amount that the appellant is entitled to receive in tort damages has already been determined by the court. The Endorsement designates this amount — the judgment — as the starting point for calculating the amount payable (cl. 2). In *Progressive Homes*, this Court reasoned that "[t]he focus of insurance policy interpretation should first and foremost be on the language of the policy at issue. General principles of tort law are no substitute for the language of the policy": para. 35. Whether a contract prohibits overcompensation or double recovery beyond what has already been determined in tort for the purpose of fixing the legal judgment is a question resolved through principles of contract interpretation. To the extent that the language of the Endorsement precludes overcompensation resulting from recoverable amounts, it does so in the nine enumerated sources. There is no overcompensation or double recovery of the judgment debt under the Endorsement.

[37] Third, the decision in *Gill* is confined to a distinct statutory context. When interpreting a statute, the court searches for the intention of the legislature. In interpreting a standard form policy of insurance, the court is concerned with the ordinary meaning of the contract as it would be understood by the average insured.

[38] Similarly, the statutory context was relied upon by the Ontario Court of Appeal in *Gignac v. Neufeld* (1999), 43 O.R. (3d) 741. The regulation entitled *Uninsured Automobile Coverage*, R.R.O. 1990, Reg. 676, under the *Insurance Act*, R.S.O. 1990, c. I.8, provided limited coverage in the event that an insured was injured by an uninsured motorist. The Court of Appeal reasoned that the clear legislative intention underlying the Regulation was to prevent double recovery and that therefore the CPP must fall within the ambit of a "policy of insurance" so that any CPP benefits would be deducted from the

[36] Deuxièmement, même si le fondement et l'historique de la règle des prestations parallèles sont pertinents pour établir le montant des dommages-intérêts qu'il convient d'accorder, l'établissement du montant des dommages-intérêts n'est pas en cause dans le contrat en l'espèce. Le montant de dommages-intérêts en responsabilité délictuelle auquel l'appelant a droit a déjà été établi par le tribunal. Ce montant — celui établi dans le jugement — est utilisé dans l'avenant comme point de départ pour calculer le montant payable (cl. 2). Dans *Progressive Homes*, la Cour a expliqué que « [l]'interprétation des polices d'assurance devrait d'abord et avant tout porter sur le libellé de la police en cause. Les principes généraux du droit de la responsabilité délictuelle ne sauraient remplacer le libellé de la police » : par. 35. La question de savoir si un contrat empêche l'indemnisation excessive ou la double indemnisation dépassant le montant déjà déterminé en matière délictuelle aux fins de l'établissement de la décision judiciaire doit être réglée au moyen des principes d'interprétation des contrats. Dans la mesure où le texte de l'avenant empêche l'indemnisation excessive découlant des montants recouvrables, il le fait dans le cas des neuf sources énumérées. Il n'y a pas d'indemnisation excessive ou de double indemnisation de la créance judiciaire en application de l'avenant.

[37] Troisièmement, la décision dans *Gill* se limite à un contexte législatif distinct. Lorsqu'elle interprète une loi, la cour se demande quelle était l'intention du législateur. Pour interpréter une police d'assurance type, la Cour doit examiner le sens ordinaire du contrat, tel qu'il serait compris par un assuré ordinaire.

[38] De même, la Cour d'appel de l'Ontario a invoqué le contexte législatif dans la décision *Gignac c. Neufeld* (1999), 43 O.R. (3d) 741. Dans cette affaire, le règlement 676, intitulé *Uninsured Automobile Coverage*, R.R.O. 1990, pris en application de la *Loi sur les assurances*, R.S.O. 1990, c. I.8, prévoyait une garantie limitée dans le cas où un assuré serait blessé par un automobiliste non assuré. La Cour d'appel a estimé que l'intention claire du législateur qui sous-tend le règlement était d'empêcher qu'il y ait double indemnisation et que, par conséquent, le RPC doit constituer une « police d'assurance »

damages owed to the insured. Like *Gill*, this interpretation relied upon the intent of the legislature and the statutory context.

[39] For these reasons, the meaning of "contract of assurance" in *Gill* — and of "policy of insurance" in *Gignac* — is confined to a distinct interpretive context and does not inform the ordinary meaning of "policy of insurance" in the Endorsement.

[40] In *Lapalme*, Chief Justice Drapeau correctly concludes that the ordinary meaning, and not *Gill*, governs the interpretation of "policy of insurance" under a standard form excess insurance policy:

> The scheme by which disability benefits are recoverable under the *Canada Pension Plan* may well be a "substitute" for a disability insurance policy, "tantamount", "comparable", "similar" or "akin" to schemes under policies of disability insurance for the purposes of the collateral benefits rule in tort, but that does not morph the *Canada Pension Plan* into a "policy of insurance" for Clause 4(b)(vii) purposes. [Emphasis deleted; para. 94.]

[41] In sum, with respect to amounts that the eligible claimant is "entitled to recover", cl. 4(b) specifies nine sources that give rise to deductions from the amount payable by the insurer, none of which include the CPP. The ordinary meaning of a "policy of insurance" in cl. 4(b)(vii) of the Endorsement is clear. It refers to a private insurance policy purchased by the insured. Portage has asked this Court to read into those clear words the jurisprudence related to the collateral benefits rule in tort so that a "policy of insurance" would also include the CPP regime. As noted above, I cannot agree. Thus, the ordinary meaning of the words "policy of insurance" in cl. 4(b)(vii) does not include the CPP regime.

de sorte que toute prestation du RPC serait déduite du montant des dommages-intérêts dus à l'assuré. Comme dans *Gill*, cette interprétation était fondée sur l'intention du législateur et le contexte législatif.

[39] Pour ces motifs, le sens de « contrat d'assurance » dans *Gill* — et de « police d'assurance » dans *Gignac* — se limite à un contexte interprétatif distinct, et ne permet pas d'éclairer le sens ordinaire de l'expression [TRADUCTION] « police d'assurance » dans l'avenant.

[40] Dans *Lapalme*, le juge en chef Drapeau a conclu, à juste titre, que le sens ordinaire, et non l'arrêt *Gill*, régit l'interprétation de l'expression « police d'assurance » aux termes d'une police type de garantie complémentaire :

> Le mécanisme qui permet de recouvrer des prestations d'invalidité en vertu de la loi intitulée *Régime de pensions du Canada* peut fort bien « remplacer » une police d'assurance d'invalidité, « équivaloir », être « comparable », « semblable » ou « assimilable » aux mécanismes prévus par des polices d'assurance invalidité pour les fins de la règle de la source parallèle applicable en matière de responsabilité civile délictuelle, mais cela ne fait pas du *Régime de pensions du Canada* un « contrat d'assurance » pour les fins de la clause 4(b)(vii). [Soulignement omis; par. 94.]

[41] En résumé, en ce qui a trait aux montants que le demandeur admissible a « le droit de recouvrer », la cl. 4(b) précise neuf sources qui donnent lieu à des déductions du montant payable par l'assureur, et aucune ne comprend le RPC. Le sens ordinaire des mots [TRADUCTION] « police d'assurance » à la cl. 4(b)(vii) de l'avenant est clair. Il désigne une police d'assurance privée achetée par l'assuré. Portage a demandé à la Cour de donner à cette expression claire le sens reconnu dans la jurisprudence relative à la règle des prestations parallèles en matière délictuelle, de sorte qu'une « police d'assurance » comprendrait également le RPC. Comme il est indiqué ci-dessus, je ne suis pas de cet avis. Ainsi, le sens ordinaire des mots « police d'assurance » à la cl. 4(b)(vii) ne comprend pas le RPC.

[42] The clear language of the provision, reading the contract as a whole, is unambiguous. There are no "two reasonable but differing interpretations of the policy": B. Billingsley, *General Principles of Canadian Insurance Law* (2nd ed. 2014), at p. 147; *Chilton v. Co-Operators General Insurance Co.* (1997), 32 O.R. (3d) 161 (C.A.), at p. 169. The mere articulation of a differing interpretation does not always establish the reasonableness of that interpretation and does not necessarily create ambiguity.

V. Conclusion

[43] Canada Pension Plan disability benefits are not disability benefits from a "policy of insurance" within the meaning of cl. 4(b)(vii) of the SEF 44 Endorsement. Thus, future CPP disability benefits are not deductible from the amounts payable by the insurer under the Endorsement.

[44] I would allow the appeal with costs to the appellant in this Court and the Nova Scotia Court of Appeal.

Appeal allowed with costs.

Solicitors for the appellant: Kimball Brogan, Wolfville, Nova Scotia.

Solicitors for the respondent: Stewart McKelvey, Halifax.

[42] Le texte clair de la disposition, compte tenu du contrat dans son ensemble, n'est pas ambigu. Il n'y a pas [TRADUCTION] « deux interprétations raisonnables mais divergentes de la police » : B. Billingsley, *General Principles of Canadian Insurance Law* (2e éd. 2014), p. 147; *Chilton c. Co-Operators General Insurance Co.* (1997), 32 O.R. (3d) 161 (C.A.), p. 169. La simple expression d'une interprétation différente n'établit pas toujours le caractère raisonnable de cette interprétation et ne crée pas nécessairement d'ambiguïté.

V. Conclusion

[43] Les prestations du Régime de pensions du Canada ne sont pas des prestations d'invalidité au titre d'une [TRADUCTION] « police d'assurance » au sens de la cl. 4(b)(vii) de l'avenant SEF 44. Ainsi, les futures prestations d'invalidité du RPC ne sont pas déductibles des montants payables par l'assureur en application de l'avenant.

[44] Je suis d'avis d'accueillir le pourvoi, avec dépens en faveur de l'appelant devant notre Cour et devant la Cour d'appel de la Nouvelle-Écosse.

Pourvoi accueilli avec dépens.

Procureurs de l'appelant : Kimball Brogan, Wolfville, Nouvelle-Écosse.

Procureurs de l'intimée : Stewart McKelvey, Halifax.

Ledcor Construction Limited *Appellant*

v.

Northbridge Indemnity Insurance Company, Royal & Sun Alliance Insurance Company of Canada and Chartis Insurance Company of Canada *Respondents*

- and -

Station Lands Ltd. *Appellant*

v.

Commonwealth Insurance Company, GCAN Insurance Company and American Home Assurance Company *Respondents*

Ledcor Construction Limited *Appelante*

c.

Société d'assurance d'indemnisation Northbridge, Royal & Sun Alliance du Canada, société d'assurances et Compagnie d'assurance Chartis du Canada *Intimées*

- et -

Station Lands Ltd. *Appelante*

c.

Commonwealth Insurance Company, GCAN Insurance Company et American Home Assurance Company *Intimées*

Indexed as: Ledcor Construction Ltd. *v.* Northbridge Indemnity Insurance Co.

2016 SCC 37

File No.: 36452.

2016: March 30; 2016: September 15.

Present: McLachlin C.J. and Abella, Cromwell, Moldaver, Karakatsanis, Wagner, Gascon, Côté and Brown JJ.

Répertorié : Ledcor Construction Ltd. *c.* Société d'assurance d'indemnisation Northbridge

2016 CSC 37

N° du greffe : 36452.

2016 : 30 mars; 2016 : 15 septembre.

Présents : La juge en chef McLachlin et les juges Abella, Cromwell, Moldaver, Karakatsanis, Wagner, Gascon, Côté et Brown.

ON APPEAL FROM THE COURT OF APPEAL FOR ALBERTA

Insurance — Property insurance — All risks policy — Exclusion clauses — Interpretation — Builders' risk policy excluding from coverage cost of making good faulty workmanship — Windows of building under construction scratched by contractor hired to clean them and windows needing replacement — Whether faulty workmanship exclusion to coverage applicable.

Appeals — Courts — Standard of review — Contractual interpretation — Standard of appellate review applicable to trial judge's interpretation of standard form insurance contract.

EN APPEL DE LA COUR D'APPEL DE L'ALBERTA

Assurances — Assurances de biens — Police d'assurance tous risques — Clauses d'exclusion — Interprétation — Police d'assurance chantier soustrayant à la garantie les frais engagés pour remédier à une malfaçon — Besoin de remplacer les fenêtres d'un immeuble en construction égratignées par l'entrepreneur qui avait été engagé pour les nettoyer — L'exclusion relative à la malfaçon s'applique-t-elle?

Appels — Tribunaux — Norme de contrôle — Interprétation contractuelle — Norme de contrôle qu'il convient d'appliquer en appel à l'interprétation d'un contrat d'assurance type retenue par le juge de première instance.

During construction, a building's windows were scratched by the cleaners hired to clean them. The cleaners used improper tools and methods in carrying out their work, and as a result, the windows had to be replaced. The building's owner and the general contractor in charge of the construction project claimed the cost of replacing the windows against a builders' risk insurance policy issued in their favour and covering all contractors involved in the construction. The insurers denied coverage on the basis of an exclusion contained in the policy for the "cost of making good faulty workmanship".

The trial judge held the insurers liable, finding that the exclusion clause was ambiguous and that the rule of *contra proferentem* applied against the insurers. The Court of Appeal reversed that decision. Applying the correctness standard of review to the interpretation of the policy, the court held that the trial judge had improperly applied the rule of *contra proferentem* because the exclusion clause was not ambiguous. The court devised a new test of physical or systemic connectedness to determine whether physical damage was excluded as the "cost of making good faulty workmanship" or covered as "resulting damage". Based on this test, the court concluded that the damage to the windows was physical loss excluded from coverage, because it was not accidental or fortuitous, but was directly caused by the intentional scraping and wiping motions involved in the cleaners' work.

Held: The appeals should be allowed.

Per McLachlin C.J. and Abella, Moldaver, Karakatsanis, Wagner, Gascon, Côté and Brown JJ.: The appropriate standard of review in this case is correctness. The interpretation of a standard form contract should be recognized as an exception to the Court's holding in *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, [2014] 2 S.C.R. 633, that contractual interpretation is a question of mixed fact and law subject to deferential review on appeal. The first reason given in *Sattva* for concluding that contractual interpretation is a question of mixed fact and law — the importance of the factual matrix — carries less weight in cases involving standard form contracts. Indeed, while a proper understanding of the factual matrix of a case is crucial to the interpretation of many contracts, it is less relevant for standard form contracts because the parties do not negotiate the terms. The contract is put to the receiving party as a take-it-or-leave-it proposition. Factors

Durant la construction, les fenêtres d'un immeuble ont été égratignées par les nettoyeurs engagés pour les laver. Les nettoyeurs ont utilisé les mauvais outils et méthodes pour exécuter leur travail et les fenêtres ont dû, en conséquence, être remplacées. La propriétaire de l'immeuble et l'entrepreneur général responsable du projet de construction ont présenté une réclamation pour le coût de remplacement des fenêtres en vertu d'une police d'assurance chantier émise en leur faveur ainsi qu'en faveur de tous les entrepreneurs qui participaient aux travaux. Les assureurs leur ont opposé un refus en raison d'une exclusion de la police visant les « frais engagés pour remédier à une malfaçon ».

Le juge de première instance a conclu à la responsabilité des assureurs, estimant que la clause d'exclusion était ambiguë et que la règle *contra proferentem* s'appliquait contre les assureurs. La Cour d'appel a infirmé cette décision. Appliquant la norme de la décision correcte à l'interprétation de la police, la Cour d'appel a conclu que le juge de première instance avait irrégulièrement appliqué la règle *contra proferentem* puisque la clause d'exclusion n'était pas ambiguë. La Cour d'appel a élaboré un nouveau critère de connexité matérielle ou systémique pour décider si les dommages matériels étaient exclus au titre des « frais engagés pour remédier à une malfaçon » ou couverts en tant que « dommages [. . .] découlant » de la malfaçon. À l'aune de ce critère, la Cour d'appel a conclu que les dommages causés aux fenêtres constituaient une perte matérielle exclue de la garantie parce qu'ils n'étaient ni accidentels ni fortuits, mais directement causés par les mouvements intentionnels de grattage et de frottage effectués par les nettoyeurs dans l'exécution de leur travail.

Arrêt : Les pourvois sont accueillis.

La juge en chef McLachlin et les juges Abella, Moldaver, Karakatsanis, Wagner, Gascon, Côté et Brown : La norme de contrôle qu'il convient d'appliquer dans la présente affaire est celle de la décision correcte. L'interprétation d'un contrat type doit être reconnue comme une exception à la conclusion tirée par la Cour dans *Sattva Capital Corp. c. Creston Moly Corp.*, 2014 CSC 53, [2014] 2 R.C.S. 633, que l'interprétation contractuelle est une question mixte de fait et de droit dont le contrôle en appel doit être empreint de déférence. Le premier motif donné dans *Sattva* à l'appui de la conclusion que l'interprétation d'un contrat est une question mixte de fait et de droit — l'importance du fondement factuel — a moins de force dans le cas des contrats types. En effet, bien qu'une compréhension adéquate du fondement factuel d'un dossier soit cruciale pour l'interprétation de nombreux contrats, le fondement factuel est moins pertinent dans le cas des contrats types parce que

such as the purpose of the contract, the nature of the relationship it creates, and the market or industry in which it operates should be considered when interpreting a standard form contract, but they are generally not inherently fact specific and will usually be the same for everyone who may be a party to a standard form contract.

Moreover, the interpretation of a standard form contract itself has precedential value and can therefore fit under the definition of a pure question of law. In general, the interpretation of a contract has no impact beyond the parties to a dispute. While precedents interpreting similar contractual language may be of some persuasive value, it is often the intentions of the parties, as reflected in the particular contractual wording at issue and informed by the surrounding circumstances of the contract, that predominate. In the case of standard form contracts, however, judicial precedent is more likely to be controlling. Establishing the proper interpretation of a standard form contract amounts to establishing the correct legal test, as the interpretation may be applied in future cases involving identical or similarly-worded provisions. The mandate of appellate courts — ensuring consistency in the law — is also advanced by permitting them to review the interpretation of standard form contracts for correctness. The result of applying the interpretation in future cases will of course depend on the facts of those cases.

In this case, while the base coverage under the relevant clause of the policy is for physical loss or damages, the exclusion clause need not necessarily encompass physical damage because perfect mutual exclusivity between exclusions and the initial grant of coverage is neither provided for under the policy nor required when interpreting the exclusion clause. Accordingly, the physical or systemic connectedness test established by the Court of Appeal was unnecessary.

While the language of the exclusion clause is ambiguous, the general principles of contractual interpretation lead to the conclusion that the exclusion clause serves to exclude from coverage only the cost of redoing the faulty work, that is, the cost of recleaning the windows. The damage to the windows and therefore the cost of their replacement is covered. Given that the general rules of contract construction resolve the ambiguity, it is not necessary to turn to the *contra proferentem* rule.

les parties ne négocient pas les modalités. Le contrat est présenté comme une proposition à prendre ou à laisser. Il y a lieu de prendre en considération des facteurs comme l'objet du contrat, la nature de la relation qu'il crée et le marché ou l'industrie où il est employé pour interpréter un contrat type, mais ces considérations ne sont généralement pas, de par leur nature même, axées sur les faits et elles sont habituellement les mêmes pour toute personne qui peut être partie à un contrat type.

De plus, l'interprétation en soi d'un contrat type a valeur de précédent et peut donc correspondre à la définition de « pure question de droit ». L'interprétation d'un contrat n'a généralement d'incidence que sur les parties au litige. Les précédents dans lesquels les tribunaux interprètent un libellé contractuel semblable peuvent avoir une certaine valeur persuasive, mais ce sont souvent les intentions des parties en cause exprimées dans le libellé particulier du contrat en litige et considérées à l'aune des circonstances entourant le contrat qui ont préséance. Toutefois, dans le cas des contrats types, le précédent judiciaire est probablement déterminant. Établir la juste interprétation d'un contrat type revient à établir le bon critère juridique, puisque cette interprétation peut être appliquée dans l'avenir à des dispositions identiques ou formulées de façon semblable. Le rôle des cours d'appel — assurer la cohérence du droit — est également servi lorsqu'on leur permet de contrôler l'interprétation d'un contrat type selon la norme de la décision correcte. Le résultat de l'application de l'interprétation dans des affaires à venir dépendra bien entendu des faits de celles-ci.

En l'espèce, même si la garantie de base prévue à la clause applicable de la police vise les pertes ou dommages matériels, la clause d'exclusion n'a pas nécessairement besoin d'englober des dommages matériels parce que l'exclusivité mutuelle parfaite entre des exclusions et la protection initiale n'est pas prévue dans la police et n'est pas non plus requise lorsqu'il s'agit d'interpréter la clause d'exclusion. En conséquence, le critère de connexité matérielle ou systémique établi par la Cour d'appel était inutile.

Bien que le texte de la clause d'exclusion soit ambigu, les principes généraux d'interprétation des contrats mènent à la conclusion que la clause d'exclusion ne vise qu'à exclure le coût de la nouvelle exécution du travail défectueux, en l'occurrence le coût du nouveau nettoyage des fenêtres. Les dommages causés aux fenêtres, et donc le coût de leur remplacement, sont couverts. Puisque les règles générales d'interprétation des contrats permettent de résoudre l'ambiguïté, il n'est pas nécessaire de recourir à la règle *contra proferentem*.

This interpretation is consistent with the reasonable expectations of the parties and reflects and promotes the purpose of builders' risk policies. The broad coverage provided in exchange for relatively high premiums provides certainty, stability and peace of mind, and ensures construction projects do not grind to a halt because of disputes and potential litigation about liability for replacement or repair amongst various contractors involved. An interpretation of the exclusion clause that precludes from coverage any and all damage resulting from a contractor's faulty workmanship merely because the damage results to that part of the project on which the contractor was working would undermine the purpose behind builders' risk policies and would deprive insureds of the coverage for which they contracted. Moreover, interpreting the exclusion clause to preclude from coverage only the cost of redoing the faulty work aligns with commercial reality and leads to realistic and sensible results, given both the purpose underlying builders' risk policies and their spreading of risk on construction projects. Such an interpretation is also consistent with the jurisprudence.

Per Cromwell J.: There is agreement as to the disposition of the appeals. The trial judge made no legal error because he properly described and applied the Court's decision in *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, 2010 SCC 33, [2010] 2 S.C.R. 245.

However, the applicable standard of review is that of palpable and overriding error. As the Court held in *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235, the general principles of appellate review in civil cases turn on characterizing the nature of the question being reviewed as one of fact, law or mixed fact and law. Questions of law are reviewed for correctness and questions of fact are reviewed for palpable and overriding error. Applying a legal standard to the facts is a question of mixed fact and law and is generally reviewable on appeal for palpable and overriding error. In rare cases, where the basis for a finding under review can be traced to a pure legal error, such as a wrong characterization of the legal test or the failure to consider a required element of the applicable standard, the reviewing court can extricate a purely legal question from the trial court's analysis and apply the correctness standard to it.

Cette interprétation est conforme aux attentes raisonnables des parties, en plus de traduire et servir l'objet des polices d'assurance chantier. La large garantie offerte en échange de primes relativement élevées confère certitude, stabilité et tranquillité d'esprit et évite que les projets de construction se retrouvent paralysés par des différends ou des actions en justice éventuelles sur la question de savoir qui, parmi les divers entrepreneurs participant aux travaux, est responsable du remplacement ou de la réparation découlant de la malfaçon. Une interprétation de la clause d'exclusion qui soustrait à la garantie tous les dommages découlant de la malfaçon de l'entrepreneur simplement parce que les dommages sont causés à la partie du projet sur laquelle l'entrepreneur travaillait minerait l'objet sous-jacent des polices d'assurance chantier et priverait les assurés de la garantie à laquelle ils ont souscrit. En outre, interpréter la clause d'exclusion pour soustraire à la garantie seulement le coût de la nouvelle exécution du travail défectueux correspond à la réalité commerciale et mène à un résultat réaliste et sensé, compte tenu de l'objet qui sous-tend les polices d'assurance chantier et de leur répartition du risque pour les projets de construction. Cette interprétation est aussi conforme à la jurisprudence.

Le juge Cromwell : Il y a accord quant au dispositif. Le juge de première instance n'a commis aucune erreur de droit parce qu'il a correctement décrit et appliqué l'arrêt *Progressive Homes Ltd. c. Cie canadienne d'assurances générales Lombard*, 2010 CSC 33, [2010] 2 R.C.S. 245.

La norme de contrôle applicable est toutefois celle de l'erreur manifeste et dominante. Tel que la Cour l'a décidé dans *Housen c. Nikolaisen*, 2002 CSC 33, [2002] 2 R.C.S. 235, les principes généraux de contrôle en appel dans les affaires civiles s'attachent à la qualification de la nature de la question faisant l'objet du contrôle en tant que question de fait, question de droit ou encore question mixte de droit et de fait. Les questions de droit sont examinées selon la norme de la décision correcte tandis que les questions de fait le sont en fonction de la norme de l'erreur manifeste et dominante. L'application d'une norme juridique à des faits constitue une question mixte de droit et de fait, qui est généralement susceptible de révision en appel selon la norme de l'erreur manifeste et dominante. Dans les rares cas où le fondement de la conclusion contrôlée est imputable à une pure erreur de droit, telle une mauvaise qualification du critère juridique ou omission d'examiner un élément essentiel de la norme applicable, la cour siégeant en révision peut dégager une pure question de droit de l'analyse du tribunal de première instance et appliquer à cette question la norme de la décision correcte.

The Court's recent decision in *Sattva* brought appellate review in contract cases within this general framework. Applying the text of a contract to a particular fact situation involves applying the legal standard set by the contract to the facts of the situation at hand. Accordingly, a trial judge's interpretation of the contract generally gives rise to a mixed question of law and fact and should be reviewable on appeal for palpable and overriding error. Contractual interpretation is generally not a pure question of law because it involves understanding the words used in light of a number of contextual factors beyond negotiation, including the purpose of the agreement, the nature of the relationship between the parties, and the market in which the parties are operating.

There is no reason for the interpretation of certain types of contracts such as standard form contracts to be excluded from the general principles that apply to appellate review in civil cases. Whether or not a contract is a standard form does not indicate anything about the degree to which it is concerned with a general legal proposition so as to attract correctness review. To ask the question in terms of precedential value rather than the generality of the legal principle in issue simply sends the analysis back to the question of the degree of generality. The more general the principle, the more the precedential value. Moreover, the absence of a factual matrix is not of much assistance, because like all contracts, standard form contracts have many surrounding circumstances — they have a purpose, they create a relationship of a particular nature between the parties, and they frequently operate within a particular market or industry — which must be taken into account in interpreting the text of the contract.

The question the present case raises involves applying a legal standard to a set of facts and does not give rise to any extricable question of law. The legal principle is that "making good faulty workmanship" means "the cost of redoing the faulty work". This principle does not operate at a very high level of generality. Applying that principle turns on the scope of the faulty work and the nature of redoing it, and its application in other cases will ultimately be decided on a case-by-case basis in light of the particular circumstances of the particular case.

La Cour a inscrit dans son récent arrêt *Sattva* le contrôle en appel dans les affaires contractuelles à l'intérieur de ce cadre général. L'application du texte d'un contrat à une situation factuelle particulière suppose l'application de la norme juridique établie par le contrat aux faits de la situation en cause. Par conséquent, l'interprétation donnée par un juge de première instance au contrat soulève généralement une question mixte de droit et de fait qui devrait être contrôlée en appel selon la norme de l'erreur manifeste et dominante. L'interprétation contractuelle n'est généralement pas une pure question de droit parce qu'elle implique de comprendre les mots utilisés eu égard à plusieurs facteurs contextuels autres que la négociation, dont l'objet de l'entente, la nature de la relation entre les parties et le marché dans lequel les parties exercent leurs activités.

Il n'y a aucune raison de penser que les principes généraux applicables au contrôle en appel dans les affaires civiles ne devraient pas régir l'interprétation de certaines catégories de contrats tels que les contrats types. Le point de savoir si un contrat est ou non un contrat type ne permet de tirer aucune conclusion sur la mesure dans laquelle il concerne une proposition juridique générale et appelle par le fait même un contrôle selon la norme de la décision correcte. Poser la question sous l'angle de la valeur de précédent plutôt que du caractère général du principe juridique en cause fait uniquement porter l'analyse sur la question du degré de généralité. Plus le principe est général, plus sa valeur comme précédent est grande. De plus, l'absence de fondement factuel n'est pas d'un grand secours car, à l'instar de tous les autres contrats, les contrats types s'inscrivent dans un contexte beaucoup plus large : ils ont un objet, créent une relation particulière entre les parties et sont fréquemment utilisés dans une industrie ou un marché donné. Il faut tenir compte de ce contexte pour interpréter le texte du contrat.

La question soulevée en l'espèce suppose l'application d'une norme juridique à un ensemble de faits et elle ne pose aucune question de droit isolable. Selon le principe juridique, l'expression « remédier à une malfaçon » s'entend « du coût de la nouvelle exécution du travail défectueux ». Ce principe n'atteint pas un très haut niveau de généralité. L'application de ce principe repose sur l'étendue de la malfaçon et la nature de sa nouvelle exécution et les tribunaux décideront de son application en dernière analyse au cas par cas à la lumière des circonstances propres à chaque affaire.

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Eugene Meehan, *Q.C.*, and *Stacey Boothman*, for the appellant Ledcor Construction Limited.

Dennis L. Picco, *Q.C.*, and *Marie-France Major*, for the appellant Station Lands Ltd.

Gregory J. Tucker, *Q.C.*, and *Scott H. Stephens*, for the respondents.

The judgment of McLachlin C.J. and Abella, Moldaver, Karakatsanis, Wagner, Gascon, Côté and Brown JJ. was delivered by

WAGNER J. —

I. Introduction

[1] The outcome of these appeals hinges on the interpretation of an exclusion clause in a common form of all-risk property insurance, variably referred to as "builders' risk", "contractors' risk", "all risks", "multi-risk" or "course of construction" insurance.[1] This type of insurance covers physical damage on a construction site. It is usually issued to the owner of the property under construction and the general contractor, providing coverage for them as well as for all contractors and subcontractors working on the project. The exclusion clause at the heart of these appeals is a standard form clause that denies coverage for the "cost of making good faulty workmanship" but, as an exception to that exclusion, nonetheless covers "physical damage" that "results" from the faulty workmanship.

[2] In the present case, a contractor was hired to clean the windows of a building under construction. In the course of the cleaning, the contractor scratched the building's windows, which ultimately

[1] Although builders' risk policies can provide coverage on either an all-risk or named-peril basis, only the former type of policy is at issue in these appeals. It is also the more common type of policy. Therefore, when I refer to builders' risk policies in these reasons, I specifically mean builders' risk policies that provide coverage on an all-risk basis.

Eugene Meehan, *c.r.*, et *Stacey Boothman*, pour l'appelante Ledcor Construction Limited.

Dennis L. Picco, *c.r.*, et *Marie-France Major*, pour l'appelante Station Lands Ltd.

Gregory J. Tucker, *c.r.*, et *Scott H. Stephens*, pour les intimées.

Version française du jugement de la juge en chef McLachlin et des juges Abella, Moldaver, Karakatsanis, Wagner, Gascon, Côté et Brown rendu par

LE JUGE WAGNER —

I. Introduction

[1] L'issue de ces pourvois repose sur l'interprétation d'une clause d'exclusion dans une forme courante d'assurance tous risques de biens, l'« assurance chantier », aussi appelée notamment « assurance des risques des entrepreneurs », « assurance tous risques », « assurance multirisque » ou encore « assurance des ouvrages en construction »[1]. Ce type d'assurance, qui couvre les dommages matériels sur un chantier, est habituellement offert au propriétaire de l'ouvrage en construction et à l'entrepreneur général. Cette assurance leur confère une protection, ainsi qu'à tous les entrepreneurs et sous-traitants qui travaillent sur le projet. La clause d'exclusion au cœur des pourvois est une clause type qui soustrait à la garantie les [TRADUCTION] « frais engagés pour remédier à une malfaçon », mais prévoit une exception pour les « dommages matériels » « en découlant ».

[2] Dans le cas qui nous occupe, un entrepreneur a été engagé pour nettoyer les fenêtres d'un immeuble en construction. Lors du nettoyage, il a égratigné les fenêtres de l'immeuble, qui ont dû être remplacées

[1] Même si les polices d'assurance chantier peuvent offrir une protection soit sur une base tous risques, soit contre un risque désigné, seul le premier type de police est en cause dans les présents pourvois. Il s'agit également du type de police le plus répandu. Ainsi, quand je parle des polices d'assurance chantier dans les présents motifs, j'entends par là les polices d'assurance chantier qui offrent une protection sur une base tous risques.

needed to be replaced. The windows' replacement cost was claimed by the building's owner and the general contractor in charge of the project under a builders' risk policy issued in favour of the owner and all contractors involved in the construction, but the insurers denied coverage on the basis of the "cost of making good faulty workmanship" exclusion. The issue before the courts was thus to determine, where windows of a construction project are damaged from post-installation cleaning by a contractor responsible for only their cleaning, if the cost of the windows' replacement was excluded from coverage under the faulty workmanship exclusion.

[3] After determining that the work performed by the contractor amounted to faulty workmanship, the trial judge applied the *contra proferentem* rule against the insurers and concluded that the faulty workmanship exclusion did not exclude from coverage the damage that the contractor had caused to the building's windows. Applying a correctness standard of review to the interpretation of the insurance policy, the Court of Appeal of Alberta overturned the trial judge's decision and declared that the damage to the building's windows was excluded from coverage, as the damage was physically or systematically connected to the very work the contractor had performed.

[4] In my opinion, the appropriate standard of review in this case is correctness. Where, like here, the appeal involves the interpretation of a standard form contract, the interpretation at issue is of precedential value, and there is no meaningful factual matrix that is specific to the particular parties to assist the interpretation process, this interpretation is better characterized as a question of law subject to correctness review.

[5] Regarding the appropriate interpretation of the faulty workmanship exclusion in all builders' risk policies, I am of the view that the exclusion clause serves to exclude from coverage only the

par la suite. La propriétaire de l'immeuble et l'entrepreneur général responsable du projet ont réclamé à leurs assureurs le coût de remplacement des fenêtres en vertu d'une police d'assurance chantier émise en leur faveur ainsi qu'en faveur de tous les entrepreneurs qui participaient aux travaux, mais les assureurs leur ont opposé un refus en raison de l'exclusion visant les « frais engagés pour remédier à une malfaçon ». Les cours saisies de l'affaire étaient donc appelées à décider si, dans le cas où les fenêtres d'un projet de construction sont endommagées après leur installation par l'entrepreneur chargé seulement de leur nettoyage, le coût de remplacement des fenêtres est exclu de la garantie d'assurance au titre de l'exclusion relative à la malfaçon.

[3] Après avoir conclu que le travail effectué par l'entrepreneur constituait une malfaçon, le juge de première instance a appliqué la règle *contra proferentem* contre les assureurs et a conclu que l'exclusion relative à la malfaçon ne visait pas les dommages que l'entrepreneur avait causés aux fenêtres de l'immeuble. Après avoir appliqué la norme de la décision correcte à l'interprétation de la police d'assurance, la Cour d'appel de l'Alberta a infirmé la décision du juge de première instance et a déclaré que les dommages causés aux fenêtres de l'immeuble n'étaient pas couverts, car ils étaient connexes, sur le plan matériel ou systémique, au travail même de l'entrepreneur.

[4] Selon moi, la norme de contrôle qu'il convient d'appliquer dans la présente affaire est celle de la décision correcte. Lorsque, comme en l'espèce, l'appel porte sur l'interprétation d'un contrat type, que l'interprétation en litige a valeur de précédent et que l'exercice d'interprétation ne repose sur aucun fondement factuel significatif qui est propre aux parties concernées, il est plus juste de dire que cette interprétation est une question de droit assujettie à un contrôle selon la norme de la décision correcte.

[5] En ce qui concerne la juste interprétation de la clause d'exclusion relative à la malfaçon dans les polices d'assurance chantier, j'estime que cette clause ne vise à exclure que le coût de la nouvelle

cost of redoing the faulty work. This interpretation is dictated by the general rules of contractual interpretation. It best represents the parties' reasonable expectations, as informed by the purpose of builders' risk policies, aligns with commercial reality, and is consistent with the jurisprudence on the matter. In this case, the cost of redoing the faulty work is that of recleaning the windows. Therefore, I would allow the appeals and hold that the windows' replacement cost is covered under the insurance policy.

II. Facts

[6] Station Lands Ltd. ("Station Lands") is the owner of the recently built EPCOR Tower ("Tower"), an office building in Edmonton. Ledcor Construction Limited ("Ledcor") was the general contractor for the Tower's construction.

[7] During construction, the Tower's installed windows were dirtied with paint specks, dirt and concrete splatter. To clean these windows prior to the completion of construction, Station Lands hired Bristol Cleaning ("Bristol"). The service contract between Station Lands and Bristol stipulated that Station Lands would provide all-risk property insurance for the project, which Station Lands did in the form of a builders' risk policy (the "Policy"). The scope of Bristol's work under the service contract was to "[p]rovide all necessary equipment, manpower, [and] materials required to complete a construction clean" of the Tower's exterior windows.

[8] Unfortunately, Bristol used improper tools and methods in carrying out its cleaning work, scratching the Tower's windows, which consequently had to be replaced. Station Lands estimated the replacement cost of the windows to be $2.5 million. Both Station Lands and Ledcor claimed this replacement cost against the Policy through their insurers at the time, the respondents Commonwealth Insurance Company, GCAN Insurance Company, and American Home Assurance Company (together,

exécution du travail défectueux. Ce sont les règles générales d'interprétation des contrats qui dictent cette interprétation, laquelle reflète le mieux les attentes raisonnables des parties fondées sur l'objectif des polices d'assurance chantier, correspond à la réalité commerciale et est conforme à la jurisprudence sur ce point. En l'espèce, le coût de la nouvelle exécution du travail déficient est celui d'un nouveau nettoyage des fenêtres. En conséquence, je suis d'avis d'accueillir les pourvois et de décider que le coût de remplacement des fenêtres est couvert par la police d'assurance.

II. Faits

[6] Station Lands Ltd. (« Station Lands ») est la propriétaire de l'EPCOR Tower (« Tour »), construite récemment, un immeuble à bureaux d'Edmonton. Ledcor Construction Limited (« Ledcor ») était l'entrepreneur général chargé de construire la Tour.

[7] Durant la construction, les fenêtres de la Tour ont été salies par des petites taches de peinture et des éclaboussures de terre et de béton. Pour nettoyer les fenêtres avant la fin des travaux, Station Lands a embauché Bristol Cleaning (« Bristol »). Il était stipulé dans le contrat de service conclu entre Station Lands et Bristol que Station Lands fournirait une assurance de biens tous risques pour le projet, ce qu'elle a fait au moyen d'une police d'assurance chantier (la « police »). Aux termes du contrat de service, Bristol devait [TRADUCTION] « [f]ournir tout l'équipement, la main d'œuvre [et] les produits nécessaires pour effectuer, lors de la construction, un nettoyage » du côté extérieur des fenêtres de la Tour.

[8] Malheureusement, Bristol a utilisé les mauvais outils et méthodes pour effectuer le travail de nettoyage et a égratigné les fenêtres de la Tour, lesquelles ont dû, en conséquence, être remplacées. Station Lands a estimé le coût de leur remplacement à 2,5 millions de dollars. Station Lands et Ledcor ont toutes deux présenté, sur la base de la police, une réclamation pour le coût de remplacement à leurs assureurs de l'époque, les intimées la Commonwealth Insurance Company, GCAN Insurance

the "Insurers").[2] The Insurers denied the claim on the basis of clause 4(A)(b) of the Policy (the "Exclusion Clause"), which is an exclusion for faulty workmanship.

[9] The relevant coverage provisions of the Policy provide that all risks of direct physical loss or damage to the property undergoing construction are insured, subject to certain outlined exclusions:

1. Property Insured

(a) Property undergoing site preparation, demolition, construction, reconstruction, fabrication, installation, erection, repair or testing (hereinafter called the "Construction Operations") while at the risk of the insured and while at the location of the insured project(s), provided the value thereof is included in the declared estimated value of construction operations;

. . .

2. Perils Insured and Territorial Limits

This policy section insures against "All Risks" of direct physical loss or damage except as hereinafter provided.

[10] The Exclusion Clause excludes from coverage the "cost of making good faulty workmanship", but provides an exception for "resulting damage":

4(A) Exclusions

This policy section does not insure:

(a) Any loss of use or occupancy or consequential loss of any nature howsoever caused including

[2] Between the date of the Policy and the date of judgment at trial, these respondents became the remaining respondents Northbridge Indemnity Insurance Company, Royal & Sun Alliance Insurance Company of Canada, and Chartis Insurance Company of Canada, respectively.

Company et American Home Assurance Company (collectivement appelées les « assureurs »)[2]. Les assureurs ont rejeté cette réclamation en invoquant la clause 4(A)b) de la police (la « clause d'exclusion »), qui prévoit une exclusion en cas de malfaçon.

[9] Les dispositions pertinentes de la police quant à la garantie prévoient que tous les risques de perte ou de dommages matériels directs touchant l'ouvrage en construction sont assurés, sous réserve de certaines exclusions énumérées :

[TRADUCTION]

1. Biens assurés

a) Les biens faisant l'objet d'une préparation de chantier, démolition, construction, reconstruction, fabrication, installation, érection, réparation ou d'un essai (ci-après appelés les « travaux de construction ») pendant que l'assuré en a la charge et qu'ils se trouvent sur les lieux du ou des projets assurés, pourvu que leur valeur ne dépasse pas les estimations déclarées des travaux de construction;

. . .

2. Risques couverts et limites territoriales

Sous réserve des exceptions stipulées ci-après, la présente police couvre « tous les risques » de perte ou de dommages matériels directs.

[10] La clause d'exclusion vise notamment les [TRADUCTION] « frais engagés pour remédier à une malfaçon », mais prévoit une exception pour les « dommages en découlant » :

[TRADUCTION]

4(A) Exclusions

La présente police ne couvre pas :

a) La perte d'usage ou d'occupation ou perte indirecte de quelque nature que ce soit, y compris les

[2] Entre la date de signature de la police et la date du jugement de première instance, les intimées en question étaient devenues les autres intimées à la présente affaire, soit, respectivement, la Société d'assurance d'indemnisation Northbridge, Royal & Sun Alliance du Canada, société d'assurances, et la Compagnie d'assurance Chartis du Canada.

penalties for non-completion of or delay in completion of contract or non-compliance with contract conditions;

(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. [Emphasis added.]

[11] Station Lands and Ledcor (together, the "Insureds") submitted their statement of claim before the Court of Queen's Bench of Alberta, seeking enforcement of the Policy and coverage for the replacement cost of the damaged windows.

III. Decisions Below

A. *Court of Queen's Bench of Alberta, 2013 ABQB 585, [2013] I.L.R. ¶ I-5495*

[12] The trial judge concluded that the cleaning work Bristol had carried out constituted "workmanship" and that it had been faulty. He declared, however, that the Exclusion Clause did not exclude from coverage the damage that Bristol's faulty workmanship had caused to the Tower's windows. In coming to this determination, he found the Exclusion Clause ambiguous and the interpretations of "making good" advanced by the Insureds and Insurers equally plausible. He therefore applied the rule of *contra proferentem* against the Insurers. The Insureds had argued that the "cost of making good" encompassed only the cost of redoing the cleaning work, whereas the Insurers had argued that it encompassed both the cost of redoing the cleaning work and the damage to the windows, as they were the very thing on which Bristol had performed the faulty workmanship.

B. *Court of Appeal of Alberta, 2015 ABCA 121, 599 A.R. 363*

[13] On appeal, the Court of Appeal reversed the trial judge's decision and declared that the damage to the Tower's windows was excluded from coverage. Applying a correctness standard of review to the

pénalités pour non-exécution du contrat, retard dans l'exécution du contrat ou non-respect des conditions du contrat;

b) Les frais engagés pour remédier à une malfaçon, des matériaux de construction défectueux ou une conception défaillante, à moins qu'il n'en découle des dommages matériels non autrement exclus par la présente police, auquel cas la présente police couvre ces dommages en découlant. [Je souligne.]

[11] Station Lands et Ledcor (collectivement appelées les « assurées ») ont présenté à la Cour du Banc de la Reine de l'Alberta une déclaration dans laquelle elles sollicitaient l'application de la police et la reconnaissance de la garantie pour le coût de remplacement des fenêtres endommagées.

III. Décisions des juridictions inférieures

A. *Cour du Banc de la Reine de l'Alberta, 2013 ABQB 585, [2013] I.L.R. ¶ I-5495*

[12] Le juge de première instance a conclu que le nettoyage effectué par Bristol constituait le « travail » et qu'il avait été mal exécuté. Il a toutefois déclaré que la clause d'exclusion ne soustrayait pas à la garantie d'assurance les dommages causés aux fenêtres de la Tour par la malfaçon de Bristol. Pour parvenir à cette conclusion, il a estimé que la clause d'exclusion était ambiguë et que les interprétations des mots « pour remédier » avancées par les assurées et les assureurs étaient aussi plausibles l'une que l'autre. En conséquence, il a appliqué la règle *contra proferentem* contre les assureurs. Les assurées ont fait valoir que les « frais engagés pour remédier » à la malfaçon ne visaient que le coût d'un nouveau nettoyage, alors que les assureurs ont soutenu que cette expression visait non seulement le coût de ce nouveau nettoyage, mais aussi les dommages causés aux fenêtres, puisque c'était justement sur celles-ci que Bristol avait exécuté le travail déficient.

B. *Cour d'appel de l'Alberta, 2015 ABCA 121, 599 A.R. 363*

[13] La Cour d'appel a infirmé la décision du juge de première instance et déclaré que les dommages causés aux fenêtres de la Tour n'étaient pas couverts par la police. Appliquant la norme de la décision

interpretation of the Policy, the court held the trial judge had improperly applied the rule of *contra proferentem* because the Exclusion Clause was not ambiguous.

[14] The Court of Appeal proceeded from the premise that because the base coverage under the Policy was for "physical loss or damage", as provided by clause 2, the Exclusion Clause had to exclude physical damage of some kind, or else it would be redundant. For the court, then, the key was to determine the dividing line between the physical damage that was excluded as the "cost of making good faulty workmanship" and the physical damage that was covered as "resulting damage". To establish this dividing line, the court devised a new test of physical or systemic connectedness, based on three primary considerations, outlined at para. 50 of its reasons: (1) 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"; (2) 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"; and (3) "[w]hether the damage was within the purview of normal risks of poor workmanship, or whether it was unexpected and fortuitous."

[15] In applying this newly formulated test, the Court of Appeal concluded that the damage to the windows was physical loss excluded as the "cost of making good faulty workmanship", because it was not accidental or fortuitous but was directly caused by the scraping and wiping motions involved in Bristol's cleaning work. According to the court, Bristol intentionally applied these motions to the windows, a core part of the work to be done, and the damage was not only foreseeable but highly likely.

correcte à l'interprétation de la police, la Cour d'appel a conclu que le juge de première instance avait irrégulièrement appliqué la règle *contra proferentem* puisque la clause d'exclusion n'était pas ambiguë.

[14] La Cour d'appel est partie de la prémisse suivante : comme la garantie de base de la police visait, aux termes de la clause 2, les [TRADUCTION] « perte ou [. . .] dommages matériels », la clause d'exclusion devait exclure une forme de dommages matériels, à défaut de quoi elle serait redondante. La Cour d'appel a donc jugé qu'il fallait tracer la ligne de démarcation entre, d'une part, les dommages matériels exclus au titre des « frais engagés pour remédier à une malfaçon » et, d'autre part, les dommages matériels qui sont couverts en tant que « dommages [. . .] découlant » de cette malfaçon. Pour ce faire, la Cour d'appel a élaboré un nouveau critère de connexité matérielle ou systémique. Ce critère comportait trois volets principaux, décrits au par. 50 des motifs de la cour : (1) la [TRADUCTION] « mesure dans laquelle les dommages ont touché une section du projet qui était alors en cours d'exécution ou touché indirectement d'autres zones »; (2) la « nature du travail effectué, le lien entre les dommages causés et l'exécution normale du travail et la mesure dans laquelle les dommages constituaient une conséquence naturelle ou prévisible du travail »; (3) « le point de savoir si les dommages faisaient partie des risques normaux liés à un travail de piètre qualité ou s'ils étaient imprévus et fortuits. »

[15] Après application de ce nouveau critère, la Cour d'appel a conclu que les dommages causés aux fenêtres constituaient une perte matérielle exclue au titre des [TRADUCTION] « frais engagés pour remédier à une malfaçon » parce qu'ils n'étaient ni accidentels ni fortuits, mais directement causés par les mouvements de grattage et de frottage effectués par Bristol lors de son nettoyage. Selon la Cour d'appel, Bristol a intentionnellement soumis les fenêtres à ce traitement, qui constituait l'essentiel du travail à accomplir, et les dommages étaient non seulement prévisibles, mais hautement probables.

IV. Issues on Appeal

[16] The Exclusion Clause in the standard form builders' risk insurance policy at issue in these appeals raises two questions that this Court must answer.

[17] First, what standard of appellate review applies to a trial judge's interpretation of a standard form insurance contract?

[18] Second, what is the proper interpretation to be given to the faulty workmanship exclusion clause and the "resulting damage" exception to that exclusion contained in builders' risk insurance policies?

V. Analysis

A. *The Standard of Review Is Correctness*

[19] In my view, the trial judge's interpretation of the Policy should be reviewed for correctness.

[20] These appeals present an opportunity to clarify how *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, [2014] 2 S.C.R. 633, applies to the interpretation of standard form contracts, sometimes called contracts of adhesion.

[21] In *Sattva*, Rothstein J. held that "[c]ontractual interpretation involves issues of mixed fact and law as it is an exercise in which the principles of contractual interpretation are applied to the words of the written contract, considered in light of the factual matrix" (para. 50). As a result, the palpable and overriding error standard of review applies to a trial court's interpretation of a contract: *Heritage Capital Corp. v. Equitable Trust Co.*, 2016 SCC 19, [2016] 1 S.C.R. 306, at paras. 21-24. However, Rothstein J. acknowledged that the correctness standard of review still applies to the "rare" extricable questions of law that arise in the interpretation process, such as "the application of an incorrect principle, the failure to consider a required element of a legal test,

IV. Questions en litige

[16] La clause d'exclusion figurant dans la formule type d'assurance chantier en cause dans les pourvois soulève deux questions auxquelles notre Cour doit répondre.

[17] Premièrement, quelle norme de contrôle s'applique en appel à l'interprétation d'un contrat d'assurance type retenue par le juge de première instance?

[18] Deuxièmement, quelle est l'interprétation que doit recevoir la clause d'exclusion relative à la malfaçon et l'exception visant les « dommages en découlant » contenues dans les polices d'assurance chantier?

V. Analyse

A. *La norme de contrôle est celle de la décision correcte*

[19] À mon avis, il faut contrôler l'interprétation de la police retenue par le juge de première instance selon la norme de la décision correcte.

[20] Les présents pourvois offrent une occasion de clarifier l'application de *Sattva Capital Corp. c. Creston Moly Corp.*, 2014 CSC 53, [2014] 2 R.C.S. 633, à l'interprétation des contrats types, parfois appelés contrats d'adhésion.

[21] Dans l'arrêt *Sattva*, le juge Rothstein conclut que « [l]'interprétation contractuelle soulève des questions mixtes de fait et de droit, car il s'agit d'en appliquer les principes aux termes figurant dans le contrat écrit, à la lumière du fondement factuel » (par. 50). En conséquence, la norme de l'erreur manifeste et dominante s'applique à l'interprétation donnée par le tribunal de première instance à un contrat (*Heritage Capital Corp. c. Équitable, Cie de fiducie*, 2016 CSC 19, [2016] 1 R.C.S. 306, par. 21-24). Le juge Rothstein a cependant reconnu que la norme de la décision correcte s'applique toujours aux « rares » questions de droit qui peuvent se dégager au cours de l'exercice d'interprétation, par exemple lorsque le décideur a « appliqu[é] le

or the failure to consider a relevant factor": *Sattva*, at paras. 53 and 55, quoting *King v. Operating Engineers Training Institute of Manitoba Inc.*, 2011 MBCA 80, 270 Man. R. (2d) 63, at para. 21. This is consistent with the jurisprudence on the standard of review for questions of mixed fact and law: *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235, at para. 36. However, in this case, the Court of Appeal did not purport to identify an extricable question of law that arose in the interpretation process. Rather, it concluded that the interpretation of the contract itself should be reviewed for correctness, despite *Sattva*'s holding that contractual interpretation is a question of mixed fact and law and is owed deference on appeal: paras. 18-19.

mauvais principe ou néglig[é] un élément essentiel d'un critère juridique ou un facteur pertinent » (*Sattva*, par. 53 et 55, citant *King c. Operating Engineers Training Institute of Manitoba Inc.*, 2011 MBCA 80, 270 Man. R. (2d) 63, par. 21). Cela s'accorde avec la jurisprudence sur la norme de contrôle applicable aux questions mixtes de fait et de droit (*Housen c. Nikolaisen*, 2002 CSC 33, [2002] 2 R.C.S. 235, par. 36). Toutefois, en l'espèce, la Cour d'appel n'a pas dégagé une question de droit qui s'est posée au cours de l'exercice d'interprétation. Elle a plutôt conclu qu'il y a lieu de contrôler l'interprétation du contrat lui-même selon la norme de la décision correcte malgré la conclusion tirée dans *Sattva* selon laquelle l'interprétation contractuelle est une question mixte de fait et de droit et commande la déférence en appel (par. 18-19).

[22] Appellate courts have disagreed on whether this Court's holding in *Sattva* on the standard of review of contractual interpretation applies to standard form contracts. Many appellate courts have held that *Sattva* does not apply, and have conducted correctness review: *Vallieres v. Vozniak*, 2014 ABCA 290, 5 Alta. L.R. (6th) 28, at paras. 11-13; *Portage LaPrairie Mutual Insurance Co. v. Sabean*, 2015 NSCA 53, 386 D.L.R. (4th) 449, at para. 13; *Precision Plating Ltd. v. Axa Pacific Insurance Co.*, 2015 BCCA 277, 387 D.L.R. (4th) 281, at paras. 28-30; *Stewart Estate v. 1088294 Alberta Ltd.*, 2015 ABCA 357, 25 Alta. L.R. (6th) 1, at para. 273, per McDonald J.A.; *MacDonald v. Chicago Title Insurance Co. of Canada*, 2015 ONCA 842, 127 O.R. (3d) 663, at paras. 40-41; *Monk v. Farmers' Mutual Insurance Co.*, 2015 ONCA 911, 128 O.R. (3d) 710, at paras. 22-24; *Daverne v. John Switzer Fuels Ltd.*, 2015 ONCA 919, 128 O.R. (3d) 188, at paras. 12-14; *True Construction Ltd. v. Kamloops (City)*, 2016 BCCA 173, at para. 34 (CanLII); and *Sankar v. Bell Mobility Inc.*, 2016 ONCA 242, at para. 26 (CanLII).

[22] Les cours d'appel ont exprimé des avis contradictoires au sujet de la question de savoir si la conclusion tirée dans *Sattva* sur la norme de contrôle applicable en matière d'interprétation contractuelle vise aussi les contrats types. Elles ont été nombreuses à juger que *Sattva* n'est pas applicable et ont effectué un contrôle selon la norme de la décision correcte (*Vallieres c. Vozniak*, 2014 ABCA 290, 5 Alta. L.R. (6th) 28, par. 11-13; *Portage LaPrairie Mutual Insurance Co. c. Sabean*, 2015 NSCA 53, 386 D.L.R. (4th) 449, par. 13; *Precision Plating Ltd. c. Axa Pacific Insurance Co.*, 2015 BCCA 277, 387 D.L.R. (4th) 281, par. 28-30; *Stewart Estate c. 1088294 Alberta Ltd.*, 2015 ABCA 357, 25 Alta. L.R. (6th) 1, par. 273, le juge McDonald; *MacDonald c. Chicago Title Insurance Co. of Canada*, 2015 ONCA 842, 127 O.R. (3d) 663, par. 40-41; *Monk c. Farmers' Mutual Insurance Co.*, 2015 ONCA 911, 128 O.R. (3d) 710, par. 22-24; *Daverne c. John Switzer Fuels Ltd.*, 2015 ONCA 919, 128 O.R. (3d) 188, par. 12-14; *True Construction Ltd. c. Kamloops (City)*, 2016 BCCA 173, par. 34 (CanLII); *Sankar c. Bell Mobility Inc.*, 2016 ONCA 242, par. 26 (CanLII)).

[23] In other cases, however, courts of appeal have applied *Sattva* and have deferred to trial courts' interpretations of standard form contracts: *Kassburg v. Sun Life Assurance Co. of Canada*, 2014 ONCA 922, 124 O.R. (3d) 171, at para. 33; *Anderson v.*

[23] En revanche, dans d'autres affaires, les cours d'appel ont appliqué *Sattva* et s'en sont remises aux interprétations des contrats types retenues par les tribunaux de première instance (*Kassburg c. Sun Life Assurance Co. of Canada*, 2014 ONCA 922,

Bell Mobility Inc., 2015 NWTCA 3, 593 A.R. 79, at paras. 9 and 33-35; *Van Camp v. Chrome Horse Motorcycle Inc.*, 2015 ABCA 83, 599 A.R. 201; *Industrial Alliance Insurance and Financial Services Inc. v. Brine*, 2015 NSCA 104, 392 D.L.R. (4th) 575, at paras. 40-41; *Ontario Society for the Prevention of Cruelty to Animals v. Sovereign General Insurance Co.*, 2015 ONCA 702, 127 O.R. (3d) 581, at paras. 34-36; *Acciona Infrastructure Canada Inc. v. Allianz Global Risks US Insurance Co.*, 2015 BCCA 347, 77 B.C.L.R. (5th) 223, at para. 35; and *GCAN Insurance Co. v. Univar Canada Ltd.*, 2016 QCCA 500, at para. 40 (CanLII). See also *Stewart Estate*, at para. 63, per Rowbotham J.A. (dissenting on this point).

[24] I would recognize an exception to this Court's holding in *Sattva* that contractual interpretation is a question of mixed fact and law subject to deferential review on appeal. In my view, where an appeal involves the interpretation of a standard form contract, the interpretation at issue is of precedential value, and there is no meaningful factual matrix that is specific to the parties to assist the interpretation process, this interpretation is better characterized as a question of law subject to correctness review.

[25] The statements made in *Sattva* on the standard of review of contractual interpretation must be considered in their full context. That case concerned a complex commercial agreement between two sophisticated parties — not a standard form contract. Professor John D. McCamus has described standard form contracts as follows:

> . . . the document put forward will typically constitute a standard printed form that the party proffering the document invariably uses when entering transactions of this kind. The form will often be offered on a "take it or leave it" basis. In the typical case, the other party, then, will have no choice but either to agree to the terms of the standard form or to decline to enter the transaction altogether. Standard form agreements are a pervasive and indispensable feature of modern commercial life. It is simply not feasible to negotiate, in any meaningful sense,

124 O.R. (3d) 171, par. 33; *Anderson c. Bell Mobility Inc.*, 2015 NWTCA 3, 593 A.R. 79, par. 9 et 33-35; *Van Camp c. Chrome Horse Motorcycle Inc.*, 2015 ABCA 83, 599 A.R. 201; *Industrial Alliance Insurance and Financial Services Inc. c. Brine*, 2015 NSCA 104, 392 D.L.R. (4th) 575, par. 40-41; *Ontario Society for the Prevention of Cruelty to Animals c. Sovereign General Insurance Co.*, 2015 ONCA 702, 127 O.R. (3d) 581, par. 34-36; *Acciona Infrastructure Canada Inc. c. Allianz Global Risks US Insurance Co.*, 2015 BCCA 347, 77 B.C.L.R. (5th) 223, par. 35; *GCAN Insurance Co. c. Univar Canada Ltd.*, 2016 QCCA 500, par. 40 (CanLII). Voir aussi *Stewart Estate*, par. 63, la juge Rowbotham (dissidente sur ce point)).

[24] Je suis d'avis de reconnaître une exception à la conclusion tirée dans *Sattva* selon laquelle l'interprétation contractuelle est une question mixte de fait et de droit dont le contrôle en appel doit être empreint de déférence. Selon moi, lorsqu'un appel porte sur l'interprétation d'un contrat type, que l'interprétation en litige a valeur de précédent et que l'exercice d'interprétation ne repose sur aucun fondement factuel significatif qui est propre aux parties concernées, il est plus juste de dire que cette interprétation est une question de droit assujettie à un contrôle selon la norme de la décision correcte.

[25] Les affirmations dans *Sattva* au sujet de la norme de contrôle applicable en matière d'interprétation contractuelle doivent être replacées dans leur contexte global. L'arrêt *Sattva* portait sur une entente commerciale complexe intervenue entre deux parties avisées, et non sur un contrat type. Le professeur John D. McCamus a décrit ainsi les contrats types :

> [TRADUCTION] . . . il s'agit typiquement d'une formule type imprimée à laquelle a toujours recours la partie qui la propose pour ce type d'opération. La formule est souvent présentée comme étant une offre « à prendre ou à laisser ». Normalement, l'autre partie n'aura comme choix que d'accepter ou de refuser l'intégralité des modalités de la formule type. Les contrats d'adhésion types sont omniprésents et constituent une caractéristique indispensable de l'activité commerciale moderne. Il n'est tout simplement pas possible de négocier réellement les

the terms of many of the transactions entered into in the course of daily life.

(*The Law of Contracts* (2nd ed. 2012), at p. 185)

Sattva did not consider the unique issues that standard form contracts raise.

[26] Moreover, the Court in *Sattva* gave two reasons for concluding that contractual interpretation is a question of mixed fact and law subject to deferential review on appeal. As a general matter, those reasons are less compelling in the context of standard form contracts.

(1) Factual Matrix

[27] The first reason is that the surrounding circumstances of the contract, or the factual matrix in which it was formed, are important considerations in contractual interpretation: *Sattva*, at para. 46. Rothstein J. stated that determining the intention of the parties is a "fact-specific goal" that requires a trial court to "read the contract as a whole, giving the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract": paras. 47 and 49.

[28] While a proper understanding of the factual matrix is crucial to the interpretation of many contracts, it is often less relevant for standard form contracts, because "the parties do not negotiate terms and the contract is put to the receiving party as a take-it-or-leave-it proposition": *MacDonald*, at para. 33. Standard form contracts are particularly common in the insurance industry, as Professor Barbara Billingsley observed in *General Principles of Canadian Insurance Law* (2nd ed. 2014), at p. 56:

As part of its business considerations and in advance of meeting with any particular client, an insurance company decides the terms and conditions under which it is willing to provide insurance coverage for certain common

modalités d'un grand nombre des opérations conclues quotidiennement.

(*The Law of Contracts* (2e éd. 2012), p. 185)

La Cour n'a pas examiné dans *Sattva* les questions uniques que soulèvent les contrats types.

[26] Par ailleurs, dans *Sattva*, la Cour a donné deux motifs à l'appui de sa conclusion selon laquelle l'interprétation contractuelle est une question mixte de fait et de droit dont le contrôle en appel doit être empreint de déférence. En règle générale, ces motifs sont moins convaincants lorsqu'il est question de contrats types.

(1) Fondement factuel

[27] Le premier motif est que les circonstances entourant le contrat, ou le fondement factuel de sa formation, sont des considérations importantes pour son interprétation (*Sattva*, par. 46). Selon le juge Rothstein, le but de l'exercice consistant à déterminer l'intention des parties est « axé sur les faits » et requiert qu'un tribunal de première instance « interprèt[e] le contrat dans son ensemble, en donnant aux mots y figurant le sens ordinaire et grammatical qui s'harmonise avec les circonstances dont les parties avaient connaissance au moment de la conclusion du contrat » (par. 47 et 49).

[28] Certes, une compréhension adéquate du fondement factuel est cruciale pour l'interprétation de nombreux contrats. Toutefois, dans le cas des contrats types, le fondement factuel est souvent moins pertinent parce que [TRADUCTION] « les parties ne négocient pas les modalités et le contrat est présenté comme une proposition à prendre ou à laisser » (*MacDonald*, par. 33). Les contrats types sont particulièrement communs dans l'industrie des assurances, comme l'a fait observer la professeure Barbara Billingsley dans *General Principles of Canadian Insurance Law* (2e éd. 2014), p. 56 :

[TRADUCTION] Eu égard aux considérations commerciales qui lui sont propres et avant de rencontrer tout client, la compagnie d'assurance décide des conditions dans lesquelles elle est disposée à fournir une garantie d'assurance

types of risk. This means that, in most situations, an insurance company does not negotiate the detailed terms of insurance coverage with individual customers. Instead, before entering into any insurance agreements, an insurer typically drafts a series of pre-fabricated contracts outlining the terms upon which particular kinds of coverage will be provided. These contracts are known as "standard form policies". The insurer then provides the appropriate standard form policy to clients purchasing insurance coverage.

[29] Parties to an insurance contract may negotiate over matters like the cost of premiums, but the actual conditions of the insurance coverage are generally determined by the standard form contract: Billingsley, at p. 58.

[30] My colleague Justice Cromwell accepts that, for standard form contracts, there are usually no relevant surrounding circumstances relating to negotiation (para. 106). However, he observes that other elements of the surrounding circumstances — such as the purpose of the contract, the nature of the relationship it creates, and the market or industry in which it operates — have a role in the interpretation process.

[31] I agree that factors such as the purpose of the contract, the nature of the relationship it creates, and the market or industry in which it operates should be considered when interpreting a standard form contract. However, those considerations are generally not "inherently fact specific": *Sattva*, at para. 55. Rather, they will usually be the same for everyone who may be a party to a particular standard form contract. This underscores the need for standard form contracts to be interpreted consistently, a point to which I will return below.

[32] In sum, for standard form contracts, the surrounding circumstances generally play less of a role in the interpretation process, and where they are relevant, they tend not to be specific to the particular parties. Accordingly, the first reason given in *Sattva* for concluding that contractual interpretation is a question of mixed fact and law — the importance of the factual matrix — carries less weight in cases involving standard form contracts.

pour certains risques courants. Ainsi, dans la plupart des cas, la compagnie d'assurance ne négocie pas les modalités détaillées de la garantie avec un client en particulier. Ce qui se passe plutôt, c'est qu'avant de conclure un contrat d'assurance, l'assureur rédige généralement une série de contrats préétablis décrivant dans quelles conditions certains types de garantie seront offerts. Ces contrats sont appelés des « polices d'assurance types ». L'assureur fournit ainsi la police d'assurance type appropriée à chaque client qui achète une garantie d'assurance.

[29] Les parties à un contrat d'assurance peuvent négocier des éléments comme le coût des primes, mais les véritables conditions de la garantie sont généralement établies par le contrat type (Billingsley, p. 58).

[30] Mon collègue le juge Cromwell convient que, dans le cas des contrats types, il n'y a habituellement aucune circonstance pertinente touchant les négociations (par. 106). Il fait toutefois remarquer que d'autres éléments des circonstances — tels l'objet du contrat, la nature de la relation qu'il crée et le marché ou l'industrie où il est employé — ont un rôle à jouer dans l'exercice d'interprétation.

[31] Je reconnais qu'il y a lieu de prendre en considération des facteurs comme l'objet du contrat, la nature de la relation qu'il crée et le marché ou l'industrie où il est employé pour interpréter un contrat type. Par contre, ces considérations ne sont généralement pas, « de par [leur] nature même, axé[es] sur les faits » (*Sattva*, par. 55). Elles sont plutôt habituellement les mêmes pour toute personne qui peut être partie à un contrat type donné. Cela fait ressortir la nécessité d'interpréter uniformément les contrats types, un point sur lequel je reviendrai plus loin.

[32] Bref, dans le cas des contrats types, les circonstances les entourant ont généralement un rôle moins important à jouer dans l'exercice d'interprétation et, lorsqu'elles sont pertinentes, elles ne sont généralement pas propres aux parties en cause. En conséquence, le premier motif donné dans *Sattva* à l'appui de la conclusion que l'interprétation d'un contrat est une question mixte de fait et de droit — l'importance du fondement factuel — a moins de force dans les cas des contrats types.

(2) The Definitions of "Question of Law" and "Question of Mixed Fact and Law"

[33] In *Sattva*, this Court gave a second reason for concluding that contractual interpretation is a question of mixed fact and law: contractual interpretation does not fit within the definition of a pure question of law. Questions of law are "about what the correct legal test is": para. 49, quoting *Canada (Director of Investigation and Research) v. Southam Inc.*, [1997] 1 S.C.R. 748, at para. 35. For instance, the content of a particular legal principle of contractual interpretation is a question of law. However, in interpreting contracts, courts apply the legal principles of contractual interpretation to determine the parties' objective intentions: *Sattva*, at para. 49. Therefore, according to *Sattva*, contractual interpretation is a question of mixed fact and law, which is defined as "applying a legal standard" (the legal principles of contractual interpretation) "to a set of facts" (the words of the contract and the factual matrix): para. 49, quoting *Housen*, at para. 26.

[34] In my view, however, while contractual interpretation is generally a question of mixed fact and law, in situations involving standard form contracts, it is more appropriately classified as a question of law in most circumstances.

[35] The law of standard of review — including the distinction between questions of law and those of mixed fact and law — seeks to achieve an appropriate division of labour between trial and appellate courts in accordance with their respective roles. The main function of trial courts is to resolve the particular disputes before them: *Housen*, at para. 9. Appellate courts, however, "operate at a higher level of legal generality": *Association des parents ayants droit de Yellowknife v. Northwest Territories (Attorney General)*, 2015 NWTCA 2, 593 A.R. 180, at para. 23. They ensure that "the same legal rules are applied in similar situations", as the rule of law demands: *Housen*, at para. 9. Appellate courts also

(2) Les définitions de « question de droit » et de « question mixte de fait et de droit »

[33] Dans l'arrêt *Sattva*, la Cour avance un deuxième motif pour justifier sa conclusion selon laquelle l'interprétation des contrats est une question mixte de fait et de droit : l'interprétation contractuelle ne cadre pas avec la définition de la pure question de droit. Les questions de droit « concernent la détermination du critère juridique applicable » (par. 49, citant *Canada (Directeur des enquêtes et recherches) c. Southam Inc.*, [1997] 1 R.C.S. 748, par. 35). À titre d'exemple, la teneur d'un principe juridique particulier d'interprétation contractuelle est une question de droit. Toutefois, dans l'interprétation des contrats, les tribunaux appliquent les principes juridiques d'interprétation contractuelle pour déterminer les intentions objectives des parties (*Sattva*, par. 49). En conséquence, selon *Sattva*, l'interprétation contractuelle est une question mixte de fait et droit, définie comme « l'application d'une norme juridique » (les principes juridiques de l'interprétation contractuelle) « à un ensemble de faits » (les termes du contrat et le fondement factuel) (par. 49, citant *Housen*, par. 26).

[34] J'estime toutefois que, si l'interprétation contractuelle est généralement une question mixte de fait et de droit, lorsqu'il s'agit de contrats types, il est plus juste de la considérer comme une question de droit dans la plupart des cas.

[35] Le droit applicable aux normes de contrôle — notamment en ce qui a trait à la distinction entre les questions de droit et les questions mixtes de fait et de droit — vise à établir une répartition appropriée des tâches entre les tribunaux de première instance et les cours d'appel, conformément à leurs rôles respectifs. La principale fonction des tribunaux de première instance est de résoudre les litiges qui leur sont soumis (*Housen*, par. 9). Quant aux cours d'appel, elles « exerce[nt] leurs fonctions à un niveau élevé de généralité » (*Association des parents ayants droit de Yellowknife c. Territoires du Nord-Ouest (Procureur général)*, 2015 NWTCA 2, 593 A.R. 180, par. 23). Elles veillent à ce que « les mêmes règles de droit

have a law-making function, which requires them to "delineate and refine legal rules": *ibid.*

[36] These particular functions of appellate courts — ensuring consistency in the law and reforming the law — justify reviewing pure questions of law on the standard of correctness. By contrast, appellate courts defer to findings of fact in part because they can discharge their mandate without second-guessing trial courts' factual determinations: *Housen*, at paras. 11-14. For questions of mixed fact and law, the correctness standard applies to extricable errors of law (such as the application of an incorrect principle) because, again, a review on the standard of correctness is necessary to allow appellate courts to fulfill their role. However, where it is "difficult to extricate the legal questions from the factual", appellate courts defer on questions of mixed fact and law: *Housen*, at para. 36; see also paras. 33-35.

[37] In many cases, appellate courts need not review for correctness the contractual interpretation *itself* in order to perform their functions — namely, ensuring the consistent application of the law and reforming the law. That is because, in general, the interpretation of a contract has no impact beyond the parties to a dispute. As Rothstein J. commented in *Sattva*, at para. 52:

> . . . this Court in *Housen* found that deference to fact-finders promoted the goals of limiting the number, length, and cost of appeals, and of promoting the autonomy and integrity of trial proceedings (paras. 16-17). These principles also weigh in favour of deference to first instance decision-makers on points of contractual interpretation. The legal obligations arising from a contract are, in most cases, limited to the interest of the particular parties. Given that our legal system leaves broad scope to tribunals of

soient appliquées dans des situations similaires », comme l'exige la primauté du droit (*Housen*, par. 9). Elles jouent aussi un rôle dans l'élaboration du droit, ce qui les oblige à « préciser et [à] raffiner les règles de droit » (*ibid.*).

[36] Ces fonctions particulières des cours d'appel — veiller à l'application uniforme du droit et à sa réforme — justifient qu'elles exercent un contrôle selon la norme de la décision correcte pour les pures questions de droit. En revanche, les cours d'appel font preuve de déférence à l'égard des conclusions de fait, et ce, notamment parce qu'elles peuvent s'acquitter de leur mandat sans avoir à se prononcer après coup sur les conclusions factuelles des tribunaux de première instance (*Housen*, par. 11-14). Pour les questions mixtes de fait et de droit, la norme de la décision correcte s'applique aux erreurs de droit susceptibles d'être isolées (comme l'application du mauvais principe) parce que, dans ce cas aussi, un contrôle selon la norme de la décision correcte est nécessaire pour permettre aux cours d'appel de jouer leur rôle. Par contre, lorsqu'il est « difficile de départager les questions de droit et les questions de fait », les cours d'appel font preuve de déférence à l'égard des questions mixtes de fait et de droit (*Housen*, par. 36; voir aussi par. 33-35).

[37] Dans bien des cas, les cours d'appel n'ont pas besoin de procéder à un examen de l'interprétation contractuelle *en soi* selon la norme de la décision correcte pour s'acquitter de leurs fonctions — qui consistent à veiller à l'application uniforme du droit et à sa réforme — et ce, parce que l'interprétation d'un contrat donné n'a généralement d'incidence que sur les parties au litige. Comme l'a fait observer le juge Rothstein dans *Sattva*, par. 52 :

> . . . la Cour dans l'arrêt *Housen* conclut que la retenue à l'égard du juge des faits contribue à réduire le nombre, la durée et le coût des appels tout en favorisant l'autonomie du procès et son intégrité (par. 16-17). Ces principes militent également en faveur de la déférence à l'endroit des décideurs de première instance en matière d'interprétation contractuelle. Les obligations juridiques issues d'un contrat se limitent, dans la plupart des cas, aux intérêts des parties au litige. Le vaste pouvoir de trancher les questions

first instance to resolve issues of limited application, this supports treating contractual interpretation as a question of mixed fact and law.

[38] For the interpretation of many contracts, precedents interpreting similar contractual language may be of some persuasive value. However, it is the intentions of the particular parties, as reflected in the particular contractual wording at issue and informed by the surrounding circumstances of the contract, that predominate, and "[i]f that intention differs from precedent, the intention will govern and the precedent will not be followed": G. R. Hall, *Canadian Contractual Interpretation Law* (3rd ed. 2016), at pp. 129-30; see also *Tenneco Canada Inc. v. British Columbia Hydro and Power Authority*, 1999 BCCA 415, 126 B.C.A.C. 9, at para. 43.

[39] These teachings, however, do not necessarily apply in cases involving standard form contracts, where a review on the standard of correctness may be necessary for appellate courts to fulfill their functions. Standard form contracts are "highly specialized contracts that are sold widely to customers without negotiation of terms": *MacDonald*, at para. 37. In some cases, a single company, such as a bank or a telephone service provider, may use its own standard form contract with all of its customers: *Monk*, at para. 23. In others, a standard form agreement may be common throughout an entire industry: *Precision Plating*, at para. 28. Either way, the interpretation of the standard form contract could affect many people, because "precedent is more likely to be controlling" in the interpretation of such contracts: Hall, at p. 131. It would be undesirable for courts to interpret identical or very similar standard form provisions inconsistently, without good reason. The mandate of appellate courts — "ensuring the consistency of the law" (*Sattva*, at para. 51) — is advanced by permitting appellate courts to review the interpretation of standard form contracts for correctness.

d'application limitée que notre système judiciaire confère aux tribunaux de première instance appuie la proposition selon laquelle l'interprétation contractuelle est une question mixte de fait et de droit.

[38] Pour interpréter de nombreux contrats, on peut recourir aux précédents dans lesquels les tribunaux interprètent un libellé contractuel semblable et leur accorder une certaine valeur persuasive, mais ce sont les intentions des parties en cause exprimées dans le libellé particulier du contrat en litige et considérées à l'aune des circonstances entourant le contrat qui ont préséance; ainsi, [TRADUCTION] « [s]i l'intention des parties concernées est différente de celle des parties dans le précédent, c'est l'intention des parties concernées qui compte et le précédent ne sera pas appliqué » (G. R. Hall, *Canadian Contractual Interpretation Law* (3e éd. 2016), p. 129-130; voir aussi *Tenneco Canada Inc. c. British Columbia Hydro and Power Authority*, 1999 BCCA 415, 126 B.C.A.C. 9, par. 43).

[39] Ces enseignements ne valent toutefois pas nécessairement pour les contrats types, à l'égard desquels un contrôle selon la norme de la décision correcte peut être requis pour que les cours d'appel puissent s'acquitter de leurs fonctions. Les contrats types sont [TRADUCTION] « des contrats hautement spécialisés qui sont largement vendus à des clients sans qu'il y ait négociation des modalités » (*MacDonald*, par. 37). Dans certains cas, une entreprise unique, comme une banque ou un fournisseur de services téléphoniques, peut utiliser son propre contrat type auprès de tous ses clients (*Monk*, par. 23). Dans d'autres cas, un contrat type peut être commun à l'ensemble d'une industrie (*Precision Plating*, par. 28). Dans les deux situations, l'interprétation du contrat type peut toucher de nombreuses personnes, parce que [TRADUCTION] « le précédent est probablement déterminant » pour l'interprétation de tels contrats (Hall, p. 131). Il ne serait pas souhaitable que les cours interprètent différemment des contrats types identiques ou très similaires sans bonne raison. Le rôle des cours d'appel — « assurer la cohérence du droit » (*Sattva*, par. 51) — est servi lorsqu'on leur permet de contrôler l'interprétation d'un contrat type selon la norme de la décision correcte.

[40] Indeed, consistency is particularly important in the interpretation of standard form insurance contracts. In *Co-operators Life Insurance Co. v. Gibbens*, 2009 SCC 59, [2009] 3 S.C.R. 605, at para. 27, Binnie J. recognized that "'courts will normally be reluctant to depart from [authoritative] judicial precedent interpreting the policy in a particular way' . . . where the issue arises subsequently in a similar context, and where the policies are similarly framed", because both insurance companies and customers benefit from "[c]ertainty and predictability". And where an insurance policy is ambiguous, courts "strive to ensure that similar insurance policies are construed consistently": *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, 2010 SCC 33, [2010] 2 S.C.R. 245, at para. 23.

[41] The definition of questions of law — "questions about what the correct legal test is" (*Southam*, at para. 35) — does not preclude classifying some questions of contractual interpretation as questions of law. There is no bright-line distinction between questions of law and those of mixed fact and law. Rather, "the degree of generality (or 'precedential value')" is the key difference between the two types of questions: *Sattva*, at para. 51. As Iacobucci J. stated in *Southam*, at para. 37:

> If a court were to decide that driving at a certain speed on a certain road under certain conditions was negligent, its decision would not have any great value as a precedent. In short, as the level of generality of the challenged proposition approaches utter particularity, the matter approaches pure application, and hence draws nigh to being an unqualified question of mixed law and fact. . . . Of course, it is not easy to say precisely where the line should be drawn; though in most cases it should be sufficiently clear whether the dispute is over a general proposition that might qualify as a principle of law or over a very particular set of circumstances that is not apt to be of much interest to judges and lawyers in the future.

[40] En effet, la constance revêt une importance particulière dans l'interprétation des contrats d'assurance types. Dans *Co-operators Compagnie d'assurance-vie c. Gibbens*, 2009 CSC 59, [2009] 3 R.C.S. 605, par. 27, le juge Binnie a reconnu que « [TRADUCTION] "les tribunaux hésitent habituellement à s'écarter de l'interprétation attribuée à une police dans une décision antérieure [faisant autorité]" [. . .] lorsqu'ils sont saisis de la même question d'interprétation dans un contexte semblable et que les polices ont un libellé analogue », parce que tant les compagnies d'assurance que les clients bénéficient de « [l]a certitude et [de] la prévisibilité ». Par ailleurs, lorsqu'une police d'assurance est ambiguë, les tribunaux « f[ont] en sorte que les polices d'assurance semblables soient interprétées d'une manière uniforme » (*Progressive Homes Ltd. c. Cie canadienne d'assurances générales Lombard*, 2010 CSC 33, [2010] 2 R.C.S. 245, par. 23).

[41] La définition des questions de droit — « [ces questions] concernent la détermination du critère juridique applicable » (*Southam*, par. 35) — ne nous empêche pas de considérer certaines questions d'interprétation contractuelle comme des questions de droit. Il n'y a pas de ligne de démarcation nette entre les questions de droit et les questions mixtes de fait et de droit. C'est plutôt « le degré de généralité (ou "la valeur comme précéden[t]") » qui constitue la principale différence entre ces deux catégories de question (*Sattva*, par. 51). Comme l'a affirmé le juge Iacobucci dans *Southam*, par. 37 :

> Si une cour décidait que le fait d'avoir conduit à une certaine vitesse, sur une route donnée et dans des conditions particulières constituait de la négligence, sa décision aurait peu de valeur comme précédent. Bref, plus le niveau de généralité de la proposition contestée se rapproche de la particularité absolue, plus l'affaire prend le caractère d'une question d'application pure, et s'approche donc d'une question de droit et de fait parfaite. [. . .] Il va de soi qu'il n'est pas facile de dire avec précision où doit être tracée la ligne de démarcation; quoique, dans la plupart des cas, la situation soit suffisamment claire pour permettre de déterminer si le litige porte sur une proposition générale qui peut être qualifiée de principe de droit ou sur un ensemble très particulier de circonstances qui n'est pas susceptible de présenter beaucoup d'intérêt pour les juges et les avocats dans l'avenir.

[42] Contractual interpretation is often the "pure application" of contractual interpretation principles to a unique set of circumstances. In such cases, the interpretation is not "of much interest to judges and lawyers in the future" because of its "utter particularity". These questions of contractual interpretation are appropriately classified as questions of mixed fact and law, as the Court explained in *Sattva*.

[43] However, the interpretation of a standard form contract could very well be of "interest to judges and lawyers in the future". In other words, the interpretation itself has precedential value. The interpretation of a standard form contract can therefore fit under the definition of a "pure question of law", i.e., "questions about what the correct legal test is": *Sattva*, at para. 49; *Southam*, at para. 35. Establishing the proper interpretation of a standard form contract amounts to establishing the "correct legal test", as the interpretation may be applied in future cases involving identical or similarly worded provisions.

[44] My colleague Cromwell J. suggests that the interpretation of a standard form contract will not be of much precedential value because "its application in other cases will ultimately be decided on a case-by-case basis in light of the particular circumstances of the particular case" (para. 120). I respectfully disagree. Settling on a consistent interpretation of a standard form provision is useful. Of course, the result of applying the interpretation in future cases will depend on the facts of those cases. The facts are for the trial judge to find, and those findings will be owed deference.

[45] For instance, in this case, the Court of Appeal interpreted the Exclusion Clause as excluding damages physically or systemically connected to the faulty work. For the reasons I will give below, I am of the view that the Exclusion Clause excludes only the cost of redoing the faulty work. These are two different interpretations of the same standard form language. Selecting one interpretation over the other as correct will give parties certainty and

[42] L'interprétation contractuelle participe souvent de l'« application pure » des principes d'interprétation contractuelle à un ensemble unique de circonstances. Dans ces cas, l'interprétation ne présente pas « beaucoup d'intérêt pour les juges et les avocats dans l'avenir » en raison de sa « particularité absolue ». Ces questions d'interprétation contractuelle sont classées à bon droit dans la catégorie des questions mixtes de fait et de droit, comme l'explique la Cour dans *Sattva*.

[43] Or, l'interprétation d'un contrat type pourrait fort bien présenter de l'« intérêt pour les juges et les avocats dans l'avenir ». Autrement dit, l'interprétation en soi a valeur de précédent. L'interprétation d'un contrat type peut donc correspondre à la définition de « pure question de droit », c.-à-d. une « questio[n] [. . .] "concern[ant] la détermination du critère juridique applicable" » (*Sattva*, par. 49; *Southam*, par. 35). Établir la juste interprétation d'un contrat type revient à établir le « bon critère juridique », puisque cette interprétation peut être appliquée dans l'avenir à des dispositions identiques ou formulées de façon semblable.

[44] D'après mon collègue le juge Cromwell, l'interprétation d'un contrat type n'a pas une grande valeur de précédent car « les tribunaux décideront [. . .] de son application en dernière analyse au cas par cas à la lumière des circonstances propres à chaque affaire » (par. 120). Soit dit en tout respect, je ne suis pas d'accord. Il est utile de s'entendre sur une interprétation constante d'une clause type. Bien sûr, le résultat de l'application de l'interprétation dans des affaires à venir dépendra des faits de celles-ci. Il revient au juge de première instance d'établir les faits et ses conclusions de fait commanderont la déférence.

[45] À titre d'exemple, en l'espèce, la Cour d'appel a jugé que la clause d'exclusion vise les dommages connexes, sur le plan matériel ou systémique, à la malfaçon. Pour les motifs exposés ci-dessous, j'estime que la clause d'exclusion vise seulement le coût de la nouvelle exécution du travail déficient. Il s'agit là de deux interprétations différentes d'une même disposition type. Le fait de retenir une interprétation aux dépens de l'autre assurera une certitude

predictability. This is true even though what constitutes the cost of redoing the faulty work will depend on the facts of future cases.

(3) Conclusion on Standard of Review

[46] *Sattva* should not be read as holding that contractual interpretation is always a question of mixed fact and law, and always owed deference on appeal. I would recognize an exception to *Sattva*'s holding on the standard of review of contractual interpretation. Where, like here, the appeal involves the interpretation of a standard form contract, the interpretation at issue is of precedential value, and there is no meaningful factual matrix specific to the particular parties to assist the interpretation process, this interpretation is better characterized as a question of law subject to correctness review.

[47] These criteria are met in the present case, so the standard of review applicable to the trial judge's interpretation of the Policy is correctness. The trial judge's underlying factual findings remain subject to deferential review, as mentioned above.

[48] Depending on the circumstances, however, the interpretation of a standard form contract may be a question of mixed fact and law, subject to deferential review on appeal. For instance, deference will be warranted if the factual matrix of a standard form contract that is specific to the particular parties assists in the interpretation. Deference will also be warranted if the parties negotiated and modified what was initially a standard form contract, because the interpretation will likely be of little or no precedential value. There may be other cases where deferential review remains appropriate. As Iacobucci J. recognized in *Southam*, the line between questions of law and those of mixed fact and law is not always easily drawn. Appellate courts should consider

et une prévisibilité aux parties. Cela vaut même si ce qui constitue le coût de la nouvelle exécution du travail défectueux dépendra des faits des affaires à venir.

(3) Conclusion sur la norme de contrôle

[46] L'arrêt *Sattva* ne devrait pas être interprété comme prescrivant que l'interprétation d'un contrat est toujours une question mixte de fait et de droit, et qu'il faut toujours faire montre de déférence envers cette interprétation en appel. Je suis d'avis de reconnaître une exception à la conclusion de *Sattva* sur la norme de contrôle applicable en matière d'interprétation contractuelle. Lorsque, comme en l'espèce, l'appel porte sur l'interprétation d'un contrat type, que l'interprétation en litige a valeur de précédent et que l'exercice d'interprétation ne repose sur aucun fondement factuel significatif qui est propre aux parties concernées, il est plus juste de dire que cette interprétation constitue une question de droit assujettie à un contrôle selon la norme de la décision correcte.

[47] Ces conditions sont satisfaites en l'espèce, de sorte que la norme de contrôle applicable à l'interprétation de la police retenue par le juge de première instance est celle de la décision correcte. Comme je l'ai déjà mentionné, les conclusions de fait sous-jacentes tirées par le juge de première instance doivent toujours faire l'objet d'un contrôle empreint de déférence.

[48] Toutefois, selon les circonstances, l'interprétation d'un contrat type peut être une question mixte de fait et de droit devant faire l'objet d'un contrôle empreint de déférence en appel. À titre d'exemple, la déférence est justifiée si le fondement factuel d'un contrat type qui est propre aux parties concernées aide à l'interpréter. La déférence est aussi justifiée si les parties ont négocié et modifié ce qui était au départ un contrat type, parce que l'interprétation n'aura probablement que peu ou pas de valeur comme précédent. Il peut y avoir d'autres cas où le contrôle empreint de déférence reste de mise. Comme l'a reconnu le juge Iacobucci dans *Southam*, il n'est pas toujours facile de tracer la ligne entre les questions de droit et les questions mixtes de fait et de droit.

whether "the dispute is over a general proposition" or "a very particular set of circumstances that is not apt to be of much interest to judges and lawyers in the future" (para. 37).

B. *The Exclusion Clause*

(1) Rules Governing the Interpretation of the Policy

[49] The parties agree that the governing principles of interpretation applicable to insurance policies are those summarized by Rothstein J. in *Progressive Homes*. The primary interpretive principle is that where the language of the insurance policy is unambiguous, effect should be given to that clear language, reading the contract as a whole: para. 22, citing *Non-Marine Underwriters, Lloyd's of London v. Scalera*, 2000 SCC 24, [2000] 1 S.C.R. 551, at para. 71.

[50] Where, however, the policy's language is ambiguous, general rules of contract construction must be employed to resolve that ambiguity. These rules include that the interpretation should be consistent with the reasonable expectations of the parties, as long as that interpretation is supported by the language of the policy; it should not give rise to results that are unrealistic or that the parties would not have contemplated in the commercial atmosphere in which the insurance policy was contracted, and it should be consistent with the interpretations of similar insurance policies. See *Progressive Homes*, at para. 23, citing *Scalera*, at para. 71; *Gibbens*, at paras. 26-27; and *Consolidated-Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888, at pp. 900-902.

[51] Only if ambiguity still remains after the above principles are applied can the *contra proferentem* rule be employed to construe the policy against the insurer: *Progressive Homes*, at para. 24, citing *Scalera*, at para. 70; *Gibbens*, at para. 25; and *Consolidated-Bathurst*, at pp. 899-901. *Progressive Homes* provides that a corollary of this rule is that

Les cours d'appel devraient se demander si « le litige porte sur une proposition générale » ou « sur un ensemble très particulier de circonstances qui n'est pas susceptible de présenter beaucoup d'intérêt pour les juges et les avocats dans l'avenir » (par. 37).

B. *La clause d'exclusion*

(1) Les règles régissant l'interprétation de la police

[49] Les parties s'entendent pour dire que les principes d'interprétation des polices d'assurance sont ceux qu'a résumés le juge Rothstein dans *Progressive Homes*. Selon le premier principe d'interprétation, lorsque le texte de la police n'est pas ambigu, le tribunal doit donner effet à ce texte clair et considérer le contrat dans son ensemble (par. 22, citant *Non-Marine Underwriters, Lloyd's of London c. Scalera*, 2000 CSC 24, [2000] 1 R.C.S. 551, par. 71).

[50] Toutefois, lorsque le texte de la police est ambigu, on doit recourir aux règles générales d'interprétation des contrats pour résoudre cette ambiguïté, entre autres : retenir une interprétation conforme aux attentes raisonnables des parties, pourvu que le texte de la police étaie cette interprétation; éviter une interprétation qui aboutirait à un résultat irréaliste ou que n'auraient pas envisagé les parties dans le climat commercial où la police d'assurance a été contractée; l'interprétation retenue doit s'accorder avec celles des polices d'assurance semblables. Voir *Progressive Homes*, par. 23, citant *Scalera*, par. 71; *Gibbens*, par. 26-27; *Exportations Consolidated Bathurst Ltée c. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 R.C.S. 888, p. 900-902.

[51] Ce n'est que s'il subsiste une ambiguïté après l'application des principes susmentionnés que les tribunaux peuvent recourir à la règle *contra proferentem* pour interpréter la police contre l'assureur (*Progressive Homes*, par. 24, citant *Scalera*, par. 70; *Gibbens*, par. 25; et *Consolidated Bathurst*, p. 899-901. Selon *Progressive Homes*, le corollaire de cette

coverage provisions in insurance policies are interpreted broadly, and exclusion clauses narrowly.

[52] It is also important to bear in mind this Court's guidance in *Progressive Homes* on the "generally advisable" order in which to interpret insurance policies (para. 28). Although that case involved commercial general liability policies and not builders' risk policies, the two types of policies share a similar alternating structure: they set out the type of coverage followed by specific exclusions, with some exclusions containing exceptions. As such, the insured has the onus of first establishing that the damage or loss claimed falls within the initial grant of coverage. The parties in these appeals have conceded that this particular onus has been met: trial judge's reasons, at para. 9. The onus then shifts to the insurer to establish that one of the exclusions to coverage applies. If the insurer is successful at this stage, the onus then shifts back to the insured to prove that an exception to the exclusion applies: see *Progressive Homes*, at paras. 26-29 and 51. Contrary to the Court of Appeal's statement at para. 26 of its reasons that the exclusion and exception in this case must be interpreted "symbiotically", I see no reason to depart from the generally accepted order of interpretation in analyzing the Policy and the Exclusion Clause.

(2) The Court of Appeal's Approach to the Exclusion Clause

[53] Before engaging in the interpretation of the Exclusion Clause, I believe it necessary to properly set out the Court of Appeal's reasoning and explain why its new physical or systemic connectedness test was unnecessary.

[54] At paras. 29 and 48 of its reasons, the Court of Appeal explained that because the base coverage under clause 2 of the Policy is for "physical loss

règle est que les dispositions relatives à la garantie dans les polices d'assurance doivent recevoir une interprétation large, et les clauses d'exclusion, une interprétation étroite.

[52] Il importe également de garder à l'esprit les indications données par notre Cour dans *Progressive Homes* quant à l'ordre « généralement recommandé » pour l'interprétation des polices d'assurance (par. 28). L'affaire *Progressive Homes* concernait des polices d'assurance de responsabilité civile des entreprises et non des polices d'assurance chantier, mais les deux types de police partagent la même structure alternative, en ce sens qu'elles prévoient le type de garantie puis des exclusions précises, et certaines exclusions comportent des exceptions. En conséquence, l'assuré a le fardeau d'établir en premier lieu que le dommage ou la perte faisant l'objet de la réclamation relevait de la garantie initiale. Les parties aux présents pourvois ont concédé que les assurées s'étaient acquittées de ce fardeau (motifs du juge de première instance, par. 9). Il y a alors déplacement du fardeau de la preuve et l'assureur doit établir que l'une des exclusions de la garantie s'applique. S'il y parvient, le fardeau de la preuve se déplace à nouveau et il incombe à l'assuré de prouver qu'une exception à l'exclusion s'applique (voir *Progressive Homes*, par. 26-29 et 51). Contrairement à l'affirmation de la Cour d'appel au par. 26 de ses motifs selon laquelle l'exclusion et l'exception en l'espèce doivent être interprétées [TRADUCTION] « en symbiose », je ne vois aucune raison de déroger à l'ordre d'interprétation généralement reconnu pour analyser la police et la clause d'exclusion.

(2) La façon dont la Cour d'appel a abordé la clause d'exclusion

[53] Avant de procéder à l'interprétation de la clause d'exclusion, je crois qu'il est nécessaire de bien situer le raisonnement de la Cour d'appel et d'expliquer pourquoi son nouveau critère de connexité matérielle ou systémique était inutile.

[54] Aux paragraphes 29 et 48 de ses motifs, la Cour d'appel a expliqué que la clause d'exclusion doit soustraire à la garantie certaines pertes

or damage", it follows that the Exclusion Clause needs to exclude from coverage some physical loss. In the Court of Appeal's opinion, a different reading of the Exclusion Clause would risk rendering it redundant. Under this view, the "cost of making good faulty workmanship" cannot be limited to the cost of redoing the faulty work. Rather, that exclusion must be construed more broadly to also exclude from coverage some type of physical loss or damage.

[55] As mentioned above, the Court of Appeal's acceptance of this initial premise led it to search for a dividing line between physical damage that is part of the "cost of making good" and therefore excluded from coverage, and physical damage that is "resulting damage" and therefore covered as an exception to the exclusion. In its quest to establish this dividing line, the court fashioned a new test of "degree of physical or systemic connectedness", which it said was "the key to determining the boundary between 'making good faulty workmanship' and 'resulting damage'": para. 50.

[56] In my respectful view, the premise from which the Court of Appeal proceeded is flawed. The "faulty workmanship" exclusion need not encompass physical damage. Although "[e]xclusions should . . . be read in light of the initial grant of coverage" (*Progressive Homes*, at para. 27; see also M. G. Lichty and M. B. Snowden, *Annotated Commercial General Liability Policy* (loose-leaf), at p. 1-10), this Court has stressed that "perfect mutual exclusivity [between exclusions and the initial grant of coverage] in an insurance contract is not required": *Progressive Homes*, at para. 40.

[57] Bearing the above-mentioned principle in mind, the Policy in this case contains exclusions that do not pertain to "physical loss or damage" otherwise covered under clause 2. For instance, clause 4(A)(a) of the Policy excludes from coverage "[a]ny loss of use or occupancy or consequential loss of any nature howsoever caused including penalties for non-completion of or delay in completion of contract

matérielles parce que la garantie de base prévue à la clause 2 de la police vise les « perte ou [. . .] dommages matériels ». Selon la Cour d'appel, toute autre interprétation de la clause d'exclusion risquerait de rendre cette disposition redondante. D'après ce point de vue, les « frais engagés pour remédier à une malfaçon » ne peuvent se limiter au coût de la nouvelle exécution du travail défectueux; ils doivent plutôt être interprétés plus largement de manière à exclure également de la garantie certains types de perte ou de dommages matériels.

[55] Comme je l'ai mentionné précédemment, l'acceptation de cette prémisse initiale par la Cour d'appel a amené cette dernière à chercher une ligne de démarcation entre les dommages matériels qui relèvent des « frais engagés pour remédier à une malfaçon » et qui sont exclus par le fait même de la garantie et les dommages matériels assimilables à des « dommages [. . .] découlant » de la malfaçon, couverts à titre d'exception à l'exclusion. En tentant d'établir cette ligne de démarcation, la cour a conçu un nouveau critère de [TRADUCTION] « degré de connexité matérielle ou systémique[,] la clé pour fixer la limite entre la "réparation d'une malfaçon" et les "dommages en découlant" » (par. 50).

[56] À mon humble avis, la prémisse de la Cour d'appel est erronée. L'exclusion relative à la « malfaçon » n'a pas besoin d'englober des dommages matériels. Bien que les exclusions « doivent [. . .] être lues à la lumière de la protection initiale » (*Progressive Homes*, par. 27; voir aussi M. G. Lichty et M. B. Snowden, *Annotated Commercial General Liability Policy* (feuilles mobiles), p. 1-10), notre Cour a souligné qu'une « exclusivité mutuelle parfaite [entre des exclusions et la protection initiale] n['est] pas obligatoire dans un contrat d'assurance » (*Progressive Homes*, par. 40).

[57] Compte tenu du principe susmentionné, la police en l'espèce contient des exclusions qui ne touchent pas les « perte ou [. . .] dommages matériels » autrement couverts aux termes de la clause 2. À titre d'exemple, la clause 4(A)a) de la police soustrait à la garantie « [l]a perte d'usage ou d'occupation ou perte indirecte de quelque nature que ce soit, y compris les pénalités pour non-exécution

or non-compliance with contract conditions". This exclusion deals with a form of pure economic loss stemming from contractual breach, not physical loss or damage. Additionally, clause 28 of the "standard conditions" section excludes "costs, fines, penalties or expenses" imposed by governments under environmental legislation. This also does not relate to the Policy's base coverage for physical loss or damage.

[58] As such, perfect mutual exclusivity is neither provided for under the Policy nor should it be required when interpreting the Exclusion Clause. The Court of Appeal consequently erred by approaching its analysis of the Exclusion Clause from a premise that was not supported by the text of the Exclusion Clause or the Policy as a whole. Adopting this premise led the Court of Appeal down an improper analytical path toward establishing a new and unnecessary test. Indeed, as I will explain below, the general rules of contractual interpretation provide the answer to whether the damage to the Tower's windows is covered under the Policy.

(3) Interpretation of the Exclusion Clause and the Policy

(a) *The Language of the Exclusion Clause Is Ambiguous*

[59] The Insureds argue that the plain language of the Exclusion Clause, read in the context of the Policy as a whole, is unambiguous. They say it leads to the conclusion that only the cost of redoing the faulty work — in this case, cleaning the windows — is excluded from coverage. The consequences of the faulty work — here, the damage to the windows, necessitating their replacement — are covered as "resulting damage".

du contrat, retard dans l'exécution du contrat ou non-respect des conditions du contrat ». Cette exclusion porte sur une forme de perte purement financière découlant de la violation du contrat, et non sur les pertes ou dommages matériels. En outre, la clause 28 de la section concernant les [TRADUCTION] « conditions types » exclut les « frais, amendes, pénalités ou dépenses » imposés par les gouvernements en vertu des lois environnementales. Cette exclusion ne se rapporte pas non plus à la garantie de base prévue par la police en cas de perte ou de dommages matériels.

[58] En conséquence, l'exclusivité mutuelle parfaite n'est pas prévue dans la police et ne devrait pas non plus être requise lorsqu'il s'agit d'interpréter la clause d'exclusion. La Cour d'appel a donc commis une erreur en faisant reposer son analyse de la clause d'exclusion sur une prémisse qui n'était étayée ni par le texte de la clause d'exclusion ni par la police dans son ensemble. En adoptant cette prémisse, la Cour d'appel s'est engagée dans un cheminement analytique vicié qui l'a menée à établir un nouveau critère inutile. En fait, comme je l'expliquerai plus loin, les règles générales d'interprétation contractuelle fournissent la réponse à la question de savoir si les dommages causés aux fenêtres de la Tour sont couverts par la police.

(3) Interprétation de la clause d'exclusion et de la police

a) *Le texte de la clause d'exclusion est ambigu*

[59] Les assurées prétendent que le texte clair de la clause d'exclusion, considéré dans le contexte de l'ensemble de la police, n'est pas ambigu. Selon elles, il mène à la conclusion que seul le coût de la nouvelle exécution du travail défectueux, en l'occurrence le nettoyage des fenêtres, est exclu de la garantie. Les conséquences de la malfaçon, en l'occurrence les dommages causés aux fenêtres en raison desquels celles-ci ont dû être remplacées, sont couvertes en tant que « dommages [. . .] découlant » de la malfaçon.

[60] The Insurers similarly argue that the Exclusion Clause is unambiguous, yet they arrive at a different conclusion as to its meaning. They say that which is excluded is not only the cost of redoing the faulty work, but also the cost of repairing that part of the insured property or project that is the subject of the faulty work. That which is covered as "resulting damage" is consequential damage to some other part of the insured property or project. They point to the case law in support, contending that the courts have consistently interpreted the language of the Exclusion Clause to bear this meaning. Accordingly, in this case, the Insurers say the Policy excludes both the cost of recleaning the windows and the cost of replacing the windows, the subject of the faulty work.

[61] I am of the view that the language of the Exclusion Clause slightly favours the interpretation advanced by the Insureds, but is nonetheless ambiguous. The word "damage" figures only in the exception to the Exclusion Clause; it is not included in the language setting out the exclusion itself, i.e., the "cost of making good faulty workmanship". As such, "making good faulty workmanship" can, on its plain, ordinary and popular meaning, be construed as redoing the faulty work, and "resulting damage" can be seen as including damages resulting from such faulty work.

[62] That said, the language of the Exclusion Clause does not clearly point to one interpretation of "cost of making good faulty workmanship" and "resulting damage" over the other. The Policy does not define these terms. The general coverage provisions, clauses 1 and 2, do not resolve the ambiguity, and neither do the other provisions in the Policy.

[63] Therefore, we must look to the general principles of contract interpretation. As I will detail below, the application of these principles points to one interpretation that is consistent with the reasonable expectations of the parties and commercial reality: the faulty workmanship exclusion serves to exclude from coverage only the cost of redoing the faulty

[60] Les assureurs prétendent eux aussi que la clause d'exclusion n'est pas ambiguë. Or, ils arrivent à une conclusion différente sur sa signification. Selon eux, ce qui est exclu est non seulement le coût de la nouvelle exécution du travail défectueux, mais aussi le coût de la réparation de la partie du bien ou du projet assuré qui est touchée par la malfaçon. Ainsi, ce qui est couvert à titre de « dommages en découlant », ce sont les dommages indirects qui ont été causés à une autre partie du bien ou du projet assuré. Ils invoquent à l'appui la jurisprudence, faisant valoir que les tribunaux ont toujours attribué ce sens au texte de la clause d'exclusion. En conséquence, dans la présente affaire, les assureurs disent que la police exclut à la fois le coût du nouveau nettoyage des fenêtres et le coût de remplacement de ces fenêtres, qui faisaient l'objet de la malfaçon.

[61] Je suis d'avis que le texte de la clause d'exclusion milite légèrement en faveur de l'interprétation proposée par les assurées, mais qu'il est néanmoins ambigu. Le mot « dommages » ne figure que dans l'exception à la clause d'exclusion; il ne fait pas partie des mots énonçant l'exclusion elle-même, soit les « frais engagés pour remédier à une malfaçon ». Voilà pourquoi les termes « remédier à une malfaçon » peuvent, selon leur sens ordinaire et courant, être interprétés comme voulant dire la nouvelle exécution du travail déficient, et « dommages en découlant », comme les dommages découlant de cette malfaçon.

[62] Cela dit, le texte de la clause d'exclusion ne favorise pas clairement une interprétation des termes « frais engagés pour remédier à une malfaçon » et « dommages en découlant » au détriment de l'autre. La police ne définit pas ces expressions. Les dispositions générales relatives à la garantie, les clauses 1 et 2, ne dissipent pas l'ambiguïté, pas plus que les autres dispositions de la police.

[63] En conséquence, nous devons nous reporter aux principes généraux d'interprétation des contrats. Comme je l'expliquerai en détail plus loin, l'application de ces principes mène à une interprétation conforme aux attentes raisonnables des parties et à la réalité commerciale : l'exclusion relative à la malfaçon sert à exclure de la garantie uniquement le coût

work, as the resulting damage exception covers costs or damages apart from the cost of redoing the faulty work. As such, excluded under the Policy is the cost of recleaning the windows, but the damage to the windows and therefore the cost of their replacement is covered. This is consistent with previous interpretations of similar clauses in the jurisprudence. Indeed, as I explain below, I disagree with the Insurers' contention that the case law consistently supports their interpretation of the Exclusion Clause.

[64] In light of this determination, it is not necessary to turn to the *contra proferentem* rule to answer the second issue raised in these appeals.

(b) *Reasonable Expectations of the Parties*

[65] Parties' reasonable expectations with respect to the meaning of a contractual provision can often be gleaned from the circumstances surrounding the contract's formation: *Sattva*, at paras. 46-47. However, as discussed above, there is no factual matrix here that would assist in ascertaining the parties' understanding of and intent regarding the Exclusion Clause. The Policy is a standard form contract. And, as the Court of Appeal noted at para. 15 of its reasons, there is no evidence that the parties gave any thought to the cleaning of the windows, the relationship of faulty workmanship to resulting damage, or anything else that would help in determining their reasonable expectations.

[66] Therefore, in my view, the purpose behind builders' risk policies is crucial in determining the parties' reasonable expectations as to the meaning of the Exclusion Clause. In a nutshell, the purpose of these polices is to provide broad coverage for construction projects, which are singularly susceptible to accidents and errors. This broad coverage — in exchange for relatively high premiums — provides certainty, stability, and peace of mind. It ensures construction projects do not grind to a halt because of

de la nouvelle exécution du travail défectueux, alors que l'exception relative aux « dommages en découlant » vise les coûts ou dommages autres que le coût de la nouvelle exécution du travail défectueux. En conséquence, est exclu aux termes de la police le coût du nouveau nettoyage des fenêtres, mais les dommages causés aux fenêtres, et donc le coût de leur remplacement, sont couverts. Cette interprétation s'accorde avec celles données à des clauses similaires dans la jurisprudence. En fait, comme je l'expliquerai ci-après, je ne suis pas d'accord avec l'affirmation des assureurs selon laquelle les tribunaux ont toujours interprété la clause d'exclusion de la même façon qu'eux.

[64] Vu cette conclusion, il n'est pas nécessaire de recourir à la règle *contra proferentem* pour répondre à la deuxième question soulevée dans les présents pourvois.

b) *Attentes raisonnables des parties*

[65] Les attentes raisonnables des parties en ce qui concerne la signification d'une disposition contractuelle peuvent souvent être dégagées des circonstances de la formation du contrat (*Sattva*, par. 46-47). Toutefois, comme nous l'avons vu dans l'analyse de la norme de contrôle, il n'y a pas de fondement factuel en l'espèce qui pourrait nous aider à cerner la conception qu'ont les parties de la clause d'exclusion et de leur intention à son égard. La police est un contrat type. En outre, comme la Cour d'appel l'a indiqué au par. 15 de ses motifs, rien ne prouve que les parties ont songé au nettoyage des fenêtres, au lien entre une malfaçon et les dommages en découlant ou à quoi que ce soit d'autre qui aiderait à établir leurs attentes raisonnables.

[66] En conséquence, j'estime que l'objet sous-jacent des polices d'assurance chantier est crucial pour déterminer les attentes raisonnables des parties en ce qui concerne la signification de la clause d'exclusion. En résumé, ces polices visent à offrir une large garantie pour les projets de construction, qui sont particulièrement vulnérables aux accidents et aux erreurs. Cette large garantie — offerte en échange de primes relativement élevées — confère aux assurés certitude, stabilité et tranquillité

disputes and potential litigation about liability for replacement or repair amongst the various contractors involved. In my view, the purpose of broad coverage in the construction context is furthered by an interpretation of the Exclusion Clause that excludes from coverage only the cost of redoing the faulty work itself — in this case, the cost of recleaning the windows.

[67] "The *raison d'être* of insurance is coverage": D. Boivin, *Insurance Law* (2nd ed. 2015), at p. 288. The purpose of builders' risk policies in particular is to offer broad coverage, which benefits both insureds and insurers:

> Urbanization and industrialization in the past 100 years have made the concept of an insurance policy covering all conceivable risks advantageous to both insureds and their insurers. The insured benefits from the extensive nature and scope of the coverage, and insurers benefit from the economies of managing and marketing a policy which, in terms of its scope, has certainty. For these reasons, the "all risk policy," which creates a special type of coverage extending to many risks not customarily covered under other types of insurance policies, is attractive to both the insurance industry and consumers.

(E. A. Dolden, "All Risk and Builders' Risk Policies: Emerging Trends" (1990-91), 2 *C.I.L.R.* 341, at pp. 341-42)

[68] This Court stated in *Commonwealth Construction Co. v. Imperial Oil Ltd.*, [1978] 1 S.C.R. 317, that the purpose of builders' risk policies is to provide certainty and stability by granting coverage that reduces the need for private law litigation. The Court also recognized the complexity of industrial life and large-scale construction projects that involve many different individual contractors:

d'esprit. Elle évite que les projets de construction se retrouvent paralysés par des différends ou des actions en justice éventuelles sur la question de savoir qui, parmi les divers entrepreneurs participant aux travaux, est responsable du remplacement ou de la réparation découlant de la malfaçon. À mon avis, une interprétation de la clause d'exclusion qui soustrait à la garantie uniquement le coût, en soi, de la nouvelle exécution du travail défectueux — en l'occurrence le coût du nouveau nettoyage des fenêtres — favorise la réalisation de l'objectif d'une garantie d'assurance large dans le contexte du droit de la construction.

[67] [TRADUCTION] « La raison d'être de l'assurance est de conférer une protection » (D. Boivin, *Insurance Law* (2e éd. 2015), p. 288). L'objectif des polices d'assurance chantier en particulier est d'offrir une large garantie, qui bénéficie tant aux assurés qu'aux assureurs :

> [TRADUCTION] L'urbanisation et l'industrialisation des 100 dernières années ont rendu l'idée d'une police d'assurance couvrant tous les risques concevables avantageuse pour les assurés comme pour leurs assureurs. Les assurés bénéficient de la grande étendue de la garantie, et les assureurs, des économies résultant de la gestion et de la commercialisation d'une police qui confère une certitude quant à sa portée. Pour ces raisons, la « police tous risques », qui crée un type de garantie s'étendant à de nombreux risques qui ne sont pas habituellement couverts par d'autres types de police d'assurance, est intéressante tant pour l'industrie des assurances que pour les consommateurs.

(E. A. Dolden, « All Risk and Builders' Risk Policies : Emerging Trends » (1990-91), 2 *C.I.L.R.* 341, p. 341-342)

[68] Dans *Commonwealth Construction Co. c. Imperial Oil Ltd.*, [1978] 1 R.C.S. 317, notre Cour a indiqué que l'objectif des polices d'assurance chantier est de conférer certitude et stabilité en fournissant une garantie qui réduit le besoin de recourir à la justice, vu la complexité de la vie industrielle et des projets de construction à grande échelle qui font intervenir de nombreux entrepreneurs :

As already noted, the multi-peril policy under consideration is called . . . a course of construction insurance. In England, it is usually called a "Contractors' all risks insurance" and in the United States, it is referred to as "Builders' risk policy". Whatever its label, its function is to provide to the owner the promise that the contractors will have the funds to rebuild in case of loss and to the contractors the protection against the crippling cost of starting afresh in such an event, the whole without resort to litigation in case of negligence by anyone connected with the construction, a risk accepted by the insurers at the outset. This purpose recognizes the importance of keeping to a minimum the difficulties that are bound to be created by the large number of participants in a major construction project, the complexity of which needs no demonstration. It also recognizes the realities of industrial life. [p. 328]

Comme je l'ai déjà fait remarquer, la police d'assurance multi-risques en cause est appelée [. . .] une assurance de construction en cours. En Angleterre, ce type d'assurance s'appelle habituellement [TRADUCTION] « une assurance tout risque des entrepreneurs » et aux États-Unis, [TRADUCTION] « une assurance des risques des entrepreneurs en construction ». Quelle que soit son étiquette, son rôle est de fournir au propriétaire la promesse que les entrepreneurs auront les fonds nécessaires pour reconstruire en cas de sinistre et de protéger les entrepreneurs contre le prix désastreux d'un départ à zéro dans une telle éventualité; le tout se fait sans recourir à la justice en cas de négligence de la part d'une personne engagée dans la construction, risque accepté par les assureurs au départ. On reconnaît ainsi l'importance de maintenir au minimum les difficultés qui ne peuvent pas manquer de surgir, vu le grand nombre de participants à un ouvrage important, dont la complexité n'a pas besoin d'être démontrée. Son objet est également en accord avec la réalité de la vie industrielle. [p. 328-329]

[69] Although such policies are said to insure against all risks, this description is not entirely accurate. As a general rule, insurance offers protection only for fortuitous contingent risk: *Progressive Homes*, at para. 45. Moreover, builders' risk policies contain various exclusions, meaning indemnity is precluded in many circumstances of fortuitous loss: Dolden, at pp. 342-44.

[69] Même si l'on soutient que de telles polices protègent contre tous les risques, le terme « tous risques » n'est pas tout à fait exact. En règle générale, l'assurance offre une protection uniquement à l'égard du risque fortuit éventuel (*Progressive Homes*, par. 45). De plus, les polices d'assurance chantier contiennent diverses exclusions. Ainsi, il n'y a pas d'indemnité dans de nombreux cas de perte fortuite (Dolden, p. 342-344).

[70] Despite these qualifiers, builders' risk construction policies are the norm, if not a requirement, on construction sites in Canada. In purchasing these policies, "contractors believe indemnity will be available in the event of an accident or damage on the construction site arising as a result of a party's carelessness or negligent acts", which are *the most common* source of loss on construction sites: Dolden, at pp. 345-46. And, in selling these policies, insurers

[70] Malgré les bémols susmentionnés, les polices d'assurance chantier sont la norme, voire l'exigence, sur les chantiers de construction au Canada. En achetant ces polices, [TRADUCTION] « les entrepreneurs s'attendent à être indemnisés en cas d'accident ou de dommages causés sur le chantier de construction à la suite de l'incurie ou de la négligence d'une partie », source de perte *la plus courante* dans les chantiers (Dolden, p. 345-346). Lorsqu'ils vendent ces polices, les assureurs sont quant à eux

are prepared to insure risks relating to problems caused by faulty . . . workmanship, but they are not prepared to insure the quality of . . . the workmanship in a construction project per se. The argument is that the contractor is responsible for doing [its] job right and the insurance company is not there to provide compensation for

[TRADUCTION] disposés à assurer les risques liés aux problèmes imputables à [. . .] une malfaçon, mais pas à assurer la qualité en tant que telle [. . .] du travail effectué sur un chantier. La prémisse est que l'entrepreneur a la responsabilité de bien faire son travail et la compagnie d'assurance n'a pas pour rôle de fournir une indemnité

inadequate performance by a contractor of the very work the contractor agreed to perform.

(Canadian College of Construction Lawyers, report of the Insurance & Surety Committee, "'Covered for What?': Faulty Materials and Workmanship Coverage under Canadian Construction Insurance Policies" (2007), 1 *J.C.C.C.L.* 101, at p. 104)

Consequently, an interpretation of the Exclusion Clause that precludes from coverage any and all damage resulting from a contractor's faulty workmanship merely because the damage results to that part of the project on which the contractor was working would, in my view, undermine the purpose behind builders' risk policies. It would essentially deprive insureds of the coverage for which they contracted.

[71] In my opinion, therefore, the Insureds' position on the meaning of the Exclusion Clause better reflects and promotes the purpose of builders' risk policies. In the words of this Court in *Commonwealth Construction*, it keeps "to a minimum the difficulties . . . created by the large number of participants in a major construction project" and "recognizes the realities of industrial life" (p. 328). Their position finds additional support in some of this Court's other comments in that case, at pp. 323-24, where it was emphasized that these policies exist to account for the fact that work of different contractors overlaps in a complex construction site and "there is ever present the possibility of damage by one tradesman to the property of another and to the construction as a whole".

[72] Further support for the Insureds' position can be found in commentary contending that all-risk coverage under builders' risk policies was intended to be broad, and the faulty workmanship exclusion narrow. For instance, Maurice G. Audet has discussed the original intent of the exclusion, reviewing the case law as well as annotated insurance policies and manuals: "Part II — Insurance" (2002), 12 C.L.R. (3d) 100; and "All Risks — a promise made or a promise broken?" (1983), 50:10

en cas de mauvaise exécution du travail même que l'entrepreneur s'est engagé à faire.

(Collège canadien des avocats en droit de la construction, rapport du Insurance & Surety Committee, « "Covered for What?" : Faulty Materials and Workmanship Coverage under Canadian Construction Insurance Policies » (2007), 1 *J.C.C.C.L.* 101, p. 104)

En conséquence, une interprétation de la clause d'exclusion qui soustrait à la garantie tous les dommages découlant de la malfaçon de l'entrepreneur simplement parce que les dommages sont causés à la partie du projet sur laquelle l'entrepreneur travaillait minerait, à mon avis, l'objet sous-jacent des polices d'assurance chantier. Une telle interprétation priverait pour ainsi dire les assurés de la garantie à laquelle ils ont souscrit.

[71] Je suis donc d'avis que la thèse des assurées sur le sens de la clause d'exclusion traduit et sert mieux l'objet des polices d'assurance chantier. Pour reprendre les mots employés par notre Cour dans *Commonwealth Construction*, une police d'assurance de cette nature permet de maintenir « au minimum les difficultés qui [. . .] surgi[ssent], vu le grand nombre de participants à un ouvrage important » et est « en accord avec la réalité de la vie industrielle » (p. 328-329). Cette thèse est également appuyée par certaines autres observations aux p. 323-324 de cet arrêt, où notre Cour a souligné que ces polices ont été conçues pour tenir compte du fait que le travail de différents entrepreneurs se chevauche dans un chantier complexe et de « la possibilité [omniprésente] qu'un homme de métier cause un dommage, aux biens d'un autre et à la construction dans son ensemble ».

[72] La thèse des assurées est aussi étayée par la doctrine selon laquelle la garantie d'assurance tous risques fournie par les polices d'assurance chantier se veut large, alors que l'exclusion pour malfaçon se veut étroite. À titre d'exemple, Maurice G. Audet a examiné l'objet initial de l'exclusion et, pour ce faire, il a passé en revue la jurisprudence ainsi que les manuels et polices d'assurance annotés (« Part II — Insurance » (2002), 12 C.L.R. (3d) 100; « All Risks — a promise made or a promise broken? »

Canadian Underwriter 34, at pp. 40-42 and 93-96. He concludes that the faulty workmanship, materials and design exclusion was meant to be narrow, to exclude only the cost of replacing the fault or defect but to provide coverage for damage caused by it.

[73] Other authors have remarked that the trend in the common law jurisprudence interpreting builders' risk policies has been to widen the scope of the above-mentioned exclusion or narrow the ambit of the exception to the exclusion. See e.g. Dolden, at pp. 350 and 358; R. B. Reynolds and S. C. Vogel, *A Guide to Canadian Construction Insurance Law* (2013), at pp. 140 and 150; and P.-S. Poitras, "L'assurance et l'industrie de la construction", in Service de la formation permanente du Barreau du Québec, vol. 147, *Développements récents en droit des assurances* (2001), 181, at p. 195. I would not go so far as to question the jurisprudence. Consistency of interpretation is important, and these judicial interpretations have undoubtedly shaped parties' reasonable expectations with respect to builders' risk policies and their exclusion clauses. I simply note that the interpretation of the Exclusion Clause advanced by the Insureds in these appeals best reflects the original intent of such exclusion clauses, as compared to the interpretation advanced by the Insurers.

[74] It should be mentioned that the service contract between Station Lands and Bristol has no bearing on the reasonable expectations of the parties to the Policy with respect to the meaning of the Exclusion Clause and whether the damage to the windows would be covered. The Insurers and Ledcor were not parties to that service contract, and it was entered into on June 16, 2011, almost three years after the Policy's effective date of June 27, 2008. At most, the service contract could shed light on Station Lands' understanding of the Policy and the Exclusion Clause, as it was a party to both. Still, the service contract was itself based on a slightly modified standard form contract published by the Canadian Construction Association.

(1983), 50:10 *Canadian Underwriter* 34, p. 40-42 et 93-96). Il conclut que l'exclusion visant la malfaçon, les matériaux défectueux et la conception défaillante est censée être étroite, pour n'exclure que le coût de correction de la faute ou du vice mais pour fournir une garantie d'assurance pour les dommages causés par cette faute ou ce vice.

[73] D'autres auteurs ont fait remarquer que la tendance observée dans la jurisprudence de common law sur l'interprétation des polices d'assurance chantier était d'élargir la portée de l'exclusion mentionnée ci-dessus ou de restreindre la portée de l'exception à l'exclusion. Voir p. ex. Dolden, p. 350 et 358; R. B. Reynolds et S. C. Vogel, *A Guide to Canadian Construction Insurance Law* (2013), p. 140 et 150; P.-S. Poitras, « L'assurance et l'industrie de la construction », dans Service de la formation permanente du Barreau du Québec, vol. 147, *Développements récents en droit des assurances* (2001), 181, p. 195. Je n'irais pas jusqu'à remettre en question la jurisprudence. Il est important de maintenir une interprétation constante, et ces interprétations des tribunaux ont sans aucun doute nourri les attentes raisonnables des parties quant aux polices d'assurance chantier et à leurs clauses d'exclusion. Je tiens simplement à ajouter que l'interprétation donnée à la clause d'exclusion par les assurées en l'espèce traduit mieux l'objet initial de ces clauses que l'interprétation proposée par les assureurs.

[74] Il convient de mentionner que le contrat de service conclu entre Station Lands et Bristol n'a aucune incidence sur les attentes raisonnables des parties à la police en ce qui concerne le sens de la clause d'exclusion et la question de savoir si les dommages causés aux fenêtres seraient couverts. Les assureurs et Ledcor n'étaient pas parties à ce contrat de service signé le 16 juin 2011, soit presque trois ans après la prise d'effet de la police, le 27 juin 2008. Le contrat de service peut tout au plus nous éclairer sur la manière dont Station Lands concevait la police et la clause d'exclusion, puisqu'elle était partie tant au contrat de service qu'à la police. Néanmoins, le contrat de service était lui-même fondé sur un contrat type légèrement modifié publié par l'Association canadienne de la construction.

[75] Despite the service contract's irrelevance to the parties' reasonable expectations, at various points in its reasons the Court of Appeal seemed to use it to bolster its interpretation of the Exclusion Clause. For instance, at para. 35, the court determined it was artificial to draw the dividing line between the "cost of making good faulty workmanship" and "resulting damage" as falling between Bristol's work and the work of other contractors, in part because under the service contract Bristol was responsible for repairing damage it did to the work of other contractors. Further, at para. 49, the court highlighted that an interpretation of "making good faulty workmanship" that included redoing the work *and* fixing the damage directly caused by the work was consistent with the service contract, because, again, the contract required Bristol to repair damage it did to the work of other contractors.

[75] Malgré l'absence de pertinence du contrat de service en ce qui a trait aux attentes raisonnables des parties, la Cour d'appel semble y référer à divers endroits dans ses motifs pour appuyer son interprétation de la clause d'exclusion. À titre d'exemple, au par. 35, la cour a conclu qu'il était factice de tracer une ligne de démarcation entre les [TRADUCTION] « frais engagés pour remédier à une malfaçon » et les « dommages en découlant » pour distinguer les travaux accomplis par Bristol des travaux des autres entrepreneurs, étant donné, notamment, que Bristol devait réparer les dommages qu'elle avait causés aux travaux des autres entrepreneurs aux termes du contrat de service. De plus, au par. 49, la cour a souligné qu'une interprétation des mots « remédier à une malfaçon » selon laquelle ils visent la nouvelle exécution du travail *et* la réparation des dommages directement causés par les travaux était compatible avec le contrat de service parce que, là encore, le contrat obligeait Bristol à réparer les dommages qu'elle avait causés aux travaux d'autres entrepreneurs.

[76] Even if the service contract were relevant to the reasonable expectations of the parties to the Policy, there are two other reasons why the Court of Appeal's reliance on it — to the extent that there was such reliance — was problematic. First, a contractor's or subcontractor's stipulated responsibility under its work contract to repair or pay for certain damage does not necessarily preclude coverage under a builders' risk policy, as recognized by this Court in *Commonwealth Construction*, at p. 330. For instance, insurance policies often have deductible amounts. In fact, clause 5 of the Policy provides that the Insurers' liability is limited to the amount by which the loss or damage exceeds the deductible amount, and clause GC 11.1.6 of the service contract provides that Bristol shall be responsible for deductible amounts under the various insurance policies except where such amounts may be excluded from its responsibility by other terms of the contract, including those adverted to by the Court of Appeal. The stipulation in the service contract could thus serve to confirm responsibility for that deductible amount, even where loss or damage is covered under the Policy. In other words, the contract stipulation does not necessarily suggest the parties expected

[76] Même à supposer que le contrat de service soit pertinent relativement aux attentes raisonnables des parties à la police, il existe deux autres raisons pour lesquelles le choix de la Cour d'appel de s'appuyer sur ce document — dans la mesure où elle s'est effectivement appuyée sur celui-ci — posait problème. Premièrement, la responsabilité de réparer ou de payer certains dommages qui est imposée à l'entrepreneur ou au sous-traitant par son contrat de travail n'a pas nécessairement pour effet d'écarter la protection d'une police d'assurance chantier, comme l'a reconnu notre Cour dans *Commonwealth Construction*, p. 330. À titre d'exemple, les polices d'assurance ont souvent des franchises. En effet, la clause 5 de la police prévoit que la responsabilité des assureurs se limite au montant de la perte ou du dommage qui excède la franchise, et la clause GC 11.1.6 du contrat de service prévoit que Bristol est responsable des franchises prévues dans les diverses polices d'assurance, sauf indication contraire dans le contrat, notamment dans les situations mentionnées par la Cour d'appel. La stipulation du contrat de service pourrait donc servir à confirmer la responsabilité pour la franchise, même lorsque la perte ou les dommages sont couverts par la police.

that Bristol would ultimately bear the entire cost of damages it caused to the work of other contractors.

[77] Second, even if the stipulation did indicate such an expectation, the Court of Appeal's new physical and systemic connectedness test does not reflect it. Under the court's new test, and using its language, certain unforeseeable, collateral damage to areas on which Bristol was not working would likely be covered under the resulting damage exception in the Exclusion Clause. Yet Bristol would also be responsible for this damage under the service contract, which makes no such distinction with respect to the foreseeability or remoteness of the damage caused. In effect, there would be dual responsibility for payment, under both the Policy and the service contract, even though, as discussed above, the Court of Appeal stated it would be artificial to draw the dividing line where such dual responsibility would result.

(c) *No Unrealistic Results*

[78] In discussing the interpretation of insurance policies in *Consolidated-Bathurst*, at pp. 901-2, Estey J. stressed the need to avoid interpretations that would bring about unrealistic results or results that the parties would not have contemplated in the commercial atmosphere in which they sold or purchased the policy. The interpretation should respect the intentions of the parties and "their objective in entering into the commercial transaction in the first place", as well as "promot[e] a sensible commercial result" (p. 901). See also *Guarantee Co. of North America v. Gordon Capital Corp.*, [1999] 3 S.C.R. 423, at para. 62, where this Court restated the importance of commercial reality, albeit in a different context. Interpreting the Exclusion Clause to preclude from coverage only the cost of redoing the faulty work aligns with commercial reality and leads to realistic and sensible results, given both the

Autrement dit, la stipulation ne donne pas nécessairement à penser que les parties s'attendaient à ce que Bristol supporte en fin de compte le coût total des dommages qu'elle a causés aux travaux des autres entrepreneurs.

[77] Deuxièmement, même si la stipulation exprimait effectivement une telle attente, le nouveau critère de connexité matérielle et systémique de la Cour d'appel ne la traduit pas. Pour reprendre les termes de la cour, selon ce nouveau critère, certains dommages imprévisibles et indirects causés à des zones où Bristol ne travaillait pas seraient probablement visés par l'exception relative aux « dommages [. . .] découlant » de la malfaçon qui figure à la clause d'exclusion, mais Bristol serait aussi responsable de ces dommages aux termes du contrat de service, qui ne fait pas de telle distinction sur l'imprévisibilité ou sur le caractère éloigné des dommages causés. En effet, il y aurait une double responsabilité pour le paiement — tant aux termes de la police que du contrat de service — même si, comme nous l'avons vu, la Cour d'appel a affirmé qu'il serait factice de tracer une ligne de démarcation lorsqu'une telle double responsabilité pourrait en découler.

c) *Aucun résultat irréaliste*

[78] Dans son analyse concernant l'interprétation des polices d'assurance aux p. 901-902 de *Consolidated Bathurst*, le juge Estey a insisté sur le besoin d'éviter les interprétations qui pourraient entraîner un résultat irréaliste ou un résultat que les parties n'auraient pas envisagé dans le climat commercial dans lequel elles ont vendu ou contracté la police d'assurance. L'interprétation devrait respecter les intentions des parties et le « but pour lequel elles ont à l'origine conclu une opération commerciale » et « favorise[r] un résultat commercial raisonnable » (p. 901). Voir aussi *Guarantee Co. of North America c. Gordon Capital Corp.*, [1999] 3 R.C.S. 423, par. 62, où notre Cour a réaffirmé l'importance de la réalité commerciale, quoique dans un contexte différent. Interpréter la clause d'exclusion pour soustraire à la garantie seulement le coût de la nouvelle exécution du travail défectueux correspond à

purpose underlying builders' risk policies and their spreading of risk on construction projects.

[79] As already discussed above, the interpretation advanced by the Insureds in these appeals best fulfills the broad coverage objective underlying builders' risk policies. These policies are commonplace on construction projects, where multiple contractors work side by side and where damage to their work or the project as a whole commonly arises from faults or defects in workmanship, materials or design. In this commercial reality, a broad scope of coverage creates certainty and economies for both insureds and insurers. In my opinion, it is commercially sensible in this context for only the cost of redoing a contractor's faulty work to be excluded under the faulty workmanship exclusion. Such an interpretation strikes the right balance between the two undesirable extremes described by Estey J. in *Consolidated-Bathurst*, at pp. 901-2: ". . . the courts should be loath to support a construction which would either enable the insurer to pocket the premium without risk or the insured to achieve a recovery which could neither be sensibly sought nor anticipated at the time of the contract". Under the Policy, the Insurers did not undertake to cover the "cost of making good faulty workmanship", but they did promise to cover "physical damage [that] results" from that "faulty workmanship". It can hardly be said that recovery for the damages to the Tower's windows in the circumstances of this case could not have been sensibly sought or anticipated when the Policy was purchased.

[80] Furthermore, such an interpretation does not, in my view, transform the insurance policy into a construction warranty. It does not inappropriately spread risk, nor would it allow or encourage contractors to perform their work improperly or negligently. Importantly, Bristol is precluded from receiving initial payment for its faulty work and

la réalité commerciale et mène à un résultat réaliste et sensé, compte tenu de l'objet qui sous-tend les polices d'assurance chantier et de leur répartition du risque pour les projets de construction.

[79] Comme nous l'avons déjà vu, l'interprétation préconisée par les assurées en l'espèce répond le mieux à l'objectif de garantie d'assurance large qui sous-tend les polices d'assurance chantier. Celles-ci sont monnaie courante dans les projets de construction, où de multiples entrepreneurs travaillent côte à côte et où les dommages causés à leurs travaux ou à l'ensemble du projet découlent généralement d'une malfaçon, de matériaux défectueux ou d'une conception défaillante. Vu cette réalité commerciale, une garantie d'assurance étendue crée une certitude et entraîne des économies tant pour les assurés que pour les assureurs. J'estime que, dans ce contexte, il est sensé sur le plan commercial que seuls soient exclus au titre de l'exclusion relative à la malfaçon les frais engagés pour remédier au travail mal exécuté par l'entrepreneur. Une telle interprétation établit un juste équilibre entre les deux situations extrêmes non souhaitées dont parle le juge Estey dans *Consolidated Bathurst*, p. 901-902 : « . . . les cours devraient être réticentes à appuyer une interprétation qui permettrait soit à l'assureur de toucher une prime sans risque soit à l'assuré d'obtenir une indemnité que l'on n'a pas pu raisonnablement rechercher ni escompter au moment du contrat ». Selon la police, les assureurs ne se sont pas engagés à couvrir « les frais engagés pour remédier à une malfaçon », mais ils ont promis de couvrir les « dommages matériels [qui] découl[ent] » de cette « malfaçon ». On peut difficilement dire que, dans la présente affaire, une indemnisation pour les dommages causés aux fenêtres de la Tour n'aurait pas pu raisonnablement être recherchée ou escomptée lors de l'achat de la police.

[80] En outre, pareille interprétation ne transforme pas à mon sens une police d'assurance en une garantie de construction. Elle ne répartit pas le risque de façon inappropriée ni n'encourage les entrepreneurs à mal exécuter leur travail ou à le faire de manière négligente. Fait important, Bristol ne peut recevoir le paiement initial pour son travail

then receiving further additional payment to repair or replace its faulty work. See C. Brown, *Insurance Law in Canada* (loose-leaf), at p. 20-31; and *Privest Properties Ltd. v. Foundation Co. of Canada Ltd.* (1991), 57 B.C.L.R. (2d) 88 (S.C.). The cost of redoing faulty or improper work is excluded from coverage. The cost can be sizeable; in the instant appeals, for example, Bristol's contract price for cleaning the windows was $45,000.

[81] The Insurers argue that accepting the Insureds' position would tether the application of the resulting damage exception to how the work is divided among various contractors on a project, a result which they say would not make commercial sense. This argument echoes the Court of Appeal's concerns at para. 40 of its reasons:

> This approach might create an incentive to artificially divide up the work as finely as possible, as then the maximum amount of damage would be covered by insurance. On the other hand, it would be dangerous for the owner to hire a single contractor to do all the work, as then nothing would be covered.

[82] With respect, I do not find this persuasive. It is premised on a theoretical concern that does not reflect the commercial reality of construction sites on the ground. In my view, it is unreasonable to expect that the owner of a property or the general contractor on a construction site will divide up work exclusively on the basis of potential coverage under their insurance policy. Many other considerations, such as costs, subcontractor expertise and the risk of delay, will likely be more relevant in deciding how to allocate work.

[83] I also note that interpreting the Exclusion Clause as precluding from coverage only the cost of redoing the faulty work breaks no new ground in the world of insurance, as it mirrors the approach courts have adopted when construing similar exclusions to comprehensive general liability insurance policies. These policies cover the risk that the insured's

mal exécuté, puis recevoir un paiement additionnel pour réparer ou remplacer ce travail. Voir C. Brown, *Insurance Law in Canada* (feuilles mobiles), p. 20-31; *Privest Properties Ltd. c. Foundation Co. of Canada Ltd.* (1991), 57 B.C.L.R. (2d) 88 (C.S.). Le coût de la nouvelle exécution du travail défectueux ou inadéquat n'est pas couvert. Ce coût peut être considérable; dans les présents pourvois, par exemple, le prix du contrat conclu par Bristol pour le nettoyage des fenêtres s'élevait à 45 000 $.

[81] Les assureurs font valoir que si l'on retient la thèse des assurées, cela limiterait l'application de l'exception relative aux dommages découlant de la malfaçon à la manière dont le travail est réparti entre les divers entrepreneurs participant à un projet, un résultat qui n'aurait selon eux aucun sens sur le plan commercial. Cet argument fait écho aux préoccupations exprimées par la Cour d'appel au par. 40 de ses motifs :

> [TRADUCTION] Cette interprétation pourrait inciter à diviser artificiellement au maximum le travail, pour que le montant maximal de dommages soit couvert par l'assurance. En revanche, il serait dangereux pour le propriétaire d'engager un seul entrepreneur pour effectuer tout le travail, parce que rien ne serait alors couvert.

[82] Avec égards, je ne trouve pas cet argument convaincant. Il a pour prémisse une préoccupation théorique qui ne correspond pas à la réalité commerciale des chantiers de construction. À mon avis, il est déraisonnable de s'attendre à ce que le propriétaire d'un bien ou l'entrepreneur général sur un chantier divisent le travail exclusivement en fonction de la garantie d'assurance éventuelle de leur police d'assurance. Bien d'autres considérations, comme les frais, l'expertise des sous-traitants et le risque de retard, sont probablement plus pertinentes pour décider de la répartition du travail.

[83] Je signale également que considérer la clause d'exclusion comme soustrayant à la garantie d'assurance uniquement le coût de la nouvelle exécution du travail défectueux n'a rien de nouveau dans le monde des assurances, puisque cela reflète l'interprétation retenue par les tribunaux à l'égard d'exclusions similaires dans des polices complètes

work might cause bodily injury or property damage. However, they generally contain a "work product" or "business risk" exception, which excludes from coverage the cost of redoing the insured's work: "Covered for What?", at p. 122.

(d) *Ensuring Consistent Interpretation*

[84] The purpose of builders' risk policies and the need to prevent unrealistic results point to an interpretation of the Exclusion Clause that would exclude from coverage only the cost of redoing the cleaning work. Such an interpretation of the Exclusion Clause is also consistent with case law. Though the Court of Appeal stated, at para. 46 of its reasons, that "numerous cases . . . hold that the exclusion is not limited to the cost of re-doing the faulty work, but also extends to the cost of repairing the thing actually being worked on", with respect, I am of the view that many of these faulty workmanship and faulty design decisions can be read as limiting the faulty workmanship exclusion to only the cost of redoing the faulty work. As these cases are highly fact-specific, the results that courts reach will be largely dictated by the particular circumstances of each case. More specifically, whether certain damage falls within the resulting damage exception to the faulty workmanship exclusion will greatly depend on the scope of the contractual obligation pursuant to which the faulty workmanship was carried out.

[85] In the appeals before us, Bristol's obligation under its service contract with Station Lands was limited to cleaning the Tower's windows after they had been properly installed. Redoing Bristol's faulty work did not require Bristol to install windows in good condition. As such, the cost of the windows' replacement represents "resulting damage" and is covered under the Policy. Conversely, if Bristol had been responsible for the windows' installation, and the windows had been damaged in the course of the installation process, the damage done to the windows

d'assurance responsabilité civile générale. Ces polices couvrent le risque que le travail de l'assuré cause des lésions corporelles ou endommage des biens. Toutefois, elles contiennent généralement une exception liée au [TRADUCTION] « fruit du travail » ou au « risque commercial », qui soustrait à la garantie d'assurance les frais engagés par l'assuré pour refaire son travail (« Covered for What? », p. 122).

d) *Assurer une interprétation constante*

[84] L'objectif des polices d'assurance chantier et la nécessité d'éviter les résultats irréalistes mènent à une interprétation de la clause d'exclusion qui soustrairait à la garantie uniquement le coût du nouveau nettoyage. Une telle interprétation de la clause d'exclusion est aussi conforme à la jurisprudence. Bien que la Cour d'appel ait dit, au par. 46 de ses motifs, qu'il [TRADUCTION] « a été jugé dans de nombreuses décisions que l'exclusion ne se limite pas au coût de la nouvelle exécution du travail défectueux et s'étend aussi au coût de la réparation de l'ouvrage en cours d'exécution », à mon humble avis, un grand nombre de ces décisions en matière de malfaçon et de conception défaillante peuvent être interprétées comme limitant l'exclusion relative à la malfaçon au coût de la nouvelle exécution du travail défectueux. Comme ces décisions se fondent en grande partie sur les faits en cause, le résultat auquel parviendront les tribunaux sera largement dicté par les circonstances de chaque affaire. Plus précisément, la question de savoir si certains dommages relèvent de l'exception relative aux dommages découlant de la malfaçon dépendra fortement de la portée de l'obligation contractuelle dont l'acquittement a débouché sur la malfaçon.

[85] Dans les pourvois dont nous sommes saisis, l'obligation imposée à Bristol par le contrat de service qu'elle a conclu avec Station Lands ne consistait qu'à nettoyer les fenêtres de la Tour après que celles-ci eurent été correctement installées. La nouvelle exécution du travail défectueux de Bristol n'obligeait pas cette dernière à installer des fenêtres en bon état. En conséquence, le coût du remplacement des fenêtres représente un « dommage [. . .] découlant » de la malfaçon qui est couvert par la police. À l'inverse, si Bristol avait été responsable

in such circumstances would not have constituted "resulting damage". Indeed, redoing the faulty work would have required installing windows in good condition, as per Bristol's (hypothetical) contractual obligation.

[86] I will now review some of the faulty workmanship cases cited by the Court of Appeal to illustrate how an interpretation that limits the scope of the faulty workmanship exclusion to the cost of redoing the faulty work is consistent with the jurisprudence.

[87] In *Sayers & Associates Ltd. v. Insurance Corp. of Ireland Ltd.* (1981), 126 D.L.R. (3d) 681 (Ont. C.A.), an electrical subcontractor was to install two bus ducts in connection with the construction of an office building in Toronto. Because of the subcontractor's failure to take adequate protective measures, which constituted faulty workmanship, rain water that had come into contact with concrete penetrated the ducts, which in turn caused a malfunction. The subcontractor argued that the damage to the equipment by water was "damage resulting from . . . faulty . . . workmanship" so as to come within the exception to the exclusion. The Ontario Court of Appeal disagreed, writing as follows, at pp. 684-85:

> In the present case the "fault" that underlay the "faulty workmanship" was the failure of the appellant to take protective measures; but by the terms of its contract its "work" was to install the electrical equipment and to keep it dry and clean until the contract was completed. It would be taking too narrow a view of the case to isolate one part of the work from the total contractual obligation. The damage to the equipment was the product of the failure to take protective measures, and so that fault rendered the appellant's performance of its contractual obligations "faulty workmanship". The damage to the ducts and the switching gear was not, therefore, "damage resulting from such faulty . . . workmanship . . .", so as to come within the exception to the exclusion. [Emphasis added.]

de l'installation des fenêtres, et que celles-ci avaient été endommagées lors de leur installation, les dommages causés aux fenêtres dans de telles circonstances n'auraient pas constitué des « dommages [. . .] découlant » de la malfaçon. En fait, la nouvelle exécution du travail défectueux aurait nécessité l'installation de fenêtres en bon état conformément à l'obligation contractuelle (hypothétique) de Bristol.

[86] J'examinerai maintenant certaines des décisions en matière de malfaçon citées par la Cour d'appel pour illustrer comment une interprétation qui limite l'exclusion pour malfaçon au coût de la nouvelle exécution du travail défectueux est conforme à la jurisprudence.

[87] Dans *Sayers & Associates Ltd. c. Insurance Corp. of Ireland Ltd.* (1981), 126 D.L.R. (3d) 681 (C.A. Ont.), un sous-traitant électricien devait installer deux barres sous gaine lors de la construction d'un immeuble à bureaux situé à Toronto. Comme le sous-traitant n'avait pas pris de mesures de protection adéquates, ce qui constituait une malfaçon, de l'eau de pluie qui est entrée en contact avec le béton a pénétré dans les barres, ce qui a causé un mauvais fonctionnement du système. Le sous-traitant a fait valoir que les dommages causés au matériel par l'eau étaient des [TRADUCTION] « dommages découlant d'une malfaçon » et relevaient par le fait même de l'exception à l'exclusion. La Cour d'appel de l'Ontario ne partageait pas cet avis et elle s'est exprimée ainsi aux p. 684-685 :

> [TRADUCTION] En l'espèce, la « faute » qui sous-tend la « malfaçon » était l'omission de la part de l'appelante de prendre des mesures de protection; or, il était stipulé dans son contrat que son « travail » consistait à installer du matériel électrique et à le garder sec et propre jusqu'à la fin du contrat. On interpréterait trop étroitement le contrat si on isolait une partie du travail de l'ensemble de l'obligation contractuelle. Les dommages causés au matériel résultaient de l'absence de mesures de protection et, de ce fait, l'exécution par l'appelante de ses obligations contractuelles constituait une « malfaçon ». Les dommages causés aux conduites et aux appareils de commutation électrique ne constituaient donc pas des « dommages découlant de cette malfaçon » visés par l'exception à l'exclusion. [Je souligne.]

The court's statement is clear: since the subcontractor was contractually required to install the electrical equipment and keep it dry, and its failure to take adequate protective measures resulted in it failing to comply with said contractual obligations, the damage to the equipment could not be considered resulting damage.

[88] In *Ontario Hydro v. Royal Insurance*, [1981] O.J. No. 215 (QL) (H.C.J.), a contractor was responsible for designing a boiler system, acquiring the material and supervising the commissioning of the boiler. After installation, as part of the testing of the boiler system, an acid wash of the superheater and reheater was carried out. But the acid wash was done improperly, ruining the reheater and resulting in extensive cracking of the tubing in the boilers. The contractor argued that the faulty workmanship exclusion served to exclude from coverage only the cost of redoing the wash, and not the cost of replacing the tubing, which it said constituted "resultant damage". The court disagreed, holding that the "cost of making good the improper workmanship is the cost of replacing the tubing which was the object of [the] procedure": para. 37. In my view, the court reached this conclusion because replacing the tubing was necessary for the contractor to fulfill its contractual obligation to design the boiler system, to acquire the material and to supervise the commissioning of the boiler. Thus, the cost of redoing the work encompassed the cost of replacing the tubing.

[89] In *Bird Construction Co. v. United States Fire Insurance Co.* (1985), 24 D.L.R. (4th) 104 (Sask. C.A.), the collapse of a truss, caused by the subcontractor's faulty workmanship in failing to properly erect it, resulted in the subcontractor failing to comply with its contractual obligation to fabricate and erect a truss in good condition. The cost of repairing the truss formed part of the cost of redoing the work, and thus did not fall within the resulting damage exception. The same reading can also be made of *Greene v. Canadian General Insurance Co.* (1995), 133 Nfld. & P.E.I.R. 151 (Nfld. C.A.).

L'énoncé de la cour est clair : comme le sous-traitant était contractuellement tenu d'installer le matériel électrique et de le garder au sec, et que son omission de prendre des mesures de protection adéquates constituait un non-respect de ces obligations contractuelles, les dommages causés au matériel ne pouvaient pas être considérés comme des dommages découlant de la malfaçon.

[88] Dans *Ontario Hydro c. Royal Insurance*, [1981] O.J. No. 215 (QL) (H.C.J.), un entrepreneur avait la responsabilité de concevoir un système de chaudières, d'acheter le matériel et de superviser le démarrage du système. Lors des essais qui ont suivi l'installation, il a procédé au lavage à l'acide du surchauffeur et du resurchauffeur, mais ce lavage a été mal effectué et a endommagé le resurchauffeur, ce qui a entraîné une fissuration importante de la tuyauterie des chaudières. L'entrepreneur a fait valoir que l'exclusion relative à la malfaçon servait à soustraire à la garantie uniquement le coût d'un nouveau lavage, et non le coût de remplacement de la tuyauterie qui, à ses dires, constituait des « dommages [. . .] découlant » de la malfaçon. La cour n'était pas du même avis, jugeant que les [TRADUCTION] « frais engagés pour remédier au travail mal exécuté sont le coût de remplacement de la tuyauterie touchée par la procédure » (par. 37). À mon avis, la cour est parvenue à cette conclusion parce que le remplacement de la tuyauterie était nécessaire pour que l'entrepreneur remplisse son obligation contractuelle de concevoir le système de chaudières, d'acheter le matériel et de superviser le démarrage du système. En conséquence, le coût de la nouvelle exécution du travail comprenait le coût de remplacement de la tuyauterie.

[89] Dans *Bird Construction Co. c. United States Fire Insurance Co.* (1985), 24 D.L.R. (4th) 104 (C.A. Sask.), vu l'effondrement d'une ferme imputable à sa mauvaise installation par le sous-traitant, ce dernier n'a pas respecté son obligation contractuelle de fabriquer et d'installer une ferme en bon état. Le coût de réparation de la ferme faisait partie du coût de la nouvelle exécution du travail et ne relevait donc pas de l'exception relative aux dommages découlant de la malfaçon. L'arrêt *Greene c. Canadian General Insurance Co.* (1995), 133 Nfld. & P.E.I.R. 151 (C.A. T.-N.), va dans le même sens.

[90] Though this interpretation of the resulting damage exception to the faulty workmanship exclusion may, at first glance, seem to run contrary to the interpretation generally given to it by courts in faulty design cases, it is actually consistent with those cases.

[91] It is true that, in faulty design cases, courts generally interpret the resulting damage exception as encompassing damage done to something other than the property which is faultily designed. Such language may thus appear to be more closely in line with the physical or systemic connectedness test established by the Court of Appeal, as exclusion from coverage may appear to depend on whether the damage has been done to the very thing being worked on or to something else. Only in the latter case would the loss qualify as "resulting damage". For instance, in *British Columbia v. Royal Insurance Co. of Canada* (1991), 7 B.C.A.C. 172, the British Columbia Court of Appeal wrote that "[d]amage for faulty or improper design encompasses all the damage to the very thing that was designed faultily or improperly. Resultant damage is damage to some part of the insured property other than the part of the property that was faultily designed": para. 11; see also *Algonquin Power (Long Sault) Partnership v. Chubb Insurance Co. of Canada* (2003), 50 C.C.L.I. (3d) 107 (Ont. S.C.J.), at para. 204.

[92] These decisions, however, are not inconsistent with holding that the faulty workmanship exclusion precludes from coverage only the cost of redoing the faulty work. Indeed, in faulty design cases, a contractor is obligated to design a given item, with the design being integral to the whole of that item. Thus, the cost of repairing the damages caused to that item will be included within the cost of redoing the faulty work, and the resulting damage exception will necessarily apply to damages caused to items other than the item being designed. As held in *Simcoe & Erie General Insurance Co.*

[90] Bien que cette interprétation de l'exception à l'exclusion fondée sur la malfaçon qui touche les dommages en découlant puisse, de prime abord, sembler contraire à l'interprétation généralement retenue par les tribunaux dans les affaires de vice de conception, elle est en fait conforme aux conclusions tirées dans ces décisions.

[91] Il est vrai que, dans les affaires de vice de conception, les tribunaux considèrent généralement que l'exception relative aux dommages découlant de la malfaçon englobe les dommages causés à un autre bien que celui entaché d'un vice de conception, ce qui peut donc sembler cadrer davantage avec le critère de connexité matérielle ou systémique établi par la Cour d'appel. En effet, l'exclusion de la garantie d'assurance peut paraître tributaire de la question de savoir si les dommages ont été causés à l'ouvrage même sur lequel on travaillait ou à un autre. Ce n'est que dans la deuxième situation que la perte constitue un « dommage [. . .] découlant » de la malfaçon. À titre d'exemple, dans *British Columbia c. Royal Insurance Co. of Canada* (1991), 7 B.C.A.C. 172, la Cour d'appel de la Colombie-Britannique a écrit que [TRADUCTION] « [l]es dommages attribuables à une conception défaillante ou inadéquate comprennent tous les dommages causés à l'élément même entaché du vice de conception. Les dommages en découlant sont les dommages causés à une autre partie du bien assuré que la partie du bien dont la conception était défaillante » (par. 11; voir aussi *Algonquin Power (Long Sault) Partnership c. Chubb Insurance Co. of Canada* (2003), 50 C.C.L.I. (3d) 107 (C.S.J. Ont.), par. 204).

[92] Ces décisions ne sont toutefois pas incompatibles avec la conclusion selon laquelle l'exclusion relative à la malfaçon ne soustrait à la garantie que le coût de la nouvelle exécution du travail défectueux. En fait, dans les cas de vice de conception, l'entrepreneur est tenu de concevoir un article donné et la conception fait partie intégrante de l'ensemble de cet article. Ainsi, le coût de réparation de l'article endommagé sera inclus dans le coût de la nouvelle exécution du travail défectueux, et l'exception relative aux dommages en découlant s'appliquera nécessairement aux dommages causés aux autres

v. Royal Insurance Co. of Canada (1982), 36 A.R. 553 (Q.B.), at para. 34:

> . . . the total contractual obligation of [the engineer] was to design and supervise the construction of a bridge required by the [city]. The damage to the structure that [the engineer] first designed was the product of its failure to properly design a bridge, which in turn prevented it from properly performing its contractual obligations. It follows therefore that the contract was not performed until a stable bridge was constructed. [Emphasis added.]

[93] In any event, I disagree with the Insurers' contention that the case law systematically supports one interpretation of the faulty workmanship exclusion. Though the jurisprudence addressing the resultant damage exception has generally interpreted it narrowly (S. C. Vogel, "Recent Developments in Construction Insurance Law", in *Review of Construction Law: Recent Developments* (2012), 169, at p. 184), courts have not always been consistent in construing the exception, and parties cannot therefore adequately predict what sort of damage will or will not be caught by the exclusion: L. Ricchetti and T. J. Murphy, *Construction Law in Canada* (2010); "Covered for What?", at p. 106; and Poitras, at p. 195. Even the Court of Appeal acknowledged the inconsistency in the jurisprudence at para. 47 of its reasons, citing as an example *Foundation Co. of Canada v. Aetna Casualty Co. of Canada*, [1976] I.L.R. ¶ 1-757 (Alta. S.C.).

[94] Additionally, in *Commercial union cie d'assurance du Canada v. Pentagon Construction Canada Inc.*, [1989] R.J.Q. 1399 (C.A.), the Quebec Court of Appeal broadened the resultant damage exception and, thus, narrowed the faulty workmanship exclusion, commenting that damage to the thing that the faulty contractor is responsible for building is covered. Though these comments were made in *obiter*, as the court had already concluded that

biens que celui en cours de conception. Comme il a été décidé dans *Simcoe & Erie General Insurance Co. c. Royal Insurance Co. of Canada* (1982), 36 A.R. 553 (B.R.), par. 34 :

> [TRADUCTION] . . . l'intégralité de l'obligation contractuelle de [l'ingénieur] consistait à concevoir un pont commandé par la [ville] et à en superviser la construction. Les dommages causés à la structure conçue au départ par [l'ingénieur] étaient attribuables à son omission de bien concevoir le pont, dommages qui ont à leur tour empêché l'entreprise de s'acquitter comme il se doit de ses obligations contractuelles. En conséquence, le contrat n'a pas été exécuté tant qu'un pont stable n'a pas été érigé. [Je souligne.]

[93] Quoi qu'il en soit, je ne suis pas d'accord avec l'affirmation des assureurs selon laquelle la jurisprudence appuie systématiquement une seule interprétation de l'exclusion relative à la malfaçon. Bien que, dans la plupart des précédents portant sur l'exception relative aux dommages découlant d'une malfaçon, les tribunaux aient interprété cette exception de façon étroite (S. C. Vogel, « Recent Developments in Construction Insurance Law », dans *Review of Construction Law : Recent Developments* (2012), 169, p. 184), ils n'ont pas toujours interprété l'exception de la même manière, et les parties ne peuvent pas en conséquence prédire adéquatement les dommages qui relèveront ou non de l'exclusion (L. Ricchetti et T. J. Murphy, *Construction Law in Canada* (2010); « Covered for What? », p. 106; Poitras, p. 195). Même la Cour d'appel a reconnu le manque de constance de la jurisprudence au par. 47 de ses motifs, citant à titre d'exemple *Foundation Co. of Canada c. Aetna Casualty Co. of Canada*, [1976] I.L.R. ¶ 1-757 (C.S. Alb.).

[94] De plus, dans *Commercial union cie d'assurance du Canada c. Pentagon Construction Canada Inc.*, [1989] R.J.Q. 1399 (C.A.), la Cour d'appel du Québec a étendu l'exception relative aux dommages découlant d'une malfaçon et restreint de ce fait l'exclusion fondée sur la malfaçon, en faisant observer que les dommages causés à l'élément que l'entrepreneur fautif doit construire sont couverts. Même s'il s'agissait d'une remarque incidente, puisque la

the workmanship at issue was not faulty, they help demonstrate that the case law on the interpretation of the faulty workmanship exclusion and resulting damage exception is not unanimous.

(e) *Conclusion on the Interpretation of the Exclusion Clause*

[95] As outlined above, the language of the Exclusion Clause, read in light of the Policy as a whole, does not provide a clear answer to the question raised before us. That said, the parties' reasonable expectations, informed largely by the purpose of builders' risk policies, point to the faulty workmanship exclusion serving to exclude from coverage only the cost of redoing the faulty work. This interpretation aligns with commercial realities and is consistent with prior jurisprudence. In the circumstances of this case, the cost of redoing the faulty work is the cost of recleaning the windows — both parties agree that the recleaning falls under the Policy's "cost of making good faulty workmanship" exclusion. The Insureds, however, have met their onus of demonstrating that the cost of replacing the damaged windows is covered under the "resulting damage" exception to that exclusion.

[96] In any event, even if I were to determine that the general rules of contractual interpretation do not clarify the ambiguous Exclusion Clause, I would reach the same conclusion on the basis of the *contra proferentem* rule.

VI. Disposition

[97] I would allow the appeals with costs throughout.

cour avait déjà conclu que les travaux exécutés dans cette affaire ne constituaient pas une malfaçon, ces propos contribuent à démontrer que la jurisprudence sur l'interprétation de l'exclusion relative à la malfaçon ainsi que de l'exception des dommages en découlant n'est pas unanime.

e) *Conclusion sur l'interprétation de la clause d'exclusion*

[95] Comme je l'ai expliqué plus tôt, le libellé de la clause d'exclusion, lu à la lumière de l'ensemble de la police, ne fournit pas de réponse claire à la question qui nous a été soumise. Cela dit, les attentes raisonnables des parties, lesquelles reposent en grande partie sur l'objectif des polices d'assurance chantier, donnent à penser que l'exclusion fondée sur la malfaçon sert à soustraire à la garantie d'assurance uniquement le coût de la nouvelle exécution du travail déficient. Cette interprétation s'accorde avec la réalité commerciale en plus d'être compatible avec la jurisprudence. Dans les circonstances de l'espèce, le coût de la nouvelle exécution du travail défectueux est le coût d'un nouveau nettoyage des fenêtres. Toutes les parties s'entendent pour dire que le nouveau nettoyage relève de l'exclusion de la police relative aux « frais engagés pour remédier à une malfaçon ». Les assurées se sont toutefois acquittées de leur fardeau de démontrer que le coût du remplacement des fenêtres endommagées est couvert par l'exception à l'exclusion pour les « dommages [. . .] découlant » de la malfaçon.

[96] Quoi qu'il en soit, même si je devais décider que l'application des règles générales d'interprétation contractuelle ne dissipe pas l'ambiguïté sur le sens de la clause d'exclusion, je parviendrais à la même conclusion en raison de la règle *contra proferentem*.

VI. Dispositif

[97] Je suis d'avis d'accueillir les pourvois avec dépens devant toutes les cours.

The following are the reasons delivered by

CROMWELL J. —

I. Introduction

[98] I agree with the disposition of these appeals proposed by my colleague, Justice Wagner, in his carefully crafted and comprehensive reasons. However, I respectfully do not agree with him on two points: the applicable standard of appellate review and whether the contractual clause that we must interpret is ambiguous. As I will explain, our very recent decision in *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, [2014] 2 S.C.R. 633, decides that the standard of review here is palpable and overriding error, not correctness, and in my opinion the trial judge did not err in finding that the clause is ambiguous. Like my colleague, I would therefore allow the appeals with costs.

[99] The merits of the appeals turn on a straightforward question. When window cleaners destroy the windows they are supposed to clean, does the cost of replacing the windows fall within the expression the "cost of making good faulty workmanship", in which case it is excluded from coverage provided by the insurance policy we must interpret in this case, or does that cost fall within the expression "physical damage . . . resulting" from the faulty workmanship, in which case it is covered by the policy?

II. The Standard of Review

A. *Sattva Brought Appellate Review in Contract Cases Within the Court's General Framework for Appellate Review in Civil Cases*

(1) The Standard of Review in Civil Appeals Turns on the Nature of the Question Under Review

[100] The standard of review aspect of the Court's judgment in *Sattva* must be understood in the context of the Court's broader jurisprudence on standard

Version française des motifs rendus par

LE JUGE CROMWELL —

I. Introduction

[98] Je souscris au dispositif proposé par mon collègue le juge Wagner dans ses motifs détaillés et rédigés avec soin. Je suis toutefois en désaccord avec lui sur deux points : la norme de contrôle applicable en appel et la question de l'ambiguïté de la clause contractuelle que nous devons interpréter. Comme je l'expliquerai, la norme de contrôle applicable en l'espèce est celle de l'erreur manifeste et dominante, et non celle de la décision correcte, selon notre arrêt très récent *Sattva Capital Corp. c. Creston Moly Corp.*, 2014 CSC 53, [2014] 2 R.C.S. 633, et le juge de première instance n'a, à mon avis, pas commis d'erreur en concluant que la clause est ambiguë. À l'instar de mon collègue, je suis donc d'avis d'accueillir les pourvois avec dépens.

[99] Le fond des pourvois se résume à une question simple. Quand un laveur de vitres endommage les fenêtres qu'il est censé nettoyer, le coût de remplacement des fenêtres est-il visé par l'expression [TRADUCTION] « frais engagés pour remédier à une malfaçon », auquel cas il est exclu de la couverture offerte par la police d'assurance que nous devons interpréter en l'espèce, ou par l'expression « dommages matériels [. . .] découlant » de la malfaçon, auquel cas il est couvert par la police?

II. La norme de contrôle

A. *Dans son arrêt Sattva, la Cour a intégré le contrôle en appel dans les affaires contractuelles à son cadre général de contrôle en appel en matière civile*

(1) La norme de contrôle applicable dans les appels civils dépend de la nature de la question à l'examen

[100] L'aspect du jugement rendu par notre Cour dans *Sattva* qui a trait à la norme de contrôle doit être replacé dans le contexte plus large de sa

of review in civil appeals. At least since *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235, the standard of appellate review has turned on the nature of the question being reviewed. Questions of law are reviewed for correctness and questions of fact for palpable and overriding error. *Housen* also holds that applying a legal standard to the facts is a mixed question of law and fact and is generally reviewable on appeal for palpable and overriding error: paras. 26-37. So, in a negligence case such as *Housen*, that is the standard that generally governs appellate review of the trial court's application of the legal standard of negligence to the evidence.

[101] I say "generally" because *Housen* recognized that this would not always be so. In some cases, the trial court's application of a legal standard to the facts will attract correctness review on appeal. This will be the case when the basis for a finding under review can be traced to a pure legal error, such as a wrong characterization of the legal standard or the failure to consider a required element of the applicable standard. In cases of this sort, the reviewing court can "extricate" a purely legal question from the trial court's analysis and having done so, apply to that purely legal question the correctness standard of appellate review: paras. 31-33. These sorts of cases are fairly rare, however. As *Housen* cautioned, it is often difficult to extricate the legal questions from the factual and therefore appellate courts should not be quick to find extricable legal errors in the trial court's application of a legal standard to the facts: para. 36.

(2) *Sattva* Brought Contract Appeals Within This Framework

[102] I review these basic points of *Housen* because, as I see it, the Court's decision in *Sattva*

jurisprudence sur les normes de contrôle en matière d'appels civils. Depuis au moins l'arrêt *Housen c. Nikolaisen*, 2002 CSC 33, [2002] 2 R.C.S. 235, la norme de contrôle applicable en appel dépend de la nature de la question examinée. Les questions de droit sont examinées selon la norme de la décision correcte tandis que les questions de fait le sont en fonction de la norme de l'erreur manifeste et dominante. Il a aussi été jugé dans *Housen* que l'application d'une norme juridique à des faits constitue une question mixte de droit et de fait, qui est généralement susceptible de révision en appel selon la norme de l'erreur manifeste et dominante (par. 26-37). Ainsi, dans une affaire de négligence comme *Housen*, c'est cette norme qui régit généralement le contrôle en appel de l'application, par le tribunal de première instance, de la norme juridique de négligence à la preuve.

[101] Je dis « généralement » parce que la Cour a reconnu dans *Housen* que ce ne serait pas toujours le cas. Il arrive parfois que l'application par le tribunal de première instance d'une norme juridique aux faits commande un contrôle en appel selon la norme de la décision correcte. C'est le cas lorsque le fondement de la conclusion contrôlée est imputable à une pure erreur de droit, telle une mauvaise qualification de la norme juridique ou omission d'examiner un élément essentiel de la norme applicable. Dans les affaires de ce genre, la cour siégeant en révision peut « dégager » une pure question de droit de l'analyse du tribunal de première instance, puis appliquer à cette question la norme de la décision correcte applicable lors d'un contrôle en appel (par. 31-33). Les affaires de cette nature sont toutefois assez rares. Selon la mise en garde formulée dans *Housen*, les cours d'appel ne devraient pas conclure trop rapidement que le tribunal de première instance a commis des erreurs de droit isolables en appliquant une norme juridique aux faits, car il est souvent difficile de départager les questions de droit des questions de fait (par. 36).

(2) Dans *Sattva*, la Cour a intégré les appels en matière contractuelle à ce cadre

[102] J'examine ces aspects fondamentaux de *Housen* parce que, à mon sens, notre Cour a inscrit

brought appellate review in contract cases within this general standard of review framework. To put it in *Housen*'s terms, applying the text of a contract to a particular fact situation involves applying the legal standard set by the contract to the facts of the situation at hand. This interpretative process, therefore, generally gives rise to a mixed question of law and fact and should be reviewable on appeal for palpable and overriding error.

[103] *Sattva* explained that this was an appropriate development for two related reasons. First, contractual interpretation is not simply a question of ascribing an abstract legal meaning to the words, but rather of understanding those words in their full context. Second, this process of interpretation should generally be considered to be the application of a legal standard to the facts; in other words, contractual interpretation is generally a mixed question of law and fact which, under the Court's standard of review jurisprudence, is generally reviewed for palpable and overriding error. Both of these related reasons, as we shall see, apply to interpreting all types of contracts.

[104] Consider the first reason. Contract interpretation cannot be understood as a process of determining the "legal" and immutable meaning of the text. "[W]ords alone do not have an immutable or absolute meaning" and therefore contractual interpretation does not often turn on ascribing immutable legal meanings to the contractual words: *Sattva*, at para. 47. Rather, the meaning of words often turns on context, such as the purpose of the agreement and the nature of the relationship between the parties: para. 48. Taking those sorts of contextual considerations into account — sometimes called the surrounding circumstances or the factual matrix — requires the court to understand the text of the agreement in light of them, not simply to ascribe purely legal meanings to the words taken in isolation. Thus, just as the Court in *Housen* cautioned against too readily finding that applying a legal standard to the facts gives rise to a purely legal question, the Court

dans *Sattva* le contrôle en appel dans les affaires contractuelles à l'intérieur de ce cadre général de contrôle. Pour reprendre les termes de *Housen*, l'application du texte d'un contrat à une situation factuelle particulière suppose l'application de la norme juridique établie par le contrat aux faits de la situation en cause. Par conséquent, cet exercice d'interprétation soulève généralement une question mixte de droit et de fait qui devrait être contrôlée en appel selon la norme de l'erreur manifeste et dominante.

[103] D'après *Sattva*, il s'agissait d'une évolution opportune pour deux raisons connexes. Premièrement, l'interprétation contractuelle ne consiste pas simplement à attribuer un sens juridique abstrait aux mots utilisés, mais plutôt à saisir ces mots dans leur contexte global. Deuxièmement, cet exercice d'interprétation devrait généralement être considéré comme l'application d'une norme juridique aux faits; autrement dit, l'interprétation contractuelle constitue généralement une question mixte de droit et de fait qui, selon la jurisprudence de la Cour en matière de normes de contrôle, est généralement susceptible de révision selon la norme de l'erreur manifeste et dominante. Comme nous le verrons, ces deux raisons connexes valent pour l'interprétation de tous les types de contrat.

[104] Examinons la première raison. L'interprétation contractuelle ne peut être considérée comme la détermination du sens « juridique » et immuable du texte. Comme « les mots en soi n'ont pas un sens immuable ou absolu », l'interprétation contractuelle consiste rarement à attribuer un sens juridique immuable aux mots employés dans le contrat (*Sattva*, par. 47). Le sens des mots est plutôt souvent fonction du contexte, comme l'objet de l'entente et la nature de la relation entre les parties (par. 48). La prise en compte de pareilles considérations contextuelles — parfois appelées les circonstances ou le fondement factuel — exige que la cour comprenne, à la lumière de ces considérations, le texte de l'entente, et non qu'elle se contente d'attribuer des significations purement juridiques aux mots pris isolément. Par conséquent, tout comme la Cour a indiqué dans *Housen* qu'il faut s'abstenir de conclure trop rapidement que l'application d'une norme juridique aux

in *Sattva* cautioned that interpretation does not often give rise to a pure question of law. Interpretation is rarely a matter of ascribing some immutable legal meaning to the text considered apart from the surrounding circumstances.

[105] A number of appellate courts and my colleague Wagner J. are of the view that this first rationale underlying *Sattva* does not apply to cases interpreting standard form contracts: *Vallieres v. Vozniak*, 2014 ABCA 290, 5 Alta. L.R. (6th) 28, at paras. 11-13; *Precision Plating Ltd. v. Axa Pacific Insurance Co.*, 2015 BCCA 277, 387 D.L.R. (4th) 281, at paras. 28-30; *Stewart Estate v. 1088294 Alberta Ltd.*, 2015 ABCA 357, 25 Alta. L.R. (6th) 1, at para. 273, per McDonald J.A.; *MacDonald v. Chicago Title Insurance Co. of Canada*, 2015 ONCA 842, 127 O.R. (3d) 663, at paras. 40-41; *Monk v. Farmers' Mutual Insurance Co.*, 2015 ONCA 911, 128 O.R. (3d) 710, at paras. 22-24; *True Construction Ltd. v. Kamloops (City)*, 2016 BCCA 173, at para. 34 (CanLII); and *Sankar v. Bell Mobility Inc.*, 2016 ONCA 242, at para. 26 (CanLII). I respectfully disagree.

[106] I accept, of course, that standard form contracts generally do not have relevant surrounding circumstances relating to their negotiation because there was in no real sense any negotiation of their terms. However, standard form contracts, like all contracts, have many other surrounding circumstances: they have a purpose, they create a relationship of a particular nature and they frequently operate within a particular market or industry. These factors are all part of the context — of the surrounding circumstances — that must be taken into account in interpreting the text of the contract. As Lord Wilberforce put it in a passage cited with approval in *Sattva*, "In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating": *Reardon Smith Line Ltd. v. Hansen-Tangen*, [1976] 3 All E.R. 570 (H.L.), at p. 574, quoted in *Sattva*, at para. 47. This point is further developed in a short passage from *Investors Compensation Scheme Ltd. v. West*

faits pose une pure question de droit, elle a précisé dans *Sattva* que l'interprétation ne pose pas souvent une pure question de droit. L'interprétation consiste rarement à attribuer un quelconque sens juridique immuable au texte pris sans égard aux circonstances.

[105] Mon collègue le juge Wagner ainsi que plusieurs cours d'appel estiment que ce premier raisonnement qui sous-tend *Sattva* ne s'applique pas aux affaires où l'on interprète des contrats types (*Vallieres c. Vozniak*, 2014 ABCA 290, 5 Alta. L.R. (6th) 28, par. 11-13; *Precision Plating Ltd. c. Axa Pacific Insurance Co.*, 2015 BCCA 277, 387 D.L.R. (4th) 281, par. 28-30; *Stewart Estate c. 1088294 Alberta Ltd.*, 2015 ABCA 357, 25 Alta. L.R. (6th) 1, par. 273, le juge McDonald; *MacDonald c. Chicago Title Insurance Co. of Canada*, 2015 ONCA 842, 127 O.R. (3d) 663, par. 40-41; *Monk c. Farmers' Mutual Insurance Co.*, 2015 ONCA 911, 128 O.R. (3d) 710, par. 22-24; *True Construction Ltd. c. Kamloops (City)*, 2016 BCCA 173, par. 34 (CanLII); *Sankar c. Bell Mobility Inc.*, 2016 ONCA 242, par. 26 (CanLII)). Avec égards, je ne suis pas d'accord.

[106] J'accepte bien sûr qu'il n'existe généralement pas, dans le cas des contrats types, de circonstances pertinentes quant à leur négociation puisque leurs conditions n'ont pas été véritablement négociées. Cependant, à l'instar de tous les autres contrats, les contrats types s'inscrivent dans un contexte beaucoup plus large : ils ont un objet, créent une relation particulière et sont fréquemment utilisés dans une industrie ou un marché donné. Ces facteurs font tous partie du contexte — les circonstances — dont il faut tenir compte pour interpréter le texte du contrat. Pour reprendre les propos de lord Wilberforce, cités avec approbation dans *Sattva*, [TRADUCTION] « [l]orsqu'un contrat commercial est en cause, le tribunal devrait certes connaître son objet sur le plan commercial, ce qui présuppose d'autre part une connaissance de l'origine de l'opération, de l'historique, du contexte, du marché dans lequel les parties exercent leurs activités » (*Reardon Smith Line Ltd. c. Hansen-Tangen*, [1976] 3 All E.R. 570 (H.L.), p. 574, cité dans *Sattva*, par. 47). Cette question est davantage approfondie dans le court extrait suivant tiré d'*Investors Compensation*

Bromwich Building Society, [1998] 1 All E.R. 98 (H.L.), also quoted by the Court in *Sattva*, at para. 48:

> The meaning which a document . . . would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. [p. 115]

[107] All contracts, whether standard form or not, have important contextual elements — elements of their surrounding circumstances — that are generally considered in applying the contractual language to a specific set of occurrences.

[108] Unlike my colleague, I do not read this aspect of *Sattva* as holding that contractual interpretation is not generally a pure question of law simply because it involves assessing a "factual matrix" relating to negotiation. Rather, as I have discussed, *Sattva* sees contractual interpretation as not being a pure question of law because it involves understanding the words used in light of a number of contextual factors beyond negotiation, including the purpose of the agreement, the nature of the relationship, the market in which the parties are operating, and so forth. While the words have a consistent meaning, how they apply to the myriad of situations that may arise will most often turn on these sorts of contextual factors. My colleague's interpretative analysis of the standard form contract before us in this case shows that this is so. That analysis relies on the nature of the particular work alleged to be faulty; the nature and cause of the particular damage in issue; the purpose of the contract; the market in which it operates (i.e. the construction industry); the parties' reasonable expectations; and commercial reality.

[109] The importance of taking these contextual matters into account is the first reason the Court relied on in *Sattva* to explain why contractual interpretation is generally not a pure question of law

Scheme Ltd. c. West Bromwich Building Society, [1998] 1 All E.R. 98 (H.L.), également cité par la Cour dans *Sattva*, par. 48 :

> [TRADUCTION] Le sens d'un document [. . .] qui est transmis à la personne raisonnable n'équivaut pas au sens des mots qui le composent. Le sens des mots fait intervenir les dictionnaires et les grammaires; le sens du document représente ce qu'il est raisonnable de croire que les parties, en employant ces mots compte tenu du contexte pertinent, ont voulu exprimer. [p. 115]

[107] Tous les contrats, qu'ils soient types ou non, comportent des éléments contextuels importants — les circonstances — dont il est généralement tenu compte pour appliquer le libellé du contrat à un ensemble précis de faits.

[108] Contrairement à mon collègue, je n'estime pas que la Cour indique à cet égard dans *Sattva* que l'interprétation contractuelle n'est en général pas une pure question de droit simplement parce qu'elle suppose l'évaluation du « fondement factuel » relatif à la négociation. Au contraire, comme je l'ai expliqué précédemment, la Cour considère dans *Sattva* que l'interprétation contractuelle n'est pas une pure question de droit parce qu'elle implique de comprendre les mots utilisés eu égard à plusieurs facteurs contextuels autres que la négociation, dont l'objet de l'entente, la nature de la relation, le marché dans lequel les parties exercent leurs activités, etc. Le sens des mots ne change pas, mais la façon dont ces mots s'appliquent à la multitude de situations qui peuvent survenir dépendra souvent de ces facteurs contextuels. C'est d'ailleurs ce que démontre l'analyse interprétative du contrat type en l'espèce effectuée par mon collègue. Cette analyse repose sur la nature du travail qui aurait été mal exécuté; la nature et la cause du dommage en question; l'objet du contrat; le marché dans lequel il est employé (en l'occurrence l'industrie de la construction); les attentes raisonnables des parties; la réalité commerciale.

[109] L'importance de prendre en compte ces éléments contextuels est la première raison donnée par la Cour dans *Sattva* pour expliquer pourquoi l'interprétation contractuelle n'est généralement pas une

and applies to standard form contracts as it does to others. While negotiating history will generally not be relevant to such contracts, many other contextual matters are.

[110] Turning to the second related reason given in *Sattva*, it too applies to the interpretation of standard form contracts. That second reason was that "the historical approach to contractual interpretation does not fit well with the definition of a pure question of law identified in *Housen* and [*Canada (Director of Investigation and Research) v. Southam Inc.*, [1997] 1 S.C.R. 748]": para. 49. Rather, contractual interpretation should be understood as generally giving rise to mixed questions of law and fact. As Rothstein J. wrote for the Court, "Contractual interpretation involves issues of mixed fact and law as it is an exercise in which the principles of contractual interpretation are applied to the words of the written contract, considered in light of the factual matrix": para. 50. In short, *Sattva* brought appellate review of contractual interpretation into the general framework for appellate review in civil cases set out in the Court's standard of review jurisprudence.

[111] I see no reason to think that the interpretation of certain types of contracts should be excluded from these general principles that apply to appellate review in all civil cases. A number of appellate courts have reached the same conclusion: *Industrial Alliance Insurance and Financial Services Inc. v. Brine*, 2015 NSCA 104, 392 D.L.R. (4th) 575, at paras. 40-41; *Ontario Society for the Prevention of Cruelty to Animals v. Sovereign General Insurance Co.*, 2015 ONCA 702, 127 O.R. (3d) 581, at paras. 34-36; *Acciona Infrastructure Canada Inc. v. Allianz Global Risks US Insurance Co.*, 2015 BCCA 347, 77 B.C.L.R. (5th) 223, at paras. 34-35; *GCAN Insurance Co. v. Univar Canada Ltd.*, 2016 QCCA 500, at paras. 37-42 (CanLII).

[112] It is important to remember that *Housen* did not hold that all applications of a legal standard to the facts should be reviewed for palpable and overriding error. As I have discussed, *Housen* recognized that sometimes the analysis will turn on an extricable

pure question de droit et vaut tant pour les contrats types que pour les autres contrats. Bien que l'historique de la négociation ne soit généralement pas pertinent pour de tels contrats, bien d'autres éléments contextuels le sont.

[110] En ce qui concerne maintenant la deuxième raison connexe donnée dans *Sattva*, elle vaut aussi pour l'interprétation des contrats types. Cette seconde raison était que « l'approche historique de l'interprétation contractuelle ne cadre pas bien avec la définition de la pure question de droit formulée dans les arrêts *Housen* et [*Canada (Directeur des enquêtes et recherches) c. Southam Inc.*, [1997] 1 R.C.S. 748] » (par. 49). On devrait plutôt considérer que l'interprétation contractuelle pose généralement des questions mixtes de droit et de fait. Comme le juge Rothstein l'a écrit au nom de la Cour, « [l]'interprétation contractuelle soulève des questions mixtes de fait et de droit, car il s'agit d'en appliquer les principes aux termes figurant dans le contrat écrit, à la lumière du fondement factuel » (par. 50). Bref, dans *Sattva*, la Cour a intégré le contrôle en appel de l'interprétation d'un contrat au cadre général de contrôle en appel en matière civile établi dans sa jurisprudence relative aux normes de contrôle.

[111] Je ne vois aucune raison de penser que ces principes généraux applicables au contrôle en appel dans toutes les affaires civiles ne devraient pas régir l'interprétation de certains types de contrat. Plusieurs cours d'appel sont parvenues à la même conclusion (*Industrial Alliance Insurance and Financial Services Inc. c. Brine*, 2015 NSCA 104, 392 D.L.R. (4th) 575, par. 40-41; *Ontario Society for the Prevention of Cruelty to Animals c. Sovereign General Insurance Co.*, 2015 ONCA 702, 127 O.R. (3d) 581, par. 34-36; *Acciona Infrastructure Canada Inc. c. Allianz Global Risks US Insurance Co.*, 2015 BCCA 347, 77 B.C.L.R. (5th) 223, par. 34-35; *GCAN Insurance Co. c. Univar Canada Ltd.*, 2016 QCCA 500, par. 37-42 (CanLII)).

[112] Il importe de se rappeler que la Cour n'a pas jugé, dans *Housen*, que toutes les applications d'une norme juridique aux faits devraient être contrôlées selon la norme de l'erreur manifeste et dominante. Comme je l'ai mentionné, la Cour a

pure question of law. *Sattva* adopted this holding. Rothstein J. in *Sattva* acknowledged, echoing *Housen*, that it may sometimes be possible to identify an extricable question of law such as the application of incorrect principles, the failure to consider a required element of a legal test, or the failure to consider a relevant factor. I therefore agree with Wagner J. that "*Sattva* should not be read as holding that contractual interpretation is always a question of mixed fact and law": para. 46. *Sattva* was explicit on this point: para. 53.

[113] However, again echoing *Housen*, Rothstein J. warned that courts should be cautious in identifying extricable questions of law in disputes over contractual interpretation; he noted that "the circumstances in which a question of law can be extricated from the interpretation process will be rare": *Sattva*, at para. 55.

B. *The Proposed Exception Does Not Conform to the General Principles of Appellate Review in Civil Cases*

[114] My colleague proposes an "exception" to *Sattva*'s holding: if an appeal involves the interpretation of a standard form contract, the interpretation itself is of precedential value and there is no meaningful factual matrix specific to the parties to assist the interpretation process, then the interpretation is a question of law and subject to correctness review (para. 46). I do not support the creation of this "exception".

[115] As I have outlined, the general principles of appellate review in civil cases turn on characterizing the nature of the question being reviewed as one of fact, law or mixed law and fact. The distinction between questions of pure law and questions of mixed law and fact turns on where the question is located along a "spectrum of particularity": *Housen*, at para. 28. Questions of law are concerned with general legal propositions: *Housen*, at para. 28,

reconnu dans *Housen* que l'analyse porte parfois sur une pure question de droit isolable, et a fait sienne cette conclusion dans *Sattva*. Le juge Rothstein y a reconnu, en faisant écho à *Housen*, qu'il peut parfois être possible de dégager une question de droit comme l'application d'un mauvais principe ou l'omission d'examiner un élément essentiel d'un critère juridique ou un facteur pertinent. Je souscris par conséquent à l'observation du juge Wagner selon laquelle « [l]'arrêt *Sattva* ne devrait pas être interprété comme prescrivant que l'interprétation contractuelle est toujours une question mixte de fait et de droit » (par. 46). L'arrêt *Sattva* était explicite à cet égard (par. 53).

[113] Or, faisant encore une fois écho à *Housen*, le juge Rothstein a prévenu les tribunaux qu'ils devaient faire preuve de prudence en dégageant des questions de droit isolables dans les litiges portant sur l'interprétation d'un contrat; il a fait remarquer que « rares seront les cas où il sera possible de dégager une question de droit de l'exercice d'interprétation » (*Sattva*, par. 55).

B. *L'exception proposée ne respecte pas les principes généraux de contrôle en appel en matière civile*

[114] Mon collègue propose une « exception » à la conclusion tirée dans *Sattva* : si un appel porte sur l'interprétation d'un contrat type, l'interprétation retenue a valeur de précédent et l'exercice d'interprétation ne repose sur aucun fondement factuel significatif qui est propre aux parties, l'interprétation constitue alors une question de droit et est assujettie à un contrôle selon la norme de la décision correcte (par. 46). Je ne suis pas en faveur de la création de cette « exception ».

[115] Comme je l'ai souligné, les principes généraux de contrôle en appel dans les affaires civiles s'attachent à la qualification de la nature de la question faisant l'objet du contrôle en tant que question de fait, question de droit ou encore question mixte de droit et de fait. La distinction entre les pures questions de droit et les questions mixtes de droit et de fait dépend de l'endroit où se situe la question sur le « spectre comportant des degrés variables de

citing *Southam*, at para. 37. As stated in *Housen* and repeated in *Sattva*, examples include applying an incorrect principle, failing to consider a required element of a legal test, or the failure to consider a relevant factor: *Sattva*, at para. 53.

[116] As I see it, the three elements of the proposed exception do not assist in deciding whether the question is sufficiently general in nature so as to attract correctness review. Whether or not a contract is a standard form does not, as I see it, tell us anything about the degree of generality of the particular interpretative principle in issue in a particular case. The absence of a "factual matrix" is not of much assistance either. All contracts have a context which is important for their interpretation. As I mentioned earlier, aspects of the transaction such as its purpose and the market or industry in which it operates are important for interpreting all contracts, and so is the nature of the allegedly faulty work and the damage allegedly resulting from it. The absence of facts about negotiations does not mean that there are no contextual matters that inform the interpretative process and therefore tend to make it a mixed question of law and fact.

[117] The third element of the proposed exception — whether the interpretation has precedential value — seems to me to simply ask the critical question, which is concerned with the level of generality of a legal principle, in a different and unhelpful way. Questions of law are reviewed on appeal for correctness because the decisions on such questions have precedential value: these sorts of decisions ensure uniformity among similar cases and serve the law-making function of appellate courts (*Housen*, at paras. 8-9). The more general the principle, the more the precedential value. To ask the question in terms of precedential value rather than the generality of the legal principle in issue seems to me to simply pose the key question in a different way and in one that simply sends the

particularité » (*Housen*, par. 28). Les questions de droit concernent des propositions juridiques générales (*Housen*, par. 28, citant *Southam*, par. 37). Comme la Cour l'a dit dans *Housen* et répété dans *Sattva*, une erreur de droit peut consister, par exemple, à appliquer le mauvais principe ou à négliger un élément essentiel d'un critère juridique ou un facteur pertinent (*Sattva*, par. 53).

[116] À mon avis, les trois éléments de l'exception proposée n'aident pas à décider si la question est de nature suffisamment générale pour appeler un contrôle selon la norme de la décision correcte. J'estime que le point de savoir si un contrat est ou non un contrat type ne nous permet de tirer aucune conclusion sur le degré de généralité du principe d'interprétation particulier en cause dans une affaire donnée. L'absence de « fondement factuel » n'est pas non plus d'un grand secours. Tous les contrats ont un contexte qui est important pour leur interprétation. Comme je l'ai mentionné précédemment, des aspects de l'opération comme son objet et l'industrie ou le marché dans lequel elle a lieu sont importants pour interpréter tous les contrats. Il en va de même de la nature du travail qui aurait été mal exécuté et du dommage qui en découlerait. L'absence de faits se rapportant aux négociations ne signifie pas qu'il n'y a aucun élément contextuel éclairant l'exercice d'interprétation, ce qui, par conséquent, tend à indiquer que cette interprétation serait une question mixte de droit et de fait.

[117] Selon moi, le troisième élément de l'exception proposée — le point de savoir si l'interprétation a valeur de précédent — pose simplement de façon différente et peu utile la question cruciale, qui a trait au niveau de généralité du principe juridique. Les questions de droit sont contrôlées en appel selon la norme de la décision correcte parce que les décisions sur ces questions ont valeur de précédent : les décisions de ce genre garantissent l'uniformité entre les affaires similaires et permettent aux cours d'appel d'accomplir leur fonction d'élaboration du droit (*Housen*, par. 8-9). Plus le principe est général, plus sa valeur comme précédent est grande. Poser la question sous l'angle de la valeur de précédent plutôt que du caractère général du principe juridique en cause équivaut, à mon sens, à poser simplement la

analysis back to the question of degree of generality.

[118] As my colleague's interpretive analysis shows, there are important contextual elements — surrounding circumstances — that inform how the text should be applied to the facts. This is not a case where there are no such contextual factors to consider. Focusing on the question of the generality of the legal principle in issue, I do not see a good case for correctness review on that basis either.

[119] The question this case raises, boiled down to its essentials, is this: Is the cost of replacing a window that was scratched by a window cleaner while cleaning it the "cost of making good faulty workmanship" (which is excluded from insurance coverage) or the cost of repairing "physical damage [that] results" from faulty workmanship (which is covered)? The answer proposed by Wagner J. is that it is the cost of repairing the physical damage, because the exclusion applies only to the cost of redoing the faulty work, in this case, recleaning the windows: para. 5. The legal principle is that "making good faulty workmanship" means "the cost of redoing the faulty work". However, this principle does not seem to me to operate at a very high level of generality.

[120] Applying the principle turns on two considerations: the scope of the "faulty work" and the nature of "redoing" it. We could say that the window cleaners' faulty work did not require them to install windows in good condition: para. 81. But this seems to me to be the assertion of the conclusion rather than a reason for it. Presumably, the window cleaners' work was to clean the windows without destroying them; if their faulty work destroyed the windows, why should we say that "redoing" their work does not involve replacing the windows? In short, I am not convinced the principle that the exclusion only relates to "the cost of redoing the faulty

question fondamentale d'une manière différente qui fait uniquement porter l'analyse sur la question du degré de généralité.

[118] Comme le démontre l'analyse interprétative de mon collègue, il existe d'importants éléments contextuels — circonstances — qui nous renseignent sur la façon dont le texte devrait être appliqué aux faits. Nous ne sommes pas en présence d'un cas où il n'existe pas de tels facteurs contextuels à prendre en considération. En axant mon examen sur le caractère général du principe juridique en cause, je n'estime pas non plus qu'il est justifié de procéder à un contrôle en fonction de la norme de la décision correcte sur cette base.

[119] Ramenée à l'essentiel, la question soulevée en l'espèce est la suivante : le coût de remplacement d'une fenêtre égratignée par un laveur de vitres pendant qu'il était en train de la nettoyer équivaut-il aux « frais engagés pour remédier à une malfaçon » (qui sont exclus de la couverture) ou au coût de la réparation des « dommages matériels [qui] découl[ent] » de la malfaçon (lesquels sont couverts)? La réponse proposée par le juge Wagner est la suivante : il s'agit du coût de la réparation des dommages matériels parce que l'exclusion ne vise que le coût de la nouvelle exécution du travail défectueux, en l'occurrence un nouveau nettoyage des fenêtres (par. 5). Selon le principe juridique, l'expression « remédier à une malfaçon » s'entend « du coût de la nouvelle exécution du travail défectueux ». Toutefois, ce principe ne me semble pas atteindre un très haut niveau de généralité.

[120] L'application du principe repose sur deux considérations : l'étendue de la « malfaçon » et la nature de sa « nouvelle exécution ». On pourrait avancer que la malfaçon des laveurs de vitres ne les obligeait pas à installer des fenêtres en bon état (par. 81). Cette affirmation me semble toutefois être l'énoncé de la conclusion plutôt que son fondement. On peut présumer que le travail des laveurs de vitres consistait à nettoyer les fenêtres sans les détruire; si, par leur malfaçon, ils ont détruit celles-ci, pourquoi devrait-on dire que la « nouvelle exécution » de leur travail n'implique pas le remplacement des fenêtres? En somme, je ne suis pas convaincu que le principe

work" can operate at a very high level of generality. Rather, its application in other cases will ultimately be decided on a case-by-case basis in light of the particular circumstances of the particular case.

[121] The extensive jurisprudence cited to us tends to confirm the view that it is difficult to define the scope of the exclusion in general terms. The line basically has to be drawn on a case-by-case basis. For example, in *Greene v. Canadian General Insurance Co.* (1995), 133 Nfld. & P.E.I.R. 151 (Nfld. C.A.), a contractor was hired by the appellants to construct the framework of a house. Shortly after the contractor completed its contract, the framework was damaged by high winds and, as a result, the house had to be substantially demolished and rebuilt: para. 2. It was uncontested that the loss was caused by the failure of the contractor to install temporary bracing.

[122] The trial judge held that the loss was caused by faulty or improper workmanship and was an excluded peril under clause 9(a) of the appellants' insurance policy with the respondent company. He rejected the appellants' contention that the exclusion clause should be limited to the cost of remedying the improper installation of permanent or temporary bracing: *Greene*, at para. 3.

[123] The Court of Appeal confirmed the trial decision, holding that "the defective or inadequate bracing was to stabilize the house during construction and the resulting accident caused the destruction of that house. I see no error in the decision of the trial judge that the loss suffered by the appellants was the cost of making good faulty or improper workmanship, not 'resultant damage', nor in his analysis of the applicable case law": *Greene*, at para. 16. As I see it, the analysis of this case could easily have gone a different way. The court could have held, as we do in this case, that because the contractor was only responsible for constructing the framework of the house, the exclusion should only be the cost of

selon lequel l'exclusion vise uniquement le « coût de la nouvelle exécution du travail défectueux » peut atteindre un très haut niveau de généralité. Les tribunaux décideront plutôt de son application en dernière analyse au cas par cas à la lumière des circonstances propres à chaque affaire.

[121] La jurisprudence abondante qui nous a été citée tend à confirmer l'opinion selon laquelle il est difficile de cerner l'étendue de l'exclusion en termes généraux. La ligne doit essentiellement être tracée au cas par cas. Par exemple, dans *Greene c. Canadian General Insurance Co.* (1995), 133 Nfld. & P.E.I.R. 151 (C.A. T.-N.), un entrepreneur avait été engagé par les appelants pour construire la charpente d'une maison. Peu après que l'entrepreneur eut mené à terme l'exécution de son contrat, la charpente en question a été endommagée par des vents violents. La maison a donc dû être démolie et reconstruite en grande partie (par. 2). Nul ne conteste que la perte était imputable à l'omission de l'entrepreneur d'installer un contreventement temporaire.

[122] Le juge de première instance a statué que la perte résultait d'une malfaçon ou d'un travail défectueux et constituait un risque exclu aux termes de la clause 9a) de la police d'assurance à laquelle les appelants avaient souscrit auprès de la société intimée. Il a rejeté la prétention des appelants selon laquelle la clause d'exclusion devrait viser uniquement les frais engagés pour remédier à l'installation défectueuse d'un contreventement temporaire ou permanent (*Greene*, par. 3).

[123] La Cour d'appel a confirmé la décision de première instance, affirmant que [TRADUCTION] « le contreventement défectueux ou inadéquat devait stabiliser la maison pendant la construction et l'accident qui en a résulté a causé la destruction de cette maison. Je ne relève aucune erreur ni dans la conclusion du juge de première instance que la perte subie par les appelants équivalait aux frais engagés pour remédier à la malfaçon ou au travail défectueux, et non aux "dommages en découlant", ni dans son analyse de la jurisprudence applicable » (*Greene*, par. 16). À mon avis, l'analyse de cette affaire aurait pu facilement donner un résultat différent. La cour aurait pu décider, tout comme nous

redoing the framework of the house, and not the cost of fixing damages to the whole house.

[124] Other examples include *Bird Construction Co. v. United States Fire Insurance Co.* (1985), 24 D.L.R. (4th) 104 (Sask. C.A.), where a subcontractor was hired to build and install roof trusses and partially damaged the trusses due to faulty erection procedures. Although the faulty workmanship occurred during the erection procedures, the cost of replacing the trusses themselves ended up also not being covered because the court considered it would be making good faulty workmanship. In *Ontario Hydro v. Royal Insurance*, [1981] O.J. No. 215 (QL) (H.C.J.), the contractual obligation of the contractor responsible for the damage was to install a power-generating boiler. As part of the installation, the plaintiff requested that the contractor perform an acid wash on the boiler. The acid wash ultimately damaged the tubing and the court held that the cost of making good improper workmanship was not only the cost of rewashing the tubing, but also to replace it: para. 37.

[125] I conclude that there are important surrounding circumstances that inform the interpretation of standard form contracts and that the legal principle is not of much precedential value. In short, the issue here involves applying a legal standard to a set of facts and did not give rise to any extricable question of law.

C. *The Merits of the Appeals*

[126] I agree in substance with the trial judge's analysis and conclusion: 2013 ABQB 585, [2013] I.L.R. ¶ I-5494. Clackson J. made no legal error because he properly described and applied the Court's decision in *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, 2010 SCC 33, [2010] 2 S.C.R. 245.

en l'espèce, que, comme l'entrepreneur n'était responsable que de la construction de la charpente de la maison, l'exclusion ne devrait viser que le coût de la nouvelle charpente de la maison, et non les frais engagés pour remédier aux dommages causés à l'ensemble de la maison.

[124] On peut également citer d'autres exemples telle l'affaire *Bird Construction Co. c. United States Fire Insurance Co*. (1985), 24 D.L.R. (4th) 104 (C.A. Sask.), où un sous-traitant avait été engagé pour fabriquer et installer des fermes de toit. Or, il a partiellement endommagé les fermes parce qu'il avait employé une mauvaise méthode d'installation. Bien que la malfaçon ait eu lieu à l'étape de l'installation, le coût de remplacement des fermes elles-mêmes a finalement été exclu lui aussi parce que la cour a considéré qu'un tel remplacement équivaudrait à remédier à une malfaçon. Dans *Ontario Hydro c. Royal Insurance*, [1981] O.J. No. 215 (QL) (H.C.J.), l'obligation contractuelle de l'entrepreneur responsable du dommage consistait à installer une chaudière génératrice de courant. Dans le cadre de ce contrat, le demandeur a demandé à l'entrepreneur de nettoyer la chaudière à l'acide. Ce nettoyage a endommagé la tuyauterie. La cour a statué que les frais engagés pour remédier à la malfaçon représentaient non seulement le coût d'un nouveau nettoyage de la tuyauterie, mais aussi le coût de son remplacement (par. 37).

[125] Je conclus qu'il existe des circonstances importantes qui nous éclairent sur l'interprétation des contrats types et que le principe juridique n'a pas une grande valeur comme précédent. Bref, le litige en l'espèce porte sur l'application d'une norme juridique à un ensemble de faits et il n'a posé aucune question de droit isolable.

C. *Le bien-fondé des pourvois*

[126] Je souscris pour l'essentiel à l'analyse et à la conclusion du juge de première instance (2013 ABQB 585, [2013] I.L.R. ¶ I-5494). Le juge Clackson n'a commis aucune erreur de droit parce qu'il a correctement décrit et appliqué l'arrêt *Progressive Homes Ltd. c. Cie canadienne d'assurances générales Lombard*, 2010 CSC 33, [2010] 2 R.C.S. 245.

[127] The trial judge considered the competing interpretations of the relevant policy provisions. The insureds' position was that excluding the cost of "making good" faulty cleaning simply excludes the cost of redoing the cleaning properly. The insurers' position was that "making good" faulty cleaning extends to the damage done by the faulty cleaning. The trial judge found that both of these interpretations were reasonable as the policy did not clearly suggest one alternative over the other. The judge then took into consideration the general rules of contract construction: he looked at the context, the language of the contract, as well as the nature and purpose of an all risks policy, which helped him to determine the reasonable expectations of the parties. It remains that, according to him, these rules did not produce a clear result. He therefore applied the *contra proferentem* principle, interpreted the clause against the insurers and held that the exclusion did not apply. I see no reviewable error in this analysis.

III. Disposition

[128] I would allow the appeals, set aside the order of the Court of Appeal (2015 ABCA 121, 599 A.R. 363) and restore the order of the trial judge with costs to the appellants throughout.

Appeals allowed with costs.

Solicitors for the appellant Ledcor Construction Limited: Supreme Advocacy, Ottawa; Stacey Boothman, Vancouver.

Solicitors for the appellant Station Lands Ltd.: Dentons Canada, Edmonton; Supreme Advocacy, Ottawa.

Solicitors for the respondents: Owen Bird Law Corporation, Vancouver.

[127] Le juge de première instance a examiné les interprétations opposées des dispositions pertinentes de la police. Les assurées faisaient valoir qu'en excluant les frais engagés pour « remédier » au nettoyage défectueux, on excluait simplement le coût d'un nouveau nettoyage adéquat. Les assureurs soutenaient quant à eux que le fait de « remédier » au nettoyage défectueux s'étendait aux dommages causés par ce nettoyage. Le juge de première instance a conclu que ces deux interprétations étaient raisonnables puisque la police ne privilégiait clairement aucune de ces interprétations aux dépens de l'autre. Le juge a ensuite pris en considération les règles générales d'interprétation des contrats et examiné le contexte, le libellé du contrat ainsi que la nature et l'objet d'une police d'assurance tous risques, ce qui l'a aidé à établir les attentes raisonnables des parties. Par contre, il a estimé que ces règles ne conduisaient pas à un résultat clair. Il a donc appliqué le principe *contra proferentem*, soit interprété la clause contre les assureurs, et jugé que l'exclusion ne s'appliquait pas. Je ne décèle aucune erreur susceptible de révision dans cette analyse.

III. Dispositif

[128] Je suis d'avis d'accueillir les pourvois, d'annuler l'ordonnance de la Cour d'appel (2015 ABCA 121, 599 A.R. 363) et de rétablir l'ordonnance du juge de première instance avec dépens en faveur des appelantes devant toutes les cours.

Pourvois accueillis avec dépens.

Procureurs de l'appelante Ledcor Construction Limited : Supreme Advocacy, Ottawa; Stacey Boothman, Vancouver.

Procureurs de l'appelante Station Lands Ltd. : Dentons Canada, Edmonton; Supreme Advocacy, Ottawa.

Procureurs des intimées : Owen Bird Law Corporation, Vancouver.

COURT OF APPEAL FOR ONTARIO

CITATION: Markham (City) v. AIG Insurance Company of Canada, 2020 ONCA 239
DATE: 20200331
DOCKET: C67455

Doherty, Brown and Thorburn JJ.A.

BETWEEN

The Corporation of the City of Markham

Applicant (Respondent)

and

AIG Insurance Company of Canada

Respondent (Appellant)

AND BETWEEN

AIG Insurance Company of Canada

Applicant (Appellant)

and

Lloyd's Underwriters and the Corporation of the City of Markham

Respondents (Respondents)

Marcus B. Snowden and Sébastien A. Kamayah, for the appellant

David G. Boghosian and Shaneka Shaw Taylor, for the respondents

Heard: February 12, 2020

On appeal from the judgment of Justice Annette Casullo of the Superior Court of Justice, dated August 23, 2019, with reasons reported at 2019 ONSC 4977, [2020] I.L.R. I-6184.

Thorburn J.A.:

OVERVIEW

[1] On February 2, 2015, the City of Markham ("the City") rented a hockey rink at the Angus Glen Community Centre to the Markham Waxers Hockey Club, the Markham Waxers Minor Hockey Association, and the Markham Minor Hockey Association (collectively "Waxers").

[2] A young boy watching his brother's hockey game at the community centre ("the plaintiff"), was injured when a hockey puck flew into his face.

[3] The plaintiff, through his litigation guardian, sued both the City and Hockey Canada. He seeks $150,000 in damages from the City and Hockey Canada for his broken jaw and associated pain and suffering.

[4] The City is insured by Lloyd's Underwriters ("Lloyd's") under a commercial general liability policy. The City is also an additional insured to Hockey Canada's insurance policy with AIG Insurance Company of Canada ("AIG").

[5] This is a dispute between AIG and Lloyd's in respect of the duty to defend the claim brought against the City and the rights and responsibilities that arise from that duty.

[6] AIG accepts responsibility to defend the action but claims that Lloyd's has a concurrent duty to defend and must pay an equitable share of the City's defence costs. AIG also claims it has a right to participate in the defence, including the right to retain and instruct counsel, alongside Lloyd's.

[7] AIG appeals the application judge's decision that:

a) AIG must defend the action;
b) AIG must pay the cost of defending the action subject to indemnification of costs, if any, from Lloyd's upon final resolution of the action; but
c) AIG may not participate in the defence by retaining or instructing counsel.

THE ISSUES

[8] The issues on this appeal are:

a) Does Lloyd's owe the City a concurrent duty to defend?
b) Must Lloyd's pay an equitable share of the City's defence costs? and
c) Does AIG have the right to participate in the defence, including the right to retain and instruct counsel?

[9] For the reasons that follow, I conclude that:

a) Both AIG and Lloyd's owe a duty to defend the City in the action;

b) AIG and Lloyd's must share the City's defence costs equally, subject to a right to seek a reallocation of the defence costs at the conclusion of the action; and

c) AIG has a right to participate in the defence, including the right to retain and instruct counsel.

PARTIES TO THE LITIGATION

[10] The City owns and maintains the rink.

[11] Hockey Canada is involved in oversight of hockey programs in Canada. It denies having any operational control over the arena or the events which take place in the arena.

[12] Waxers develops and promotes minor ice hockey for youth in the City. Waxers rented the rink from the City for the hockey game. The rental agreement provides that Waxers assumes "all liabilities and costs for damages caused directly or indirectly by the licensee or invitees while on or using the facility."

THE CLAIMS

[13] The plaintiff commenced legal proceedings against the City and Hockey Canada. He claims that one or both of the City and Hockey Canada failed to:

a) put in place adequate safety systems for spectators;

b) take reasonable and proper measures to ensure the hockey rink was reasonably safe for spectators;

c) ensure the hockey rink was clear of hazards;

d) ensure the reasonable safety of spectators by taking reasonable safety measures, including putting a net around the rink to prevent hockey pucks from striking spectators; and

e) place signs or warnings of danger.

[14] The plaintiff further claims that the City, Hockey Canada, or both:

a) permitted spectators to be at the hockey rink when they knew or ought to have known that it was unsafe and dangerous; and

b) allowed incompetent employees, agents or contractors to supervise the rink without suitable skill, ability or training and without ensuring that they followed safety rules and regulations.

[15] The City and Hockey Canada crossclaimed against one another.

[16] The City also commenced a third-party claim against Waxers. The City claims Waxers knew or ought to have known of the hazards at the location of the accident and failed to:

a) fulfil the contractual obligations;

b) take steps to prevent the plaintiff from being in the area;

c) supervise the plaintiff;

d) prevent the plaintiff from engaging in reckless behaviour;

e) instruct the plaintiff to obey the ice rink policies and procedures; and

f) otherwise take reasonable steps to prevent the plaintiff's accident.

[17] The City further claims that in accordance with the rental agreement, Waxers is obligated to indemnify and hold it harmless from and against all claims and proceedings in respect of any loss, damages or injury arising from Waxers' performance of and responsibilities under the Contract.

[18] Waxers defended the Claim and pleaded that they are not responsible for the physical structure, layout, design, construction, inspection, or maintenance of the arena.

THE CITY'S INSURANCE POLICIES

(a) The Lloyd's Policy

[19] The Lloyd's commercial general liability policy covers the City against damages related to bodily injury, personal injury, and property damage. The policy with the City provides that Lloyd's:

> agrees to pay on behalf of the Insured all sums which the Insured shall become legally obligated to pay by reason of liability imposed upon the Insured by law or … under Contract or agreement for damages because of
>
> (a) Bodily Injury …
>
> (b) Personal Injury

> (c) Property Damage
>
> caused by an Occurrence during the Policy Period[.]

[20] Each occurrence is insured for up to $5 million, subject to a $100,000 deductible which "shall be deducted from the total amount of all claims".

[21] The policy also requires Lloyd's to defend the City against claims for damages that fall within the policy. Lloyd's promises to:

> defend in the name of and on behalf of the Insured and at the cost of the Insurer any civil action which may at any time be brought against the Insured on account of such Bodily Injury, Personal Injury or Property Damage or Wrongful Act but the Insurer shall have the right to make such investigation, negotiation and settlement of any claim as may be deemed expedient by the Insurer[.]

[22] Finally, the policy provides for how liability is determined when another insurance policy also covers the claim. It states that:

> The Insurer shall not be liable if at the time of any accident or occurrence covered by the Policy, there is any other insurance which would have attached if this insurance had not been effected, except that this insurance shall apply only as excess and in no event as contributing insurance and then only after all such other insurance has been exhausted. [Emphasis added.]

(b) The AIG Policy

(i) AIG's Policy Covering Hockey Canada and Waxers

[23] AIG insures Hockey Canada and other entities, including Waxers, pursuant to a commercial general liability policy. The AIG policy insures

against damages because of bodily injury or property damage that fall within the policy:

> [AIG] will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies.

[24] The policy also provides that "[n]o other obligation or liability to pay sums or perform acts or services is covered unless explicitly provided for" and that AIG "will have the right and duty to defend any 'action' seeking those damages [to which this insurance policy applies until AIG has] … used up the applicable limit of insurance in the payment of judgments or settlements".

[25] "Action" is defined as "a civil proceeding in which damages because of 'bodily injury', 'property damage' or 'personal injury' to which this insurance applies are alleged."

[26] The AIG policy also provides indemnity for legal fees incurred to defend the insured for actions that fall within the coverage.

[27] Section IV, subsection 9 of the AIG policy provides that "[t]he insurance afforded by this Policy is primary insurance". There is no excess provision in the AIG policy, in respect of claims occurring in Canada.

(ii) AIG's Third-Party Liability Insurance for the City

[28] As part of its rental agreement, the City required Waxers to obtain general liability insurance for bodily injury arising from Waxers' use of the rink and to include the City as an additional insured under that policy.

[29] Waxers delivered a Certificate of Insurance to the City confirming that the City was added as an additional insured to the AIG policy "but only with respect to the operations of the named insured [Hockey Canada and Waxers]" (emphasis added).

[30] Similarly, Endorsement 2 of the AIG Policy provides that the City is included "as Additional Insured but only in respect of liability arising out of the Named Insured's operations."

[31] The Certificate also provides that it is subject to the limitations, exclusions and conditions of the policy.

[32] The City is insured for up to $5 million per occurrence under the AIG policy as an additional insured.

THE PROCEEDINGS

(a) Overview

[33] The City and AIG brought competing applications to determine which insurers had a duty to defend the action and participate in the defence.

[34] The City and Lloyd's were represented by the same counsel who sought a declaration that AIG had a duty to defend the City and that the City was entitled to appoint and instruct counsel of its choice without having to report to or take instructions from AIG.

[35] AIG admitted that it has a duty to defend but claimed that Lloyd's owes a concurrent duty to defend and to contribute to the defence costs. AIG opposed the application and sought a declaration requiring AIG and Lloyd's to jointly agree on and instruct counsel to defend the City in the underlying action.

(b) The Application Judge's Reasons

(i) Duty to Defend

[36] The application judge did not expressly state that Lloyd's has no duty to defend, though paras. 37-39 of her reasons would seem to suggest that she concluded that AIG alone has a duty to defend all claims in this action.

[37] Under the heading "Does Lloyd's have a continuing duty to defend the City?", the application judge focused on the fact that AIG had a clear duty to defend the underlying action. She held that:

> [37] Where a plaintiff advances allegations of negligence which fall outside the scope of the contract, and the insurer has not clearly specified in its policy that the duty to defend is limited to covered rather than uncovered claims, then the insurer's duty is to defend all

> of the claims, both covered and non-covered. See, for example, *Carneiro v. Durham (Regional Municipality)*, [2015] O.J. No. 6812.
>
> [38] There is nothing in AIG's Policy that qualifies its duty to defend, or to suggest that the duty to defend did not apply to "mixed claims." AIG could have written qualifying words into the policy providing for an allocation of "mixed claims." It chose not to do so.
>
> [39] If the court acceded to AIG's request there would potentially be three or more lawyers defending the action (one for the Waxers, one for the City, and one for Lloyd's). This simply does not make economic sense.

(ii) Costs of the Defence

[38] In respect of paying the costs of the defence however, she held that AIG had a right to seek contribution from Lloyd's at the end of the action for the cost of defending claims that fell outside the coverage of the AIG policy but within the coverage of the Lloyd's policy. She concluded that:

> [40] In the result, AIG shall pay all reasonable costs associated with the defence of the underlying action, even though those costs further the defence of uncovered claims. This is, of course, subject to AIG's right to seek reimbursement from Lloyd's for costs incurred in relation to uncovered claims.

(iii) AIG's Participation in the Defence

[39] Despite concluding that AIG had a duty to fund the City's defence, the application judge held that AIG was not permitted to participate in the defence.

[40] She found that there were two sources of potential or actual conflicts of interest between the City and AIG. First, the City had launched a cross-claim and third-party claims against AIG's own insureds alleging that they were either liable for breach of contract, for contribution and indemnity, or both. Second, as submitted by counsel for the City and Lloyd's, some claims were not covered by the AIG policy and were only covered by the Lloyd's policy. As such, AIG had an incentive to conduct the defence so as to impose the majority of liability on the City based on the uncovered risk, rather than the covered risk.

[41] The application judge found that there was a perceived if not actual conflict of interest. She noted that AIG proposed to implement a "split file" protocol where separate claims handlers would be appointed to instruct defence counsel for the City and the other defendants in the actions, as well as to handle any coverage issues against the City. Their files would be screened from the files of other claims handlers and marked as confidential.

[42] For the reasons that follow, she rejected AIG's proposal:

> [24] The case for independent counsel grows stronger, … considering the crossclaims for contribution and indemnity brought by the City and AIG. AIG's own casualty claims analyst admitted at his cross-examination that a perceived, if not actual, conflict of interest exists between the City and AIG.
>
> [25] AIG suggests that any conflict can be managed by ensuring a separate claims handler at AIG handles

the City's defence, and by following a "split file" protocol. This protocol consists of physically and digitally screening the file from other claims handlers with AIG. The physical documents are put into a folder marked confidential, and the electronic documents are marked "internal" or "confidential." AIG's casualty claims analyst agreed there is no way to monitor whether other handlers can access and review the confidential documents.

[26] Further, with no written policy setting out a formal practice in respect of managing conflicts through the "split file" protocol, AIG has not satisfied the court that this ethical wall is adequate to resolve the conflict of interest concerns.

[27] I am mindful of Ferguson J.'s very recent decision in *HMQ v. AIG*, 2019 ONSC 2964, where an application identical to the one before me was dismissed. I note there were some differences in the evidence in respect of AIG's "split file" protocol. For example, there was no evidence before me that a claims handler would be subject to discipline if she/he breached protocol. Further, AIG's analyst indicated there was no way of knowing whether other handlers could access and see documents marked "confidential." Moreover, in that case only HMQ had issued a crossclaim, so the potential for AIG being in a position of conflict was not as evident.

…

[29] … AIG would only be liable to indemnify the City to the extent of the Waxers' liability, so its efforts would obviously be to reduce that exposure and play to the uncovered claims' strength, being the occupiers' liability claims.

[30] Ultimately, I am persuaded by the City's argument that counsel's mandate from AIG in respect of defending the Waxers can reasonably be seen to conflict with AIG's mandate to defend the City.

[43] She concluded that there is an “irremediable conflict of interest” in AIG defending both the City and Hockey Canada and that the “split file” protocol proposed by AIG is unworkable in respect of this claim for negligence and breach of contract. As such, she concluded that the City should be permitted to select and instruct its own counsel without having to report to AIG.

ANALYSIS

THE FIRST ISSUE: DOES LLOYD’S HAVE A CONCURRENT DUTY TO DEFEND?

(a) The Governing Principles

(i) The Relationship between an Insured and an Insurer

[44] The relationship between an insured and an insurer is a contractual one governed primarily by the terms of the insurance policy. The proper instrument to determine the liability of each insurer is the contract itself: *Family Insurance Corp. v. Lombard Canada Ltd.*, 2002 SCC 48, [2002] 2 S.C.R. 695, at paras. 16-18 and *Van Huizen v. Trisura Guarantee Insurance Company*, 2020 ONCA 222.

[45] The language of the policy is construed in accordance with the usual rules of construction rather than inferred "expectations" not apparent on a fair reading of the document. This is particularly so in the case of commercial insurance policies involving sophisticated parties. In so doing, the insurer

must explicitly state the basis on which coverage may be limited: *Hanis v. Teevan*, 2008 ONCA 678, 92 O.R. (3d) 594, at para. 22, leave to appeal refused, [2008] S.C.C.A. No. 504.

(ii) The Duty to Defend Claims

[46] An insurer has a duty to defend where there is a "mere possibility" that the true nature of the pleaded claim, if proven at trial, falls within coverage and would trigger the insurer's duty to indemnify: *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, 2010 SCC 33, [2010] 2 S.C.R. 245, at para. 19.

[47] If the pleadings allege facts which, if true, would require the insurer to indemnify the insured for the claim, then the insurer is obliged to provide a defence, even though the actual facts may differ from the allegations in the statement of claim: *Monenco Ltd. v. Commonwealth Insurance Co.*, 2001 SCC 49, [2001] 2 S.C.R. 699, at para. 28; *Alie v. Bertrand & Frère Construction Company Limited (2002)*, 62 O.R. (3d) 345 (C.A.), at para. 182, leave to appeal refused, [2003] S.C.C.A. No. 48.

[48] In Hanis, at para. 23, Doherty J.A. held that.

> I see no unfairness to the insurer in holding it responsible for all reasonable costs related to the defence of covered claims if that is what is provided for by the language of the policy. If the insurer has contracted to cover all defence costs relating to a claim, those costs do not increase because they also assist

> the insured in the defence of an uncovered claim. The insurer's exposure for liability for defence costs is not increased. Similarly, the insured receives nothing more than what it bargained for -- payment of all defence costs related to a covered claim. [Emphasis added.]

[49] However, an insurer is not obligated to pay costs incurred solely to defend uncovered claims: *Hanis*, at para. 25.

(iii) Primary and Excess Coverage

[50] In *Trenton Cold Storage v. St. Paul Fire & Marine* (2001), 199 D.L.R. (4th) 654 (Ont. C.A.), at para. 24, this court explained the difference between primary and excess insurance. Where there is primary insurance coverage, liability attaches immediately upon the happening of the occurrence that gives rise to the liability. An excess policy, on the other hand, is one that provides that the insurer is liable for the excess above and beyond that collected on primary insurance.

[51] Determining priority for overlapping coverage requires both policies to cover the same risk. An excess policy is excess to the claims covered in the primary policy: *Family Insurance*, at para. 15.

[52] Where there is both primary and excess insurance coverage, the limits of the primary insurance must be exhausted before the primary carrier has a right to require the excess carrier to contribute to a settlement. The remote position of an excess carrier greatly reduces its chance of exposure to a

loss: *Trenton Cold Storage*, at para. 24, citing with approval the explanation in *St. Paul Mercury Insurance Co. v. Lexington Insurance Company*, 78 F. 3d. 202 (5th Cir. 1996) at footnote 23, quoting from *Emscor Mfg., Inc. v. Alliance Ins. Group*, 879 S.W.2d 894 at 903 (Tex. App. 1994), *writ denied*, at 903.

(b) Application of the Law to the Facts in this Case

(i) The Parties' Positions

[53] There is no dispute that the AIG policy covers the City against all liability with respect to the operations of Hockey Canada and Waxers, that the AIG policy is a primary insurance policy, and that AIG has a duty to defend the City against claims which fall within the scope of its policy.

[54] However, AIG argues that Lloyd's is also a primary insurer on the claims covered by the AIG policy and the only insurer who is liable to indemnify the City against other claims in the action. As a result, Lloyd's also owes a duty to defend.

[55] In response, Lloyd's and the City argue that AIG is the primary insurer on all of the claims in the action and that Lloyd's is an excess insurer only. They contend that the decision of the British Columbia Court of Appeal in *Saanich (District) v. Aviva Insurance Company of Canada*, 2011 BCCA 391, 23 B.C.L.R. (5th) 272, (although that case dealt with a dispute between an

insurer and an insured not two insurers) supports their submission that the language in the AIG policy regarding coverage for the additional insured – "only in respect of the operations of the named insured" – is broad enough to cover all claims alleged against the City. As well, because the claimed amount in the underlying action – $150,000 – falls well within AIG's policy limits, they claim there is no duty to indemnify under the Lloyd's policy and therefore no duty to defend.

(ii) The Lloyd's Policy

[56] The Lloyd's policy covers the City for *all* claims of bodily injury, personal injury or property damage "caused by an Occurrence during the Policy Period".

[57] The only limitation in the Lloyd's policy is that:

> The Insurer shall not be liable if at the time of any accident or occurrence covered by this Policy, there is any other insurance which would have attached if this insurance had not been effected, except that this insurance shall apply only as excess and in no event as contributing insurance and then only after all such other insurance has been exhausted.

[58] This provision seems to provide that if:

a) at the time of the accident;

b) the claim is covered by the Lloyd's policy; and

c) another insurance policy would have attached to cover all or part of the claim had the Lloyd's policy not been in place,

Lloyd's is not liable except as an excess insurer such that it has an obligation to contribute only after all other insurance has been exhausted.

[59] In this case, at the time of the accident, the claim was covered by the Lloyd's policy and the AIG policy would have attached to cover part of the claim had the Lloyd's policy not been in place.

[60] Therefore, to the extent but *only* to the extent that claims would be covered by the AIG policy, Lloyd's would be an excess insurer with respect to those claims.

[61] AIG refers to the case of *State Farm Fire and Casualty Co. v. Royal Insurance of Canada* (1998), 115 O.A.C. 388 (C.A.), where a similar clause was held not to be an excess insurance policy clause.

[62] It is not necessary to address the conclusion in this brief endorsement in interpreting the Lloyd's provision because in this case, unlike *State Farm Fire and Casualty Co.*, there are some claims in the underlying action which may not be covered by the AIG policy and may *only* be covered by the Lloyd's policy.

[63] In any event, I note that the *State Farm Fire and Casualty Co.* decision appears to have been made without the benefit of two other decisions –

McGeough v. Stay 'N Save Motor Inns Inc. (1994), 92 B.C.L.R. (2d) 288 (C.A.), and *Gagnon v. Insurance Company of North America and Industrial Acceptance Co. Ltd.* (1967), 64 D.L.R. (2d) 355 (Que. C.A.), aff'd on a different point, [1969] S.C.R. 824 – that interpreted similar policy language and adopted a different conclusion, one that seems more consistent with the plain meaning of the words in the provision.

[64] I conclude therefore, that Lloyd's has a duty to defend the City against those claims in the action not covered by the AIG policy. The parties are free to seek a final determination of the issue of coverage for the portion of the claim covered by the AIG policy, including the applicability, if any, of the reasoning of the British Columbia Court of Appeal in *Saanich* to the interpretation of the additional insured provision in the AIG policy, upon final resolution of the action and apportionment of liability.

(iii) Lloyd's Duty to Defend

[65] Lloyd's has a duty to defend the City in respect of all claims of bodily injury, personal injury or property damage caused by "an Occurrence".

[66] The AIG policy only covers the City for "liability in respect of [Hockey Canada and Waxers'] operations". AIG expressly limited its obligation as "[n]o other obligation or liability to pay sums or perform acts or services is covered unless explicitly provided for". All other occurrences that cause

bodily injury, personal injury or property damage are not covered by the AIG policy but are covered by the Lloyd's policy.

[67] Thus, for example, the alleged failure on the part of the City to "ensure the reasonable safety of spectators through the use of reasonable safety measures, including a net around the rink to prevent hockey pucks from striking spectators" and the failure to "put into place proper and sufficient systems for the safety of spectators" may be covered by the Lloyd's policy but may not be covered under the AIG policy.

[68] As a result, both AIG and Lloyd's have a duty to defend.

[69] This conclusion is consistent with the decision of this court in *Carneiro v. Durham (Regional Municipality)*, 2015 ONCA 909, 55 C.C.L.I. (5th) 1.[1] This court held, at para. 13, that:

> Durham was an additional insured under Zurich's policy. The policy contained an unqualified promise to defend the insured for actions covered by the policy. Zurich is therefore obligated to pay the reasonable costs of Durham's defence of covered claim, even if that defence furthers the defence of uncovered claims. However, it is not obligated to pay costs related solely to the defence of uncovered claims: *Hanis v. Teevan*, 2008 ONCA 678, 92 O.R. (3d) 594, at para. 2. [Emphasis added.]

1 Contrary to the respondents' assertion, *Carneiro* does not stand for the proposition that whenever one aspect of a claim is covered by the policy, all costs of the defence must be borne by that insurer.

[70] In response, Lloyd's and the City submit that there is an exclusion in the Lloyd's policy that absolves Lloyd's of the duty to defend. It does not.

[71] The words in the Lloyd's policy:

> This Policy does not apply directly or indirectly to … any liability of the Insured [City] … to any obligation to share damages with or repay someone else who must pay damages because of Bodily Injury[.]

refer to the City assuming an obligation *for* a third party's actions, not a third party (Waxers) agreeing *to* indemnify the City for the third party's actions.

[72] Lastly, while the $100,000 deductible in the Lloyd's policy may affect the sum Lloyd's is required to pay out to the insured City upon final resolution of the claim, the deductible does not affect the duty to defend the action based on the wording of the policy.

(c) Conclusion

[73] AIG is the primary insurer for claims resulting in bodily injury or property damage arising from the operations of Hockey Canada and Waxers up to the $5 million policy limit because the AIG policy contains no excess provision: *Progressive Homes*. The $150,000 claim falls within AIG's policy limit.

[74] To the extent the AIG and Lloyd's policies cover *the same* claims, AIG has a duty to defend up to its policy limit, and Lloyd's may be an excess insurer.

[75] However, at a minimum, Lloyd's owes a duty to defend the City against claims which may fall outside the scope of the AIG policy and which fall within the scope of its own policy.

[76] The fact that AIG has a duty to defend the City does not, by itself, excuse another insurer from its duty to defend: *Unger (Litigation guardian of) v. Unger* (2004), 68 O.R. (3d) 257 (C.A.), at para. 10. Lloyd's also has a duty to defend.

[77] Therefore, the application judge's determination that only AIG has the duty to defend the action is incorrect.

THE SECOND ISSUE: MUST LLOYD'S PAY THE ONGOING COSTS OF DEFENDING THE CLAIM?

(a) The Governing Principles

[78] Where two insurers have an obligation to defend the same claim, the insured is entitled to select the policy under which to claim indemnity, subject to any conditions in the policy to the contrary: *Family Insurance*, at paras. 14-15.

[79] However, where both insurers are responsible to defend and one is selected by the insured to assume the defence, it may be inequitable for one insurer to pay all costs and the other to pay nothing unless for example, there is no realistic chance the policy would be reached by the claim: *Alie*. As a result, the insurer selected by the insured to defend the claim may be entitled to contribution from all other insurers who have a concurrent duty to defend the insured.

[80] As noted by the Supreme Court in *Family Insurance,* at paras. 14-15:

> It is a well-established principle of insurance law that where an insured holds more than one policy of insurance that covers the same risk, the insured may never recover more than the amount of the full loss but is entitled to select the policy under which to claim indemnity, subject to any conditions to the contrary. The selected insurer, in turn, is entitled to contribution from all other insurers who have covered the same risk. This doctrine of equitable contribution among insurers is founded on the general principle that parties under a coordinate liability to make good a loss must share that burden pro rata. It finds its historic articulation in the words of Lord Mansfield C.J. in *Godin v. London Assurance Co.* (1758), 1 Burr. 489, 97 E.R. 419 (K.B.), at p. 420:
>
> > If the insured is to receive but one satisfaction, natural justice says that the several insurers shall all of them contribute pro rata, to satisfy that loss against which they have all insured.
>
> [Emphasis added.]

[81] Similarly, in *Broadhurst & Ball v. American Home Assurance Co.* (1991), 1 O.R. (3d) 225 (C.A.), at p. 241, leave to appeal refused, [1991] S.C.C.A. No. 55, the court held that where two insurers have a concurrent obligation to defend:

> [T]heir respective obligations cannot be a matter of contract. Nonetheless, their obligations should be subject to and governed by the principles of equity and good conscience, which, in my opinion, dictate that the costs of litigation should be equitably distributed between them.

[82] The full and early participation of all insurers who are potentially liable promotes settlement and expedites the trial process: *Alie,* at para. 201. The insurers have the same interest in minimizing their exposure by conducting the best defence possible.

[83] The allocation of defence costs as among insurers who have a concurrent obligation to defend is essentially a matter of fairness as among those insurers. As such, the allocation of costs is not an exact science and an application or trial judge's determination is owed considerable deference: *Alie,* at para. 235; *Broadhurst,* at p. 241.

(b) Application of the Law to the Facts in This Case

[84] Each of AIG and Lloyd's has a duty to defend at least some of the claims in the action so each is responsible to contribute to the defence costs of the City: *Aquatech Logistics et al. v. Lombard Insurance et al.*, 2015

ONSC 5858, 55 C.C.L.I. (5th) 326, at paras. 43-47. As there is no contract between them with respect to the defence, their respective obligations should be governed by the principles of equity.

[85] On the facts of this case, the respective risk of the two insurers is real but the level of risk cannot yet be ascertained given the early stage of the proceedings and the claim does not allow for a precise allocation of defence costs.

[86] The usual deference does not apply to the application judge's decision in this case as her analysis is premised on the faulty assumption that Lloyd's has no duty to defend and her analysis does not address the central issue of fairness and equity.

[87] In these circumstances where there are two primary insurers, the Lloyd's policy is more comprehensive than AIG's, and there is a concurrent duty to defend, the fairest and most equitable allocation of defence costs would seem to be to require each of AIG and Lloyd's to pay an equal share of the defence costs pending final disposition of the action and the final determination of the allocation of defence costs: *General Accident Assurance Co. of Canada v. Ontario Provincial Police Commissioner* (1988), 64 O.R. (2d) 321 (H.C.), at p. 325, cited approvingly in *Reeb v. The Guarantee Company of North America*, 2019 ONCA 862, at para. 11;

General Electric Canada Co. v. Aviva Canada Inc., 2010 ONSC 6806, 10 C.C.L.I. (5th) 16, at para. 82, aff'd 2012 ONCA 525, 10 C.C.L.I. (5th) 42.

THE THIRD ISSUE: DOES AIG HAVE THE RIGHT TO PARTICIPATE IN THE DEFENCE INCLUDING THE RIGHT TO RETAIN AND INSTRUCT COUNSEL?

(a) The Governing Principles

[88] In *Brockton (Municipality) v. Frank Cowan Co.* (2002), 57 O.R. (3d) 447 (C.A.), at para. 31, this court explained that an insurer who has a duty to defend an action also has a *prima facie* right to control the conduct of that defence.

[89] In order to remove the insurer's contractual right to "defend and control the defence of the litigation," there must be a "reasonable apprehension of conflict of interest on the part of counsel appointed by the insurer": *Brockton*, at para. 43.

[90] In *Brockton*, at para. 43, this court held that:

> The balance is between the insured's right to a full and fair defence of the civil action against it and the insurer's right to control that defence because of its potential ultimate obligation to indemnify.
>
> …
>
> The question is whether counsel's mandate from the insurer can reasonably be said to conflict with his mandate to defend the insured in the civil action. Until that point is reached, the insured's right to a defence

> and the insurer's right to control that defence can satisfactorily co-exist.

[91] Counsel defending the action should have the confidence of the insurer who is obliged to pay the legal fees and may have to pay a substantial judgment on behalf of the insured. Counsel must also meet their legal and ethical obligation to represent and protect the interests of the insured: *Hoang v. Vincentini,* 2015 ONCA 780, 57 C.C.L.I. (5th) 119, at para. 14; *Mallory v. Werkmann Estate*, 2015 ONCA 71, 330 O.A.C. 337, at para. 29.

[92] The mere fact that an insurer has reserved its rights on coverage does not cause the insurer to lose its right to control the defence and appoint counsel. The question is whether the circumstances of the case create a reasonable apprehension of conflict of interest if that counsel were to act for both the insurer and the insured in defending the action: *Brockton,* at paras. 39-40, 43, citing *Zurich of Canada v. Renaud & Jacob*, [1996] R.J.Q. 2160 (C.A.) at pp. 2168-69, per Lebel J.A. (as he then was).

[93] The onus is on the insured to establish a reasonable apprehension of conflict of interest on the part of the insurer: *Brockton*, at para. 43; *Wal-Mart v. Intact*, 2016 ONSC 4971, 133 O.R. (3d) 716; and *Brookfield Johnson Controls Canada LP v. Continental Casualty Company*, 2017 ONSC 5978.

(b) Application of the Law to the Facts in This Case

[94] In this case, AIG's policy provides that AIG has a duty and right to defend the action. Lloyd's policy also provides that it has a duty and right to defend the action. The insured elected to have AIG defend the action.

[95] Lloyd's and the City are represented by the same counsel on this appeal. Counsel claims that if AIG retains and instructs counsel to defend the claims against the City, that counsel will have a strong incentive to "settle the claim as quickly as possible as against the City" or "[a]t the very least … to try to prove that only the City is liable for the Plaintiff's damages by way of any claims falling outside of what AIG believes is the scope of coverage afforded by the AIG Policy", because the AIG policy only covers occurrences arising from the operations of Hockey Canada and Waxers.

[96] This they say, creates a reasonable apprehension of conflict of interest in counsel retained and instructed by AIG.

[97] However, counsel for AIG argues that there is also a reasonable apprehension that counsel retained and instructed by Lloyd's and/or the City would also find themselves in a conflict of interest.

[98] The issue in this case is not *whether* the City has coverage for some or all of the claims in the action but which of two insurers is responsible to cover which claims in accordance with their respective policies of insurance.

Consequently, cases which address the question of whether there is coverage for all or part of a claim are distinguishable. See for example: *Pabla v. City of Mississauga*, 2015 ONSC 5156; *Glassford v. TD Home & Auto Insurance Co.* (2009), 94 O.R. (3d) 630 (S.C.); and *Lefeuvre v. Boekee,* 2017 ONSC 6874, 74 C.C.L.I. (5th) 174.

[99] The AIG policy only covers claims in respect of the operations of Hockey Canada and Waxers, while the Lloyd's policy covers all occurrences subject to its $100,000 deductible, which is lower than the amount claimed.

[100] As such, if Lloyd's were to retain and instruct counsel, counsel might seek to have responsibility for any wrongdoing attributed to the operations of Hockey Canada or Waxers rather than the City, so that any damages are either shared by or fully encompassed by AIG's policy.

[101] Similarly, if the City were to retain and instruct counsel, the City has an interest in having claims paid by AIG rather than Lloyd's, as any payment made by Lloyd's might result in an increase in premiums paid by the City pursuant to the Lloyd's policy. The Lloyd's policy also has a $100,000 deductible, while the AIG policy does not. The City has already aligned its interest with Lloyd's, as evidenced by the fact that one counsel represents them both on this appeal.

[102] It would appear that each of AIG, Lloyd's and the City have conflicting interests as follows:

a) AIG has an interest in having liability determined on the basis of the City's actions alone so that AIG is not responsible for paying any damages. This is because its policy only covers the incidents that arise out of the operations of Hockey Canada or Waxers and because it is also defending Hockey Canada and Waxers in the main action;
b) Lloyd's has an interest in having liability determined on the basis that the claim arose from the operations of Hockey Canada or Waxers and not from the actions of the City to minimize its exposure to the losses; and
c) The City also has an interest in having liability determined on the basis that the claim arose from the operations of Hockey Canada or Waxers so that the City's premiums do not rise and so that they do not have to assume the full $100,000 deductible in the Lloyd's policy.

[103] The court must endeavour to balance the insured's right to a full and fair defence of the civil action with the insurers' right to control the defence such that AIG does not abuse its right to defend and settle the claim to the detriment of Lloyd's and/or the City: *Brockton*, at para. 43.

[104] In situations such as this, it is important to have in place mechanisms to minimize conflicts of interest and provide meaningful protections to the

party not having control of the defence: *PCL Constructors Canada Inc. v. Lumbermens Mutual Casualty Company Kemper Canada* (2009), 76 C.C.L.I. (4th) 259 (Ont. S.C.), at para. 89.

[105] AIG suggests implementing a "split file" verbal protocol to lessen the concerns and provide protection to the insured and Lloyd's. This would ensure that potentially conflicting interests insured by one policy are handled separately and that the separate claims be dealt with by separate counsel.

[106] AIG's proposal is as follows:

a) The City's defence as an additional insured would be handled and screened internally so that Hockey Canada and Waxers' information is held separately and kept confidential from information in respect of the City claim;
b) Physical files would be scanned and converted into digital format upon receipt;
c) A file subject to the "split file" protocol would be digitally marked confidential and would not be accessed by any other handler, including the handler responsible for the defence of another adverse insured party. This is to protect confidential information and avoid any perceived or actual "party-based" conflict of interest between the insured interests;

d) The handlers for the City defence would be different from those handling the Hockey Canada defence. Similarly, the handlers for coverage issues would be different from the handlers for liability issues;

e) A claims handler in breach of the "split file" protocol would be subject to disciplinary action and could be dismissed if confidential information is disclosed;

f) AIG agrees to work cooperatively with Lloyd's to agree upon, appoint/instruct, and pay for an independent defence counsel. That counsel will be different from AIG's coverage counsel; and

g) AIG commits to sharing funding costs incurred in the City's defence.

[107] Lloyd's and the City by contrast, make no proposal save that AIG fund the defence but have no role in retaining or instructing counsel.

[108] The application judge erred when she determined that there were no measures that could alleviate the City's concerns short of removing AIG from the defence entirely.

[109] There is no reason to believe that appropriate counsel who has an ethical obligation to defend the insured properly, will not conduct the defence in the best interest of the insured. There is also no evidence that any of the handlers have misused any confidential information or, with appropriate disciplinary measures put in place, will misuse confidential information.

[110] I note that one of the key reasons cited by the application judge for not accepting the proposed protocol was that no disciplinary measures would be taken against persons at AIG who contravened the protocol.

[111] The application judge was mistaken.

[112] The AIG handler confirmed that any person contravening the protocol would be met with disciplinary action that could lead to dismissal.

[113] The AIG proposal attempts to minimize the risk of harm by creating a system to protect confidential information and separate files, enable all three parties to participate in retaining, instructing and receiving instructions from counsel and provide recourse against those who do not adhere to the system.

[114] However, if AIG is to retain its right to participate in the defence, a few additional terms are warranted. This court imposes these additional obligations in accordance with AIG's acknowledgment of the "balanced screen" approach set out in *PCL Constructors Canada* and its powers under the *Courts of Justice Act*, R.S.O. 1990, c. C. 43, s. 134(1)(a) as follows:

a) The terms of this proposal must be provided in writing to those involved in managing the defence;
b) Counsel appointed would be instructed to fully and promptly inform the City and Lloyd's of all steps taken in the defence of the litigation against the

City such that each would be in a position to monitor the defence effectively and address any concerns;

c) Defence counsel must have no discussion about the case with either coverage counsel; and

d) Counsel must provide identical and concurrent reports to the insured and both insurers regarding the defence of the main action.

UPS Supply Chain Solutions, Inc. v. Airon HVAC Service Ltd., 2015 ONSC 3104, 49 C.C.L.I. (5th) 201, at para. 31; *PCL Constructors Canada*, at para. 93.

[115] This will allow AIG to participate in the defence and resolution of the action as set out in the AIG policy, while at the same time, allowing Lloyd's and the City the opportunity to know of and address concerns in a timely manner: *PCL Constructors Canada,* at para. 90.

[116] Given the multiple conflicting interests, this protocol and the safeguards it provides, albeit not without any concerns, recognize the legitimate interests of both the insured and the insurers and address the concern that AIG may abuse its right to defend and settle to the prejudice of the insured.

SUMMARY OF CONCLUSIONS

[117] Each of AIG and Lloyd's has a duty to defend the action.

[118] Each must therefore contribute to the ongoing cost of the defence.

[119] The apportionment of costs cannot yet be determined. AIG and Lloyd's are required to share the cost of the defence equally, subject to a right to seek a re-apportionment of the costs upon final resolution of the action.

[120] AIG and Lloyd's may also jointly retain and instruct counsel provided the above steps are implemented to safeguard the interests of all parties. This order is without prejudice to the parties' right to move for directions from the Superior Court should they be unable to agree on the conduct of the defence.

[121] In cases such as this where there is a dispute among the insurers and the City, it is incumbent upon all parties to work with one another and to exchange ideas in respect of a proposed protocol. Insurers and sophisticated parties like the City are best placed to determine what systems could work best.

[122] Unless there is an agreement among the parties, all parties should make submissions in respect of their proposed protocol.

[123] For the above reasons, the appeal is allowed.

[124] On agreement of the parties, the costs order in the proceedings below is set aside. Costs of this appeal are awarded to AIG in the amount of $15,000, inclusive of HST.

Released: March 31, 2020 (“D.D.”)

“J.A. Thorburn J.A.”

“I agree. Doherty J.A.”

“I agree. David Brown J.A.”

CITATION: Goodfellow v. CUMIS General Insurance Company, 2021 ONSC 3604
COURT FILE NOS.: CV-21-00658241-00CL
CV-21-00658643-00CL
CV-21-00655599-00CL
CV-21-00656590-00CL
CV-21-00655627-00CL
DATE: 20210518

SUPERIOR COURT OF JUSTICE - ONTARIO

RE: **CV-21-00658241-00CL**

IAN GOODFELLOW, WENDY MITCHELL, NEIL WILLIAMSON, PAULINE WAINWRIGHT, DEBORAH BAKER, BRENT BAILEY, JIM TINDALL, PETER REBELLATI, AL JONES, AND GEIRGE POHLE, Applicants

AND:

CUMIS GENERAL INSURANCE COMPANY, Respondent

AND:

FINANCIAL SERVICES REGULATORY AUTHORITY OF ONTARIO, in its capacity as the Administrator of PACE SAVINGS & CREDIT UNION INC., Intervenor

CV-21-00658643-00CL

FRANK KLEES and KLEES and ASSOCIATES, Applicants

AND:

CUMIS GENERAL INSURANCE COMPANY, Respondent

CV- 21-00655599-00CL

LARRY SMITH, Applicant

AND:

CUMIS GENERAL INSURANCE COMPANY, Respondent

CV-21-00656590-00CL

PHILLIP SMITH, Applicant

AND:

CUMIS GENERAL INSURANCE COMPANY, Respondent

CV-21-00655627-00CL

BRIAN HOGAN, Applicant

AND:

CUMIS GENERAL INSURANCE COMPANY, Respondent

BEFORE: Cavanagh J.

COUNSEL: *Steven Stieber*, for the Goodfellow Applicants

Michael A. Cohen, for the Applicants, Frank Klees and Klees and Associates

Alistair Crawley and *Clarke Tedesco*, for the Applicant, Larry Smith

Steven Weisz and *Pat Corney*, for the Applicant, Phillip Smith

Victor L. Vandergust, for the Applicant, Brian Hogan

Thomas J. Donnelly and *Joyce Tam*, for the Respondent, CUMIS General Insurance Company

Jason Wadden and *Michael Wilson*, for the Intervenor in Goodfellow application, Financial Services Regulatory Authority of Ontario, in its capacity as the Administrator of PACE Savings & Credit Union Ltd.

HEARD: April 20, 2021

ENDORSEMENT

Introduction

[1] There are five applications before me. The applicants are former directors of PACE Savings & Credit Union Limited ("PACE"), a credit union. An action has been brought against the applicants in the name of PACE by its regulator and administrator, the Financial Services Regulatory Authority ("FSRA").

[2] In these applications, the applicants seek a declaration that CUMIS General Insurance Company ("CUMIS") is obligated to defend the applicants in this underlying claim pursuant to a Directors' and Officers' Liability Policy (the "D&O Policy") issued by CUMIS.

[3] For the following reasons, I conclude that CUMIS is obligated under the D&O Policy to defend the applicants in the underlying claim.

Factual background

[4] The FSRA is the regulator of credit unions in Ontario pursuant to the *Credit Unions and Caisses Populaire Act, 1994* (the "Act"). On June 8, 2019, the FSRA amalgamated with the Deposit Insurance Corporation of Ontario, the former entity that carried out the regulation of credit unions in Ontario under the Act. For ease of reference, I refer to the regulator as FSRA, regardless of whether the event described took place before or after June 8, 2019.

[5] The FSRA administers deposit insurance to members of Ontario's credit unions. It is the regulatory supervisor and, where required, the administrator and liquidator of credit unions (as those terms are defined in the Act).

[6] PACE is a credit union incorporated under the Act and is regulated by the FSRA. As a credit union, PACE is owned and controlled by its members.

[7] The Applicants are each former members of the Board of Directors of PACE.

[8] CUMIS is an Ontario-based insurance company which provides, among other things, insurance products and services to credit unions, caisses populaires, and their members in Canada.

[9] CUMIS issued the D&O Policy for the policy period January 1, 2018 through January 1, 2019. Capitalized words in the D&O Policy have the meanings in the "Definitions" section of the policy.

[10] The D & O Policy provides the following coverage to the applicants:

> Subject to the terms and conditions of this Policy, the Insurer will pay on behalf of:
>
> For a DIRECTOR OR OFFICER, any of the following:
>
> 1. All LOSS arising from any CLAIM first made against such DIRECTOR OR OFFICER during the POLICY PERIOD, for which the DIRECTOR OR OFFICER is not indemnified by the CORPORATION.
> 2. All LOSS arising from any CLAIM first made against such DIRECTOR OR OFFICER during the POLICY PERIOD, and for which they become legally obligated to pay solely as a result of INSOLVENCY of the CORPORATION.

[11] The D & O Policy provides that it shall not apply to loss based upon, arising out of, or attributable to:

> A CLAIM by or on behalf of the CORPORATION or a DIRECTOR OR OFFICER except for a CLAIM:
>
> a. that is a derivative action brought or maintained on behalf of the CORPORATION by a person who is not a DIRECTOR OR OFFICER without the cooperation, solicitation, assistance or active participation of the CORPORATION or any DIRECTOR OR OFFICER; ...
>
> ...
>
> e. brought or maintained by a liquidator, receiver, or trustee in bankruptcy and made directly against a DIRECTOR of the CORPORATION and then only for DEFENCE COSTS, to the extent that they are covered under this policy.

[12] Following an investigation into various transactions and conduct that had occurred or were occurring at PACE, the FSRA issued an Administration Order dated September 28, 2018 and took control of PACE as administrator. This ultimately resulted in the Board of Directors of PACE being rendered functus and the employment of the former CEO and former president being terminated for cause. Pursuant to the Administration Order, the FSRA as administrator took control of PACE and now exercises the powers of the Board of Directors and controls the management of PACE.

[13] By Notice of Action issued on March 18, 2019, a claim was commenced by the FSRA as administrator for PACE. In the Fresh as Amended Statement of Claim dated October 11, 2019 (the "Underlying Claim"), the plaintiff is identified as "PACE Savings & Credit Union Limited, by its administrator, Financial Services Regulatory Authority". In the Underlying Claim, the plaintiff makes claims for damages suffered by PACE caused by wrongful conduct allegedly engaged in by the defendants against PACE including breaches of duties owed to PACE.

[14] CUMIS was provided with notice of the Underlying Claim and the applicants requested coverage under the D&O Policy.

[15] On October 25, 2019, CUMIS denied coverage for the Underlying Claim on the basis of the "Insured vs. Insured" exclusion in the D&O Policy.

Analysis

[16] CUMIS acknowledges that the Underlying Claim against the Applicants falls within the insuring agreement of the CUMIS policy, for purposes of the duty to defend.

[17] The issues to be decided on these applications are:

a. whether the "Insured vs. Insured" exclusion applies to the claim brought in the name of PACE by the FSRA against PACE's officers and directors;

b. whether the "derivative action" exception to the "insured vs. insured" exclusion restores coverage for the claim;

c. whether the "liquidator" exception to the "insured vs. insured" exclusion restores coverage for the claim; and

d. whether, if there is coverage for the defence of the Underlying Claim, the applicants are entitled to retain and instruct counsel of their choice without the need to report to or take instructions from CUMIS.

Legal principles applicable to interpretation of policies of insurance

[18] An insurer is required to defend an action in which the pleadings allege facts which, if true, could possibly require the insured to indemnify the insured on a claim. The mere possibility that a claim within the policy may succeed is sufficient to trigger the insured's duty to defend: *Progressive Homes v. Lombard General Insurance Co. of Canada*, 2010 SCC 33, at para. 19.

[19] In *Progressive*, at paras. 22-28, the Supreme Court of Canada reviewed the following principles to be applied to the interpretation of insurance policies (in that case, a comprehensive general liability policy):

a. The primary interpretive principle is that when the language of the policy is unambiguous, the court should give effect to clear language, reading the contract as a whole.

b. Where the language of the insurance policy is ambiguous, the courts rely on general rules of contract construction. For example, courts should prefer interpretations that are consistent with the reasonable expectations of the parties, so long as such an interpretation can be supported by the text of the policy.

c. Courts should avoid interpretations that would give rise to an unrealistic result or that would not have been in the contemplation of the parties at the time the policy was concluded.

d. Courts should also strive to ensure that similar insurance policies are construed consistently.

e. When these rules of construction fail to resolve an ambiguity, courts will construe the policy contract *contra proferentem* - against the insurer. One corollary of the *contra proferentem* rule is that coverage provisions are interpreted broadly, and exclusion clauses narrowly.

f. Exceptions to exclusions do not create coverage - they bring an otherwise excluded claim back within coverage, where the claim fell within the initial grant of coverage in the first place.

g. Because of this alternating structure, it is generally advisable to interpret the policy in the order of coverage, exclusions and then exceptions.

[20] In *Sabean v. Portage La Prairie*, [2017] 1 S.C.R. 121, the Supreme Court of Canada confirmed, at para. 12, that the overriding principle is that where the language of the disputed clause is unambiguous, reading the contract as a whole, effect should be given to that clear language. Only where the disputed language in the policy is found to be ambiguous should general rules of contract construction be employed to resolve that ambiguity. If these general rules of construction fail to resolve the ambiguity, courts will construe the contract *contra proferentem*, and interpret coverage provisions broadly and exclusion clauses narrowly.

[21] In *Markham v. AIG Insurance Company of Canada*, 2020 ONCA 239, the Court of Appeal, at para. 45, confirmed that the language of the policy is construed in accordance with the usual rules of construction rather than inferred "expectations" not apparent on a fair reading of the document. The Court of Appeal held that this is particularly so in the case of commercial insurance policies involving sophisticated parties. The insurer must explicitly state the basis on which coverage may be limited.

Does the Insured vs. Insured exclusion apply?

[22] The D&O Policy expressly provides that it shall not apply to loss based upon, arising out of, or attributable to a claim "by or on behalf of" of PACE, except for claims specified.

[23] The applicants submit that this exclusion was intended to provide protection for insurance companies against collusive suits between insured corporations and their insured officers and directors. They submit that when the plaintiff is not the insured corporation, but a representative acting as a genuinely adverse party to the defendant officers and directors, there is no threat of collusion and the underlying rationale for the exclusion does not apply. The applicants contend that to interpret the D&O Policy such that the Underlying Claim is excluded from coverage would result in the virtual nullification of the coverage provided by the D&O Policy and would be contrary to the reasonable expectations of the ordinary person as to the coverage afforded.

[24] In *Stuart v. Hutchins*, 1998 CarswellOnt 3540, the insured argued that to construe the notice provision in the policy as the insurer submitted it should be read would contravene the spirit of s. 129 of the *Insurance Act* providing for relief against forfeiture. The Court of Appeal, at paras. 28-30, did not accept that the language of the policy should be interpreted to avoid this outcome:

> On a more fundamental level, the position advanced by RE/MAX is one which leads inexorably to the discarding of basic principles that

> have long governed the interpretation and construction of contracts of insurance.
>
> To the extent that the wording in a contract of insurance is found to be ambiguous, it is accepted that the ambiguity will generally be resolved in favour of the insured. This rule, however, has no application where the wording of the policy is plain on its face and capable of only one meaning.
>
> Trite though it may be, an insurer has the right to limit coverage in a policy issued by it and when it does so, the plain language of the limitation must be respected.

[25] I observe that the question of collusion is not implicated by the language of the exclusion itself. The question of collusion between the insured corporation and officers or directors is addressed in the D&O Policy by the language of an exception to the exclusion, where the claim is a derivative action brought or maintained on behalf of the insured corporation by a person who is not a director or officer, "without the cooperation, solicitation, assistance or active participation of the CORPORATION or any DIRECTOR or OFFICER".

[26] The language of the exclusion, when the D&O Policy is read as a whole, is not ambiguous. The "Insured vs. Insured" exclusion applies because the Underlying Claim is brought by FSRA on behalf of PACE.

Does the exception to the exclusion relating to a "derivative action" apply so as to restore coverage?

[27] The Applicants argue that if coverage is excluded by the Insured vs. Insured exclusion, the exception to the exclusion relating to a claim that is a "derivative action" applies such that coverage is restored.

[28] This exception in the D&O Policy to the "Insured vs. Insured" exclusion reads:

> ... except for a CLAIM:
>
> a. that is a derivative action brought or maintained on behalf of the CORPORATION by a person who is not a DIRECTOR OR OFFICER, without the cooperation, solicitation, assistance or active participation of the CORPORATION or any DIRECTOR OR OFFICER;

[29] CUMIS submits that this exception does not apply for two reasons. First, CUMIS submits that the exception only applies where a derivative action is brought or maintained on behalf of the insured by a "person", and that neither FSRA nor CUMIS is a "person" as that word

should be interpreted when used in the D&O Policy. Second, CUMIS submits that the Underlying Claim is not a "derivative action". I address each of these arguments in turn.

[30] The word "person" is not defined in the D&O Policy. In the absence of a definition, it is necessary to give meaning to this word following the application of principles of interpretation of insurance policies. Where the language in an exception is unambiguous, I must give effect to the clear language, reading the policy as a whole. Where the language is not unambiguous, I must rely on general rules of contract construction. If the ambiguity is not then resolved, I am to construe the D&O Policy against CUMIS according to the doctrine of *contra proferentem* and, in so doing, interpret the exception broadly and the exclusion narrowly.

[31] The *Financial Services Regulatory Authority of Ontario Act, 2016,* S.O. 2016, c. 37, Sch. 8 provides in s. 2(1) that "the predecessor Authority and DICO [Deposit Insurance Corporation of Ontario] are amalgamated and shall continue as one corporation without share capital under the name Financial Services Regulatory Authority of Ontario ...". Section 6(1) of this statute provides that FSRA "has the capacity, rights, powers and privileges of a natural person for carrying out its objects, subject to the limitations of this Act". It is clear that the FSRA is a corporation which has the capacity, rights, powers and privileges of a natural person for carrying out its objects.

[32] Apart from the statutory power of FSRA to bring an action, a corporation, generally, is capable of making a "CLAIM" (as this word is defined in the D&O Policy) and bringing an action. A corporation is a creature of statute and a legal "person" when this word is used in the context of a corporation making a claim or bringing an action. In this context, the ordinary meaning of the word "person" would generally include a corporation.

[33] The *Legislation Act, 2006,* R.S.O. 2006, c. C-21, Sch F provides in s. 87 that in every Act and regulation, "person" includes a corporation. The D&O Policy includes a condition which states that "[t]erms of this Policy which are in conflict with any statute of the province or territory in which it is issued are amended to conform to such statute". Although I do not hold that to interpret the word "person" as used in the D&O Policy to mean only a human being would conflict with the *Legislation Act, 2006* (which does not apply to contracts such as insurance policies), I find support in this statutory provision for my conclusion that the ordinary meaning of the word "person", when used in a contractual provision in reference to a "person" who brings an action, includes a corporation.

[34] CUMIS contends, however, that the D&O Policy, read as a whole, makes a clear distinction between "persons" and "entities", and that "persons" is used to refer to human beings and "entities" is used to refer to corporations or other entities which are not human beings. CUMIS submits that different words used in an insurance policy are presumed to have different meanings and that PACE and FSRA are "entities", and not "persons". Therefore, CUMIS submits, the derivative action exception does not apply.

[35] CUMIS points to several terms in the D&O Policy which refer to a "person or entity" (the definitions of "Change of Control", "Co-operation", and "Subrogation"). CUMIS points to

other terms which refer to "the entity", "an entity", or "any entity" (the definitions of "Corporation", "Predecessor", and "Subsidiary"; and the condition with respect to an "entity" which has undergone a change of control), without also referring to a "person". CUMIS points to other policy terms which refer only to "any person" (the Bodily Injury and Property damage exclusion) or to "a person" (definition of "Employee"), without also referring to an "entity".

[36] In those paragraphs in the D&O Policy in which the word "entity" is used, and not the words "person or entity", the context of the policy term indicates that the word "entity" does not refer to a human being. In these policy terms, the context does not require more than the use of the word "entity" to give it the meaning that is intended.

[37] In other policy terms, where the words "person or entity" are used, these words apply broadly to capture any person or entity, human, corporate, or other. A human or a non-human person or entity is able to acquire ownership of securities. A human or a non-human person or entity is able to execute documents or render assistance to the insurer. The insurer may have rights of subrogation against a human or a non-human person or entity, including a corporation, a partnership, an unincorporated association, or any legal entity capable of being sued.

[38] In other terms of the D&O Policy, the word "person" is used in a context that indicates that the word refers to a human person and not a corporation where, for example, the policy refers to "bodily injury, sickness, disease, mental anguish or death of any person".

[39] It does not follow, however, that because the word "entity" is used in the D&O Policy in contexts where the word does not refer to a human being, and the word "person" is used elsewhere in the policy in contexts where the word does not refer to a corporation or other non-human entity, the word "person" must be given a narrower meaning than its ordinary meaning where the context does not so require. In the exception to the Insured vs. Insured exclusion, the context in which the word "person" is used does not require that the "person" making the "CLAIM" that is a derivative action ..." must be a human being. An individual member of a credit union could make a claim that is a derivative action as could a member of a credit union that is a corporation.

[40] CUMIS argues that the reference in the exception itself to a "person who is not a DIRECTOR OR OFFICER" can only refer to a human being. I disagree. A derivative action may be brought or maintained by an individual who is not an officer or director or by a corporation which is not, and cannot be, an officer or director. In either case, if the meaning of the word "person" includes a corporation, the exception would apply.

[41] CUMIS also relies on the definition of the capitalized word "CORPORATION" in the D&O Policy to mean "[t]he entity named as the Insured in the Declarations or Certificate ..." in support of its submission that a corporation is an "entity" as that word is used in the D&O Policy but not a "person". I disagree that this definition assists CUMIS. The word "CORPORATION" is a defined term in the D&O Policy that means the insured, PACE, which is a corporation described as an "entity". It does not follow, however, that where the

word "person" is used in other terms of the D&O Policy, the meaning to be given to this word must exclude a corporation where the context does not so require.

[42] I observe that the D&O Policy does not consistently use the word "person" to refer to a human being. In the exclusion dealing with "Outside Directorship", the D&O Policy refers to "[a]ny act of an individual while serving as a director ..." CUMIS submits that the word "individual" has the same meaning as "person", and both refer to a human being. I agree that the word "individual" as used in this policy term means a human being. I do not agree, however, that the meaning of the word "person" where it is used elsewhere in the D&O Policy is limited to a human being, unless the context so requires. The ordinary meaning of the word "person" is broader than the ordinary meaning of the word "individual". Because these two words are each used in the D&O Policy, I presume that, depending on the context in which each is used, the words do not necessarily have the same meaning.

[43] When I consider the language of the exception in the context of the D&O Policy as a whole, I do not agree that the word "person" should be given a meaning other than its ordinary meaning, which, in the context of a person making a claim or bringing an action, includes both an individual and a corporation. It is not necessary to give this word a narrower and more limited meaning. The purpose of the exception applies to both individuals and corporations. If CUMIS wished to limit its risk and exclude coverage for a person bringing a derivative action which is a corporation, it could have done so using clear language. I conclude that the language of the exception is not ambiguous and the word "person", as used in the exception, includes a person that is a corporation.

[44] If I had concluded that the meaning of the word "person" as used in the exception is ambiguous, I would consider the reasonable expectations of the parties to give meaning to this word. The D&O Policy provides coverage to a director or officer for a loss arising from any claim first made against such director or officer for which the director or officer is not indemnified by PACE. The exception to the exclusion for a claim by or on behalf of PACE that is a derivative action does not expressly limit its application to a claim that is a derivative action brought by an individual. The stated purpose of the D&O Policy is to ensure PACE's officers and directors against loss from claims made for breach of duty. This purpose would be severely restricted if suits initiated by the FSRA, the regulator of PACE, were not covered.

[45] Given the stated purpose of the D&O Policy, to give the word "person" the narrow meaning advanced by CUMIS would be contrary to the reasonable expectations of an ordinary person as to the coverage purchased. See *Zurich Insurance Co. v. 686234 Ontario Ltd*., [2002] O.J. No. 4496 (ONCA), at para. 28.

[46] The interpretation of "person" as used in the exception to include a corporation is consistent with the reasonable expectations of the parties and supported by the text of the D&O Policy. To give the word "person" the restrictive meaning advanced by CUMIS would lead to unreasonably restrictive coverage because it would exclude coverage for claims by FSRA, the regulator of PACE, one of the most significant risks faced by directors of a credit union. If I had concluded that the language of the exception is ambiguous, I would conclude that

after applying these rules of construction, the D&O Policy should not be given the restrictive interpretation advanced by CUMIS.

[47] If, after applying rules of construction to resolve ambiguity, I had held that the meaning of the word "person" in the exception remained ambiguous, I would apply the *contra preferentem* rule and interpret the D&O Policy against CUMIS by giving the language of the exception a broad interpretation which includes a corporation within the meaning of the word "person".

[48] The second submission made by CUMIS is that the Underlying Claim is not a "derivative action" within the meaning of this phrase in the exception.

[49] CUMIS submits that the term "derivative action" is a term of art which has a meaning recognized under Ontario law and that the Underlying Claim does not fall within any of the types of derivative actions so recognized. In support of this submission, CUMIS contends:

a. The Underlying Claim is not a derivative action under s. 246 of the Ontario *Business Corporations Act* ("OBCA") because that statute does not apply to corporations to which the Act applies.

b. Prior to the enactment of statutory provisions like s. 246 of the *OBCA*, a common law derivative action for shareholders existed through exceptions to the rule in *Foss v. Harbottle*. The Underlying Claim does not qualify as a common law derivative action because the conditions precedent to such an action have not been fulfilled. The action is not brought by minority shareholders on behalf of the credit union.

c. The PACE action is not a derivative action under s. 50 (1) of the *Act* which, CUMIS contends, is the only derivative action available in Ontario in the credit union context and, given this, the "derivative action" exception to the "insured versus insured" exclusion can only refer to the s. 50 derivative action.

[50] In *Rea v. Wildeboer*, 2015 ONCA 373, the question before the Court was whether a complainant may assert by way of an oppression remedy proceeding a claim that is by nature a derivative action for a wrong done to the corporation, thereby circumventing the statutory requirement to obtain leave to commence such an action. In its analysis, the Court of Appeal for Ontario described, at para. 18, the nature of a "derivative action" under the OBCA:

> The derivative action was designed to counteract the impact of *Foss v. Harbottle* by providing a "complainant" - broadly defined to include more than minority shareholders - with the right to apply to the court for leave to bring an action "in the name of or on behalf of the corporation ... for the purpose of prosecuting, defending or discontinuing the action on behalf of the body corporate": *Business Corporations Act*, RSO 1990, c. B. 16, s. 246 ("OBCA"). It is an action for "corporate" relief, in the sense that the goal is to recover

> for wrongs done to the company itself. As Professor Welling has colourfully put it in his text, *Corporate Law in Canada: The Governing Principles,* 3rd ed. (Mudgeeraba: Scribblers Publishing, 2006), at p. 509, "[a] statutory representative action is the minority shareholder's sword to the majority's twin shields of corporate personality and majority rule."

[51] Although in *Rea v. Wildeboer* the legal basis for the derivative action was the OBCA, the nature of a derivative action, as described by the Court of Appeal, is one brought by a person in the name of or on behalf of a corporation to recover for wrongs done to the corporation itself. The term "derivative action" describes such an action. This meaning of the term "derivative action" is consistent with the language of the exception in the D&O Policy which refers to a "derivative action brought or maintained on behalf of the CORPORATION by a person who is not a DIRECTOR OR OFFICER ...".

[52] CUMIS also maintains that s. 50 of the Act does not apply to the Underlying Claim because it was not brought by a credit union member, and no leave was obtained from the court permitting the start of the action. CUMIS contends that there is no other type of "derivative action" known to law which could possibly apply to the Underlying Claim.

[53] Subsections 50(1) and (2) of the Act provide:

> Members may maintain representative actions
>
> 50(1) Subject to subsection (2), a member of a credit union may maintain an action in a court of competent jurisdiction in a representative capacity for the member and all other members of the credit union suing for and on behalf of the credit union to enforce any right, duty or obligation owed to the credit union under this Act or under any other statute or rule of law or equity that could be enforced by the credit union itself, or to obtain damages for any breach of any such right, duty or obligation.
>
> (2) An action under subsection (1) shall not be started until the member has obtained an order of the court permitting the start of the action.

[54] The D&O Policy, in the exception to the "Insured v. Insured" exclusion, does not limit the words "derivative action" to a derivative action brought under s. 50 of the Act. As I have noted, the term "derivative action" is not defined in the D&O Policy, although many other words are defined. If CUMIS had intended to give particular meaning to the term "derivative action", or to limit it to an action brought under s. 50 of the Act, it could have done so using clear language. In the absence of a meaning assigned to this term through a definition in the D&O Policy, the term "derivative action" must be given a meaning having regard to the context in which it is used in the D&O Policy, reading the policy as a whole.

[55] I do not accept the submission by CUMIS that a derivative action is a term of art limited to a common law derivative action by a minority shareholder of a corporation, a statutory derivative action under the OBCA or the federal corporate statute, or an action brought under s. 50 of the Act. In making this submissions, CUMIS conflates the common law or statutory requirements for a person to bring an action in the name of or on behalf of a corporation with the action itself. At common law, and under the federal and provincial corporate statutes, a shareholder of a company may only bring an action in a representative capacity on behalf of a company for remedies available to the company in respect of a wrong done to it if certain requirements are satisfied. Under s. 50 of the *CUCP Act*, a member of a credit union may maintain an action described in this provision in a representative capacity provided that the member has obtained a court order permitting the start of such an action. These requirements are legal rules that, where they apply, specify who may bring such an action and when it may be brought. They do not, however, change the nature of the action.

[56] The nature of the Underlying Claim is clear from the Fresh as Amended Statement of Claim in which PACE, by its administrator, FSRA, sues for wrongful acts by the defendants against PACE. In the Fresh as Amended Statement of Claim, the plaintiff claims remedies for losses suffered by PACE, as pleaded in paragraph 26:

> Through the Investigation, the Administrator and the Credit Union learned that the conduct of the Defendants, individually and collectively, had resulted in the Credit Union suffering material losses which in some instances, are continuing. The basis of each of the claims against the Defendants is outlined in detail below.

[57] In paragraph 146 of the Fresh as Amended Statement of Claim, the plaintiff pleads that each of the defendants has engaged in wrongful conduct against PACE:

> Each of the Defendants has engaged in wrongful conduct against the Credit Union. Such wrongful conduct includes, but is not limited to, fraud, deceit, breach of fiduciary duties, breach of employment duties, negligence, conversion, unjust enrichment, breach of trust, knowing assistance of breach of fiduciary duty and breach of trust, knowing receipt of the proceeds from breach of fiduciary duty and breach of trust, and breach of contract, all as set out above. The Defendants are liable to compensate and pay damages to the Credit Union on a joint and several basis for the losses suffered by the Credit Union with respect to the wrongful conduct they were involved with, and to disgorge any amounts that they received on account of such wrongful conduct.

[58] The Underlying Claim is one brought by FSRA in the name of and on behalf of PACE for wrongs allegedly done to the corporation itself. This is, by its nature, a derivative action.

[59] When I give the words used in the exception their plain meaning, I conclude that the Underlying Claim is "a derivative action brought or maintained by or on behalf of the "CORPORATION by a person who is not a DIRECTOR OR OFFICER, without the cooperation, solicitation, assistance or active participation of the CORPORATION or any DIRECTOR OR OFFICER".

[60] The exception to the "Insured vs. Insured" exclusion applies to restore coverage under the D&O Policy.

Does the exception for a claim brought or maintained by a liquidator, receiver, or trustee in bankruptcy and made directly against a Director of the Corporation apply?

[61] The applicants Larry Smith and Phillip Smith submit that if the "derivative action" exception does not apply, the Underlying Claim is, nonetheless, excepted from the exclusion because the Underlying Claim is, in substance, one "brought or maintained by a liquidator, receiver, or trustee in bankruptcy". This exception applies only for "DEFENCE COSTS", as defined in the D&O Policy. These applicants contend that although FSRA has authority over PACE as an "Administrator" under the Act, its powers are functionally equivalent to a liquidator, receiver, or trustee in bankruptcy, such that the exception should apply.

[62] Because I have concluded that the "derivative action" exception applies, it is not necessary for me to decide whether this exception applies.

Are the applicants entitled to appoint and instruct counsel of their choice in the Underlying Claim?

[63] CUMIS acknowledges that if it is held that the Underlying Claim is not excluded from coverage, Larry Smith, Philip Smith, Frank Klees and Brian Hogan are entitled to choose and instruct defence counsel. This is so because the claims of fraud and other similar conduct against them potentially trigger exclusions in the policy which would create a conflict of interest and entitle them to independent counsel.

[64] The applicants in the Goodfellow application contend that they are also entitled to appoint and instruct counsel of their choice to defend them in the Underlying Claim, which counsel is to be paid for by CUMIS without needing to report to or take instructions from CUMIS. CUMIS disagrees on the basis that the claims against them are in negligence and there is no conflict of interest.

[65] And insurer who has a duty to defend an action also has a *prima facie* to choose and instruct counsel and to control the defence. This right to defend and control the defence of the litigation is lost only where there is a reasonable apprehension of conflict of interest on the part of counsel appointed by the insurer. See *Markham (City) v. AIG Insurance Company of Canada*, 2020 ONCA 239, at paras. 88-89.

[66] The Goodfellow applicants argue that (i) CUMIS denied coverage for defence obligations without a reservation of rights with respect to coverage and thereby repudiated the D&O

Policy, and (ii) the actions have been ongoing for some time, and these applicants have retained and instructed counsel who are closely involved in the litigation, such that a change on representation will be prejudicial. The Goodfellow applicants submit that in these circumstances, CUMIS has lost the right under the D&O Policy to retain and instruct counsel.

[67] In support of their submission, the Goodfellow applicants rely on *Ontario v. Kansa General Insurance* 1991 CanLII 7318 (ONSC). In that case, the insured argued that the insurer had repudiated the contract of insurance by refusing to defend the claim, with the result that the insurer lost its right to appoint and instruct counsel. The application judge examined the correspondence exchanged between the insurer and the insured and concluded that the conduct of the insurer did not entitle the insured to treat the policy as having been repudiated. The request by the insured that it be given the right to appoint counsel and control the defence of the claim was denied.

[68] On the evidence before me, the Goodfellow applicants did not elect to accept the repudiation and treat the D&O Policy as having been terminated. As a result, the D&O Policy remains in full force and effect.

[69] There is no reasonable apprehension of conflict of interest on the part of counsel to be appointed by CUMIS. The right of CUMIS under the D&O Policy to appoint and instruct counsel for the Goodfellow applicants has not been lost.

Disposition

[70] For these reasons, I make the following declarations:

a. A declaration that CUMIS is obligated to defend the applicants in the Underlying Claim pursuant to the D&O Policy.

b. A declaration that the applicants Larry Smith, Phillip Smith, Frank Klees, and Brian Hogan are entitled to appoint counsel of their choosing at CUMIS' sole expense who need not report to or take instructions from CUMIS.

c. A declaration that CUMIS is required to reimburse the applicants on a full indemnity basis for all past legal and administrative expenses incurred in defending the Underlying Claim and pursuing coverage.

[71] If the parties are unable to resolve costs, the applicants may make written submissions (not exceeding 3 pages for each application excluding costs outlines) within 10 days. CUMIS may make written responding submissions within 10 days thereafter. The applicants may make brief reply submissions (not exceeding one page) if so advised, within 5 days thereafter.

Cavanagh J.

Date: May 18, 2021

COURT OF APPEAL FOR ONTARIO

CITATION: Trillium Mutual Insurance Company v. Emond, 2023 ONCA 729
DATE: 20231103
DOCKET: COA-22-CV-0315

Lauwers, Zarnett and Thorburn JJ.A.

BETWEEN

Trillium Mutual Insurance Company

Appellant

and

Stephen Emond and Claudette Emond

Respondents

Pat Peloso and Jaime Wilson, for the appellant

Joseph Y. Obagi and Elizabeth Quigley, for the respondents

Heard: August 24, 2023

On appeal from the order of Justice Robyn M. Ryan Bell of the Superior Court of Justice, dated September 29, 2022, with reasons reported at 2022 ONSC 5519.

Thorburn J.A.:

I. OVERVIEW

[1] The respondents, Stephen and Claudette Emond, lived in a home on the Ottawa river. Their home was located in the catchment area of the Mississippi Valley Conservation Authority (the "MVCA"). The MVCA Regulation Policies regulate development and activities in or adjacent to rivers, lakes, shorelines, hazardous lands, and wetlands.

[2] The Emonds had purchased a standard form residential Homeowners' Package Comprehensive Form Insurance Policy from the appellant, Trillium Mutual Insurance Company. The Policy provided coverage from September 27, 2018 to September 27, 2019.

[3] On April 29, 2019, the Emonds' home was severely damaged by a flood and was deemed a total loss.

[4] Although Trillium acknowledged coverage for the loss under the Policy, the parties could not agree on what, if any, costs of "replacement" of the Emonds' dwelling were excluded from coverage under the Policy.

[5] The Policy includes (i) a Guaranteed Rebuilding Cost Coverage endorsement to pay the insured to replace a dwelling with materials of similar quality using current building techniques (the "GRC"); (ii) an exclusion for "increased costs of repair or replacement due to the operation of any law regulating the zoning, demolition, repair, or construction of buildings" (the "para. 8

Exclusion"); and (iii) a Building By-Law and Code Compliance Coverage endorsement (the "BBCC") that provides for payment of up to $10,000 for increased costs of demolition, construction, or repair to comply with any law regulating the zoning, demolition, repair, or construction. The coverage limit listed on the Declaration Page for the dwelling was $585,092.

[6] The application judge accepted the Emonds' position that the GRC coverage was intended to guarantee the costs of rebuilding their home on the same location, using materials of similar quality and current building techniques, without any limitation of coverage resulting from the operation of any rule, regulation, by-law, or ordinance. She rejected Trillium's position that such a limitation applied because rules, regulations, by-laws and ordinances fell within the meaning of "any law" in the para. 8 Exclusion. This meant that costs of compliance with the MVCA Regulation Policies did not fall within the para 8 Exclusion.

[7] Trillium claims that the application judge erred in her interpretation of this standard form Policy and that if her interpretation is upheld, this will have a wide-reaching and detrimental effect on the insurance industry in Canada.

II. BACKGROUND TO THIS APPEAL

[8] The central dispute between the parties is: what costs of rebuilding, if any, are excluded from coverage under this Policy?

[9] The Emonds claimed that the GRC fully guaranteed their rebuilding costs.

[10] Trillium acknowledged that the GRC applied to replace their dwelling with materials of similar quality using current building techniques, but took the position that the costs to be incurred to comply with the Regulation Policies enacted by the MVCA and other by-laws and regulations enacted after the original building of the house (the "compliance costs") were excluded from coverage by the para. 8 Exclusion. Trillium was required and did agree to pay an additional $10,000 to cover such costs under the BBCC.

[11] Trillium advised the Emonds that pending resolution of their compliance costs dispute, they would be paid Trillium's calculation of the Actual Cash Value of $498,107.13, (which is "the cost of replacement/rebuilding, less any depreciation without prejudice to their right to dispute the Actual Cash Value assessment and/or the application of the GRC").

[12] The GRC provides that if the dwelling is rebuilt, the insured has the option to be paid either "[t]he cost of repairs or replacement (whichever is less) without deduction for depreciation even if it is more than the amount of insurance shown on the 'Declaration Page'", or to receive "[t]he 'Actual Cash Value' of the damage at the date of the occurrence" which includes depreciation.

[13] Because the Emonds' property is subject to the MVCA Regulation Policies, there were major costs associated with the requirement that the rebuild comply with the Regulation Policies enacted by the MVCA under the *Conservation*

Authorities Act, R.S.O. 1990, c. C.27, s. 28. In oral submissions, counsel for the respondents noted that those Regulation Policies came into effect after the original building of the house.

[14] Trillium retained two contractors to prepare rebuild estimates based on a designer's renderings, the topography and features of the property, and the drainage and septic requirements. Trillium estimated the construction costs at between $553,452.37 and $612,900.72.

[15] The Emonds rejected these estimates. They took the position that since rebuilding their home required compliance with the MVCA Regulation Policies, municipal by-laws, and other building code regulations, the compliance costs could increase construction costs by as much as $700,000.

[16] Trillium updated its construction cost estimates on a without prejudice basis to include the relevant compliance costs. This increased Trillium's estimates to between $580,261.06 and $873,830.48.

[17] The Emonds continued to dispute the estimates and provided their own valuation of replacement costs which reflected an increase to between $925,000 and $1,252,668.04.

[18] The Emonds brought an application for a declaration that the GRC entitled them to recover the total costs of rebuilding their home, with no limitation of coverage for compliance costs.

[19] The parties sought only an interpretation of the relevant provisions in this standard form Policy. Neither party sought quantification of the loss and neither party provided evidence to enable the court to determine the exact compliance costs.

III. THE ISSUES

[20] The central issues on this appeal are whether the application judge erred in holding that the GRC entitled the Emonds to recover all costs of rebuilding their home, with no limitation of coverage for compliance costs, and whether the effect of excluding compliance costs would nullify the GRC coverage under the Policy.

[21] An analysis of these issues entails a review of:

a) The coverage provided in the GRC;
b) The exclusion of coverage in the para. 8 Exclusion for “increased costs of repair or replacement due to operation of any law”;
c) The effect of the Policy coverage in the BBCC for “an additional amount up to $10,000 or the amount shown on the ‘Declaration Page’, for the increased cost … to comply with any law”;
d) The extent to which, if at all, the para. 8 Exclusion limits coverage in this case; and
e) Whether applying the para. 8 Exclusion to the GRC would nullify the GRC.

IV. THE RELEVANT POLICY PROVISIONS

[22] The relevant Policy provisions are as follows:

The Guaranteed Rebuilding Cost Endorsement

[23] The GRC provides that:

> If the "Declaration Page" shows that the Guaranteed Rebuilding Cost Endorsement applies, the Basis of Claim Payment for the "Dwelling" Building is amended as follows:
>
> When coverage applies "we" will pay for insured loss or damage if "you" repair or replace the damaged or destroyed "dwelling" building on the same location with materials of similar quality using current building techniques within a reasonable amount of time after the damage.
>
> "You" may choose as the basis of loss settlement either (A) or (B) below; otherwise settlement will be as in (B).
>
> (A) The cost of repairs or replacement (whichever is less) without deduction for depreciation even if it is more than the amount of insurance shown on the "Declaration Page" for the "dwelling" building provided:
>
> > 1. The amount of insurance shown on the "Declaration Page" for the "dwelling" building represents 100% of the cost to rebuild the insured "dwelling" on the same site with materials of similar quality as determined by a building valuation guide acceptable to "us";
> >
> > …
>
> (B) The "Actual Cash Value" of the damage at the date of the occurrence.

> "Actual Cash Value" will take into account such things as the cost of replacement/rebuilding less any depreciation. In determining depreciation "we" will consider the condition immediately before the damage, type of construction material and techniques and their normal life expectancy.
>
> In all other respects, the policy provisions and limits of liability remain unchanged.
>
> This coverage is void if "you" fail to comply with its provisions. [Emphasis added.]

The Exclusion of Increased Costs of Repair or Replacement Due to Any Law

[24] The para. 8 Exclusion provides that:

> "We" do not insure against loss or damage resulting from, contributed to or caused directly or indirectly:
>
> ...
>
> 8. because of increased costs of repair or replacement due to operation of any law regulating the zoning, demolition, repair or construction of buildings and their related services except as provided under Additional Coverages of Section 1. [Emphasis added.]

The Building By-Law & Code Compliance Coverage ("BBCC")

[25] While increased costs due to the operation of any law are excluded by the Exclusion at para. 8, some coverage for those costs is set out in the BBCC. The BBCC, found in both the "Additional Coverages – Section 1" and the "Section 4 Miscellaneous Coverages Section" of the Policy, provides that:

> "We" will pay an additional amount up to $10,000 or the amount shown on the "Declaration Page", for the increased cost of demolition, construction, or repair to comply with any law regulating the zoning, demolition, repair or construction of any insured building(s). This endorsement responds only as a result of direct damage caused by an insured peril. This endorsement is extended to pay for:
>
> …
>
> 3. any increase in the cost of repairing, replacing, construction or reconstructing the insured building(s) on the same site or on an adjacent site, of like height, floor area and style, and for like occupancy; arising from the enforcement of the minimum requirements of any by-law, regulation, ordinance or law which:
>
> > a) regulates zoning or the demolition, repair or construction of damaged buildings or structures; and
> >
> > b) is in force at the time of such loss or damage.
> >
> > …
> >
> > This endorsement does not override any provision in the Basis of Claim Payment of the policy to which this endorsement is attached. [Emphasis added.]

V. THE APPLICATION JUDGE'S DECISION

[26] The application judge accepted the Emonds' position that the GRC coverage was intended to guarantee the cost to rebuild, and she rejected Trillium's position that the GRC did not include coverage for increased costs to comply with "any law".

[27] She relied on *Wigle v. Allstate Insurance Co. of Canada*, 49 O.R. (2d) 101 (C.A.), and held that limitations on endorsements such as the GRC that are not clearly apparent should be set out in the endorsement itself. Since the GRC did not purport to limit compliance costs, in her view, the GRC covered all of these costs.

[28] The application judge found that the para. 8 Exclusion did not apply to the MVCA Regulation Policies. She held that the term "law" in the para. 8 Exclusion was restricted to statutes and did not include rules, regulations, by-laws, or ordinances:

> The para. 8 Exclusion is clear and unequivocal: it excludes only the costs of repair or replacement due to the operation of "any law."
>
> That the term "law" in the para. 8 Exclusion does not include, and was not intended to include, rules, regulations, by-laws, or ordinances is evident from the wording of the Policy itself: the BBCC coverage uses the terms "law", "by-law", "regulation", and "ordinance." The language of the Policy must be read to give effect to each word of the Policy and the Policy should not be interpreted in a manner which would render any words superfluous. Had Trillium wanted the term "law" to include subordinate authority for the purpose of the para. 8 Exclusion, it could have drafted the Policy accordingly. It did not.

[29] She held that since the onus was on the insurer to prove that the para. 8 Exclusion clearly applied, and the MVCA Regulation Policies were not "laws", the

para. 8 Exclusion did not limit the complete replacement cost coverage provided to the Emonds under the GRC.

[30] The application judge also found that Trillium's interpretation of the Policy would contravene the nullification of coverage doctrine. Trillium knew that the Emonds' home was not new, that it was located within the MVCA's catchment area, and that the Emonds were required to comply with the MVCA Regulation Policies and other laws regulating the construction and repair of the home. In the application judge's view, under Trillium's interpretation, almost all compliance costs would be excluded from coverage. She held that this would "render nugatory the coverage for the most obvious risks" for which the GRC was issued and would be contrary to the reasonable expectations of the insured.

[31] The application judge concluded that under the Policy, the Emonds were entitled to recover the cost of rebuilding their home on the same location and with materials of similar quality using current building techniques, without any limitation of coverage resulting from the operation of any rule, regulation, by-law, or ordinance.

VI. THE PARTIES' POSITIONS ON THIS APPEAL

[32] Trillium claims that the application judge erred in concluding that the respondents were entitled to recover 100% of the costs of rebuilding their home "without any limitation of coverage resulting from the operation of any rule,

regulation, by-law, or ordinance". Trillium submits that such an interpretation would render the GRC a warranty for any and all rebuilding costs, is commercially unreasonable, and would have the effect of reading out the para. 8 Exclusion.

[33] Trillium submits that (i) the GRC is part of the Policy of insurance and the Policy should be read as a whole with all of its terms, including the exclusions and limitations on coverage; (ii) the words "any law" in the exclusion clause include subordinate legislation such as by-laws and regulations; (iii) the BBCC confirms this interpretation, specifically providing that only up to $10,000 will be paid by the insurer to comply with laws, by-laws, and regulations; and (iv) the fact that there is no reference to the BBCC on the Declaration Page is of no moment because the BBCC itself provides that "'We' will pay an additional amount up to $10,000 or the amount shown on the 'Declaration Page'" (emphasis added). Trillium denies that its proposed interpretation of the Policy would nullify the GRC.

[34] The Emonds submit that the application judge correctly interpreted the GRC to mean there is no cap on the costs to be reimbursed by the insurer to rebuild because (i) the GRC provides for the full cost to rebuild using "current building techniques" and the terms of the GRC prevail; (ii) the term "law" in the para. 8 Exclusion only refers to statutes, not to any subordinate authority such as by-laws, regulations, or the MVCA Regulation Policies; (iii) the BBCC does not appear on the Declaration Page for the Policy and therefore does not limit the available coverage under the GRC; and (iv) if the para. 8 Exclusion applies, coverage under

the GRC would be effectively nullified since the GRC clearly provides coverage for replacement using “current building techniques”.

[35] The parties did not precisely articulate what the additional costs in dispute are for, or what regulation, by-law, or provision of the MVCA Regulation Policies required the additional costs, save to say that some involved the construction of a more expensive foundation to provide flood protection for the dwelling. The application judge proceeded, as do I, on the basis that the parties may have resort to the appraisal remedy under the *Insurance Act*, R.S.O. 1990, c. I.8 to quantify the claim in accordance with the interpretation of the Policy that results from these proceedings.

VII. PRINCIPLES OF INSURANCE CONTRACT INTERPRETATION

[36] I begin my analysis with a review of the principles applicable to the interpretation of contracts of insurance.

[37] As the Supreme Court of Canada explained in *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.*, 2016 SCC 37, [2016] 2 S.C.R. 23, at para. 24:

> [W]here an appeal involves the interpretation of a standard form contract, the interpretation at issue is of precedential value, and there is no meaningful factual matrix that is specific to the parties to assist the interpretation process, this interpretation is better characterized as a question of law subject to correctness review.

[38] The factual matrix is less relevant in such standard form contracts because, as Wagner J. (as he then was) explained, “the parties do not negotiate terms and the contract is put to the receiving party as a take-it-or-leave-it proposition”: *Ledcor*, at para. 28, citing *MacDonald v. Chicago Title Insurance Company of Canada*, 2015 ONCA 842, 127 O.R. (3d) 663, at para. 33, leave to appeal refused, [2016] S.C.C.A. No. 39.

[39] The general principles for interpreting insurance policies as set out in *Ledcor*, at paras. 49-51, are that:

> [W]here the language of the insurance policy is unambiguous, effect should be given to that clear language, reading the contract as a whole.
>
> Where, however, the policy’s language is ambiguous, general rules of contract construction must be employed to resolve that ambiguity. These rules include that the interpretation should be consistent with the reasonable expectations of the parties, as long as that interpretation is supported by the language of the policy; it should not give rise to results that are unrealistic or that the parties would not have contemplated in the commercial atmosphere in which the insurance policy was contracted, and it should be consistent with the interpretations of similar insurance policies.
>
> Only if ambiguity still remains after the above principles are applied can the *contra proferentem* rule be employed to construe the policy against the insurer. [Citations omitted.]

[40] All parts of a policy should be given meaning: *RBC Travel Insurance Co. v. Aviva Canada Ltd*. (2006), 82 O.R. (3d) 490 (C.A.), at para. 11.

[41] Provisions granting coverage should be construed broadly and provisions excluding coverage construed narrowly: *Sam's Auto Wrecking Co. Ltd. v. Lombard General Insurance Company of Canada*, 2013 ONCA 186, 114 O.R. (3d) 730, at para. 37. Even a clear and unambiguous clause should not be given effect if to do so would nullify the coverage provided by the policy: *Sam's Auto Wrecking*, at para. 37.

[42] Endorsements to an insurance policy should be read together with the other policy provisions because "an endorsement is generally not understood to be a self-contained policy": *Pilot Insurance Co. v. Sutherland*, 2007 ONCA 492, 86 O.R. (3d) 789, at para. 21.

[43] The objective of replacement cost insurance as distinct from actual cash value, and the reasons for providing such coverage, were articulated by Laskin J.A. in *Carter v. Intact Insurance Company*, 2016 ONCA 917, 133 O.R. (3d) 721, at paras. 20-24, leave to appeal refused, [2017] S.C.C.A. No. 53. He held that:

> The insurance industry has marketed two types of protection for residential and commercial properties: actual cash value coverage and replacement cost coverage. Under actual cash value coverage, property is insured to the extent of its actual cash value. This coverage recognizes that the insurer is entitled to deduct reasonable depreciation from the value of the loss. Under replacement cost coverage, the insured is entitled to the full cost of repair or replacement without any deduction for depreciation.
>
> A main objective of property insurance is indemnity, and a policy providing for actual cash value coverage is a

> pure indemnity contract. Actual cash value recovery puts insureds in the position they were in before the loss. Since most property depreciates over time, actual cash value is equivalent to replacement cost less depreciation. So actual cash value recovery prevents insureds from profiting or benefiting from their loss.
>
> But actual cash value recovery poses a problem for insureds who want to build a similar structure to replace the insured property that was damaged or destroyed. Because of depreciation, these insureds will incur a cash shortfall, which they may not be able to afford, and which will thus prevent them from reconstructing their damaged structure.
>
> Replacement cost insurance solves this problem. It goes beyond the notion of indemnity. It recognizes that depreciation, or the deterioration of a property over time, is an insurable risk. Replacement cost insurance, in effect, insures depreciation: the difference between replacement cost and actual cash value. So, under replacement cost insurance, if insureds do indeed repair or replace their damaged property, they are entitled to recover from their insurer the full cost of the repairs or the replacement. They can replace "old" with "new". In that sense, even though replacement cost insurance makes insureds better off and violates the indemnity principle, it is justifiable, because without it, many property owners would be unable to cover the shortfall caused by the depreciation of their damaged or destroyed property. [Emphasis added.]

[44] In short, what is insured in the case of replacement cost insurance is the cost of replacing the dwelling without taking into account depreciation: see also *Brkich & Brkich Enterprises Ltd. v. American Home Assurance Co.*, 8 B.C.L.R. (3d) 1 (C.A.), at para. 28, aff'd [1997] 1 S.C.R. 1149.

[45] With these guiding principles in mind, I will analyze the relevant provisions in the Policy.

VIII. ANALYSIS OF THE MEANING OF THE RELEVANT POLICY PROVISIONS

[46] Because this is a standard form contract, the standard of review of the application judge's contractual interpretation on this appeal is correctness.

[47] I will begin by reviewing what is covered and what is excluded in the Policy, followed by an analysis of the application judge's determination of coverage in view of the provisions in the Policy.

Coverage for Flood Protection

[48] This Policy provides coverage for flood protection. As acknowledged by Trillium, while "Section 1 Property Coverages" does not include flood loss coverage, flood protection is covered in the "Water Protection Endorsement" which extends coverage for losses resulting from "direct physical loss or damage to insured property caused by: 1) flood…."

[49] Because the Emonds' house was destroyed in a flood, Trillium acknowledged coverage under the Policy.

Coverage to Repair or Replace a Dwelling

[50] The Policy provides that where there is coverage, the insured may choose as the basis of loss settlement, either the cost of repairs or replacement or the actual cash value:

> If “you” repair or replace the damaged or destroyed building on the same location with materials of similar quality within a reasonable amount of time after the damage, “you” may choose as the basis of loss settlement either (**A**) or (**B**) below; otherwise, settlement will be as in (**B**).
>
> > **A.** The cost of repairs or replacement (whichever is less) without deduction for depreciation, in which case “we” will pay in the proportion that the applicable amount of insurance bears to 80% of the replacement cost of the damaged building at the date of damage, but not exceeding the actual cost incurred.
> >
> > **B.** The Actual Cash Value of the damage at the date of the occurrence.

[51] The GRC enhances the coverage in the Policy to repair or replace the dwelling by excluding any “deduction for depreciation <u>even if it is more than the amount of insurance shown on the ‘Declaration Page’</u>.” It also provides that the dwelling will be replaced “using current building techniques.” This language opens up the possibility of coverage in excess of the coverage limit listed on the Declaration Page, in this case, $585,092.

The Para. 8 Exclusion of Coverage and the BBCC Coverage

[52] The para. 8 Exclusion specifically excludes coverage for "increased costs of repair or replacement due to operation of any law regulating the zoning, demolition, repair or construction of buildings and their related services; except as provided under Additional Coverages of Section 1."

[53] The onus rests on the insurer to establish an exclusion of coverage: *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, 2010 SCC 33, [2010] 2 S.C.R. 245, at para. 51.

(1) The meaning of "increased costs"

[54] The application judge did not specifically address the meaning of "increased costs" in the para. 8 Exclusion nor did the parties raise this issue on the application or address it on this appeal other than in response to questions from the bench. However, some understanding of it is necessary to appreciate the scope of the para. 8 Exclusion.

[55] The para. 8 Exclusion was the subject of discussion between representatives of the parties before the litigation. Trillium's representative explained the concept this way:

> By contrast, bylaws passed and building code changes made since the original date of construction force a homeowner to enhance some of the features when they are required to renovate or rebuild their house. These can include such things as enlarging the size of joists or

> studs, improving electrical wiring, increasing the insulation factor or creating a flood proof foundation. Trillium sees these requirements as being separate from the term “using current building techniques” and, as such, allows up to $10,000.00 for bylaw and building code requirements.

[56] From a review of the case law, it would seem that “increased costs” are those that exceed the amount payable by the insurer to replace the dwelling as it was. This necessarily implies that they result from a “law” enacted after the dwelling was originally built that requires features of the house to be enhanced (the position Trillium articulated in the lead up to the litigation, consistent with case law), or that they pertain to correcting deficiencies in the building as it stood at the time of the loss (a meaning that is also consistent with case law).

[57] The determination of what constitutes “increased costs” begins with an explanation of the “amount payable” on the Declaration page of the Policy for the dwelling, which is: $585,092. The “amount payable” to replace a dwelling would not reasonably be expected to include costs associated with correcting legal deficiencies that exist in the building at the time of the loss, or complying with laws that were enacted after the dwelling was built.

[58] In *Roth v. Economical Mutual Insurance Company*, 2016 ABCA 399, 46 Alta L.R. (6th) 1, the Alberta Court of Appeal considered whether an insurance policy covers costs associated with fixing pre-existing deficiencies discovered as a result

of, but not caused by, an insured peril (these types of costs are specifically excluded from coverage in the Emonds' Policy). The court found, at para. 23, that

> "[e]xtending coverage in such cases would require that the insurer determine in each case whether the property complied with all relevant bylaws … Quite apart from the fact that this would be practically impossible in most cases, it would also effectively turn an insurer into a guarantor of construction defects and building code violations." [Emphasis added]

[59] In *Allemand v. State Farm Ins. Cos.* (2010), 160 Wn. App. 365, the policy excluded "increased costs resulting from enforcement of any ordinance or law", except for a specified amount in an additional coverage clause. The Washington Court of Appeal excluded from coverage the rebuilding costs to address deficiencies in the foundation, crawl space, and electrical wiring as required by law. This reasoning is consistent with the Alberta Court of Appeal's reasoning in *Roth* that extending coverage in such cases "would require that the insurer determine in each case whether the property complied with all relevant bylaws" which would turn the insurer "into a guarantor of construction defects and building code violations": *Roth*, at para. 23.

[60] The para. 8 Exclusion for increased costs in this case takes into account the fact that the insurer has not accounted for these types of costs in its estimate of the replacement cost listed on the Declaration Page. As such, any "increase" to the cost of repair or replacement that results from any law that does not allow the building to be rebuilt with the deficiencies that existed at the time of the loss, is

excluded from coverage by the para. 8 Exclusion. There is recognition however, that there may be compliance costs borne by the insurer: the BBCC provides up to $10,000 payable by the insurer for such costs.

[61] In terms of what is being repaired or rebuilt, “increased costs” only includes those increased costs related to replacing the dwelling “as it was”. Therefore, enhancements required by laws enacted after the building was constructed are increased costs.

[62] In *Fabian v. BCAA Insurance Corporation*, 2022 BCSC 552, for example, the “increased costs” excluded were those costs to add a sprinkler system and other items that were not part of the home before it was destroyed, but were now required by a by-law: see paras. 15 and 19. Those costs were excluded by an exclusion similar to the para. 8 Exclusion.

[63] For these reasons, in my view, “increased costs” in these standard form contracts, are those that exceed the amount payable by the insurer to replace the dwelling as it was, because either existing deficiencies have to be fixed, or a law enacted after the original construction requires enhancements on rebuilding.

(2) The meaning of the words “any law”

[64] The application judge held that the words “any law” in the para. 8 Exclusion do not include by-laws or regulations. In support of her proposition, she noted that the BBCC specifically refers to “any by-law, regulation, ordinance or law,” while the

para. 8 Exclusion only refers to “any law”. She held that, “[h]ad Trillium wanted the term ‘law’ to include subordinate authority for the purpose of the para. 8 Exclusion, it could have drafted the Policy accordingly. It did not.” As such, she held that the increased costs to comply with by-laws and regulations were not subject to the para. 8 Exclusion.

[65] For the reasons that follow, I do not agree with this interpretation of the words “any law”.

[66] First, the word “law” is a clear and well-known concept. It is defined in the Oxford Dictionary as “a rule or system of rules recognized by a country or community as regulating the actions of its members and enforced by the imposition of penalties”: Angus Stevenson and Maurice Waite, eds., *Concise Oxford English Dictionary*, 12th ed. (New York: Oxford University Press, 2011), at p. 807. Case law has also defined “law” as, in essence, creating or imposing an enforceable obligation: *Valley Rubber Resources Inc. v. British Columbia (Minister of Environment, Lands & Parks)*, 2002 BCCA 524, 5 B.C.L.R. (4th) 1, at para. 25. See also *Armadale Communications Ltd. v. Saskatoon (City)* (1990), 90 Sask. R. 23 (Q.B.), at para. 9, where the court found that, in general terms, “the term ‘law’ includes rules of conduct laid down by a legislative authority by way of statute, regulation, ordinance, by-law or some other form of prescribed method.” The plain meaning of the word “law” therefore includes both legislation and rules of subordinate authority such as by-laws and regulations.

[67] Second, the para. 8 Exclusion refers not just to "law" but to "any law" (emphasis added). The term "any" is all-embracing and without limitation or qualification: *Epp School District v. Park (Rural Municipality)*, [1936] 2 W.W.R. 331 (S.K.C.A.), at para. 20. The words "any law" are expansive.

[68] Third, the BBCC supports the interpretation that "any law" includes by-laws, regulations, and other subordinate legislation. It provides that the insurer will pay up to an additional $10,000 or the amount on the Declaration Page for the increased cost to comply with "any law" regulating construction. Like the para. 8 Exclusion, it uses the general term "any law" in the opening words articulating this additional coverage. It goes on to specify that this sum is to pay for, among other things, "any increase in the cost of…construction or reconstruction…arising from the enforcement of the minimum requirements of any by-law, regulation, ordinance or law." Within the Policy, the term "any law" is an umbrella term that includes by-laws, regulations, ordinances, and laws. Furthermore, if the para. 8 Exclusion did not apply to cost increases relating to by-laws, regulations, or ordinances, the BBCC could not purport to provide "additional coverage". Such costs are already fully covered under the GRC.

[69] Fourth, even if the MVCA Regulation Policies are "policies" as suggested by the respondent, they are included in the definition of "any law".

[70] The MVCA Regulation Policies provide a detailed regulatory scheme that must be followed by those within the MVCA's catchment area. Counsel for the respondents conceded in oral submissions that the MVCA Regulatory Policies reflect building requirements set by a public authority. They are not optional; the Emonds must comply with them when rebuilding their home.

[71] In *Ainsley Financial Corp. v. Ontario (Securities Commission)*, 21 O.R. (3d) 104 (C.A.), Doherty J.A. considered the characterization of a policy statement issued by the Ontario Securities Commission. He held, at paras. 18-21, that the policy was regulatory in nature and constituted a "de facto legislative scheme" because it set out a comprehensive and minutely detailed regime that attracted sanctions if not followed. Doherty J.A. accepted the lower court's finding that to hold otherwise would "ignore the plain language of the document itself and the reality of the regulatory environment in which it [was] to be implemented": see para. 18.

[72] Similarly, the MVCA Regulation Policies clearly set out a detailed regulatory scheme which is mandatory in order to construct. As such, they are a de facto legislative scheme that captured by the term "any law".

[73] Finally, the decision in *Choukair v. Allstate Insurance*, 2015 ONSC 4989, relied on by the respondents, is distinguishable. The exclusion clause in *Choukair* only excluded by-laws, a much more specific term than the more general term,

"law". Furthermore, the *Choukair* policy did not contain anything similar to the BBCC coverage in this Policy, which applies to by-laws, regulations, ordinances, or laws that clearly fall under the umbrella of the term "any law".

[74] For these reasons, I find that the para. 8 Exclusion applies to increased costs to demolish and replace the dwelling as it was that are due to the operation of "any law" including the MVCA Regulation Policies, municipal by-laws, and other regulations regarding demolition or reconstruction of the dwelling, in the manner I have described above.

Whether the Exclusion Clause Applies to Coverage in the GRC Endorsement

[75] As stated above, the law is clear that endorsements must be read together with the policy of insurance as a whole, including any exclusions from or limitations on coverage: *Pilot Insurance Co.*, at para. 21. This is recognized in the GRC itself, which provides that "in all other respects, the Policy provisions and limits of liability remain unchanged."

[76] The application judge held that, since there was no limitation on compliance costs in the GRC, the Emonds could recoup all of these costs. In so finding, she relied on the decision in *Wigle*.

[77] For the reasons that follow, I disagree with the conclusion that the para. 8 Exclusion does not limit the Emonds' coverage under the Policy.

[78] In my view, the decision in *Wigle* relied on by the application judge, is distinguishable from this case. In *Wigle*, the insured was injured in a motor vehicle accident by an unidentified automobile. The insured had purchased a standard automobile insurance policy and an additional "underinsured motorist endorsement". The insurer denied coverage under the endorsement on the ground that the endorsement did not provide for indemnification where the injury resulted from an unidentified automobile. The insurer argued that the term "uninsured automobile" in the endorsement did not include an "unidentified automobile". Importantly, there was no exclusion clause elsewhere in the policy that purported to exclude injuries resulting from unidentified automobiles from coverage. There was also no language elsewhere in the policy that would exclude "unidentified automobiles" from the meaning of the term "uninsured automobiles". The court held that it was not clearly apparent in the endorsement that the term "uninsured automobile" excluded unidentified automobiles. Since this limitation was not apparent, it should have been set out in the endorsement itself.

[79] By contrast, this Policy contains the para. 8 Exclusion of coverage for the increased costs of demolition and replacement due to the operation of any law. The para. 8 Exclusion applies "except as provided under Additional Coverages of Section 1", which includes the BBCC. The BBCC provides a coverage limit of $10,000 for these increased costs. The fact that this coverage limit is not repeated

in the GRC itself is not determinative because the Policy provisions must be read as a whole: *Pilot Insurance Co*., at para. 21.

[80] For these reasons, I conclude that when the GRC is read along with the para. 8 Exclusion and the BBCC, there is a limit on the increased costs (as defined above) to comply with "any law", including the MVCA Regulation Policies: they are only covered up to $10,000. This is not a circumstance, as in *Wigle*, where the alleged limitation was not set out anywhere in the policy. Here, the exclusion for costs associated with legal compliance is explicit in the Policy and is clearly applicable to the GRC.

[81] I also reject the respondents' submission that because the BBCC is not included on the Declaration Page, it does not apply to this Policy. Unlike many of the other "Section 4 Miscellaneous Coverages Section" provisions, the BBCC does not say that "coverage is shown as covered on the Declaration Page." Rather, the BBCC specifically provides that the increased amount for compliance is <u>either</u> "an additional amount up to $10,000 <u>or</u> the amount shown on the 'Declaration Page'" (emphasis added). Trillium has conceded that the BBCC applies and that the Emonds would receive the full $10,000 under that provision.

[82] The Emonds make much of the fact that the GRC uses the term "current building techniques", which is not defined in the Policy and only appears in the GRC. According to the respondents, this constitutes a conflict between the GRC

coverage and the para. 8 Exclusion which must be resolved in favour of the insured: *Sam's Auto Wrecking*, at para. 37.

[83] Trillium concedes that the Policy provides for replacement costs which "will be determined by the lowest estimate which can rebuild the home with '*materials of similar quality using current building techniques within a reasonable amount of time following the loss*,' so the insured does not profit from its loss" (emphasis in original).

[84] The plain language meaning of the term "technique" is "a way of..." doing something: *Concise Oxford English Dictionary*, at p. 1480. Trillium confirmed that in using the phrase "current building techniques", it undertook to use construction methods that are commonly used today rather than those used in the original construction of the home. Trillium's adjuster noted that in many instances, current building techniques are, in fact, cost-effective. However, even where they are not, they are clearly provided for in the GRC.

[85] Trillium concedes that replacing the dwelling as it was, includes the use of similar quality materials and "current building techniques" as provided for in the GRC. Whether increased costs are covered as costs of using similar quality materials or current building techniques are questions to be determined by the trier of fact.

[86] As such, the para. 8 Exclusion only applies to increased costs required by "any law".

Does this Interpretation Nullify the Coverage in the GRC?

[87] Nullification occurs when a policy defeats the purpose of the coverage the policy provides: *Cabell v. Personal Insurance Company*, 2011 ONCA 105, 104 O.R. 3(d) 709, at para. 14; *Indemnity Insurance Co. of North America v. Excel Cleaning Service*, [1954] S.C.R. 169, at pp. 177-78; see also *Foodpro National Inc. v. General Accident Assurance Co. of Canada* (1988), 63 O.R. (2d) 288 (C.A.), at p. 288, leave to appeal refused, [1988] S.C.C.A. No. 707.

[88] The GRC provides the Emonds with enhanced coverage to rebuild their home the way it was, using materials of similar quality and current building techniques, (i) without deduction for depreciation and (ii) even if the cost of replacement exceeds the policy limit on the Declaration Page (i.e., inflation protection). The application of the para. 8 Exclusion does not deny the Emonds these benefits; it only applies to increased costs required by "any law".

[89] While the operation of the para. 8 Exclusion may deny the insured some funds, this does not "render nugatory coverage for the most obvious risks for which the endorsement [was] issued": *Foodpro*, at p. 288. It is clear that the "most obvious risks" for which the GRC was issued are depreciation and inflation, not [bylaw] compliance costs: see e.g. *Carter*, at paras. 20-24.

[90] I therefore reject the Emonds' submission that the application of the para. 8 Exclusion to the GRC would result in nullification of coverage.

IX. CONCLUSION

[91] In sum, a proper interpretation of the Policy provides that,

a) Floods are an insured peril;

b) The GRC is part of the Policy of insurance and all of the terms of the Policy should be read as a whole. The GRC provides coverage without any deduction for depreciation even if the amount exceeds the Policy limit to repair or replace the dwelling as it was, using similar materials and current building techniques. (Trillium concedes that the flood coverage provides for use of current building techniques);

c) The para. 8 Exclusion excludes coverage for "increased costs" (over and above the cost to replace the dwelling as it was using current building techniques) to comply with "any law". The words "any law" include by-laws and regulations such as the MVCA Regulation Policies;

d) Notwithstanding this exclusion, the BBCC provides up to $10,000 to pay for these excluded costs; and

e) The Policy does not nullify coverage.

[92] The Emonds may therefore recover the costs of rebuilding their home, without any deduction for depreciation, even if the amount exceeds the Policy limit.

The home is to be built on the same location, with materials of similar quality using current building techniques, but without full coverage for “increased costs” to comply with any law regulating the construction or repair of the home. This excludes full coverage for the MVCA Regulation Policies’ and other regulations and by-laws enacted after the original dwelling was built that would require fixing deficiencies or making enhancements to any features of the home as it stood before the loss occurred. The Emonds have been offered $10,000 to cover these additional costs.

[93] As noted, on this appeal, the parties have not sought quantification of the loss provided for in this standard form Policy. Moreover, quantification is not possible because the parties did not provide information as to the requirements of the MVCA and other laws and concomitant costs to be incurred to comply with same.

[94] The issue of quantification of the replacement loss must now be determined. This will involve determinations of fact as to (i) whether an increased expense is covered as a “current building technique”, or as “materials of similar quality” that are covered under the Policy, or (ii) whether the increased costs are not covered under (i), but are required by “any law”, and are therefore excluded from coverage except for payment of up to $10,000.

[95] For these reasons, I would allow the appeal.

[96] On the agreement of both parties, I would award costs to the appellant, Trillium as the successful party, in the amount of $20,000 (including HST) and disbursements (on which HST must be calculated).

Released: November 03, 2023 “P.D.L”

“Thorburn J.A.”

“I agree. P. Lauwers J.A.”

“I agree. B. Zarnett J.A.”

Saskatchewan Supreme Court

COURT OF APPEAL

Citation: Epp School District v. Park (Rural Municipality)
Date: 1936-05-04

Schools and School Districts—Errors in Assessment or Tux Levy—Validity of Order of Minister Correcting Error—S:70, School Assessment Act as Retrospective—"Any Year."

Sec. 70 of *The School Assessment Act,* R.S.S., 1930, ch. 133, as amended by ch. 51, .1934-35, winch provides for the making or correction by order of the minister, of the assessment or tax levy of any school district winch has not been made in any year as provided by law or has been incorrectly or improperly made," is retrospective; and therefore, applies to errors made in years prior to that in which the amendment, became law.

[Note up with 7 C.E.D., *Schools and School Districts,* secs. 25, 26: *Statutes,* secs. 41, 100, 119.]

Appeal from a judgment by Bryant, D.C.J. Appeal allowed with costs.

The judgment of the Court was delivered by

Council:
B. J. McDaniel, for defendant, appellant.
P. G. Makaroff, K.C., for plaintiff, respondent.

May 4, 1936.

[1] GORDON, J.A.—This is an appeal from the judgment of the learned District Court Judge of the judicial district of Saskatoon. The action was tried on an agreed statement of facts, so the question raised in the appeal is entirely one of law.

[2] The following is an epitome of the facts as so agreed: The plaintiff (hereinafter referred to as the "Epp school district") is a duly formed school district under *The School Act* of Saskatchewan, R.S.S., 1930, ch. 131. The defendant (hereinafter referred to as the "municipality") is a duly formed municipality under *The Rural Municipality Act,* of Saskatchewan, now 1934-35, ch. 30. Within the territorial borders of the municipality are two rural school districts, viz. Epp school district and Findlayson school district. For some reason which is not disclosed the secretary-treasurer of the municipality was not aware of the real boundaries of these two school districts with the result that for the years 1924 to 1931 inclusive he considered two grain elevators as being within the Epp school district, when, as a matter of fact, they were within the Findlayson school district. The school taxes collected during these years in respect of these two elevators was $73875.

[3] On March 12, 1934, a meeting of the trustees of these two school districts was held in an effort to effect an amicable adjustment of the matter but the effort was not successful.

[4] In the month of May, 1934, an investigation was made by an inspector of the Department of Municipal Affairs, and on May 22 an order was made by the Minister directing the municipality to pay to Findlayson school district $350, which was standing to the credit of the Epp school district, and ordered further that the municipality should, in the years .1934 to 1937 inclusive, levy an additional sum of $97.19 on the lands in the Epp school district and pay such levies to Findlayson school district.

[5] Acting on this order the municipality transferred the $350 from the Epp school district to the Findlayson school district, and in the year 1934 levied a further sum of $97.19 in the Epp school district

and transferred this sum on its books to the Findlayson school district.

[6] On May 28, 1935, this action was commenced. I shall deal with this more particularly later.

[7] On July 29 the municipality acting on instructions of the Department of Municipal Affairs obtained a refund from Findlayson school district of the two sums of $350 and $97.19 and credited them to Epp school district. The statement of facts does not disclose why this was done but it was agreed before us that it was because there was no authority to make the order of May 22, 1934.

[8] On July 31, 1935, a new order was made by the Minister directing the municipality to pay to the Findlayson school district $350 charging that amount to the Epp school district and also directing the municipality to levy the sum of $97.19 in each of the years 1935 to 1938 inclusive, on the land in the Epp school district, and pay such sum to the Findlayson school district.

[9] The municipality complied with this order to date and intended to comply with it in the future.

[10] The action brought by the Epp school district sets up that the transfer of the sum of $350 from its account to the account of the Findlayson school district and the levy of $97.19 in the year 1935 were illegal and judgment is asked for this sum and an injunction restraining the municipality from levying any further sums in accordance with the order of the Minister dated July 31, 1935.

[11] The learned District Court Judge agreed with the contention put forward on behalf of the Epp school district and gave judgment for the return of the sum of $447.19 and granted an injunction restraining the municipality from levying any further sums as directed by the last-mentioned order of the Minister. From this judgment the municipality now appeals.

[12] To my mind the question must be determined on a construction of ch. 51 of the statutes of Saskatchewan, 1934-35, which was an amendment to *The School Assessment Act,* R.S.S., 1930, ch. 133.

[13] Before dealing with this amendment I should give an outline of how school districts are financed.

[14] Every school district is given corporate existence by virtue of sec. 104 of *The School Act.* By sec. 324 of *The Rural Municipality Act,* the school district is required to send to the municipality a map of the school district and a resolution of the board of trustees showing the total amount required to be levied on the total assessment of the school district. Under sec. 327 the municipality strikes a rate on the dollar to be levied for school purposes. This assessment is, of course, confined to the lands in the school district in question, so if there is more than one school district in a municipality as there is in the defendant municipality, the rates may be, and actually were, different in the districts of Epp and Findlayson. The municipality is bound to pay over to the school districts a quarter of the total so requisitioned by them in March, June, September and December of the year whether such amount has been collected in taxes or not. Mistakes have, no doubt, been made, and, in order that the same might be rectified, there has appeared in *The School Assessment Act* since 1915 the following sec. 70:

> "Notwithstanding anything contained in this Act, *The City Act, The Town Act, The Village Act* or *The Rural Municipality Act,* it is hereby expressly declared that, if it is shown to the satisfaction of the minister that the assessment or tax levy of any school district has not been made in any year as provided by law or has been incorrectly or improperly made in any respect, the minister shall have power by written order to make any provision he deems necessary for the making or correction of such assessment or tax levy or for the making of a new assessment or tax levy, and every such

order and all the terms and conditions thereof shall have the effect of law and shall be binding on all parties concerned."

[15] Doubts were entertained as to whether this section went far enough, and the new section was passed by ch. 51 of the statutes of 1934-35 as follows:

"70.—(1) Notwithstanding anything contained in this or any other Act, where it is shown to the satisfaction of the minister that the assessment or tax levy of any school district has not been made in any year as provided by law or has been incorrectly or improperly made in any respect, the minister may by written order make any provision which he deems necessary for the making or correction of such assessment or tax levy, or for the making of a new assessment or tax levy.

"(2) Without limiting the generality of subsection (1) the minister may by any such order direct a municipality, from the school taxes levied or to be levied on behalf of a school district, to pay to, another school district in accordance with the terms of the order such amount or amounts as he may deem necessary for the adjustment of accounts between the school districts affected and the municipality.

"(3) Every such order and all the terms and conditions thereof shall have the effect of law and shall be binding on all parties concerned."

[16] It was not contended before us that the amendment was not retrospective, but that it would be so manifestly unfair to allow the Minister authority to attempt to correct errors many years old that we should construe the section as giving this authority for the current year only.

[17] The learned trial Judge held that the amended section was not retrospective and refers to some of the many authorities which lay down the rule that a statute shall not be given a retrospective interpretation unless this is expressly declared to be intended or is necessarily implied by the language used.

[18] With due deference to the learned trial Judge, I am of the opinion that the amended section is retrospective. I have not overlooked the rule laid down by the Supreme Court in *Trans-Canoda Insur. Co. v. Winter* [1935] S.C.R. 184, to the effect that, where a statutory enactment is repealed in one Act and re-enacted with certain other provisions only the re-enacted clauses should be deemed retrospective.

[19] The amended section became law on February 21, 1935. If on the following day an error similar to the one in question had been discovered to have been made in the year 1934, could it be contended that the Minister could not have made an order correcting it?. The statute, speaking as at the day it became law, says: "where it is shown to the satisfaction of the Minister that the assesment or tax levy of any school district has not been made in any year as provided by law * * *." If it had been intended that the Act only applied to errors which might be made after the Act had become law it would have indicated that intention by stating, "* * * that the assessment or tax levy of any school district has not been made in any year *hereafter* * *."

[20] A reference to the legal dictionaries shows that the word "any" is all-embracing. It is a word which, in its natural meaning, excludes limitation or qualification. I think, therefore, that the section as amended applies to all errors in assessment. Further, I am clearly of the opinion that, if it had been the intention of the Legislature to confine the operation of the section to the current year in which the error is discovered, as suggested by counsel for the Epp school district, other words would have been used. In its present form it refers to "any year." Further, sec. 302 of *The Rural Municipality Act* empowers the council at any

time to correct any gross or palpable errors in the assessment roll even after its adoption, so I do not think that it can be held that sec. 70 of *The School Assessment Act* as amended could be held to apply to the current year only. Further, errors such as the one in question may not be discovered for years, or if discovered within the then current year, the council would correct the assessment without reference to the Minister.

[21] If it had been the intention of the Legislature to confine the power of the Minister to the rectification of only such errors which had been discovered after the amendment came into force, I think it should have done so in explicit words. The words of the amendment as it now stands are such as to convince me that it was the clear intention of the Legislature to empower the Minister with authority to make the order in question.

[22] Again, subsec. (2) of sec. 70 provides that the Minister may order the municipality to pay for the "school taxes levied or to be levied," which clearly shows that the section was not to be confined to any one year. Then necessarily it must apply to all.

[23] The Minister having dealt with the matter, it follows that this appeal should be allowed with costs and the judgment entered set aside and the action dismissed. The plaintiff will be entitled to its costs up to the date of the order of the Minister, i.e., July 31, 1935. The defendant will be entitled to costs thereafter. There will be a set-off.

Fed. Ins. Co. v. Raytheon Co.

United States Court of Appeals for the First Circuit

October 21, 2005, Decided

No. 05-1086

Reporter
426 F.3d 491 *; 2005 U.S. App. LEXIS 22742 **; 36 Employee Benefits Cas. (BNA) 1333

FEDERAL INSURANCE COMPANY; AXIS SURPLUS INSURANCE COMPANY, Plaintiffs, Appellees; v. RAYTHEON COMPANY Defendant, Appellant.

Subsequent History: As Amended December 8, 2005.

Prior History: [**1] APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF MASSACHUSETTS. Hon. Richard G. Stearns, U.S. District Judge.

Counsel: David Newmann, with whom Ellen S. Kennedy, Kurt B. Gerstner, Hogan & Hartson, LLP, and Campbell Campbell Edwards & Conroy, P.C., were on brief, for appellee Federal Insurance Company.

John D. Hughes, with whom Wendy L. Rosebush and Edwards & Angell, LLP, were on brief, for appellee Axis Surplus Insurance Company.

Christopher Landau, with whom James F. Kavanaugh, Jr., Johanna L. Matloff, James P. Gillespie, Eric B. Wolff, Conn, Kavanaugh, Rosenthal, Peisch & Ford, LLP, and Kirkland & Ellis, LLP, were on brief, for appellant Raytheon Company.

Judges: Before Torruella, Dyk *, and Howard, Circuit Judges. HOWARD, Circuit Judge, dissenting.

Opinion by: Timothy B. Dyk

Opinion

[*493] **DYK, *Circuit Judge*.** This is an insurance coverage dispute. On May 19, 2003, a class action was filed against Raytheon Company ("Raytheon") under the Employee Retirement Income Security Act of 1974 ("the ERISA action"). At that time, Raytheon was insured under a liability insurance policy issued by Federal Insurance Company ("Federal") and [**2] an excess policy issued by Axis Surplus Insurance Company ("Axis"). Raytheon requested coverage from the insurers. In response, the insurers filed suits for declaratory judgment of non-coverage, invoking the district court's diversity jurisdiction. The insurers contended that the ERISA action was excluded from coverage under the pending and prior litigation exclusions of the policies because there

* Of the Federal Circuit, sitting by designation.

were overlapping allegations between the ERISA action and an earlier securities lawsuit brought against Raytheon in 1999, before the effective dates of the policies.

The district court held that coverage was excluded under the prior and pending litigation exclusion clauses of both policies. We hold that coverage for both insurers is excluded under the Federal policy. We accordingly affirm the judgment of the district court.

I

Raytheon provides products and services in the areas of defense and commercial electronics. It is a public company listed on the New York Stock Exchange. On October 12, 1999, the Wall Street Journal published an article reporting that Raytheon, unbeknownst to investors, experienced cost overruns and was behind schedule on many defense-related contracts. Later [**3] that day, Raytheon reported one-off charges totaling $ 638 million and reduced earnings expectations. The charges and reduced earnings forecast caused a sharp decline in Raytheon's stock price.

On October 19, 1999, a class action invoking *section 10* the Securities Exchange Act of 1934, *15 U.S.C. § 78j (2000)*, and *Rule 10b-5*, *17 C.F.R. § 240.10b-5 (2005)*, was filed in the District of Massachusetts against Raytheon and several of its senior officers ("the Securities action"). *In re Raytheon Co. Sec. Litig.*, No. 99-CV-12142 (D. Mass. June 12, 2000) (amended complaint). The lead plaintiff was the New York State Common Retirement Fund, which sought to represent a class of persons who purchased Raytheon stock from October 7, 1998, to October 12, 1999 (the date of the Wall Street Journal article). The complaint in the Securities action alleged that during the class period, Raytheon issued materially false and misleading statements regarding its financial performance. Briefly, the Securities complaint alleged that (1) Raytheon's Engineering & Constructors division ("RE&C") failed to disclose losses on major contracts; (2) RE&C misleadingly [**4] reported revenues on existing and anticipated contracts; [*494] (3) Raytheon failed to disclose that projects relating to the P-3 Orion aircraft and other defense equipment were over budget and behind schedule; and (4) Raytheon failed to disclose that the Joint Primary Aircraft Training System was over budget and behind schedule. The Securities action apparently settled in December 2004.

In May 2003 a second class action was filed against Raytheon and several of its officers and employees in the District of Massachusetts, this time based on the Employee Retirement Income Security Act of 1974, *29 U.S.C. § 1001 et seq.* *In re Raytheon ERISA Litig.*, No. 03-CV-10940 (D. Mass. Apr. 20, 2004) (amended complaint). The lead plaintiffs were Benjamin Wall and Joseph Duggan III, former Raytheon employees

who sought to represent a class of persons who were participants in or beneficiaries of Raytheon's Savings and Investment Plan (the "Plan") [1] at any time between October 7, 1998, and date of the complaint. In contrast to the Securities complaint, the ERISA complaint alleged that the defendants were ERISA fiduciaries of the Plan; that the defendants regularly communicated [**5] to Plan participants during the all relevant times; and that the defendants had financial interests tied to the Raytheon stock price at all relevant times. It then charged the defendants with four counts of breach of fiduciary duty, specifically (1) imprudent investment; (2) failure to monitor other fiduciaries; (3) misrepresentation and failure to disclose information to beneficiaries; and (4) failure to avoid conflicts of interest. The ERISA litigation is ongoing.

Apart from differences in parties and legal theories, the factual allegations of the ERISA complaint were in many respects nearly identical to the Securities complaint, but in other respects were different from the Securities [**6] complaint. With respect to alleged misdeeds by Raytheon occurring prior to October 12, 1999 (the cut-off date for the Securities class action), the factual allegations of the ERISA complaint mirrored those of the Securities complaint; including (1) RE&C failed to disclose and improperly accounted for losses on major contracts; (2) RE&C misleadingly recognized revenues on existing and anticipated contracts; and (3) Raytheon failed to disclose material cost overruns and delays affecting projects related to the P-3 Orion aircraft. With the exception of allegations concerning several Raytheon Systems Corporation projects and the Joint Primary Aircraft Training System, it is fair to say that all the allegations of Raytheon misdeeds made in the Securities complaint were also included in the ERISA complaint.

However, in two major respects the ERISA complaint included allegations not found in the Securities complaint. First, there were substantial allegations of misdeeds pertaining to the post-October 12, 1999, period in the ERISA complaint that were not alleged in the Securities complaint. For example, the ERISA complaint alleged the existence of "recurring indications of accounting and [**7] control irregularities . . . ." J.A. at 194. It alleged that "Defendants' misleading, inaccurate, and incomplete statements regarding the Company's fiscal health extended from 1998 through 1999, and beyond." *Id.* at 195. Other post-October 12, 1999, events alleged included (1) the SEC commenced an investigation into Raytheon's accounting practices in 2003; (2) Raytheon made material [*495] misrepresentations in selling the

[1] The Plan comprised three types of plans: (1) an employee stock ownership plan, in which Raytheon employees received Raytheon stock annually as a fixed percentage of their annual income; (2) a participant-controlled 401(k) style plan; and (3) a matching plan where Raytheon matched any employee investments in Raytheon stock.

RE&C division to Washington Group International ("WGI"), leading to litigation by WGI and its shareholders; and (3) the SEC commenced proceedings against Raytheon and its former CFO relating to violations of SEC regulations.

Second, to support the different legal theories asserted under ERISA in contrast to the Securities Exchange Act, relevant facts not contained in the Securities complaint were alleged in the ERISA complaint. The complaint alleged that the defendants were ERISA plan fiduciaries. To support the imprudent investment charge, the ERISA complaint alleged that at "all relevant times, Defendants knew or should have known that Raytheon was engaged in the questionable business practices detailed above which made Raytheon stock an imprudent Plan investment. [**8] " *Id.* at 215. To support the failure to disclose and misrepresentation charge, the complaint alleged that "Raytheon regularly communicated with employees, including Plan participants, about Raytheon's performance" and failed to disclose and misrepresented material information to Plan beneficiaries. *Id.* at 217. To support the conflict of interest charge, the complaint alleged that the defendants' "compensation was [] closely tied to the price of Raytheon Stock" and that the defendants had failed to avoid improper conflicts of interest. *Id.* at 218.

After the ERISA action was filed, Raytheon sought coverage from the insurers. The insurers denied coverage and filed suit in the District of Massachusetts, seeking a declaratory judgment of non-coverage. The insurers contended that coverage was excluded under the prior and pending litigation clause in the Federal Insurance policy, which states

> The Company [Federal] shall not be liable for Loss on account of any Claim made against any Insured . . . based upon, arising from, or in consequence of any demand, suit or other proceeding pending, or order, decree or judgment entered against any Insured, on or prior to [September 15, 2000], [**9] or the same or any substantially similar fact, circumstance or situation underlying or alleged therein.

J.A. at 32-33.

As an excess policy, the Axis policy has a clause stating, "In no event shall this Policy grant broader coverage than would be provided by the most restrictive policy constituting part of the applicable Underlying Insurance." J.A. at 54. Thus, if coverage is excluded under the Federal policy, it is also excluded under the Axis policy. The Axis policy also has its own prior and pending litigation exclusion, which is worded somewhat differently, stating

> the Insurer [Axis] shall not be liable for any amount in any Claim . . . based upon, arising from, or attributable to:
> (a) any demand, suit or other

> proceeding pending, or order, decree or judgment entered, against any Insured on or prior to September 15, 2000 or any wrongful act, fact, circumstance or situation underlying or alleged therein; or
>
> (b) any other wrongful act, fact, circumstance or situation whenever occurring, which together with a wrongful act, fact, circumstance or situation described in (a) above are causally or logically interrelated by a common nexus.

J.A. at 62.

The insurers [**10] moved for judgment on the pleadings. In an oral decision, the district court construed the language "based upon . . . the same or any substantially similar fact, circumstance or situation underlying or alleged" to mean that "if the prior complaint contains any overlapping claims made against any Insured, the exclusion is triggered." Applying this test, the district [*496] court found that "Raytheon has not, and cannot, credibly argue that the core allegations of the prior litigation complaint and the ERISA complaint do not overlap." Instead, the district court found that the complaints in the Securities action and the ERISA action revealed "numerous allegations of substantially similar facts, circumstances or situations." Thus, the district court concluded that coverage was excluded, i.e. there was neither a duty to defend nor liability for any loss. Raytheon appeals from the final judgment of the district court.

II

As a preliminary matter, Raytheon submits that the case should be stayed pending the outcome of the ERISA litigation, and in the interim the insurers must defend Raytheon. According to Raytheon, whether a subsequent lawsuit is "based upon . . . any substantially similar [**11] fact, circumstance or situation underlying or alleged" in a prior lawsuit cannot be determined until both lawsuits are over. We disagree.

Under Massachusetts law, [2] as a general matter, "the question of the initial duty of a liability insurer to defend third-party actions against the insured is decided by matching the third-party complaint with the policy provisions." *Cont'l Cas. Co. v. Gilbane Bldg. Co., 391 Mass. 143, 461 N.E.2d 209, 212 (Mass. 1984)*. In this inquiry, "if the allegations of the complaint are 'reasonably susceptible' of an interpretation that they state or adumbrate a claim covered by the policy terms, the insurer must undertake the defense." *Id.* (quoting *Sterilite Corp. v. Cont'l Cas. Co., 17 Mass. App. Ct.*

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[2] The parties assume that Massachusetts' substantive law applies to the contract interpretation issue. In this situation, we follow the rule of *Bird v. Centennial Ins. Co., 11 F.3d 228, 231 n.5 (1st Cir. 1993)*, that where "there is at least a 'reasonable relation' between the dispute and the forum whose law has been selected by the parties, we will forego an independent analysis of the choice-of-law issue and apply" the state substantive law selected by the parties. *Merchs.' Ins. Co. of N.H., Inc. v. U.S. Fid. & Guar. Co., 143 F.3d 5, 8 (1st Cir. 1998)* (quoting *Bird, 11 F.3d at 231 n.5*).

316, 458 N.E.2d 338, 340 (Mass. Ct. App. 1983)). The duty to defend is triggered even if the allegations of the complaint are baseless. Mt. Airy Ins. Co. v. Greenbaum, 127 F.3d 15, 18-19 (1st Cir. 1997). "However, 'when the allegations in the underlying complaint lie expressly outside the policy coverage and its purpose, the insurer is relieved of the duty to investigate or defend the claimant.'" Herbert A. Sullivan, Inc. v. Utica Mut. Ins. Co., 439 Mass. 387, 788 N.E.2d 522, 531 (Mass. 2003) [**12] (quoting Timpson v. Transamerica Ins. Co., 41 Mass. App. Ct. 344, 669 N.E.2d 1092, 1095 (Mass. Ct. App. 1996)); *see also* Terrio v. McDonough, 16 Mass. App. Ct. 163, 450 N.E.2d 190, 194 (Mass. Ct. App. 1983).

Raytheon cites a line of cases holding that even if an insurer has an initial duty to defend based on the complaints alone, [**13] it may be absolved of the duty to defend and liability for loss by subsequent developments in the litigation. *See, e.g.*, Lumbermens Mut. Cas. Co. v. Belleville Indus., Inc., 407 Mass. 675, 555 N.E.2d 568, 575 (Mass. 1990); Sterilite Corp., 458 N.E.2d at 343-44. This line of cases provides no aid to Raytheon. The insurers are not contending that there have been subsequent developments in the litigation absolving them of an initial duty to defend. Rather, they are contending that they do not even have the initial duty to defend. [3] [**14] Nor is Raytheon [*497] contending that subsequent developments have created a duty to defend. [4] Massachusetts law clearly provides that resolution of the issue of coverage, at least initially, is to be based on the allegations of the third-party complaints, here the complaints in the Securities and ERISA actions.

Lastly, Raytheon relies on various district court cases, especially Home Ins. Co. of Ill. v. Spectrum Info. Techs., Inc., 930 F. Supp. 825 (E.D.N.Y. 1996), for the proposition that resolution of the duty to defend on the pleadings is premature. To the extent that these cases are contrary to Massachusetts law, we must follow the Supreme Judicial Court.

III

On the merits, we must construe the Federal insurance policy and apply it to the allegations of the complaints. In light [**15] of our conclusion that

[3] We note that "the obligation of the insurer to defend is based not only on the facts alleged in the complaints but also on the facts that are known or readily knowable by the insurer." Desrosiers v. Royal Ins. Co. of Am., 393 Mass. 37, 468 N.E.2d 625, 627-28 (Mass. 1984). This exception is not applicable because Raytheon has not alleged that any such fact exists.

[4] We thus have no occasion to decide whether subsequent developments in the ERISA litigation could later trigger the duty to defend and liability for loss. "A note of caution is in order. . . . Should a trial subsequently establish that the facts were other than first pleaded . . ., and should an amendment of the complaint be allowed, the insurer would be bound to indemnify the insured for the damages recovered against him and for the costs of the defense. To that degree an insurer's decision not to defend is made at some peril." Terrio, 450 N.E.2d at 194 (citations omitted).

coverage is excluded under the Federal policy, we need not analyze the Axis exclusion.

"The responsibility of construing the language of an insurance contract is a question of law for the trial judge, and then for the reviewing court." *Cody v. Conn. Gen. Life Ins. Co., 387 Mass. 142, 439 N.E.2d 234, 237 (Mass. 1982)*. We thus must independently determine the construction of the policy. In this inquiry, "doubts about ambiguous insurance policy provisions are to be resolved against the insurance company." *J. D'Amico, Inc. v. City of Boston, 345 Mass. 218, 186 N.E.2d 716, 721 (Mass. 1962)*. But when the policy is "plain and free from ambiguity, we do not . . . construe them strictly against the insurer. Rather, we must construe the words of the policy in their usual and ordinary sense." *Barnstable County Mut. Fire Ins. Co. v. Lally, 374 Mass. 602, 373 N.E.2d 966, 968 (Mass. 1978)*.

The Federal policy provides an exclusion for

> any Claim made against any Insured . . . based upon, arising from, or in consequence of any demand, suit or other proceeding pending . . . on or prior to [September 15, 2000], [**16] or the same or any substantially similar fact, circumstance or situation underlying or alleged therein.

J.A. at 32-33. The Federal policy is a "claims-made" policy, where liability for coverage is triggered by the filing of a claim during the policy period instead of the occurrence of an underlying event in the policy period. The policy defines a "claim" as including "a civil proceeding commenced by the service of a complaint or similar pleading . . . against any Insured for a Wrongful Act." J.A. at 37. Thus a claim for present purposes is equivalent to a complaint.

The language of the policy cannot reasonably be given the broadest possible construction, under which any overlapping fact between the two proceedings -- for example, the identity of Raytheon as the defendant in the context of otherwise unrelated facts -- would trigger the exclusion. We do not understand any party to contend otherwise. At the same time, complete identity between the lawsuits is plainly not required. Indeed, all parties agree that the two complaints need not be identical, and that differences in theories [*498] of recovery or the identity of the parties in the proceedings do not in and of themselves preclude [**17] exclusion. [5] Beyond that, they disagree. The district court here construed "based upon . . . any substantially similar fact, circumstance or situation underlying or alleged" to exclude coverage when there are "any

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[5] *See Comerica Bank v. Lexington Ins. Co., 3 F.3d 939 (6th Cir. 1993)* (prior and pending litigation exclusion applied to subsequent suit when bank trustee entered into two conflicting contracts to sell trust assets, was first sued for breach of contract by one contracting party, and then subsequently sued for mismanagement of the trust by the beneficiaries for having entered into conflicting contracts).

overlapping claims." The district court, however, did not make clear the degree of overlap required for the allegations in the complaint, instead finding only that Raytheon cannot "credibly argue that the core allegations of the prior litigation complaint and the ERISA complaint do not overlap" and that "a comparison of the complaints reveals numerous allegations of substantially similar facts, circumstances or situations."

[**18] Axis submits that "all that is required is for the ERISA litigation to contain 'any substantially similar fact, circumstance or situation' alleged in the Prior Litigation," though we understand this to mean any overlap in determinative facts. Br. of Axis at 20 (emphasis omitted). Federal appears to distance itself from this construction, stating that "whether a 'single overlapping fact or claim' would trigger the Exclusion is not a question the Court need answer," Br. of Federal at 18, but does not offer an alternative construction of the exclusion clause. For its part, Raytheon advocates that "the exclusion is triggered only when two *lawsuits* are 'the same' or 'substantially similar,'" or alternatively where "there is significant overlap between the lawsuits as a whole," Br. of Raytheon at 13, 14 (emphasis in original), apparently meaning that the two lawsuits must be virtually identical save for differences in the parties and theories of liability. *See id.* at 14-15 (purporting to cite cases articulating requirements of, *inter alia*, "allegations of 'virtually identical false statements'"; "the same underlying circumstance"; or "'essentially the same set of facts'"). We [**19] think that the correct construction is somewhat different from the position of any of the parties.

Raytheon's construction, apparently relying on the "same or any substantially similar fact, circumstance or situation" language in the policy, is not warranted. While the exclusion clause uses the language "substantially similar," it refers to the subsequent "fact, circumstance or situation." The "substantially similar" language cannot by itself be read to refer to the "demand, suit, or other proceeding."

Raytheon argues alternatively that the second claim must be "based upon" the first. This is correct, [6] and we must determine the meaning of the word "based" in this context. We do not agree with Raytheon's apparent construction of "based" to mean "virtually identical."

[**20] "Words in exclusionary clauses of insurance contracts should be construed 'in their usual and ordinary sense.'" *Bagley v. Monticello Ins. Co., 430 Mass. 454, 720 N.E.2d 813, 816 (Mass. 1999)* (quoting *Liquor Liab. Joint Underwriting Ass'n of Mass. v. Hermitage Ins. Co., 419 Mass. 316, 644 N.E.2d 964, 967 (Mass. 1995)*); *see also Barnstable, 373 N.E.2d at 968*;

[6] As noted, the exclusion clause also excludes claims "arising from" and "in consequence of" any substantially similar fact, situation or circumstance previously alleged. However, no party has asserted that either of the two other exclusionary grounds ("arising from" or "in consequence of") applies here.

Metropolitan Prop. & Cas. Ins. Co. v. Fitchburg Mut. Ins. Co., 58 Mass. App. Ct. 818, 793 N.E.2d 1252, 1255 (Mass. Ct. App. 2003). In construing contracts [*499] courts often look to dictionaries for assistance in determining ordinary meaning. *See*, *e.g.*, *Norfolk S. Ry. v. James N. Kirby, Pty Ltd., 543 U.S. 14, 125 S. Ct. 385, 397-98, 160 L. Ed. 2d 283 (2004)*. Reference to dictionaries in interpreting contracts of insurance is also appropriate. *Aschenbrenner v. U. S. Fid. & Guar. Co., 292 U.S. 80, 85, 78 L. Ed. 1137, 54 S. Ct. 590 (1934)*. In particular, Massachusetts courts refer to dictionaries in interpreting insurance contracts. *Ellery v. Merchs.' Ins. Co., 20 Mass. (3 Pick.) 46, 48, 3 Pick. 46 (1825)* (using dictionary [**21] to define "bilging" in insurance contract).

Consulting the dictionary, the ordinary meaning of "based," used as a verb in this context, is "to use as a base or basis for . . . used with *on* or *upon*," *Webster's Third New International Dictionary of the English Language* 180 (3d ed. 1961) ("Webster's Dictionary") (emphasis in original), or "to place on or upon a foundation or logical basis." *Oxford English Dictionary* 979 (2d ed. 1989). Webster's Dictionary clarifies the usage in this context, explaining that "BASE now usually applies to what underlies a belief, a system of thought, a judgment, a hope, and so on." *Webster's Dictionary* at 181. The dictionary definition of the word "based" here excludes situations in which the complaint in the second action does not draw substantial support from the allegations of the first complaint. Conversely, it does not require that the first action provide the sole support for the second. *Cf. MCI Telecomms. Corp. v. Am. Tel. & Tel. Co., 512 U.S. 218, 225, 129 L. Ed. 2d 182, 114 S. Ct. 2223 (1994)* ("modify" in its ordinary usage does not encompass fundamental change). We think that the policy thus requires the allegations in [**22] the second complaint find substantial support in the first complaint, i.e. that the allegations of the second complaint substantially overlap those of the first. Only with a substantial overlap can the first complaint be said to be a "foundation or logical basis" for the second. "Based" also suggests that the appropriate inquiry is whether the second complaint substantially overlaps the first with respect to relevant facts, without regard to whether the first complaint substantially overlaps the second. [7]

Requiring a substantial [**23] but not complete overlap with the prior complaint also serves the policy behind such prior and pending litigation exclusion clauses. Most directly, prior and pending litigation exclusions "promote the giving of prompt notice

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[7] The Third Circuit, in dictum, suggested in *Bensalem Township v. Int'l Surplus Lines Ins. Co., 38 F.3d 1303 (3d Cir. 1994)*, that a similar clause "limited coverage to claims completely unrelated to any prior matter." *Id. at 1304*. However, that opinion did not consider the dictionary definition of "based" and the clause at issue was broader because it excluded subsequent claims "in any way involving" the prior claim. *See id. at 1305*.

and [] avoid stacking the limits of successive policies to cover essentially the same or very closely related claims." Kenneth S. Abraham, *Insurance Law and Regulation: Cases and Materials* 587 (4th ed. 2005). Prior and pending litigation exclusions thus combat the problem of adverse selection or "insuring the building already on fire"; that is, an insured who has previously been sued faces a greater risk of related litigation and has a corresponding incentive to seek insurance. John H. Mathias, Jr., et al., *Directors and Officers Liability: Prevention, Insurance and Indemnification* § 8.09 (2003) (internal quotations omitted); *see* George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 Yale L. J. 1521, 1574 (1987). The insurance company's legitimate interest in combating the adverse selection problem is properly implicated when there is a real and substantial overlap with the complaint in the prior lawsuit, [*500] as opposed [**24] to an incidental or fortuitous relationship to the prior complaint.

Accordingly, we hold that the Federal exclusion, excluding any subsequent claim "based upon . . . the same or any substantially similar fact, circumstance or situation underlying or alleged" in a prior claim, applies when there is substantial overlap in the second complaint with the facts underlying or alleged in the first complaint.

IV

Applying the policy as we have interpreted it to the allegations of the complaints, there is little doubt that there is substantial overlap in the allegations of the two complaints. Raytheon's counsel readily conceded at oral argument that "there is no question that the ERISA plaintiffs cut and pasted a lot of the factual allegations from the securities lawsuit."

As outlined previously, the ERISA complaint alleged important pre-October 12, 1999, misdeeds, including (1) Raytheon stock was overvalued due to cost overruns in defense related contracts; (2) RE&C improperly accounted for losses on major contracts; (3) RE&C prematurely recognized revenues on anticipated contracts; (4) RE&C improperly accelerated recognition of revenues on existing contracts; and (5) Raytheon failed [**25] to disclose material cost overruns and delays affecting projects related to the P-3 Orion aircraft. These allegations mirror the allegations of the Securities complaint. All four counts of the ERISA complaint recite these allegations by reference. As should be clear even from this brief summary, a substantial part of the operative facts alleged in the ERISA complaint appears in the Securities complaint. Thus these allegations substantially overlap with the prior allegations contained the Securities complaint.

To be sure, not all of the facts alleged in

the ERISA complaint are contained in the Securities complaint. In particular, most of the activities occurring after the Securities class cut-off date of October 12, 1999, do not appear in the Securities complaint. The ERISA plaintiffs allege, for example, that Raytheon shares continued to be an imprudent investment due to continuing accounting improprieties after October 12, 1999. They allege that "Defendants' misleading, inaccurate, and incomplete statements regarding the Company's fiscal health extended from 1998 through 1999, and beyond." J.A. at 195. Other post-October 12, 1999, conduct alleged includes the sale of the RE&C division [**26] to WGI and the consequent litigation with WGI and its shareholders, and SEC investigations into Raytheon and its executives. Raytheon correctly points out that, solely from a temporal perspective, the overlap constitutes one-sixth of the relevant period of the ERISA complaint. So too, some allegations pertaining exclusively to the elements of an ERISA lawsuit, such as communication with Plan beneficiaries by the fiduciary defendant, do not appear in the Securities complaint. Some of these non-overlapping facts are critical to the ERISA action -- for example, the defendants' ERISA fiduciary status is a *sine qua non* of the ERISA action. But acknowledging that there are substantial areas of non-overlap does not defeat the fact here that there is substantial overlap between the two complaints.

V

We conclude that the Federal prior and pending litigation exclusion, excluding "any Claim made against any Insured . . . based upon, arising from, or in consequence of any demand, suit or other proceeding pending, or order, decree or judgment entered against any Insured . . ., or the same or any substantially similar fact, circumstance or situation underlying or alleged therein," is [**27] properly construed [*501] to exclude coverage if there is substantial overlap between allegations in the complaint of the claimed proceeding and allegations in the complaint of the prior proceeding. While we recognize that our interpretation will not cleanly resolve every case involving exclusionary policy language similar to that involved here, it easily resolves this case. There is clearly substantial overlap between the allegations in the ERISA complaint and the allegations in the Securities complaint. Coverage is therefore excluded. Accordingly, the judgment of the district court is affirmed.

It is so ordered.

Dissent by: HOWARD

Dissent

HOWARD, *Circuit Judge*, dissenting. The majority reads the Federal exclusion to apply "if there is substantial overlap between the allegations in the complaint of the claimed proceeding and allegations in the complaint of the

prior proceeding." *Ante* at 20. The majority's formulation, while well explained, is both overinclusive and underinclusive. The formulation is overinclusive because, as in this case, it works to deny the insured a defense and indemnification under a claims-made policy for claims made within the policy period which are "based [**28] upon, arise[] from, or in consequence of . . . [a] fact, circumstance or situation" that has never been the subject of a demand or suit. [8] The formulation is underinclusive because, in some future case where there is overlap that is not "substantial" between the allegations in the complaint and the allegations in some prior complaint, it could work to create on the part of Federal a duty to indemnify for a judgment that is premised entirely on a claim "based upon, arising from, or in consequence of . . . [a] fact, circumstance or situation" pleaded against the insured in a demand or lawsuit prior to the effective date of the policy.

The majority says that its formulation, inexact though it may be, is the inevitable result of the lawsuit-to-lawsuit [**29] comparison required by the policy's definition of the term "claim" - i.e., "a civil proceeding commenced by the service of a complaint or similar pleading . . . against any Insured for a Wrongful Act." To avoid the inexactitude, the majority says, one would have to adopt a more conventional definition of the term "claim," one which refers not to the entire lawsuit, but to individual liability theories asserted within the complaint. (This more common definition is, I must acknowledge, implicit in my use of the term "claim" in the opening paragraph of this dissent.) But application of this more common definition, in the majority's view, is precluded by the unambiguous, lawsuit-focused definition the policy adopts.

I disagree. Certainly, the policy's definitions section contemplates that the entire lawsuit will constitute the "claim" when the lawsuit is premised on a single "Wrongful Act" - even when the single "Wrongful Act" gives rise to multiple liability theories. In such a situation, it makes sense to look to the "Act" on which the lawsuit is based, to ask whether that same (or a substantially similar) "Act" was the subject of a demand or suit brought prior to the effective date [**30] of the policy, and to apply the exclusion if so. But what of a situation, as here, where the lawsuit alleges not a single "Wrongful Act," but a number of "Wrongful Acts," only some of which were previously asserted against the insured? [9] [**31] The definitions section

[8] There is no dispute that, at the very least, the amended complaint can be read to state breach of fiduciary duty claims on behalf of putative plaintiffs who joined Raytheon in 2000 - after the conduct at issue in the earlier securities lawsuit had concluded.

[9] The underlying lawsuit alleges at least four categories of "Wrongful Acts" on the part of Raytheon: (1) failure to provide complete and accurate information to plan participants and beneficiaries, (2) imprudent investment, (3) a failure to monitor certain decision makers within the company, and (4) breach of the duty to avoid conflicts of interest. Only the first category of

of the [*502] policy does not compel us to treat the entire second lawsuit as the relevant "claim" in such a situation. Rather, it is silent. Given this silence, we should strive to adopt and apply a definition of the term "claim" which addresses the parties' reasonable expectations when they bargained for the "claims-made" policy underlying this litigation. And the definition which best addresses the parties' reasonable expectations is one which regards as the relevant "claim" the liability theory (or liability theories) arising out of each alleged "Wrongful Act." [10]

Application of this definition quickly yields the conclusion that there is a duty to defend in this case, as the complaint is reasonably susceptible of an interpretation under which there is at least one "claim" which arises from a "Wrongful Act" which was not alleged in the earlier securities litigation. *See Herbert A. Sullivan, Inc. v. Utica Mut. Ins. Co., 439 Mass. 387, 788 N.E.2d 522, 530 (Mass. 2003)* [**32] (the duty to defend arises under Massachusetts law whenever "the allegations of the complaint are reasonably susceptible of an interpretation that they state or adumbrate a claim covered by the policy terms") (citation and internal quotation marks omitted); *see also supra* n.2. Application of this definition also will yield more sensible results at the end of the lawsuit should there be a plaintiffs' judgment on one or more of the asserted liability theories. Those "claims" ending in plaintiffs' verdicts which are based on the same (or substantially similar) facts to those pleaded in the securities lawsuit would be excluded from coverage, but those based on different facts would be covered.

In sum, to the extent that the majority's formulation reads the exclusion to deny coverage for claims that would be covered but for the fortuity that they are asserted in a complaint which also sets forth claims that are excluded, it denies the insured coverage (both defense and indemnification) to which it is entitled. And to the extent that the formulation allows for the possibility that Federal will be called upon to indemnify an insured for liability under a claim based on allegations that [**33] were lodged against the insured before the policy was purchased, it denies Federal a liability immunity for which it has bargained. I therefore respectfully dissent.

"Wrongful Acts" was alleged in the earlier securities litigation.

[10] Raytheon did not develop an argument for such a definition in either its papers opposing the insurers' *Fed. R. Civ. P. 12(b)(6)*) motion for judgment on the pleadings or in its appellate brief. But the question is one of law, *see Cody v. Conn. Gen. Life Ins. Co., 387 Mass. 142, 439 N.E.2d 234, 237 (Mass. 1982)*, as to which the movant insurers bore the burden of persuasion. As the majority recognizes, our construction of the policy is not circumscribed by the parties' arguments, *see ante* at 14, especially since we confront here boilerplate language which has been the subject of litigation before, *see, e.g.*, *id.* at 13 n.4, and which likely will be the subject of litigation again.

Vincent Scalera *Appellant*

v.

M. J. Oppenheim in his quality as Attorney in Canada for the Non-Marine Underwriters, members of Lloyd's of London *Respondent*

INDEXED AS: NON-MARINE UNDERWRITERS, LLOYD'S OF LONDON *v.* SCALERA

Neutral citation: 2000 SCC 24.

File No.: 26695.

1999: October 14; 2000: May 3.

Present: L'Heureux-Dubé, Gonthier, McLachlin, Iacobucci, Major, Bastarache and Binnie JJ.

ON APPEAL FROM THE BRITISH COLUMBIA COURT OF APPEAL

Insurance — Homeowner's insurance — Insurer's duty to defend — Plaintiff bringing action against insured alleging battery, negligent battery, negligent misrepresentation and breach of fiduciary duty — Policy containing exclusion for intentional acts of insured — Whether insurer has a duty to defend.

Torts — Intentional torts — Battery — Evidence — Burden of proof — Consent — Whether plaintiff must prove lack of consent.

In 1996, a plaintiff brought a civil action against five B.C. Transit bus drivers, including the appellant, arising out of various alleged sexual assaults between 1988 and 1992. The allegations included battery, negligent battery, negligent misrepresentation and breach of fiduciary duty. The appellant owned a homeowner's insurance policy issued by the respondent insurer. The policy provided coverage for "compensatory damage because of bodily injury" arising from the insured's personal actions, excepting "bodily injury or property damage caused by any intentional or criminal act". The British Columbia Supreme Court dismissed the respondent's request for a declaration that it not be required to defend

Vincent Scalera *Appelant*

c.

M. J. Oppenheim en sa qualité de fondé de pouvoir au Canada des Non-Marine Underwriters, membres de Lloyd's of London *Intimé*

RÉPERTORIÉ: NON-MARINE UNDERWRITERS, LLOYD'S OF LONDON *c.* SCALERA

Citation neutre: 2000 CSC 24.

N° du greffe: 26695.

1999: 14 octobre; 2000: 3 mai.

Présents: Les juges L'Heureux-Dubé, Gonthier, McLachlin, Iacobucci, Major, Bastarache et Binnie.

EN APPEL DE LA COUR D'APPEL DE LA COLOMBIE-BRITANNIQUE

Assurance — Assurance propriétaires occupants — Obligation de défendre de l'assureur — Action intentée par la demanderesse contre l'assuré pour voies de fait, voies de fait imputables à la négligence, déclaration inexacte faite par négligence et manquement à l'obligation fiduciaire — Exclusion de la garantie de la police prévue pour actes intentionnels de l'assuré — L'assureur a-t-il une obligation de défendre?

Responsabilité délictuelle — Délits intentionnels — Voies de fait — Preuve — Fardeau de la preuve — Consentement — Incombe-t-il à la demanderesse de prouver l'absence de consentement?

En 1996, une demanderesse a intenté une action au civil contre cinq conducteurs d'autobus de B.C. Transit, dont l'appelant, par suite de différentes agressions sexuelles qui auraient été perpétrées entre 1988 et 1992. Les allégations portaient, entre autres, sur des voies de fait, voies de fait imputables à la négligence, déclaration inexacte faite par négligence et manquement à l'obligation fiduciaire. L'appelant était titulaire d'une police propriétaires occupants établie par l'assureur intimé. La police fournissait une garantie à l'égard de «dommages-intérêts compensatoires par suite de l'infliction d'un préjudice corporel» découlant des actes de l'assuré, sauf en cas de «préjudice corporel ou matériel infligé par l'action ou l'omission intentionnelles ou criminelles». La Cour suprême de la Colombie-Britannique a rejeté la demande de l'intimé visant à obtenir un jugement décla-

the appellant against the plaintiff's claims. The Court of Appeal allowed the respondent's appeal.

Held: The appeal should be dismissed.

Per L'Heureux-Dubé, Gonthier, McLachlin and Binnie JJ.: The plaintiff's claims could not trigger coverage under the policy. Accordingly, the respondent has no duty to defend. While there is substantial agreement with Iacobucci J.'s reasoning, his approach to the tort of battery in the sexual context is disagreed with. In the tort of sexual battery, consent operates as a defence and must be proven by the defendant. The plaintiff is not required to prove that the defendant either knew that she was not consenting or that a reasonable person in the defendant's position would have known that she was not consenting.

The traditional rights-based approach to the law of battery that is now the law of Canada should not be set aside lightly. The tort of battery is a form of trespass against the person and is aimed at protecting the personal autonomy of the individual. Its purpose is to recognize the right of each person to control his or her body and who touches it, and to permit damages where this right is violated. The compensation stems not from fault, but from violation of the right to personal autonomy. When a person interferes with the body of another, a *prima facie* case of violation of the plaintiff's autonomy is made out. The law may then fairly call upon the person thus implicated to explain, or raise some defence, such as the defence of consent. If he can show that he acted with consent, the *prima facie* violation is negated and the plaintiff's claim will fail. But it is not up to the plaintiff to prove that, in addition to directly interfering with her body, the defendant was also at fault. Unlike negligence, where the requirement of fault can be justified because the tortious sequence may be complicated, trespass to the person is confined to direct interferences. Where the trespass causes actual injury to the plaintiff, there is a direct connection between the defendant's action and the plaintiff's injury. The traditional approach to trespass is also practical, since, if the defendant is in a position to say what happened, it is both sensible and just to give him an incentive to do so by putting the burden of explanation on him. In addition, the close causal relationship between the defendant's conduct and the violation of the plaintiff's bodily integrity, the identification of the loss with the plaintiff's personality and freedom, the infliction of the loss in isolated (as opposed to systemic) circumstances, and

ratoire selon lequel il n'est pas tenu de défendre l'appelant contre les allégations formulées par la demanderesse. La Cour d'appel a accueilli l'appel formé par l'intimé.

Arrêt: Le pourvoi est rejeté.

Les juges L'Heureux-Dubé, Gonthier, McLachlin et Binnie: Les allégations de la demanderesse ne pouvaient entraîner l'application de la garantie prévue dans la police. Par conséquent, l'intimé n'avait pas d'obligation de défendre. Les motifs du juge Iacobucci sont acceptés pour l'essentiel, mais sa démarche relativement au délit de voies de fait dans le contexte sexuel est rejetée. Pour ce qui est du délit de voies de fait de nature sexuelle, le consentement est un moyen de défense et il doit être établi par le défendeur. Il n'incombe pas à la demanderesse de prouver que le défendeur savait qu'elle n'était pas consentante ou qu'une personne raisonnable dans la situation du défendeur aurait su qu'elle ne l'était pas.

La démarche traditionnelle fondée sur les droits en ce qui concerne le droit en matière de voies de fait actuellement en vigueur au Canada ne doit pas être rejetée à la légère. Le délit de voies de fait constitue une forme d'atteinte à la personne et le droit en cette matière vise à protéger l'autonomie personnelle de l'individu. Il a pour objectif de reconnaître le droit de chaque personne d'avoir le contrôle de son corps et de décider qui peut y toucher, et de permettre que des dommages-intérêts soient accordés lorsque ce droit est violé. La réparation découle de la violation du droit à l'autonomie personnelle et non de la faute. Lorsqu'une personne porte atteinte au corps d'une autre personne, une preuve *prima facie* d'atteinte à l'autonomie du demandeur est établie. Il est alors possible en droit d'enjoindre, en toute équité, à la personne impliquée de s'expliquer ou d'invoquer un moyen de défense tel le consentement. Si elle peut établir qu'elle avait obtenu le consentement de l'autre personne, la preuve *prima facie* de l'atteinte est réfutée et le demandeur ne pourra avoir gain de cause. Toutefois, il n'incombe pas au demandeur de prouver que, en plus d'infliger une atteinte directe à son corps, le défendeur a également commis une faute. Contrairement à la négligence, pour laquelle l'exigence d'une faute peut être justifiée vu que l'enchaînement délictuel peut être complexe, la notion d'atteinte à la personne se limite aux atteintes directes. Lorsque l'atteinte cause un préjudice réel au demandeur, il existe un lien direct entre l'acte du défendeur et le préjudice du demandeur. La démarche traditionnelle en matière d'atteinte est également sensée sur le plan pratique, car, si le défendeur est en mesure de dire ce qui s'est produit, il est raisonnable et juste de l'inciter à le faire en l'obligeant à fournir

the perception of the defendant's conduct as anti-social all support the legal position that once the direct interference with the plaintiff's person is shown, the defendant may fairly be called upon to explain his behaviour if indeed it was innocent.

Therefore, while a plaintiff generally must prove all elements of the tort she alleges, the fact that contact must be harmful or offensive to constitute battery does not mean that the plaintiff must prove that she did not consent and that the defendant actually or constructively knew she did not consent to sexual contact. When it is accepted that the foundation of the tort of battery is a violation of personal autonomy, all contact outside the exceptional category of contact that is generally accepted or expected in the course of ordinary life is *prima facie* offensive. Since sexual contact is not generally accepted or expected in the course of ordinary activities, the plaintiff may establish an action for sexual battery without negativing actual or constructive consent. Nothing special about sexual battery justifies requiring the plaintiff to prove that she did not consent or that the defendant either knew or ought to have known that she did not consent.

The exclusion clause in the policy must be interpreted as requiring an intent to injure. Where there is an allegation of sexual battery, courts will conclude as a matter of legal inference that the defendant intended harm for the purpose of construing exemptions of insurance coverage for intentional injury.

It is unnecessary to comment on the relationship between battery and negligence.

Per Iacobucci, Major and Bastarache JJ.: The respondent has no duty to defend the appellant because the plaintiff's statement of claim makes no allegation that could potentially give rise to indemnity under the insurance contract.

An insurer only has a duty to defend when a lawsuit against the insured raises a claim that could potentially

une explication. De plus, le lien de causalité étroit entre la conduite du défendeur et la violation de l'intégrité physique du demandeur, l'identification de la perte avec la personnalité et la liberté du demandeur, l'infliction de la perte dans une situation particulière (par opposition à systémique) et la perception que la conduite du défendeur est antisociale étayent tous le point de vue juridique qu'une fois que l'atteinte directe à la personne du demandeur a été établie, il est juste d'obliger le défendeur à expliquer son comportement si, de fait, il était innocent.

Par conséquent, bien qu'un demandeur doive, de façon générale, prouver tous les éléments du délit qu'il prétend avoir subi, le fait que le contact doive être préjudiciable ou nocif pour constituer des voies de fait ne veut pas dire qu'il incombe à la demanderesse de prouver qu'elle ne donnait pas son consentement et que le défendeur savait, ou était réputé savoir, qu'elle ne consentait pas au contact sexuel. Si l'on accepte que le fondement du délit de voies de fait est une violation de l'autonomie personnelle, il s'ensuit que tout contact qui n'est pas visé par la catégorie exceptionnelle des contacts généralement acceptés ou auxquels on peut s'attendre dans la vie quotidienne est nocif à première vue. Comme le contact sexuel n'est pas visé par la catégorie des contacts généralement acceptés ou auxquels on peut s'attendre dans le cours d'activités ordinaires, le demandeur peut établir le bien-fondé d'une action pour voies de fait de nature sexuelle sans devoir réfuter le consentement véritable ou le consentement présumé. Les voies de fait de nature sexuelle n'ont pas de particularités justifiant que l'on exige de la demanderesse qu'elle prouve qu'elle ne donnait pas son consentement ou que le défendeur le savait, ou aurait dû le savoir.

Il faut interpréter la clause d'exclusion de la police comme exigeant l'intention d'infliger un préjudice. En cas d'allégation de voies de fait de nature sexuelle, les tribunaux concluront, en droit, que le défendeur a eu l'intention d'infliger un préjudice, dans le cadre de l'interprétation des clauses d'exclusion de la police d'assurance visant l'infliction délibérée d'un préjudice.

Il n'est pas nécessaire de faire des remarques sur le lien entre les voies de fait et la négligence.

Les juges Iacobucci, Major et Bastarache: L'intimé n'a aucune obligation de défendre l'appelant parce que, dans sa déclaration, la demanderesse ne formule aucune allégation susceptible d'entraîner l'indemnisation en application du contrat d'assurance.

L'assureur n'est tenu de défendre l'assuré que lorsque la poursuite en justice se fonde sur une allégation

fall within coverage. The insurer's duty to defend is related to its duty to indemnify. Therefore if an insurance policy, like the one in this case, excludes liability arising from intentionally caused injuries, there will be no duty to defend actions based on such injuries.

A three-step process must be applied to determine whether a claim could trigger indemnity. First, a court should determine which of the plaintiff's legal allegations are properly pleaded. In doing so, courts are not bound by the legal labels chosen by the plaintiff. A plaintiff cannot change an intentional tort into a negligent one simply by choice of words, or vice versa. Therefore, when ascertaining the scope of the duty to defend, a court must look beyond the choice of labels, and examine the substance of the allegations contained in the pleadings. This does not involve deciding whether the claims have any merit; all a court must do is decide, based on the pleadings, the true nature of the claims. At the second stage, the court should determine if any claims are entirely derivative in nature. The duty to defend will not be triggered simply because a claim can be cast in terms of both negligence and intentional tort. A claim for negligence will not be derivative if the underlying elements of the negligence and of the intentional tort are sufficiently disparate to render the two claims unrelated. However, if both the negligence and intentional tort claims arise from the same actions and cause the same harm, the negligence claim is derivative, and it will be subsumed into the intentional tort for the purposes of the exclusion clause analysis. If neither claim is derivative, the claim of negligence will survive and the duty to defend will apply. Finally, at the third stage, the court must decide whether any of the properly pleaded, non-derivative claims could potentially trigger the insurer's duty to defend. This appeal's holding with respect to the proper characterization of a plaintiff's tort allegations should not be taken to affect any areas of law outside the insurance context presented by this appeal.

In this case, the exclusion clause must be read to require that the injuries be intentionally caused, in that they must be the product of an intentional tort and not of negligence. The plaintiff has stated three possible claims arising out of the alleged sexual assaults: sexual battery, negligent battery, and breach of fiduciary duty. Sexual

susceptible d'entraîner l'application de la garantie. L'obligation de l'assureur de défendre l'assuré est liée à son obligation de l'indemniser. Par conséquent, lorsque la police d'assurance exclut, comme c'est le cas en l'espèce, la responsabilité découlant d'un préjudice infligé intentionnellement, l'assureur n'a aucune obligation de défendre l'assuré auquel un tel délit est imputé.

Trois étapes doivent être franchies pour déterminer si une demande en justice est susceptible d'entraîner l'indemnisation. Premièrement, le tribunal doit établir lesquelles des allégations juridiques de la partie demanderesse sont adéquatement formulées. Pour ce faire, il n'est pas lié par la terminologie juridique qu'emploie cette dernière. Un délit intentionnel ne peut devenir un délit de négligence, et vice versa, du seul fait des mots employés par la partie demanderesse. Pour confirmer l'étendue de l'obligation de défendre, le tribunal doit donc aller au-delà de la terminologie choisie et tenir compte de la substance des allégations contenues dans les actes de procédure. Il ne s'agit pas de se prononcer sur le bien-fondé des allégations, mais seulement d'en déterminer la nature véritable sur la base des actes de procédure. Dans un deuxième temps, le tribunal doit vérifier si certaines d'entre elles sont entièrement de nature dérivée. Il ne saurait y avoir d'obligation de défendre simplement parce que l'allégation peut être formulée en fonction à la fois du délit de négligence et du délit intentionnel. Une allégation de négligence n'est pas tenue pour dérivée si les éléments sous-jacents de la négligence et du délit intentionnel sont suffisamment distincts pour en faire deux allégations n'ayant aucun point en commun. Cependant, si les deux allégations découlent des mêmes actes et causent le même préjudice, la négligence est tenue pour dérivée et elle est subsumée sous le délit intentionnel aux fins de l'application de la clause d'exclusion. Si aucun des délits allégués n'est dérivé, l'allégation de négligence subsiste et l'obligation de défendre s'applique. Enfin, à la troisième étape, le tribunal doit déterminer si les allégations non dérivées qui sont adéquatement formulées sont susceptibles d'entraîner l'obligation de défendre de l'assureur. La décision concernant la qualification appropriée des allégations d'une poursuite pour délit civil ne devrait pas s'appliquer à d'autres domaines du droit que celui de l'assurance présenté dans le contexte de la présente affaire.

En l'espèce, la clause d'exclusion doit être interprétée de façon que son application exige que le préjudice ait été infligé intentionnellement, c'est-à-dire qu'il ait été le fruit d'un délit intentionnel, et non d'une négligence. La demanderesse a mentionné trois allégations éventuelles relativement aux agressions sexuelles qu'elle aurait

battery requires the plaintiff to prove that a reasonable person should have known that the plaintiff did not validly consent to the sexual activity in question. Since non-consensual sexual activity is inherently harmful, any injuries resulting therefrom are intentionally caused, and the exclusion clause would apply. If a reasonable person would not have known that the plaintiff did not validly consent, the plaintiff's claim will fail, and there will be no duty to indemnify or duty to defend. The plaintiff's claims of negligence and breach of fiduciary duty are either not properly pleaded or are subsumed into the sexual battery because these claims are based on the same facts and resulted in the same harm. Therefore the exclusion clause applies equally to them. There being no potentially indemnifiable claim, the respondent has no duty to defend.

subies: les voies de fait de nature sexuelle, les voies de fait imputables à la négligence et le manquement à l'obligation fiduciaire. Pour prouver les voies de fait de nature sexuelle, il faut établir qu'une personne raisonnable aurait dû savoir que le consentement de la demanderesse à l'activité sexuelle en cause n'était pas valable. Comme les rapports sexuels non consensuels sont en soi préjudiciables, tout préjudice en résultant est intentionnel, et la clause d'exclusion s'applique. Si une personne raisonnable n'aurait pu savoir que le consentement de la demanderesse n'était pas valable, la demande sera rejetée, de sorte que l'assureur n'aura aucune obligation d'indemniser l'assuré non plus que de le défendre. Les allégations de négligence et de manquement à l'obligation fiduciaire ne sont pas adéquatement formulées ou sont subsumées sous l'allégation de voies de fait de nature sexuelle, car elles se fondent sur les mêmes faits, et les actes reprochés ont donné lieu au même préjudice. Par conséquent, la clause d'exclusion s'applique à leur égard. En l'absence de toute allégation susceptible d'entraîner l'indemnisation, l'intimé n'a aucune obligation de défendre.

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APPEAL from a judgment of the British Columbia Court of Appeal (1998), 106 B.C.A.C. 268, 172 W.A.C. 268, 48 B.C.L.R. (3d) 143, 158 D.L.R. (4th) 385, 2 C.C.L.I. (3d) 1, [1998] I.L.R. ¶1-3568, [1998] 9 W.W.R. 209, [1998] B.C.J. No. 834 (QL), allowing an appeal from the British Columbia Supreme Court (1997), 47 B.C.L.R. (3d) 187, 49 C.C.L.I. (2d) 305, [1998] I.L.R. ¶1-3519, [1997] B.C.J. No. 2481 (QL). Appeal dismissed.

POURVOI contre un arrêt de la Cour d'appel de la Colombie-Britannique (1998), 106 B.C.A.C. 268, 172 W.A.C. 268, 48 B.C.L.R. (3d) 143, 158 D.L.R. (4th) 385, 2 C.C.L.I. (3d) 1, [1998] I.L.R. ¶1-3568, [1998] 9 W.W.R. 209, [1998] B.C.J. No. 834 (QL), qui a accueilli un appel formé contre une décision de la Cour suprême de la Colombie-Britannique (1997), 47 B.C.L.R. (3d) 187, 49 C.C.L.I. (2d) 305, [1998] I.L.R. ¶1-3519, [1997] B.C.J. No. 2481 (QL). Pourvoi rejeté.

Bruce P. Cran and *Murray G. Madryga*, for the appellant.

Bruce P. Cran et *Murray G. Madryga*, pour l'appelant.

Eric A. Dolden and *Karen F. W. Liang*, for the respondent.

Eric A. Dolden et *Karen F. W. Liang*, pour l'intimé.

The judgment of L'Heureux-Dubé, Gonthier, McLachlin and Binnie JJ. was delivered by

Version française du jugement des juges L'Heureux-Dubé, Gonthier, McLachlin et Binnie rendu par

MCLACHLIN J. — I have read the reasons of Iacobucci J. and agree with the result he reaches and with much of his reasoning. I would respectfully disagree, however, from the view that in the tort of sexual battery, the onus rests on the plaintiff to prove that the defendant either knew that she was not consenting or that a reasonable person in

LE JUGE MCLACHLIN — J'ai lu les motifs du juge Iacobucci et je souscris au résultat auquel il est parvenu de même qu'à une grande partie de son raisonnement. En toute déférence, je ne conviens cependant pas que, pour ce qui est du délit de voies de fait de nature sexuelle, il incombe à la demanderesse de prouver que le défendeur savait qu'elle

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the defendant's position would have known that she was not consenting.

2 As Goff L.J. (as he then was) stated in *Collins v. Wilcock*, [1984] 3 All E.R. 374 (Q.B.), at p. 378, "[t]he fundamental principle, plain and incontestable, is that every person's body is inviolate". The law of battery protects this inviolability, and it is for those who violate the physical integrity of others to justify their actions. Accordingly, in my respectful view, the plaintiff who alleges sexual battery makes her case by tendering evidence of force applied directly to her. "Force", in the context of an allegation of sexual battery, simply refers to physical contact of a sexual nature, and is neutral in the sense of not necessarily connoting a lack of consent. If the defendant does not dispute that the contact took place, he bears the burden of proving that the plaintiff consented or that a reasonable person in his position would have thought that she consented. My reasons for so concluding are the following.

I. Analysis

A. *The Canadian Law of Battery Places the Onus of Proving Consent on the Defendant*

3 As Iacobucci J. states (at para. 103) "for traditional batteries, consent is conceived of as an affirmative defence that must be raised by the defendant".

4 This Court has long affirmed this proposition. In *Cook v. Lewis*, [1951] S.C.R. 830, at p. 839, Cartwright J. stated that "where a plaintiff is injured by force applied directly to him by the defendant his case is made by proving this fact and

n'était pas consentante ou qu'une personne raisonnable dans la situation du défendeur aurait su qu'elle ne l'était pas.

Comme le lord juge Goff (plus tard juge à la Chambre des lords) l'a dit dans la décision *Collins c. Wilcock*, [1984] 3 All E.R. 374 (Q.B.), à la p. 378, [TRADUCTION] «[l]e principe fondamental, clair et incontestable, est que le corps humain est inviolable». Le droit en matière de voies de fait protège cette inviolabilité, et il incombe à la personne qui viole l'intégrité physique d'autrui de justifier ses actions. Par conséquent, à mon humble avis, le demandeur qui prétend avoir subi des voies de fait de nature sexuelle établit le bien-fondé de sa prétention lorsqu'il produit une preuve démontrant qu'une force a été directement employée contre lui. Dans le contexte d'une allégation de voies de fait de nature sexuelle, la «force» fait uniquement référence au contact physique de nature sexuelle et ce terme est neutre en ce sens qu'il ne sous-entend pas nécessairement l'absence de consentement. Dans le cas où le défendeur ne conteste pas qu'il y a eu contact, il lui incombe de prouver que le demandeur y consentait ou qu'une personne raisonnable dans sa situation aurait cru qu'il y consentait. Voici les motifs sur lesquels je fonde cette conclusion.

I. Analyse

A. *Le droit canadien en matière de voies de fait impose au défendeur le fardeau de prouver qu'il y a eu consentement*

Comme l'indique le juge Iacobucci (au par. 103), «[d]ans les affaires de voies de fait traditionnelles, le consentement est clairement considéré comme une défense affirmative, que doit invoquer le défendeur».

Notre Cour a depuis longtemps confirmé cette proposition. Dans l'arrêt *Cook c. Lewis*, [1951] R.C.S. 830, à la p. 839, le juge Cartwright a dit que, [TRADUCTION] «lorsque le demandeur a subi un préjudice du fait que le défendeur a directement eu recours à la force contre lui, il établit le bien-fondé de sa demande en prouvant ce fait, et c'est

the onus falls upon the defendant to prove 'that such trespass was utterly without his fault'."

In *Larin v. Goshen* (1974), 56 D.L.R. (3d) 719 (N.S.C.A.), at p. 722, Macdonald J.A., citing numerous authorities, stated: "The law in Canada at present is this: In an action for damages in trespass where the plaintiff proves that he has been injured by the direct act of the defendant, the onus falls upon the defendant to prove that his act was both *unintentional and without negligence* on his part, in order for him to be entitled to a dismissal of the action." (Emphasis in original.) See also *Walmsley v. Humenick*, [1954] 2 D.L.R. 232 (B.C.S.C.); *Tillander v. Gosselin* (1966), 60 D.L.R. (2d) 18 (Ont. H.C.), aff'd (1967), 61 D.L.R. (2d) 192 (Ont. C.A.); *Dahlberg v. Naydiuk* (1969), 10 D.L.R. (3d) 319 (Man. C.A.), and *Ellison v. Rogers* (1967), 67 D.L.R. (2d) 21 (Ont. H.C.). A number of academic commentators also agree that the burden of proving consent lies on the defence: see J. G. Fleming, *The Law of Torts* (9th ed. 1998), at p. 86; A. M. Linden and L. N. Klar, *Canadian Tort Law: Cases, Notes and Materials* (10th ed. 1994), at p. 102, note 2; and G. H. L. Fridman, *The Law of Torts in Canada* (1989), vol. 1, at p. 63.

This proposition holds for particular forms of battery like medical battery and sexual battery. In *Reibl v. Hughes*, [1980] 2 S.C.R. 880, at p. 890, dealing with medical battery, Laskin C.J. stated for the Court that:

> The tort [of battery] is an intentional one, consisting of an unprivileged and unconsented to invasion of one's bodily security. True enough, it has some advantages for a plaintiff over an action of negligence since it does not require proof of causation and it casts upon the defendant the burden of proving consent to what was done.

And in *Norberg v. Wynrib*, [1992] 2 S.C.R. 226, dealing with sexual battery, La Forest J., for the plurality, stated, at p. 246, that "[a] battery is the intentional infliction of unlawful force on another person. Consent, express or implied, is a defence

au défendeur qu'il incombe de prouver "que l'atteinte n'est absolument pas de sa faute"».

5 Dans *Larin c. Goshen* (1974), 56 D.L.R. (3d) 719 (C.A.N.-É.), à la p. 722, le juge Macdonald, citant de nombreux précédents, a noté: [TRADUCTION] «L'état actuel du droit canadien est le suivant: Dans le cadre d'une action en dommages-intérêts pour atteinte où le demandeur prouve qu'il a subi un préjudice par suite d'un acte direct du défendeur, il incombe à ce dernier, pour que l'action puisse être rejetée, d'établir que l'acte n'était *ni intentionnel, ni le résultat d'une négligence* de sa part.» (En italique dans l'original.) Voir également *Walmsley c. Humenick*, [1954] 2 D.L.R. 232 (C.S.C.-B.); *Tillander c. Gosselin* (1966), 60 D.L.R. (2d) 18 (H.C. Ont.), conf. par (1967), 61 D.L.R. (2d) 192 (C.A. Ont.); *Dahlberg c. Naydiuk* (1969), 10 D.L.R. (3d) 319 (C.A. Man.), et *Ellison c. Rogers* (1967), 67 D.L.R. (2d) 21 (H.C. Ont.). Bon nombre d'auteurs s'entendent également pour dire qu'il incombe à la défense de prouver le consentement: voir J. G. Fleming, *The Law of Torts* (9e éd. 1998), à la p. 86; A. M. Linden et L. N. Klar, *Canadian Tort Law: Cases, Notes and Materials* (10e éd. 1994), à la p. 102, note 2, et G. H. L. Fridman, *The Law of Torts in Canada* (1989), vol. 1, à la p. 63.

6 Cette proposition s'applique à des types particuliers de voies de fait tels les voies de fait de nature médicale et celles de nature sexuelle. Dans l'arrêt *Reibl c. Hughes*, [1980] 2 R.C.S. 880, qui portait sur des voies de fait de nature médicale, le juge en chef Laskin a dit au nom de la Cour, à la p. 890:

> L'acte délictuel [de voies de fait] est intentionnel, puisque c'est une atteinte injustifiée et non autorisée à la sécurité physique d'une personne. Il est vrai qu'elle offre à un demandeur certains avantages dont il ne bénéficie pas dans une action fondée sur la négligence puisqu'elle n'exige pas la preuve de la causalité et qu'elle impose au défendeur l'obligation de prouver qu'il y a eu consentement à ce qui a suivi.

En outre, dans l'arrêt *Norberg c. Wynrib*, [1992] 2 R.C.S. 226, qui traitait de voies de fait de nature sexuelle, le juge La Forest a signalé, au nom de la pluralité des juges, à la p. 246, que «[l]es voies de fait consistent à recourir délibérément à une force

to battery." None of the members of the Court participating in the decision dissented from the view that the burden lies on the defendant to prove consent.

7 The question, then, is whether we should in this case depart from the settled rule that requires the plaintiff in a battery case to show only contact through a direct, intentional act of the defendant and places the onus on the defendant of showing consent or lawful excuse, including actual or constructive consent. For the reasons that follow, I am not convinced that we should alter the established rule.

B. *The Traditional Approach to Trespass is Justified as a Rights-Based Tort*

8 The traditional rule, as noted, is that the plaintiff in an action for trespass to the person (which includes battery) succeeds if she can prove direct interference with her person. Interference is direct if it is the immediate consequence of a force set in motion by an act of the defendant: see *Scott v. Shepherd* (1773), 2 Black. W. 892, 96 E.R. 525 (K.B.); *Leame v. Bray* (1803), 3 East 593, 102 E.R. 724 (K.B.). The burden is then on the defendant to allege and prove his defence. Consent is one such defence.

9 Some critics have suggested that this rule should be altered. They suggest that tort must always be fault-based. This means the plaintiff must prove fault as part of her case, by showing either: (1) that the defendant intended to harm; (2) that the defendant failed to take reasonable care or was "negligent"; or (3) that the tort is one of strict liability, i.e. legally presumed fault. On a practical level, some, like F. L. Sharp, argue that the traditional approach confers an unfair advantage on the plaintiff by easing her burden of proof: "Negligent Trespass in Canada: A Persistent Source of Embarrassment" (1977-78), 1 *Advocates' Q.* 311,

illégale contre une autre personne. Le consentement, exprès ou implicite, est opposable comme moyen de défense aux voies de fait.» Les juges de la Cour qui ont pris part à la décision étaient tous d'avis qu'il incombait au défendeur de prouver qu'il y avait eu consentement.

La question est donc de savoir si nous devons, en l'espèce, nous écarter de la règle bien établie qui prévoit que, dans une affaire de voies de fait, le demandeur n'a qu'à prouver qu'il y a eu contact par voie d'acte direct et intentionnel du défendeur, et qui impose à ce dernier l'obligation de prouver le consentement ou l'excuse légitime, notamment le consentement véritable ou présumé. Pour les motifs qui suivent, je ne suis pas convaincue que nous devrions modifier la règle établie.

B. *La démarche traditionnelle en matière d'atteinte est justifiée en tant que délit fondé sur des droits*

Comme je l'ai souligné, la règle traditionnelle est que le demandeur aura gain de cause dans le cadre d'une action pour atteinte à sa personne (ce qui comprend les voies de fait) s'il est en mesure de prouver qu'il a été directement atteint. L'atteinte est directe si elle est la conséquence immédiate d'une force mise en branle par un acte du défendeur: voir *Scott c. Shepherd* (1773), 2 Black. W. 892, 96 E.R. 525 (K.B.); *Leame c. Bray* (1803), 3 East 593, 102 E.R. 724 (K.B.). Il incombe donc au défendeur d'invoquer un moyen de défense et d'en établir le bien-fondé. L'existence d'un consentement constitue un tel moyen de défense.

Certains commentateurs ont proposé que cette règle soit modifiée. Ils soutiennent que la responsabilité délictuelle doit toujours être fondée sur la faute. Le demandeur doit donc prouver, dans son argumentation, qu'une faute a été commise, en établissant: (1) soit que le défendeur a eu l'intention de lui causer un préjudice; (2) soit que le défendeur a omis de faire preuve de diligence raisonnable ou qu'il a été «négligent»; (3) soit encore que la responsabilité délictuelle en question est de nature stricte, c.-à-d. que la faute est légalement présumée. Sur le plan pratique, certains, comme F. L. Sharp, soutiennent que la démarche tradition-

at pp. 312-14 and 326. It is suggested that the law has moved in this direction in England: see *Fowler v. Lanning*, [1959] 1 Q.B. 426, approved in *obiter* in *Letang v. Cooper*, [1965] 1 Q.B. 232 (C.A.). In the spirit of these comments, my colleague Iacobucci J. proposes to alter the traditional rule, at least for sexual battery, to require the plaintiff to prove fault, i.e. that the defendant either knew or ought to have known that she was not consenting.

nelle confère un avantage injuste au demandeur en allégeant son fardeau de la preuve: «Negligent Trespass in Canada: A Persistent Source of Embarrassment» (1977-78), 1 *Advocates' Q.* 311, aux pp. 312 à 314 et 326. D'aucuns soutiennent que le droit a pris cette direction en Angleterre: voir *Fowler c. Lanning*, [1959] 1 Q.B. 426, approuvé dans des remarques incidentes dans *Letang c. Cooper*, [1965] 1 Q.B. 232 (C.A.). Dans l'esprit de ces commentaires, mon collègue le juge Iacobucci propose de modifier la règle traditionnelle, du moins en ce qui concerne les voies de faits de nature sexuelle, de sorte que la demanderesse soit tenue de prouver qu'une faute a été commise, c.-à-d. que le défendeur savait, ou aurait dû savoir, qu'elle ne donnait pas son consentement.

I do not agree with these criticisms of the traditional rule. In my view the law of battery is based on protecting individuals' right to personal autonomy. To base the law of battery purely on the principle of fault is to subordinate the plaintiff's right to protection from invasions of her physical integrity to the defendant's freedom to act: see R. Sullivan, "Trespass to the Person in Canada: A Defence of the Traditional Approach" (1987), 19 *Ottawa L. Rev.* 533, at p. 546. Although I do not necessarily accept all of Sullivan's contentions, I agree with her characterization, at p. 551, of trespass to the person as a "violation of the plaintiff's right to exclusive control of his person". This right is not absolute, because a defendant who violates this right can nevertheless exonerate himself by proving a lack of intention or negligence: *Cook*, *supra*, at p. 839, *per* Cartwright J. Although liability in battery is based not on the defendant's fault, but on the violation of the plaintiff's right, the traditional approach will not impose liability without fault because the violation of another person's right can be considered a form of fault. Basing the law of battery on protecting the plaintiff's physical autonomy helps explain why the plaintiff in an action for battery need prove only a direct interference, at which point the onus shifts to the person who is alleged to have violated the right to justify

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Je ne souscris pas à ces critiques de la règle traditionnelle. À mon avis, le droit en matière de voies de fait repose sur la protection du droit à l'autonomie personnelle des individus. Fonder le droit en matière de voies de fait uniquement sur le principe de la faute revient à subordonner à la liberté d'agir du défendeur le droit du demandeur à la protection contre toute atteinte à son intégrité physique: voir R. Sullivan, «Trespass to the Person in Canada: A Defence of the Traditional Approach» (1987), 19 *R.D. Ottawa* 533, à la p. 546. Bien que je n'accepte pas nécessairement toutes les prétentions de Sullivan, je suis d'accord avec elle lorsque, à la p. 551, elle qualifie l'atteinte à la personne [TRADUCTION] «d'atteinte au droit du demandeur d'avoir le contrôle exclusif de sa personne». Ce droit n'est pas absolu, car le défendeur qui y porte atteinte peut néanmoins s'exonérer en prouvant l'absence d'intention ou la négligence: *Cook*, précité, à la p. 839, le juge Cartwright. Bien que la responsabilité en matière de voies de fait soit fondée non pas sur la faute du défendeur mais sur l'atteinte au droit du demandeur, la démarche traditionnelle n'impose pas de responsabilité quand il n'y a pas de faute, car l'atteinte à un droit d'autrui peut être considérée comme une forme de faute. Fonder le droit en matière de voies de fait sur la protection de l'autonomie physique du demandeur aide à expliquer pourquoi le demandeur qui intente une action pour voies de fait n'a

the intrusion, excuse it or raise some other defence.

11 I agree with Sullivan's view that the traditional approach to trespass to the person remains appropriate in Canada's modern context for a number of reasons. First, unlike negligence, where the requirement of fault can be justified because the tortious sequence may be complicated, trespass to the person is confined to direct interferences. Where the trespass causes actual injury to the plaintiff, there is a direct connection between the defendant's action and the plaintiff's injury. As Sullivan notes, at p. 562:

> . . . where the injury complained of is an immediate consequence of the defendant's act, it is intuitively sound to require compensation from the defendant unless he offers a defence. In cases of direct interference, the relationship between the defendant's will, his decision to act, and the injury to the plaintiff is both simple and clear; there are no competing causal factors to obscure the defendant's role or dilute his factual responsibility. The question of his moral and legal responsibility is thus posed with unusual sharpness: as between the defendant who caused the injury and the plaintiff who received it, other things being equal, who shall pay? . . . Once the plaintiff has shown that his right to personal autonomy has been violated by the defendant, *prima facie* the defendant should pay. [Emphasis added.]

12 Another factor supporting retaining the traditional approach to trespass and battery is that it makes practical sense. Linden J. in *Bell Canada v. COPE (Sarnia) Ltd.* (1980), 11 C.C.L.T. 170 (Ont. H.C.), aff'd (1980), 31 O.R. (2d) 571 (C.A.), after noting the attacks on the Canadian law of trespass, writes (at p. 180):

> The trespass action still performs several functions, one of its most important being a mechanism for shifting the onus of proof of whether there has been intentional or negligent wrongdoing to the defendant, rather than

qu'à prouver l'existence d'une atteinte directe, après quoi il incombe à la personne accusée d'avoir violé le droit de justifier l'atteinte ou de présenter une excuse légitime ou un autre moyen de défense.

Je partage l'avis de Sullivan que la démarche traditionnelle en matière d'atteinte à la personne convient toujours au contexte moderne canadien pour plusieurs raisons. Premièrement, contrairement à la négligence, pour laquelle l'exigence d'une faute peut être justifiée vu que l'enchaînement délictuel peut être complexe, la notion d'atteinte à la personne se limite aux atteintes directes. Lorsque l'atteinte cause un préjudice réel au demandeur, il existe un lien direct entre l'acte du défendeur et le préjudice du demandeur. Comme le souligne Sullivan, à la p. 562:

> [TRADUCTION] . . . lorsque le préjudice allégué est une conséquence immédiate de l'acte du défendeur, il est intuitivement judicieux de chercher à obtenir une réparation de ce dernier, à moins qu'il ne présente un moyen de défense. Dans les cas d'atteinte directe, le lien entre la volonté du défendeur, sa décision d'agir et le préjudice que le demandeur a subi est à la fois simple et clair; aucun facteur de causalité concurrent ne cache le rôle du défendeur ni ne diminue sa responsabilité dans les faits. La question de sa responsabilité morale et juridique se pose donc avec une clarté inhabituelle: toutes choses étant égales par ailleurs, qui, du défendeur qui a causé le préjudice, ou du demandeur qui l'a subi, devra payer? [. . .] Une fois que le demandeur a établi que le défendeur a violé son droit à l'autonomie personnelle, ce dernier devrait, à première vue, être tenu de payer. [Je souligne.]

Un autre facteur qui étaye la décision de conserver la démarche traditionnelle en matière d'atteinte et de voies de fait est qu'elle est sensée sur le plan pratique. Dans la décision *Bell Canada c. COPE (Sarnia) Ltd.* (1980), 11 C.C.L.T. 170 (H.C. Ont.), conf. par (1980), 31 O.R. (2d) 571 (C.A.), après avoir mentionné les attaques contre le droit canadien en matière d'atteinte, le juge Linden écrit, à la p. 180:

> [TRADUCTION] L'action pour atteinte remplit toujours plusieurs fonctions, dont l'une des plus importantes est de fournir un mécanisme permettant de déplacer le fardeau de la preuve vers le défendeur, pour ce qui est de

requiring the plaintiff to prove fault. The trespass action, though perhaps somewhat anomalous, may thus help to smoke out evidence possessed by defendants, who cause direct injuries to plaintiffs, which should assist Courts to obtain a fuller picture of the facts, a most worthwhile objective. [Emphasis added.]

savoir si un acte fautif a été commis intentionnellement ou par négligence, au lieu d'exiger du demandeur qu'il prouve qu'une faute a été commise. L'action pour atteinte, bien que quelque peu inusitée, peut donc permettre de dénicher des éléments de preuve qu'ont en leur possession des défendeurs qui ont causé des préjudices directs à des demandeurs, éléments qui devraient aider les tribunaux à se faire une image plus claire des faits, un objectif des plus valables. [Je souligne.]

In cases of direct interference, the defendant is likely to know how and why the interference occurred. I agree with Sullivan's suggestion, at p. 563, that "if the defendant is in a position to say what happened, it is both sensible and just to give him an incentive to do so by putting the burden of explanation on him".

13 En cas d'atteinte directe, il est probable que le défendeur saura comment et pourquoi il y a eu atteinte. Je suis d'accord avec la proposition de Sullivan, à la p. 563, que [TRADUCTION] «si le défendeur est en mesure de dire ce qui s'est produit, il est raisonnable et juste de l'inciter à le faire en l'obligeant à fournir une explication».

Finally, I share Sullivan's concern with the fact that cases of direct interference with the person tend to produce high "demoralization costs" (p. 563). Victims and those who identify with them tend to feel resentment and insecurity if the wrong is not compensated. The close causal relationship between the defendant's conduct and the violation of the plaintiff's bodily integrity, the identification of the loss with the plaintiff's personality and freedom, the infliction of the loss in isolated (as opposed to systemic) circumstances, and the perception of the defendant's conduct as anti-social, all support the legal position that once the direct interference with the plaintiff's person is shown, the defendant may fairly be called upon to explain his behaviour if indeed it was innocent.

14 Enfin, je partage la préoccupation de Sullivan relativement au fait que les cas d'atteinte directe à la personne tendent à entraîner d'importants [TRADUCTION] «coûts sur le plan du découragement» (p. 563). Les victimes et les personnes qui s'y identifient ont tendance à éprouver du ressentiment et de l'insécurité si le préjudice ne fait pas l'objet d'une réparation. Le lien de causalité étroit entre la conduite du défendeur et la violation de l'intégrité physique du demandeur, l'identification de la perte avec la personnalité et la liberté du demandeur, l'infliction de la perte dans une situation particulière (par opposition à systémique) et la perception que la conduite du défendeur est antisociale étayent tous le point de vue juridique qu'une fois que l'atteinte directe à la personne du demandeur a été établie, il est juste d'obliger le défendeur à expliquer son comportement si, de fait, il était innocent.

These arguments persuade me that we should not lightly set aside the traditional rights-based approach to the law of battery that is now the law of Canada. The tort of battery is aimed at protecting the personal autonomy of the individual. Its purpose is to recognize the right of each person to control his or her body and who touches it, and to permit damages where this right is violated. The compensation stems from violation of the right to autonomy, not fault. When a person interferes with

15 Ces arguments me convainquent que nous ne devons pas rejeter à la légère la démarche traditionnelle fondée sur les droits en ce qui concerne le droit en matière de voies de fait actuellement en vigueur au Canada. Le droit en matière de voies de fait vise à protéger l'autonomie personnelle de l'individu. Il a pour objectif de reconnaître le droit de chaque personne d'avoir le contrôle de son corps et de décider qui peut y toucher, et de permettre que des dommages-intérêts soient accordés

the body of another, a *prima facie* case of violation of the plaintiff's autonomy is made out. The law may then fairly call upon the person thus implicated to explain, if he can. If he can show that he acted with consent, the *prima facie* violation is negated and the plaintiff's claim will fail. But it is not up to the plaintiff to prove that, in addition to directly interfering with her body, the defendant was also at fault.

lorsque ce droit est violé. La réparation découle de la violation du droit à l'autonomie et non de la faute. Lorsqu'une personne porte atteinte au corps d'une autre personne, une preuve *prima facie* d'atteinte à l'autonomie du demandeur est établie. Il est alors possible en droit d'enjoindre, en toute équité, à la personne impliquée de s'expliquer, si elle est en mesure de le faire. Si elle peut établir qu'elle avait obtenu le consentement de l'autre personne, la preuve *prima facie* de l'atteinte est réfutée et le demandeur ne pourra avoir gain de cause. Toutefois, il n'incombe pas au demandeur de prouver que, en plus d'infliger une atteinte directe à son corps, le défendeur a également commis une faute.

16 Having stated that we should not set aside the traditional approach to battery, I do not wish to foreclose the possibility of future growth in this area of the law. References in definitions of the tort of battery to "injury", or to contact being "unlawful" or "harmful or offensive" are different ways of expressing the idea that not every physical contact constitutes a battery. In other words, the tort requires contact "plus" something else. One view, as I discuss in the next section, is that the "plus" refers merely to non-trivial contact. The caselaw to date tends to support this view, and generally does not require actual physical or psychological injury: *Cole v. Turner* (1704), 6 Mod. 149, 87 E.R. 907; *Stewart v. Stonehouse*, [1926] 2 D.L.R. 683 (Sask. C.A.), at p. 684; Fleming, *supra*, at p. 29; Fridman, *supra*, at p. 45. In a future case, it may be necessary to consider whether the "plus" required in addition to contact should be extended beyond the minimum of non-trivial acts. However, the issue does not arise in this case, since the plaintiff pleads physical and psychological damage. This is sufficient to bring the case within the traditional view of battery, however the "plus" is defined. Therefore, for the purposes of this case, I proceed upon the traditional view.

Ayant dit que nous ne devrions pas rejeter la démarche traditionnelle en matière de voies de fait, je ne voudrais pas exclure la possibilité de l'évolution du droit dans ce domaine. La mention, dans le délit de voies de fait, de «préjudice» ou de contact qui soit «illégal» ou bien «préjudiciable ou nocif» est une manière différente d'exprimer l'idée que ce ne sont pas tous les contacts physiques qui constituent des voies de fait. En d'autres termes, pour qu'il y ait délit, il doit y avoir un contact «plus» autre chose. Selon certains, point que j'analyse dans la section suivante, le «plus» ne fait référence qu'au contact non anodin. Jusqu'ici, la jurisprudence semble appuyer ce point de vue et, en règle générale, elle n'exige pas qu'il y ait un préjudice physique ou psychologique réel: *Cole c. Turner* (1704), 6 Mod. 149, 87 E.R. 907; *Stewart c. Stonehouse*, [1926] 2 D.L.R. 683 (C.A. Sask.), à la p. 684; Fleming, *op. cit.*, à la p. 29; Fridman, *op. cit.*, à la p. 45. Il pourrait s'avérer nécessaire, dans une affaire future, de déterminer si ce qui est exigé en «plus» du contact devrait s'étendre au-delà du minimum des actes non anodins. Toutefois, la question ne se pose pas en l'espèce, puisque la demanderesse allègue un préjudice physique et psychologique. Cela suffit pour que l'affaire soit considérée comme une affaire traditionnelle de voies de fait, de quelque façon que soit défini le «plus». Par conséquent, pour les fins de la présente affaire, je procède selon le point de vue traditionnel.

C. *The Argument that the Contact Must Be "Harmful or Offensive" Does Not Support Placing the Onus of Proving Non-Consent on the Plaintiff*

The proposition that the law should require a plaintiff in an action for sexual battery to prove that she did not consent, is supported, it is suggested, by a requirement that the contact involved in battery must be harmful or offensive. The argument may be summarized as follows. The plaintiff must prove all the essential elements of the tort of battery. One of these is that the contact complained of was inherently harmful or offensive on an objective standard. Consensual sexual contact is neither harmful nor offensive. Therefore the plaintiff, in order to make out her case, must prove that she did not consent or that a reasonable person in the defendant's position would not have thought she consented.

I do not dispute that a plaintiff generally must prove all elements of the tort she alleges. Nor do I dispute that contact must be "harmful or offensive" to constitute battery. However, I am not persuaded that plaintiffs in cases of sexual battery must prove that contact was "non-consensual" in order to prove that it was "harmful or offensive". If one accepts that the foundation of the tort of battery is a violation of personal autonomy, it follows that all contact outside the exceptional category of contact that is generally accepted or expected in the course of ordinary life, is *prima facie* offensive. Sexual contact does not fall into the category of contact generally accepted or expected in the course of ordinary activities. Hence the plaintiff may establish an action for sexual battery without negativing actual or constructive consent.

The idea that battery is confined to conduct that is "harmful or offensive" finds root in the old

C. *L'argument que le contact doit être «préjudiciable ou nocif» n'étaye pas l'imposition au demandeur de l'obligation de prouver l'absence de consentement*

17 La proposition que le droit devrait enjoindre au demandeur, dans une action pour voies de fait de nature sexuelle, de prouver qu'il n'a pas donné son consentement, est étayée, soutient-on, par une exigence que le contact en cause dans une affaire de voies de fait doit être préjudiciable ou nocif. L'argument peut être résumé de la façon suivante. Le demandeur doit établir tous les éléments essentiels du délit de voies de fait, dont le fait que le contact en cause était, de façon objective, intrinsèquement préjudiciable ou nocif. Le contact sexuel consensuel n'est ni préjudiciable, ni nocif. Par conséquent, la demanderesse doit, pour établir le bien-fondé de sa demande, prouver qu'elle n'a pas donné son consentement ou qu'une personne raisonnable dans la situation du défendeur n'aurait pas cru qu'elle l'avait donné.

18 Je ne conteste pas qu'un demandeur doive, de façon générale, prouver tous les éléments du délit qu'il prétend avoir subi. Je ne conteste pas non plus que le contact doive être «préjudiciable ou nocif» pour constituer des voies de fait. Cependant, je ne suis pas convaincue que, dans les cas de voies de fait de nature sexuelle, les demandeurs doivent prouver que le contact était «non consensuel» pour démontrer qu'il était «préjudiciable ou nocif». Si l'on accepte que le fondement du délit de voies de fait est une violation de l'autonomie personnelle, il s'ensuit que tout contact qui n'est pas visé par la catégorie exceptionnelle des contacts généralement acceptés ou auxquels on peut s'attendre dans la vie quotidienne est nocif à première vue. Le contact sexuel n'est pas visé par la catégorie des contacts généralement acceptés ou auxquels on peut s'attendre dans le cours d'activités ordinaires. D'où la possibilité qui s'offre au demandeur d'établir le bien-fondé d'une action pour voies de fait de nature sexuelle sans devoir réfuter le consentement véritable ou le consentement présumé.

19 L'idée selon laquelle les voies de fait se limitent à la conduite «préjudiciable ou nocive» tire son

cases involving trivial contacts. While the law of battery traditionally has held that the defendant, not the plaintiff, bears the onus of proving consent, it has also held that not every trivial contact suffices to establish battery. The classic example is being jostled in a crowd. A person who enters a crowd cannot sue for being jostled; such contact is not "offensive". Two theories have been put forward to explain this wrinkle on the general rule that all a plaintiff in a battery action must prove is direct contact. The first is implied consent: *Salmond and Heuston on the Law of Torts* (21st ed. 1996), at p. 121. The second sees these cases as "a general exception embracing all physical contact which is generally acceptable in the ordinary conduct of everyday life": *In re F.*, [1990] 2 A.C. 1 (H.L.), at p. 73, *per* Lord Goff.

20 Both these theories are consistent with the settled rule in Canadian law that a plaintiff in a battery action need not prove the absence of consent. On the implied consent theory, even if the plaintiff proves contact, the burden never shifts to the defendant to prove consent because consent is implied by law. On the "exception" theory, the plaintiff cannot succeed merely by proving contact if such contact falls within the exceptional category of conduct generally acceptable in ordinary life. It is not necessary in this appeal to choose between these approaches, but in my view both refer to the sort of everyday physical contact which one must be expected to tolerate, even if one does not actually consent to it.

21 The question then becomes whether sexual battery falls into the extraordinary category of cases where proving contact will not suffice to establish the plaintiff's case. Is sexual activity the sort of activity where consent is implied? Clearly it is not.

origine d'anciens cas portant sur des contacts anodins. Bien qu'il ait traditionnellement prévu qu'il incombe au défendeur, et non au demandeur, de prouver qu'il y a eu consentement, le droit en matière de voies de fait prévoit également qu'un contact anodin peut ne pas être suffisant pour établir qu'il y a eu voies de fait. L'exemple classique est le fait d'être bousculé dans une foule. La personne qui se joint à une foule ne peut intenter une action pour avoir été bousculée; un tel contact n'est pas «nocif». Deux théories ont été élaborées pour expliquer cette entorse à la règle générale selon laquelle, dans une action pour voies de fait, le demandeur doit seulement prouver qu'il y a eu contact direct. La première est celle du consentement implicite: *Salmond and Heuston on the Law of Torts* (21e éd. 1996), à la p. 121. La seconde considère de tels cas comme [TRADUCTION] «une exception générale couvrant tous les contacts physiques généralement acceptables dans le cours de la vie quotidienne»: *In re F.*, [1990] 2 A.C. 1 (H.L.), à la p. 73, lord Goff.

Ces deux théories sont compatibles avec la règle bien établie en droit canadien que, dans une action pour voies de fait, un demandeur n'est pas tenu de prouver l'absence de consentement. En ce qui concerne la théorie du consentement implicite, même si le demandeur prouve qu'il y a eu contact, il n'incombe jamais au défendeur de prouver qu'il y a eu consentement, vu que ce dernier est implicite en droit. Pour ce qui est de la théorie de l'«exception», pour avoir gain de cause, le demandeur ne peut se contenter de prouver qu'il y a eu contact lorsque ce contact est visé par la catégorie exceptionnelle des comportements généralement acceptables dans la vie quotidienne. Il n'est pas nécessaire de choisir entre ces théories dans le présent pourvoi, mais j'estime qu'elles se réfèrent toutes deux au genre de contacts physiques quotidiens qu'une personne est censée tolérer, même si elle n'y consent pas.

La question revient donc à savoir si les voies de fait de nature sexuelle sont visés par la catégorie extraordinaire des cas pour lesquels la demanderesse ne peut se contenter de prouver qu'il ya eu contact pour avoir gain de cause. L'activité

Alternatively, is it the sort of activity, like being jostled in a crowd, that is generally accepted and expected as a normal part of life? Again, I think not. The sort of conduct the cases envision is the inevitable contact that goes with ordinary human activity, like brushing someone's hand in the course of exchanging a gift, a gratuitous handshake, or being jostled in a crowd. Sexual contact does not fall into this category. It is not the casual, accidental or inevitable consequence of general human activity and interaction. It involves singling out another person's body in a deliberate, targeted act.

sexuelle est-elle un type d'activité à l'égard duquel le consentement est implicite? Certainement pas. Ou bien s'agit-il d'une activité qui, comme le fait d'être bousculé dans une foule, est généralement acceptée et à laquelle on peut s'attendre dans la vie quotidienne? Encore une fois, j'estime que non. Le type de conduite que visent ces cas est le contact inévitable qui accompagne l'activité humaine courante, comme le fait d'effleurer la main de quelqu'un en offrant un cadeau, de se donner la main sans raison particulière, ou d'être bousculé dans une foule. Le contact sexuel n'est pas visé par cette catégorie. Il ne s'agit pas de la conséquence fortuite, accidentelle ou inévitable d'une activité ou d'une interaction humaine. Il suppose la décision de toucher au corps d'une autre personne par un geste intentionnel et ciblé.

The assertion in some of the authorities that the contact must be harmful or offensive to constitute battery (see, e.g., La Forest J. in *M. (K.) v. M. (H.)*, [1992] 3 S.C.R. 6, at p. 25), reflects the need to exclude from battery the casual contacts inevitable in ordinary life. It does not, however, require the conclusion that to make out a case of battery, a plaintiff must prove that the contact was physically or psychologically injurious or morally offensive. The law of battery protects the inviolability of the person. It starts from the presumption that apart from the usual and inevitable contacts of ordinary life, each person is entitled not to be touched, and not to have her person violated. The sexual touching itself, absent the defendant showing lawful excuse, constitutes the violation and is "offensive". Sex is not an ordinary casual contact which must be accepted in everyday life, nor is it the sort of contact to which consent can be implied. To require a plaintiff in an action for sexual battery to prove that she did not consent or that a reasonable person in the defendant's position would not have thought she consented, would be to deny the protection the law has traditionally afforded to the

22

L'affirmation, dans certains précédents, que le contact doit être préjudiciable ou nocif pour constituer des voies de fait (voir, par exemple, les motifs du juge La Forest dans *M. (K.) c. M. (H.)*, [1992] 3 R.C.S. 6, à la p. 25) reflète la nécessité d'exclure des voies de fait les contacts fortuits inévitables dans la vie quotidienne. Elle n'exige cependant pas la conclusion que, pour établir le bien-fondé d'une action pour voies de fait, le demandeur doit prouver que le contact était physiquement ou psychologiquement préjudiciable, ou nocif sur le plan moral. Le droit en matière de voies de fait protège l'inviolabilité de la personne. Il est fondé sur la présomption que, hormis les contacts habituels et inévitables de la vie quotidienne, chacun a le droit de ne pas être touché et de ne pas subir une violation de sa personne. L'attouchement sexuel en soi, à moins que le défendeur ne présente une excuse légitime, constitue la violation et est «nocif». Le sexe n'est pas un contact fortuit qui doit être accepté dans la vie quotidienne et il ne s'agit pas du genre de contact pour lequel le consentement peut être considéré comme étant implicite. Exiger d'un demandeur qu'il prouve, dans une action pour voies de fait de nature sexuelle, qu'il n'était pas consentant ou qu'une personne raisonnable dans la situation du défendeur n'aurait pas cru qu'il l'était, reviendrait à le priver de la protection que la loi a traditionnellement offerte en matière d'inviolabilité du corps dans la situation où cette protection

inviolability of the body in the situation where it is perhaps most needed and appropriate.

23 Only two cases, one in England concerning therapeutic administration of drugs and one in New Zealand concerning sexual assault, are cited in favour of the proposition that the plaintiff must show harm by proving a lack of consent as an element of the tort of battery: see *Freeman v. Home Office*, [1983] 3 All E.R. 589 (Q.B.), aff'd [1984] 1 All E.R. 1036 (C.A.), *H. v. R.*, [1996] 1 N.Z.L.R. 299 (H.C.). The proposition that the plaintiff must prove a lack of consent, on the basis that she must prove that the impugned contact was harmful, is not supported by the law of battery, which has traditionally been confined to acts which are inherently harmful, like hitting, shooting or stabbing someone. Rather, its focus is on the protection of one's bodily integrity from any unwanted contact. Many of the older cases concern contacts devoid of any real harm apart from the violation of bodily integrity: *Pursell v. Horn* (1838), 8 AD. & E. 602, 112 E.R. 966 (pouring water on a person); *Green v. Goddard* (1704), 2 Salkeld 641, 91 E.R. 540 (forcibly taking an object held by another); *Humphries v. Connor* (1864), 17 Ir. Com. L. Rep. 1 (Q.B.) (taking flower worn by plaintiff), and *Forde v. Skinner* (1830), 4 Car. & P. 239, 172 E.R. 687 (cutting a person's hair). In more modern times, the same is true of medical battery cases. Like sexual acts, medical interventions may incidentally produce physical and psychological harm which may go to damages, but the basic "offence" or "harm" upon which the tort rests is the violation of the plaintiff's bodily integrity. As I discuss below, Canadian courts do not require plaintiffs alleging medical battery to prove that the defendant medical practitioner knew or ought to have known that the plaintiff did not consent to the medical contact.

est peut-être la plus nécessaire et la plus appropriée.

Deux cas seulement, l'un, en Angleterre, qui portait sur l'administration thérapeutique de médicaments, et l'autre, en Nouvelle-Zélande, qui portait sur une agression sexuelle, ont été cités pour étayer la proposition que le demandeur doit établir qu'il a subi un préjudice en prouvant l'absence de consentement, en tant qu'élément du délit de voies de fait: voir *Freeman c. Home Office*, [1983] 3 All E.R. 589 (Q.B.), conf. par [1984] 1 All E.R. 1036 (C.A.), et *H. c. R.*, [1996] 1 N.Z.L.R. 299 (H.C.). La proposition voulant que la demanderesse doive prouver l'absence de consentement, fondée sur le fait qu'elle doive établir que le contact reproché était préjudiciable, n'est pas étayée par le droit en matière de voies de fait, lesquelles ont traditionnellement été limitées à des actes intrinsèquement nuisibles, comme le fait de frapper, d'abattre ou de poignarder quelqu'un. Le droit en cette matière vise plutôt à protéger l'intégrité physique de la personne contre tout contact non souhaité. Plusieurs des anciennes affaires portent sur des contacts n'entraînant pas de préjudice réel outre la violation de l'intégrité physique: *Pursell c. Horn* (1838), 8 AD. & E. 602, 112 E.R. 966 (verser de l'eau sur une personne); *Green c. Goddard* (1704), 2 Salkeld 641, 91 E.R. 540 (prendre de force un objet détenu par une autre personne); *Humphries c. Connor* (1864), 17 Ir. Com. L. Rep. 1 (Q.B.) (prendre une fleur que portait la demanderesse), et *Forde c. Skinner* (1830), 4 Car. & P. 239, 172 E.R. 687 (couper les cheveux d'une personne). Pour ce qui est de l'époque plus contemporaine, on peut en dire autant des cas de voies de fait de nature médicale. À l'instar des actes sexuels, les interventions médicales peuvent incidemment entraîner un préjudice physique et psychologique susceptible de donner lieu à des dommages-intérêts, mais l'«offense» ou le «préjudice» fondamental sur lequel le délit est fondé est la violation de l'intégrité physique du demandeur. Comme je le mentionne plus loin, les tribunaux canadiens n'exigent pas que le demandeur allègue l'existence de voies de fait de nature médicale pour prouver que le médecin défendeur savait ou aurait dû savoir qu'il n'avait pas consenti au contact médical.

The practical counterpart of the argument that battery must involve inherently harmful or offensive conduct in some larger sense is the suggestion that absent such a requirement, plaintiffs will be able to unfairly drag defendants into court as a result of consensual sex, putting them to the trouble and risk of proving that the plaintiff consented or that a reasonable person would have concluded she consented. This point was not strongly argued, and with reason. Few plaintiffs to consensual sex or in situations where consent is a reasonable inference from the circumstances, are likely to sue if they are virtually certain to lose when the facts come out. Moreover, the rules of court provide sanctions for vexatious litigants. There is no need to change the law of battery to avoid vexatious claims.

24 La contrepartie, sur le plan pratique, de l'argument que les voies de fait supposent nécessairement une conduite préjudiciable ou nocive dans un sens plus large est l'idée qu'en l'absence d'une telle exigence, les demandeurs pourront injustement poursuivre les défendeurs après avoir eu des relations sexuelles consensuelles, les obligeant ainsi à prendre le risque d'avoir à prouver que le demandeur avait consenti aux relations sexuelles ou qu'une personne raisonnable aurait conclu qu'il y avait consenti. Ce point n'a pas été débattu énergiquement, et avec raison. Il est peu probable que le demandeur qui a eu des relations sexuelles consensuelles, ou qui se trouve dans une situation où il est raisonnable de déduire des circonstances qu'il avait consenti à ces relations, intente une action s'il est presque certain qu'il sera débouté après que les faits auront été établis. En outre, les règles de procédure prévoient l'infliction de sanctions aux parties qui intentent des actions vexatoires. Il n'est pas nécessaire de modifier le droit en matière de voies de fait pour éviter de telles actions.

Moreover, the prospect of plaintiffs suing and saying nothing about consent is more theoretical than real. In fact, plaintiffs suing for sexual battery usually testify that they did not consent to the sexual contact. Failure to do so, absent an explanation, makes it more likely the defendant could win when he calls evidence of consent or reasonable appearance of consent. Even if a plaintiff were to bring an action in sexual battery against the estate of a deceased defendant, many provincial and territorial evidence acts would not allow the plaintiff to obtain a judgment against the estate unless her evidence were corroborated by other material evidence: see *Evidence Acts* of Alberta, R.S.A. 1980, c. A-21, s. 12; Newfoundland, R.S.N. 1990, c. E-16, s. 16; Northwest Territories, R.S.N.W.T. 1988, c. E-8, s. 17; Nova Scotia, R.S.N.S. 1989, c. 154, s. 45; Ontario, R.S.O. 1990, c. E.23, s. 13; Prince Edward Island, R.S.P.E.I. 1988, c. E-11, s. 11; Yukon, R.S.Y. 1986, c. 57, s. 14. At the same time, as discussed more fully below, placing on the plaintiff the legal burden of always

25 De plus, la possibilité que des demandeurs intentent une action, mais restent muets sur la question du consentement, est plus théorique que réelle. En fait, les demandeurs qui intentent une action pour voies de fait de nature sexuelle témoignent habituellement qu'ils n'ont pas consenti au contact sexuel. Leur omission à cet égard, en l'absence d'explication, fait en sorte qu'il est plus probable que le défendeur ait gain de cause après avoir produit des éléments de preuve établissant le consentement ou l'apparence raisonnable de consentement. Même si un demandeur intentait une action pour voies de fait de nature sexuelle contre la succession d'un défendeur, plusieurs lois provinciales et territoriales sur la preuve ne lui permettraient pas d'obtenir un jugement contre la succession, à moins que son témoignage ne soit corroboré par d'autres éléments de preuve substantielle: voir les lois sur la preuve de l'Alberta, R.S.A. 1980, ch. A-21, art. 12; de Terre-Neuve, R.S.N. 1990, ch. E-16, art. 16; des Territoires du Nord-Ouest, L.R.T.N.-O. 1988, ch. E-8, art. 17; de la Nouvelle-Écosse, R.S.N.S. 1989, ch. 154, art. 45; de l'Ontario, L.R.O. 1990, ch. E.23, art. 13; de l'Île-du-Prince-Édouard, R.S.P.E.I.

negativing actual and constructive consent on pain of non-suit, may lead to injustice.

26 I conclude that the fact that the law of battery excludes trivial contact and requires contact that is "harmful or offensive" does not require us to conclude that the plaintiff bears the burden of proving that the defendant actually or constructively knew she did not consent to sexual contact.

D. *There Is Nothing Particular About Sexual Assault that Makes it Necessary to Have a Special Rule of Battery for Sexual Assaults for What the Plaintiff Must Prove*

27 If there were something special about sexual battery that justified requiring the plaintiff to prove that the defendant either knew she was not consenting or ought to have known that she was not consenting, a case might be made for so doing. The result would be a special rule for sexual battery inconsistent with the law of battery generally, and the creation of a new tort of sexual battery. Thus far the courts have declined to do this. As Professor Feldthusen notes, "[t]here has yet to be recognised a new nominate tort of *sexual* battery" (emphasis in original): "The Canadian Experiment with the Civil Action for Sexual Battery", in N. J. Mullany, ed., *Torts in the Nineties* (1997), 274, at p. 281. The sexual aspects of the claim go only to damages. However, as I stated above, a new tort of sexual battery with different rules from ordinary battery could be recognized in an appropriate case.

28 Before examining whether sexual battery is so different that special rules are required as to what the plaintiff must show, it is important to take note of the danger of placing special, unjustified

1988, ch. E-11, art. 11, et du Yukon, L.R.Y. 1986, ch. 57, art. 14. Par ailleurs, j'en discuterai plus longuement ci-après, imposer au demandeur le fardeau ultime de toujours devoir réfuter le consentement véritable et le consentement présumé afin d'éviter le non-lieu peut mener à l'injustice.

À mon avis, le fait que le droit en matière de voies de fait exclut les contacts anodins et exige que le contact soit «préjudiciable ou nocif» ne nous oblige pas à conclure qu'il incombe à la demanderesse de prouver qu'en fait, le défendeur savait, ou était réputé savoir, qu'elle ne consentait pas au contact sexuel.

D. *L'agression sexuelle n'a rien de particulier qui rende nécessaire une règle spéciale sur ce que la demanderesse doit prouver en matière de voies de fait de nature sexuelle*

Si les voies de fait de nature sexuelle avaient des particularités justifiant que l'on exige de la demanderesse qu'elle prouve que le défendeur savait, ou aurait dû savoir, qu'elle ne donnait pas son consentement, on pourrait établir le bien-fondé d'une telle proposition. Il en résulterait une règle spéciale en matière de voies de fait de nature sexuelle qui serait incompatible avec le droit applicable aux voies de fait en général, de même que la création d'un nouveau délit de voies de fait de nature sexuelle. Jusqu'à maintenant, les tribunaux s'y sont refusé. Comme le fait remarquer le professeur Feldthusen, [TRADUCTION] «[u]n nouveau type de délit de voies de fait de nature *sexuelle* n'a toujours pas été reconnu» (en italique dans l'original): «The Canadian Experiment with the Civil Action for Sexual Battery», dans N. J. Mullany, dir., *Torts in the Nineties* (1997), 274, à la p. 281. Les aspects sexuels de l'action n'ont trait qu'aux dommages-intérêts. Cependant, comme je l'ai déjà mentionné, on pourrait, dans un cas approprié, reconnaître un nouveau délit de voies de fait de nature sexuelle doté de règles distinctes des règles applicables aux voies de fait ordinaires.

Avant d'examiner la question de savoir si les voies de fait de nature sexuelle sont tellement différentes que des règles particulières doivent prévoir ce que la demanderesse doit établir, il importe

burdens on victims of sexual encounters. At p. 282, Feldthusen notes that "in the criminal sphere, enquiries into alleged consent have allowed the focus of the criminal trial to shift from the actions of the defendant to the character of the complainant. The same potential exists in tort law" (emphasis added). As he points out, "[t]here exist in our law deeply imbedded tendencies towards victim blaming" (p. 283). This is not to say that alleged victims of sexual assault could never be singled out by placing special rules of proof on them that do not apply to other types of plaintiffs. It is rather to say that we must guard against placing such burdens upon alleged victims of sexual assault unless it can objectively be shown that it is necessary to do so in order to achieve justice.

de tenir compte du danger d'imposer des fardeaux particuliers et injustifiés aux victimes de contacts sexuels. Feldthusen fait remarquer, à la p. 282, que [TRADUCTION] «dans le domaine criminel, les enquêtes sur le prétendu consentement ont déplacé l'objet principal du procès criminel, de sorte qu'il ne porte plus sur les actes du défendeur, mais plutôt sur la réputation du plaignant. La même chose pourrait arriver en droit de la responsabilité délictuelle» (je souligne). Comme il le signale, [TRADUCTION] «[i]l existe, dans notre droit, une tendance ancrée à blâmer la victime» (p. 283). Cela ne veut pas dire que la personne qui prétend avoir été victime d'agression sexuelle ne sera jamais tenue de s'expliquer en vertu de règles de preuve particulières qui ne s'appliquent pas à d'autres types de demandeurs. Cela signifie plutôt que nous devons nous garder d'imposer de tels fardeaux aux personnes qui prétendent avoir été victimes d'agression sexuelle, à moins que l'on puisse objectivement établir qu'une telle mesure est nécessaire pour rendre justice.

To require plaintiffs in actions for sexual battery to prove that they did not consent and that a reasonable person in the circumstances of the defendant would not have believed they consented, is to place a burden on plaintiffs in actions for sexual battery that plaintiffs in other types of battery do not bear. It is to do so, moreover, in the absence of any compelling reason. Indeed, there are powerful reasons for applying the usual rules that require a plaintiff to prove only direct contact in cases of sexual battery.

29 Exiger du demandeur qui intente une action pour voies de fait de nature sexuelle qu'il prouve qu'il n'avait pas donné son consentement ou qu'une personne raisonnable dans la situation du défendeur n'aurait pas cru qu'il donnait son consentement, lui impose un fardeau dont les demandeurs n'ont pas à s'acquitter à l'égard d'autres types de voies de fait. En outre, on le ferait sans raison impérieuse. En fait, il y a de fortes raisons d'appliquer, dans une action pour voies de fait de nature sexuelle, les règles habituelles selon lesquelles le demandeur doit seulement prouver qu'il y a eu contact direct.

The first concern is that by requiring the plaintiff to prove more than the traditional battery claim requires, we inappropriately shift the focus of the trial from the defendant's behaviour to the plaintiff's character. Requiring the plaintiff to prove that a reasonable person in the position of the defendant would have known that she was not consenting requires her to justify her actions. In practical terms, she must prove that she made it clear through her conduct and words that she did not consent to the sexual contact. Her conduct, not the

30 Ma première réserve est qu'en imposant à la demanderesse un fardeau de la preuve plus lourd que celui que l'action pour voies de fait a traditionnellement exigé, nous déplaçons de façon inappropriée l'objet principal du procès, de sorte qu'il ne porte plus sur le comportement du défendeur, mais plutôt sur la réputation de la demanderesse. Exiger de la demanderesse qu'elle prouve qu'une personne raisonnable dans la situation du défendeur aurait su qu'elle ne donnait pas son consentement revient à exiger d'elle de justifier ses actes. Dans la

defendant's, becomes the primary focus from the outset. If she cannot prove these things, she will be non-suited and the defendant need never give his side of the story.

pratique, elle doit prouver qu'elle a clairement exprimé, par sa conduite et ses paroles, qu'elle ne consentait pas au contact sexuel. Sa conduite, plutôt que celle du défendeur, devient l'objet principal dès le départ. Si elle ne parvient pas à établir ces éléments, le non-lieu sera accordé et le défendeur ne sera pas tenu de donner sa version des faits.

31 The proposed shift to the plaintiff of the onus of disproving constructive consent runs the risk of victim blaming, against which Feldthusen and others properly warn. It also runs the risk of making it impossible for deserving victims of sexual battery to even get their foot in the litigation door. Consider the case of the victim of sexual assault who cannot testify to the events because of shock, loss of memory or inebriation. If she can prove that she was sexually assaulted and identify the perpetrator through third-person evidence, should she be non-suited at the outset because she cannot prove that her conduct in the circumstances would have led a reasonable person to conclude she was not consenting? Is it not better in such cases that the defendant be called upon to give evidence so the court can decide the case on a more complete picture of the facts? This is what the law of battery would traditionally require. Why should we exempt the defendant because the battery is a sexual battery?

Le déplacement proposé du fardeau de la preuve, de sorte qu'il incomberait à la demanderesse de réfuter le consentement présumé, pourrait faire en sorte que la victime soit blâmée, un développement contre lequel Feldthusen et d'autres auteurs nous mettent en garde à bon droit. Il pourrait également en découler que des victimes méritantes dans des affaires de voies de fait de nature sexuelle soient incapables de même intenter une action. Prenons le cas de la victime d'agression sexuelle qui ne peut témoigner sur les événements parce qu'elle est en état de choc, souffre de perte de mémoire, ou était en état d'ébriété quand les événements se sont produits. Dans le cas où elle est en mesure de prouver qu'elle a subi une agression sexuelle et d'identifier son agresseur au moyen du témoignage d'un tiers, le non-lieu doit-il être prononcé dès le début parce qu'elle ne peut prouver que sa conduite dans les circonstances aurait mené une personne raisonnable à conclure qu'elle n'était pas consentante? N'est-il pas mieux dans de tels cas que le défendeur soit invité à témoigner, de sorte que la cour puisse trancher l'affaire sur le fondement d'une meilleure connaissance des faits? C'est ce qu'exige traditionnellement le droit en matière de voies de fait. Pourquoi le défendeur serait-il dispensé de témoigner parce que les voies de fait en cause sont de nature sexuelle?

32 The proposed shift of onus runs counter to Parliament's expressed view in the criminal context. Although the aims of criminal law and the law of tort are not identical, it remains significant that Parliament in s. 273.2(*b*) of the *Criminal Code*, R.S.C., 1985, c. C-46, stipulates that those accused of sexual assault who seek to invoke the defence of honest but mistaken belief in consent must have taken reasonable steps in the circumstances known to them at the time to ascertain the complainant's

Le déplacement proposé du fardeau de la preuve va à l'encontre du point de vue que le législateur a exprimé dans le contexte criminel. Bien que les objectifs du droit criminel et du droit de la responsabilité délictuelle ne soient pas identiques, il n'en demeure pas moins révélateur que le législateur a prévu, à l'al. 273.2*b*) du *Code criminel*, L.R.C. (1985), ch. C-46, que la personne accusée d'agression sexuelle qui fait valoir comme moyen de défense qu'elle croyait sincèrement mais de façon

consent. Parliament has thus moved to counteract the historic tendency of criminal trials for sexual assault to focus unduly on the behaviour of the complainant, and to redirect some of the focus to the defendant. The traditional tort of battery already provides this focus in the civil domain. That focus should be retained in my view. To quote Sullivan, *supra*, at p. 563, "if the defendant is in a position to say what happened, it is both sensible and just to give him an incentive to do so by putting the burden of explanation on him".

erronée qu'elle avait obtenu le consentement du plaignant doit avoir pris les mesures raisonnables, dans les circonstances dont elle avait alors connaissance, pour s'assurer du consentement de ce dernier. Pour contrebalancer la tendance qui a cours depuis toujours dans les procès criminels pour agression sexuelle à examiner excessivement le comportement du plaignant, le législateur s'est donc efforcé d'attirer davantage l'attention sur le défendeur, ce qui est déjà prévu en matière civile pour le délit de voies de fait traditionnel. À mon avis, cette démarche devrait être conservée. Comme le dit Sullivan, *loc. cit.*, à la p. 563, [TRADUCTION] «si le défendeur est en mesure de dire ce qui s'est produit, il est raisonnable et juste de l'inciter à le faire en l'obligeant à fournir une explication».

Requiring the plaintiff to disprove constructive consent seems all the more unfair because the relevant facts lie first and foremost within the defendant's sphere of knowledge. He alone knows whether he actually believed the plaintiff was consenting, and if he believed she was consenting, he is in the best position to give evidence on the factors that led him to believe that. The plaintiff, by contrast, is not in a position to produce evidence of what was in the defendant's mind nor in as good a position to say what factors led him to that state of mind and whether he acted reasonably. While the defendant's particular knowledge about his state of mind regarding consent is not determinative of who bears the burden of proof regarding consent, it is one of the principles of fairness and policy that are said to influence the allocation of this burden: see J. Sopinka, S. N. Lederman, and A. W. Bryant, *The Law of Evidence in Canada* (2nd ed. 1999), at § 3.70; *McCormick on Evidence* (5th ed. 1999), vol. 2, at § 337.

33 Exiger de la demanderesse qu'elle réfute le consentement présumé semble d'autant plus injuste que c'est le défendeur, qui, d'abord et avant tout, connaît les faits pertinents. Il est le seul à savoir s'il croyait vraiment que la demanderesse était consentante, et, s'il le croyait effectivement, il est le mieux placé pour témoigner sur les facteurs qui l'ont mené à le croire. La demanderesse, par contre, ne peut témoigner sur ce que le défendeur avait à l'esprit, et elle n'est pas bien placée pour dire quels facteurs ont suscité cet état d'esprit chez ce dernier ni pour déterminer s'il a agi de façon raisonnable. Bien que la connaissance particulière du défendeur sur son propre état d'esprit en ce qui concerne le consentement ne permette pas de déterminer à qui incombe le fardeau de la preuve relativement à cette question, il s'agit de l'un des principes d'équité et de l'une des considérations de principe qui, dit-on, ont une incidence sur la question de savoir à qui ce fardeau incombe: voir J. Sopinka, S. N. Lederman et A. W. Bryant, *The Law of Evidence in Canada* (2e éd. 1999), au § 3.70; *McCormick on Evidence* (5e éd. 1999), vol. 2, au § 337.

I conclude that there is nothing about sexual battery that requires that the traditional rules of onus governing battery actions be changed. On the contrary, placing the onus on the plaintiff of disproving consent and constructive consent seems

34 Je conclus que rien dans les voies de fait de nature sexuelle n'exige que l'on modifie les règles traditionnelles en matière de fardeau de la preuve applicables aux actions pour voies de fait. Au contraire, imposer à la demanderesse le fardeau de

unfairly to impose special obligations on plaintiffs who sue for sexual assault.

réfuter le consentement réel et le consentement présumé semble imposer injustement des obligations particulières à la personne qui intente une action pour agression sexuelle.

E. *To Require the Plaintiff to Prove that the Defendant Knew or Ought to Have Known She Was Not Consenting Presents the Dilemma of Either Changing the Law for Other Types of Battery or Introducing an Inconsistency in the Law of Battery*

E. *Exiger de la demanderesse qu'elle prouve que le défendeur savait, ou aurait dû savoir, qu'elle ne donnait pas son consentement pose un dilemme: faut-il modifier le droit à l'égard d'autres types de voies de fait ou introduire une incohérence dans le droit en matière de voies de fait?*

35 To hold that battery must involve a contact that is inherently harmful or offensive has the potential to change the law relating to other types of battery, like medical battery. Alternatively, if it does not, it will introduce an inconsistency into the law of battery.

Soutenir qu'il doit y avoir un contact fondamentalement préjudiciable ou nocif pour qu'il y ait voies de fait est susceptible de modifier le droit applicable à d'autres types de voies de faits, tels les voies de faits de nature médicale. Sinon, s'il n'en est rien, cela introduira une incohérence dans le droit en matière de voies de fait.

36 As discussed, Canadian courts have repeatedly held that for medical battery, the defendant bears the onus of proving consent as a defence: see, for example, *Reibl*, *supra*; *Schweizer v. Central Hospital* (1974), 53 D.L.R. (3d) 494 (Ont. H.C.); *Allan v. New Mount Sinai Hospital* (1980), 109 D.L.R. (3d) 634 (Ont. H.C.), rev'd on other grounds (1981), 33 O.R. (2d) 603 (C.A.); *Brushett v. Cowan* (1990), 3 C.C.L.T. (2d) 195 (Nfld. C.A.), at p. 199, and *O'Bonsawin v. Paradis* (1993), 15 C.C.L.T. (2d) 188 (Ont. Ct. (Gen. Div.)). Like sexual contact, the act of medical intervention is not inherently harmful or offensive, beyond its potential to violate bodily integrity. If sexual battery requires the plaintiff to prove that the defendant knew or ought to have known that the plaintiff did not consent, it is difficult to see why the same would not hold for medical malpractice. Yet no one has suggested that the law of medical malpractice ought to be changed to place an additional burden on the plaintiff of proving a culpable state of mind in the defendant medical practitioner. The alternative, if the law of battery were changed in this regard for sexual battery, would be inconsistency in the law of battery. Neither alternative is attractive. This suggests a further reason for being wary of the proposition that battery requires proof

Comme je l'ai déjà mentionné, les tribunaux canadiens ont statué à maintes reprises que pour ce qui est des voies de fait de nature médicale, il incombe au défendeur de prouver qu'il y a eu consentement: voir, par exemple, *Reibl*, précité; *Schweizer c. Central Hospital* (1974), 53 D.L.R. (3d) 494 (H.C. Ont.); *Allan c. New Mount Sinai Hospital* (1980), 109 D.L.R. (3d) 634 (H.C. Ont.), inf. pour d'autres motifs par (1981), 33 O.R. (2d) 603 (C.A.); *Brushett c. Cowan* (1990), 3 C.C.L.T. (2d) 195 (C.A.T.-N.), à la p. 199, et *O'Bonsawin c. Paradis* (1993), 15 C.C.L.T. (2d) 188 (C. Ont. (Div. gén.)). À l'instar du contact sexuel, l'intervention médicale n'est pas intrinsèquement préjudiciable ou nocive, hormis le fait qu'elle est susceptible de violer l'intégrité physique. Si, en matière de voies de fait de nature sexuelle, le demandeur doit prouver que le défendeur savait, ou aurait dû savoir, qu'il n'était pas consentant, on peut difficilement voir pourquoi il n'en serait pas de même pour ce qui est de la faute professionnelle médicale. Pourtant, personne n'a suggéré de modifier le droit applicable en cette matière de sorte qu'incombe au demandeur le fardeau supplémentaire de prouver que le praticien défendeur avait une intention criminelle. Autrement, si le droit en matière de voies de fait était modifié à cet égard

by the plaintiff of an inherently harmful or offensive act.

F. *Requiring the Plaintiff to Prove that the Defendant Knew or Ought to Have Known that She Did Not Consent is Neither Necessary nor Sufficient to Permit the Conclusion that the Insurers in this Case Are Not Obligated to Defend the Defendant*

The question at issue on this appeal is whether the insurer may avoid the obligation to defend the defendant to the battery action under the policy exclusion for "any intentional . . . act". I agree with Iacobucci J. that this clause must be interpreted as requiring an intent to injure. It follows that for the tort of sexual battery to be excluded from policy coverage, it must always involve intent to injure.

As I understand his reasons, Iacobucci J. finds this intent to injure is present on the basis of legal inference, not as a matter of fact. The law presumes that in actions of battery for sexual assault, the defendant intends to injure the plaintiff. Thus Iacobucci J. states "[g]iven . . . actual or constructive knowledge of non-consent, the law will not permit the appellant to claim that he did not intend any harm" (para. 94 (emphasis added)). This legal inference is necessary because in cases of constructive knowledge, the defendant may be held liable despite the fact that he had no actual knowledge of lack of consent and hence no actual intent to harm the plaintiff. Iacobucci J. elaborates at para. 121 in reviewing the American jurispru-

pour ce qui est des voies de fait de nature sexuelle, on introduirait une incohérence dans ce droit. Ni l'une ni l'autre solution n'est attrayante. Voilà une autre raison de se méfier de la proposition selon laquelle, en matière de voies de fait, le demandeur doit prouver qu'il a subi un acte fondamentalement préjudiciable ou nocif.

F. *Exiger de la demanderesse qu'elle prouve que le défendeur savait, ou aurait dû savoir, qu'elle ne donnait pas son consentement n'est ni nécessaire ni suffisant pour conclure que les assureurs en l'espèce ne sont pas tenus de défendre le défendeur*

37 La question en litige dans le présent pourvoi est de savoir si l'assureur peut éviter l'obligation de défendre le défendeur à l'égard du délit de voies de fait en vertu de l'exclusion prévue dans la police d'assurance à l'égard du préjudice infligé [TRADUCTION] «par l'action [. . .] intentionnelle». Tout comme le juge Iacobucci, j'estime qu'il faut considérer que cette clause exige l'intention d'infliger un préjudice. Il s'ensuit que pour que le délit de voies de fait de nature sexuelle soit exclu de la garantie de la police, il doit toujours supposer l'intention d'infliger un préjudice.

38 Si je comprends bien ses motifs, le juge Iacobucci estime, sur la base d'une conclusion fondée en droit et non d'une conclusion de fait, que cette intention d'infliger un préjudice existe en l'espèce. La loi présume, en ce qui concerne les actions pour voies de fait de nature sexuelle, que le défendeur avait l'intention d'infliger un préjudice au demandeur. Ainsi, le juge Iacobucci estime que «[c]omme il savait ou était réputé savoir qu'il n'y avait pas eu consentement, l'appelant ne pourra prétendre, suivant le droit applicable, qu'il n'avait pas l'intention d'infliger un préjudice» (par. 94 (je souligne)). Cette conclusion fondée en droit est nécessaire vu que, dans les cas de connaissance présumée, le défendeur peut être tenu responsable malgré le fait qu'il n'avait pas de connaissance réelle de l'absence de consentement et qu'il n'avait donc pas véritablement eu l'intention d'infliger un préjudice au demandeur. Le juge Iacobucci développe sa pensée, au par. 121, en examinant la

dence on this issue, in the context of sexual assaults on children:

> Courts have had little difficulty in concluding that defendants in these cases are presumed to intend harm to their victims — notwithstanding the fact that "males who are involved in such activities do not expect or intend that the females will sustain any injury". . . . [Emphasis added.]

In other words, where there is an allegation of sexual battery, courts will conclude as a matter of legal inference that the defendant intended harm for the purpose of construing exemptions of insurance coverage for intentional injury.

39 This presumption of intent to harm does not depend on requiring the plaintiff to prove that the defendant knew or ought to have known that the plaintiff was not consenting to the sexual contact. Rather, the presumption flows from the allegation in the pleadings of battery of a sexual nature. American cases, like *State Farm Fire and Casualty Co. v. Williams*, 355 N.W.2d 421 (Minn. 1984), do not turn on the plaintiff's bearing the burden of showing the defendant either knew or ought to have known she did not consent. The logic is simply that either the act must have been consensual or not consensual. If it was not consensual, the policy does not apply because neither the insured nor the insurer contemplated coverage for non-consensual sexual activities. If it was consensual, then there is no battery and no claim for recovery. In either case, the policy does not apply. As stated in *Williams*, at p. 424:

> Does the fact that Williams, the victim, was an adult distinguish this case? We think not. Neither the insured nor the insurer in entering into the insurance contract contemplated coverage against sexual claims arising out of non-consensual sexual assaults.

40 This reasoning applies equally to allegations of negligent sexual battery where the alleged negligence relates to the defendant's belief in the plaintiff's consent to sexual contact. For these reasons

jurisprudence américaine sur cette question, dans le contexte de l'agression sexuelle d'un enfant:

> Les tribunaux n'ont pas hésité à dire que les défendeurs dans ce genre d'affaires sont présumés avoir voulu infliger un préjudice à leurs victimes — malgré le fait que [TRADUCTION] «les hommes qui se livrent à de tels actes ne s'attendent pas à ce que les femmes subissent un préjudice ni ne veulent leur en infliger un». . . [Je souligne.]

En d'autres termes, en cas d'allégation de voies de fait de nature sexuelle, les tribunaux concluront, en droit, que le défendeur a eu l'intention d'infliger un préjudice, dans le cadre de l'interprétation des clauses d'exclusion de la garantie de la police d'assurance visant l'infliction délibérée d'un préjudice.

Cette présomption de l'intention d'infliger un préjudice ne dépend pas d'une exigence, imposée au demandeur, de prouver que le défendeur savait, ou aurait dû savoir, qu'il ne consentait pas au contact sexuel. Elle découle plutôt de l'allégation, dans les actes de procédure, de voies de fait de nature sexuelle. Les affaires américaines, telles que *State Farm Fire and Casualty Co. c. Williams*, 355 N.W.2d 421 (Minn. 1984), ne portent pas sur la question de l'imposition au demandeur du fardeau de prouver que le défendeur savait, ou aurait dû savoir, qu'il n'était pas consentant. La logique de ces affaires est simple: l'acte était consensuel ou il ne l'était pas. Dans le cas où l'acte n'était pas consensuel, la police ne s'applique pas, car ni l'assuré, ni l'assureur n'envisageait une garantie à l'égard d'activités sexuelles non consensuelles. Dans le cas où l'acte était consensuel, on considère qu'il n'y a pas eu de voies de fait et, partant, qu'une action en dommages-intérêts ne peut être intentée. Dans l'un et l'autre cas, la police ne s'applique pas. Comme on le dit dans *Williams*, à la p. 424:

> [TRADUCTION] Le fait que la victime, Williams, était un adulte établit-il une distinction en l'espèce? Nous ne le croyons pas. En concluant le contrat d'assurance, ni l'assuré ni l'assureur n'ont envisagé que la garantie s'applique à une poursuite pour agression sexuelle non consensuelle.

Ce raisonnement s'applique également aux allégations de voies de fait de nature sexuelle imputables à la négligence, dans les cas où la prétendue négligence est liée à la croyance du défendeur que

I conclude that it is not necessary to place on the plaintiff the burden of proving the defendant's knowledge or constructive knowledge of the plaintiff's non-consent.

If this reasoning is correct, then placing the non-traditional burden of disproving consent or constructive consent on the plaintiff is neither a necessary nor a sufficient condition of concluding that the policy does not apply in cases like this. Regardless of how one views the matter of onus, the result will be the same.

G. *Negligent Battery*

It is unnecessary on this appeal to comment on the relationship between battery (traditionally thought of mainly as an intentional tort) and negligence. In this case, insofar as one could speak of negligent battery, it would be to recognize the defence of reasonable belief in consent to a suit based on an intentional act. As discussed, the law in these circumstances presumes an intention to injure, taking it out of the realm of pure negligence and bringing it within the ambit of the exclusion clause.

II. Conclusion

I conclude that there is no justification in cases of battery of a sexual nature for departing from the traditional rule that the plaintiff in a battery action must prove direct contact, at which point the onus shifts to the defendant to prove consent. To do so would be to place a burden upon plaintiffs in battery actions of a sexual nature which plaintiffs in other battery actions do not bear. I see neither the need nor the justification for doing this on the material before us in this case.

le demandeur consentait au contact sexuel. Pour ces motifs, je conclus qu'il n'est pas nécessaire d'imposer au demandeur le fardeau de prouver que le défendeur savait ou était présumé savoir qu'il ne donnait pas son consentement.

41 Si ce raisonnement est exact, imposer au demandeur le fardeau non traditionnel de réfuter le consentement ou le consentement présumé n'est une condition ni nécessaire, ni suffisante pour conclure que la police ne s'applique pas dans des cas comme en l'espèce. Peu importe la façon dont on considère la question du fardeau de la preuve, le résultat sera le même.

G. *Voies de fait imputables à la négligence*

42 Il n'est pas nécessaire dans le présent pourvoi de faire des remarques sur le lien entre les voies de fait (traditionnellement considérées surtout comme un délit intentionnel) et la négligence. En l'espèce, dans la mesure où on peut parler de voies de fait imputables à la négligence, ces remarques reviendraient à reconnaître que le moyen de défense de la croyance raisonnable au consentement peut être présenté contre une poursuite fondée sur un acte intentionnel. Comme je l'ai mentionné, le droit dans ces circonstances présume une intention d'infliger un préjudice, de sorte que le principe de la stricte négligence ne s'applique plus et que l'affaire relève du champ d'application de la clause d'exclusion.

II. Conclusion

43 Je conclus qu'aucune justification ne permet, dans les cas de voies de fait de nature sexuelle, de s'écarter de la règle traditionnelle voulant que dans le cadre d'une action pour voies de fait le demandeur doive prouver qu'il y a eu contact direct, après quoi il incombe au défendeur de prouver qu'il y a eu consentement. S'écarter de cette règle imposerait aux personnes qui intentent une action pour voies de fait de nature sexuelle une obligation que les personnes qui intentent des actions pour d'autres types de voies de fait n'auraient pas à remplir. À mon avis, une telle démarche n'est ni nécessaire ni justifiée, compte tenu des documents dont nous disposons dans la présente affaire.

44 This said, I agree fully with Iacobucci J. that the law will not permit a defendant in an action for sexual battery to say that though he might be found to have committed the battery, he did not intend any harm. This leaves the defendant with two alternatives discussed in *Williams*, *supra*. Either the plaintiff consented, in which case no action lies, or she did not consent and the defendant is deemed to have intended to injure her. In neither case does the policy provide coverage.

Cela dit, je souscris entièrement à l'opinion du juge Iacobucci que la loi ne permet pas à un défendeur dans une action pour voies de fait de nature sexuelle de dire que, même si l'on déterminait qu'il a commis les voies de fait, il n'avait pas l'intention de causer un préjudice. En définitive, les deux solutions de rechange analysées dans l'arrêt *Williams*, précité, s'offrent au défendeur. Soit la demanderesse a donné son consentement, auquel cas l'action sera rejetée, soit elle n'a pas donné son consentement, et le défendeur est réputé avoir eu l'intention de lui causer un préjudice. La garantie de la police ne s'appliquera dans ni l'un ni l'autre cas.

45 Like Iacobucci J., I would dismiss the appeal with costs.

À l'instar du juge Iacobucci, je suis d'avis de rejeter le pourvoi avec dépens.

The reasons of Iacobucci, Major and Bastarache JJ. were delivered by

Version française des motifs des juges Iacobucci, Major et Bastarache rendus par

IACOBUCCI J. —

LE JUGE IACOBUCCI —

I. Introduction and Overview

I. Introduction et aperçu

46 This appeal raises the novel question of whether an insurance company has a duty to defend the holder of a homeowner's insurance policy against a civil sexual assault suit. In answering this question, we must also address the role of consent in an action for sexual assault.

Le présent pourvoi soulève la question nouvelle de savoir si l'assureur a l'obligation de défendre le titulaire d'une police d'assurance propriétaires occupants qui fait l'objet d'une poursuite civile pour agression sexuelle. Pour trancher la question, notre Cour doit également examiner le rôle du consentement sur l'issue d'une telle poursuite.

47 It should be noted that this appeal was heard along with the appeal in *Sansalone v. Wawanesa Mutual Insurance Co.*, [2000] 1 S.C.R. 627, 2000 SCC 25, reasons in which are being released concurrently.

Il convient de signaler que le présent pourvoi a été entendu de pair avec celui introduit dans l'affaire *Sansalone c. Wawanesa Mutual Insurance Co.*, [2000] 1 R.C.S. 627, 2000 CSC 25, dont les motifs sont déposés simultanément.

48 This appeal concerns the insurance implications of a series of allegedly non-consensual sexual touchings. For ease of reference, I will use the term "sexual assault" to refer in general to any allegation of non-consensual sexual touching. My use of the term "sexual assault" should not be taken to imply any specific legal ramifications. But for "sexual battery", by contrast, I will give a more specific definition in the course of these reasons.

Le présent pourvoi porte sur les répercussions en matière d'assurance d'allégations de contacts sexuels non consensuels. Pour faciliter l'analyse, j'emploie le terme «agression sexuelle» pour désigner de façon générale toute allégation de contact sexuel non consensuel, et non pour suggérer quelque implication juridique possible. Par contre, en ce qui concerne les «voies de fait de nature sexuelle», je les définirai plus précisément dans les présents motifs.

An insurance company's duty to defend is related to its duty to indemnify. A homeowner's insurance policy entitles the holder to have the insurer indemnify any liability falling within the policy's terms. Since the insurance company will be paying these costs, it has also developed the right — now a duty — to conduct the defence of such claims. However, the duty to defend is not so great that it is presumed to be independent of the duty to indemnify. Absent express language to the contrary, the duty to defend extends only to claims that could potentially trigger indemnity under the policy. Therefore if an insurance policy, like the one in this case, excludes liability arising from intentionally caused injuries, there will be no duty to defend intentional torts.

L'obligation de l'assureur de défendre l'assuré est liée à son obligation de l'indemniser. Une police d'assurance propriétaires occupants donne à l'assuré le droit d'être indemnisé par l'assureur relativement à toute responsabilité visée par la garantie. Comme il sera appelé à payer ces frais, l'assureur a obtenu le droit — qui constitue désormais une obligation — d'opposer une défense dans de tels cas. Cependant, l'obligation de défendre n'a pas une portée à ce point étendue qu'il y ait lieu de présumer qu'elle est indépendante de l'obligation d'indemniser. À défaut d'une stipulation contraire expresse, l'obligation de défendre n'existe que dans les cas de poursuites susceptibles d'entraîner l'indemnisation en vertu du contrat d'assurance. Par conséquent, lorsque la police d'assurance exclut, comme c'est le cas en l'espèce, la responsabilité découlant d'un préjudice infligé intentionnellement, l'assureur n'a aucune obligation de défendre les délits civils intentionnels. 49

Determining whether or not a given claim could trigger indemnity is a three-step process. First, a court should determine which of the plaintiff's legal allegations are properly pleaded. In doing so, courts are not bound by the legal labels chosen by the plaintiff. A plaintiff cannot change an intentional tort into a negligent one simply by choice of words, or vice versa. Therefore, when ascertaining the scope of the duty to defend, a court must look beyond the choice of labels, and examine the substance of the allegations contained in the pleadings. This does not involve deciding whether the claims have any merit; all a court must do is decide, based on the pleadings, the true nature of the claims.

Trois étapes doivent être franchies pour déterminer si une demande en justice est susceptible d'entraîner l'indemnisation. Premièrement, le tribunal doit établir lesquelles des allégations juridiques de la partie demanderesse sont adéquatement formulées. Pour ce faire, il n'est pas lié par la terminologie juridique qu'emploie cette dernière. Un délit intentionnel ne peut devenir un délit de négligence, et vice versa, du seul fait des mots employés par la partie demanderesse. Pour confirmer l'étendue de l'obligation de défendre, le tribunal doit donc aller au-delà de la terminologie choisie et tenir compte de la substance des allégations contenues dans les actes de procédure. Il ne s'agit pas de se prononcer sur le bien-fondé des allégations, mais seulement d'en déterminer la nature véritable sur la base des actes de procédure. 50

At the second stage, having determined what claims are properly pleaded, the court should determine if any claims are entirely derivative in nature. The duty to defend will not be triggered simply because a claim can be cast in terms of both negligence and intentional tort. If the alleged negligence is based on the same harm as the inten-

Dans un deuxième temps, après avoir précisé quelles allégations sont adéquatement formulées, le tribunal doit vérifier si certaines d'entre elles sont entièrement de nature dérivée. Il ne saurait y avoir d'obligation de défendre simplement parce que l'allégation peut être formulée en fonction à la fois du délit de négligence et du délit intentionnel. Si la prétendue négligence découle des mêmes actes préjudiciables que le délit intentionnel, elle 51

tional tort, it will not allow the insured to avoid the exclusion clause for intentionally caused injuries.

52 Finally, at the third stage the court must decide whether any of the properly pleaded, non-derivative claims could potentially trigger the insurer's duty to defend. In this appeal, I conclude that the respondent has no duty to defend. The plaintiff has alleged three basic claims against the appellant: sexual battery, negligence, and breach of fiduciary duty.

53 To prove a claim for sexual battery, the plaintiff will have to establish that the defendant intentionally inflicted a harmful or offensive touching on her. In the context of sexual battery, "harmful or offensive" is equivalent to non-consensual. This test is objective: to establish sexual battery, the plaintiff must demonstrate that a reasonable person would have known that the plaintiff did not validly consent to sexual relations. To put it another way, the plaintiff will have to prove that the defendant should have known that she did not validly consent. It is important to note that, absent any evidence from the defendant, a simple allegation of non-consensual sex will suffice to meet this initial burden. If the plaintiff succeeds, then the defendant must also be presumed to have intended to injure the plaintiff, given the inherently harmful nature of non-consensual sexual activity. The same facts that prove the sexual battery also necessarily prove an intent to injure, and therefore the exclusion clause should apply. If, on the other hand, the plaintiff cannot establish non-consent, then the plaintiff's action would have no chance of success, there would be no possibility of a claim for indemnity, and the duty to defend would not arise.

54 The claims for negligence and breach of fiduciary duty fail to trigger the duty to defend not because they could not fall within coverage, but because they are either not properly pleaded, or derivative of the claim for sexual battery. As a

ne permettra pas à l'assuré d'éviter l'application de la clause d'exclusion du préjudice intentionnel.

Enfin, à la troisième étape, le tribunal doit déterminer si les allégations non dérivées qui sont adéquatement formulées sont susceptibles d'entraîner l'obligation de défendre de l'assureur. Aux fins du présent pourvoi, je conclus que l'intimé n'a aucune obligation de défendre l'assuré. Les trois principales allégations de la demanderesse contre l'appelant sont les voies de fait de nature sexuelle, la négligence et le manquement à l'obligation fiduciaire.

Pour prouver les voies de fait de nature sexuelle, la demanderesse devra établir que le défendeur lui a intentionnellement infligé des contacts sexuels préjudiciables ou nocifs. Dans le contexte des voies de fait de nature sexuelle, «préjudiciable ou nocif» s'entend de non consensuel. Le critère est objectif: pour prouver les voies de fait de nature sexuelle, la demanderesse doit démontrer qu'une personne raisonnable aurait su qu'elle n'a pas donné un consentement valable aux rapports sexuels. Autrement dit, elle doit prouver que le défendeur aurait dû savoir qu'elle ne donnait pas un consentement valable. Il est important de souligner que, en l'absence de preuve présentée par le défendeur, la simple allégation qu'il y a eu des rapports sexuels non consensuels suffira pour satisfaire à ce fardeau de preuve initial. Si la demanderesse réussit à faire cette preuve, le défendeur doit également être présumé avoir voulu lui infliger un préjudice étant donné le caractère intrinsèquement préjudiciable de l'activité sexuelle non consensuelle. Les faits qui fondent l'allégation de voies de fait de nature sexuelle prouvent nécessairement par ailleurs l'intention d'infliger un préjudice, de sorte que la clause d'exclusion s'applique. Si, par contre, la demanderesse ne peut établir l'absence de consentement, elle sera déboutée, aucune demande d'indemnisation ne pourra être présentée et il n'y aura pas d'obligation de défendre.

Les allégations de négligence et de manquement à l'obligation fiduciaire ne font pas naître l'obligation de défendre, non pas parce qu'elles ne sont pas visées par la garantie, mais bien parce qu'elles ne sont pas adéquatement formulées ou qu'elles

result, they are also covered by the exclusion for injuries intentionally caused.

As there are no properly pleaded claims that, even if successful, could potentially trigger indemnity, the respondent has no duty to defend, and I would therefore dismiss the appeal.

II. Facts

The underlying action in this appeal is based on a series of alleged sexual assaults committed against a young girl ("the plaintiff"), who was born in 1974 and was an adolescent at the time of the incidents in question. The plaintiff worked part-time at a grocery store owned and operated by her parents, located near the terminus of two B.C. Transit bus routes. In 1996, the plaintiff brought a civil action against five B.C. Transit bus drivers, including the appellant, alleging various sexual assaults between 1988 and 1992. The liability insurance policy owned by one of the bus drivers, Vincent Scalera, is at issue in this appeal.

The plaintiff's statement of claim alleges that between 1986 and 1992, while on duty with B.C. Transit, the appellant regularly attended the store belonging to the plaintiff's parents, and became acquainted with the plaintiff. She, in turn, regularly rode on buses driven by the appellant. The statement of claim further alleges as follows:

103. On one occasion between approximately January and June of 1991 Scalera committed various sexual acts upon [the plaintiff], including:

(a) sexual kissing;

(b) sexual touching of her neck, back, breasts, and genitals; and

(c) fellatio

together (the "Scalera sexual acts").

sont dérivées de l'allégation de voies de fait de nature sexuelle. Par conséquent, elles tombent également sous le coup de la clause d'exclusion du préjudice infligé intentionnellement.

55 Comme il n'existe pas d'allégations adéquatement formulées qui, même si elles étaient retenues, pourraient entraîner l'indemnisation de l'appelant, l'intimé n'est pas tenu de le défendre. Je suis donc d'avis de rejeter le pourvoi.

II. Les faits

56 La poursuite qui sous-tend le présent pourvoi s'appuie sur une série d'agressions sexuelles dont aurait été victime une jeune fille («la demanderesse»), née en 1974, qui était une adolescente au moment des incidents en question. La demanderesse travaillait à temps partiel à l'épicerie de ses parents située près d'un arrêt d'autobus de B.C. Transit desservant deux circuits. En 1996, elle a intenté une action au civil contre cinq conducteurs d'autobus de B.C. Transit, dont l'appelant, par suite de différentes agressions sexuelles qui auraient été perpétrées entre 1988 et 1992. La police d'assurance de la responsabilité civile détenue par l'un de ces conducteurs d'autobus, Vincent Scalera, est au cœur du présent pourvoi.

57 Dans sa déclaration, la demanderesse allègue que, entre 1986 et 1992, pendant l'exercice de ses fonctions à titre d'employé de B.C. Transit, l'appelant allait régulièrement au magasin de ses parents, où il a fait sa connaissance. Pour sa part, elle prenait régulièrement place à bord des autobus conduits par l'appelant. La déclaration renferme en outre les allégations suivantes:

[TRADUCTION]

103. Une fois, entre janvier et juin 1991 approximativement, Scalera s'est livré à divers actes sexuels avec [la demanderesse], dont les suivants:

a) baiser à connotation sexuelle;

b) contact à connotation sexuelle du cou, du dos, de la poitrine et des parties génitales;

c) fellation

(collectivement, les «actes sexuels commis par Scalera»).

104. Scalera committed the Scalera sexual acts upon [the plaintiff] in various locations, including:

(a) on buses owned by B.C. Transit; and

(b) in his truck.

105. The Scalera sexual acts were committed upon [the plaintiff] by Scalera for a sexual purpose and/or without [the plaintiff]'s consent.

106. Scalera committed the Scalera sexual acts upon [the plaintiff] by coercion, manipulation, and abuse of power.

107. The Scalera sexual acts were sexual assaults and/or sexual exploitation and/or unlawful.

108. At all material times, Scalera was an adult and [the plaintiff] was an infant and/or a young person.

109. Scalera, by words or conduct, threatened that harm would come to [the plaintiff] if she disclosed the Scalera sexual acts to another person, intending to persuade [the plaintiff] to submit to the Scalera sexual acts.

110. Scalera, by words or conduct, knowingly, fraudulently, and deceitfully misrepresented the Scalera sexual acts committed by him upon [the plaintiff] as:

(a) the prerogative of an adult;

(b) consensual activity; and/or

(c) a healthy, normal expression of his affection for her

together (the "Scalera Representations").

111. Scalera made the Scalera Representations intending to persuade [the plaintiff] to submit to the Scalera sexual acts.

112. The Scalera Representations were untrue.

113. [The plaintiff] relied on the Scalera Representations concerning the nature of the Scalera sexual acts and thereby submitted to the Scalera sexual acts.

114. [The plaintiff] relied on the Scalera Representations concerning the nature of the Scalera sexual acts and thereby failed to report Scalera's conduct to other adults.

115. Scalera knew or ought to have known that the Scalera sexual acts were unlawful and/or the Scalera Representations were untrue.

104. Les actes sexuels commis par Scalera ont eu lieu à divers endroits, notamment:

a) à bord des autobus de B.C. Transit;

b) dans son camion.

105. Scalera a commis les agressions sexuelles dans un but sexuel et sans le consentement de [la demanderesse].

106. Pour se livrer aux actes sexuels qu'il a commis, Scalera a eu recours à la contrainte, à la manipulation et à l'abus de pouvoir.

107. Les actes sexuels commis par Scalera équivalaient à des agressions sexuelles ou à de l'exploitation sexuelle, ou étaient par ailleurs illicites.

108. À tous les moments en cause, Scalera était un adulte et [la demanderesse] une mineure ou une jeune personne.

109. Par ses paroles ou par sa conduite, Scalera a menacé de faire du mal à [la demanderesse] si elle dénonçait à un tiers les actes sexuels qu'il a commis et ce, afin de l'amener s'y soumettre.

110. Par ses paroles ou par sa conduite, Scalera a sciemment, frauduleusement et trompeusement laissé entendre à [la demanderesse] que les actes sexuels qu'il a commis étaient:

a) la prérogative d'un adulte,

b) une activité consensuelle ou

c) l'expression normale et saine de l'affection qu'il avait pour elle

(collectivement, les «affirmations faites par Scalera»).

111. Scalera a fait ses affirmations afin d'amener [la demanderesse] à se soumettre aux actes sexuels.

112. Les affirmations faites par Scalera étaient fausses.

113. [La demanderesse] s'est fiée aux affirmations faites par Scalera concernant la nature des actes sexuels et s'est donc soumise à sa volonté.

114. [La demanderesse] s'est fiée aux affirmations faites par Scalera concernant la nature des actes sexuels et a donc omis de dénoncer sa conduite à d'autres adultes.

115. Scalera savait ou aurait dû savoir que les actes sexuels qu'il a commis étaient illicites ou que ses affirmations étaient fausses.

116. Scalera knew or ought to have known that [the plaintiff] was an infant and/or a young person.

117. Scalera knew or ought to have known that [the plaintiff] did not consent to the Scalera sexual acts.

118. Scalera owed a duty of care to [the plaintiff], which duty of care arose from the relationship of authority and trust between himself as an adult and/or bus driver and [the plaintiff] as an infant and/or young person and/or bus passenger, and Scalera breached this duty of care.

119. Scalera owed a fiduciary duty to [the plaintiff], which fiduciary duty arose from the relationship of authority and trust between himself as an adult and/or bus driver and [the plaintiff] as an infant and/or young person and/or bus passenger, and Scalera breached this fiduciary duty.

120. Scalera committed the Scalera sexual acts willfully and without lawful justification.

121. The Scalera sexual acts were committed intentionally and/or with reckless disregard as to their effect on [the plaintiff].

122. By reason of Scalera's actions in committing the Scalera sexual acts [the plaintiff] has suffered nervous shock and sustained severe personal injuries, particulars of which are set out in paragraph 127 below.

. . .

128. As a result of the aforesaid sexual assaults, sexual exploitation, intentional infliction of nervous shock, misrepresentations, negligence, breaches of duty, and breaches of fiduciary duty committed by . . . Scalera, and/or B.C. Transit [the plaintiff] has suffered a loss of income and a loss of ability to earn income in the future.

129. As a result of the aforesaid sexual assaults, sexual exploitation, intentional infliction of nervous shock, misrepresentations, negligence, breaches of duty, and breaches of fiduciary duty committed by . . . Scalera, and/or B.C. Transit [the plaintiff] has and/or will continue to incur expenses, including obtaining proper psychiatric and psychological counselling and treatment which will be required on both an ongoing and crisis basis.

116. Scalera savait ou aurait dû savoir que [la demanderesse] était une mineure ou une jeune personne.

117. Scalera savait ou aurait dû savoir que [la demanderesse] ne consentait pas aux actes sexuels.

118. Scalera avait envers [la demanderesse] une obligation de diligence qui découlait du rapport d'autorité et de confiance existant entre lui, en tant qu'adulte ou conducteur d'autobus et [la demanderesse], en tant que mineure ou jeune personne, ou encore, à titre de passagère, et Scalera a manqué à cette obligation de diligence.

119. Scalera avait envers [la demanderesse] une obligation fiduciaire qui découlait du rapport d'autorité et de confiance existant entre lui, en tant qu'adulte ou conducteur d'autobus et [la demanderesse], en tant que mineure ou jeune personne, ou encore, à titre de passagère, et Scalera a manqué à cette obligation fiduciaire.

120. Scalera s'est livré délibérément et sans justification légitime aux actes sexuels qu'il a commis.

121. Scalera s'est livré de manière intentionnelle aux actes sexuels qu'il a commis ou avec insouciante quant à leurs effets sur [la demanderesse].

122. À cause de la conduite de Scalera pendant les actes sexuels qu'il a commis, [la demanderesse] a subi un choc nerveux et un grave préjudice personnel, dont le détail figure au paragraphe 127 ci-après.

. . .

128. En raison des agressions sexuelles, de l'exploitation sexuelle, de l'infliction délibérée d'un choc nerveux, des déclarations inexactes, de la négligence, des manquements aux obligations et des manquements à l'obligation fiduciaire, qui sont susmentionnés et imputables [. . .] à Scalera, ou à B.C. Transit, ou aux deux, [la demanderesse] a subi un manque à gagner et une perte de la capacité de toucher ultérieurement un revenu.

129. En raison des agressions sexuelles, de l'exploitation sexuelle, de l'infliction délibérée d'un choc nerveux, des déclarations inexactes, de la négligence, des manquements aux obligations et des manquements à l'obligation fiduciaire, qui sont susmentionnés et imputables à [. . .] Scalera, ou à B.C. Transit, ou aux deux, [la demanderesse] a engagé ou continuera d'engager des dépenses, notamment pour l'obtention des soins psychiatriques et psychologiques appropriés qui s'avéreront nécessaires de façon tant ponctuelle que permanente.

58 In response to a demand for particulars, counsel for the plaintiff stated that the coercion, manipulation, and abuse of power alleged in para. 106 of the statement of claim consisted of:

(a) pressure to engage in the sexual acts as a result of Scalera's position as an adult and [the plaintiff]'s position as an infant and/or young person;

(b) pressure to engage in the sexual acts in order to demonstrate affection to Scalera;

(c) pressure to engage in the sexual acts in order to secure and/or maintain Scalera's alleged affection and/or friendship;

(d) pressure to engage in the sexual acts in order to overcome personal loneliness and/or insecurity;

(e) pressure to engage in the sexual acts in order to demonstrate maturity.

En réponse à une demande de précisions, l'avocat de la demanderesse a indiqué que la contrainte, la manipulation et l'abus de pouvoir allégués au para. 106 de la déclaration consistaient en ce qui suit:

[TRADUCTION]

a) l'exercice de pressions pour que [la demanderesse] se soumette aux actes sexuels du fait que Scalera était un adulte et [la demanderesse] une mineure ou une jeune personne;

b) l'exercice de pressions pour que [la demanderesse] se soumette aux actes sexuels et témoigne ainsi son affection à Scalera;

c) l'exercice de pressions pour que [la demanderesse] se soumette aux actes sexuels et obtienne ou conserve ainsi la prétendue affection ou amitié de Scalera;

d) l'exercice de pressions pour que [la demanderesse] se soumette aux actes sexuels et surmonte ainsi sa solitude ou son insécurité personnelles;

e) l'exercice de pressions pour que [la demanderesse] se soumette aux actes sexuels et fasse ainsi la preuve de sa maturité.

59 The appellant owned a homeowner's insurance policy issued by the respondent. The relevant provisions of that policy are as follows:

SECTION TWO — PERSONAL LIABILITY INSURANCE

. . .

This insurance applies only to accidents or occurrences which take place during the period of insurance indicated on the Declarations.

. . .

We will pay all sums which you become legally liable to pay as compensatory damage because of bodily injury or property damage.

. . .

You are insured for claims made against you arising from:

L'appelant était titulaire d'une police d'assurance propriétaires occupants établie par l'intimé, dont voici les clauses pertinentes:

[TRADUCTION]

ARTICLE DEUX — ASSURANCE DE LA RESPONSABILITÉ CIVILE DES PARTICULIERS

. . .

La présente police d'assurance ne s'applique qu'aux accidents et aux sinistres qui surviennent pendant la période de validité indiquée dans les Conditions particulières.

. . .

L'assureur versera toute somme que l'assuré est légalement tenu de payer à titre de dommages-intérêts compensatoires par suite de l'infliction d'un préjudice corporel ou matériel.

. . .

L'assurance s'applique à toute demande visant l'assuré et portant sur ce qui suit:

1. Personal Liability — legal liability arising out of your personal actions anywhere in the world.

. . .

We will defend, by counsel of our choice, any suit against you alleging bodily injury or property damage and seeking compensatory damages, even if it is groundless, false or fraudulent. We reserve the right to investigate, negotiate and settle any claim or suit if we decide this is appropriate.

. . .

GENERAL EXCLUSIONS APPLICABLE TO THIS SECTION TWO

You are not insured for claims arising from:

. . .

(5) bodily injury or property damage caused by any intentional or criminal act or failure to act by:

(a) any person insured by this document . . .

1. Responsabilité civile des particuliers — La responsabilité légale découlant des actes de l'assuré n'importe où dans le monde.

. . .

Par l'entremise de l'avocat de son choix, l'assureur présentera une défense dans le cadre de toute poursuite intentée contre l'assuré pour la réparation d'un préjudice corporel ou matériel et l'obtention de dommages-intérêts compensatoires, même si elle est sans fondement, fallacieuse ou frauduleuse. L'assureur se réserve le droit de faire enquête, de négocier et de convenir d'un règlement s'il le juge opportun.

. . .

EXCLUSIONS GÉNÉRALES APPLICABLES AU PRÉSENT ARTICLE DEUX

L'assurance ne s'applique pas aux demandes découlant de ce qui suit:

. . .

(5) le préjudice corporel ou matériel infligé par l'action ou l'omission intentionnelles ou criminelles:

a) d'une personne assurée suivant le présent document . . .

The respondent sought a declaration that it not be required to defend the appellant against the plaintiff's claims. Humphries J. dismissed the respondent's petition, but the Court of Appeal allowed the appeal.

L'intimé a demandé un jugement déclaratoire selon lequel il n'est pas tenu de défendre l'appelant contre les allégations formulées par la demanderesse. Le juge Humphries a rejeté la requête mais l'intimé a eu gain de cause devant la Cour d'appel. 60

III. Judicial Decisions

III. Les décisions judiciaires

A. *British Columbia Supreme Court* (1997), 47 B.C.L.R. (3d) 187

A. *Cour suprême de la Colombie-Britannique* (1997), 47 B.C.L.R. (3d) 187

Humphries J. interpreted the insurance policy's exclusion such that only intentional acts, but not intentional injuries, trigger exclusion. However, she believed that the relevant act underlying the plaintiff's claim must be sexual assault, not merely sexual contact, for it to fall within the exclusion. Relying on *Co-operative Fire & Casualty Co. v. Saindon*, [1976] 1 S.C.R. 735, she found at para. 23 that "[i]f the allegations in the Statement of Claim include a possible claim in negligence against [the appellant], and if such a plea is a legitimate one made in good faith, [the respondent]

Le juge Humphries a conclu que seul l'accomplissement d'un acte intentionnel, et non l'infliction délibérée d'un préjudice, entraînait l'application de la clause d'exclusion prévue dans la police d'assurance. Elle a cependant exprimé l'avis que, pour que l'exclusion s'applique, l'acte sous-tendant la poursuite de la demanderesse devait être l'agression sexuelle, et non simplement un contact sexuel. Se fondant sur l'arrêt *Co-operative Fire & Casualty Co. c. Saindon*, [1976] 1 R.C.S. 735, elle a affirmé, au par. 23, que [TRADUCTION] «[s]i la déclaration renferme une allégation éventuelle de 61

cannot rely on the exclusion clause because injury or damage caused by a negligent act falls outside it". Since it was possible that the appellant had intended only sexual contact, but was simply negligent regarding sexual assault, there was a duty to defend.

B. *British Columbia Court of Appeal* (1998), 48 B.C.L.R. (3d) 143

(i) Hollinrake J.A., Proudfoot J.A. concurring

62 The appeals of the respondent and Wawanesa Mutual Insurance Co., respondent in the companion appeal, *Sansalone*, were consolidated at the Court of Appeal. Having accepted *Saindon* as the leading case on point, Hollinrake J.A. turned to the specific issues raised by the *Scalera* appeal. He concluded that the exclusion clause in question barred claims based on intentional acts. Since most tort claims allege negligence and not intent to injure, excluding intentional acts from coverage was "in keeping with coverage historically provided by policies insuring against liability imposed by law caused by accident" (para. 91). It was also consistent with the reasonable expectations of the parties.

63 Hollinrake J.A. found that the claim advanced sounded in intentional tort, and saw no reason to require the respondent to prove the intent to injure. The appellant's act was clearly intentional and was within the exclusion clause, so there was no possibility of coverage. Any claims based on the power-dependency relationship between the plaintiff and the appellant also fell within the exclusion, as it had in *Sansalone*. Finally, Hollinrake J.A. disagreed with Finch J.A. as to the meaning of the duty to defend clause. He concluded that, in order for there to be a duty to defend, there had to be at least a possibility of coverage. Since he had

négligence contre [l'appelant] et qu'il s'agit d'une allégation légitime et formulée de bonne foi, [l'intimé] ne peut invoquer la clause d'exclusion parce qu'elle ne s'applique pas au préjudice ou aux dommages causés par négligence». Étant donné qu'il était possible que l'appelant ait eu l'intention de n'avoir que des contacts sexuels, mais qu'il ait simplement fait preuve de négligence en ce qui concerne l'agression sexuelle, l'assureur avait l'obligation de défendre.

B. *Cour d'appel de la Colombie-Britannique* (1998), 48 B.C.L.R. (3d) 143

(i) Le juge Hollinrake (avec l'appui du juge Proudfoot)

Les appels interjetés par l'intimé et par Wawanesa Mutual Insurance Co., intimée dans le pourvoi connexe *Sansalone*, ont été réunis à la Cour d'appel. Ayant accepté l'arrêt *Saindon* comme l'arrêt de principe dans cette affaire, le juge Hollinrake a analysé les principales questions en litige en l'espèce. Il a affirmé que la clause d'exclusion en question rendait irrecevables les allégations fondées sur des actes intentionnels. Comme la plupart des poursuites en responsabilité civile délictuelle allèguent la négligence et non l'intention d'infliger un préjudice, l'exclusion des actes intentionnels de la garantie était [TRADUCTION] «conforme à la garantie fournie de tout temps par les polices d'assurance visant la responsabilité imposée par la loi à la suite d'un accident» (par. 91). Elle était également conforme aux attentes raisonnables des parties.

Selon le juge Hollinrake, la poursuite intentée participait du délit intentionnel et il ne voyait aucune raison d'exiger de l'intimé qu'il prouve l'intention d'infliger un préjudice. L'appelant a manifestement accompli un acte intentionnel, qui relevait de l'application de la clause d'exclusion, de sorte qu'il n'y avait aucune possibilité que la garantie s'applique. La clause d'exclusion s'appliquait également à toute demande fondée sur le rapport de force et de dépendance qui existait entre la demanderesse et l'appelant, tout comme dans l'affaire *Sansalone*. Enfin, le juge Hollinrake n'était pas d'accord avec le juge Finch quant à la signifi-

already determined that there was no possibility of coverage, he allowed the appeal.

(ii) Finch J.A., dissenting

Finch J.A. concluded that in spite of the exclusion clause's language referring only to intentional acts, it must be read to exclude liability only for injury or damage caused intentionally. To do otherwise would exclude the vast majority of all claims, since most accidents or occurrences can be traced back to an intentional act. Finch J.A. did not read the pleadings as alleging an intention on the part of the appellant to cause the plaintiff injury. He therefore concluded that the duty to defend should apply.

Moreover, Finch J.A. held that under the wording of the appellant's policy, the duty to defend was not linked to the duty to indemnify. As a result, the respondent was obliged to defend any claim for bodily injury causing compensable damages, regardless of whether that claim could also trigger indemnity.

IV. Issues

This appeal raises four issues.

1. Is the duty to defend in the appellant's insurance policy linked to the duty to indemnify?

2. Do the intentional act exclusion clauses in the appellant's insurance policy operate to relieve the respondent's duty in this case?

3. Was there an "accident" or "occurrence" that is sufficient to trigger coverage?

4. Does s. 28 of the British Columbia *Insurance Act*, R.S.B.C. 1996, c. 226, absolve the respondent of any duty to defend the appellant?

cation de la clause relative à l'obligation de défendre. À son avis, pour qu'il y ait obligation de défendre, il devait y avoir à tout le moins une possibilité d'application de la garantie. Comme il avait déterminé que cette possibilité n'existait pas, il a accueilli l'appel.

(ii) Le juge Finch, dissident

64 Le juge Finch a d'abord dit que, malgré son libellé qui ne fait mention que d'actes intentionnels, la clause d'exclusion devait être interprétée comme n'excluant que la responsabilité pour l'infliction délibérée d'un préjudice ou de dommages. Sinon, la très grande majorité des demandes d'indemnisation serait écartée puisque la plupart des accidents ou des sinistres découlent d'un acte intentionnel. Selon l'interprétation qu'en a faite le juge Finch, les actes de procédures n'alléguaient pas que l'appelant avait eu l'intention de d'infliger un préjudice à la demanderesse. Il a donc conclu que l'obligation de défendre s'appliquait.

65 Par ailleurs, le juge Finch a affirmé que, suivant le libellé de la police d'assurance de l'appelant, l'obligation de défendre n'était pas liée à l'obligation d'indemniser. Par conséquent, l'intimé devait assurer une défense relativement à toute allégation de préjudice corporel causant un préjudice compensable, indépendamment du fait que l'allégation puisse ou non entraîner également l'indemnisation.

IV. Questions en litige

66 Le présent pourvoi soulève quatre questions.

1. Suivant la police d'assurance détenue par l'appelant, l'obligation de défendre est-elle liée à l'obligation d'indemniser?

2. Les clauses d'exclusion stipulées dans la police d'assurance relativement à l'acte intentionnel s'appliquent-elles de façon à soustraire l'intimé à son obligation?

3. Y a-t-il eu «accident» ou «sinistre» de nature à déclencher l'application de la garantie?

4. L'article 28 de l'*Insurance Act* de la Colombie-Britannique, R.S.B.C., ch. 226, décharge-t-il l'intimé de son obligation d'assurer la défense de l'appelant?

Because of my disposition of the first two issues, I find it unnecessary to address the latter two in this appeal.

V. Analysis

A. *General Principles of Insurance Contract Interpretation*

67 To begin with, I should like to discuss briefly several principles that are relevant to the interpretation of the insurance policy in question. While these principles are merely interpretive aids that cannot decide any issues by themselves, they are nonetheless helpful when interpreting provisions of an insurance contract.

(i) The General Purpose of Insurance

68 It is important to keep in mind the underlying economic rationale for insurance. C. Brown and J. Menezes, *Insurance Law in Canada* (2nd ed. 1991), state this point well at pp. 125-26:

> Insurance is a mechanism for transferring fortuitous contingent risks. Losses that are neither fortuitous nor contingent cannot economically be transferred because the premium would have to be greater than the value of the subject matter in order to provide for marketing and adjusting costs and a profit for the insurer. It follows, therefore, that even where the literal working of a policy might appear to cover certain losses, it does not, in fact, do so if (1) the loss is from the inherent nature of the subject matter being insured, or (2) it results from the intentional actions of the insured.

69 In other words, insurance usually makes economic sense only where the losses covered are unforeseen or accidental: "The assumptions on which insurance is based are undermined if successful claims arise out of loss which is not fortuitous" (C. Brown, *Insurance Law in Canada* (3rd ed. 1997), at p. 4). This economic rationale takes on a public policy flavour where, as here, the acts for which the insured is seeking coverage are socially harmful. It may be undesirable to encourage people to injure others intentionally by indemnifying them from the civil consequences. On the other hand, denying coverage has the unde-

Vu ma décision concernant les deux premières questions en litige, j'estime qu'il n'est pas nécessaire d'examiner les deux autres dans le cadre du présent pourvoi.

V. Analyse

A. *Principes généraux d'interprétation des contrats d'assurance*

Tout d'abord, j'aimerais examiner brièvement certains principes applicables à l'interprétation de la police d'assurance en cause. Même si ces principes ne constituent que des outils d'interprétation et ne peuvent en soi trancher les questions en litige, ils sont néanmoins utiles pour interpréter les clauses d'un contrat d'assurance.

(i) L'objet général de l'assurance

Il importe de rappeler la raison d'être de l'assurance sur le plan financier. C. Brown et J. Menezes, dans *Insurance Law in Canada* (2e éd. 1991), le précisent bien aux pp. 125 et 126:

> [TRADUCTION] L'assurance est un mécanisme de transfert du risque fortuit éventuel. Les sinistres qui ne sont ni fortuits ni éventuels ne peuvent être financièrement transférés parce qu'il faudrait que la prime soit supérieure à la valeur de l'objet pour couvrir les frais de marketing et de règlement et permettre à l'assureur de réaliser un profit. Par conséquent, même lorsque, suivant le libellé de la police, la garantie semble s'appliquer à certains sinistres, ce n'est pas le cas dans les faits (1) si le sinistre est inhérent à la nature de l'objet de l'assurance ou (2) s'il résulte d'actes délibérés de l'assuré.

En d'autres termes, l'assurance n'est généralement justifiée sur le plan financier que lorsque les sinistres garantis sont imprévus ou fortuits: [TRADUCTION] «La raison d'être du contrat d'assurance est sapée s'il est fait droit à une demande d'indemnisation relativement à un sinistre qui n'est pas fortuit» (C. Brown, *Insurance Law in Canada* (3e éd. 1997), à la p. 4). À la raison d'être financière s'ajoute l'intérêt de la collectivité lorsque, comme en l'espèce, les actes pour lesquels l'assuré demande une indemnité sont préjudiciables à la société. Il n'est pas souhaitable d'encourager les gens à infliger intentionnellement un préjudice à

sirable effect of precluding recovery against a judgment-proof defendant, thus perhaps discouraging sexual assault victims from bringing claims. See B. Feldthusen, "The Civil Action for Sexual Battery: Therapeutic Jurisprudence?" (1993), 25 *Ottawa L. Rev.* 203, at p. 233.

(ii) *Contra Proferentem*

Since insurance contracts are essentially adhesionary, the standard practice is to construe ambiguities against the insurer: *Brissette Estate v. Westbury Life Insurance Co.*, [1992] 3 S.C.R. 87, at p. 92; *Wigle v. Allstate Insurance Co. of Canada* (1984), 49 O.R. (2d) 101 (C.A.), *per* Cory J.A. A corollary of this principle is that "coverage provisions should be construed broadly and exclusion clauses narrowly": *Reid Crowther & Partners Ltd. v. Simcoe & Erie General Insurance Co.*, [1993] 1 S.C.R. 252, at p. 269; *Indemnity Insurance Co. of North America v. Excel Cleaning Service*, [1954] S.C.R. 169, at pp. 179-80, *per* Estey J. Therefore one must always be alert to the unequal bargaining power at work in insurance contracts, and interpret such policies accordingly.

(iii) Reasonable Expectations

Where a contract is unambiguous, a court should give effect to the clear language, reading the contract as a whole: *Brissette Estate*, *supra*, at p. 92; *Parsons v. Standard Fire Insurance Co.* (1880), 5 S.C.R. 233. Where there is ambiguity, this Court has noted "the desirability . . . of giving effect to the reasonable expectations of the parties": *Reid Crowther*, *supra*, at p. 269 (citing Brown and Menezes, *supra*, at pp. 123-31, and *Brissette Estate*, *supra*). See also *Scott v. Wawanesa Mutual Insurance Co.*, [1989] 1 S.C.R. 1445, at p. 1467; *Wigle*, *supra*. Estey J. stated the point succinctly in *Consolidated-Bathurst Export Ltd. v. Mutual*

autrui en les indemnisant des conséquences civiles de leurs actes. Par contre, le refus de garantie a la conséquence non souhaitable d'empêcher l'obtention de dommages-intérêts d'un défendeur dès lors insolvable, ce qui pourrait dissuader les victimes d'agressions sexuelles d'intenter des poursuites. Voir B. Feldthusen, «The Civil Action for Sexual Battery: Therapeutic Jurisprudence?» (1993), 25 *R.D. Ottawa* 203, à la p. 233.

(ii) *Contra Proferentem*

70 Comme le contrat d'assurance est essentiellement un contrat d'adhésion, il est courant d'interpréter les ambiguïtés contre l'assureur: *Brissette, Succession c. Westbury Life Insurance Co.*, [1992] 3 R.C.S. 87, à la p. 92; *Wigle c. Allstate Insurance Co. of Canada* (1984), 49 O.R. (2d) 101 (C.A.), le juge Cory. Le corollaire de ce principe est que «les dispositions concernant la garantie doivent recevoir une interprétation large, et les clauses d'exclusion une interprétation restrictive»: *Reid Crowther & Partners Ltd. c. Simcoe & Erie General Insurance Co.*, [1993] 1 R.C.S. 252, à la p. 269; *Indemnity Insurance Co. of North America c. Excel Cleaning Service*, [1954] R.C.S. 169, aux pp. 179 et 180, le juge Estey. Il faut donc toujours être vigilant face au déséquilibre du rapport de force entre les parties à un contrat d'assurance et en interpréter les clauses en conséquence.

(iii) Attentes raisonnables

71 Quand un contrat n'est pas ambigu, le tribunal doit l'interpréter en le considérant dans son ensemble et en donnant effet au libellé non équivoque: *Brissette, Succession*, précité, à la p. 92; *Parsons c. Standard Fire Insurance Co.* (1880), 5 R.C.S. 233. En cas d'ambiguïté, notre Cour a signalé «qu'il est souhaitable [. . .] de donner effet aux attentes raisonnables des parties»: *Reid Crowther*, précité, à la p. 269 (citant Brown et Menezes, *op. cit.*, aux pp. 123 à 131, et *Brissette, Succession*, précité). Voir également *Scott c. Wawanesa Mutual Insurance Co.*, [1989] 1 R.C.S. 1445, à la p. 1467, et *Wigle*, précité. Le juge Estey a énoncé le principe succinctement dans l'arrêt *Exportations Consolidated Bathurst Ltée c. Mutual Boiler and*

Boiler and Machinery Insurance Co., [1980] 1 S.C.R. 888, at pp. 901-2:

> [L]iteral meaning should not be applied where to do so would bring about an unrealistic result or a result which would not be contemplated in the commercial atmosphere in which the insurance was contracted. Where words may bear two constructions, the more reasonable one, that which produces a fair result, must certainly be taken as the interpretation which would promote the intention of the parties. Similarly, an interpretation which defeats the intentions of the parties and their objective in entering into the commercial transaction in the first place should be discarded in favour of an interpretation of the policy which promotes a sensible commercial result. . . . Said another way, the courts should be loath to support a construction which would either enable the insurer to pocket the premium without risk or the insured to achieve a recovery which could neither be sensibly sought nor anticipated at the time of the contract.

This court recently re-stated the importance of commercial reality, in another context, in *Guarantee Co. of North America v. Gordon Capital Corp.*, [1999] 3 S.C.R. 423, at para. 62.

72 With these principles in mind, I now wish to discuss the principal issues in this appeal.

B. *The Scope of the Insurer's Duty to Defend*

(i) The Linkage Between the Duties to Indemnify and to Defend

73 The appellant's first argument is that the duty to defend is independent of the duty to indemnify. The relevant clause in the appellant's policy states: "We will defend, by counsel of our choice, any suit against you alleging bodily injury or property damage and seeking compensatory damages, even if it is groundless, false or fraudulent." The appellant argues, and Finch J.A. agreed in dissent at the Court of Appeal, that this requires not a potentially

Machinery Insurance Co., [1980] 1 R.C.S. 888, aux pp. 901 et 902:

> . . . on ne doit pas utiliser le sens littéral lorsque cela entraînerait un résultat irréaliste ou qui ne serait pas envisagé dans le climat commercial dans lequel l'assurance a été contractée. Lorsque des mots sont susceptibles de deux interprétations, la plus raisonnable, celle qui assure un résultat équitable, doit certainement être choisie comme l'interprétation qui traduit l'intention des parties. De même, une interprétation qui va à l'encontre des intentions des parties et du but pour lequel elles ont à l'origine conclu une opération commerciale doit être écartée en faveur d'une interprétation de la police qui favorise un résultat commercial raisonnable. [. . .] En d'autres mots, les cours devraient être réticentes à appuyer une interprétation qui permettrait soit à l'assureur de toucher une prime sans risque soit à l'assuré d'obtenir une indemnité que l'on n'a pas pu raisonnablement rechercher ni escompter au moment du contrat.

Notre Cour a récemment confirmé l'importance de la réalité commerciale, dans un autre contexte, dans l'arrêt *Guarantee Co. of North America c. Gordon Capital Corp.*, [1999] 3 R.C.S. 423, au par. 62.

Compte tenu de ces principes, j'analyse maintenant les principales questions en litige dans le présent pourvoi.

B. *L'étendue de l'obligation de défendre de l'assureur*

(i) Le lien entre l'obligation d'indemniser et l'obligation de défendre

Le premier argument invoqué par l'appelant est que l'obligation de défendre est indépendante de l'obligation d'indemniser. La clause pertinente de la police d'assurance dit ce qui suit: «Par l'entremise de l'avocat de son choix, l'assureur présentera une défense dans le cadre de toute poursuite intentée contre l'assuré pour la réparation d'un préjudice corporel ou matériel et l'obtention de dommages-intérêts compensatoires, même si elle est sans fondement, fallacieuse ou frauduleuse.» L'appelant fait valoir, à l'instar du juge Finch, dissident en Cour d'appel, que l'application de cette clause n'exige pas l'existence d'une allégation susceptible d'entraîner l'indemnisation de l'assuré,

indemnifiable claim, but only a claim alleging bodily injury and seeking compensatory damages.

With respect, I cannot agree. McLachlin J. addressed this question in *Nichols v. American Home Assurance Co.*, [1990] 1 S.C.R. 801. The policy in that appeal specifically limited the duty to defend to suits "seeking damages which are or may be payable under the terms of this Policy" (p. 805), and so there was obviously no independent duty to defend under that particular policy. However, McLachlin J. went on, at pp. 810-11, to set out general principles governing the duty to defend, regardless of whether there is express language or not:

Thus far, I have proceeded only by reference to the actual wording of the policy. However, general principles relating to the construction of insurance contracts support the conclusion that the duty to defend arises only where the pleadings raise claims which would be payable under the agreement to indemnify in the insurance contract. Courts have frequently stated that "[t]he pleadings govern the duty to defend": *Bacon v. McBride* (1984), 6 D.L.R. (4th) 96 (B.C.S.C.), at p. 99. Where it is clear from the pleadings that the suit falls outside of the coverage of the policy by reason of an exclusion clause, the duty to defend has been held not to arise: *Opron Maritimes Construction Ltd. v. Canadian Indemnity Co.* (1986), 19 C.C.L.I. 168 (N.B.C.A.), leave to appeal refused by this Court, [1987] 1 S.C.R. xi.

At the same time, it is not necessary to prove that the obligation to indemnify will in fact arise in order to trigger the duty to defend. The mere possibility that a claim within the policy may succeed suffices. In this sense, as noted earlier, the duty to defend is broader than the duty to indemnify.

. . .

Other Canadian authority overwhelmingly supports the view that normally the duty to defend arises only with respect to claims which, if proven, would fall

mais seulement celle d'une allégation de préjudice corporel doublée d'une demande de dommages-intérêts compensatoires.

74 En toute déférence, je ne puis être d'accord. Le juge McLachlin a abordé la question dans l'arrêt *Nichols c. American Home Assurance Co.*, [1990] 1 R.C.S. 801. Dans cette affaire, la police d'assurance prévoyait expressément que l'obligation de défendre ne s'appliquait qu'aux poursuites où le demandeur «réclame des dommages-intérêts qui sont ou peuvent être payables en vertu des conditions de la présente police» (p. 805), de sorte qu'il n'existait manifestement pas d'obligation indépendante de défendre l'assuré suivant ce contrat en particulier. Cependant, le juge McLachlin a énoncé, aux pp. 810 et 811, les principes généraux régissant l'obligation de défendre, indépendamment de l'existence ou de l'inexistence d'un libellé exprès:

Jusqu'ici, je m'en suis tenue à la formulation même de la police. Cependant, les principes généraux applicables à l'interprétation des contrats d'assurance étayent la conclusion que l'obligation de défendre n'existe que lorsque les actes de procédure portent sur des réclamations qui seraient payables en vertu de la clause d'indemnisation du contrat d'assurance. Les tribunaux ont souvent affirmé que [TRADUCTION] «[l]es actes de procédure régissent l'obligation de défendre»: *Bacon v. McBride* (1984), 6 D.L.R. (4th) 96 (C.S.C.-B.), à la p. 99. On a conclu que l'obligation de défendre n'existe pas lorsqu'il ressort clairement des actes de procédure que la poursuite ne relève pas de la portée de la police en raison d'une clause d'exclusion: *Opron Maritimes Construction Ltd. v. Canadian Indemnity Co*. (1986), 19 C.C.L.I. 168 (C.A.N.-B.), autorisation de pourvoi refusée par notre Cour, [1987] 1 R.C.S. xi.

En même temps, il n'est pas nécessaire d'établir qu'il y aura effectivement obligation d'indemniser pour déclencher l'obligation de défendre. La seule possibilité qu'une réclamation relevant de la police puisse être accueillie suffit. En ce sens, comme je l'ai déjà souligné, l'obligation de défendre a une portée plus large que l'obligation d'indemniser.

. . .

La très grande majorité des arrêts canadiens confirment l'opinion qu'en temps normal l'obligation de défendre n'intervient qu'à l'égard des réclamations qui,

within the scope of coverage provided by the policy. . . .

The same view generally prevails in the United States. . . .

75 McLachlin J. also provided two policy reasons in support of this conclusion, and in so doing refuted the contrary arguments made in the American case *Conner v. Transamerica Insurance Co.*, 496 P.2d 770 (Okla. 1972). First, the insurer would have to pay defence costs for claims outside the policy's scope. This raised "policy questions of whether others in the insurance pool should be taxed with providing defences for matters outside the purview of the policy": *Nichols*, *supra*, at pp. 811-12. Second, an independent duty to defend raises conflict of interest problems. If the insurer is defending claims for which it owes no duty to indemnify, there is a strong incentive simply to settle the claim as quickly as possible. At the very least, the insurer has an incentive to try to prove only that the insured is liable for claims falling outside coverage. There would be little incentive to establish that the insured was entirely without blame. McLachlin J. therefore concluded, at p. 812, that

considerations relat[ing] to insurance law and practice, as well as the authorities, overwhelmingly support the view that the duty to defend should, unless the contract of insurance indicates otherwise, be confined to the defence of claims which may be argued to fall under the policy. That said, the widest latitude should be given to the allegations in the pleadings in determining whether they raise a claim within the policy.

76 While this is *obiter dictum*, I find McLachlin J.'s arguments compelling. Absent specific language to the contrary, the duty to defend is broader than the duty to indemnify only in so far as it extends to groundless, false, or fraudulent claims. Given the historical evolution of the duty

si elles sont prouvées, relèveraient de la couverture de la police . . .

Le même point de vue l'emporte généralement aux États-Unis . . .

Le juge McLachlin a également invoqué deux considérations de principe à l'appui de sa conclusion et, ce faisant, elle a réfuté les arguments contraires avancés dans la décision américaine *Conner c. Transamerica Insurance Co.*, 496 P.2d 770 (Okla. 1972). Premièrement, l'assureur serait tenu d'assumer les frais judiciaires du défendeur relativement à une demande d'indemnisation qui échappe à l'application de la police. Cela soulevait «des questions de principe quant à savoir si d'autres assurés devraient se voir assujettis à défrayer des défenses contre des réclamations qui ne relèvent pas de la police»: *Nichols*, précité, à la p. 812. Deuxièmement, l'existence d'une obligation de défendre indépendante soulève l'éventualité de conflits d'intérêts. S'il devait défendre l'assuré relativement à une poursuite pour laquelle il n'a aucune obligation de l'indemniser, l'assureur serait très enclin à régler tout simplement l'affaire le plus rapidement possible. À tout le moins, l'assureur aurait intérêt à tenter de prouver seulement que l'assuré est responsable d'un préjudice qui échappe à l'application de la garantie. L'assureur n'aurait pas vraiment intérêt à prouver l'absence de toute responsabilité de l'assuré. Le juge McLachlin a donc conclu à la p. 812:

. . . que les considérations relatives au droit et à la pratique en matière d'assurance, ainsi que la doctrine et la jurisprudence, appuient en très grande majorité l'opinion que l'obligation de défendre ne devrait s'appliquer que lorsque l'on peut prétendre que les réclamations relèvent de la police, sous réserve de stipulations contraires dans le contrat d'assurance. Cela étant dit, il faut accorder la portée la plus large possible aux allégations contenues dans les actes de procédure pour déterminer si elles constituent une réclamation qui relève de la police.

Bien qu'il s'agisse d'une opinion incidente, je trouve les arguments du juge McLachlin convaincants. Sauf s'il existe une clause contraire expresse, l'obligation de défendre a une portée plus étendue que l'obligation d'indemniser dans la seule mesure où elle s'applique aux demandes sans

to defend as a way for insurers to protect their interests when they will be forced to pay any resulting judgment (see J. M. Fischer, "Broadening the Insurer's Duty to Defend: How *Gray v. Zurich Insurance Co.* Transformed Liability Insurance Into Litigation Insurance" (1991), 25 *U.C. Davis L. Rev.* 141, at pp. 146-57; E. S. Pryor, "The Tort Liability Regime and the Duty to Defend" (1999), 58 *Md. L. Rev.* 1), it makes little sense to presume an independent duty to defend absent express language: see B. Vail, "'My Mistake, Your Problem': The Duty to Defend Liability Claims in Canada" (1996), 6 *C.I.L.R.* 201, at p. 207, and Fischer, *supra*. To hold otherwise would convert indemnity insurance into litigation insurance. In my opinion, such an interpretation would violate the reasonable expectations of the parties absent express language to that effect.

fondement, fallacieuses ou frauduleuses. Étant donné que, avec le temps, l'obligation de défendre est devenue pour les assureurs une façon de protéger leurs intérêts dans l'éventualité où ils seraient contraints de payer toute somme accordée par jugement (voir J. M. Fischer, «Broadening the Insurer's Duty to Defend: How *Gray v. Zurich Insurance Co.* Transformed Liability Insurance Into Litigation Insurance» (1991), 25 *U.C. Davis L. Rev.* 141, aux pp. 146 à 157; E. S. Pryor, «The Tort Liability Regime and the Duty to Defend» (1999), 58 *Md. L. Rev.* 1), on ne saurait présumer, en l'absence d'une clause expresse, qu'une obligation de défendre indépendante existe: voir B. Vail, «'My Mistake, Your Problem': The Duty to Defend Liability Claims in Canada» (1996), 6 *C.I.L.R.* 201, à la p. 207, et Fischer, *loc. cit*. Conclure en sens contraire équivaudrait à faire d'une assurance à caractère indemnitaire une assurance de frais juridiques. À mon avis, pareille interprétation irait à l'encontre des attentes raisonnables des parties en l'absence d'une clause expresse en ce sens.

Although prior to *Nichols*, Canadian courts were split on the issue, since *Nichols* courts have followed the dictum from that case. See *Modern Livestock Ltd. v. Kansa General Insurance Co.* (1993), 11 Alta. L.R. (3d) 355 (Q.B.); *B.P. Canada Inc. v. Comco Service Station Construction & Maintenance Ltd.* (1990), 73 O.R. (2d) 317 (H.C.), and *Kates v. Hall*, [1990] 5 W.W.R. 569 (B.C.S.C.).

77 Même si, avant l'arrêt *Nichols*, les tribunaux canadiens étaient divisés à ce sujet, ils se sont depuis ralliés à l'opinion incidente de notre Cour dans cette affaire. Voir *Modern Livestock Ltd. c. Kansa General Insurance Co.* (1993), 11 Alta. L.R. (3d) 355 (B.R.); *B.P. Canada Inc. c. Comco Service Station Construction & Maintenance Ltd.* (1990), 73 O.R. (2d) 317 (H.C.), et *Kates c. Hall*, [1990] 5 W.W.R. 569 (C.S.C.-B.).

This conclusion is consistent with the majority of American courts, which have concluded that the "duty to defend arises when the underlying complaint alleges any facts that might fall within the coverage of the policy": *Colorado Farm Bureau Mutual Insurance Co. v. Snowbarger*, 934 P.2d 909 (Colo. Ct. App. 1997), at p. 912. See also, e.g., *Aerojet-General Corp. v. Transport Indemnity Co.*, 948 P.2d 909 (Cal. 1997), at p. 921; *Lawyers Title Insurance Corp. v. Knopf*, 674 A.2d 65 (Md. Ct. Spec. App. 1996), at p. 70; *Allstate Insurance Co. v. Patterson*, 904 F. Supp. 1270 (D. Utah 1995); *Allstate Insurance Co. v. Brown*, 834 F. Supp. 854

78 Cette conclusion est compatible avec l'avis majoritaire des tribunaux américains, savoir que [TRADUCTION] «l'obligation de défendre naît lorsque la plainte s'appuie sur des faits susceptibles d'emporter l'application de la garantie»: *Colorado Farm Bureau Mutual Insurance Co. c. Snowbarger*, 934 P.2d 909 (Colo. Ct. App. 1997), à la p. 912. Voir également, par exemple, *Aerojet-General Corp. c. Transport Indemnity Co.*, 948 P.2d 909 (Cal. 1997), à la p. 921; *Lawyers Title Insurance Corp. c. Knopf*, 674 A.2d 65 (Md. Ct. Spec. App. 1996), à la p. 70; *Allstate Insurance Co. c. Patterson*, 904 F. Supp. 1270 (D. Utah

(E.D. Pa. 1993). To the contrary, see *Gray v. Zurich Insurance Co.*, 419 P.2d 168 (Cal. 1966).

(ii) The Relevance of the Pleadings

79 The appellant notes that the plaintiff's statement of claim alleged the non-intentional torts of negligence and breach of fiduciary duty. He therefore argues that the respondent has a duty to defend because the exclusion clause does not apply to these claims. However, these bare assertions alone cannot be determinative. Otherwise, the parties to an insurance contract would always be at the mercy of the third-party pleader. What really matters is not the labels used by the plaintiff, but the true nature of the claim.

80 The general rule regarding the role of the pleadings is well stated by Wallace J. in *Bacon v. McBride* (1984), 6 D.L.R. (4th) 96 (B.C.S.C.), at p. 99:

> The pleadings govern the duty to defend — not the insurer's view of the validity or nature of the claim or by the possible outcome of the litigation. If the claim alleges a state of facts which, if proven, would fall within the coverage of the policy the insurer is obliged to defend the suit regardless of the truth or falsity of such allegations.

This principle was expanded upon by McLachlin J., for the Court in *Nichols*, *supra*, at pp. 810-11, in the following words cited in part above:

> Where it is clear from the pleadings that the suit falls outside of the coverage of the policy by reason of an exclusion clause, the duty to defend has been held not to arise: *Opron Maritimes Construction Ltd. v. Canadian Indemnity Co.* (1986), 19 C.C.L.I. 168 (N.B.C.A.), leave to appeal refused by this Court, [1987] 1 S.C.R. xi.

> At the same time, it is not necessary to prove that the obligation to indemnify will in fact arise in order to trigger the duty to defend. The mere possibility that a claim within the policy may succeed suffices. In this sense, as noted earlier, the duty to defend is broader than the duty

1995), et *Allstate Insurance Co. c. Brown*, 834 F. Supp. 854 (E.D. Pa. 1993). Pour un avis contraire, voir *Gray c. Zurich Insurance Co.*, 419 P.2d 168 (Cal. 1966).

(ii) La pertinence des actes de procédure

L'appelant fait remarquer que, dans sa déclaration, la demanderesse allègue les délits non intentionnels de négligence et de manquement à l'obligation fiduciaire. Il fait donc valoir que l'intimé a l'obligation de le défendre, car la clause d'exclusion ne s'applique pas à ces allégations. Cependant, ces simples assertions ne sauraient être déterminantes. Sinon, l'application du contrat d'assurance dépendrait toujours des allégations d'un tiers. Ce qui compte vraiment, ce n'est pas la terminologie employée par le demandeur, mais la nature véritable de la demande.

Dans *Bacon c. McBride* (1984), 6 D.L.R. (4th) 96 (C.S.C.-B.), le juge Wallace énonce bien, à la p. 99, la règle générale concernant le rôle des actes de procédure:

> [TRADUCTION] L'obligation de défendre dépend des actes de procédure, et non du point de vue de l'assureur quant à la validité ou à la nature de la demande ni de l'issue possible de l'instance. Lorsque la demande énonce des faits qui, s'ils étaient prouvés, seraient visés par la garantie prévue dans la police, l'assureur est tenu d'opposer une défense à la poursuite, que ces allégations soient véridiques ou non.

Dans l'extrait suivant de l'arrêt *Nichols*, précité, dont une partie est citée précédemment, le juge McLachlin développe ce principe au nom de notre Cour (aux pp. 810 et 811):

> On a conclu que l'obligation de défendre n'existe pas lorsqu'il ressort clairement des actes de procédure que la poursuite ne relève pas de la portée de la police en raison d'une clause d'exclusion: *Opron Maritimes Construction Ltd. v. Canadian Indemnity Co.* (1986), 19 C.C.L.I. 168 (C.A.N.-B.), autorisation de pourvoi refusée par notre Cour, [1987] 1 R.C.S. xi.

> En même temps, il n'est pas nécessaire d'établir qu'il y aura effectivement obligation d'indemniser pour déclencher l'obligation de défendre. La seule possibilité qu'une réclamation relevant de la police puisse être accueillie suffit. En ce sens, comme je l'ai déjà souligné,

to indemnify. O'Sullivan J.A. wrote in *Prudential Life Insurance Co. v. Manitoba Public Insurance Corp.* (1976), 67 D.L.R. (3d) 521 (Man. C.A.), at p. 524:

> Furthermore, the duty to indemnify against the costs of an action and to defend does not depend on the judgment obtained in the action. The existence of the duty to defend depends on the nature of the claim made, not on the judgment that results from the claim. The duty to defend is normally much broader than the duty to indemnify against a judgment. (Emphasis added.)

In that case it was unclear whether the insurer might be liable to indemnify under the policy, so the duty to defend was held to apply. In the court's view it would have been unjust for the insurers to be able to assert that "the claim is probably groundless, or will probably end up falling outside of the indemnity coverage. Since we have no proof that we owe an indemnity in this case, we take the position that we owe no duty to defend".

This does not, however, mean that the parties to an insurance contract are to be bound by the plaintiff's choice of labels, and thus defenceless against inaccurate or manipulative pleadings. *Nichols* only held that, having determined the nature of the claim, an insured need not further prove that the claim would succeed. This is just common sense, since otherwise an insured would have to prove he is actually liable in order to get an insurer to defend a liability claim.

In my view, the correct approach in the circumstances of this case is to ask if the allegations, properly construed, sound in intentional tort. If they do, the plaintiff's use of the word "negligence" will not be controlling. The Rhode Island Supreme Court, in *Peerless Insurance Co. v. Viegas*, 667 A.2d 785 (1995), cleverly expressed the point as follows at p. 789:

l'obligation de défendre a une portée plus large que l'obligation d'indemniser. Le juge O'Sullivan de la Cour d'appel a écrit dans l'arrêt *Prudential Life Insurance Co. v. Manitoba Public Insurance Corp.* (1976), 67 D.L.R. (3d) 521 (C.A. Man.), à la p. 524:

> [TRADUCTION] En outre, l'obligation d'indemniser à l'égard des frais d'une action et de défendre ne dépend pas du jugement rendu dans l'action. L'existence de l'obligation de défendre dépend de la nature de la réclamation, non du jugement qui en résulte. L'obligation de défendre a normalement une portée beaucoup plus large que l'obligation d'indemniser à l'égard d'un jugement. (Je souligne.)

Dans cette affaire, on ne savait pas si l'assureur pourrait être tenu d'indemniser en vertu de la police, alors le tribunal a conclu que l'obligation de défendre s'appliquait. De l'avis du tribunal, il aurait été injuste que les assureurs puissent affirmer que [TRADUCTION] «la réclamation est probablement non fondée, ou ne relèvera probablement pas de la portée de la police en fin de compte. Puisque nous n'avons aucune preuve que nous sommes tenus de verser une indemnité dans cette affaire, nous prétendons que nous ne sommes tenus à aucune obligation de défendre».

81 Cela ne veut toutefois pas dire que la terminologie choisie par la partie demanderesse lie les parties à un contrat d'assurance et rend ces dernières impuissantes face à des allégations inexactes ou manipulatrices. Dans l'arrêt *Nichols*, notre Cour a seulement statué que, après avoir déterminé la nature de la demande, l'assuré n'a pas à établir en outre que le demandeur aurait gain de cause. Il s'agit du simple bon sens car, autrement, l'assuré devrait prouver qu'il est de fait responsable pour obtenir de l'assureur qu'il oppose une défense à une action en responsabilité.

82 Vu les circonstances de l'espèce, je suis d'avis que la démarche appropriée consiste à se demander si les allégations, correctement interprétées, renvoient à un délit intentionnel. Si tel est le cas, la mention de la «négligence» par la demanderesse n'est pas déterminante. Dans l'affaire *Peerless Insurance Co. c. Viegas*, 667 A.2d 785 (1995), la Cour suprême du Rhode Island a habilement exposé le principe de la manière suivante, à la p. 789:

In civil actions for damages that result from an act of child sexual molestation, an insurer will be relieved from its duty to defend and to indemnify its insured if the perpetrator is insured under a policy in which there is contained an intentional act exclusion provision. . . . The fact that the allegations in that complaint are described in terms of "negligence" is of no consequence. A plaintiff, by describing his or her cat to be a dog, cannot simply by that descriptive designation cause the cat to bark.

[TRADUCTION] Dans le cadre de poursuites civiles en dommages-intérêts faisant suite à une atteinte à la pudeur contre un enfant, l'assureur n'est pas tenu de défendre et d'indemniser l'assuré lorsque l'auteur de l'infraction est titulaire d'une police d'assurance renfermant une clause d'exclusion de l'acte intentionnel. [. . .] Que les actes reprochés dans la plainte soient imputés à la «négligence» n'a pas d'importance. En appelant son chat un chien, le demandeur ne peut, simplement par cette désignation, faire aboyer le chat.

83 To be somewhat more prosaic, when determining the scope of the duty to defend, courts must take the factual allegations as pleaded, but then ask which of the plaintiff's legal claims could potentially be supported by those factual allegations. This is clear from *Bacon*, *supra*, at p. 99, where the court limited the duty to defend to cases where the "claim alleges a state of facts which, if proven, would fall within . . . coverage" (emphasis added). Similarly, in *Nichols*, *supra*, at p. 810, McLachlin J. cited with approval O'Sullivan J.A.'s direction to look at "the nature of the claim made".

De manière en quelque sorte plus prosaïque, les tribunaux appelés à déterminer l'étendue de l'obligation de défendre doivent tenir compte des allégations factuelles telles qu'elles sont formulées, puis se demander lesquelles des prétentions juridiques de la partie demanderesse ces allégations factuelles pourraient étayer. C'est ce qui ressort de *Bacon*, précité, à la p. 99, où le tribunal a statué que l'obligation de défendre ne s'appliquait que lorsque [TRADUCTION] «la demande énonce des faits qui, s'ils étaient prouvés, seraient visés par la garantie» (je souligne). De même, dans *Nichols*, précité, à la p. 810, le juge McLachlin cite, en l'approuvant, la directive du juge O'Sullivan de tenir compte de «la nature de la réclamation».

84 I would note that this approach can assist the insured, and not just the insurer. For example, as the California Supreme Court noted in *Gray*, *supra*, at p. 176,

Je fais remarquer que cette démarche peut également être favorable à l'assuré, et non seulement à l'assureur. Par exemple, comme la Cour suprême de la Californie l'a indiqué dans *Gray*, précité, à la p. 176,

the complainant in the third party action drafts his complaint in the broadest terms; he may very well stretch the action which lies in only nonintentional conduct to the dramatic complaint that alleges intentional misconduct. In light of the likely overstatement of the complaint and of the plasticity of modern pleading, we should hardly designate the third party as the arbiter of the policy's coverage.

[TRADUCTION] le plaignant aux fins de l'action intentée par un tiers rédige sa plainte de la manière la plus générale qui soit; il peut fort bien transformer une action fondée uniquement sur des actes non intentionnels en une plainte radicale alléguant l'action fautive intentionnelle. Vu le risque d'exagération et la malléabilité des actes de procédure de nos jours, nous pourrions difficilement désigner le tiers comme arbitre de la garantie prévue dans le contrat d'assurance.

Conversely, a plaintiff may draft a statement of claim in a way that seeks to turn intention into negligence in order to gain access to an insurer's deep pockets. See E. S. Pryor, "The Stories We Tell: Intentional Harm and the Quest for Insurance Funding" (1997), 75 *Tex. L. Rev.* 1721, at p. 1735. A court must therefore look beyond the labels used by the plaintiff, and determine the true nature of

À l'inverse, un demandeur peut rédiger sa déclaration de manière à tenter de transformer l'intention en négligence afin de bénéficier d'une indemnisation plus substantielle de la part de l'assureur. Voir E. S. Pryor, «The Stories We Tell: Intentional Harm and the Quest for Insurance Funding» (1997), 75 *Tex. L. Rev.* 1721, à la p. 1735. Le tribunal doit donc aller au-delà de la terminologie

the claim pleaded. It is important to emphasize that at this stage a court must not attempt to determine the merit of any of the plaintiff's claims. Instead, it should simply determine whether, assuming the verity of all of the plaintiff's factual allegations, the pleadings could possibly support the plaintiff's legal allegations.

Having construed the pleadings, there may be properly pleaded allegations of both intentional and non-intentional tort. When faced with this situation, a court construing an insurer's duty to defend must decide whether the harm allegedly inflicted by the negligent conduct is derivative of that caused by the intentional conduct. In this context, a claim for negligence will not be derivative if the underlying elements of the negligence and of the intentional tort are sufficiently disparate to render the two claims unrelated. If both the negligence and intentional tort claims arise from the same actions and cause the same harm, the negligence claim is derivative, and it will be subsumed into the intentional tort for the purposes of the exclusion clause analysis. If, on the other hand, neither claim is derivative, the claim of negligence will survive and the duty to defend will apply. Parenthetically, I note that the foregoing should not preclude a duty to defend simply because the plaintiff has pleaded in the alternative. As Pryor, "The Stories We Tell: Intentional Harm and the Quest for Insurance Funding", *supra*, points out at p. 1752, "[p]laintiffs must have the freedom to plead in the alternative, to develop alternative theories, and even to submit alternative theories to the jury". A claim should only be treated as "derivative", for the purposes of this analysis, if it is an ostensibly separate claim which nonetheless is clearly inseparable from a claim of intentional tort.

The reasons for this conclusion are twofold. First, as discussed above, one must always remember that insurance is presumed to cover only negligence, not intentional injuries. Second, this

employée par le demandeur et déterminer la nature véritable des allégations. Il importe de souligner que, à cette étape, le tribunal ne doit pas tenter d'établir le bien-fondé des allégations du demandeur. Il doit plutôt simplement décider, en tenant pour acquis que toutes les allégations factuelles du demandeur sont véridiques, si les actes de procédures sont susceptibles d'étayer ses allégations.

85 L'interprétation des actes de procédure peut faire ressortir des allégations adéquatement formulées de délit intentionnel et de délit non intentionnel. En pareille situation, le tribunal appelé à interpréter l'obligation de défendre de l'assureur doit décider si le préjudice qui aurait été infligé par le comportement négligent est dérivé de celui causé par le comportement intentionnel. Dans ce contexte, une allégation de négligence n'est pas tenue pour dérivée si les éléments sous-jacents de la négligence et du délit intentionnel sont suffisamment distincts pour en faire deux allégations n'ayant aucun point en commun. Si les deux allégations découlent des mêmes actes et causent le même préjudice, la négligence est tenue pour dérivée et elle est subsumée sous le délit intentionnel aux fins de l'application de la clause d'exclusion. Si, par contre, aucun des délits allégués n'est dérivé, l'allégation de négligence subsiste et l'obligation de défendre s'applique. Incidemment, ce n'est pas parce que l'allégation est formulée à titre subsidiaire que l'obligation de défendre disparaît. Comme le dit Pryor, «The Stories We Tell: Intentional Harm and the Quest for Insurance Funding», *loc. cit.*, à la p. 1752, [TRADUCTION] «[l]es demandeurs doivent être libres de formuler des allégations subsidiaires, d'élaborer des thèses subsidiaires et même de présenter des thèses subsidiaires au jury». Une allégation ne devrait être considérée comme «dérivée», aux fins de la présente analyse, que s'il s'agit manifestement d'une allégation distincte, mais qui est néanmoins nettement inséparable d'une allégation de délit intentionnel.

86 Deux raisons justifient cette conclusion. Premièrement, comme je l'indique précédemment, il faut toujours se rappeler que l'assurance est présumée ne garantir que le préjudice résultant de la négli-

approach will discourage manipulative pleadings by making it fruitless for plaintiffs to try to convert intentional torts into negligence, or vice versa. While courts should not concern themselves with whether or not pleadings are designed to generate insurance coverage, following the guidelines set out above will provide insurers with sufficient protections against manipulative pleadings.

gence, et non celui qui est infligé intentionnellement. Deuxièmement, cette démarche fera obstacle aux actes de procédures manipulateurs en rendant vaine la tentative du demandeur de transformer un délit intentionnel en délit de négligence, ou vice-versa. Même si les tribunaux ne devraient pas se préoccuper de savoir si les actes de procédure visent à entraîner l'application de la garantie d'une police d'assurance, en suivant les lignes directrices énoncées ci-dessus, ils fourniront aux assureurs une protection suffisante contre les actes de procédure manipulateurs.

87 These concepts may seem rather complicated in the abstract, but they are more straightforward to apply in practice. While this issue is relatively new to Canadian law, it has been extensively canvassed in the United States, where courts have denied insurance coverage for claims of negligent battery, negligent misrepresentation, negligent infliction of emotional distress, negligent interference with familial relations, and any other claim of "negligence" where it is derivative of an intentional sexual assault. For example, in *Houg v. State Farm Fire and Casualty Co.*, 481 N.W.2d 393 (Minn. Ct. App. 1992), a parishioner sued a priest who had been counselling her for sexual assault. In addition to intentional sexual battery, the plaintiff alleged negligent counselling by the defendant.

Ces notions peuvent paraître compliquées dans l'abstrait, mais elles sont plus simples à appliquer en pratique. Bien qu'il s'agisse d'une question relativement nouvelle en droit canadien, elle a fait l'objet d'un examen approfondi aux États-Unis, où les tribunaux ont exclu l'application de la garantie d'assurance à l'égard des poursuites pour voies de fait, déclarations inexactes, trouble émotionnel, atteinte aux relations familiales et toute autre allégation de «négligence» lorsqu'elles étaient dérivées d'une agression sexuelle intentionnelle. Par exemple, dans *Houg c. State Farm Fire and Casualty Co.*, 481 N.W.2d 393 (Minn. Ct. App. 1992), une paroissienne avait poursuivi pour agression sexuelle un prêtre auprès de qui elle suivait des séances de counseling. Outre les voies de fait de nature sexuelle intentionnelles, la demanderesse avait allégué la négligence du défendeur en tant que conseiller.

88 The court had little difficulty in finding that this allegation of negligence did not raise the duty to defend, because "[a]ny negligent counseling is so intertwined with [the insured]'s sexual exploitation of a psychologically dependent person as to be inseparable" (*Houg*, *supra*, at p. 397). To use the approach I have set out above, the negligent counselling claim was merely derivative of the sexual assault. The fact that there may have been negligent aspects of the priest's conduct will not change the essentially intentional nature of his conduct, for the purpose of the exclusion clause. To similar effect are: *Linebaugh v. Berdish*, 376 N.W.2d 400 (Mich. Ct. App. 1985) (denying a claim for "negligent" child molestation, which was "a transparent

Le tribunal a eu peu de mal à conclure que cette allégation de négligence ne faisait pas naître l'obligation de défendre, car [TRADUCTION] «[l]a négligence dans la prestation du counseling est si imbriquée dans l'exploitation sexuelle par [l'assuré] d'une personne psychologiquement dépendante qu'elle en est inséparable» (*Houg*, précité, à la p. 397). Pour reprendre l'analyse exposée précédemment, l'allégation de négligence relative au counseling était simplement dérivée de l'agression sexuelle. Que certains aspects de la conduite du prêtre puissent être qualifiés de négligence ne modifie pas la nature essentiellement intentionnelle de ses actes aux fins de l'application de la clause d'exclusion. Dans le même ordre d'idée,

attempt to trigger insurance coverage by characterizing allegations of tortious conduct under the guise of 'negligent' activity" (p. 406)); *Horace Mann Insurance Co. v. Leeber*, 376 S.E.2d 581 (W. Va. 1988) (alleged negligent seduction of a child by a teacher (p. 587)); *Allstate Insurance Co. v. Troelstrup*, 789 P.2d 415 (Colo. 1990) (same (p. 418, n. 7)); *Nationwide Mutual Fire Insurance Co. v. Lajoie*, 661 A.2d 85 (Vt. 1995) (agreeing with the trial judge that "labeling [the insured]'s conduct as negligent 'is simply a disingenuous attempt to create a factual dispute'" (p. 86)); *Colorado Farm Bureau Mutual Insurance Co. v. Snowbarger*, *supra* ("[T]he only facts recited in the complaint concern the repeated acts of sexual assault. There are no factual allegations provided in the complaint to substantiate a negligence theory" (p. 912)).

voir *Linebaugh c. Berdish*, 376 N.W.2d 400 (Mich. Ct. App. 1985) (rejet d'une poursuite pour atteinte à la pudeur commise contre un enfant par «négligence» parce qu'il s'agissait [TRADUCTION] «d'une tentative manifeste d'obtenir l'application de la garantie d'assurance en imputant à la "négligence" un comportement délictueux» (p. 406)); *Horace Mann Insurance Co. c. Leeber*, 376 S.E.2d 581 (W. Va. 1988) (allégation de séduction d'un enfant par un enseignant ayant fait preuve de négligence (p. 587)); *Allstate Insurance Co. c. Troelstrup*, 789 P.2d 415 (Colo. 1990) (idem (p. 418, n. 7)); *Nationwide Mutual Fire Insurance Co. c. Lajoie*, 661 A.2d 85 (Vt. 1995) (le tribunal convient avec le juge de première instance que [TRADUCTION] «l'imputation des actes de [l'assuré] à la négligence "vise simplement à susciter un désaccord d'ordre factuel"» (p. 86)); *Colorado Farm Bureau Mutual Insurance Co. c. Snowbarger*, précité, ([TRADUCTION] («[L]es seuls faits énoncés dans la plainte touchent les actes répétés d'agression sexuelle. Aucune allégation factuelle dans la plainte n'étaye la thèse de la négligence» (p. 912)).

I wish to make it clear that I am not denying that a given state of facts may give rise to several different tort claims. For example, in *M. (K.) v. M. (H.)*, [1992] 3 S.C.R. 6, the Court noted at p. 59 that "[i]ncest is a breach of both common law and equitable duties". The Court therefore held that limitation periods applying to intentional or negligent actions did not apply to claims for breach of fiduciary duty. While I fully agree with this proposition, I would note that the present appeal presents a distinct question. In the context of an insurance contract's intentional injury exclusion clause, the goal is to determine the gravamen of the complaint, and whether one can infer an intent to injure from that complaint. Limitations issues, as shown by *M. (K.)*, are different, and not applicable in the present appeal. Indeed, this appeal's holding with respect to the proper characterization of a plaintiff's tort allegations should not be taken

89

Je tiens à préciser qu'un même ensemble de faits peut néanmoins donner lieu à plusieurs allégations de délit. Par exemple, dans *M. (K.) c. M. (H.)*, [1992] 3 R.C.S. 6, notre Cour a indiqué à la p. 59 que «[l]'inceste est un manquement à des obligations de common law et d'*equity*». Notre Cour a donc décidé que la prescription applicable aux actions fondées sur un délit intentionnel ou sur la négligence ne s'appliquait pas aux actions fondées sur le manquement à l'obligation fiduciaire. Bien que je partage tout à fait ce point de vue, je signale que le présent pourvoi porte sur une question différente. Dans le contexte d'un contrat d'assurance qui renferme une clause d'exclusion du préjudice infligé intentionnellement, l'objectif est de déterminer quel est l'élément primordial de la plainte et si on peut déduire de celle-ci l'intention d'infliger un préjudice. Comme il ressort de l'arrêt *M. (K.)*, les questions liées à la prescription sont différentes et ne sont pas pertinentes dans le cadre du présent pourvoi. En fait, la décision de notre Cour en l'espèce concernant la qualification appropriée des allégations d'une poursuite pour délit civil ne devrait pas s'appliquer à d'autres domaines du

to affect any areas of law outside the insurance context presented by this appeal.

(iii) Conclusion on the Scope of the Insurer's Duty to Defend

90 I therefore conclude that the respondent will only have to defend the appellant if the plaintiff's statement of claim alleges a state of facts that, properly construed, would support an action that could potentially fall within coverage.

C. *Is There a Claim that Could Fall Within Coverage?*

91 There is no dispute in this case that the plaintiff's allegations fall within the general coverage provisions of the policy. All that is at stake is whether the exclusion clause applies. That clause states that the appellant is "not insured for claims arising from: . . . bodily injury or property damage caused by any intentional or criminal act or failure to act" by the insured.

92 At the outset, the wording of this clause presents a threshold issue. The respondent argues that the clause requires only an intentional act, not an intent to injure. The majority below agreed with this interpretation. However, I agree with Finch J.A.'s dissent on this point. If the respondent were correct, almost any act of negligence could be excluded under this clause. After all, most every act of negligence can be traced back to an "intentional . . . act or failure to act". As this Court made clear in *Canadian Indemnity Co. v. Walkem Machinery & Equipment Ltd.*, [1976] 1 S.C.R. 309, "negligence is by far the most frequent source of exceptional liability which [an insured] has to contend with. Therefore, a policy which would not cover liability due to negligence could not properly be called 'comprehensive'" (pp. 316-17). Consistent with this decision, the purpose of insurance, and the doctrines of reasonable expectations and *contra proferentem* referred to above, I believe the exclusion clause must be read to require that the injuries be intentionally caused, in that they are the

droit que celui de l'assurance présenté dans le contexte de la présente affaire.

(iii) Conclusion concernant l'étendue de l'obligation de défendre de l'assureur

J'arrive donc à la conclusion que l'intimé ne sera tenu de défendre l'appelant que si, dans sa déclaration, la demanderesse énonce des faits qui, s'ils sont interprétés correctement, appuient une action susceptible d'entraîner l'application de la garantie.

C. *Existe-t-il une allégation susceptible d'entraîner l'application de la garantie?*

Il ne fait aucun doute en l'espèce que les allégations de la demanderesse ressortissent à la garantie générale de la police d'assurance. La seule question à trancher est de savoir si la clause d'exclusion s'applique. Cette clause prévoit que «[l]'assurance ne s'applique pas aux demandes découlant de ce qui suit: [. . .] le préjudice corporel ou matériel infligé par l'action ou l'omission intentionnelles ou criminelles» de l'assuré.

D'emblée, le libellé de cette clause soulève une question préliminaire. L'intimé fait valoir que l'application de la clause exige uniquement un acte intentionnel, et non l'intention d'infliger un préjudice. La juridiction inférieure à la majorité a abondé en ce sens. Cependant, je partage l'avis du juge Finch, dissident sur ce point. Si on donnait raison à l'intimé, presque tout acte de négligence pourrait être exclu par l'application de cette clause. Après tout, un acte de négligence découle presque toujours d'une «action ou [d'une] omission intentionnelles». Comme notre Cour l'a dit clairement dans *Canadian Indemnity Co. c. Walkem Machinery & Equipment Ltd.*, [1976] 1 R.C.S. 309, «la négligence est de loin la source la plus fréquente de responsabilité exceptionnelle à laquelle [un assuré] doit faire face. Par conséquent, une police qui ne couvrirait pas la responsabilité résultant de la négligence ne pourrait pas à juste titre s'appeler "générale"» (pp. 316 et 317). Conformément à cette décision, à l'objet de l'assurance, ainsi qu'au principe des attentes raison-

product of an intentional tort and not of negligence.

Our task, therefore, is to decide which of the plaintiff's legal allegations are properly pleaded, whether any of them are derivative, and whether any of the surviving claims evince an intention to injure, thus triggering the exclusion clause. To do this, it is necessary to understand precisely what the elements of the various torts alleged against the appellant are. If the elements of a tort claim require proof of conduct that also proves an intent to injure, there will be no duty to defend because any potentially successful claim would fall under the exclusion clause.

As will be seen from the following discussion, I conclude that each of the plaintiff's properly pleaded claims necessarily involves an intent to injure, because each requires proof that the appellant either knew, or should have known, that the plaintiff did not validly consent to sexual activity. Given this actual or constructive knowledge of non-consent, the law will not permit the appellant to claim that he did not intend any harm. The exclusion therefore applies because there is no claim against the appellant that, if successful, could potentially fall within coverage. There being no potentially indemnifiable claim, the respondent has no duty to defend.

(i) Sexual Battery

(a) *Elements of the Tort of Sexual Battery*

The tort of sexual battery is a relatively new one. As Professor Feldthusen points out in "The Canadian Experiment with the Civil Action for

nables et à la règle *contra proferentem* susmentionnés, j'estime que la clause d'exclusion doit être interprétée de façon que son application exige que le préjudice ait été infligé intentionnellement, c'est-à-dire qu'il ait été le fruit d'un délit intentionnel, et non d'une négligence.

93 Notre Cour est donc appelée à déterminer lesquelles des prétentions juridiques de la demanderesse sont adéquatement formulées, si l'une ou l'autre d'entre elles est dérivée et si celles qui subsistent font ressortir l'intention d'infliger un préjudice déclenchant ainsi l'application de la clause d'exclusion. Pour ce faire, il lui est nécessaire de comprendre exactement quels sont les éléments constitutifs des divers délits reprochés à l'appelant. Lorsque les éléments constitutifs du délit allégué exigent la preuve d'un comportement qui établit également l'intention d'infliger un préjudice, l'assureur n'a aucune obligation de défendre l'assuré car, si l'auteur de la poursuite avait gain de cause, la clause d'exclusion s'appliquerait.

94 Comme le fait ressortir l'analyse qui suit, je suis d'avis que chacune des allégations adéquatement formulées par la demanderesse suppose nécessairement l'intention d'infliger un préjudice, parce qu'elle exige la preuve que l'appelant savait, ou aurait dû savoir, que la demanderesse n'a pas consenti à l'activité sexuelle de façon valable. Comme il savait ou était réputé savoir qu'il n'y avait pas eu consentement, l'appelant ne pourra prétendre, suivant le droit applicable, qu'il n'avait pas l'intention d'infliger un préjudice. La clause d'exclusion s'applique donc, car la demande contre l'appelant ne renferme aucune allégation qui, si elle était retenue, serait susceptible d'entraîner l'application de la garantie. En l'absence de toute allégation susceptible d'entraîner l'indemnisation de l'assuré, l'intimé n'a aucune obligation de le défendre.

(i) Voies de fait de nature sexuelle

a) *Éléments constitutifs du délit de voies de fait de nature sexuelle*

95 Le délit de voies de fait de nature sexuelle est relativement récent. Comme le professeur Feldthusen le signale dans «The Canadian Experi-

Sexual Battery", in N. J. Mullany, ed., *Torts in the Nineties* (1997), 274, at p. 274, this action is one that has appeared more frequently in the last 15 years. The sexual battery action signals the possibility of "dramatic changes to the law of consent, to the action for breach of fiduciary duty, to the rules governing punitive damages, to the rules of discovery and to the law of evidence" (p. 275). However, this appeal requires no such changes. Contrary to McLachlin J.'s assertions, my approach entails nothing more than understanding how traditional tort law applies in the context of sexual battery.

ment with the Civil Action for Sexual Battery», dans N. J. Mullany, dir., *Torts in the Nineties* (1997), 274, à la p. 274, ce genre d'action est plus fréquent depuis les 15 dernières années. L'existence de ce nouveau délit pourrait occasionner [TRADUCTION] «la modification radicale du droit en matière de consentement ainsi que des actions pour manquement à l'obligation fiduciaire, des règles régissant les dommages-intérêts punitifs et la communication préalable, de même que du droit de la preuve» (p. 275). Toutefois, le présent pourvoi n'exige pas une telle modification. Contrairement à ce qu'affirme le juge McLachlin, ma méthode ne comporte rien de plus qu'une analyse de la manière dont le droit de la responsabilité civile délictuelle traditionnel s'applique dans le contexte des voies de fait de nature sexuelle.

96 Sexual battery is a form of battery, the traditional test for which is relatively straightforward. In *M. (K.)*, *supra*, at p. 25, La Forest J. defined assault and battery as "causing another person to apprehend the infliction of immediate harmful or offensive force on her person coupled with the actual infliction of that harmful or offensive force". What is notably absent from this definition is any intent to injure. Professor Klar, in his second edition of *Tort Law* (1996), makes this point at p. 42:

> For the tort of intentional battery, the defendant must have intended an offensive, physical contact with the plaintiff. The defendant need not have intended to harm or injure the plaintiff, although in most battery cases there is an intention to injure.

Les voies de fait de nature sexuelle constituent une forme de voies de fait, et le critère traditionnellement applicable est relativement simple. Dans *M. (K.)*, précité, à la p. 25, le juge La Forest définit les voies de fait comme étant «le fait d'amener une autre personne à craindre l'emploi direct d'une force préjudiciable ou nocive contre sa personne, conjugué à l'emploi réel de cette force préjudiciable ou nocive». Manifestement, l'intention d'infliger un préjudice ne fait pas partie de cette définition. Dans la deuxième édition de son ouvrage intitulé *Tort Law* (1996), le professeur Klar précise, à la p. 42:

> [TRADUCTION] En ce qui concerne le délit de voies de fait intentionnelles, il faut que le défendeur ait voulu avoir un contact physique nocif avec le demandeur. Il n'est pas nécessaire qu'il ait voulu infliger un préjudice au demandeur, bien que dans la plupart des cas concernant des voies de fait, il y ait une telle intention.

97 A. M. Linden, in *Canadian Tort Law* (6th ed. 1997), emphasizes this point at p. 43: "A battery can be committed even though no harm or insult is intended by the contact. If the contact is offensive to the recipient, even if a compliment was intended, it is tortious." See also *Wilson v. Pringle*, [1986] 2 All E.R. 440 (C.A.), at p. 445; *Spivey v. Battaglia*, 258 So.2d 815 (Fla. 1972); O. M. Reynolds, "Tortious Battery: Is 'I Didn't

A. M. Linden insiste sur ce point dans son ouvrage intitulé *Canadian Tort Law* (6e éd. 1997), à la p. 43: [TRADUCTION] «Il peut y avoir acte de violence même si son auteur ne voulait aucunement blesser ou insulter quelqu'un. Si le contact est perçu comme offensant par celui qui en est l'objet, même s'il s'agissait d'un compliment dans l'esprit de l'auteur, il s'agit d'un délit.» Voir également *Wilson c. Pringle*, [1986] 2 All E.R. 440

Mean Any Harm' Relevant?" (1984), 37 *Okla. L. Rev.* 717.

Intentional battery generally requires only the intent to cause the physical consequences, namely, an offensive touching. Klar, *supra*, makes this point at p. 30:

> Technically, however, the concept of "intention" in the intentional torts does not require defendants to know that their acts will result in harm to the plaintiffs. Defendants must know only that their acts will result in certain consequences. It is not necessary for defendants to realize that these intended consequences are in fact an infringement of the legal rights of others. Intention, in other words, focusses on physical consequences.

To similar effect is Linden, *supra*, at p. 33: "Conduct is intentional if the actor desires to produce the consequences that follow from an act."

Moreover, if a tort is intended, it will not matter that the result was more harmful than the actor should, or even could have foreseen. Linden, *supra*, at p. 45, quotes Borins Co. Ct. J. (as he then was) in *Bettel v. Yim* (1978), 20 O.R. (2d) 617, at p. 628:

> If physical contact was intended, the fact that its magnitude exceeded all reasonable or intended expectations should make no difference. To hold otherwise . . . would unduly narrow recovery where one deliberately invades the bodily interests of another with the result that the totally innocent plaintiff would be deprived of full recovery for the totality of the injuries suffered as a result of the deliberate invasion of his bodily interests. [Emphasis added.]

The appellant's argument, in light of the foregoing, is quite simple. Battery requires only intentional contact, not an intent to harm. Therefore, he could have had non-consensual sex with the plaintiff, thus committing battery, while thinking consent was present and thus not intending any harm. Any injuries could therefore have been uninten-

(C.A.), à la p. 445; *Spivey c. Battaglia*, 258 So.2d 815 (Fla. 1972), et O. M. Reynolds, «Tortious Battery: Is "I Didn't Mean Any Harm" Relevant?» (1984), 37 *Okla. L. Rev.* 717.

98 Les voies de fait intentionnelles n'exigent généralement que l'intention de causer les conséquences physiques, savoir un contact nocif. Le professeur Klar, *op. cit.*, dit ce qui suit à la p. 30:

> [TRADUCTION] Cependant, en théorie, la notion d'«intention» en matière de délits intentionnels n'exige pas du défendeur qu'il soit conscient que ses actes infligeront un préjudice à la victime. Il doit seulement savoir que ses actes auront certaines conséquences. Il n'est pas nécessaire que le défendeur se rende compte que les conséquences voulues constituent en fait une violation des droits de l'autre. En d'autres termes, l'intention est axée sur les conséquences d'ordre physique.

Dans le même ordre d'idée, Linden, *op. cit.*, ajoute à la p. 33: [TRADUCTION] «Un acte est intentionnel si son auteur désire produire les conséquences qui en découlent.»

99 De plus, si le délit est intentionnel, il importe peu que les conséquences soient plus préjudiciables que celles que l'auteur du délit aurait dû ou même aurait pu prévoir. Linden, *op. cit.*, à la p. 45, cite le juge Borins, de la Cour de comté (maintenant juge de la Cour d'appel), dans *Bettel c. Yim* (1978), 20 O.R. (2d) 617, à la p. 628:

> [TRADUCTION] Si le contact physique était intentionnel, le fait que son importance ait dépassé les attentes raisonnables ou intentionnelles ne devrait pas faire de différence. Toute autre décision (. . .) limiterait sans raison l'indemnité à laquelle pourrait avoir droit une personne lorsque quelqu'un viole intentionnellement son intégrité physique; le résultat serait qu'un demandeur complètement innocent serait privé de recevoir tous les dommages-intérêts auxquels il pourrait avoir droit pour l'ensemble des préjudices subis à la suite de l'atteinte intentionnelle à son intégrité physique. [Je souligne.]

100 Vu ce qui précède, l'argumentation de l'appelant est fort simple. La preuve des voies de fait exige uniquement le contact intentionnel, et non l'intention d'infliger un préjudice. Il aurait donc pu avoir des rapports sexuels non consensuels avec la demanderesse et se livrer ainsi à des voies de fait, tout en croyant qu'il y avait consentement et en ne

tional, and the exclusion clause should not apply because a claim within coverage could succeed.

101 The problem with the appellant's argument is that it fails to recognize the subtleties of intentional tort, particularly as they apply to sexual battery. The law of intentional tort has traditionally focussed on a different set of problems from those presented in cases of sexual battery. In traditional battery, which is what the above-cited authorities were considering, what is usually at stake is whether the defendant can be liable for unintended physical consequences of his or her intentional actions, as in *Bettel*, *supra*. In these cases, the plaintiff's consent is not in question because of the nature of the conduct. Punching, shooting, stabbing, or otherwise attempting to injure another person is clearly offensive, and we would not expect someone to consent to it. See, e.g., *Long v. Gardner* (1983), 144 D.L.R. (3d) 73 (Ont. H.C.); *Veinot v. Veinot* (1977), 81 D.L.R. (3d) 549 (N.S.C.A.); *Rumsey v. The Queen* (1984), 12 D.L.R. (4th) 44 (F.C.T.D.); *Holt v. Verbruggen* (1981), 20 C.C.L.T. 29 (B.C.S.C.). As Borins Co. Ct. J. said in *Bettel*, *supra*, at p. 627, defendants in these cases have acted "with intent to violate the interests of others" (quoting J. J. Atrens, "International Interference with the Person", in *Studies in Canadian Tort Law* (1968), 378). Consent simply is not an issue, and intent to injure is obvious.

102 Moreover, even in those cases where intent to harm is less obvious, lack of consent usually is obvious. For example, Reynolds, *supra*, discusses various instances where courts have debated the need to show intent to harm. These cases typically involve childish pranks, see *Garratt v. Dailey*, 279 P.2d 1091 (Wash. 1955), *Vosburg v. Putney*, 50 N.W. 403 (Wis. 1891); unconsented medical treat-

voulant pas, par conséquent, infliger un préjudice. Tout préjudice infligé pouvait donc être involontaire, de sorte que la clause d'exclusion ne devrait pas s'appliquer, car une demande susceptible d'entraîner l'application de la garantie pourrait être accueillie.

L'argumentation de l'appelant comporte une faille en ce qu'elle ne tient pas compte des subtilités du délit intentionnel, en particulier en ce qui concerne les voies de fait de nature sexuelle. En droit, le délit intentionnel met traditionnellement l'accent sur des éléments différents de ceux qui touchent les voies de fait de nature sexuelle. La question qui se pose habituellement dans les affaires de voies de fait générales (ce sur quoi portaient les décisions susmentionnées) est de savoir, comme dans *Bettel*, précité, si le défendeur peut être tenu responsable des conséquences physiques involontaires de ses actes intentionnels. Le consentement du demandeur n'est alors pas en cause en raison de la nature du comportement. Les coups de poing, de feu et de couteau, et les autres tentatives de blesser autrui sont clairement nocifs et on ne saurait s'attendre à ce qu'une personne y consente. Voir, par exemple, *Long c. Gardner* (1983), 144 D.L.R. (3d) 73 (H.C. Ont.); *Veinot c. Veinot* (1977), 81 D.L.R. (3d) 549 (C.A.N.-É.); *Rumsey c. The Queen* (1984), 12 D.L.R. (4th) 44 (C.F. 1re inst.), et *Holt c. Verbruggen* (1981), 20 C.C.L.T. 29 (C.S.C.-B.). Comme l'a dit le juge Borins, dans *Bettel*, précité, à la p. 627, dans ces affaires, le défendeur a agi [TRADUCTION] «avec l'intention de porter atteinte aux droits d'autrui» (citant J. J. Atrens, «International Interference with the Person», dans *Studies in Canadian Tort Law* (1968), 378). La question du consentement ne se pose tout simplement pas, et l'intention d'infliger un préjudice est manifeste.

En outre, même dans les cas où l'intention d'infliger un préjudice est moins manifeste, l'absence de consentement l'est habituellement. Par exemple, Reynolds, *loc. cit.*, analyse les différentes affaires où les tribunaux se sont penchés sur la nécessité de démontrer l'intention d'infliger un préjudice. Ces affaires portaient sur des frasques d'enfants, voir *Garratt c. Dailey*, 279 P.2d 1091

ment, see *Reibl v. Hughes*, [1980] 2 S.C.R. 880; *Clayton v. New Dreamland Roller Skating Rink, Inc.*, 82 A.2d 458 (N.J. Super. Ct. App. Div. 1951); or unintended consequences, see *Bettel*, *supra*, *Kirkpatrick v. Crutchfield*, 100 S.E. 602 (N.C. 1919). In all of these situations, there is never any suggestion that the plaintiff consented to the battery; the focus instead is on whether the appellant intended any harm, and these cases have generally decided that no such intent is needed.

(Wash. 1955), et *Vosburg c. Putney*, 50 N.W. 403 (Wis. 1891); sur l'absence de consentement au traitement médical, voir *Reibl c. Hughes*, [1980] 2 R.C.S. 880, et *Clayton c. New Dreamland Roller Skating Rink, Inc.*, 82 A.2d 458 (N.J. Super. Ct. App. Div. 1951), ou sur les conséquences non voulues, voir *Bettel*, précité, et *Kirkpatrick c. Crutchfield*, 100 S.E. 602 (N.C. 1919). Dans aucune de ces affaires il n'a été avancé que le demandeur avait consenti aux voies de fait, l'accent ayant plutôt été mis sur la question de savoir si l'appelant avait voulu infliger un préjudice, et les tribunaux ont généralement statué qu'une telle intention n'était pas nécessaire.

What is necessary, therefore, is to decide what role consent plays in an action for sexual battery. It is clear that for traditional batteries, consent is conceived of as an affirmative defence that must be raised by the defendant. As Cartwright J. said in *Cook v. Lewis*, [1951] S.C.R. 830, at p. 839, "where a plaintiff is injured by force applied directly to him by the defendant his case is made by proving this fact and the onus falls upon the defendant to prove 'that such trespass was utterly without his fault'". Obviously, one way to make this showing, is by establishing that the plaintiff consented to the touching. Therefore in *Norberg v. Wynrib*, [1992] 2 S.C.R. 226, La Forest J. stated in *obiter dictum* that "[c]onsent, express or implied, is a defence to battery" (p. 246). See also *Reibl*, *supra*, at p. 890 (battery "casts upon the defendant the burden of proving consent to what was done"); *Hambley v. Shepley* (1967), 63 D.L.R. (2d) 94 (Ont. C.A.), at p. 95; Linden, *supra*, at p. 67; G. H. L. Fridman, *The Law of Torts in Canada* (1989), vol. 1, at p. 63. If consent is merely a defence to battery, then presumably the plaintiff could establish battery without showing lack of consent. To paraphrase Cartwright J. in *Cook*, the plaintiff's case would be made by showing the mere application of force by the defendant. As I understand it, this is the position taken by McLachlin J. However, I have trouble concluding on these terms that the appellant necessarily intended injury. Without a fault requirement of any kind, I cannot agree that the exclusion clause

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Ce qu'il faut déterminer, c'est donc le rôle que joue le consentement dans le cadre d'une poursuite pour voies de fait de nature sexuelle. Dans les affaires de voies de fait traditionnelles, le consentement est clairement considéré comme une défense affirmative, que doit invoquer le défendeur. Comme le juge Cartwright l'a dit dans *Cook c. Lewis*, [1951] R.C.S. 830, à la p. 839, [TRADUCTION] «lorsque le demandeur a subi un préjudice du fait que le défendeur a directement eu recours à la force contre lui, il établit le bien-fondé de sa demande en prouvant ce fait, et c'est au défendeur qu'il incombe de prouver "que l'atteinte n'est absolument pas de sa faute"». De toute évidence, cette preuve peut notamment être faite en démontrant que le demandeur a consenti aux contacts. Ainsi, dans l'arrêt *Norberg c. Wynrib*, [1992] 2 R.C.S. 226, le juge La Forest a dit, dans une opinion incidente, que le «consentement, exprès ou implicite, est opposable comme moyen de défense aux voies de fait» (p. 246). Voir également *Reibl*, précité, à la p. 890 (les voies de fait «impose[nt] au défendeur l'obligation de prouver qu'il y a eu consentement à ce qui a suivi»); *Hambley c. Shepley* (1967), 63 D.L.R. (2d) 94 (C.A. Ont.), à la p. 95; Linden, *op. cit.*, à la p. 67; G. H. L. Fridman, *The Law of Torts in Canada* (1989), vol. 1, à la p. 63. Si le consentement constitue simplement un moyen de défense à une accusation de voies de fait, on peut présumer que la demanderesse pourrait prouver celles-ci sans établir l'absence de consentement. Pour reprendre les propos du juge

would necessarily apply, and the respondent would therefore have a duty to defend.

104 This doctrine is of course consistent with our basic notions of intentional tort. A person's body is inviolable, and those who interfere with one's "intangible right to autonomy over one's own body" will be held liable: Klar, *supra*, at p. 41. However, not all intentional touchings are presumptively instances of battery. There are any number of contacts that are usually consensual. For example, in *Mandel v. The Permanent* (1985), 7 O.A.C. 365 (Div. Ct.), at p. 370, Henry J. noted that a man's placing his hand on the plaintiff's arm to guide her to the door was "merely a polite gesture and an accepted usage in daily life in a civilized society, whether or not she was in fact consenting to it". A more obvious example is certain sports, where physical contact is expected and even encouraged. What these examples show is that, in all cases, one must look to the context to understand the role of consent.

105 While, for reasons already given, consent is not a well-developed concept in battery cases, it is closely related to the more familiar requirement in tort law that a given contact be "harmful or offensive" if it is to generate liability: see *M. (K.)*, *supra*, at p. 25. Unlike more traditional batteries, sexual activity by itself is not inherently harmful. Without denying the seriousness and frequency of sexual assault, the simple fact is that sexual activity — unlike being punched, stabbed, or shot — is usually consensual. It generally becomes harmful only if it is non-consensual, in the wider meaning of that word. Without trying to catalogue the vari-

Cartwright dans *Cook*, précité, le bien-fondé de la demande serait établi en prouvant le simple recours à la force par le défendeur. Si je comprends bien, c'est la position adoptée par le juge McLachlin. J'ai toutefois de la difficulté à dire dans ce contexte que l'appelant a nécessairement voulu infliger un préjudice. En l'absence d'exigence de faute de quelque nature que ce soit, je ne peux pas convenir que la clause d'exclusion s'appliquerait nécessairement, et l'intimé aurait donc l'obligation de défendre.

Il va sans dire que ce principe est compatible avec nos notions fondamentales de délit intentionnel. La personne est inviolable, et celui qui porte atteinte à son intégrité physique, c'est-à-dire à son [TRADUCTION] «droit intangible à l'autonomie physique de sa personne», engage sa responsabilité: Klar, *op. cit.*, à la p. 41. Cependant, tous les contacts intentionnels ne sont pas présumés constituer des voies de fait. Il existe de nombreux contacts qui sont habituellement consensuels. Par exemple, dans l'affaire *Mandel c. The Permanent* (1985), 7 O.A.C. 365 (C. div.), à la p. 370, le juge Henry a signalé que l'homme qui met sa main sur le bras d'une femme pour la diriger vers la sortie [TRADUCTION] «accomplit simplement un acte de politesse qui est généralement accepté et courant dans une société civilisée, qu'elle y ait en fait consenti ou non». Un exemple encore plus patent est celui de certains sports où le contact physique est prévu, voire encouragé. Ces exemples montrent que, dans tous les cas, il faut se pencher sur le contexte pour comprendre le rôle du consentement.

Bien que, pour les motifs déjà donnés, la notion de consentement ne soit pas très développée en matière de voies de fait, elle est étroitement liée à l'exigence, mieux connue en droit de la responsabilité délictuelle, que le contact soit «préjudiciable ou noci[f]» pour qu'il y ait responsabilité: voir *M. (K.)*, précité, à la p. 25. Contrairement aux voies de fait plus traditionnelles, l'activité sexuelle n'est pas en soi préjudiciable. Sans nier la gravité et la fréquence des agressions sexuelles, il n'en demeure pas moins que l'activité sexuelle est — contrairement aux coups de poings, de couteau ou de feu — habituellement consensuelle. Elle

ous ways that consent may be vitiated, I note that *Norberg*, *supra*, established that simply because someone ostensibly consents to sexual activity does not mean that their consent is valid. See, generally, Feldthusen, "The Canadian Experiment with the Civil Action for Sexual Battery", *supra*, at pp. 282-86.

devient généralement préjudiciable dans le seul cas où elle est non consensuelle, au sens le plus étendu de ce terme. Sans tenter de classer par catégorie les différentes manières dont le consentement peut être vicié, je remarque que, dans *Norberg*, précité, notre Cour a statué que le consentement ostensible à l'activité sexuelle n'est pas nécessairement valable. Voir, de façon générale, Feldthusen, «The Canadian Experiment with the Civil Action for Sexual Battery», *loc. cit.*, aux pp. 282 à 286.

That the "harmful or offensive" standard is a familiar one in tort law is shown by *Wiffin v. Kincard* (1807), 2 Bos. & Pul. (N.R.) 471, 127 E.R. 713 (C.P.), and *Coward v. Baddeley* (1859), 4 H. & N. 478, 157 E.R. 927 (Ex.). In those cases, the courts determined that touching someone on the shoulder to get their attention is not a battery, even if the recipient objected to the contact. As Linden, *supra*, at p. 44, points out:

106 Il ressort des décisions *Wiffin c. Kincard* (1807), 2 Bos. & Pul. (N.R.) 471, 127 E.R. 713 (C.P.), et *Coward c. Baddeley* (1859), 4 H. & N. 478, 157 E.R. 927 (Ex.), que la norme du caractère «préjudiciable ou nocif» est bien connue en droit de la responsabilité délictuelle. Dans ces affaires, les tribunaux ont statué que toucher une personne à l'épaule pour attirer son attention ne constituait pas des voies de fait, même lorsque la personne touchée s'était opposée au contact. Comme le juge Linden, *op. cit.*, le signale à la p. 44:

> A line must be drawn between those contacts which are regarded as normal everyday events, which people must put up with in a crowded world, and those which are considered to be offensive and, therefore, unacceptable.

> [TRADUCTION] Il faut faire une distinction entre les contacts qui sont considérés comme des actes de la vie quotidienne et que les gens doivent tolérer dans nos villes encombrées, et les contacts qui sont considérés comme offensants et qui sont donc inacceptables.

Klar, *supra*, at pp. 43-44, elaborates on this point:

> The distinction between "hostile" and "friendly" contact seems to depend upon the standard of generally acceptable conduct in society. The test is objective: what would the reasonable person consider to be acceptable? Two recent English cases demonstrate this proposition. In the first, *Collins v. Wilcock*, [1984] 1 W.L.R. 1172 (Q.B.), the act of a police officer in taking hold of someone's arm to restrain her from walking off was deemed to constitute a battery. The test suggested by Goff L.J. was this: "whether the physical conduct so persisted in has in the circumstances gone beyond generally acceptable standards of conduct." *Ibid.*, at 1178. . . . In the second case, *Wilson v. Pringle*, [1986] 2 All E.R. 440 (C.A.), a schoolboy playfully pulled the schoolbag off the plaintiff's shoulder, causing him injury. In deciding whether this was a hostile touching and consequently a battery, Croom-Johnson L.J. . . . agreed that certain conduct must be judged as

Klar, *op. cit.*, développe ce point aux pp. 43 et 44:

> [TRADUCTION] La distinction entre le contact «malveillant» et le contact «amical» semble se fonder sur la norme du comportement généralement acceptable dans la société. Le critère est objectif: qu'est-ce qu'une personne raisonnable jugerait acceptable? Deux arrêts britanniques récents appuient ce point de vue. Dans le premier, *Collins c. Wilcock*, [1984] 1 W.L.R. 1172 (B.R.), le fait pour un policier de retenir une personne par le bras pour l'empêcher de quitter les lieux a été assimilé à des voies de fait. Le critère proposé par le lord juge Goff était le suivant: «il s'agit de savoir si le comportement physique a persisté de telle manière que, dans les circonstances, la norme du comportement généralement acceptable n'a pas été respectée.» *Ibid.*, à la p. 1178 [. . .] Dans le second, *Wilson c. Pringle*, [1986] 2 All E.R. 440 (C.A.), un écolier avait tiré en jouant le cartable que le demandeur portait à l'épaule et, ce faisant, l'avait blessé. Pour déterminer s'il s'agissait d'un contact malveillant et, par conséquent, de voies de fait, le lord juge Croom-Johnson [. . .] a convenu que cer-

"acceptable in the ordinary conduct of everyday life." [Emphasis added.]

tains comportements devaient être jugés «acceptables dans la vie ordinaire de tous les jours». [Je souligne.]

107 In England, courts have concluded that "[t]he absence of consent is so inherent in the notion of a tortious invasion of interests in the person that the absence of consent must be established by the plaintiff": *Street on Torts* (10th ed. 1999), at p. 32. This issue was decided by *Freeman v. Home Office*, [1983] 3 All E.R. 589 (Q.B.), aff'd [1984] 1 All E.R. 1036 (C.A.), where the court held that a prisoner suing for battery because of therapeutic drug injections had the burden of proving non-consent. While it is not necessary in this appeal to decide whether the burden of proving non-consent will always rest on the plaintiff, I believe that it should for sexual battery. To repeat, sexual contact is only "harmful or offensive" when it is non-consensual. To succeed in an action for intentional battery, one must prove both that (a) the defendant intended to do the action; and (b) the reasonable person would have perceived that action as being harmful or offensive. For sexual activity, an action is harmful or offensive if it is non-consensual. Therefore in sexual battery, the trier of fact must be satisfied that the defendant intended to engage in sexual activity which a reasonable person would have perceived to be non-consensual.

En Angleterre, les tribunaux ont conclu que [TRADUCTION] «[l]'absence de consentement est si inhérente à la notion d'atteinte délictuelle aux droits de la personne qu'elle doit être établie par le demandeur»: *Street on Torts* (10e éd. 1999), à la p. 32. Cette question a été tranchée dans *Freeman c. Home Office*, [1983] 3 All E.R. 589 (Q.B.), conf. par [1984] 1 All E.R. 1036 (C.A.), où le tribunal a jugé qu'il incombait au détenu intentant une poursuite pour voies de fait par suite de l'injection d'un médicament à des fins thérapeutiques de prouver l'absence de consentement. Même s'il n'est pas nécessaire, dans le cadre du présent pourvoi, de décider s'il incombe toujours au demandeur d'établir l'absence de consentement, je crois qu'il devrait avoir cette obligation dans le cas de voies de fait de nature sexuelle. Encore une fois, c'est l'absence de consentement qui rend le contact sexuel «préjudiciable ou nocif». Pour avoir gain de cause dans une poursuite pour voies de fait intentionnelles, il faut prouver à la fois a) que le défendeur avait l'intention de faire ce qu'il a fait et b) qu'une personne raisonnable aurait jugé l'action préjudiciable et nocive. Dans le cas d'une activité sexuelle, l'absence de consentement rend l'action préjudiciable et nocive. Par conséquent, en cas de voies de fait de nature sexuelle, le juge des faits doit être convaincu que le défendeur a eu l'intention de se livrer à des activités sexuelles qu'une personne raisonnable aurait jugées non consensuelles.

108 The New Zealand High Court came to the same conclusion in *H. v. R.*, [1996] 1 N.Z.L.R. 299, at p. 305:

> In sexual abuse cases, a conceptual difficulty with the tort has been as to whether an absence of consent is an element of the tort, or a defence. It seems to me that to the extent that it has always been necessary for the plaintiff to prove a hostile intent to ground this tort, the burden of demonstrating a lack of consent must be surmounted by the plaintiff, of course on the civil standard. I[f] that is so, lack of consent has always been, strictu sensu, an element of the offence.

La Haute Cour de la Nouvelle-Zélande est arrivée à la même conclusion dans *H. c. R.*, [1996] 1 N.Z.L.R. 299, à la p. 305:

> [TRADUCTION] Dans le cas d'abus sexuels, une difficulté d'ordre conceptuel a été soulevée quant à savoir si l'absence de consentement était un élément constitutif du délit ou si le consentement était un moyen de défense. À mon avis, dans la mesure où on a toujours exigé du demandeur qu'il prouve l'intention malveillante pour étayer le délit allégué, il doit incomber au demandeur d'établir l'absence de consentement, selon la norme applicable au civil, bien entendu. Ainsi, l'absence de consentement a toujours été considérée, au sens strict, comme un élément constitutif de l'infraction.

In short, the appellant's attempt to convert an intentional tort into negligence because of the possibility that he lacked a subjective intent to injure must fail. Consent, in so far as it is concerned with whether something is harmful or offensive, is an objective standard. If the plaintiff can prove that the appellant failed to meet this standard, the latter is liable for intentional sexual battery, not negligence.

En somme, il y a lieu de rejeter la tentative de l'appelant de transformer un délit intentionnel en délit de négligence en raison de la possibilité qu'il n'ait pas eu d'intention subjective de causer un préjudice. Lorsqu'il s'agit de déterminer si un acte est préjudiciable ou nocif, le consentement constitue une norme objective. Si la demanderesse peut prouver que l'appelant a omis de satisfaire à cette norme, ce dernier est responsable de voies de fait de nature sexuelle intentionnelles, et non de négligence.

In summary, I would advance the following basic propositions. For there to be a duty to defend, there must be the possibility of a duty to indemnify. In the context of the pleadings in this case raising in substance a sexual assault through a sexual battery, the issue of consent produces two possible results for the purposes of the duty to defend, both of which are unfavourable to the appellant. If the consent of the plaintiff was present, then no claim of sexual battery is made out since the conduct of the appellant would not be regarded objectively as being harmful or offensive, and therefore the duty to indemnify would not arise because the plaintiff's claim has no possibility of success. See *State Farm Fire and Casualty Co. v. Williams*, 355 N.W.2d 421 (Minn. 1984), at p. 424. On the other hand, if consent of the plaintiff is absent, the conduct of the appellant would be actionable as an intentional tort of sexual battery. As I will discuss, *infra*, in such a case an intent to harm is inferred, the exclusion clause would apply, and there would be no duty to indemnify. There being no state of affairs in which there could be a duty to indemnify, the duty to defend does not apply.

109 En résumé, je formulerais les propositions fondamentales suivantes. L'obligation de défendre dépend de l'obligation éventuelle d'indemniser. Vu le contexte de la présente espèce où la demanderesse allègue, en fait, une agression sexuelle qualifiée de voies de fait de nature sexuelle, la question du consentement débouche sur deux résultats possibles quant à l'obligation de défendre, et les deux sont défavorables à l'appelant. S'il y a eu consentement de la part de la demanderesse, les voies de fait de nature sexuelle ne peuvent être établies, car le comportement de l'appelant ne peut objectivement être considéré comme préjudiciable ou nocif, et il ne peut donc y avoir d'obligation d'indemniser, l'allégation de la demanderesse n'ayant aucune chance d'être retenue. Voir *State Farm Fire and Casualty Co. c. Williams*, 355 N.W.2d 421 (Minn. 1984), à la p. 424. Par contre, si la demanderesse n'a pas donné son consentement, le comportement de l'appelant fait naître une cause d'action pour le délit intentionnel de voies de fait de nature sexuelle. Comme je l'indique ci-après, dans un tel cas, l'intention d'infliger un préjudice est inférée, la clause d'exclusion s'applique et il n'y a aucune obligation d'indemniser l'assuré. Comme il n'existe aucun angle sous lequel les faits sont susceptibles de faire naître l'obligation d'indemniser l'assuré, il n'existe aucune obligation de le défendre.

I wish to emphasize that the foregoing should not be taken to endorse in any way the inappropriate stereotype that women are to be presumed willing partners to sexual activity. See *R. v. Mills*, [1999] 3 S.C.R. 668, at para. 90; *R. v. Osolin*, [1993] 4 S.C.R. 595, at p. 670; *R. v. Seaboyer*,

110 J'insiste sur le fait que les propos qui précèdent n'appuient en rien le stéréotype non fondé selon lequel une femme est présumée consentir à l'activité sexuelle. Voir *R. c. Mills*, [1999] 3 R.C.S. 668, au par. 90; *R. c. Osolin*, [1993] 4 R.C.S. 595, à la p. 670; *R. c. Seaboyer*, [1991] 2 R.C.S. 577, à la

[1991] 2 S.C.R. 577, at p. 604; Federal/Provincial/Territorial Working Group of Attorneys General Officials on Gender Equality in the Canadian Justice System, *Gender Equality in the Canadian Justice System: Summary Document and Proposals for Action* (1992). Nothing in these reasons should be read to the contrary. Putting the onus of proving lack of consent on the plaintiff simply recognizes that in the sexual assault context, "non-consensual" is equivalent to "harmful or offensive"; and the latter has always been an element of the plaintiff's case.

p. 604; Groupe de travail fédéral-provincial-territorial sur l'égalité des sexes dans le système de justice au Canada, *L'égalité des sexes dans le système de justice au Canada: Document récapitulatif et propositions de mesures à prendre* (1992). Les présents motifs ne doivent pas être interprétés en sens contraire. Exiger du demandeur qu'il prouve l'absence de consentement, c'est simplement reconnaître que, en matière d'agression sexuelle, «non consensuel» équivaut à «préjudiciable ou nocif», et cette dernière caractéristique a toujours été considérée comme un élément dont la preuve incombe au demandeur.

111 I would also emphasize that the plaintiff's burden in a civil action to prove non-consent is much less onerous than the one faced by the prosecution in a criminal case. As Major J. noted in *R. v. Ewanchuk*, [1999] 1 S.C.R. 330, at para. 42, the *mens rea* of criminal sexual assault requires the Crown to prove beyond a reasonable doubt that the accused was "knowing of, or being reckless of or wilfully blind to, a lack of consent on the part of the person touched". To prove the civil tort of sexual battery, by contrast, one need only prove by a balance of probabilities that the defendant knew or ought to have known that the plaintiff did not consent.

J'insiste par ailleurs sur le fait que, dans le cadre d'une action civile, l'obligation du demandeur de prouver l'absence de consentement est beaucoup moins contraignante que celle du poursuivant en matière pénale. Comme l'a signalé le juge Major dans *R. c. Ewanchuk*, [1999] 1 R.C.S. 330, au par. 42, la *mens rea* de l'agression sexuelle exige du ministère public qu'il prouve hors de tout doute raisonnable «la connaissance de [l']absence de consentement [de la personne visée] ou l'insouciance ou l'aveuglement volontaire à cet égard». À l'opposé, pour prouver le délit civil de voies de fait de nature sexuelle, il faut seulement établir, suivant la prépondérance des probabilités, que le défendeur savait ou aurait dû savoir qu'il n'y avait pas de consentement de la part du demandeur.

112 The onus of proving consent will be largely of theoretical importance. To meet her initial burden, the plaintiff need simply allege that the sexual activity was non-consensual. The issue will then be the same regardless of where the onus lies: on the balance of probabilities, should the defendant have known that the plaintiff did not validly consent? The only time the plaintiff's burden of pleading non-consent would be relevant is in those rare cases where, for whatever reason, the defence chooses to present no evidence. In such a case, having the onus on the plaintiff ensures that the defendant will only be liable if the plaintiff alleges, at a minimum, that the sexual activity was non-consensual. While the practical difference is thus minimal, I believe the theoretical one is important. Placing the onus of proving lack of consent on the

La charge de prouver le consentement revêt une importance hautement théorique. Pour s'acquitter de son fardeau de preuve initial, le demandeur n'a qu'à alléguer que l'activité sexuelle était non consensuelle. La question qui se pose alors est la même, que l'une ou l'autre des parties ait le fardeau de la preuve: suivant la prépondérance des probabilités, le défendeur aurait-il dû savoir que le consentement du demandeur n'était pas valable? Le seul cas où l'obligation du demandeur d'alléguer l'absence de consentement serait pertinente est celui où, chose rare, pour une raison ou une autre, la défense décide de ne présenter aucune preuve. Dans un tel cas, faire reposer le fardeau de la preuve sur le demandeur fait en sorte que le défendeur ne sera responsable que si le demandeur allègue, au moins, que l'activité sexuelle était non

plaintiff better reflects our traditional notions of tort law, as adapted to the relatively new tort of sexual battery.

consensuelle. Bien que, en pratique, la différence soit minime, j'estime que la distinction théorique est importante. Exiger du demandeur qu'il prouve l'absence de consentement reflète mieux les notions traditionnelles de droit de la responsabilité délictuelle adaptées au délit relativement récent des voies de fait de nature sexuelle.

Having concluded that in the context of sexual battery the "harmful or offensive" element is satisfied by showing lack of consent, I will now discuss whether the elements of a sexual battery claim necessarily prove an intent to injure on the part of the defendant. If a sexual battery claim requires proof of elements that also establish an intent to injure, then any successful claim would necessarily be excluded under the policy and there can be no duty to defend such a claim.

113 Après avoir conclu que, dans le contexte des voies de fait de nature sexuelle, le caractère «préjudiciable ou nocif» des actes est établi par la preuve de l'absence de consentement, j'analyserai maintenant la question de savoir si les éléments constitutifs de ce délit prouvent nécessairement l'intention du défendeur d'infliger un préjudice. Si la preuve d'éléments qui établissent par ailleurs l'intention d'infliger un préjudice est exigée, toute demande à laquelle il est fait droit serait nécessairement exclue suivant le libellé de la police, et l'assureur n'aurait aucune obligation d'y opposer une défense.

(b) *Are There Properly Pleaded Allegations of Sexual Battery that Could Trigger the Duty to Indemnify?*

b) *Existe-t-il des allégations adéquatement formulées de voies de fait de nature sexuelle susceptibles de faire naître l'obligation d'indemniser?*

As set out above, the first step is to determine whether there are properly pleaded allegations of sexual battery. In my opinion, this requirement is clearly satisfied. The plaintiff has alleged intentional sexual activity by the appellant, to which the plaintiff did not consent. Moreover, para. 117 of the statement of claim specifically alleges that "Scalera knew or ought to have known that [the plaintiff] did not consent to the Scalera sexual acts". The next question is whether sexual battery necessarily implies an intent to injure sufficient to trigger the exclusion clause.

114 Comme je l'indique précédemment, la première étape consiste à déterminer s'il existe des allégations adéquatement formulées de voies de fait de nature sexuelle. À mon avis, tel est manifestement le cas. La demanderesse a allégué l'activité sexuelle intentionnelle de l'appelant, à laquelle elle n'a pas consenti. De plus, au par. 117 de sa déclaration, elle affirme précisément que [TRADUCTION] «Scalera savait ou aurait dû savoir que [la demanderesse] ne consentait pas aux actes sexuels». La question qui se pose dès lors est de savoir si les voies de fait de nature sexuelle supposent nécessairement une intention d'infliger un préjudice suffisante pour que la clause d'exclusion s'applique.

This Court was presented with this issue, in a different context, in *Norberg*, *supra*. In that case the Court split three ways on the appropriate characterization of the actions of a doctor who convinced a drug-addicted patient to engage in sexual acts with him in return for pills to which she was addicted. This issue is not before the Court in this

115 Notre Cour a été appelée à trancher cette question, dans un contexte différent, dans l'arrêt *Norberg*, précité. Dans cette affaire, l'opinion des juges était partagée sur la façon de qualifier les actes d'un médecin qui avait convaincu une patiente pharmacodépendante d'avoir des rapports sexuels avec lui en échange du médicament faisant

appeal. However, I will assume all three approaches set out in that case — sexual battery, breach of duty, and breach of fiduciary duty — are possible.

l'objet de la dépendance. Notre Cour n'est pas appelée à trancher cette question en l'espèce. Cependant, je tiens pour acquis que les trois angles d'analyse adoptés dans cette affaire, savoir les voies de fait de nature sexuelle, le manquement à une obligation et le manquement à l'obligation fiduciaire, sont possibles.

116 Writing for himself, Gonthier and Cory JJ., La Forest J. concluded that Wynrib's conduct amounted to sexual assault. Drawing an analogy to contract law, La Forest J. concluded that consent may be vitiated where "there is an overwhelming imbalance in the power relationship between the parties" (p. 248). If there was no valid consent, Wynrib was liable for battery.

S'exprimant également au nom des juges Gonthier et Cory, le juge La Forest s'est dit d'avis que les actes de Wynrib équivalaient à une agression sexuelle. Par analogie avec le droit des contrats, il a affirmé que le consentement pouvait être vicié «lorsqu'il y a inégalité écrasante du rapport de force entre les parties» (p. 248). En l'absence d'un consentement valable, Wynrib pouvait être tenu responsable de voies de fait.

117 What La Forest J.'s reasons left undecided is whether or not Wynrib had any intent to harm, or indeed whether such intent is necessary for sexual battery. La Forest J. did not inquire into subjective intent to harm, but instead focused on the presence or absence of valid consent. This approach is consistent with the few reported lower court decisions addressing sexual assault. For example, in *M. (M.) v. K. (K.)* (1989), 61 D.L.R. (4th) 392 (B.C.C.A.), the court concluded that notwithstanding the fact that the victim initiated the sexual contact, there could be no valid consent between a 41-year-old man and his 15-year-old foster daughter. *Harder v. Brown* (1989), 50 C.C.L.T. 85 (B.C.S.C.), and *Lyth v. Dagg* (1988), 46 C.C.L.T. 25 (B.C.S.C.), similarly declined to consider intention to harm, instead finding that consent was vitiated by the extreme power imbalances in the relationships.

La question que les motifs du juge La Forest n'ont pas réglée est celle de savoir si Wynrib avait eu quelque intention d'infliger un préjudice ou, en fait, si cette intention était nécessaire pour qu'il y ait voies de fait de nature sexuelle. Le juge La Forest n'a pas examiné la question de l'intention subjective d'infliger un préjudice, mais a plutôt mis l'accent sur la présence ou l'absence d'un consentement valable. Cette démarche est compatible avec les quelques décisions publiées par les juridictions inférieures relativement à des affaires d'agression sexuelle. Par exemple, dans *M. (M.) c. K. (K.)* (1989), 61 D.L.R. (4th) 392 (C.A.C.-B.), la cour a décidé que, même si la victime avait été l'instigatrice des contacts sexuels, il ne pouvait y avoir de consentement valable entre un homme de 41 ans et sa fille nourricière de 15 ans. Dans *Harder c. Brown* (1989), 50 C.C.L.T. 85 (C.S.C.-B.), et *Lyth c. Dagg* (1988), 46 C.C.L.T. 25 (C.S.C.-B.), le tribunal a également refusé de prendre en considération l'intention d'infliger un préjudice, et a plutôt statué que le consentement n'était pas valable en raison du déséquilibre marqué du rapport de force entre les intéressés.

118 One conclusion that could be drawn from these cases is that sexual battery requires no intent to harm, only the absence of consent. If this is correct, the exclusion clause would not necessarily apply to a sexual battery claim, and the respondent would have a duty to defend. However, in my view

On peut tirer de ces décisions la conclusion que les voies de fait de nature sexuelle n'exigent pas que soit prouvée l'intention d'infliger un préjudice, mais seulement l'absence de consentement. Si cette conclusion est juste, la clause d'exclusion ne s'appliquerait pas nécessairement à la poursuite

this interpretation is not correct. Consent, linked as it is to the "harmful or offensive" standard, as already discussed, is an objective standard. Sexual battery requires an objective set of circumstances such that the defendant either knew or should have known that there was no valid consent.

relative à un tel délit, et l'intimé aurait l'obligation de défendre l'assuré. Cependant, cette interprétation n'est pas juste selon moi. Comme je l'indique précédemment, le consentement est lié au caractère «préjudiciable ou nocif» et il constitue donc une norme objective. Les voies de fait de nature sexuelle exigent un ensemble objectif de circonstances selon lesquelles le défendeur savait ou aurait dû savoir que le consentement n'était pas valable.

Leaving aside the physical injuries that can be inflicted by sexual assault, there can be no question that it occasions untold injury to the victim's dignity, physical integrity, and psychological well-being. The same facts that prove lack of consent will prove intent to injure; this follows because if a reasonable person should have known there was no consent, the law will not excuse that person's failure to perceive the lack of consent. On the other hand, a defendant will not be liable for sexual assault if there was no way for him or her to know that the victim did not, or could not, consent to sexual activity.

Mis à part le préjudice corporel qui peut être infligé à la victime d'une agression sexuelle, il ne fait aucun doute que l'infraction porte un préjudice indescriptible à la dignité, à l'intégrité physique et au bien-être psychologique de la victime. Les faits qui établissent l'absence de consentement prouvent également l'intention d'infliger un préjudice. Il en est ainsi parce que, si une personne raisonnable aurait dû conclure à l'absence de consentement, la loi n'excusera pas l'omission de cette personne de percevoir l'absence de consentement. Par contre, le défendeur ne sera pas tenu responsable d'une agression sexuelle s'il ne disposait d'aucun moyen de savoir que la victime ne consentait pas à l'activité sexuelle ou ne pouvait y consentir. 119

This Court has recognized the grave harm occasioned by sexual assault. For example, in *R. v. McCraw*, [1991] 3 S.C.R. 72, the Court held that threats of rape amounted to threats of serious bodily harm, within the meaning of s. 264.1(1)(*a*) of the *Criminal Code*. Cory J. aptly summarized the harm inherent in non-consensual sexual activity, at pp. 83-84:

Notre Cour a reconnu le grave préjudice découlant d'une agression sexuelle. Par exemple, dans *R. c. McCraw*, [1991] 3 R.C.S. 72, elle a jugé qu'une menace de viol équivalait à une menace de lésions corporelles graves au sens de l'al. 264.1(1)*a*) du *Code criminel*. Le juge Cory a fort bien résumé le préjudice inhérent à l'activité sexuelle non consensuelle, aux pp. 83 et 84: 120

> It seems to me that to argue that a woman who has been forced to have sexual intercourse has not necessarily suffered grave and serious violence is to ignore the perspective of women. For women rape under any circumstance must constitute a profound interference with their physical integrity. As well, by force or threat of force, it denies women the right to exercise freedom of choice as to their partner for sexual relations and the timing of those relations. These are choices of great importance that may have a substantial effect upon the life and health of every woman. Parliament's intention in replacing the rape laws with the sexual assault offences was to convey the message that rape is not just a sexual act but is basically an act of violence. See K.

> Il me semble que le fait de soutenir qu'une femme qui a été obligée d'avoir des rapports sexuels n'a pas nécessairement subi une violence grave ne tient pas compte du point de vue des femmes. Pour les femmes, le viol dans toutes les circonstances doit constituer une grave atteinte à leur intégrité physique. De même, par le recours à la force ou la menace de recours à la force, le viol enlève aux femmes le droit d'exercer la liberté de choisir leur partenaire sexuel et le moment de ces rapports. Il s'agit de choix d'une grande importance qui peuvent avoir un effet considérable sur la vie et la santé de chaque femme. L'intention du législateur lorsqu'il a remplacé les dispositions concernant le viol par les infractions en matière d'agression sexuelle était de

Mahoney, "*R. v. McCraw*: Rape Fantasies v. Fear of Sexual Assault" (1989), 21 *Ottawa L. Rev.* 207, at pp. 215-16.

transmettre le message que le viol n'est pas simplement un acte sexuel mais est fondamentalement un acte de violence. Voir K. Mahoney, «*R. v. McCraw*: Rape Fantasies v. Fear of Sexual Assault» (1989), 21 *R. de D. d'Ottawa* 207, aux pp. 215 et 216.

See also *Osolin*, *supra*, at p. 669; *Ewanchuk*, *supra*, at para. 69 (*per* L'Heureux-Dubé J.). While *McCraw* was concerned with forcible rape, I do not think the harm is any less real just because the victim has been coerced into sex by mental as opposed to physical means. It can hardly be disputed, I think, that any type of non-consensual sex clearly evinces an intent to harm the victim thereof.

Voir également *Osolin*, précité, à la p. 669, et *Ewanchuk*, précité, au par. 69 (le juge L'Heureux-Dubé). Bien que l'arrêt *McCraw* portait sur le viol avec usage de la force, je ne crois pas que le préjudice soit moins réel uniquement parce que la victime a été contrainte psychologiquement, et non physiquement, à des rapports sexuels. Je crois qu'on peut difficilement nier que l'intention d'infliger un préjudice sous-tend clairement tout genre d'activité sexuelle non consensuelle.

121 In the considerable jurisprudence on the point, most U.S. courts have reached the same conclusion. The majority of these cases have involved sexual assaults of children. Courts have had little difficulty in concluding that defendants in these cases are presumed to intend harm to their victims — notwithstanding the fact that "males who are involved in such activities do not expect or intend that the females will sustain any injury": *CNA Insurance Co. v. McGinnis*, 666 S.W.2d 689 (Ark. 1984), at p. 690. See also *B.B. v. Continental Insurance Co.*, 8 F.3d 1288 (8th Cir. 1993); *J.C. Penney Casualty Insurance Co. v. M.K.*, 804 P.2d 689 (Cal. 1991); *Horace Mann Insurance Co. v. Leeber*, *supra*; *State Farm Fire & Casualty Co. v. D.T.S.*, 867 S.W.2d 642 (Mo. Ct. App. 1993); *Amercian States Insurance Co. v. Borbor*, 826 F.2d 888 (9th Cir. 1987); *Troelstrup v. District Court*, 712 P.2d 1010 (Colo. 1986) (*en banc*); *Rodriguez v. Williams*, 729 P.2d 627 (Wash. 1986) (*en banc*); *Linebaugh v. Berdish*, *supra*; *Horace Mann Insurance Co. v. Independent School District No. 656*, 355 N.W.2d 413 (Minn. 1984). These cases are obviously much easier than the present appeal. It is difficult to imagine someone successfully arguing that they intended no harm from sex with someone too young to consent to sexual activity.

Il ressort de la jurisprudence abondante sur la question que la plupart des tribunaux américains sont arrivés à la même conclusion. La majorité de ces affaires traitaient d'agression sexuelle contre un enfant. Les tribunaux n'ont pas hésité à dire que les défendeurs dans ce genre d'affaires sont présumés avoir voulu infliger un préjudice à leurs victimes — malgré le fait que [TRADUCTION] «les hommes qui se livrent à de tels actes ne s'attendent pas à ce que les femmes subissent un préjudice ni ne veulent leur en infliger un»: *CNA Insurance Co. c. McGinnis*, 666 S.W.2d 689 (Ark. 1984), à la p. 690. Voir également *B.B. c. Continental Insurance Co.*, 8 F.3d 1288 (8th Cir. 1993); *J.C. Penney Casualty Insurance Co. c. M.K.*, 804 P.2d 689 (Cal. 1991); *Horace Mann Insurance Co. c. Leeber*, précité; *State Farm Fire & Casualty Co. c. D.T.S.*, 867 S.W.2d 642 (Mo. Ct. App. 1993); *American States Insurance Co. c. Borbor*, 826 F.2d 888 (9th Cir. 1987); *Troelstrup c. District Court*, 712 P.2d 1010 (Colo. 1986) (en formation plénière); *Rodriguez c. Williams*, 729 P.2d 627 (Wash. 1986) (en formation plénière); *Linebaugh c. Berdish*, précité; *Horace Mann Insurance Co. c. Independent School District No. 656*, 355 N.W.2d 413 (Minn. 1984). Il était manifestement plus facile de trancher dans ces affaires qu'en l'espèce. Il est difficile d'imaginer qu'on puisse faire droit à l'argument voulant qu'une personne n'ait pas voulu infliger un préjudice en ayant des rapports sexuels avec une personne trop jeune pour y consentir.

While there is more of a divergence of opinion when it comes to assaults on adults, some U.S. courts have also inferred an intent to harm in these cases. For example, in *State Farm Fire and Casualty Co. v. Williams*, *supra*, the court denied insurance coverage to someone who had sexually assaulted a man with cerebral palsy who was confined to a wheelchair. The court first examined cases involving assaults on minors, and concluded as follows, at p. 424:

Does the fact that Williams, the victim, was an adult distinguish this case? We think not. Neither the insured nor the insurer in entering into the insurance contract contemplated coverage against claims arising out of nonconsensual sexual assaults. On the other hand, if the sexual contacts were consensual, as asserted by respondent Keller, there would be no assault and hence no claim for recovery.

See also *Houg*, *supra*; *Altena v. United Fire and Casualty Co.*, 422 N.W.2d 485 (Iowa 1988); and D. S. Florig, "Insurance Coverage for Sexual Abuse or Molestation" (1995), 30 *Tort & Ins. L.J.* 699.

Finally, I would note that the Canadian case most directly on point has reached a similar conclusion. *Wilkieson-Valiente v. Wilkieson*, [1996] I.L.R. ¶1-3351 (Ont. Ct. (Gen. Div.)), involved an action by a young girl against her stepfather. The court disagreed with the defendant's assertion that "it is possible to commit a sexual assault without necessarily 'intending' injury" (p. 4132). Instead, the court concluded as follows at p. 4133:

It may be conceivable, in rare circumstances, to commit a sexual assault without an intent to cause any psychological harm, (such as in the case of a transitory touching of a sleeping or unconscious victim). However, bearing in mind that "intentionally" does not refer to "desired result" but "awareness of possible result" such cases will be rare indeed. Particularly, as here, where the pleadings claim repeated sexual assaults over a period of many years on a victim who is a child, it is inconceivable that any right-thinking person would not be fully

Bien qu'ils soient moins unanimes en ce qui concerne l'agression d'un adulte, certains tribunaux américains y voient également l'intention d'infliger un préjudice. Par exemple, dans *State Farm Fire and Casualty Co. c. Williams*, précité, le tribunal a statué qu'une personne ayant agressé sexuellement un homme atteint d'infirmité motrice cérébrale et confiné à un fauteuil roulant ne pouvait bénéficier de la garantie de l'assurance. Il a tout d'abord examiné des décisions relatives à l'agression de mineurs et a conclu, à la p. 424: 122

[TRADUCTION] Le fait que la victime, Williams, était un adulte établit-il une distinction en l'espèce? Nous ne le croyons pas. En passant le contrat d'assurance, ni l'assuré ni l'assureur n'ont envisagé que la garantie s'applique à une poursuite pour agression sexuelle non consensuelle. Par contre, si les contacts sexuels ont été consensuels comme le prétend l'intimé Keller, il n'y aurait pas eu d'agression et, partant, aucune demande d'indemnisation n'aurait été présentée.

Voir également *Houg*, précité; *Altena c. United Fire and Casualty Co.*, 422 N.W.2d 485 (Iowa 1988), et D. S. Florig, «Insurance Coverage for Sexual Abuse or Molestation» (1995), 30 *Tort & Ins. L.J.* 699.

Enfin, je signale que la décision canadienne portant le plus directement sur la question comporte une conclusion semblable. Dans l'affaire *Wilkieson-Valiente c. Wilkieson*, [1996] I.L.R. ¶1-3351 (C. Ont. (Div. gén.)), une action avait été intentée par une fillette contre son beau-père. Le tribunal s'est dit en désaccord avec la prétention du défendeur selon laquelle [TRADUCTION] «il est possible de commettre une agression sexuelle sans avoir nécessairement l'"intention" d'infliger un préjudice» (p. 4132). Le tribunal a plutôt conclu, à la p. 4133: 123

[TRADUCTION] On peut concevoir que, dans des circonstances très particulières, une agression sexuelle puisse être perpétrée sans que l'agresseur n'ait l'intention de causer un préjudice psychologique (comme dans le cas d'attouchements furtifs pendant que la victime dort ou est sans connaissance). Cependant, si on garde présent à l'esprit que l'«intention» ne renvoie pas au «résultat souhaité», mais à la «conscience d'un résultat possible», de telles circonstances sont effectivement très rares. En l'espèce tout particulièrement, où un enfant aurait été

aware of the possible, indeed probable consequences of such conduct; that is, psychological harm to the victim.

124 Unlike the Court in *Wilkieson-Valiente*, *supra*, I cannot accept that one can commit sexual assault without an intent to harm: see Linden, *supra*, at p. 45; *Restatement (Second) of Torts*, § 18 cmt. *d* (1965). Even if the victim is unconscious, the perpetrator has still violated another person's physical integrity. However, I agree that to prove sexual assault, a plaintiff must prove sufficient culpability on the part of the defendant that an intent to harm follows. Accordingly, the exclusion clause must apply, and the respondent has no duty to defend the plaintiff's claim of sexual battery.

victime d'agressions sexuelles répétées pendant plusieurs années, il est inconcevable qu'une personne douée de raison puisse ne pas être pleinement consciente des conséquences possibles, voire probables, d'un tel comportement, c'est-à-dire le préjudice psychologique infligé à la victime.

Contrairement au tribunal saisi de cette affaire, je ne puis admettre qu'une personne puisse se livrer à une agression sexuelle sans avoir l'intention d'infliger un préjudice: voir Linden, *op. cit.*, à la p. 45; *Restatement (Second) of Torts*, § 18 cmt. *d*. (1965). L'agression porte atteinte à l'intégrité physique de la victime même lorsque cette dernière est sans connaissance. Cependant, je concède que, pour prouver l'agression sexuelle, la demanderesse doit établir que le défendeur avait une intention coupable suffisante pour qu'on puisse en inférer l'intention d'infliger un préjudice. Par conséquent, la clause d'exclusion doit s'appliquer et l'intimé n'a aucune obligation d'opposer une défense à la poursuite pour voies de fait de nature sexuelle intentée par la demanderesse.

(ii) Negligent Battery

(a) *Elements of Negligent Battery*

125 Klar, *supra*, defines negligent battery at p. 47:

> A negligent battery exists when the defendant causes a direct, offensive, physical contact with the plaintiff as a result of negligent conduct. The defendant's negligence consists of unreasonably disregarding a foreseeable risk of contact, even though the contact was neither desired nor substantially certain to occur.

The plaintiff has also alleged breach of duty, which is essentially negligence. In *Norberg*, *supra*, Sopinka J. relied on this theory to find Dr. Wynrib liable to Ms. Norberg. However, his reasoning was based on the professional duty owed by a physician to a patient. No such duty was alleged in the present appeal. Instead, and absent any particularized pleading by the plaintiff, I must presume that

(ii) Voies de fait imputables à la négligence

a) *Éléments constitutifs des voies de fait imputables à la négligence*

Klar, *op. cit.*, définit ainsi les voies de fait imputables à la négligence, à la p. 47:

> [TRADUCTION] Il y a voies de fait imputables à la négligence lorsque, par son comportement négligent, le défendeur est à l'origine d'un contact physique direct et nocif avec le demandeur. La négligence du défendeur consiste à faire fi déraisonnablement d'un risque prévisible de contact, même si le contact n'était pas souhaité ou qu'il n'y avait pas de quasi-certitude qu'il se produise.

La demanderesse a également allégué un manquement à une obligation qui équivaut essentiellement à la négligence. Dans *Norberg*, précité, le juge Sopinka s'est fondé sur cette théorie pour conclure à la responsabilité du D^r^ Wynrib envers M^me^ Norberg. Cependant, son raisonnement s'appuyait sur l'obligation professionnelle du médecin vis-à-vis d'un patient. Aucune des parties n'allègue l'existence d'une telle obligation en l'espèce. Vu que la demanderesse n'a pas formulé d'allégation précise

she is relying on a traditional negligent battery theory.

As Klar's definition makes clear, the "negligence" in negligent battery refers only to the "risk of contact". One might commit negligent battery by carelessly stretching one's arms, thereby striking someone. More commonly, negligent battery cases have involved projectiles. See *Cook*, *supra*; *Ellison v. Rogers* (1967), 67 D.L.R. (2d) 21 (Ont. H.C.); *Hatton v. Webb* (1977), 81 D.L.R. (3d) 377 (Alta. Dist. Ct.). The important point is that negligent battery is concerned with the physical consequences of one's actions. However, the appellant has not disputed the physical consequence of his actions for the purposes of this appeal. He has, appropriately, assumed the truth of the allegations contained in the plaintiff's Statement of Claim, which asserts that he intended to have sexual relations with the plaintiff. The only question is whether it was consensual, which is determined on an objective standard, as I have explained above.

I therefore do not find *Co-operative Fire & Casualty Co. v. Saindon*, *supra*; *Newcastle (Town) v. Mattatall* (1988), 52 D.L.R. (4th) 356 (N.B.C.A.); *Long Lake School Division No. 30 of Saskatchewan Board of Education v. Schatz* (1986), 18 C.C.L.I. 232 (Sask. C.A.), and *Devlin v. Co-operative Fire & Casualty Co.* (1978), 90 D.L.R. (3d) 444 (Alta. C.A.), to be relevant. These cases are not helpful in the present appeal, as they all involved unforeseen physical consequences of the actions of the insured, and asked whether the result was "substantially certain" given the defendant's actions. The "substantial certainty" test, focusing as it does on physical consequences, has no bearing on the issue of consent. The case at bar involves deciding solely whether the plaintiff validly consented to the appellant's actions. A negligent battery is properly pleaded only if the plaintiff alleges that the appellant was negligent as to the physical consequences of his actions; in other words, that he did not intend for sexual contact to

en ce sens, je dois plutôt présumer qu'elle invoque la théorie traditionnelle des voies de fait imputables à la négligence.

126 Comme la définition proposée par Klar le précise, la «négligence» renvoie uniquement en ce cas au «risque [. . .] de contact». Une personne pourrait se livrer à des voies de fait imputables à la négligence lorsqu'en étirant négligemment les bras elle frappe quelqu'un. Plus couramment, ce type de voies de fait a comporté l'utilisation de projectiles. Voir *Cook*, précité; *Ellison c. Rogers* (1967), 67 D.L.R. (2d) 21 (H.C. Ont.); *Hatton c. Webb* (1977), 81 D.L.R. (3d) 377 (C. dist. Alb.). Il importe de retenir que les conséquences physiques des actes d'une personne sont l'élément déterminant pour ce type de voies de fait. Toutefois, l'appelant n'a pas contesté les conséquences physiques de ses actes aux fins du présent pourvoi. Il a, à juste titre, tenu pour avérées les allégations contenues dans la déclaration de la demanderesse, selon lesquelles il voulait avoir des rapports sexuels avec celle-ci. La seule question qui se pose est celle du consentement, question qui, comme je l'ai expliqué plus haut, est tranchée selon une norme objective.

127 Par conséquent, j'estime que les arrêts *Co-operative Fire & Casualty Co. c. Saindon*, précité; *Newcastle (Town) c. Mattatall* (1988), 52 D.L.R. (4th) 356 (C.A.N.-B.); *Long Lake School Division No. 30 of Saskatchewan Board of Education c. Schatz* (1986), 18 C.C.L.I. 232 (C.A. Sask.), et *Devlin c. Co-operative Fire & Casualty Co.* (1978), 90 D.L.R. (3d) 444 (C.A. Alb.), ne sont pas pertinents. Ils ne sont pas utiles aux fins du présent pourvoi puisqu'ils portent tous sur les conséquences physiques imprévues des actes de l'assuré et que la question était de savoir si le résultat découlant de ces actes était «quasiment certain». Le critère de la «quasi-certitude», qui met l'accent sur les conséquences physiques, ne s'applique pas au consentement. La présente affaire exige uniquement que l'on détermine si la demanderesse a donné un consentement valable aux actes de l'appelant. L'allégation de voies de fait imputables à la négligence n'est adéquatement formulée que si la demanderesse soutient que l'appelant a fait preuve

occur. As explained above, lack of intention to have non-consensual sex is more properly construed as going to the "harmful or offensive" element of intentional battery, and will not found a claim for negligent battery. Therefore negligent battery will only be relevant if the pleadings allege that the appellant negligently harmed the plaintiff by disregarding a foreseeable risk of physical contact. No such allegation has been made. As the court said in *Pistolesi v. Nationwide Mutual Fire Insurance Co.*, 644 N.Y.S.2d 819 (App. Div. 1996), at p. 820:

> . . . the mere allegation that the injuries were the unintended result of an intentional act does not convert the cause of action from one sounding in intentional tort to one sounding in negligence. . . .

(b) *Are There Properly Pleaded Allegations of Negligent Battery That Could Trigger the Duty to Indemnify?*

128 Once again, the first step is to determine whether negligent battery was properly pleaded. I have concluded that it was not. As discussed above, negligent battery occurs when the defendant causes harm by negligently disregarding a foreseeable risk of physical contact. The plaintiff has not alleged such conduct; both parties have assumed, for the purposes of this appeal, that the appellant intended to have sexual contact with the plaintiff. Since there is no properly pleaded allegation of negligent battery, it is unnecessary to determine whether the exclusion clause would apply to such a claim.

(iii) Negligent Misrepresentations

129 Aside from the vague assertions of "breach of duty", the appellant notes that the plaintiff has

de négligence à l'égard des conséquences physiques de ses actes, c'est-à-dire qu'il n'avait pas l'intention que les contacts sexuels aient lieu. Comme je l'explique précédemment, l'absence d'intention d'avoir des rapports sexuels non consensuels relève davantage du caractère «préjudiciable ou nocif» des actes, lequel est un élément constitutif des voies de faits intentionnelles, et elle ne saurait étayer une allégation de négligence à cet égard. Par conséquent, la négligence ne serait pertinente que si la demanderesse prétendait que l'appelant, en raison de sa négligence, lui a infligé un préjudice en faisant fi du risque prévisible de contact physique. Aucune allégation n'a été faite en ce sens. Comme le tribunal l'a dit dans *Pistolesi c. Nationwide Mutual Fire Insurance Co.*, 644 N.Y.S.2d 819 (App. Div. 1996), à la p. 820:

> [TRADUCTION] . . . la simple allégation voulant que le préjudice soit le résultat imprévu d'un acte intentionnel ne transforme pas la cause d'action fondée sur le délit intentionnel en une cause d'action fondée sur la négligence. . .

b) *Existe-t-il des allégations adéquatement formulées de voies de fait imputables à la négligence susceptibles de faire naître l'obligation d'indemniser?*

À nouveau, la première étape consiste à déterminer si l'allégation de voies de fait imputables à la négligence est adéquatement formulée. Ce n'est pas le cas selon moi. Je le répète, il n'y a de voies de fait imputables à la négligence que lorsque le défendeur inflige un préjudice en faisant fi, par négligence, du risque prévisible qu'un contact physique ait lieu. La demanderesse n'a pas allégué un tel comportement; les deux parties ont tenu pour acquis, aux fins du présent pourvoi, que l'appelant voulait avoir des contacts sexuels avec la demanderesse. Étant donné l'absence d'allégation adéquatement formulée de voies de fait imputables à la négligence, il n'est pas nécessaire de déterminer si la clause d'exclusion s'appliquerait à une telle allégation.

(iii) Déclarations inexactes faites par négligence

L'appelant signale que non seulement la demanderesse a fait de vagues assertions concernant le

alleged negligent acts independent of the sexual assault. For example, the statement of claim alleges negligent misrepresentations. It is unnecessary to spend much time on this issue. It is well established that one can be liable for damages to personal security caused by negligent statements, as well as acts:

A statement of fact, on which the plaintiff relied, would give rise to liability if (i) it were inaccurate as a result of negligence (and *a fortiori* deceit); and (ii) it caused physical injury to the plaintiff or damage to his property.

(Fridman, *supra*, at p. 263.)

See also Klar, *supra*, at p. 177; *M'Alister v. Stevenson*, [1932] A.C. 562 (H.L.), at pp. 580-81 (*per* Atkin L.J.).

Assuming without deciding that negligent misrepresentation has been properly pleaded here, I find that these claims are entirely derivative of the intentional sexual battery, and are thus subsumed into the latter for the purposes of the exclusion clause. The statement of claim alleges that the misrepresentations were designed to seduce the plaintiff, and convince her to engage in sexual activity with the appellant. As such, they were entirely subservient to the sexual battery. They arise from the same actions and cause the same harm. Indeed, para. 111 of the plaintiff's statement of claim alleges that the appellant "made the Scalera Representations intending to persuade [the plaintiff] to submit to the Scalera sexual acts". The West Virginia Supreme Court of Appeals reached the same conclusion in *Horace Mann Insurance Co. v. Leeber*, *supra*, at p. 587, where an exclusion clause applied in spite of allegations of negligent seduction of a student by a teacher. The court concluded that the allegations of "negligence" in the complaint were

a transparent attempt to trigger insurance coverage by characterizing allegations of [intentional] tortious con-

«manquement à une obligation», mais qu'elle a également invoqué des actes de négligence indépendants de l'agression sexuelle. Par exemple, la déclaration renferme une allégation de déclarations inexactes faites par négligence. Il n'est pas nécessaire de s'attarder longuement à cette question. Il est bien établi qu'une personne peut être tenue responsable du préjudice infligé à la sécurité personnelle par suite de déclarations négligentes ou d'actes empreints de négligence:

[TRADUCTION] Un énoncé de faits sur lequel le demandeur se serait fondé engagerait la responsabilité (i) s'il était inexact en raison d'une négligence (et, a fortiori, s'il était trompeur) et (ii) s'il avait causé un préjudice corporel au demandeur ou endommagé ses biens.

(Fridman, *op. cit.*, à la p. 263.)

Voir également Klar, *op. cit.*, à la p. 177; *M'Alister c. Stevenson*, [1932] A.C. 562 (H.L.), aux pp. 580 et 581 (le lord juge Atkin).

130 À supposer, sans en décider, qu'une allégation de déclaration inexacte faite par négligence ait été adéquatement formulée en l'espèce, je suis d'avis qu'une telle allégation est entièrement dérivée de celle de voies de fait de nature sexuelle intentionnelles et est donc subsumée sous cette dernière aux fins de l'application de la clause d'exclusion. Dans sa déclaration, la demanderesse allègue que les déclarations inexactes visaient à la séduire et à la convaincre d'avoir des rapports sexuels avec l'appelant. Elles étaient donc totalement subordonnées aux voies de fait de nature sexuelle. Les allégations s'y rapportant découlent des mêmes faits et elles ont causé le même préjudice. En fait, au par. 111 de sa déclaration, la demanderesse allègue que l'appelant [TRADUCTION] «a fait ses affirmations afin d'amener [la demanderesse] à se soumettre aux actes sexuels». La Supreme Court of Appeals de la Virginie-Occidentale est arrivée à la même conclusion dans *Horace Mann Insurance Co. c. Leeber*, précité, à la p. 587, où la clause d'exclusion s'appliquait malgré les allégations de séduction, par négligence, d'une élève par un enseignant. La cour a dit que les allégations de «négligence» contenues dans la plainte constituent

[TRADUCTION] une tentative manifeste d'obtenir l'application de la garantie d'assurance en imputant à la

duct under the guise of 'negligent' activity. [Insertion in *Leeber*; quoting *Linebaugh*, *supra*, at p. 406.]

I reach the same conclusion in this appeal. While courts must be careful not to restrict pleading in the alternative unduly and should only subsume allegations of negligence that are clearly derivative of the intentional tort, I conclude that this is one of those cases. The plaintiff has clearly alleged intentional conduct by the appellant. Without ruling out the possibility that the plaintiff's pleadings could support claims of both intention and negligence as a matter of tort law, I conclude as a matter of insurance law that the negligent claims are subsumed for the purposes of the exclusion clause. The allegations of negligent misrepresentation are derivative of the intentional sexual assault claims, and cannot trigger the duty to defend.

«négligence» un comportement délictueux [intentionnel]. [Ajout dans *Leeber*; citant *Linebaugh*, précité, à la p. 406.]

J'arrive à la même conclusion en l'espèce. Bien que les tribunaux doivent s'efforcer de ne pas restreindre indûment les arguments subsidiaires et qu'ils doivent subsumer seulement les allégations de négligence qui sont manifestement dérivées du délit intentionnel, je suis d'avis qu'il s'agit d'un tel cas en l'espèce. La demanderesse a expressément allégué que l'appelant avait agi intentionnellement. Sans rejeter la possibilité que les actes de procédure de la demanderesse puissent étayer à la fois l'intention et la négligence en droit de la responsabilité délictuelle, j'estime que, en matière de droit des assurances, les allégations de négligence sont subsumées aux fins de l'application de la clause d'exclusion. Les allégations de déclarations inexactes faites par négligence sont dérivées des allégations de voies de fait de nature sexuelle intentionnelles et ne peuvent faire naître l'obligation de défendre.

(iv) Breach of Fiduciary Duty

131 The final approach to allegations of sexual misconduct in *Norberg*, *supra*, was the fiduciary duty route taken by McLachlin J., L'Heureux-Dubé J. concurring. They concluded that the duty owed from a doctor to the patient met the test for fiduciary relationships set out by Wilson J. in *Frame v. Smith*, [1987] 2 S.C.R. 99, at p. 136. No doubt relying on these reasons, the plaintiff has also alleged breach of fiduciary duties against the appellant.

132 Without commenting on whether the relationship between the appellant and the plaintiff could potentially be characterized as a fiduciary one, the plaintiff's claims for breach of fiduciary duty are excluded much for the same reasons as the negligence claims. Looking beyond the label to what is actually alleged in the pleadings, and without expressing any opinion on the validity of a fiduciary duty claim on the facts of this appeal, there are no facts pleaded to suggest that the breach of fidu-

(iv) Manquement à l'obligation fiduciaire

Le dernier angle sous lequel ont été analysées les allégations d'inconduite sexuelle formulées dans *Norberg*, précité, était celui de l'obligation fiduciaire utilisé par le juge McLachlin, avec l'appui du juge L'Heureux-Dubé. Elles ont affirmé que l'obligation d'un médecin envers son patient pouvait être qualifiée de fiduciaire selon les critères énoncés par le juge Wilson dans *Frame c. Smith*, [1987] 2 R.C.S. 99, à la p. 136. S'appuyant sans aucun doute sur ces motifs, la demanderesse a allégué entre autres le manquement de l'appelant à son obligation fiduciaire.

Sans me prononcer quant à savoir si le lien entre l'appelant et la demanderesse pourrait être qualifié de fiduciaire, j'estime que les allégations de manquement à l'obligation fiduciaire sont exclues essentiellement pour les mêmes motifs que les allégations de négligence. Si l'on va au-delà de la terminologie pour n'examiner que ce que renferment vraiment les actes de procédure et sans exprimer un quelconque avis concernant le bien-fondé de l'allégation d'obligation fiduciaire compte tenu

ciary duty was anything but intentional in nature. The appellant was alleged to have intentionally seduced the plaintiff, and whether or not this can be characterized as a fiduciary duty claim, any injuries resulting therefrom were caused intentionally. The harm caused by any breach of fiduciary duty is identical to that caused by the sexual battery, and the claim is therefore subsumed, for the purpose of the exclusion clause, into the intentional battery.

(v) Conclusion

In summary, all of the plaintiff's claims against the appellant are covered by the exclusion clause for injuries caused intentionally. To prove her case, the plaintiff will have to establish that the appellant knew or should have known that the plaintiff did not validly consent to sexual relations with him. In such a situation, the appellant will not be heard to complain that he did not intend any harm. One who engages in objectively non-consensual sexual activity will be presumed to have intended harm; whether or not he subjectively intended harm will not change the injurious nature of his actions, and will not deny an insurer its bargained-for exclusion of intentionally injurious activities. This conclusion is consistent with the basic principles of insurance law discussed above.

In particular, it is consistent with the reasonable expectations of the parties. In this respect, I agree with the Iowa Supreme Court in *Altena*, *supra*, at p. 490, where the court quoted the following passage from *Rodriguez by Brennan v. Williams*, 713 P.2d 135 (Wash. Ct. App. 1986), at pp. 137-38:

. . . [t]he average person purchasing homeowner's insurance would cringe at the very suggestion that [the person] was paying for such coverage. And certainly [the person] would not want to share that type of risk with

des faits de la présente espèce, aucun fait allégué ne permet de conclure au caractère non intentionnel du manquement à l'obligation fiduciaire. Il a été allégué que c'est à dessein que l'appelant a séduit la demanderesse et, que l'on puisse ou non qualifier sa conduite de manquement à l'obligation fiduciaire, le préjudice en résultant a été infligé intentionnellement. Le préjudice découlant de tout manquement à l'obligation fiduciaire est identique à celui causé par les voies de fait de nature sexuelle, de sorte que, aux fins de l'application de la clause d'exclusion, l'allégation est subsumée sous celle de voies de fait intentionnelles.

(v) Conclusion

133 En résumé, toutes les allégations formulées par la demanderesse contre l'appelant emportent l'application de la clause d'exclusion du fait que le préjudice a été infligé intentionnellement. Pour avoir gain de cause, la demanderesse devra établir que l'appelant savait ou aurait dû savoir que son consentement aux rapports sexuels n'était pas valable. Dans un tel contexte, l'appelant ne pourra invoquer en défense qu'il n'avait pas l'intention d'infliger un préjudice. La personne qui se livre à une activité sexuelle objectivement non consensuelle est présumée avoir voulu infliger un préjudice; qu'elle ait ou non subjectivement eu l'intention d'infliger un préjudice ne modifie en rien le caractère préjudiciable de ses actes et ne saurait priver l'assureur de l'application de la clause d'exclusion négociée à l'égard des actes délibérément préjudiciables. Cette conclusion est compatible avec les principes fondamentaux du droit des assurances examinés précédemment.

134 Tout particulièrement, elle est compatible avec les attentes raisonnables des parties. À cet égard, je suis d'accord avec la Cour suprême de l'Iowa qui, dans *Altena*, précité, à la p. 490, a cité l'extrait suivant de la décision *Rodriguez by Brennan c. Williams*, 713 P.2d 135 (Wash. Ct. App. 1986), aux pp. 137 et 138:

[TRADUCTION] . . . [l]a personne ordinaire contractant une assurance propriétaires occupants se rebifferait à la seule idée de payer pour une telle garantie. [La personne] ne voudrait certainement pas partager ce genre

other homeowner's policy holders. [Insertions added in *Altena*.]

Similarly, in *Horace Mann Insurance Co. v. Leeber*, *supra*, at pp. 586-87, the court said the following:

> The majority rule rejecting an alleged duty to defend or to pay in sexual misconduct liability insurance cases is consistent with the "doctrine of reasonable expectations." . . . [W]e simply believe that the insured under a homeowner's insurance policy does not reasonably expect the insurer to defend an action against the insured for, and to pay for, damages alleged to have been caused by the sexual misconduct of the insured.

See also R. Bell, "Sexual Abuse and Institutions: Insurance Issues" (1996), 6 *C.I.L.R.* 53, at pp. 54-55.

135 This conclusion is also consistent with basic insurance theory. Insurance is meant to cover risk of loss. See C. Brown, *Insurance Law in Canada* (loose-leaf), vol. 1, at p. 1-1. Where the loss is caused intentionally, it is hardly the result of a risk. Regardless of whether an insurance company could find a way profitably to insure someone against intentionally caused injuries, the respondent clearly did not believe it was doing so when it wrote the policy at issue in this appeal. Sexually assaulting someone is not like getting in a car accident, or having someone injure themselves by slipping on an unshovelled sidewalk. If the plaintiff is to succeed, she must prove that the appellant's conduct went beyond mere negligence, and rose to the level of sexual assault. Absent express language to the contrary, I am unable to conclude that the parties to this insurance contract agreed to cover such a claim.

136 Nor do I believe that *contra proferentem*, or any other insurance principle, is sufficient to overcome these conclusions. While ambiguous language will often be construed against the insurer, this consideration alone cannot be determinative. Moreover, I find that the most accurate reading of the lan-

de risque avec les autres titulaires d'une police d'assurance propriétaires occupants. [Ajout dans *Altena*.]

De même, dans *Horace Mann Insurance Co. c. Leeber*, précité, aux pp. 586 et 587, le tribunal a dit:

> [TRADUCTION] La décision de la majorité d'écarter, en matière d'assurance de la responsabilité civile, l'obligation alléguée de défendre l'assuré ou de l'indemniser par suite d'une inconduite sexuelle est compatible avec le «principe des attentes raisonnables» . . . [N]ous estimons simplement que le titulaire d'une police d'assurance propriétaires occupants ne peut raisonnablement s'attendre à ce que l'assureur le défende dans le cadre d'une poursuite pour inconduite sexuelle et répare le préjudice qui en aurait découlé.

Voir également R. Bell, «Sexual Abuse and Institutions: Insurance Issues» (1996), 6 *C.I.L.R.* 53, aux pp. 54 et 55.

Cette conclusion est par ailleurs compatible avec la théorie fondamentale de l'assurance. L'assurance vise à garantir le risque de sinistre. Voir C. Brown, *Insurance Law in Canada* (feuilles mobiles), vol. 1, à la p. 1-1. Lorsque le sinistre est causé intentionnellement, on peut difficilement l'imputer à la réalisation d'un risque. Même si un assureur pouvait trouver une façon profitable d'assurer une personne contre le préjudice infligé intentionnellement, ce n'est clairement pas ce que l'intimé croyait faire lorsqu'il a rédigé la police faisant l'objet du présent pourvoi. Agresser sexuellement une personne ne saurait se comparer à être impliqué dans un accident de la route ou à causer la chute d'une personne en omettant de déblayer un trottoir. Pour avoir gain de cause, la demanderesse doit prouver que la conduite de l'appelant n'était pas imputable à la seule négligence et équivalait à une agression sexuelle. En l'absence d'un libellé exprès en sens contraire, je ne puis dire que les parties au contrat d'assurance ont convenu que la garantie s'appliquerait en pareil cas.

Je ne crois pas non plus que la règle *contra proferentem* ou quelque autre principe d'assurance suffise à contrer ces conclusions. Même si une clause ambiguë est souvent interprétée contre l'assureur, cette seule pratique ne peut être déterminante. De plus, j'estime que l'interprétation la plus

guage and intentions of the contract is that the exclusion clause applies to the allegations of sexual misconduct made by the plaintiff.

D. *Other Arguments Raised by the Respondent*

The respondent has also argued that the actions alleged by the plaintiff are not "accidents" or "occurrences", as required by the policy, and that s. 28 of the British Columbia *Insurance Act*, excludes the claim because it alleges a criminal act. Given my interpretation of the exclusion clause, I find it unnecessary to consider these other questions and therefore express no opinion on them.

VI. Summary and Disposition

I believe my conclusions in this appeal can be summarized fairly briefly:

1. An insurance company only has a duty to defend when a lawsuit against the insured raises a claim that could potentially fall within coverage.
2. In determining if a claim falls within coverage, courts are not bound by the labels chosen by the plaintiff, but must determine the true nature of the claim stated in the pleadings.
3. In this appeal, the plaintiff has stated three possible claims arising out of an alleged sexual assault: sexual battery, negligent battery, and breach of fiduciary duty. None of these claims could potentially fall within coverage because, even if ultimately successful, the respondent will have no duty to indemnify owing to the insurance policy's exclusion for injuries caused intentionally by the insured.
   a. Sexual battery requires proof that a reasonable person should have known that the plaintiff did not validly consent to the sexual activity in question. Since non-consensual

fidèle du libellé du contrat et de l'intention des parties est que la clause d'exclusion s'applique aux allégations d'inconduite sexuelle formulées par la demanderesse.

D. *Autres arguments soulevés par l'intimé*

137 L'intimé a également fait valoir que les actes allégués par la demanderesse ne constituent ni des «accidents» ni des «sinistres», comme l'exige la police, et que l'art. 28 de l'*Insurance Act* de la Colombie-Britannique frappe d'exclusion l'allégation puisqu'elle a pour objet un acte criminel. Vu l'interprétation que je fais de la clause d'exclusion, j'estime qu'il n'est pas nécessaire que j'examine ces autres questions, et je n'exprime donc aucun avis à leur sujet.

VI. Résumé et dispositif

138 Les conclusions que je tire dans le cadre du présent pourvoi peuvent être résumées comme suit:

1. L'assureur n'est tenu de défendre l'assuré que lorsque la poursuite en justice se fonde sur une allégation susceptible d'entraîner l'application de la garantie.
2. Pour déterminer si une allégation entraîne l'application de la garantie, le tribunal n'est pas lié par la terminologie choisie par le demandeur, mais doit plutôt déterminer quelle est la nature véritable des allégations faites dans les actes de procédure.
3. Aux fins du présent pourvoi, trois allégations découlent de la prétendue agression sexuelle: les voies de fait de nature sexuelle, les voies de fait imputables à la négligence et le manquement à l'obligation fiduciaire. Aucune de ces allégations n'est susceptible d'emporter l'application de la garantie, car, même si la demanderesse avait gain de cause, l'intimé ne serait pas tenu d'indemniser l'assuré étant donné l'exclusion dans la police d'assurance du préjudice infligé intentionnellement.
   a. Pour prouver les voies de fait de nature sexuelle, il faut établir qu'une personne raisonnable aurait dû savoir que le consentement de la demanderesse à l'activité sexuelle

sexual activity is inherently harmful, any injuries resulting therefrom are intentionally caused, and the exclusion clause would apply. If, to the contrary, a reasonable person would not have known that the plaintiff did not validly consent, the plaintiff's claim will fail, there will be no duty to indemnify, and therefore equally no duty to defend.

b. Claims of negligence and breach of fiduciary duty are either not properly pleaded, or are subsumed into the sexual battery in this case because these claims are based on the same facts and resulted in the same harm. Therefore the exclusion clause applies equally to them.

4. Since there is no possible set of circumstances in which one of the plaintiff's claims could trigger indemnity, there is no duty to defend.

139 For the foregoing reasons, I would dismiss the appeal with costs.

Appeal dismissed with costs.

Solicitors for the appellant: Cran Law Offices, Vancouver.

Solicitors for the respondent: Dolden Walker Folick, Vancouver.

en cause n'était pas valable. Comme les rapports sexuels non consensuels sont en soi préjudiciables, tout préjudice en résultant est intentionnel, et la clause d'exclusion s'applique. Si, au contraire, une personne raisonnable n'aurait pu savoir que le consentement de la demanderesse n'était pas valable, la demande sera rejetée, de sorte que l'assureur n'aura aucune obligation d'indemniser l'assuré non plus que de le défendre.

b. Les allégations de négligence et de manquement à l'obligation fiduciaire ne sont pas adéquatement formulées ou sont subsumées sous l'allégation de voies de fait de nature sexuelle, car elles se fondent sur les mêmes faits, et les actes reprochés ont donné lieu au même préjudice. Par conséquent, la clause d'exclusion s'applique également à leur égard.

4. Étant donné qu'aucune des allégations de la demanderesse n'est susceptible de faire naître l'obligation d'indemniser l'assuré, dans quelque combinaison possible de circonstances que ce soit, l'assureur n'a aucune obligation de le défendre.

Pour les motifs qui précèdent, je suis d'avis de rejeter le pourvoi avec dépens.

Pourvoi rejeté avec dépens.

Procureurs de l'appelant: Cran Law Offices, Vancouver.

Procureurs de l'intimé: Dolden Walker Folick, Vancouver.

COURT OF APPEAL FOR ONTARIO

CITATION: Lloyds Syndicate 1221 (Millennium Syndicate) v. Coventree Inc., 2012 ONCA 341
DATE: 20120524
DOCKET: C54323

O'Connor A.C.J.O., Armstrong and Watt JJ.A.

BETWEEN

Lloyds Syndicate 1221 (Millennium Syndicate)

Respondent (Appellant)

and

Coventree Inc.

Applicant (Respondent in Appeal)

Eric A. Dolden and Paul Dawson, for the respondent (appellant)

Geoffrey D.E. Adair, Q.C., and Jennifer King, for the applicant (respondent)

Heard: February 9, 2012

On appeal from the order of Justice Lederer of the Superior Court of Justice, dated September 13, 2011, reported at 2011 ONSC 4788.

O'Connor A.C.J.O.:

[1] The issue on this appeal is whether a director's and officer's insurance policy provided coverage for a claim when notice of the potential for that claim had been provided to a previous insurer. The application judge, Lederer J., considered the language of the policy as well as circumstances underlying the negotiation and issuance of the policy. He concluded that the policy afforded coverage. I see no basis to interfere with his conclusion.

BACKGROUND

[2] The respondent ("Coventree") was a major participant in the asset backed commercial paper ("ABCP") market in Canada. In August 2007, the ABCP market experienced a severe disruption. Coventree's business was devastated and its share price dropped significantly. Soon after, Coventree wound up its business.

[3] Prior to the collapse of the ABCP market, Coventree and its directors and senior officers had been insured under a policy issued by Great American Insurance Company ("Great American") with a coverage limit of $1 million.

[4] Shortly after the collapse of the market, Great American informed Coventree that it would not renew its directors' and senior officers' policy, which was due to expire on October 17, 2007. The Great American policy included coverage for claims made after the expiration of the policy if Coventree had given notice of the potential claims during the policy period.

[5] The management of Coventree considered that there was the potential for claims against the company and its directors and officers arising from the market disruption. As a result, on October 16, 2007, Coventree gave notice to Great American of all of the potential claims it could envision relating to the market collapse (the October 16, 2007 notice). Coventree cast the October 16, 2007 notice as broadly as possible in order to maximize the coverage.

[6] Coventree obtained extended coverage from Great American in the amount of $1 million for claims made between October 17, 2007 and October 17, 2008 which were based upon acts alleged to have occurred before October 17, 2007.

[7] In addition, Coventree obtained a new directors and officers insurance policy from the appellant, Lloyds Syndicate 1221 (“Lloyds”) for the period October 17, 2007 to October 17, 2008 (the Lloyd’s 2007 policy). The Lloyd’s 2007 policy provided coverage in the amount of $10 million, but expressly excluded “prior act coverage” – that is coverage for any claim based upon an alleged wrongful act that occurred before October 17, 2007.

[8] In March 2008, Coventree requested Lloyds to provide excess coverage to that provided by Great American for the period up to October 17, 2008. Lloyds declined.

[9] In September 2008, Coventree set about to acquire coverage for the period following October 17, 2008. Although it had not received any claims relating to

the collapse of its business, Coventree was aware that there was an ongoing investigation being conducted by the Ontario Securities Commission ("OSC") and that there was the potential for a claim for costs in relation to an OSC hearing.

[10] On September 18, 2008, Coventree applied to Lloyds for directors and officers coverage for the period beginning October 17, 2008. A number of discussions, exchanges of documents and negotiations ensued. Eventually, Lloyds issued a policy in the amount of $10 million for the period from October 17, 2008 to April 17, 2010 (the Lloyds 2008 policy). Coverage for "prior acts" was capped at the first $5 million of the $10 million limit. The Lloyds 2008 policy was a claims-made policy – meaning it covered claims made during the policy period. The policy provided coverage to Coventree and its directors and officers for among other matters defence costs for proceedings against the insureds. The exclusion for prior acts coverage in the Lloyds 2007 policy was removed.

[11] In July 2009, the OSC issued a notice of hearing and statement of allegations against Coventree and two of its senior officers. That notice related to matters referred to in Coventree's October 16, 2007 notice to Great American. In the course of responding to the OSC notice, Coventree and its two senior officers incurred legal fees in excess of $12 million. In time, Great American accepted that its policy responded to the claim and paid its limits of $1 million. Coventree claimed against Lloyds for reimbursement for defence costs under the

Lloyds 2008 policy. Lloyds denied coverage. Coventree brought the application underlying this appeal.

[12] On the application, it was common ground that the Lloyds 2008 policy was a claims-made policy and that Coventree made the claim for reimbursement of the OSC related defence costs within the policy period. It was also agreed that absent an exclusion provision, the costs incurred in defending the OSC proceeding were properly the subject of a claim under the policy. In addition, it was agreed that if the Lloyds 2008 policy responded to the claim, it did so only to the extent of the first $5 million of the policy limits.

[13] Lloyds argued, however, that there were three provisions in the Lloyds 2008 policy that excluded coverage for acts referred to in the October 16, 2007 notice. In particular, Lloyds referred to (i) a carve out clause in the application for insurance submitted by Coventree; (ii) section VI.B; and (iii) section IV.B of the Lloyds 2008 policy.

[14] The application judge found that the Lloyds 2008 policy provided coverage for the “prior acts” referred to in the October 16, 2007 notice to the extent of the first $5 million of the $10 million policy limits. He based this conclusion on a careful analysis of the provisions in the policy and the circumstances relating to the negotiation and issuance of the policy, including Endorsement 24 to that policy which addressed exclusions for prior acts. He concluded that none of the

exclusion clauses relied upon by Lloyds applied to matters referred to in the October 16, 2007 notice.

ANALYSIS

(a) The Legal Principles

[15] The Supreme Court of Canada has set out the general principles to be used in interpreting insurance policies. In *Reid Crowther & Partners Ltd.*, [1993] 1 S.C.R. 252, at p. 269, the court said:

> In each case, the courts must interpret the provisions of the particular policy at issue in light of general principles of interpretation of insurance policies, including but not limited to: (i) the *contra proferentem* rule; (2) the principle that coverage provisions should be construed broadly and exclusion clauses narrowly; and (3) the desirability, at least where the policy is ambiguous, of giving effect to the reasonable expectations of the parties.

[16] When interpreting the terms of a contract, including an insurance contract, the aim is to determine the intentions of the parties viewed objectively at the time they entered into the contract. The analysis begins with an examination of the text of the written agreement. The aim is to determine the objective intentions of the parties from the words they have used.

[17] However, the words of a contract alone may not be determinative of the objective intention of the parties. Contracts are not to be looked at in a vacuum. Rather, it is “perfectly proper, and indeed may be necessary, to look at the

surrounding circumstances in order to ascertain what the parties were really contracting about": *Hill v. Nova Scotia (Attorney General)*, [1997] 1 S.C.R. 69, at para. 20. The court's search for the intention of the parties may be aided by reference to the surrounding circumstances or factual matrix at the time of the negotiation and execution of the contract, as viewed objectively by a reasonable person: see also *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust et al.*, 2007 ONCA 205, 85 O.R. (3d) 254.

[18] Words used in a contact are often better understood when the context of their use is understood. The purpose of the context is to determine what a reasonable person in the context of the surrounding circumstances would have understood the agreement to be. The subjective intentions of the parties are not relevant. Consideration of the surrounding circumstances is generally restricted to the circumstances known to both parties at the time of the execution of the contract. These circumstances include facts that were known or reasonably capable of being known by the parties when they entered into the contract. See: *Dumbrell v. Regional Group of Companies Inc.*, 2007 ONCA 59, 85 O.R. (3d) 616, at paras. 50, 53 and 56; *Ventas*, at para. 24; and *King v. Operating Engineers Training Institute of Manitoba Inc.*, 2011 MBCA 80, 341 D.L.R. (4th) 520, at paras. 69-73.

(b) The Carve Outs

[19] On September 18, 2008, Coventree delivered an application for insurance to an agent for Lloyds. The application was in the standard form used by Lloyds for parties applying for insurance. Question 6(c) in the application asked the following question:

> 6(c) Has anyone for whom this insurance is intended given notice under the provisions of any other previous or current insurance policy of any facts or circumstances which may give rise to a claim being made against the Company and/or any Director and/or Officer? If Yes, provide details.

This question was followed by what is described as a "carve out provision". It stated as follows:

> IT IS UNDERSTOOD AND AGREED THAT IF ANY SUCH CLAIMS EXIST, OR ANY SUCH FACTS OR CIRCUMSTANCES EXIST WHICH COULD GIVE RISE TO A CLAIM, THEN THOSE CLAIMS ARISING FROM SUCH FACTS OR CIRCUMSTANCES ARE EXCLUDED FROM THE PROPOSED INSURANCE. [Emphasis in original].

[20] Coventree answered question 6(c) in the affirmative. In response to the request for details, it referred to Appendix 6(c). Coventree attached the October 16, 2007 notice to Great American as Appendix 6(c).

[21] Coventree's evidence was that in applying to Lloyds, it was specifically seeking coverage for matters referred to in the October 16, 2007 notice. Following the ABCP market disorder, Coventree was winding down its

operations. Its business activities were limited to providing administrative services to certain market participants. It was not conducting any new business. It was concerned, however, that the coverage with Great American was limited to $1 million for acts relating to the market disruption which occurred before October 17, 2007. Its objective in applying to Lloyds in 2008 was to obtain full prior acts coverage, including most particularly those potential claims referred to in the October 16, 2007 notice. When it answered question 6(c) in the affirmative, it did not know whether Lloyds would be agreeable to providing prior act coverage or not. Answering question 6(c) in the affirmative and providing the October 17, 2007 notice ensured that Lloyds was aware of the potential for claims being made during the policy period relating to the matters set out in the October 17, 2007 notice.

[22] Question 7 in the application form asked if anyone for whom the insurance was intended had any knowledge of any act or omission which may give rise to a claim which may fall within the scope of the proposed insurance. Question 7 was followed by a similar carve out to that which followed question 6. Coventree answered question 7 in the negative.

[23] On September 30, 2008, the parties had a telephone conversation to allow the senior vice-president of Lloyds' agent to assess the risks involved in insuring Coventree. The main topic of conversation concerned the potential litigation risks that were the subject of the October 16, 2007 notice.

[24] A back and forth process ensued. On October 3 and 14, Lloyds' agent sent a document to Coventree's brokers variously referred to as a "quote", a "proposal" or a "binder". There are two important aspects of these documents. First, each was subject to Lloyds accepting an application "with original signature". Second, each of these documents contained the phrase:"waive questions number 6 and 7".

[25] On October 16, 2008, Coventree's broker emailed Lloyds' agent stating in part: "Please bind coverage effective 10/17/08 - 4/17/10 ... for a limit of 10M (of which 5M will have full prior act coverage) and a premium of $535,000". [Emphasis added.]

[26] On October 17, 2008, the senior vice-president of Lloyds' agent sent a temporary binder providing coverage with the same language as referred to in para. 25 above waiving the answers to questions 6 and 7.

[27] Pausing in the narrative here, the application judge found that Lloyds intended to waive the answers to clauses 6(c) and 7 in the application form as well as the carve outs that followed these questions. Specifically, the application judge found that Lloyds intended to waive the carve outs in the applications as they applied to matters referred to in the October 17, 2007 notice.

[28] In my view, the application judge's conclusion that Lloyds had waived the carve out provisions as of October 17, 2008 was supported by the evidence.

Lloyds knew about the October 16, 2007 notice. It had a copy of it. Coventree, through its brokers, had made it clear that it wanted “full prior act coverage” and on October 17, 2008, Lloyds issued a binder providing temporary coverage in which it waived the answer to questions 6 and 7. I accept that waiving an answer to a question does not necessarily imply waiver of the carve out that followed. However, it makes little sense in these circumstances that if Lloyds wished to exclude the matters referred to in the October 16, 2007 notice, it would have waived the answers to questions 6 and 7. Prior to including the words “waive questions number 6 and 7” in its temporary binder, Lloyds had received an application on September 18 in which the questions had been answered. Further, Lloyds waived the answer to those questions in the face of Coventree’s express request on October 16, 2008 for full prior act coverage.

[29] In addition, I am satisfied that, as of October 17, 2008, a reasonable person viewing these circumstances objectively would have understood that the parties had agreed that Lloyds would provide full prior acts coverage to the extent of $5 million, at least for the matters included in the October 16, 2007 notice. I recognize that a temporary binder is not part of the final policy of insurance when issued. That said, I think that the temporary binder is part of the factual matrix and is therefore relevant to what the objectively viewed intention of the parties was as they proceeded forward after October 17, 2008.

[30] Lloyds relies heavily on the next series of events arguing that they show that the parties did not intend to include full prior act coverage in the issued policy.

[31] In the weeks following October 17, 2008, Coventree submitted three further applications to Lloyds electronically. In each, it answered question 6(c) as it had done in its original application of September 18.

[32] On November 20, Lloyds issued the 2008 policy. The policy provided that Coventree's application for insurance forms a part of the policy. Lloyds appended a copy of Coventree's application with question 6(c) answered in the affirmative, but without the October 17, 2007 notice appended. Lloyds argues that as a result, the issued insurance policy includes the carve out which became operative when question 6(c) was answered in the affirmative.

[33] I do not accept this argument. It would be more than a little surprising if once Coventree obtained a temporary binder to cover the prior acts referred to in the October 17, 2007 notice, it then forewent that coverage in submitting the further applications.

[34] Moreover, despite the issuance of the policy on November 20, 2008, the parties did not finally settle the wording of the endorsement that dealt with what prior acts were excluded from coverage until Lloyds issued Endorsement 24 later in 2009.

[35] In my view, the events following November 20, 2008 refute the argument that the parties intended to exclude the matters referred to in the October 16, 2007 notice. On November 21, 2008, Coventree's broker emailed the agent for Lloyds expressing concern about Endorsement 21 to the issued policy, which excluded coverage for prior acts from the first $5 million coverage rather than the second $5 million as Coventree's broker understood the agreement to be. In his email, he said:

> ... as it is the second $5M that will not provide full prior act coverage before 10/17/07. The first $5M will have full prior act coverage ... [Emphasis added.]

[36] Thus, Coventree continued to take the position that it was purchasing full prior act coverage. Lloyds did not take issue with this assertion.

[37] On December 10, 2008, Coventree's broker forwarded to Lloyds' agent a new application with questions 6(c) and 7 unanswered. Lloyds' binder of October 17, 2008 required Coventree to submit an application with an original signature. The application forwarded on December 10, 2008 had an original signature and was the only one submitted with an original signature.

[38] The senior vice-president of Lloyds' agent testified that frequently the final application comes in late in the day. Lloyds did not respond to receiving the December 10, 2008 application. Moreover, in December 2008, the parties had

yet to finalize the wording of the endorsement to the policy that specifically dealt with prior act coverage.

[39] Later in 2009, Lloyds issued what turned out to be the final version of the endorsement dealing with prior act coverage. Endorsement 24 amends the exclusion provisions of the policy by adding:

> It is agreed that **Section IV**; **Exclusions**, is amended by adding the following:
>
> based upon, arising out of, relating to, directly or indirectly resulting from or consequence of, or in any way involving any **Wrongful Acts** or related **Wrongful Acts** where all or any part of such acts were committed, attempted or allegedly committed or attempted prior to October 17, 2007, applies only to the $5,000,000 excess of $5,000,000 limit of liability.

[40] The effect of Endorsement 24 is that the second $5 million of $10 million coverage does not apply to acts committed prior to October 17, 2007. Implicitly, however, the first $5 million coverage does apply. Had Lloyds intended to exclude coverage for the acts referred to in the October 16, 2007 notice, it would have been logical to have done so in the endorsement specifically addressing exclusions for prior acts. Instead, it worded the endorsement to implicitly provide $5 million prior act coverage for acts committed before October 17, 2007.

[41] Given the history of the dealings between the parties, I am satisfied that, objectively viewed, the intention of the parties was that the 2008 insurance policy cover the matters referred to in the October 16, 2007 notice.

(c) Section VI.B

[42] Lloyds argues that section VI.B of the 2008 policy operates to exclude coverage for the acts referred to in the October 17, 2007 notice. Section VI(B) reads as follows:

> B. More than one **Claim** involving the same **Wrongful Act** or **Related Wrongful Acts** of one of more **Insureds** shall be considered a single **Claim**, and only one Retention shall be applicable to such single **Claim**. All such **Claims** constituting a single **Claim** shall be deemed to have been made on the earlier of the following dates: (1) the earliest date on which any such **Claim** was first made; or (2) the earliest date on which any such **Wrongful Act** or **Related Wrongful Act** was reported under this Policy or any other policy providing similar coverage.

[43] I do not accept Lloyds' argument. Section VI.B deals with the subject of retention – the amount of loss the insured is responsible for before the insurer has to begin paying up to the policy limits (somewhat akin to a deductible). On the face of it, s. VI.B does not purport to exclude coverage for claims that would otherwise be covered under the policy. In any event, having concluded that the parties intended the Lloyds' 2008 policy to cover acts referred to in October 16, 2007. I do not interpret s. VI.B – a retention clause – to alter that specific agreement relating to coverage.

(d) Section IV.B

[44] Lloyds argues that s. IV.B excludes coverage of matters referred to in the October 17, 2007 notice. Section IV.B is a general exclusion clause for claims for which notice was previously given to another insurer. The applicable part reads as follows:

> The Insurer shall not be liable to make any payment for **Loss** for any **Claim** made against any **Insured** based upon, arising out, relating to, directly or indirectly resulting, in consequence of, in any way involving, or in connection with:
>
> B. any **Wrongful Act** or related **Wrongful Act** or any fact, circumstance or situation which has been the subject of any notice or **Claim** given under any other policy of which this Policy is a renewal or replacement.

[45] Lloyds argues that the Lloyds' 2008 policy was a renewal or replacement of the Great American policy and that clause s. IV.B, therefore, excludes coverage. Coventree takes the opposite position. I do not find it necessary to resolve this issue. I agree with the application judge that once one concludes that the parties intended the Lloyds' 2008 policy to cover the matters referred to in the October 17, 2007 notice, it would make no sense to interpret the general exclusion clause as intending to refer to matters set out in that notice.

[46] The Supreme Court of Canada in the case of *Reid Crowther* set out the principle that in interpreting insurance contracts, exclusion clauses should be narrowly construed. See also: *Derksen v. 539938 Ontario Ltd.*, 2001 SCC 72,

[2001] 3 S.C.R. 398, at para. 49. It follows that a generally worded exclusion clause, as in the case of Section IV.B, should give way to an agreement to cover a specific matter. Having found that the parties intended to cover the matters referred to in the October 16, 2007 notice, I do not accept that s. IV.B overrules that specific agreement.

CROSS-APPEAL ON COSTS

[47] Coventree cross-appeals from the award of costs on a partial indemnity scale. Coventree claims that the application judge erred in not awarding costs on a full indemnity scale because this case involved an insured applying for a declaration regarding the obligation to pay defence costs. Both parties agree that the application judge inadvertently omitted $12,805.63 in disbursements.

[48] Cost awards are discretionary and should not be lightly interfered with. A judge of first instance is in the best position to determine the entitlement, scale and quantum of any such award: *McNaughton Automobile Ltd. v. Co-operators General Insurance Co.*, 2008 ONCA 597, 298 D.L.R. (4th) 86, at para. 27.

[49] The application judge in this case did acknowledge that costs on a full indemnity scale have been awarded in cases involving the duty of the insurer to provide a defence to a claim. However, he found that this case was one where the costs of the defence were claimed as an item insured under the policy, and not one based on the duty of the insurer to provide a defence to a claim that may

fall within the insurance policy. Lloyds had a legitimate question with respect to the interpretation of this policy and it should have been able to raise this question without incurring an exposure to substantial indemnity costs. I see no reason to interfere with the application judge's findings on costs.

[50] Therefore, Coventree's cross appeal on costs is dismissed but the costs award below is increased by $12,805.63 to reflect the application judge's inadvertent oversight of Coventree's claimed disbursements.

DISPOSITION

[51] In the result, I would dismiss the appeal with the respondent's costs on the appeal fixed in the amount of $15,000 and the appellant's costs on the cross appeal fixed in the amount of $5,000. The net amount owing to the respondent is $10,000, inclusive of disbursements and applicable taxes. In addition, and as the parties agreed, the costs award below in favour of Coventree is increased by $12,805.63.

RELEASED: "DOC" "MAY 24 2012"

"D. O'Connor A.C.J.O."
"I agree Robert P. Armstrong J.A."
"I agree David Watt J.A."

Onex Corporation et al. v. American Home Assurance Companyet al. [Indexed as: Onex Corp. v. American Home Assurance Co.]

Ontario Reports

Court of Appeal for Ontario,

O'Connor A.C.J.O., Rosenberg and Simmons JJ.A.

February 25, 2013

114 O.R. (3d) 161 | 2013 ONCA 117

Case Summary

Insurance — Liability insurance — Interpretation and construction — Exclusion clause in directors' and officers' liability insurance policy excluding claims for losses arising from any claim made by or brought against insured's subsidiary M or any act of M's director or officer — M litigation trust established during Chapter 11 bankruptcy proceedings to pursue claims on behalf of M's unsecured creditors — Trustee suing insured and four of its directors (who were also directors of M) for allegedly using their control of M to enrich themselves at M's expense — Claim not "brought by" M — Exclusion clause ambiguous with respect to whether claim against personal defendants in their capacity as directors of insured were excluded — Factual nexus not resolving which interpretation of clause reflected parties' reasonable expectations and intentions — Motion judge erroneously finding that clause was unambiguous and therefore not making findings of fact that were necessary to resolve issue on appeal — Case returned to Superior Court.

Onex and four of its directors and officers (the "personal defendants") were sued in Georgia in 2005 by the trustee of the Magnatrax litigation trust. Magnatrax was a former subsidiary of Onex, and the personal defendants were also directors and officers of Magnatrax. The trust was established during Chapter 11 bankruptcy proceedings to pursue claims on behalf of Magnatrax's unsecured creditors. The trustee alleged that Onex and the personal defendants used their control of Magnatrax to enrich themselves at Magnatrax's expense. That action was eventually settled. Onex incurred substantial costs in defending the action. American issued a 2002-2003 directors' and officers' liability policy to Onex. Clause 7(c) of that policy permitted an insured to give written notice to American of any circumstance that might reasonably be expected to give rise to a claim to enable the insured to obtain coverage for a claim during the policy period even though the claim was not advanced until after the policy period. Another policy -- the Magnatrax Run-Off Policy -- was issued in 2003, in anticipation of Magnatrax ceasing to be an Onex subsidiary and therefore ceasing to be covered under the Onex 2002-2003 Policy. When the Magnatrax Run-Off Policy was issued, Endorsement #14 was added to the Onex 2002-2003 Policy. It provided that American was not liable for any loss arising out of claims brought by or made against Magnatrax or any claim arising out of any breach of duty, act, error or omission of any director or officer of Magnatrax. Onex renewed its directors' and officers' coverage with American in 2003-2004 and in 2004-2005. Clause 4(d) of the Onex 2004-2005 Policy created an exclusion from coverage where a claim was covered under a prior

policy. In 2008, Onex and the personal defendants commenced an action against American and various excess insurers claiming that they were entitled to reimbursement for defence costs incurred in the Georgia action. Before that action was commenced, American had paid out US$15 million -- the full limit of liability -- under the Magnatrax Run-Off Policy to defray the Georgia action defence costs of the personal defendants. On competing motions for summary judgment, the motion judge found that Onex had given notice of circumstances under clause 7(c) of the Onex 2002-2003 Policy so that, [page162] under clause (d) of the 2004-2005 Policy, Onex and the personal defendants were not entitled to reimbursement under the 2004-2005 Policy. The motion judge found that Endorsement #14 of the 2002-2003 Policy did not exclude Onex's claim for reimbursement of defence costs in connection with the Georgia action as it did not exclude any claim by a third party against Onex's directors and officers in their capacity as such for their wrongful acts in relation to Magnatrax. The motion judge therefore ordered American to pay Onex US$15 million on behalf of the personal defendants for defence costs under the 2002-2003 Policy. American moved to amend its pleadings to further particularize its claim for legal or equitable set-off of amounts owing under the 2002-2003 Policy, and moved for summary judgment on its amended counterclaim. The motion judge permitted American to amend its pleadings, but dismissed the motion for summary judgment on the claim as amended. American appealed from the orders requiring it to pay Onex and the personal defendants under the 2002-2003 Policy and dismissing its claim for set-off. Onex and the personal defendants cross-appealed from the dismissal of their action for indemnification under the Onex 2004-2005 Policy and the 2004-2005 Excess Policies, and cross-appealed from the order granting American leave to amend its pleadings to plead set-off.

Held, American's appeal should be allowed; Onex's cross-appeal should be dismissed.

The motion judge did not err in finding that a letter sent by counsel for the Magnatrax creditors' committee to counsel for Magnatrax in 2003, which was forwarded to American, asserting that Magnatrax had claims against Onex, its directors and officers, and the directors and officers of Magnatrax, for breach of fiduciary duty, unjust enrichment "and possibly other claims yet to be identified" satisfied the requirements of clause 7(c) of the 2002-2003 Policy. Accordingly, the Georgia action constituted a claim made during the policy period of the 2002-2003 Policy.

The motion judge did not err in permitting American to amend its pleadings. The set-off issue was not res judicata, and Onex was not prejudiced by the permitted amendments.

The Georgia action was not a claim "brought by" Magnatrax within the meaning of Endorsement #14 of the 2002-2003 Policy. Had the parties intended that the exclusion was to apply to loss arising from a claim brought by assignees, trustees or other representatives asserting Magnatrax's claims, they would have specifically said so. The motion judge erred in finding that Endorsement #14 unambiguously excluded coverage for claims against the personal defendants acting in their capacity as Magnatrax executives, but did not exclude from coverage claims against the personal defendants acting in their capacity as Onex executives. Endorsement #14 was ambiguous on that issue, and the factual matrix did not resolve which interpretation of Endorsement #14 reflected the parties' reasonable expectations or intentions. As the motion judge did not make findings of fact with respect to the issue of the parties' reasonable

expectations or intentions, the matter had to be returned to the Superior Court.

Cases referred to

Brissette Estate v. Westbury Life Insurance Co., [1992] 3 S.C.R. 87, [1992] S.C.J. No. 86, 96 D.L.R. (4th) 609, 142 N.R. 104, J.E. 92-1622, 58 O.A.C. 10, 13 C.C.L.I. (2d) 1, 47 E.T.R. 109, [1992] I.L.R. Â1-2888 at 2051, 36 A.C.W.S. (3d) 449; Combined Air Mechanical Services Inc. v. Flesch (2011), 108 O.R. (3d) 1, [2011] O.J. No. 5431, 2011 ONCA 764, 286 O.A.C. 3, 97 C.C.E.L. (3d) 25, 14 C.P.C. (7th) 242, 13 R.P.R. (5th) 167, 93 B.L.R. (4th) 1, 10 C.L.R. (4th) 17, 211 A.C.W.S. (3d) 845; [page163] Continental Insurance Co. v. Superior Court Los Angeles County, 37 Cal. App. 4th 69, 43 Cal. Rptr. 2d 374 (1995); Co-operators Life Insurance Co. v. Gibbens, [2009] 3 S.C.R. 605, [2009] S.C.J. No. 59, 2009 SCC 59, 99 B.C.L.R. (4th) 1, 396 N.R. 165, 79 C.C.L.I. (4th) 1, J.E. 2010-1, 2010EXP-5, 313 D.L.R. (4th) 513, [2010] 1 W.W.R. 575, [2010] I.L.R. I-4928, 278 B.C.A.C. 283; Dumbrell v. The Regional Group of Companies Inc. (2007), 85 O.R. (3d) 616, [2007] O.J. No. 298, 2007 ONCA 59, 279 D.L.R. (4th) 201, 220 O.A.C. 64, 25 B.L.R. (4th) 171, 55 C.C.E.L. (3d) 155, 154 A.C.W.S. (3d) 1097; Dunn v. Chubb Insurance Co. of Canada (2009), 97 O.R. (3d) 701, [2009] O.J. No. 2726, 2009 ONCA 538, 266 O.A.C. 1, 75 C.C.L.I. (4th) 29; Jesuit Fathers of Upper Canada v. Guardian Insurance Co. of Canada, [2006] 1 S.C.R. 744, [2006] S.C.J. No. 21, 2006 SCC 21, 267 D.L.R. (4th) 1, 348 N.R. 307, J.E. 2006-1123, 211 O.A.C. 363, [2006] R.R.A. 523, 36 C.C.L.I. (4th) 161, [2006] I.L.R. I-4512, 147 A.C.W.S. (3d) 1058, EYB 2006-105962; Kentucky Fried Chicken Canada, a Division of Pepsi-Cola Canada Ltd. v. Scott's Food Services Inc., [1998] O.J. No. 4368, 114 O.A.C. 357, 41 B.L.R. (2d) 42, 83 A.C.W.S. (3d) 382 (C.A.); Lombard Canada Ltd. v. Zurich Insurance Co. (2010), 101 O.R. (3d) 371, [2010] O.J. No. 1645, 2010 ONCA 292, 268 O.A.C. 317, 93 M.V.R. (5th) 188, 83 C.C.L.I. (4th) 163, [2010] I.L.R. I-4980 (C.A.); McCullough v. Fidelity & Deposit Co., 2 F.3d 110 (5th Cir. 1993); Non-Marine Underwriters, Lloyd's of London v. Scalera, [2000] 1 S.C.R. 551, [2000] S.C.J. No. 26, 2000 SCC 24, 185 D.L.R. (4th) 1, 253 N.R. 1, [2000] 5 W.W.R. 465, J.E. 2000-935, 135 B.C.A.C. 161, 75 B.C.L.R. (3d) 1, 18 C.C.L.I. (3d) 1, 50 C.C.L.T. (2d) 1, [2000] I.L.R. I-3810, 96 A.C.W.S. (3d) 479; Onex Corp. v. American Home Assurance Co., [2011] O.J. No. 3031, 2011 ONSC 1142, [2011] I.L.R. I-5166, 98 C.C.L.I. (4th) 228 (S.C.J.); Onex Corp. v. American Home Assurance Co., unreported, January 20, 2012, Patillo J. (S.C.J.); Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada, [2010] 2 S.C.R. 245, [2010] S.C.J. No. 33, 2010 SCC 33, 293 B.C.A.C. 1, [2010] I.L.R. I-5051, 406 N.R. 182, 323 D.L.R. (4th) 513, 9 B.C.L.R. (5th) 1, EYB 2010-179515, 93 C.L.R. (3d) 1, 2010EXP-3049, J.E. 2010-1683, [2010] 10 W.W.R. 573, 73 B.L.R. (4th) 163, 89 C.C.L.I. (4th) 161; Reid Crowther & Partners Ltd. v. Simcoe & Erie General Insurance Co., [1993] 1 S.C.R. 252, [1993] S.C.J. No. 10, 99 D.L.R. (4th) 741, 147 N.R. 44, [1993] 2 W.W.R. 433, J.E. 93-230, 83 Man. R. (2d) 81, 13 C.C.L.I. (2d) 161, 6 C.L.R. (2d) 161, [1993] I.L.R. Â1-2914 at 2206, 37 A.C.W.S. (3d) 1267; Township of Center, Butler County, Pa. v. First Mercury Syndicate, Inc., 117 F.3d 115 (3d Cir. 1997)

Statutes referred to

Bankruptcy Code, 11 U.S.C.

Courts of Justice Act, R.S.O. 1990, c. C.43, s. 134(1)

Rules and regulations referred to

Rules of Civil Procedure, R.R.O. 1990, Reg. 194, rule 20.01(2.1)

APPEAL AND CROSS-APPEAL from the judgment of Pattillo J., [2011] O.J. No. 3031, 2011 ONSC 1142, 98 C.C.L.I. (4th) 228 (S.C.J.) on a motion for summary judgment and a motion for leave to amend pleadings.

Geoffrey D.E. Adair, Q.C., and Alexa Sulzenko, for respondents/cross-appellants.

Glenn A. Smith, Rory Gillis and Marcus B. Snowden, for appellant and respondent on cross-appeal American Home Assurance Company. [page164]

Alan L.W. D'Silva, Mark E. Walli and Ellen M. Snow, for respondents Brit Syndicates Ltd. (Lloyd's Syndicate 2987), Heritage Managing Agency Limited (Lloyd's Syndicate 3245) and XL Insurance Company Limited.

The judgment of the court was delivered by
O'CONNOR A.C.J.O. AND SIMMONS J.A.: —

A. Overview

[1] The main issues before this court concern whether Onex Corporation is entitled to reimbursement for defence and settlement costs ("defence costs") under various directors' and officers' ("D&O") liability insurance policies.

[2] In 2005, Onex, four of its directors and officers -- Gerald W. Schwartz, Christopher A. Govan, Mark Hilson and Nigel Wright (the "personal defendants") -- and others were sued in the State of Georgia by the trustee of the Magnatrax litigation trust (the "Georgia action").

[3] The Georgia action arose out of bankruptcy proceedings involving Magnatrax Corporation under Chapter 11 of the United States Bankruptcy Code, 11 U.S.C. Magnatrax was a former subsidiary of Onex. The Magnatrax litigation trust was established during the Chapter 11 proceedings to pursue claims on behalf of the unsecured creditors of Magnatrax and its subsidiaries.

[4] In the Georgia action, the trustee of the Magnatrax litigation trust alleged that Onex and the personal defendants used their control of Magnatrax to enrich themselves at the expense of Magnatrax and ultimately caused Magnatrax and its subsidiaries to become insolvent.

[5] The Georgia action eventually settled for US$9.25 million. In the course of defending the Georgia action on behalf of itself and the personal defendants, Onex incurred [costs] close to US$35 million.

[6] Like many corporations, Onex regularly purchased D&O liability insurance and excess D&O liability insurance to protect both its own directors and officers, and also the directors and officers of its subsidiaries, from claims arising from their actions while acting in their capacity as directors and officers.

[7] In 2008, Onex and the personal defendants commenced this action (the "Onex action") against American Home Assurance [page165] Company[1] and various excess insurers ("Excess Insurers"). Onex and the personal defendants claimed they were entitled to reimbursement for defence costs incurred in the Georgia action under a US$15 million 2004-2005 American Home D&O policy (the "Onex 2004-2005 Policy") and under various excess D&O policies purchased for the 2004-2005 policy year (the "2004-2005 Excess Policies").[2]

[8] In the alternative, Onex and the personal defendants claimed they were entitled to reimbursement under a US$15 million 2002-2003 American Home D&O policy (the "Onex 2002-2003 Policy").

[9] While serving as directors and officers of Onex, the personal defendants, Wright and Hilson, were also directors and officers of Magnatrax. In the Georgia action, it was alleged that the personal defendants, Schwartz and Govan, acted as de facto directors and officers of Magnatrax.

[10] Before Onex and the personal defendants commenced the Onex action, American Home paid out US$15 million -- the full limit of liability -- under a D&O policy issued to Magnatrax (the "Magnatrax Run-Off Policy") to defray the Georgia action defence costs of the personal defendants and two other directors and officers of Magnatrax.

[11] The Magnatrax Run-Off Policy was issued on May 12, 2003 -- on the eve of Magnatrax's insolvency. It was issued in anticipation of Magnatrax ceasing to be an Onex subsidiary and therefore ceasing to be covered under the Onex 2002-2003 Policy.[3] [page166]

[12] In defending the Onex action, American Home and the Excess Insurers claimed that Onex learned about the possibility of the Georgia action in August 2003 and gave notice to American Home of that possibility (the "notice of circumstances") in compliance with clause 7(c) of the Onex 2002-2003 Policy, as well as clause 7(c) of the Magnatrax Run-Off Policy. Accordingly, under clause 4(d) of the Onex 2004-2005 Policy, if Onex was entitled to any coverage for defence costs in connection with the Georgia action under its American Home D&O policies, it could only be under the Onex 2002-2003 Policy and not under the Onex 2004-2005 Policy or the 2004-2005 Excess Policies.

[13] Further, American Home relied on Endorsement #14 of the Onex 2002-2003 Policy, which was added effective on the date the Magnatrax Run-Off Policy was issued. American Home denied coverage under the Onex 2002-2003 Policy based on its position that Endorsement #14 of that policy excludes any Magnatrax-related claims from coverage.

[14] On competing motions for summary judgment, Pattillo J. accepted American Home's argument that Onex gave notice of circumstances under clause 7(c) of the Onex 2002-2003 Policy. Therefore, under clause 4(d) of the Onex 2004-2005 Policy, Onex and the personal defendants were not entitled to reimbursement for defence costs in connection with the Georgia action. It followed that the Excess Insurers, who had agreed to follow the form of the Onex 2004-2005 Policy, were also excluded from liability under the 2004-2005 Excess Policies for any loss

in respect of the Georgia action. The motion judge accordingly dismissed Onex's action against the Excess Insurers in reasons dated June 30, 2011 and reported at [2011] O.J. No. 3031, 2011 ONSC 1142, 98 C.C.L.I. (4th) 228 (S.C.J.) (the "reported reasons").

[15] However, in his reported reasons, the motion judge rejected American Home's argument that Endorsement #14 of the Onex 2002-2003 Policy excluded Onex's claim for reimbursement of defence costs in connection with the Georgia action. He concluded [at para. 173] that Endorsement #14 does not exclude "any claim by a third party against Onex's directors and officers in their capacity as such for their wrongful acts in relation to Magnatrax".

[16] The motion judge therefore ordered American Home to pay Onex US$15 million on behalf of the personal defendants for [page167] defence costs in connection with the Georgia action under the Onex 2002-2003 Policy.

[17] Following the original summary judgment motions, American Home moved to amend its pleadings to further particularize its claim for legal or equitable set-off of amounts that it paid under the Magnatrax Run-Off Policy against amounts owing under the Onex 2002-2003 Policy. American Home also moved for summary judgment on its amended counterclaim. In unreported reasons dated January 20, 2012 (the "unreported reasons"), the motion judge permitted American Home to amend its pleadings, but went on to dismiss the motion for summary judgment on the claim as amended.

[18] American Home appeals from the motion judge's judgments requiring that it pay US$15 million to Onex and the personal defendants under the Onex 2002-2003 Policy and dismissing its claim for set-off.

[19] Onex and the personal defendants cross-appeal from that part of the motion judge's judgment dismissing their action for indemnification under the Onex 2004-2005 Policy and the 2004-2005 Excess Policies. They also cross-appeal from the motion judge's judgment granting American Home leave to amend its pleadings to plead set-off (collectively, the "Onex cross-appeal").

[20] For the reasons that follow, we would allow American Home's appeal, set aside the decision of the motion judge and return the matter to the Superior Court. In addition, we would dismiss the Onex cross-appeal.

B. Facts

(i) Onex and Magnatrax

[21] Onex is an Ontario corporation that regularly acquires operating businesses with a view to creating value and subsequently either retaining them or disposing of them.

[22] To the knowledge of its D&O insurers, Onex's directors and officers often serve in a dual capacity as directors and officers of its subsidiaries while they remain directors and officers of Onex.

[23] Onex incorporated Magnatrax in Delaware in 1999. Between May 1999 and March 2000, Magnatrax and/or its subsidiaries purchased several U.S. and Canadian manufacturing companies. Three of these transactions were the subject matter of the allegations against Onex

and the personal defendants in the Georgia action. [page168]

(ii) Aon Reed Stenhouse

[24] Aon Reed Stenhouse is an insurance broker who acted as agent and broker for both Onex and Magnatrax in obtaining and negotiating the various policies of insurance at issue.

(iii) Onex's D&O coverage

[25] As we have said, Onex regularly purchased D&O liability insurance to protect both its own directors and officers and also the directors and officers of its subsidiaries from claims arising from their actions while acting in their capacity as directors and officers. These policies were generally "claims made and reported policies", meaning they provide coverage for claims first made against an insured party during the policy period and reported to the insurer within a time frame defined in the policy.

[26] The specific language of all relevant policy provisions referred to in these reasons is set out in the Appendix.

(iv) Onex 2002-2003 Policy

[27] In 2002, American Home, which is a member of the American International Group ("AIG"), issued the Onex 2002-2003 Policy. The policy covered the period from November 29, 2002 to November 29, 2003 and had a US$15 million limit of liability.

[28] Among other things, the Onex 2002-2003 Policy provided "Executive Liability Insurance" and "Organization Insurance". Put briefly, "Executive Liability Insurance" coverage requires an insurer to pay defence costs incurred by directors and officers of a corporation arising from a proceeding against them based on their wrongful conduct as directors and officers of the corporation. "Organization Insurance" entitles a corporation to be reimbursed by the insurer for defence costs it pays on behalf of its directors and officers for such proceedings.

[29] More specifically, the Onex 2002-2003 Policy's Executive Liability Insurance coverage provision provides that American Home would pay the "Loss" of any "Insured Person" arising from a "Claim" made against the "Insured Person" for any "Wrongful Act" of the "Insured Person". The Organization Insurance coverage provision provides that American Home would pay the "Organization" for such loss only to the extent that the Organization has indemnified such "Insured Person".

[30] In the definition section of the Onex 2002-2003 Policy, "Loss" is defined to include "Defence Costs". "Insured Person" is defined to include any Executive of Onex or its subsidiaries. "Executive" is defined to include directors and officers, and [page169] de facto directors and officers, of a corporation, which would include Onex and its subsidiaries.

[31] The definitions of "Claim" and "Wrongful Act" are important for the purposes of this appeal. The relevant portions of these definitions read as follows:

"Claim" means:

(1) a written demand for monetary, non-monetary or injunctive relief;

(2) a civil . . . proceeding for monetary, non-monetary or injunctive relief which is commenced by: (i) service of a Writ of Summons, Statement of Claim or similar originating legal document;

. . . . .

"Wrongful Act" means:

(1) any actual or alleged breach of duty, neglect, error, misstatement, misleading statement, omission or act . . . :

(i) with respect to any Executive of an Organization, by such Executive in his or her capacity as such or any matter claimed against such Executive solely by reason of his or her status as such[.]

[32] Clause 7(c) of the Onex 2002-2003 Policy permits an insured to give written notice to the insurer "of any circumstance which may reasonably be expected to give rise to a Claim" to enable the insured to obtain coverage for a Claim during the policy period even though the Claim is not advanced until after the expiry of the policy period.

[33] Endorsement #10 of the Onex 2002-2003 Policy excludes coverage under the policy for "Loss in connection with any Claim made against any Insured in any bankruptcy proceeding by or against an Organization, when such Claim is brought by the examiner, trustee, receiver, creditors' committee, trust, liquidator or rehabilitator (or any assignee thereof) of such Organization."

[34] In addition to the Onex 2002-2003 Policy, Onex also obtained US$45 million in excess "follow form" D&O insurance for the 2002-2003 coverage period from various excess insurers other than those involved in these proceedings. Onex renewed its D&O policies in each policy year between 2002 and 2005. The level of excess coverage increased over this time frame.

(v) The Magnatrax Run-Off Policy and changes to the Onex 2002-2003 Policy

[35] In January 2003, Onex contemplated selling Magnatrax to a third party. The proposed sale would have ended Magnatrax's status as an Onex subsidiary. This, in turn, would have removed Magnatrax and its executives from coverage under the Onex 2002-2003 Policy. [page170]

[36] In the face of this possibility, Aon, on Onex's behalf, requested a quote from American Home for a "run-off" D&O policy. The proposed run-off policy would protect Magnatrax and its executives for a period of six years against claims commenced after Magnatrax ceased to be an Onex subsidiary (and therefore ceased to be protected under Onex's D&O policies), but which claims related to the executives' conduct or status before Magnatrax ceased to be an Onex subsidiary.

[37] As noted by the motion judge, American Home's quote proposed a number of endorsements to the run-off policy, including #13 -- Non-Pyramiding of Limits; and #14 --

Absolute Onex Corporation Exclusion -- Carve-out for co-defendant with Onex Corporation. Underneath the listed exclusions, the following appeared:

NOTE: Endorsements to be added to Onex Corporation Policy

1. Absolute Exclusion from Magnatrax Corporation;
2. Non-Pyramiding of Limits.

[38] The motion judge found that Aon had concerns about American Home's quote. However, the contemplated sale of Magnatrax was abandoned before the concerns were fully resolved.

[39] On May 11, 2003, Aon was advised by the Magnatrax board of directors that Magnatrax was intending to file for bankruptcy protection. Aon asked American Home to bind coverage for a run-off D&O policy for Magnatrax on an urgent basis. On May 12, 2003, American Home issued a temporary and conditional binder of insurance ("binder") that described the coverages and endorsements to be included in the US$15 million Magnatrax Run-Off Policy.

[40] As noted by the motion judge [at para. 30], 13 endorsements were listed in the binder. In particular, Endorsements #12 and #13 were: "12. Non-pyramiding of Limits (To Be Manuscripted) and 13. Absolute Onex Corporation Exclusion -- Carve-put (sic) for co-defendant with Onex Corporation (To Be Manuscripted)". "To Be Manuscripted" means that the wording of these endorsements had not yet been finalized.

[41] The binder also indicated that two endorsements were to be added to the Onex 2002-2003 Policy. The following language appeared under the listed exclusions:

NOTE: Endorsements to be added to Onex Corporation Policy

Non-pyramiding of Limits (To Be Manuscripted)
Absolute Exclusion from Magnatrax Corporation (To Be Manuscripted) [page171]

[42] Although the binder indicated that two endorsements were to be manuscripted for the Magnatrax Run-Off Policy and two endorsements were to be manuscripted and added to the Onex 2002-2003 Policy, ultimately Endorsements #16 and #4 were added to the Magnatrax Run-Off Policy and only one endorsement was added to the Onex 2002-2003 Policy, namely, Endorsement #14. All of these endorsements are significant for the purposes of this appeal.

[43] Endorsement #16 of the Magnatrax Run-Off Policy deals with coordinating the limits of liability between the Magnatrax Run-Off Policy and other American Home or AIG policies. The relevant portions of Endorsement #16 read as follows:

ENDORSEMENT #16

. . . . .

COORDINATION OF AIG LIMITS
In consideration of the premium charged, it is hereby understood and agreed that, with respect to any Claim under this policy for which coverage is provided by one or more other

policies issued by the Insurer or any other member of the American International Group (AIG), . . . the Limit of Liability provided by virtue of this policy shall be reduced by the limit of liability provided by said other AIG policy.

[44] Endorsement #4 of the Magnatrax Run-Off Policy is important because it provides coverage for Onex Executives in certain circumstances:

ENDORSEMENT #4

. . . . .

DEFINITION OF ORGANIZATION AMENDED TO INCLUDE

ENTITY

(CO-DEFENDANT ONLY)

In consideration of the premium charged, it is hereby understood and agreed that the term "Organization" is amended to include the following entity, subject to the terms, conditions and limitations of this endorsement and this policy.

ENTITY

Onex Corporation

Coverage as is afforded under this policy with respect to a Claim made against Onex Corporation or any Insured Persons thereof shall only apply if: (1) such Claim relates to a Wrongful Act committed by an Insured (other than Onex Corporation or an Insured Person thereof); and (2) an Insured (other than Onex Corporation or an Insured Person thereof) is and remains a defendant in the Claim along with Onex Corporation or any Insured Person thereof.
In all events coverage as is afforded under this policy with respect to a Claim made against Onex Corporation or any Insured Person thereof [page172] shall only apply to Wrongful Acts committed or allegedly committed prior to May 12, 2003.

[45] Neither Onex nor Magnatrax obtained excess insurance for the Magnatrax Run-Off Policy.

(vi) Endorsement #14 to the Onex 2002-2003 Policy

[46] Endorsement #14 is central to the issues on appeal. It was added to the Onex 2002-2003 Policy as part of finalizing the terms of the Magnatrax Run-Off Policy. It is a "Specific Entity/Subsidiary Exclusion", which excludes continuing coverage under the policy for certain Magnatrax-related losses:

ENDORSEMENT #14

SPECIFIC ENTITY/SUBSIDIARY EXCLUSION

(Claims brought by or made against)

In consideration of the premium charged, it is hereby understood and agreed that the Insurer shall not be liable for any Loss alleging, arising out of, based upon or attributable to or in connection with any Claim brought by or made against the Entity listed below and/or any Insureds thereof.

1. MAGNATRAX Corporation (including any subsidiary or affiliate thereof)

It is further understood and agreed that the Definition of Subsidiary shall not include MAGNATRAX Corporation. Further, the Insurer shall not be liable to make any payment for Loss in connection with any Claim made against an Insured alleging, arising out of, based upon or attributable to any breach of duty, act, error or omission of MAGNATRAX Corporation, or any director, officer, member of the board of managers or employee thereof.

(vii) Magnatrax's Chapter 11 bankruptcy proceedings

[47] Magnatrax sought Chapter 11 bankruptcy protection on May 12, 2003. A creditors' committee was formed on May 22, 2003. The creditors' committee selected the law firm of Foley & Lardner to act as its counsel.

[48] On August 19, 2003, the creditors' committee reached an agreement with Magnatrax and its subsidiaries on a plan of reorganization. The Magnatrax plan of reorganization was subsequently confirmed by the U.S. Bankruptcy Court on November 17, 2003. Magnatrax emerged from Chapter 11 protection on January 20, 2004. After that date, Onex no longer had any ownership interest in Magnatrax.

(viii) Notice of circumstances -- The Foley letter

[49] On August 1, 2003, Foley and Lardner, counsel for the Magnatrax creditors' committee, wrote a letter to counsel for [page173] Magnatrax asserting that the creditors' committee believed that Magnatrax had various claims against Onex and its affiliates, and the officers and directors of Onex and Magnatrax.

[50] As described in the Foley letter, the purported claims were against "those parties involved in the May 1999, September 1999 and March 2000 transactions, as well as the credit facilities and related agreements supporting those transactions". The letter refers to numerous claims, including breach of fiduciary duty, aiding and abetting breach of fiduciary duty, unjust enrichment, preference claims "and possibly other claims yet to be identified".

[51] The Foley letter requested confirmation that Magnatrax would prosecute all of these claims or, in the alternative, sought confirmation that the committee could pursue the claims on Magnatrax's behalf.

[52] After receiving the Foley letter, counsel for Magnatrax forwarded it to Aon on August 7, 2003 and inquired about what notice should be sent to Magnatrax's insurers.

[53] On November 28, 2003, the day before the Onex 2002-2003 Policy was to expire, Aon faxed the Foley letter to American Home. In doing so, Aon referenced both the Onex 2002-2003

Policy and the Magnatrax Run-Off Policy and stated that the Foley letter "contains information on a situation which could in future give rise to a claim under [those] polic[ies]".

(ix) Onex's 2004-2005 D&O coverage

[54] Onex renewed its US$15 million D&O coverage with American Home in 2003-2004 and in 2004-2005. As it had done in other years, Onex also obtained excess "follow form" D&O coverage for 2004-2005.

[55] The coverage provisions under the Onex 2004-2005 Policy are the same as the coverage provisions under the Onex 2002-2003 Policy.

[56] Clause 4(d) of the Onex 2004-2005 Policy is significant to this appeal. It creates an exclusion from coverage where a Claim is covered under a prior policy:

> 4. EXCLUSIONS
> The Insurer shall not be liable to make any payment for Loss in connection with any Claim made against an Insured:
>
> . . . . .
>
> (d) alleging, arising out of, based upon or attributable to the facts alleged, or to the same or related Wrongful Acts alleged or contained in any Claim which has been reported, or in any circumstances of which notice has been given, under any policy of which this policy is a renewal or replacement or which it may succeed in time[.][page174]
>
> (e) Removal of the Specific Entity/Subsidiary Exclusion endorsement

[57] The policy wording for the Onex 2004-2005 Policy was not sent to Aon for review until May 10, 2005. After receiving the policy language, Aon requested that American Home delete the endorsement containing the Specific Entity/Subsidiary Exclusion, which was Endorsement #14 in the Onex 2002-2003 Policy and Endorsement #13 in the Onex 2003-2004 Policy, and replace it with a Prior Acts Exclusion to provide coverage under the Onex 2004-2005 Policy for wrongful acts committed by Magnatrax directors and officers during the period May 12, 2003 to January 20, 2004 when Magnatrax and its subsidiaries were in Chapter 11 protection.

[58] The Onex 2004-2005 Policy was later re-issued with the Prior Acts Exclusion replacing the Specific Entity Exclusion. The Prior Acts Exclusion appears in the 2004-2005 Policy as Endorsement #13, which states in part:

> PRIOR ACTS EXCLUSION FOR LISTED ENTITIES
>
> . . . . .
>
> In consideration of the premium charged, it is hereby understood and agreed that the term Subsidiary is amended to include the entity(ies) listed below, but only for Wrongful Acts committed by such entity(ies) and/or any Insureds thereof which occurred subsequent to

such entity's respective acquisition/creation date listed below and prior to the time the Named Entity no longer maintains Management Control of such entity(ies), respectively, either directly, or indirectly through one or more other Subsidiaries. Loss arising from the same or related Wrongful Act shall be deemed to arise from the first such same or related Wrongful Act.

ENTITIES ACQUISITION/CREATION DATE
Magnatrax Corporation . . . May 12, 2003

[59] Significantly, the Excess Insurers never agreed to this change in the policy provisions.

(xi) The Georgia action

[60] On May 10, 2005, the trustee of the Magnatrax litigation trust commenced the Georgia action.

[61] The Magnatrax litigation trust was established under s. 4.21 of the Magnatrax plan of reorganization, which was approved by the U.S. Bankruptcy Court, to pursue causes of action on behalf of the litigation trust beneficiaries, who are defined as unsecured creditors of Magnatrax.

[62] Of the 19 counts asserted in the Georgia action, four are asserted against the personal defendants, as well as against two [page175] directors of Magnatrax: (i) breach of fiduciary duty; (ii) aiding and abetting breach of fiduciary duty; (iii) civil conspiracy; and (iv) unjust enrichment. These four counts were also asserted against Onex and various Onex-related companies. The remaining 15 counts in the Georgia action are pleaded only against Onex and Onex affiliates.

[63] The breach of fiduciary duty count alleges that Onex was the de facto board and alter ego of Magnatrax and its subsidiaries. The count further alleges that the defendants exploited their positions as directors and officers of Magnatrax, as de facto directors and officers of Magnatrax, or as the alter ego to the board of Magnatrax, to further their own benefit and in breach of their duties owed to the "Debtors" ("Debtors" refers to Magnatrax and Magnatrax-related companies).

[64] The aiding and abetting breach of fiduciary duty count alleges that each of the defendants knowingly induced, participated in and substantially assisted the other defendants' breaches of fiduciary duty owed to the Debtors.

[65] The civil conspiracy count alleges that the defendants wilfully conspired to embark on a scheme to divert value from the Debtors to themselves; to fraudulently transfer assets and value from the Debtors to the benefit of themselves; and to breach fiduciary duties.

[66] The unjust enrichment count alleges that the defendants used their "complete domination and control of the Debtors" to receive a "benefit from their management of the Debtors, and this benefit inured to the detriment of both the Debtors and the Debtors' creditors".

(xii) Notice of the Georgia action to American Home and the coverage provided by American Home

[67] On July 4, 2005, Aon sent on Onex's behalf a copy of the complaint in the Georgia action to American Home as notice of a Claim under the Onex 2004-2005 Policy.

[68] On September 15, 2005, American Home denied coverage under that policy because the allegations in the Georgia action pre-dated May 12, 2003. According to American Home, the Prior Acts Exclusion in Endorsement #13 of the Onex 2004-2005 Policy limited coverage to Wrongful Acts committed after May 12, 2003.

[69] American Home also contended that the Claim is excluded because the allegations relate to the personal defendants' actions in a capacity other than as an Executive of Onex and subsidiaries of Onex. Finally, American Home raised the possibility that coverage was not available because the allegations in the Georgia [page176] action involved intentional acts that are excluded from coverage by clauses 4(a) and (c) of the Onex 2004-2005 Policy.

[70] Initially, American Home also denied coverage under the Magnatrax Run-Off Policy. However, on August 28, 2006, American Home's counsel indicated that coverage would be available for the personal defendants under that policy based on Endorsement #4. In counsel's view, this co-defendant endorsement afforded coverage with respect to a Claim against Onex Executives provided an insured under the policy remained as a co-defendant in the Claim along with Onex or an Insured Person of Onex.

[71] As we have said, Onex and the personal defendants were jointly represented by counsel throughout the Georgia action and incurred defence costs totalling approximately US$35 million and settlement costs of over US$9 million. American Home paid out US$15 million -- the limit of liability under the Magnatrax Run-Off Policy -- to reimburse the personal defendants and two other Magnatrax directors and officers for their defence costs. Of this US$15 million, US$13,881,991.90 was paid to reimburse the personal defendants and the remaining US$1,118,008.10 was paid to reimburse the two other Magnatrax directors and officers. As noted, Onex and Magnatrax did not obtain excess insurance for the Magnatrax Run-Off Policy.

(xiii) The Onex action against American Home and the Excess Insurers

[72] Onex and the personal defendants commenced this action in 2008 against American Home and the various Excess Insurers seeking coverage under the Onex 2004-2005 Policy and under the 2004-2005 Excess Policies. In the alternative, the plaintiffs sought coverage under the Onex 2002-2003 Policy. American Home and the Excess Insurers defended and also counterclaimed for declarations that they had no obligation to provide coverage.

[73] Onex and the personal defendants, American Home and the Excess Insurers brought competing motions for summary judgment.[4] [page177]

C. Motion Judge's Reasons

[74] In his reported reasons dated June 30, 2011, the motion judge held as follows:

- The Foley letter constituted notice of circumstances under clause 7(c) of the Onex 2002-2003 Policy with
- respect to the Georgia Action.

- Clause 4(d) of the Onex 2004-2005 Policy operates to exclude American Home from having to pay any
- defence costs in connection with the Georgia action under the Onex 2004-2005 Policy. The follow-form 2004-2005 Excess Policies also excluded the Excess Insurers from any liability in respect of the Georgia action.

- Endorsement #14 of the Onex 2002-2003 Policy does not exclude coverage for any claim by a third party
- against Onex's directors and officers in their capacity as such for their wrongful acts in relation to Magnatrax, and thus, under the Onex 2002-2003 Policy, American Home is required to indemnify Onex and the personal defendants for defence costs incurred in relation to the Georgia action.

[75] In reaching these conclusions, the motion judge found, at para. 97, that the terms of the D&O policies in issue are clear and unambiguous and that evidence of intention adduced by the various parties was inadmissible.

[76] After receiving the motion judge's decision, American Home brought a motion to amend its counterclaim to have the moneys owing under the Onex 2002-2003 Policy set-off against the US$13,881,991.90 already paid to the personal defendants under the Magnatrax Run-Off Policy. American Home also moved for summary judgment on the set-off issue.

[77] The motion judge granted American Home leave to amend. However, on the motion for summary judgment, he dismissed American Home's counterclaim. In his unreported reasons dated January 20, 2012, he found that Endorsement #16 of the Magnatrax Run-Off Policy does not reduce the limit of liability of the Magnatrax Run-Off Policy, and thus American Home was not entitled to repayment of amounts previously paid to the personal defendants under the Magnatrax Run-Off Policy. Given his conclusion that American Home was not entitled to repayment, he did not consider American Home's claim for set-off. [page178]

D. Issues

The appeal by American Home

[78] American Home raises two issues on the appeal:

(1) Did the motion judge err in concluding that Endorsement #14 of the Onex 2002-2003 Policy does not exclude coverage for defence costs of the personal defendants in connection with the Georgia action?

(2) Did the motion judge err in concluding that Endorsement #16 of the Magnatrax Run-Off Policy does not entitle American Home to set-off amounts owing under the Onex 2002-2003 Policy against payments made under the Magnatrax Run-Off Policy?

[79] It is worth noting that American Home accepts that, but for Endorsement #14, it would be liable to pay the personal defendants the amounts claimed under the Onex 2002-2003 Policy. Thus, American Home accepts that the coverage provisions in that policy include the payment of defence costs of the personal defendants arising from the Georgia action.

The Onex cross-appeal

[80] On the cross-appeal, two issues need to be considered:

(1) Did the motion judge err in concluding that the Foley letter complied with the requirements of clause 7(c) of the Onex 2002-2003 Policy?

(2) Did the motion judge err in granting American Home leave to amend its amended amended statement of defence and counterclaim?

[81] We will deal with the Onex cross-appeal first.

E. The Onex Cross-Appeal

(1) The Foley letter and clause 7(c) of the Onex 2002-2003 Policy

[82] On its cross-appeal, Onex argues that the motion judge erred in concluding that the Onex 2004-2005 Policy and the 2004-2005 Excess Policies did not provide coverage because Onex had previously given notice of the circumstances that [page179] gave rise to the Georgia action pursuant to the Onex 2002-2003 Policy.[5]

[83] The Onex 2002-2003 Policy and the Onex 2004-2005 Policy are claims made and reported policies. Losses resulting from a Claim are eligible for coverage under a policy if the Claim is made and reported during the policy period.

[84] Clause 7(c) of the Onex 2002-2003 Policy provides that the period of coverage can be extended beyond the policy period if an insured party provides notice during the policy period of circumstances that may lead to a future Claim. Clause 7(c) states in relevant part:

> If during the Policy Period . . . an Organization or an Insured shall become aware of any circumstances which may reasonably be expected to give rise to a Claim being made against an Insured and shall give written notice to the Insurer of the circumstances, the Wrongful Act allegations anticipated and the reasons for anticipating such a Claim, with full particulars as to dates, persons and entities involved, then a Claim which is subsequently made against such Insured and reported to the Insurer alleging, arising out of, based upon or attributable to such circumstances or alleging any Wrongful Act which is the same as or related to any Wrongful Act alleged or contained in such circumstances, shall be considered made at the time such notice of such circumstances was given.

[85] Clause 7(c) dovetails with clause 4(d) of the standard exclusions in American Home's D&O policies, including the Onex 2004-2005 Policy. Clause 4(d) excludes from coverage under the present policy Loss from any Claim arising out of Wrongful Acts of which notice has been given under a previous policy.

[86] The cross-appeal turns on whether Onex provided American Home with notice of circumstances during the policy period for the Onex 2002-2003 Policy that complied with clause 7(c) of that policy. If it did, then coverage under the Onex 2004-2005 Policy is excluded pursuant to clause 4(d) and, consequently, coverage under the excess insurance follow-form policies would also be excluded.

[87] As we have said, at paras. 49-53, on August 1, 2003, Foley and Lardner, counsel for the Magnatrax creditors' committee, wrote a letter to counsel for Magnatrax asserting that Magnatrax had claims against Onex, the directors and officers of Onex, and the directors and

officers of Magnatrax. These claims were said to arise from "the May 1999, September 1999, and March 2000 transactions, as well as the credit facilities and related agreements supporting those transactions". The letter [page180] refers to numerous claims, including breach of fiduciary duty, aiding and abetting breach of fiduciary duty, unjust enrichment, "and possibly other claims yet to be identified".

[88] On November 28, 2003, the day before the Onex 2002-2003 Policy was to expire, Aon faxed the Foley letter to American Home. In doing so, Aon referred to both the Onex 2002-2003 Policy and the Magnatrax Run-Off Policy and stated that the Foley letter "contains information on a situation which could in future give rise to a claim under [those] polic[ies]".

[89] Onex argues that the Foley letter does not satisfy the specificity requirements of clause 7(c) of the Onex 2002-2003 Policy in that it does not set out full particulars as to dates, persons and entities involved. Onex contends that the letter did not describe the nature of the commercial transactions or Onex's role in them, did not specify any wrongful act that might be alleged, nor did it set out the names of the directors and officers who were involved in the transactions.

[90] The motion judge rejected these same arguments. In his reported reasons, he indicated that he was in agreement with U.S. cases holding that, in determining whether a notice by an insured to an insurer is sufficient, an objective test should be applied having regard to the wording of the policy. He held, at para. 136: "The test is whether the insured objectively complied with the notice provision in the Policy", citing Continental Insurance Co. v. Superior Court Los Angeles County, 37 Cal. App. 4th 69, 43 Cal. Rptr. 2d 374 (1995), at p. 80 Cal. App.; and McCullough v. Fidelity & Deposit Co., 2 F.3d 110 (5th Cir. 1993), at p. 113 F.3d.

[91] We see no reason to interfere with the motion judge's finding that the Foley letter contains sufficient particulars to meet the requirements of clause 7(c). We agree with the motion judge's conclusion, at para. 150, that "it sets out the specific transactions and agreement involved, the dates of the transactions, the claims which are alleged to exist and the entities and individuals involved". What is important here is that Onex, through Aon, provided American Home with the specifics of the threatened litigation as those specifics were provided to it. It was not necessary for the insured to speculate about the names of the individual directors or officers who might be named in the threatened litigation. As found by the motion judge, when viewed objectively as a whole, the Foley letter contains sufficient particulars of the dates, persons and entities involved to comply with clause 7(c) of the Onex 2002-2003 Policy.

[92] We share the motion judge's view that the claims being advanced in the Georgia action are "the same as or related to" [page181] the claims asserted in the Foley letter. The Foley letter referred to claims arising out of transactions in May 1999, September 1999 and March 2000. The Georgia action is based on corporate acquisitions by Magnatrax of American Buildings Company in May 1999, Republic Builders Products in August 1999 and Jannock Limited in March 2000.

[93] Further, the claims asserted in the Georgia action against the personal defendants are breach of fiduciary duty, aiding and abetting breach of fiduciary duty, civil conspiracy and unjust enrichment. The Foley letter sets out a number of claims, including breach of fiduciary duty, aiding and abetting breach of fiduciary duty and unjust enrichment. Thus, the Foley letter alleges

the same or related claims against Onex and the personal defendants as were alleged in the Georgia action.

[94] We therefore agree with the motion judge that the Foley letter meets the requirement of clause 7(c) of the Onex 2002-2003 Policy such that the Georgia action constitutes a Claim made during the policy period of the Onex 2002-2003 Policy.

[95] As a result of clause 4(d) of the Onex 2004-2005 Policy, coverage is excluded under that policy. Coverage is also excluded under the 2004-2005 Excess Policies.

(2) Leave to amend American Home's pleadings

[96] Onex cross-appeals the motion judge's order granting American Home leave to amend its amended amended statement of defence and counterclaim and to further particularize its claim for legal or equitable set-off. Onex submits that the motion judge erred in failing to find that the set-off issue raised by American Home was res judicata. On appeal, Onex advances the same arguments that were made to the motion judge on the issue of res judicata. Onex also submits, as it did on the motion, that permitting the amendment would result in non-compensable prejudice because American Home was effectively allowed to bolster arguments that had already been considered and rejected by the motion judge.

[97] The motion judge dealt with these arguments, at para. 30 of his unreported January 20, 2012 reasons:

> In my view, res judicata does not apply to American Home's proposed amendments. Cause of action estoppel is not applicable. Nor, in my view, is issue estoppel. The issues of whether the limits of the Magnatrax Policy were reduced by the limits of the 2002-2003 D&O Policy and whether American Home was entitled to a refund of amounts paid under the Magnatrax Policy were not decided by me. The former issue was pleaded but not argued. The latter issue is a corollary which arises only on a determination of the first issue. The Action, and specifically the counterclaim has not been concluded. [page182]

[98] We see no reason to interfere with the motion judge's exercise of discretion permitting American Home to amend its pleadings. The motion judge had not yet decided whether the limits of the Magnatrax Run-Off Policy were reduced by the Onex 2002-2003 Policy, nor the corollary issue of whether American Home was entitled to a refund of amounts paid under the Magnatrax Run-Off Policy. We fail to see how Onex was prejudiced by the permitted amendments.

[99] For the foregoing reasons, we would dismiss the Onex cross-appeal.

F. American Home's Appeal

(1) Legal principles

[100] The issues raised by American Home relate to the proper interpretation of certain endorsements in the Onex 2002-2003 Policy and the Magnatrax Run-Off Policy. American Home does not argue that the motion judge erred in setting out the legal principles for

interpreting the terms of an insurance policy. However, we include a summary of these principles because they inform our analysis of the issues raised by American Home's appeal.

[101] The Supreme Court of Canada has canvassed the principles of insurance policy interpretation on several occasions: see Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada, [2010] 2 S.C.R. 245, [2010] S.C.J. No. 33, 2010 SCC 33, at paras. 21-24; Co-operators Life Insurance Co. v. Gibbens, [2009] 3 S.C.R. 605, [2009] S.C.J. No. 59, 2009 SCC 59, at paras. 20-28; Jesuit Fathers of Upper Canada v. Guardian Insurance Co. of Canada, [2006] 1 S.C.R. 744, [2006] S.C.J. No. 21, 2006 SCC 21, at paras. 27-30; Non-Marine Underwriters, Lloyd's of London v. Scalera, [2000] 1 S.C.R. 551, [2000] S.C.J. No. 26, 2000 SCC 24, at paras. 67-71; and Brissette Estate v. Westbury Life Insurance Co., [1992] 3 S.C.R. 87, [1992] S.C.J. No. 86, at pp. 92-93 S.C.R.

[102] The primary interpretative principle is that when language of the policy is unambiguous, the court should give effect to the clear language, reading the contract as a whole: Scalera, at para. 71. The terms of the policy must be examined "in light of the surrounding circumstances, in order to determine the intent of the parties and the scope of their understanding": Jesuit Fathers, at para. 27.

[103] In Kentucky Fried Chicken Canada, a Division of Pepsi-Cola Canada Ltd. v. Scott's Food Services Inc., [1998] O.J. No. 4368, 114 O.A.C. 357 (C.A.), at para. 25, this court referred to the need to examine the language of a contract in light of the [page183] surrounding circumstances: "While the task of interpretation must begin with the words of the document and their ordinary meaning, the general context that gave birth to the document or its 'factual matrix' will also provide the court with useful assistance." In cases of insurance contracts, the evidence of the factual matrix may be of more assistance when the contract is an individually negotiated contract rather than a standard form contract resulting from a routine purchase of an insurance policy.

[104] Be that as it may, before reaching a finding that a contractual provision is ambiguous, the court must assess the words of a contract in light of the factual matrix in which the agreement was written. As Doherty J.A. stated in Dumbrell v. The Regional Group of Companies Inc., 85 O.R. (3d) 616, [2007] O.J. No. 298, 2007 ONCA 59, at para. 54:

> A consideration of the context in which the written agreement was made is an integral part of the interpretative process and is not something that is resorted to only where the words viewed in isolation suggest some ambiguity. To find ambiguity, one must come to certain conclusions as to the meaning of the words used. A conclusion as to the meaning of words used in a written contract can only be properly reached if the contract is considered in the context in which it was made: see McCamus, The Law of Contracts (Toronto: Irwin Law, 2005) at 710-11.

[105] It is important to distinguish what is meant by the factual matrix from extrinsic evidence that is admissible to resolve an ambiguity. The factual matrix is gleaned from the context of the transaction. Doherty J.A. explained in Dumbrell, at para. 55, that the factual matrix "clearly extends to the genesis of the agreement, its purpose, and the commercial context in which the agreement was made".

[106] Where the language of an insurance policy is found to be ambiguous, the court will rely on general rules of contract construction. As explained in Progressive Homes, at para. 23:

> For example, courts should prefer interpretations that are consistent with the reasonable expectations of the parties (Gibbens, at para. 26; Scalera, at para. 71; Consolidated-Bathurst, at p. 901 [Consolidated-Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co., [1980] 1 S.C.R. 888]), so long as such an interpretation can be supported by the text of the policy. Courts should avoid interpretations that would give rise to an unrealistic result or that would not have been in the contemplation of the parties at the time the policy was concluded (Scalera, at para. 71; Consolidated-Bathurst, at p. 901). Courts should also strive to ensure that similar insurance policies are construed consistently (Gibbens, at para. 27). These rules of construction are applied to resolve ambiguity. They do not operate to create ambiguity where there is none in the first place.

[107] In Lombard Canada Ltd. v. Zurich Insurance Co. (2010), 101 O.R. (3d) 371, [2010] O.J. No. 1645, 2010 ONCA 292, at para. 33, this court held that, where there is ambiguity in the [page184] sense that a phrase is capable of bearing two equally reasonable interpretations, the court may consider extrinsic evidence and the applicability of the contra proferentem rule.

[108] However, the admission of extrinsic evidence does not mean that the parties' subjective views of what was intended by the agreement will be used to resolve the ambiguity. On the contrary, the court should adopt the interpretation that gives effect to the reasonable expectations or intentions of the parties: Scalera, at para. 71; Reid Crowther & Partners Ltd. v. Simcoe & Erie General Insurance Co., [1993] 1 S.C.R. 252, [1993] S.C.J. No. 10, at p. 269 S.C.R.; Dunn v. Chubb Insurance Co. of Canada (2009), 97 O.R. (3d) 701, [2009] O.J. No. 2726, 2009 ONCA 538, 266 O.A.C. 1, at para. 35.

[109] We turn now to the arguments with respect to the interpretation of Endorsement #14 of the Onex 2002-2003 Policy.

(2) Endorsement #14 of the Onex 2002-2003 Policy

[110] American Home argues that the motion judge erred in finding that Endorsement #14 of the Onex 2002-2003 Policy does not exclude coverage for the personal defendants' claims for defence costs arising from the Georgia action. According to American Home, under the plain meaning of Endorsement #14, the personal defendants' losses in the form of defence costs fall into each of the following three exclusions in Endorsement #14:

(i) the Georgia action is a Claim made against Magnatrax or its Executives;

(ii) the Georgia action is a Claim brought by Magnatrax; and

(iii) the Georgia action is a Claim based on an act or omission of Magnatrax Executives.

[111] Before turning to the specific arguments, it is important to note that Endorsement #14 to the Onex 2002-2003 Policy is one part of an individually negotiated set of insurance arrangements between Onex, American Home and Magnatrax. Those arrangements resulted from a number of discussions and e-mail exchanges. Those arrangements also included the

issuance of the Magnatrax Run-Off Policy. The origin of those arrangements goes back to the discussions between the parties in January 2003, when Onex was contemplating a sale of Magnatrax. The parties added Endorsement #14 to the Onex 2002-2003 Policy as a result of a negotiated set of contractual arrangements.

[112] Next, it is worth noting that the positions of both parties in approaching the interpretation dispute are commercially reasonable. Onex says that it is reasonable that Onex Executives [page185] would have wanted to maintain coverage under the more extensive Onex tower of insurance policies in the face of Magnatrax's Chapter 11 filing and the heightened litigation risk associated with that filing. American Home, on the other hand, says it would be reasonable for it to provide no more than one of its policy limits to respond to any "Claim" related to Magnatrax. Both of these positions are commercially reasonable when viewed from the parties' own perspective. Hence, the difficulty.

[113] We first explain why we would not give effect to American Home's argument based on the second exclusion identified by American Home in Endorsement #14 of the Onex 2002-2003 Policy.

(a) The Georgia action is a claim brought by Magnatrax

[114] American Home argues that the Loss arising from the Georgia action is excluded by Endorsement #14 of the Onex 2002-2003 Policy because the Loss arises out of or in connection with a Claim brought by Magnatrax. We repeat for convenience the language of the first paragraph of Endorsement #14 that relates to this argument:

> [T]he Insurer shall not be liable for any Loss . . . arising out of . . . or in connection with any Claim brought by . . . [Magnatrax]"[.]

(Emphasis added)

[115] The question then becomes whether the Georgia action, which was brought by the Magnatrax litigation trust as plaintiff, and which asserts only causes of action assigned to it under the Magnatrax plan of reorganization, is a Claim brought by Magnatrax. If so, the Loss arising therefrom is excluded by Endorsement #14.

[116] The motion judge set out the facts relevant to this argument, at paras. 175-77 of his reported reasons. American Home does not dispute the motion judge's summary of the facts.

[117] As we said above, the Georgia action was brought by the trustee of the Magnatrax litigation trust. The Magnatrax litigation trust was established pursuant to s. 4.21 of the Magnatrax plan of reorganization, which was approved by the U.S. Bankruptcy Court in the Chapter 11 proceedings. It is clear, however, from both the Foley letter and the complaint in the Georgia action, that the claims being advanced are claims which, up until their assignment to the litigation trust, belonged entirely to Magnatrax and its subsidiaries.

[118] The Foley letter requested immediate confirmation from Magnatrax and its subsidiaries in bankruptcy that it would pursue the claims identified against the entities and the individuals [page186] named, failing which it requested confirmation that the creditors' committee could pursue the claims of Magnatrax on their behalf.

[119] American Home argues that the motion judge erred in concluding that the Georgia action was not brought by Magnatrax so as to come within the second exclusion in Endorsement #14 of the Onex 2002-2003 Policy. The Georgia action is a derivative action instituted by the litigation trust and alleges causes of action originally belonging to Magnatrax. American Home correctly points out that if the Georgia action had been brought by Magnatrax, it would be clear that Endorsement #14 would have excluded coverage.

[120] American Home also points out that prior to the issuance of Endorsement #14, the exclusion in Endorsement #10 of the Onex 2002-2003 Policy, which amends clause 4(i) in that policy, would have excluded coverage for proceedings --including derivative actions -- commenced by a trustee established in bankruptcy proceedings of Magnatrax for the benefit of its creditors.

[121] The exclusion in clause 4(i) of the Onex 2002-2003 Policy is a standard "Insured versus Insured" exclusion (see the Appendix for the text of clause 4(i)). This exclusion is designed to protect the insurer from having to provide coverage in relation to a legal proceeding by one insured party against another insured party. The "Insured versus Insured" exclusion is designed to prevent collusive proceedings whereby "an insured company might seek to force its insurer to pay for the poor business decisions of its officers or managers": Township of Center, Butler County, Pa. v. First Mercury Syndicate, Inc., 117 F.3d 115 (3d Cir. 1997), at p. 119 F.3d.

[122] Paragraph 3 of clause 4(i) provides that the Insured versus Insured exclusion "shall not apply to":

> (3) in any bankruptcy proceeding by or against an Organization, any Claim brought by the examiner, trustee, receiver, receiver manager, liquidator or rehabilitator (or any assignee thereof) of such Organization, if any[.]

[123] Endorsement #10 deleted subpara. 3 of clause 4(i). Thus, the "Insured versus Insured" exclusion would apply to exclude coverage for a Claim brought in bankruptcy proceedings by a trustee of an Organization as defined in the Onex 2002-2003 Policy.

[124] However, the effect of Endorsement #10 was removed insofar as Magnatrax was concerned after the parties agreed upon Endorsement #14. Endorsement #14 provides that Magnatrax is no longer a Subsidiary of Onex. "Organization" is defined to mean each "Subsidiary". [page187]

[125] American Home argues that there is no evidence that the parties intended that the amendments to the Onex 2002-2003 Policy resulting from the inclusion of Endorsement #14 should operate to expose it to a form of coverage previously excluded -- liability for derivative legal proceedings brought against Onex by a creditors' litigation trust.

[126] The motion judge rejected these arguments. We agree with his conclusion and his reasons, at paras. 178-80 of his reported reasons:

> Notwithstanding that the claims which are asserted against [the personal defendants] in the [Georgia action] are derivative claims which initially belonged to Magnatrax and its subsidiaries, in my view, they are not brought by Magnatrax. The exclusion in the first

> paragraph of Endorsement #14 of the [Onex 2002-2003 Policy] is clear. It applies to "any Claim brought by . . ." Magnatrax or any subsidiary or affiliate thereof. While [the Georgia action] asserts claims which originally belonged to Magnatrax and its subsidiaries, it is brought by the Trustee on behalf of the Magnatrax Litigation Trust and not Magnatrax.
>
> As noted earlier, exclusions are to be interpreted narrowly. In the absence of more expansive wording in Endorsement #14 to exclude derivative claims, the words: "any Claim brought by or made against [Magnatrax, its subsidiaries and affiliates]" restrict the application of the exclusion to claims brought by Magnatrax, its subsidiaries and affiliates. As [the Georgia action] is not such a Claim, Endorsement #14 does not exclude it from coverage.
> Nor, in my view, can American Home rely on Endorsement #10 of the [Onex 2002-2003 Policy] which excludes claims against any Insured where the claim is brought in any bankruptcy proceeding by or against an Organization when the claim is brought by, among others, the creditors' committee or trust. Endorsement #14 removed Magnatrax as a subsidiary thereby excluding it from the definition of Organization under the [Onex 2002-2003 Policy].

[127] To those reasons, we would add that the circumstances surrounding the adoption of Endorsement #14 support the motion judge's interpretation of the words in that clause. The reason for the negotiations that resulted in Endorsement #14, as well as Endorsements #4 and #16 to the Magnatrax Run-Off Policy, was the impending bankruptcy of Magnatrax. Although these three endorsements were not, in fact, issued until sometime after the Chapter 11 proceedings involving Magnatrax had commenced, the endorsements were dated May 12, 2003 so as to coincide with the beginning of the Chapter 11 proceedings.

[128] Endorsement #14 had the effect of removing the bankruptcy exclusion in Endorsement #10 as it applied to Magnatrax. It is significant, we suggest, that the language in Endorsement #14 excludes coverage for Loss arising from a Claim brought by Magnatrax (the insolvent entity) but does not, [page188] as Endorsement #10 had, exclude Loss arising from a Claim brought by a trustee, a creditors' committee or a trust. We do not think that this omission, viewed objectively and reasonably, should be treated as an oversight, particularly when it is considered that Endorsement #14 was drafted in the circumstances of Magnatrax declaring bankruptcy. Rather, given the experience and sophistication of the parties, we conclude, as the motion judge did, that the parties intended the exclusion in Endorsement #14 to apply only to Loss arising from a Claim brought by Magnatrax. Had the parties intended that the exclusion was to apply to Loss arising from a Claim brought by assignees, trustees or other representatives asserting Magnatrax's claims, they would have specifically said so.

[129] We now consider together the remaining two exclusions identified by American Home.

(b) The Georgia action is a claim made against Magnatrax or its executives/The Georgia action is claim based on an act or omission of Magnatrax Executives

[130] American Home argues that the defence costs claimed by the personal defendants are excluded from coverage by two additional exclusions in Endorsement #14 of the Onex 2002-2003 Policy: the remaining language in the first paragraph of Endorsement #14 and the second sentence of the second paragraph of Endorsement #14. We repeat the relevant language for

convenience:

> In consideration of the premium charged, it is hereby understood and agreed that the Insurer shall not be liable for any Loss alleging, arising out of, based upon or attributable to or in connection with any Claim brought by or made against [Magnatrax Corporation] and/or any [Executive] thereof.
>
> . . . . .
>
> Further, the Insurer shall not be liable to make any payment for Loss in connection with any Claim made against an Insured alleging, arising out of, based upon or attributable to any breach of duty, act, error or omission of MAGNATRAX Corporation, or any director, officer, member of the board of managers or employee thereof.

(Emphasis added)

[131] The motion judge did not accept American Home's arguments based on either the first or second paragraphs of Endorsement #14. He concluded, at para. 169 of his reported reasons, that although Endorsement #14 of the Onex 2002-2003 Policy is an exclusion provision, it does not operate as an "absolute" exclusion in respect of all claims against Onex's directors [page189] and officers relating to Magnatrax. He concluded that the language of Endorsement #14 was unambiguous and thus only open to the interpretation he adopted.

[132] We have considered the language of Endorsement #14 of the Onex 2002-2003 Policy in the context of the surrounding circumstances or the factual matrix. In our view, the language viewed in that context is ambiguous. It is open to two reasonable interpretations: the one urged by American Home and the one adopted by the motion judge.

[133] Because there is ambiguity, it becomes necessary to turn to extrinsic evidence to assist with the interpretative exercise. Before turning to the use of extrinsic evidence, we will set out why we consider both of the competing interpretations to be reasonable.

[134] We start with the motion judge's interpretation.

[135] In the motion judge's view, Endorsement #14 excludes coverage for claims against the personal defendants acting in their capacity as Magnatrax Executives, but it does not exclude from coverage claims against the personal defendants acting in their capacity as Onex Executives. The motion judge drew the distinction between the capacity in which the personal defendants were acting, at para. 105 of his reported reasons:

> Further, based on a review of the entire Complaint in the [Georgia] Action and in particular the allegations against [the personal defendants], it is my view that the claims against the [personal defendants] are asserted against them in their capacity both as directors and officers of Onex and as directors (or de facto directors . . .) and officers of Magnatrax. The overarching theme of the Complaint [i.e., the Georgia action] is that Onex, as directed by the [personal defendants] in their capacity as Onex directors and officers, engineered the demise of Magnatrax and its subsidiaries for their collective benefit.

(Emphasis added)

[136] The motion judge went on, at paras. 173-74, to interpret the exclusionary effect of Endorsement #14 as follows:

> Accordingly, when read in its entirety, Endorsement #14 operates to remove Magnatrax (and any subsidiary or affiliate) from coverage under the [Onex 2002-2003 Policy] and exclude any claim against Onex directors and officers by or against Magnatrax or arising out of, based upon or attributable to any act on the part of Magnatrax or its directors and officers. What Endorsement #14 does not exclude, in my view, is any claim by a third party against Onex's directors and officers in their capacity as such for their wrongful acts in relation to Magnatrax.
>
> Based on the above interpretation of Endorsement #14, it is my view that the [Georgia] Action is not excluded from coverage under the [Onex 2002-2003 Policy]. As has been previously discussed, the [Georgia] Action asserts claims against the [personal defendants] in their capacity as directors and/or officers of Onex relating to Magnatrax. The claims are [page190] not based upon or attributable to any act on the part of Magnatrax or its directors and officers.

[137] The motion judge elaborated on his understanding of the term "Claim" in the Magnatrax Run-Off Policy and the Onex 2002-2003 Policy, at paras. 54-55 of his unreported January 20, 2012 reasons:

> The term "Claim" is broadly defined in both the Magnatrax [Run-Off] Policy and the [Onex 2002-2003 Policy] to include, among other things, a written demand for monetary, non-monetary or injunctive relief as well as [a] civil proceeding for monetary, non-monetary or injunctive relief commenced by statement of claim. It is intended to define a triggering event in respect of coverage under the Policies. In my view, however, based on the wording of the Policies as a whole, the definition of Claim is broad enough to also encompass multiple individual claims within an action or proceeding as well. It is not restricted to mean solely an action or proceeding.
>
> To define Claim as being limited to a legal action or proceeding makes no sense having regard to the wording of the Policies. The Policies refer to and deal with actions or proceedings which assert multiple claims where some of the claims are covered and some are not. They also provide for claims against insured in actions where there are co-defendants who are not covered. It is the covered claims within an action or proceeding that are covered rather than the entire action.

[138] These reasons indicate that the motion judge was satisfied that the Georgia action advanced claims against the personal defendants both in their capacities as Executives of Magnatrax and in their capacities as Executives of Onex. American Home does not challenge this finding on appeal.

[139] It is also apparent that the motion judge was satisfied that while the term "Claim" as it is defined in the Onex 2002-2003 Policy refers to a civil proceeding, the term need not necessarily

encompass the entirety of the civil proceeding. According to the motion judge, when the wording of the policies is looked at as a whole, "the definition of Claim is broad enough to also encompass multiple individual claims within an action or proceeding as well. It is not restricted to mean solely an action or proceeding": unreported reasons, at para. 54.

[140] We think that the motion judge's view is tenable to the following extent. We agree that when the wording of the policies is looked at as a whole, it is reasonable to interpret the term "Claim" in Endorsement #14 as not necessarily referring to the entirety of a proceeding. The phrase in the first paragraph of Endorsement #14 --"any Claim . . . made against [Magnatrax or its Executives]" -- can be taken as referring to the Georgia action as advanced against Magnatrax or its Executives, and not as referring to the Georgia action as advanced against Onex or its Executives acting in their capacity as such. [page191]

[141] The following wording of the policies supports this view. Under the terms of the executive liability coverage in the Onex 2002-2003 Policy, American Home was responsible to pay the Loss of an Onex Executive arising from a Claim made against the Executive for any "Wrongful Act" of the Executive.

[142] "Wrongful Act" is defined as meaning:

> (1) any actual or alleged breach of duty, neglect, error, misstatement, misleading statement, omission or act . . .
>
> (2) with respect to any Executive of an Organization, by such Executive in his or her capacity as such or any matter claimed against such Executive solely by reason of his or her status as such[.]

[143] It is apparent from this definition that the capacity in which an Executive is acting when committing a Wrongful Act is a crucial feature of coverage. It is only when acting in his or her capacity as an Executive of the covered Organization that the Executive is covered.

[144] When the Magnatrax Run-Off Policy was issued and Magnatrax and Magnatrax Executives were removed from coverage under the Onex 2002-2003 Policy, it would be reasonable to interpret these policies as providing that Magnatrax Executives would no longer be covered under the Onex 2002-2003 Policy for a Claim brought against them in their capacity as Magnatrax Executives, but that Onex Executives would continue to be covered under the Onex 2002-2003 Policy for Wrongful Acts committed by them in their capacity as Onex Executives. In other words, it is reasonable to interpret the term "Claim" in Endorsement #14 as referring to a proceeding against a particular insured acting in the capacity that attracts coverage. Considered in this light, the wording of the first paragraph of Endorsement #14 -- "the Insurer shall not be liable for any Loss . . . arising out of . . . any Claim . . . made against [Magnatrax or its Executives]" -- could reasonably mean a Claim to the extent that it is advanced against Magnatrax or its Executives in their capacity as such.

[145] On this interpretation of the phrase "any Claim", the exclusion in the second paragraph of Endorsement #14 could reasonably be interpreted as not excluding all of the defence costs of the Georgia action from coverage. If a proceeding (in this case, a civil action) includes causes of action against an insured acting in more than one capacity, it would be necessary to separate

the claims based upon the capacities in which the insured is being sued and to then determine whether or not the insured is covered or excluded under the provisions of the policy. [page192]

[146] In this case, the motion judge found, at para. 105 of his reported reasons, that "[t]he overarching theme of the Complaint [i.e., the Georgia action] is that Onex, as directed by the [personal defendants] in their capacity as Onex directors and officers, engineered the demise of Magnatrax and its subsidiaries for their collective benefit". At para. 174 of his reported reasons, he held that at least some of the claims were advanced against the personal defendants "in their capacity as directors and/or officers of Onex" and are not "based upon or attributable to any act on the part of Magnatrax or its directors and officers".

[147] At least with respect to the unjust enrichment claim, we agree with the motion judge's characterization. This claim is not [at para. 36] "alleging, arising out of, based upon or attributable to any breach of duty, act, error or omission of Magnatrax [or any Magnatrax Executive]". On this view, it would be reasonable to interpret the second paragraph of Endorsement #14 of the Onex 2002-2003 Policy as not excluding the cost of defending the unjust enrichment aspect of the Georgia action.

[148] Having said that, we are not prepared to find that the motion judge's interpretation of Endorsement #14 of the Onex 2002-2003 Policy is the only reasonably available interpretation. We find that American Home's suggested interpretations of the first paragraph of Endorsement #14 and of the second paragraph of Endorsement #14 are also reasonable ones.

[149] In advancing the argument based on the exclusion in the first paragraph of Endorsement #14, American Home's fundamental position is that the word "Claim" in this clause should be read as it is defined in the Onex 2002-2003 Policy. The definition of "Claim" states:

> "Claim" means:
>
> . . . . .
>
> (2) a civil, criminal, administrative, regulatory or arbitration proceeding for monetary, non-monetary or injunctive relief which is commenced by: (i) service of a Writ of Summons, Statement of Claim or similar originating legal document; (ii) return of a summons, information, indictment or similar document (in the case of a criminal proceeding); or (iii) receipt or filing of a notice of charges[.]

[150] Based on the definition of the term "Claim" as a civil proceeding, American Home contends that the first paragraph of Endorsement #14 clearly excludes the personal defendants' defence costs from coverage for two main reasons.

[151] First, the personal defendants' defence costs constitute Loss arising out of, attributable to or in connection with "a civil proceeding", namely, the Georgia action. Second, the Georgia [page193] action is a civil proceeding against Magnatrax Executives, who were named as individual defendants in the Georgia action. Thus, on a plain reading of the first paragraph of Endorsement #14, the personal defendants' Loss in the form of defence costs arising from the Georgia action is excluded from coverage.

[152] Similarly, American Home's argument based on the second paragraph of Endorsement #14 is that this language operates to exclude coverage for Loss in connection with any civil proceeding against Onex Executives alleging, arising out of, based upon or attributable to the conduct of Magnatrax Executives. The Georgia action includes allegations of wrongful acts committed by directors and officers of both Magnatrax and Onex. Thus, the argument goes, the Georgia action is a "Claim" -- that is, a civil proceeding -- arising out of acts by Magnatrax Executives. That being the case, the defence costs associated with the Georgia action are excluded from coverage by the above-quoted language from the second paragraph of Endorsement #14.

[153] On American Home's interpretation, there is no basis in the language of Endorsement #14 or elsewhere in the policy language for assigning a different meaning to the term "Claim" than is provided by the definition in the policy. American Home argues that giving a different meaning to the term "Claim" as it appears in Endorsement #14 would deviate from the meaning of the term most commonly used in the D&O insurance industry.

[154] We agree with American Home to the extent that we conclude that it is reasonable to interpret the term "Claim" in Endorsement #14 in the way the term is defined in the Onex 2002-2003 Policy, namely, as a civil proceeding. On one reading of the first paragraph of Endorsement #14, the Georgia action constitutes a civil proceeding brought against Magnatrax Executives, and the insurer is not liable for "any Loss" in connection with this Claim.

[155] We agree that it is also reasonable to interpret the second paragraph of Endorsement #14 as excluding coverage for the claimed defence costs because these costs arise from a Claim that is based on acts or omissions of Magnatrax Executives. Each of the four counts in the Georgia Action against the individual defendants name both the personal defendants who served as Onex Executives (i.e., Schwartz, Govan, Wright and Hilson), as well as two individual defendants who only served as Magnatrax Executives (i.e., Richard T. Ammerman and Raymond C. Blackmon Jr.). The language of the second paragraph of Endorsement #14 can be read to exclude from coverage the costs of defending the Georgia action because these costs constitute [page194] Loss in connection with a Claim alleging, arising out of, based upon or attributable to the conduct of Magnatrax Executives (i.e., Wright, Hilson, Ammerman and Blackmon).

[156] In assessing the reasonableness of the competing interpretations of the term "Claim" in Endorsement #14, it is necessary to consider if each interpretation is consistent with the use of that term elsewhere in the Onex 2002-2003 Policy. We have reviewed the language of the policy, and in particular have examined Endorsements #5 and #9. American Home contended that the language of these endorsements supports its interpretation of Endorsement #14. We conclude that the way the term "Claim" is used elsewhere in the policy does not assist in determining which interpretation of the use of that term in Endorsement #14 is the correct one. There are reasonable arguments pointing in both directions.

[157] We have also considered the factual matrix in this case, which is set out above in paras. 25-48, above. As we see it, plausible arguments can be made on both sides as to the reasonableness of either interpretation in view of the surrounding circumstances, the provisions of the Magnatrax Run-Off Policy and, when viewed objectively, what the parties to the negotiations would have been trying to accomplish.

[158] In reaching the conclusion that Endorsement #14 is ambiguous, we have specifically considered Endorsements #16 and #4 to the Magnatrax Run-Off Policy (see paras. 43 and 44, above). In our view, these endorsements can be interpreted to sit comfortably with American Home's interpretation of Endorsement #14 in the Onex 2002-2003 Policy.

[159] Using the plain meaning of the definitions provided in the policies, under American Home's interpretation of Endorsement #14 in the Onex 2002-2003 Policy and Endorsement #16 in the Magnatrax Run-Off Policy, coverage is not simultaneously available under the two policies.

[160] According to American Home, Endorsement #4 of the Magnatrax Run-Off Policy would afford coverage with respect to any civil proceeding against Onex or Onex Executives provided that the civil proceeding relates to a Wrongful Act committed by Magnatrax or a Magnatrax Executive if either Magnatrax or a Magnatrax Executive remains as a defendant in the civil proceeding.

[161] That said, we do not think that the compatibility of Endorsements #16 and #4 of the Magnatrax Run-Off Policy with American Home's interpretation of Endorsement #14 in the Onex 2002-2003 Policy is determinative of the interpretation exercise. [page195]

[162] As a starting point, American Home's interpretation of these paragraphs in Endorsement #14 of the Onex 2002-2003 Policy leaves a potential gap in coverage for Onex Executives. On American Home's interpretation, Onex Executives would be covered by the Magnatrax Run-Off Policy for their Wrongful Acts in relation to Magnatrax provided they were sued along with Magnatrax or a Magnatrax Executive. However, they would not be afforded coverage under either policy if they were sued on their own in their capacity as Onex Executives for the same Wrongful Acts.

[163] Further, Endorsement #16 also can be read in a manner that is consistent with the motion judge's interpretation of Endorsement #14 to the Onex 2002-2003 Policy. If "Claim" as it appears in Endorsement #14 to the Onex 2002-2003 Policy is interpreted as meaning the Georgia action as advanced against Magnatrax or its Executives, and not as referring to the Georgia action as advanced against Onex or its Executives acting in their capacity as such, the coverage afforded to Magnatrax Executives under the Magnatrax Run-Off Policy would not trigger Endorsement #16 to the Magnatrax Run-off Policy. Similarly, aspects of the Georgia action advanced against Onex Executives that do not attract coverage under Endorsement #4 of the Magnatrax Run-Off Policy would not trigger Endorsement #16 of the Magnatrax Run-Off Policy. Viewed in this way, Endorsement #16 of the Magnatrax Run-Off Policy does not make the motion judge's interpretation of Endorsement #14 of the Onex 2002-2003 Policy unreasonable.

[164] Endorsement #4 of the Magnatrax Run-Off Policy may sit less comfortably with the motion judge's interpretation of Endorsement #14 of the Onex 2002-2003 Policy. Arguably, the motion judge's interpretation avoids the potential for a gap in coverage if a civil proceeding involving Magnatrax named only Onex and Onex Executives as defendants and did not name as defendants Magnatrax or any individuals who served as Magnatrax Executives. That said, it is not entirely clear what effect such an interpretation would have on the coordination of liability limits under Endorsement #16 of the Magnatrax Run-Off Policy.

[165] In our view, however, the difficulty in reconciling the two endorsements from the Magnatrax Run-Off Policy with the motion judge's interpretation of Endorsement #14 of the Onex 2002-2003 Policy does not determine the interpretative exercise. We have concluded that the ambiguity, as discussed above in these reasons, remains. The factual matrix in this case does not resolve which interpretation of Endorsement #14 of the Onex 2002-2003 Policy reflects the parties' reasonable expectations [page196] or intentions in putting in place the Magnatrax Run-Off Policy and amending the Onex 2002-2003 Policy by adding Endorsement #14.

[166] Each party advanced an interpretation of Endorsement #14 reflecting their reasonable expectation of coverage. Viewed objectively, either interpretation of Endorsement #14 would produce a commercially sensible result.

[167] In summary, we are of the view that the wording of Endorsement #14 in the Onex 2002-2003 Policy is susceptible of more than one meaning and is therefore ambiguous. Accordingly, we do not agree with the motion judge's conclusion, at para. 169 of his reported reasons, that the wording of Endorsement #14 is clear and unambiguous.

[168] Where an ambiguity is first identified on appeal, it must be asked if the appellate court is in a position to resolve the ambiguity de novo. Section 134(1) of the Courts of Justice Act, R.S.O. 1990, c. C.43 empowers this court to make any order that the motion judge could have made. The parties brought competing motions to decide the personal defendants' action by way of summary judgment. The evidentiary record from the motions was filed electronically in this court with leave.

[169] The governing test for assessing if it is appropriate to exercise the powers conferred by rule 20.01(2.1) of the Rules of Civil Procedure, R.R.O. 1990, Reg. 194 on a motion for summary judgment is the full appreciation test from Combined Air Mechanical Services Inc. v. Flesch (2011), 108 O.R. (3d) 1, [2011] O.J. No. 5431, 2011 ONCA 764. This court described the test as follows, at para. 50: "can the full appreciation of the evidence and issues that is required to make dispositive findings be achieved by way of summary judgment, or can this full appreciation only be achieved by way of a trial"?

[170] We have examined the record carefully. Regrettably, we find that we are not in a position to decide the factual issues that need to be determined in order to resolve the interpretative dispute. Having found that Endorsement #14 was unambiguous, the motion judge did not make findings of fact with respect to the issues we consider relevant to the resolution of the interpretation exercise.

[171] In arguing the appeal, the parties each took the position that the interpretation they urged on the court was unambiguous. That being the case, they paid little attention to the issues that we now find must be determined -- what were the reasonable expectations or intentions of the parties in adopting Endorsement #14 of the Onex 2002-2003 Policy? [page197]

[172] Given the disposition we would make of this appeal, we will not express an opinion on the body of evidence that may be relevant to determining that issue. Suffice it to say that there is evidence of discussions and correspondence that took place in January 2003, and again at the time of the issuance of the Magnatrax Run-Off Policy and the issuance of Endorsement #14.

[173] We note that it will be open to the Superior Court to decide, if need be, whether Endorsement #16 of the Magnatrax Run-Off Policy entitles American Home to set-off amounts

that may be found owing under the Onex 2002-2003 Policy against payments made under the Magnatrax Run-Off Policy.

G. Disposition

[174] In the result, we would dismiss the Onex cross-appeal. We would allow American Home's appeal, set aside the order of the motion judge and return the matter to the Superior Court. We leave it open to the parties to decide whether to renew motions for summary judgment or to proceed by way of a trial of the issues that we have identified in these reasons.

[175] The parties may make brief written submissions on costs within a period of 30 days from the release of these reasons.

Appeal allowed; cross-appeal dismissed.

Appendix

1. Onex 2002-2003 Policy

Coverage A: EXECUTIVE LIABILITY INSURANCE
This policy shall pay the Loss of any Insured Person arising from a Claim (including, but not limited to, an Employment Practices Claim, an Oppressive Conduct Claim, a Canadian pollution Claim and a Statutory Claim) made against such Insured Person for any Wrongful Act of such Insured Person, except when and to the extent that an Organization has indemnified such Insured Person. Coverage A shall not apply to Loss arising from a Claim made against an Outside Entity Executive.

. . . . .

2. DEFINITIONS

. . . . .

(c) "Claim" means:

(1) a written demand for monetary, non-monetary or injunctive relief,

(2) a civil, criminal, administrative, regulatory or arbitration proceeding for monetary, non-monetary or injunctive relief which is commenced by: (i) service of a Writ of Summons, Statement of Claim or similar originating legal document; (ii) return of a summons, [page198] information, indictment or similar document (in the case of a criminal proceeding); or (iii) receipt or filing of a notice of charges; or

(3) a civil, criminal, administrative or regulatory investigation of an Insured Person:

(i) once such Insured Person is identified in writing by such investigating authority as a person against whom a proceeding described in Definition (c)(2) may be commenced; or

(ii) in the case of an investigation by any PSC or similar foreign securities authority, after the service of a subpoena upon such Insured Person.

The term "Claim" shall include any Securities Claim, Employment Practices Claim, Oppressive Conduct Claim, Canadian Pollution Claim and Statutory Claim.

. . . . .

(h) "Defence Costs" means reasonable and necessary fees, costs and expenses consented to by the Insurer (including premiums for any appeal bond, attachment bond or similar bond arising out of a covered judgment, but without any obligation to apply for or furnish any such bond) resulting solely from the investigation, adjustment, defence and/or appeal of a Claim against an Insured, but excluding any compensation of any Insured Person or any Employee of an Organization.

. . . . .

(l) "Executive" means any:

(1) past, present and future duty elected or appointed director, officer, trustee or governor of a corporation, management committee member of a joint venture and member of the management board of a limited liability company (or equivalent position), including a de facto director, officer, trustee, governor, management committee member or member of the management board of such entities;

(2) past, present and future person in a duty elected or appointed position in an entity organized and operated in a Foreign Jurisdiction that is equivalent to an executive position listed in Definition (l)(1); or

(3) past, present and future General Counsel and Risk Manager (or equivalent position) of the Named Entity.

. . . . .

(p) "Insured" means any:

(1) Insured Person; or

(2) Organization, but only with respect to a Securities Claim, an Oppressive Conduct Claim or a Canadian Pollution Claim.

(q) "Insured Person" means any:

(1) Executive of an Organization; [page199]

(2) Employee of an Organization; or

(3) Outside Entity Executive.

(r) "Loss" means damages (including aggravated damages), settlements, judgments (including pre/post-judgment Interest on a covered judgment), Defence Costs and Crisis Loss; however, "Loss" (other than Defence Costs) shall not include: (1) civil or criminal fines or penalties; (2) taxes; (3) punitive or exemplary damages; (4) multiplied portion of multiplied damages; (5) any amounts for which an Insured is not financially liable or which are without legal recourse to an Insured; and (6) matters which may be deemed uninsurable under the provincial or state law pursuant to which this policy shall be construed.

. . . . .

(w) "Organization" means:

(1) the Named Entity[.]

. . . . .

(dd) "Subsidiary" means: (1) any for-profit entity that is not formed as a partnership of which the Named Entity has Management Control ("Controlled Entity") on or before the inception of the Policy Period either directly or indirectly through one or more other Controlled Entities and (2) a not-for-profit organization as defined in Section 149.1(b) of the Income Tax Act, R.S.C., 1985 (5th Supp.) sponsored exclusively by the Named Entity.

(ee) "Wrongful Act" means:

(1) any actual or alleged breach of duty, neglect, error, misstatement, misleading statement, omission or act or any actual or alleged Employment Practices Violation:

(i) with respect to any Executive of an Organization, by such Executive in his or her capacity as such or any matter claimed against such Executive solely by reason of his or her status as such;

(ii) with respect to any Employee of an Organization, by such Employee in his or her capacity as such, but solely in regard to any: (a) Securities Claim; or (b) other Claim so long as such other Claim is also made and continuously maintained against an Executive of an Organization; or

(iii) with respect to any Outside Entity Executive, by such Outside Entity Executive in his or her capacity as such or any matter claimed against such Outside Entity Executive solely by reason of his or her status as such; or

(2) with respect to an Organization, any actual or alleged breach of duty, neglect, error, misstatement, mis-leading statement, omission or act by such Organization, but solely in regard to: (a) any Securities Claim or Oppressive Conduct Claim; or (b) a Canadian Pollution Claim so long as such Canadian Pollution Claim is also

made and continuously maintained against an Executive of an Organization. [page200]

. . . . .

4. EXCLUSIONS

The Insurer shall not be liable to make any payment for Loss in connection with any Claim made against an Insured:

(i) which is brought by or on behalf of an Organization or any Insured Person, other than an Employee of an Organization; or which is brought by any security holder or member of an Organization, whether directly or derivatively, unless such security holder's or member's Claim is instigated and continued totally independent of, and totally without the solicitation of, or assistance of, or active participation of, or intervention of, any Executive of an Organization or any Organization, provided, however, this exclusion shall not apply to:

(1) any Claim brought by an Insured Person in the form of a cross-claim or third-party claim for contribution or indemnity which is part of, and results directly from, a Claim that is covered by this policy;

(2) any Employment Practices Claim brought by an Insured Person, other than an Insured Person who is or was a member of the Board of Directors (or equivalent governing body) of an Organization;

(3) in any bankruptcy proceeding by or against an Organization, any Claim brought by the examiner, trustee, receiver, receiver manager, liquidator or rehabilitator (or any assignee thereof) of such Organization, if any;

(4) any Claim brought by any past Executive of an Organization who has not served as a duty elected or appointed director, officer, trustee, governor, management committee member, member of the management board, General Counsel or Risk Manager (or equivalent position) of or consultant for an Organization for at least four (4) years prior to such Claim being first made against any person; or

(5) any Claim brought by an Executive of an Organization formed and operating in a Foreign Jurisdiction against such Organization or any Executive thereof, provided that such Claim is brought and maintained outside Canada, the United States, or any other common law country (including any territories thereof)[.]

. . . . .

7. NOTICE/CLAIM REPORTING PROVISIONS

Notice hereunder shall be given in writing to American Home Assurance Company, 145 Wellington Street West, Toronto, Ontario M5J 1H8: Attention Claims Department. If mailed, the date of mailing shall constitute the date that such notice was given and proof of mailing shall be sufficient proof of notice.

. . . . .

(c) If during the Policy Period or during the Discovery Period (if applicable) an Organization or an Insured shall become aware of any circumstances which may reasonably be expected to give rise [page201] to a Claim being made against an Insured and shall give written notice to the Insurer of the circumstances, the Wrongful Act allegations anticipated and the reasons for anticipating such a Claim, with full particulars as to dates, persons and entities involved, then a Claim which is subsequently made against such Insured and reported to the Insurer alleging, arising out of, based upon or attributable to such circumstances or alleging any Wrongful Act which is the same as or related to any Wrongful Act alleged or contained in such circumstances, shall be considered made at the time such notice of such circumstances was given.

ENDORSEMENT #5

. . . . .

"NO LIABILITY" PROVISION DELETED AND SECURITIES

CLAIM RETENTION APPLIES TO ALL LOSS

In consideration of the premium charged, it is hereby understood and agreed that the policy is hereby amended as follows:

(1) The Definition of and all provisions referring to "No Liability" are hereby deleted in their entirety.

(2) Clause 6 RETENTION CLAUSE is deleted in its entirety and replaced by the following:

6. RETENTION CLAUSE

For each Claim, the Insurer shall only be liable for the amount of Loss arising from a Claim which is in excess of the applicable Retention amounts stated in Items 4(a) through 4(e) of the Declarations, such Retention amounts to be borne by an Organization and/or the Insured Person and remain uninsured, with regard to all Loss other than Non-Indemnifiable Loss. The Retention amount specified in:

(i) Item 4(a) applies to Loss that arises out of a Securities Claim;

(ii) Item 4(b) applies to Loss that arises out of an Employment Practices Claim; and

(iii) Item 4(c) applies to Loss that arises out of Oppressive Conduct Claim;

(iv) Item 4(d) applies to Loss that arises out of a Canadian Pollution Claim; and

(v) Item 4(e) applies to Loss that arises out of any Claim other than a Claim listed in Clause 6(i) through 6(iv) above.

A single Retention amount shall apply to Loss arising from all Claims alleging the same Wrongful Act or related Wrongful Acts.

In the event a Claim triggers more than one of the Retention amounts stated in Items 4(a) through 4(e) of the Declarations, then, as to that Claim, the highest of such Retention amounts shall be deemed the Retention amount applicable to Loss (to which a Retention is applicable pursuant to the terms of this policy) arising from such Claim.
No Retention amount is applicable to Crisis Loss or Non-Indemnifiable Loss. [page202]

. . . . .

ENDORSEMENT #9

. . . . .

PREDETERMINED ALLOCATION FOR DEFENCE COSTS OTHER THAN SECURITIES CLAIM OR EMPLOYMENT PRACTICES CLAIM

In consideration of the premium charged, it is hereby understood and agreed that Clause 8 is hereby amended by adding the following at the end thereof:

If a covered Claim other than a Securities Claim(s) or Employment Practices Claim(s) results in Loss which is both covered under the terms and conditions of this policy and uncovered by the terms and conditions of this policy (other than as a result of an exception of the Definition of Loss, the Definition of Defence Costs or the terms, conditions and limitations of this Clause 8), because such Claim includes both covered and uncovered matters or covered or uncovered parties, then the Insurer, the Insureds and the Company agree to allocate Defence Costs incurred in connection with such Claim, as follows:

Eighty percent (80%) shall be deemed to be Loss incurred by the Insureds; however, the Insurer shall only be liable to pay such Loss of the Insureds subject to the policy's application retention amount, limits of liability, and expressed exceptions to the definition of Loss and the other provisions of this Clause 8 and the definition of Defence Costs; and the remainder shall be deemed to be the obligation of the Organization and the Insureds and not insured under this policy. ("Preset Allocation of Defence Costs")
Provided that in all events the Preset Allocation of Defence Costs described above shall not apply to or create any presumption with respect to the allocation of any damages, judgments or settlement in regard to any Claim.

. . . . .

ENDORSEMENT #10

BANKRUPTCY TRUSTEE, RECEIVER, LIQUIDATOR OR

REHABILITATOR EXCLUSION

In consideration of the premium charged, it is hereby understood and agreed that the Insurer shall not be liable to make any payment for Loss in connection with any Claim made against any Insured in any bankruptcy proceeding by or against an Organization, when such Claim is brought by the examiner, trustee, receiver, creditors' committee, trust, liquidator or rehabilitator (or any assignee thereof) of such Organization.

It is further understood and agreed that the policy is modified as follows:

1. Clause 4. EXCLUSIONS, Exclusion (i) is hereby amended by deleting subparagraph (3) in its entirety.

. . . . .

ENDORSEMENT #14

SPECIFIC ENTITY/SUBSIDIARY EXCLUSION (Claims brought by or made against)

In consideration of the premium charged, it is hereby understood and agreed that the Insurer shall not be liable for any Loss alleging, arising out [page203] of, based upon or attributable to or in connection with any Claim brought by or made against the Entity listed below and/or any Insureds thereof.

1. MAGNATRAX Corporation (Including any subsidiary or affiliate thereof)

It is further understood and agreed that the Definition of Subsidiary shall not include MAGNATRAX Corporation. Further, the Insurer shall not be liable to make any payment for Loss in connection with any Claim made against an Insured alleging, arising out of, based upon or attributable to any breach of duty, act, error or omission of MAGNATRAX Corporation, or any director, officer, member of the board of managers or employee thereof.

2. Magnatrax Run-Off Policy
ENDORSEMENT #4

. . . . .

DEFINITION OF ORGANIZATION AMENDED TO INCLUDE ENTITY (CO-DEFENDANT ONLY)

In consideration of the premium charged, it is hereby understood and agreed that the term "Organization" is amended to include the following entity, subject to the terms, conditions and limitations of this endorsement and this policy.

ENTITY

Onex Corporation

Coverage as is afforded under this policy with respect to a Claim made against Onex Corporation or any Insured Persons thereof shall only apply if: (1) such Claim relates to a Wrongful Act committed by an Insured (other than Onex Corporation or an Insured Person thereof); and (2) an Insured (other than Onex Corporation or an Insured Person thereof) is and remains a defendant in the Claim along with Onex Corporation or any Insured Person thereof.
In all events coverage as is afforded under this policy with respect to a Claim made against Onex Corporation or any Insured Person thereof shall only apply to Wrongful Acts committed or allegedly committed prior to May 12, 2003.

. . . . .

ENDORSEMENT #11

. . . . .

COVERAGES B(i) DELETED ALLOCATION ENDORSEMENT

. . . . .

DEFENCE COSTS) is deleted in its entirety and replaced with the following:

8. DEFENCE COSTS, SETTLEMENTS, JUDGMENTS (INCLUDING THE ADVANCEMENT OF DEFENCE COSTS)

   (a) Under Coverage A, B and C of this policy, except as hereinafter stated, the Insurer shall advance, excess of any applicable retention amount, [page204] covered Defence Costs no later than ninety (90) days after the receipt by the Insurer of such defence bills. Such advance payments by the Insurer shall be repaid to the Insurer by each and every Insured Person or Organization, severally according to their respective interests, in the event and to the extent that any such Insured Person or Organization shall not be entitled under this policy to payment of such Loss.

. . . . .

   (f) In connection with any Claim, other than a Claim that is or includes a Securities Claim, with respect to: (i) Defence Costs jointly incurred by, (ii) any joint settlement entered into by, or (iii) any judgment of joint and several liability against any Organization and any Insured Person, there shall be a fair and equitable allocation as between any such Organization and any such Insured Person, taking into account the relative legal and financial exposures and the relative benefits obtained by any such Insured Person and any such Organization, without any presumption that the coverage afforded to the Insured Person shall in any way

reduce the allocation to the Organization which shall not be insured for such allocation. In the event that a determination as to the amount of Defence Costs to be advanced under the policy cannot be agreed to, then the Insurer shall advance Defence Costs excess of any applicable retention amount which the Insurer states to be fair and equitable until a different amount shall be agreed upon or determined pursuant to the provisions of this policy and applicable law.

. . . . .

ENDORSEMENT #16

. . . . .

COORDINATION OF AIG LIMITS

In consideration of the premium charged, it is hereby understood and agreed that, with respect to any Claim under this policy for which coverage is provided by one or more other policies issued by the Insurer or any other member of the American International Group (AIG), (or would be provided but for the exhaustion of the limit of liability, the applicability of the retention/deductible amount or coinsurance amount, or the failure of the Insured to submit a notice of a Claim), the Limit of Liability provided by virtue of this policy shall be reduced by the limit of liability provided by said other AIG policy.

Notwithstanding the above, in the event such other AIG policy contains a provision which is similar in intent to the foregoing paragraph, then the foregoing paragraph will not apply, but instead:

(1) the Insurer shall not be liable under this policy for a greater proportion of the Loss than the applicable Limit of Liability under this policy bears to the total limit of liability of all such policies, and

(2) the maximum amount payable under all such policies shall not exceed the limit of liability of the policy that has the highest available limit of liability.

Nothing contained in this endorsement shall be construed to increase the limit of liability of this policy. [page205]

3. Onex 2004-2005 Policy

. . . . .

4. EXCLUSIONS

The Insurer shall not be liable to make any payment for Loss in connection with any Claim made against an Insured:

. . . . .

(d) alleging, arising out of, based upon or attributable to the facts alleged, or to the same or related Wrongful Acts alleged or contained in any Claim which has been reported, or in any circumstances of which notice has been given, under any policy of which this policy is a renewal or replacement or which it may succeed in time[.]

. . . . .

ENDORSEMENT #13

PRIOR ACTS EXCLUSION FOR LISTED ENTITIES

In consideration of the premium charged, it is hereby understood and agreed that the term Subsidiary is amended to include the entity(ies) listed below, but only for Wrongful Acts committed by such entity(ies) and/or any Insureds thereof which occurred subsequent to such entity's respective acquisition/creation date listed below and prior to the time the Named Entity no longer maintains Management Control of such entity(ies), respectively, either directly or indirectly through one or more other Subsidiaries. Loss arising from the same or related Wrongful Act shall be deemed to arise from the first such same or related Wrongful Act.

ENTITY(IES) ACQUISITION/CREATION DATE

1. MAGNATRAX Corporation . . . May 12, 2003

For the purpose of the applicability of the coverage provided by this endorsement, the entities listed above and the Organization will be conclusively deemed to have indemnified the Insureds of . . . each respective entity to the extent that such entity or the Organization is permitted or required to indemnify such Insureds pursuant to law or contract or the charter, bylaws, operating agreement or similar documents of an Organization. The entity and the Organization hereby agree to indemnify the Insureds to the fullest extent permitted by law, including the making in good faith of any required application for court approval.

Notes

1 Now known as Chartis Insurance Company of Canada.

2 As will be further discussed below, the personal defendants' claim for defence costs was based on the executive liability section of the applicable D&O policies. Onex's coverage under the applicable D&O policies was limited to reimbursement for defence costs that it incurred on behalf of the personal defendants.

3 It is not clear from the record when Magnatrax in fact ceased to be an Onex subsidiary. The motion judge stated that Magnatrax ceased to be an Onex subsidiary on November 17, 2003, which was the date the U.S. Bankruptcy Court approved the Magnatrax plan of reorganization. In their appeal facta, the parties suggest different dates for when Magnatrax ceased to be an Onex subsidiary. Onex and the Excess Insurers indicate that Magnatrax ceased to be an Onex subsidiary when it emerged from Chapter 11 protection on January 20, 2004, whereas American Home indicates that Magnatrax ceased to be an Onex subsidiary when it declared bankruptcy, which was May 12, 2003. We need not

resolve this issue because Endorsement #14 of the Onex 2002-2003 Policy provides that the definition of subsidiary shall not include Magnatrax Corporation as of May 12, 2003, which is the date that Endorsement #14 became effective and is the inception date of the Magnatrax Run-Off Policy.

4 The motion judge was advised by the parties that as a result of the settlement of the Georgia action, the total amount of Onex and the personal defendants' claim in the action would not impact the third and fifth excess layers of D&O coverage insured by excess D&O policies issued by the defendants Liberty Mutual Insurance Company and Houston Casualty Company for the 2004-2005 period. The parties agreed that the action should be dismissed against these defendants on consent.

5 The Onex 2004-2005 Policy does not contain the exclusion found in Endorsement #14 in the Onex 2002-2003 Policy.

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COURT OF APPEAL FOR ONTARIO

CITATION: Onex Corporation v. American Home Assurance Company, 2015 ONCA 573
DATE: 20150814
DOCKET: C59844

Juriansz, Lauwers and Huscroft JJ.A.

BETWEEN

Onex Corporation, Gerald W. Schwartz, Christopher A. Govan, Mark Hilson and Nigel Wright

Plaintiffs/Defendants by Counterclaim

(Respondents)

and

American Home Assurance Company, Brit Syndicates Ltd. (Lloyd's Syndicate 2987) and Heritage Managing Agency Limited (Lloyd's Syndicate 3245), XL Insurance Company Limited, Liberty Mutual Insurance Company, Lloyd's Underwriters Syndicates No. 2623, 0623, 0033, AIG Europe (UK) Limited and Houston Casualty Company

Defendant/Plaintiff by Counterclaim

(Appellant)

Ronald G. Slaght Q.C., Glenn A. Smith and Jaclyn Greenberg, for the appellant

Geoffrey D.E. Adair Q.C. and Valarie A. Hogan, for the respondents

Heard: June 4, 2015

On appeal from the judgment of Justice Mary M. Sanderson of the Superior Court of Justice, dated December 5, 2014, with reasons reported at 2014 ONSC 6918

Juriansz J.A.:

A. INTRODUCTION

[1] This appeal is the second time this dispute comes before this court. The appellant, American Home Assurance Company ("American Home"), disputes its liability for defence costs under a directors' and officers' ("D&O") liability insurance policy it issued to the corporate respondent, Onex Corporation ("Onex"). The personal respondents were directors or officers of Onex at the relevant time.

[2] The dispute first came before this court when American Home appealed the summary judgment granted in the respondents' action claiming reimbursement for defence costs in an action pursuant to certain D&O policies issued by American Home. Contrary to the finding of the motion judge, this court found ambiguity in an endorsement to one of the relevant policies. It allowed American Home's appeal, set aside the order of the motion judge, and returned the matter to the Superior Court to hear evidence to resolve the ambiguity.

[3] The trial judge granted judgment in favour of the respondents against American Home in the amount of US$15 million. American Home appeals this judgment. For the reasons that follow, I would dismiss the appeal.

B. BACKGROUND

[4] The history and background to this litigation is discussed extensively in the reasons of the trial judge, and there is no reason to repeat her discussion. I will, therefore, only refer to those matters material to this appeal.

(i) The D&O policies

[5] Onex is a private equity firm incorporated under the laws of Ontario. Magnatrax Corporation ("Magnatrax") was an Onex subsidiary that went into bankruptcy in May 2003.

[6] In 2002, Onex purchased a D&O liability policy from American Home (the "2002-2003 Onex Policy"). The 2002-2003 D&O Policy covered officers and directors of Onex and its subsidiaries in respect of liability for claims first made against them and reported during the policy period. It had an aggregate limit of liability for all loss, including defence costs, of US$15 million. Onex also purchased excess insurance, giving it D&O liability coverage of US$60 million for the period from November 29, 2002 to November 29, 2003.

[7] In May 2003, as Magnatrax was filing for bankruptcy, Aon Reed Stenhouse ("Aon"), an insurance broker who acted as agent and broker for Onex and Magnatrax, asked American Home to bind coverage for a run-off D&O policy for Magnatrax. On May 12, 2003, American Home issued a temporary and

conditional binder of coverage for Executive and Organization Liability Policy number 350 35 03, for the period May 12, 2003 to May 12, 2009, with a limit of US$15 million (the "Run-Off Policy"). The binder indicated that certain endorsements were to be manuscripted[1] and added to the Run-Off Policy and the 2002-2003 Onex Policy.

[8] Ultimately, Endorsement #14, a specific entity subsidiary exclusion, was added to the 2002-2003 Onex Policy ("Endorsement #14"). Endorsement #16, a coordination of limits endorsement ("Endorsement #16"), and Endorsement #4, a co-defendant carve-out endorsement ("Endorsement #4"), were added to the Run-Off Policy.[2] The interpretation of Endorsement #14 to the 2002-2003 Onex Policy and Endorsement #16 to the Run-Off Policy are at the heart of the disputed coverage and this appeal.

[9] Endorsement #14 provides that American Home is not liable for any "Loss alleging, arising out of, based upon or attributable to or in connection with any Claim brought by or made against" Magnatrax. It further provides that American Home is not liable to make payment for any "Loss in connection with any Claim made against an Insured alleging, arising out of, based upon or attributable to any breach of duty, act, error or omission" of Magnatrax or its executives.

---

[1] "To Be Manuscripted" means that the wording of the endorsements had not been finalized.
[2] The full text of these endorsements can be found at Appendix "A" to this decision.

[10] Endorsement #16 (coordination of limits endorsement) deals with coordinating of limits between the Run-Off Policy and other American Home polices. Endorsement #4 (co-defendant carve-out endorsement) provides coverage for Onex executives in certain circumstances.

[11] The 2003-2004 and 2004-2005 Onex Policies each also contained specific entity subsidiary exclusions, which were identical to Endorsement #14 found in the 2002-2003 Onex Policy. In July 2005, the parties agreed to remove the specific entity subsidiary exclusion from the 2004-2005 Onex Policy and replace it with a prior acts exclusion ("Endorsement #13"), which did not remove or exclude any coverage for Onex executives for acts in relation to Magnatrax in their capacity as Onex executives.

(ii) The Georgia Action

[12] On May 10, 2005, the Trustee for the Magnatrax Litigation Trust commenced an action in the US Federal Court of the State of Georgia alleging that the respondents caused the bankruptcy of Magnatrax for the benefit of Onex and its executives (the "Georgia Action"). The Georgia Action described the individual respondents as executives of both Onex and Magnatrax. Mark Hilson and Nigel Wright were officers and directors of both Magnatrax and Onex. Gerald W. Schwartz and Christopher A. Govan were officers and directors of Onex and were alleged to also be *de facto* directors and officers of Magnatrax.

[13] The Georgia Action was settled for US$9.25 million. The settlement and the costs for the defence of the action totaled US$33,344,081 and CDN$103,440.

[14] American Home paid US$13,881,991.90 to the respondents in respect of defence costs incurred in the Georgia Action pursuant to the Run-Off Policy. The remaining US$1,118,008.10 of the US$15 million limit was paid to Robert C. Blackmon Jr. and Robert T. Ammerman, officers and directors of Magnatrax.

(iii) The Onex action against American Home

[15] On October 10, 2008, Onex commenced an action against American Home seeking reimbursement for outstanding defence costs in the Georgia Action pursuant to the 2002-2003 Onex Policy.[3] Onex claimed the individual respondents were covered by the policy for wrongful acts committed in their capacity of Onex executives.

[16] American Home denied coverage under the 2002-2003 Onex Policy. It relied on Endorsement #14 (specific entity subsidiary exclusion), which it submitted excluded coverage for any Magnatrax-related claims. In the

[3] The claim that the individual respondents were covered by the 2002-2003 Onex Policy was made in the alternative. Onex's primary claim was that the respondents were covered by the D&O liability insurance policy for the period 2004-2005. At the motion for summary judgment, the motion judge held that the 2002-2003 Onex Policy applied to the claims made in respect of the Georgia Action because the claim was made and reported prior to the expiration of the 2002-2003 policy period.

alternative, American Home claimed that any monies owing under the 2002-2003 Onex Policy could be set off against the monies already paid out under the Run-Off Policy pursuant to Endorsement #16 (coordination of limits endorsement).

[17] Both parties moved for summary judgment. The motion judge held that the 2002-2003 Onex Policy provided coverage for Onex and its executives for defence costs incurred in connection with the Georgia Action and denied American Home's claim for set off pursuant to Endorsement #16. American Home was ordered to pay the US$15 million limit to Onex and the individual respondents.

[18] On appeal, this court considered the wording of the 2002-2003 Onex Policy, focusing on the meaning of the word "Claim" in both the first and second paragraphs of Endorsement #14 (specific entity subsidiary exclusion).

[19] As noted above, the first paragraph of Endorsement #14 provides that American Home has no liability "for any Loss alleging, arising out of, based upon or attributable to or in connection with any Claim brought by or made against" Magnatrax. The second paragraph provides there is no coverage for "any Loss in connection with any Claim made against an Insured alleging, arising out of, based upon or attributable to any breach of duty, act, error or omission of MAGNATRAX Corporation, or any director, officer, member of the board of managers or employee thereof."

[20] This court found that the wording of Endorsement #14 is ambiguous because the word "Claim" is susceptible to more than one meaning. On the one hand, "Claim" can be interpreted to encompass only an entire civil proceeding without differentiating between the allegations or specific "claims" within that proceeding. On the other hand, "Claim" can be construed to refer to each of the several bases for relief made within a single civil proceeding. The question whether coverage is excluded turns on this distinction because the Georgia Action – one "claim" in the "civil proceeding" sense – asserts several "claims" in the "claim for relief" sense.

[21] This court concluded it was not in a position to resolve the ambiguity *de novo* because it lacked the evidence necessary to determine which interpretation reflected the parties' reasonable expectations or intentions in adopting Endorsement #14. The court set aside the summary judgment and sent the matter back to the Superior Court so factual findings would be made to resolve the dispute.

C. THE TRIAL JUDGE'S DECISION

[22] The trial judge heard four days of evidence and granted judgment in favour of the respondents against American Home in the amount of US$15 million. American Home appeals her judgment.

[23] The trial judge recognized the narrow and specific task assigned by this court. At the outset of her reasons, she reviewed the procedural history of the dispute, and she explained that "[t]he Court of Appeal concluded it was unable to resolve which interpretation of 'Claim' reflected the parties' reasonable expectations or intentions at the time when they put the [Run-Off Policy] into place and when they amended the Onex 2002-2003 Policy by adding Endorsement #14, the Specific Entity Endorsement": at para. 18.

[24] This court's reasons, at paras. 170-172, contain the specific direction to the Superior Court, which the trial judge set out at para 21:

> We have examined the record carefully. Regrettably, we find that we are not in a position to decide the factual issues that need to be determined in order to resolve the interpretative dispute. Having found that Endorsement 14 was unambiguous, the motion judge did not make findings of fact with respect to the issues we consider relevant to the resolution of the interpretation exercise.
>
> In arguing the appeal, the parties each took the position that the interpretation they urged on the court was unambiguous. That being the case, they paid little attention to the issues that we now find must be determined -- what were the reasonable expectations or intentions of the parties in adopting Endorsement #14 of the Onex 2002-2003 Policy?
>
> Given the disposition we would make of this appeal, we will not express an opinion on the body of evidence that may be relevant to determining that issue. Suffice it to say that there is evidence of discussions and correspondence that took place in January 2003, and

> again at the time of the issuance of the Magnatrax Run-Off Policy and the issuance of Endorsement #14.

[25] The trial judge correctly identified her task – to hear evidence required to determine the reasonable expectations or intentions of the parties in adopting Endorsement #14. She also recognized this court's direction at para. 172 that "evidence of discussions and correspondence that took place in January 2003 and again at the time of the issuance of the Magnatrax Run-Off Policy and the issuance of Endorsement #14" would be relevant to the analysis.

[26] The trial judge then identified certain matters about which the parties agreed, namely:

> (a) The Onex 2002-2003 Policy is the relevant Onex Policy.
>
> (b) Of the wrongful acts mentioned in the Georgia Action with respect to Magnatrax, some were alleged to have been committed by Onex directors in their capacity as directors of Onex. Others were alleged to have been committed by Onex directors in their capacity as directors of Magnatrax.
>
> (c) The allegations made in the Georgia Action of wrongful acts committed by Onex directors in their capacity as Onex directors, fell within the grant of coverage in the 2002-2003 Onex Policy.
>
> (d) None of the claims advanced in the Georgia Action were claims by Magnatrax.

[27] The trial judge reviewed the chronology of Onex's incorporation of Magnatrax and the liability policies it purchased. Hano Pak, an underwriter for

American Home, gave evidence that Onex wanted to keep Magnatrax-related claims in a separate policy so it would not impact Onex's limits with respect to other business going forward. According to Pak, American Home wanted everything to do with Magnatrax to be on one policy so that only one policy limit would respond to any claim in connection with Magnatrax. Jonathan Ashall, a vice president at Aon, gave evidence that he wanted full coverage for the Onex executives and was concerned about possible gaps in coverage. He was trying to find solutions to protect Onex and its executives. Andrew Brown of Aon also gave evidence about several different versions of policy wordings that had been circulated.

[28] The trial judge found that the wording of the Run-Off Policy and the Onex policies was not finalized until July 2005. While there was a tentative agreement in January 2003 to keep everything Magnatrax-related in the Run-Off Policy, this was never finalized or included in an agreement. In January 2003, the parties did not discuss the meaning of the word "Claim", nor did they discuss the "dual capacity" issue, that is, whether both policies could be triggered if Onex executives were sued in two different capacities (as executives of Magnatrax and as executives of Onex).

[29] Having reviewed all the evidence surrounding the negotiations, the trial judge concluded that when the wording of the policies was finally settled in July

2005, all parties mutually agreed that Endorsement #4 (co-defendant carve-out endorsement) of the Run-Off Policy would not cover Onex executives acting in their capacity as Onex executives, and that Endorsement #14 of the 2002-2003 Onex Policy would not exclude coverage for Onex executives acting as such in relation to Magnatrax. The Run-Off Policy would, however, cover Onex executives acting in their capacity as Magnatrax executives before May 2003; the Onex Policy would not.

[30] The trial judge found that Pak confirmed this mutual intention and did not add any qualifications or say that the Onex Policy would not provide coverage if the executives were sued in both capacities in the same action. This was because all parties understood that the two policies provided different coverage for Onex executives for different wrongful acts committed in different capacities.

[31] The trial judge also noted that Pak agreed to remove the specific entity subsidiary exclusion from the 2004-2005 Onex Policy and replace it with a prior acts exclusion that would not exclude coverage for Onex executives acting in their capacity as such. Pak explained that the parties did not remove Endorsement #14, the specific entity subsidiary exclusion, from the 2002-2003 Onex Policy because they regarded that policy as obsolete. Both parties assumed the 2004-2005 Onex Policy would respond to the Georgia Action because Aon sent a copy of the complaint in that action to American Home as

notice of a claim under the 2004-2005 Onex Policy. The parties failed to recognize that notice of the claim was made on November 28, 2003, the day before the 2002-2003 Onex Policy expired, when Aon forwarded a letter from the firm Foley & Lardner, counsel for the Magnatrax Creditors' Committee, to American Home (the "Foley Letter").[4]

[32] The trial judge concluded that the term, "Claim", as defined in the 2002-2003 Onex Policy, need not encompass the entirety of a civil proceeding. It is broad enough to encompass multiple claims within a single proceeding. It can mean any allegation triggering coverage, whether alone or included in a larger action.

[33] The trial judge found that American Home had not satisfied the onus of showing that Endorsement #14 (specific entity subsidiary exclusion) plainly and unequivocally removed coverage under the 2002-2003 Onex Policy for Onex executives acting in their capacity as Onex executives. Furthermore, American Home drafted Endorsement #14. While not necessary in these circumstances, if the evidence did not resolve the ambiguity in the endorsement, the doctrine of *contra proferentem* would apply.

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[4] The letter was originally sent to counsel for Magnatrax, and it indicated that Magnatrax and its subsidiaries had various causes of action against Onex and its executives. The letter requests that Magnatrax and its subsidiaries prosecute these claims, and if they do not intend to do so, to provide confirmation to the Creditors' Committee so it may prosecute the claims on their behalf.

[34] The trial judge concluded that the Onex 2002-2003 Policy provides coverage to the Onex executives in their capacity as such, and the plaintiff is entitled to the US$15 million limit of the policy.

[35] The trial judge went on to conclude that Endorsement #16 (coordination of limits endorsement) did not entitle American Home to set off the monies paid under the Run-Off Policy against monies payable under the 2002-2003 Onex Policy.

D. ISSUES

[36] This appeal raises two issues:

1. Did the trial judge err in concluding that Endorsement #14 (specific entity subsidiary exclusion) of the 2002-2003 Onex Policy does not exclude coverage for the respondents' defence costs in connection with the Georgia Action?

2. Did the trial judge err in concluding that Endorsement #16 (coordination of limits endorsement) of the Run-Off Policy does not entitle American Home to set-off amounts owing under the 2002-2003 Onex Policy against payments made under the Run-Off Policy?

E. ANALYSIS

(1) Standard of Review

[37] The issues in this case arise from clauses in insurance contracts that both parties had a real hand in negotiating. The trial judge, as directed by this court, heard evidence of the extensive discussions and correspondence between the parties during those negotiations and made findings accordingly. Issues of contractual interpretation in these circumstances are issues of mixed fact and law that ordinarily attract review on a deferential standard. Extricable errors of law, however, remain subject to the correctness standard: *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, [2014] 2 S.C.R. 633. American Home characterizes the new issues it raises as extricable errors of law.

(2) ISSUE 1: Endorsement #14 of the 2002-2003 Onex Policy

[38] American Home advanced careful and comprehensive arguments as to why it should be concluded that Endorsement #14 (specific entity subsidiary exclusion) of the 2002-2003 Onex Policy excludes any coverage for the Georgia Action. In my view, many of these arguments are repetitions of submissions previously advanced before this court when American Home appealed from summary judgment.

[39] It must be remembered that when this matter was remitted for trial, the trial judge did not have to start from scratch in considering the interpretation of Endorsement #14. That is because this court did not leave the entire interpretive exercise to the trial judge. Rather, this court resolved many of the issues and sent the matter back for the Superior Court judge to determine the meaning of the ambiguous term "Claim" in Endorsement #14 in light of extrinsic evidence.

[40] Certainly the extrinsic evidence of the reasonable expectations of the parties had to be considered with due regard to the words in the policies, read as a whole, bearing in mind their purposes and the surrounding circumstances. However, to the extent that American Home's arguments did not rely on the extrinsic evidence led at trial, they are merely repetitions of arguments previously advanced before this court. The summary of these arguments in the court's previous decision satisfies me that they are the same arguments, perhaps refined, that are advanced before us in this appeal. In my view, this court has already disposed of these arguments, and I find it unnecessary to consider them anew.

[41] I will briefly summarize these arguments and show that this court has already addressed them. I will then address the new arguments that rely on extrinsic evidence and explain why there is no basis to conclude that the trial judge erred in concluding that Endorsement #14 (specific entity subsidiary

exclusion) does not exclude coverage for the respondents' defence costs in the Georgia Action.

(1) Appellant's arguments previously advanced before this court

(i) "Claim" is a defined term in the 2002-2003 Onex Policy, and its meaning is not ambiguous

[42] American Home presented detailed argument as to why the definition of "Claim" in the 2002-2003 Onex Policy is the best evidence of the meaning and use of the word "claim" in other parts of the policy, and that the definition makes evident that the word "Claim" in Endorsement #14 should be understood to mean an entire "civil proceeding". The argument focuses on the words in the policies and does not rely on the extrinsic evidence.

[43] I need not address this argument because this court has already concluded that the way the term "Claim" as used elsewhere in the policy does not resolve the ambiguity. This court noted that the definition of "Claim" was important to the appeal. Nevertheless, it described as tenable the motion judge's conclusion, at para. 54, that "the "definition of Claim is broad enough to also encompass multiple individual claims within an action or proceeding as well. It is not restricted to mean solely an action or proceeding". In taking that view, this court reviewed the wording of the entire policies at issue, and said at paragraph 156:

> In assessing the reasonableness of the competing interpretations of the term "Claim" in Endorsement #14, it is necessary to consider if each interpretation is consistent with the use of that term elsewhere in the Onex 2002-2003 Policy. We have reviewed the language of the policy, and in particular have examined Endorsements #5 and #9. American Home contended that the language of these endorsements supports its interpretation of Endorsement #14. *We conclude that the way the term "Claim" is used elsewhere in the policy does not assist in determining which interpretation of the use of that term in Endorsement #14 is the correct one.* There are reasonable arguments pointing in both directions. [Emphasis added.]

(ii) The D&O insurance industry uses the term "Claim" to refer to a civil proceeding

[44] The appellant reviewed the evidence of Ashall to support its submission that the term "Claim" was widely used in the insurance industry to refer to a lawsuit or "civil proceeding". While Ashall's evidence may not have been before the court on the summary judgment appeal, American Home did advance the argument that the meaning given to the word "Claim" should not deviate from the meaning of the term most commonly used in the D&O insurance industry.

[45] This court considered this argument but concluded it did not resolve the ambiguity as to the meaning of "Claim" in Endorsement #14 (specific entity subsidiary exclusion). I need not consider the argument afresh. Ashall's evidence to which we were taken was far from robust in any event.

(iii) The objective factual matrix supports the conclusion that "Claim" refers to a civil proceeding

[46] American Home submitted that the objective factual matrix in which the policies were negotiated makes evident that the intention was that coverage for Magnatrax-related claims be excluded under the 2002-2003 Onex policy. Before the Run-Off Policy was purchased, there was US$15 million in coverage under the 2002-2003 Onex Policy for all wrongful acts and claims against all executives and subsidiaries, including Magnatrax. The parties arranged the Run-Off Policy and added Endorsement #14 to the Onex policy because of Magnatrax's impending bankruptcy. According to American Home, the purpose of these arrangements was to isolate claims against Magnatrax in order to preserve the US$15 million coverage of the Onex policy for all other ventures. The expectation was that at the time of the bankruptcy, Onex would have no further connection with Magnatrax and any potential claims against Magnatrax would crystallize as of the date of bankruptcy. To give effect to this, coverage under the Run-Off Policy commenced as of the bankruptcy and continued for six years until limitation periods would expire. Onex never took up excess insurance for Magnatrax. Endorsement #14 (specific entity subsidiary exclusion) was added to properly mirror the coverage that had previously been available for Magnatrax-related claims under the Onex policy when Magnatrax was an Onex subsidiary.

[47] This court was alive to this argument and was persuaded it put forward a reasonable view as to what the parties to the negotiations were trying to accomplish. However, it was not the only reasonable view supported by the objective factual matrix. The court specifically stated it had considered the factual matrix and that commercially reasonable arguments could be made to support both of the competing interpretations. At paras. 132 and 165 the court said:

> We have considered the language of Endorsement #14 of the Onex 2002-2003 Policy in the context of the surrounding circumstances or the factual matrix. In our view, the language viewed in that context is ambiguous. It is open to two reasonable interpretations: the one urged by American Home and the one adopted by the motion judge.
>
> …
>
> … The factual matrix in this case does not resolve which interpretation of Endorsement #14 of the Onex 2002-2003 Policy reflects the parties' reasonable expectations or intentions in putting in place the Magnatrax Run-Off Policy and amending the Onex 2002-2003 Policy by adding Endorsement #14.

[48] At paragraph 166 the court added, "Viewed objectively, either interpretation of Endorsement #14 would produce a commercially sensible result."

[49] The argument about what intended purpose and meaning should be inferred from the surrounding objective facts of the commercial context in which the policy was issued was advanced before us without relying on specific

extrinsic evidence introduced at trial. I do not propose to reconsider the argument. The court has already decided that the factual matrix of surrounding objective facts of the commercial context also supports Onex's position. For example, the court observed at para. 162 that American Home's interpretation of Endorsement #14 (specific entity subsidiary exclusion) would leave a potential gap in coverage for Onex Executives:

> … American Home's interpretation of these paragraphs in Endorsement #14 of the Onex 2002-2003 Policy leaves a potential gap in coverage for Onex Executives. On American Home's interpretation, Onex Executives would be covered by the Magnatrax Run-Off Policy for their Wrongful Acts in relation to Magnatrax provided they were sued along with Magnatrax or a Magnatrax Executive. *However, they would not be afforded coverage under either policy if they were sued on their own in their capacity as Onex Executives for the same Wrongful Acts.* [Emphasis added.]

[50] I turn to the appellant's fresh arguments arising from the trial itself.

(2) Appellant's submissions pertaining to use of extrinsic evidence

(a) The appellant submits the trial judge erred in beginning contractual interpretation by considering the extrinsic evidence

[51] The appellant submits that the trial judge approached the exercise of interpreting Endorsement #14 (specific entity subsidiary exclusion) backwards. The appellant says that the correct approach to contract interpretation is to begin with the language of the agreement and then resort to further evidence only

when necessary. Instead, the trial judge started her contractual interpretation with a consideration of extrinsic evidence.

[52] This argument has no merit. As explained above, the trial judge was not tasked with considering the matter afresh. The Court of Appeal had already made findings about the wording of the policies read as a whole in the context of the surrounding circumstances and factual matrix.

[53] In addition, American Home had agreed before the trial judge that the allegations made in the Georgia Action with respect to wrongful acts of Onex executives committed within their capacity as Onex executives fell within the grant of coverage in the 2002-2003 Onex Policy. The trial judge had the narrow task of considering whether the conceded coverage was excluded by Endorsement #14 in light of extrinsic evidence, especially evidence of the discussions and correspondence that took place in January 2003 and again at the time of the issuance of the Run-Off Policy and Endorsement #14.

[54] At para. 20 of her reasons, the trial judge set out what she considered to be the specific question that this court directed her to resolve: “Does Endorsement #14 … to the Onex Policy exclude from coverage, those claims advanced in the [Georgia Action] alleging wrongful acts on the part of the Onex directors said to have been committed in their capacity as Onex Directors?” I agree that that is precisely the exercise this court assigned to her. In that

exercise, the burden of proof was on American Home to establish that the exclusion plainly removed the claim from coverage. The trial judge cited ample authority for this well-established principle at para. 212 of her reasons.

(b) The appellant submits the trial judge erred in giving effect to what she found were the subjective intentions of the parties, and thereby granted "rectification by interpretation"

[55] American Home submits that the trial judge used direct evidence of the parties' subjective intentions to overwhelm the language of the policy, and in effect, granted rectification by giving effect to those subjective intentions. The appellant notes that the respondents did not seek rectification in this case and, in any event, submits they could not have possibly satisfied the strict test for rectification.

[56] American Home's argument centres on the evidence of Pak and the trial judge's treatment of that evidence. Pak negotiated the Run-Off Policy and several Onex policies on behalf of American Home. The wording of the policies was not finalized until July 2005. At that time, Pak agreed with Brown that a specific entity subsidiary endorsement identical to Endorsement #14 (specific entity subsidiary exclusion) had been mistakenly added to successive versions of the Onex policy. Pak, in contradiction to the submission of counsel for American Home, testified that Endorsement #4 (co-defendant carve-out endorsement) of

the Run-Off Policy did not provide coverage for Onex executives acting in their capacity as Onex executives when sued in connection with Magnatrax. As well, Brown and Pak agreed the specific entity subsidiary exclusion in the Onex policies could potentially be construed to exclude coverage under the Onex policy for Onex executives acting in their capacity as Onex executives in relation to Magnatrax. In an email dated July 5, 2005 that Brown sent to Pak confirming the changes they discussed, Brown indicates the concern that "Excluding claims against the specified entity and "any insureds thereof" might have been misinterpreted to mean that this individual was excluded altogether". As the trial judge found, Pak agreed with this and consequently, in July 2005, he and Brown removed the specific entity subsidiary exclusion from the 2004-2005 Onex Policy then in force and replaced it with a prior acts endorsement (Endorsement #13) that did not remove or exclude any coverage from the Onex policy for Onex executives acting in their capacity as Onex executives in relation to Magnatrax.

[57] Pak gave evidence that when the specific entity subsidiary exclusion was deleted from the 2004-2005 Onex Policy, he and Brown did not discuss revising the 2002-2003 Onex Policy to replace the specific entity subsidiary exclusion in that policy with the prior acts exclusion (Endorsement #13) because they mistakenly believed that the 2002-2003 Onex Policy was spent. The 2002-2003 Onex Policy (like the other Onex D&O policies) is a "claims made" policy, that is, it provides coverage for claims first made against an insured party during the

policy period and reported to the insurer within the time frame defined in the policy. Pak and Brown assumed the 2002-2003 Onex Policy was spent because they did not believe any claims were made during the policy period. They had failed to recognize that a notice of claim had been provided by way of the Foley Letter in 2003.

[58] The trial judge placed great weight on Pak's testimony and the evidence about the agreement to remove the specific entity subsidiary exclusion from the 2004-2005 Onex Policy, agreeing with the respondents that this evidence "'changed the landscape' of the interpretive exercise". Based on this evidence, she concluded that the specific entity subsidiary exclusion "was not intended to be included in successive Onex primary policies, including the Onex 2002-2003 Policy, after May 12, 2003."

[59] Thus, American Home submits that the trial judge, in effect, used Pak's direct evidence of the parties' subjective intention to read Endorsement #14 (specific entity subsidiary exclusion) out of the 2002-2003 Onex Policy thereby granting "rectification by interpretation". American Home further submits that the fact that the parties replaced the specific entity subsidiary exclusion in the 2004-2004 Onex Policy with the prior acts exclusion shows that they both regarded the wording of Endorsement #14 in the 2002-2003 Onex Policy to exclude coverage for Onex executives acting in the capacity as such in relation to Magnatrax.

American Home says the trial judge erred by giving effect to what she found was the parties' mutual subjective intention rather than giving effect to the wording of the policy.

[60] I do not accept the submission. This court had already ruled that Endorsement #14 was ambiguous and directed the trial judge to resolve the ambiguity after hearing evidence that included the "discussions and correspondence that took place in January 2003 and again at the time of the issuance of the Magnatrax Run-Off Policy and the issuance of Endorsement #14." The trial judge did not use the extrinsic evidence to give effect to the parties' mutual subjective intention; rather, she used it to resolve the ambiguity in the language of the endorsement.

[61] The trial judge expressly considered Endorsement #14 as properly included in the 2002-2003 Onex Policy and concluded that, in light of the extrinsic evidence relating to the circumstances and discussions leading to the finalization of the policies, American Home's position as to how the ambiguous word "Claim" should be interpreted was simply not tenable. The extrinsic evidence revealed that the parties' mutually intended for the 2002-2003 Onex Policy to cover Onex executives for wrongful acts committed in their capacity as Onex executives. It was, therefore, "objectively unreasonable" to conclude that "Claim" referred only to an entire civil proceeding such that Endorsement #14

(specific entity subsidiary exclusion) would preclude Onex executives from receiving coverage for wrongful acts committed in their capacity as Onex executives contrary to the parties' stated mutual intention.

[62] Finally, the trial judge stated that had there been any lingering ambiguity in the meaning of "Claim", she would have resolved it by applying the doctrine of *contra proferentem*, choosing the meaning resisted by the party who drafted the contract, American Home.

[63] As the trial judge points out, American Home conceded at the outset that the wrongful acts of Onex executives acting as Onex executives alleged in the Georgia Action fell within the grant of coverage of the Onex Policy and would be covered unless excluded by Endorsement #14. The onus was on American Home to show that the endorsement clearly and unequivocally removed coverage. The trial judge found that American Home had not satisfied that onus.

[64] I have not been persuaded that there is any basis to interfere with the trial judge's conclusion.

(3) ISSUE 2: Is American Home entitled to set off the monies dues under the 2002-2003 Onex Policy against the monies paid under the Run-Off Policy?

[65] The second question on appeal is whether Endorsement #16 (coordination of limits endorsement) of the Run-Off Policy entitles American Home to set off the US$15 million payable under the 2002-2003 Onex Policy against the monies it already paid under the Run-Off Policy.

[66] Endorsement #16 provides:

> *In consideration of the premium charged, it is hereby understood and agreed that, with respect to any Claim under this policy for which coverage is provided by one or more other policies issued by the Insurer or any other member of the American International Group (AIG)*, (or would be provided but for the exhaustion of the limit of liability, the applicability of the retention/deductible amount or coinsurance amount, or the failure of the Insured to submit a notice of a Claim), *the Limit of Liability provided by virtue of this policy shall be reduced by the limit of liability provided by said other AIG policy*.
>
> Notwithstanding the above, in the event such other AIG policy contains a provision which is similar in intent to the foregoing paragraph, then the foregoing paragraph will not apply, but instead:
>
> 1. the Insurer shall not be liable under this policy for a greater proportion of the Loss than the applicable Limit of Liability under this policy bears to the total limit of liability of all such policies, and

> 2. the maximum amount payable under all such policies shall not exceed the limit of liability of the policy that has the highest available limit of liability.
>
> Nothing contained in this endorsement shall be construed to increase the limit of liability of this policy. [Emphasis added.]

[67] American Home submits that the trial judge made an extricable legal error by using an incorrect interpretive approach in deriving the meaning of this endorsement. American Home points out that in its previous decision this court did not find that Endorsement #16 was ambiguous. The trial judge should, therefore, have begun by considering the wording of the endorsement, instead of immediately resorting to the extrinsic evidence as American Home submits she did.

[68] I do not accept the argument.

[69] It is true that the trial judge's analysis began with a reference to the extrinsic evidence. She did so to highlight what both counsel had agreed before her: "that [the] parties intended that whatever coverage for Onex directors was provided by the [Run-Off Policy] would be taken away from the Onex 2002-2003 Policy." This agreed proposition was the springboard for the trial judge's analysis of the wording of Endorsement #16.

[70] In addressing the wording, the trial judge noted that the word "Claim" in Endorsement #16 was not used in isolation but was part of the phrase "claim

under this policy." In her view, American Home chose this wording so that Endorsement #16 applied to “allegations of wrongful acts limited to wrongful acts covered under the [Run-Off Policy] i.e., wrongful acts committed by Magnatrax or Magnatrax directors [including those of Onex directors acting in their capacity as Magnatrax directors]” (emphasis in original): *Onex* (S.C. 2014), at para. 258. She added, at para. 258:

> It would strain the wording of "claim under this policy" to interpret "claim under this policy" to extend beyond wrongful acts covered under the [Run-Off Policy] to include allegations of wrongful acts covered under the [Run-Off Policy] AND wrongful acts **not** covered under the [Run-Off Policy] [e.g., allegations of wrongful acts made against Onex directors acting in their capacity as Onex directors]. [Emphasis in original.]

[71] It seems to me American Home’s failure on this issue follows from its failure on the first issue. In order for Endorsement #16 (coordination of limits endorsement) to entitle American Home to a set off, the “dual capacity” interpretation would have to be rejected and the word “Claim” would have to be taken to mean a “civil proceeding” and not each allegation made within a civil proceeding.

[72] Given the meaning of “Claim” adopted under Issue 1 above, it follows that the trial judge’s reading of the language of Endorsement #16 is correct. The phrase “claim under this policy” indicates that Endorsement #16 has no application to allegations not covered at all under the Run-Off Policy.

Conclusion

[73] For these reasons, I would dismiss the appeal.

[74] I would fix the respondents costs in the amount of $35,000 all-inclusive as agreed by counsel.

Released: August 14, 2015 (RGJ)

"R.G. Juriansz J.A."
"I agree P. Lauwers J.A."
"I agree Grant Huscroft J.A."

Appendix "A"

1. 2002-2003 Onex Policy

Coverage A: EXECUTIVE LIABILITY INSURANCE

This policy shall pay the Loss of any Insured Person arising from a Claim (including, but not limited to, an Employment Practices Claim, an Oppressive Conduct Claim, a Canadian pollution Claim and a Statutory Claim) made against such Insured Person for any Wrongful Act of such Insured Person, except when and to the extent that an Organization has indemnified such Insured Person. Coverage A shall not apply to Loss arising from a Claim made against an Outside Entity Executive.

…

2. DEFINITIONS

…

(c) "Claim" means:

(1) a written demand for monetary, non-monetary or injunctive relief,
(2) a civil, criminal, administrative, regulatory or arbitration proceeding for monetary, non-monetary or injunctive relief which is commenced by: (i) service of a Writ of Summons, Statement of Claim or similar originating legal document; (ii) return of a summons, information, indictment or similar document (in the case of a criminal proceeding); or (iii) receipt or filing of a notice of charges; or
(3) a civil, criminal, administrative or regulatory investigation of an Insured Person:
    (i) once such Insured Person is identified in writing by such investigating authority as a person against whom a proceeding described in Definition (c)(2) may be commenced; or
    (ii) in the case of an investigation by any PSC or similar foreign securities authority, after the service of a subpoena upon such Insured Person.

The term "Claim" shall include any Securities Claim, Employment Practices Claim, Oppressive Conduct Claim, Canadian Pollution Claim and Statutory Claim.

…

(h) "Defence Costs" means reasonable and necessary fees, costs and expenses consented to by the Insurer (including premiums for any

appeal bond, attachment bond or similar bond arising out of a covered judgment, but without any obligation to apply for or furnish any such bond) resulting solely from the investigation, adjustment, defence and/or appeal of a Claim against an Insured, but excluding any compensation of any Insured Person or any Employee of an Organization.

…

(l) "Executive" means any:

(1) past, present and future duty elected or appointed director, officer, trustee or governor of a corporation, management committee member of a joint venture and member of the management board of a limited liability company (or equivalent position), including a de facto director, officer, trustee, governor, management committee member or member of the management board of such entities;

(2) past, present and future person in a duty elected or appointed position in an entity organized and operated in a Foreign Jurisdiction that is equivalent to an executive position listed in Definition (l)(1); or

(3) past, present and future General Counsel and Risk Manager (or equivalent position) of the Named Entity.

…

(p) "Insured" means any:

(1) Insured Person; or
(2) Organization, but only with respect to a Securities Claim, an Oppressive Conduct Claim or a Canadian Pollution Claim.

(q) "Insured Person" means any:

(1) Executive of an Organization;
(2) Employee of an Organization; or
(3) Outside Entity Executive.

(r) "Loss" means damages (including aggravated damages), settlements, judgments (including pre/post-judgment Interest on a covered judgment), Defence Costs and Crisis Loss; however, "Loss" (other than Defence Costs) shall not include: (1) civil or criminal fines or penalties; (2) taxes; (3) punitive or exemplary damages; (4) multiplied portion of multiplied damages; (5) any amounts for which an Insured is not financially liable or which are without legal recourse to an Insured; and

(6) matters which may be deemed uninsurable under the provincial or state law pursuant to which this policy shall be construed.

…

(w) "Organization" means:

(1) the Named Entity;

…

(dd) "Subsidiary" means: (1) any for-profit entity that is not formed as a partnership of which the Named Entity has Management Control ("Controlled Entity") on or before the inception of the Policy Period either directly or indirectly through one or more other Controlled Entities and (2) a not-for-profit organization as defined in Section 149.1(b) of the Income Tax Act, R.S.C., 1985 (5th Supp.) sponsored exclusively by the Named Entity.

(ee) "Wrongful Act" means:

(1) any actual or alleged breach of duty, neglect, error, misstatement, misleading statement, omission or act or any actual or alleged Employment Practices Violation:
   (i) with respect to any Executive of an Organization, by such Executive in his or her capacity as such or any matter claimed against such Executive solely by reason of his or her status as such;
   (ii) with respect to any Employee of an Organization, by such Employee in his or her capacity as such, but solely in regard to any: (a) Securities Claim; or (b) other Claim so long as such other Claim is also made and continuously maintained against an Executive of an Organization; or
   (iii) with respect to any Outside Entity Executive, by such Outside Entity Executive in his or her capacity as such or any matter claimed against such Outside Entity Executive solely by reason of his or her status as such; or

(2) with respect to an Organization, any actual or alleged breach of duty, neglect, error, misstatement, mis-leading statement, omission or act by such Organization, but solely in regard to: (a) any Securities Claim or Oppressive Conduct Claim; or (b) a Canadian Pollution Claim so long as such Canadian Pollution Claim is also made and continuously maintained against an Executive of an Organization.

…

4. EXCLUSIONS

The Insurer shall not be liable to make any payment for Loss in connection with any Claim made against an Insured:

(i) which is brought by or on behalf of an Organization or any Insured Person, other than an Employee of an Organization; or which is brought by any security holder or member of an Organization, whether directly or derivatively, unless such security holder's or member's Claim is instigated and continued totally independent of, and totally without the solicitation of, or assistance of, or active participation of, or intervention of, any Executive of an Organization or any Organization, provided, however, this exclusion shall not apply to:

(1) any Claim brought by an Insured Person in the form of a cross-claim or third-party claim for contribution or indemnity which is part of, and results directly from, a Claim that is covered by this policy;
(2) any Employment Practices Claim brought by an Insured Person, other than an Insured Person who is or was a member of the Board of Directors (or equivalent governing body) of an Organization;
(3) in any bankruptcy proceeding by or against an Organization, any Claim brought by the examiner, trustee, receiver, receiver manager, liquidator or rehabilitator (or any assignee thereof) of such Organization, if any;
(4) any Claim brought by any past Executive of an Organization who has not served as a duty elected or appointed director, officer, trustee, governor, management committee member, member of the management board, General Counsel or Risk Manager (or equivalent position) of or consultant for an Organization for at least four (4) years prior to such Claim being first made against any person; or
(5) any Claim brought by an Executive of an Organization formed and operating in a Foreign Jurisdiction against such Organization or any Executive thereof, provided that such Claim is brought and maintained outside Canada, the United States, or any other common law country (including any territories thereof);

…

ENDORSEMENT #14

SPECIFIC ENTITY/SUBSIDIARY EXCLUSION
(Claims brought by or made against)

In consideration of the premium charged, it is hereby understood and agreed that the Insurer shall not be liable for any Loss alleging, arising out of, based upon or attributable to or in connection with any Claim brought by or made against the Entity listed below and/or any Insureds thereof.

1. MAGNATRAX Corporation (Including any subsidiary or affiliate thereof)

It is further understood and agreed that the Definition of Subsidiary shall not include MAGNATRAX Corporation. Further, the Insurer shall not be liable to make any payment for Loss in connection with any Claim made against an Insured alleging, arising out of, based upon or attributable to any breach of duty, act, error or omission of MAGNATRAX Corporation, or any director, officer, member of the board of managers or employee thereof.

2. Run-Off Policy

ENDORSEMENT #4

...

DEFINITION OF ORGANIZATION AMENDED TO INCLUDE ENTITY
(CO-DEFENDANT ONLY)

In consideration of the premium charged, it is hereby understood and agreed that the term “Organization” is amended to include the following entity, subject to the terms, conditions and limitations of this endorsement and this policy.

ENTITY

Onex Corporation

Coverage as is afforded under this policy with respect to a Claim made against Onex Corporation or any Insured Persons thereof shall only apply if: (1) such Claim relates to a Wrongful Act committed by an Insured (other than Onex Corporation or an Insured Person thereof); and (2) an Insured (other than Onex Corporation or an Insured Person thereof) is and remains a defendant in the Claim along with Onex Corporation or any Insured Person thereof.

In all events coverage as is afforded under this policy with respect to a Claim made against Onex Corporation or any Insured Person thereof shall only apply to Wrongful Acts committed or allegedly committed prior to May 12, 2003.

...

ENDORSEMENT #16

...

COORDINATION OF AIG LIMITS

In consideration of the premium charged, it is hereby understood and agreed that, with respect to any Claim under this policy for which coverage is provided by one or more other policies issued by the Insurer or any other member of the American International Group (AIG), (or would be provided but for the exhaustion of the limit of liability, the applicability of the

retention/deductible amount or coinsurance amount, or the failure of the Insured to submit a notice of a Claim), the Limit of Liability provided by virtue of this policy shall be reduced by the limit of liability provided by said other AIG policy.

Notwithstanding the above, in the event such other AIG policy contains a provision which is similar in intent to the foregoing paragraph, then the foregoing paragraph will not apply, but instead:

(1) the Insurer shall not be liable under this policy for a greater proportion of the Loss than the applicable Limit of Liability under this policy bears to the total limit of liability of all such policies, and

(2) the maximum amount payable under all such policies shall not exceed the limit of liability of the policy that has the highest available limit of liability.

Nothing contained in this endorsement shall be construed to increase the limit of liability of this policy.

3. 2004-2005 Onex Policy

4. EXCLUSIONS

The Insurer shall not be liable to make any payment for Loss in connection with any Claim made against an Insured:

…

(d) alleging, arising out of, based upon or attributable to the facts alleged, or to the same or related Wrongful Acts alleged or contained in any Claim which has been reported, or in any circumstances of which notice has been given, under any policy of which this policy is a renewal or replacement or which it may succeed in time;

…

ENDORSEMENT #13

…

PRIOR ACTS EXCLUSION FOR LISTED ENTITIES

In consideration of the premium charged, it is hereby understood and agreed that the term Subsidiary is amended to include the entity(ies) listed below, but only for Wrongful Acts committed by such entity(ies) and/or any Insureds thereof which occurred subsequent to such entity's respective acquisition/creation date listed below and prior to the time the Named Entity no longer maintains Management Control of such entity(ies), respectively, either directly or indirectly through one or more other Subsidiaries. Loss arising from the same or related Wrongful Act shall be deemed to arise from the first such same or related Wrongful Act.

ENTITY(IES)	ACQUISITION/CREATION DATE
1. MAGNATRAX Corporation [...]	May 12, 2003

For the purpose of the applicability of the coverage provided by this endorsement, the entities listed above and the Organization will be conclusively deemed to have indemnified the Insureds of [...] each respective entity to the extent that such entity or the Organization is permitted or required to indemnify such Insureds pursuant to law or contract or the charter, bylaws, operating agreement or similar documents of an Organization. The entity and the Organization hereby agree to indemnify

the Insureds to the fullest extent permitted by law, including the making in good faith of any required application for court approval.

Boland v. Allianz Insurance Co. of Canada et al.

[Indexed as: Boland v. Allianz Insurance Co. of Canada]

91 O.R. (3d) 796

Court of Appeal for Ontario,
Winkler C.J.O., Feldman J.A. and Lax J. (ad hoc)
July 30, 2008

Insurance -- Insurer's duty to defend -- Application judge erring in her interpretation of extension of coverage provision in directors' and officers' liability insurance policy -- Application judge also erring in characterizing negligence claim as derivative of claim alleging deliberate conduct -- Insurer having duty to defend insured.

The purchaser of a condominium unit which had been illegally enlarged was forced by the condominium corporation to return the unit to its original condition. She sued the corporation and the appellant, who was a director of the corporation in the 1990s. The corporation in turn brought an action against the appellant for a declaration that he intentionally or negligently breached his legal duties to the corporation while he was a director as he was aware of the existence of the illegal unit and failed to disclose it to the corporation, and that he was liable to indemnify the corporation in respect of the purchaser's claim. The appellant brought an application for a declaration that the respondent insurer, which provided directors' and officers' liability insurance to the corporation and its directors and officers, was obliged to defend him. The application was dismissed. The appellant appealed.

Held, the appeal should be allowed.

The policy period was 2005-2006 and the events leading to the claims occurred in the 1990s. However, the policy contained an extension of coverage provision which covered any wrongful act which occurred prior to the policy period if a claim was made during the policy period, provided that the directors and officers, at the effective date of the policy, had no knowledge of, and could not reasonably foresee, any circumstances which might result in a claim. The "effective date of the policy" for the purpose of looking at the knowledge of the insured director that could preclude the extension of coverage was the effective date of the first policy in succession, which was September 2004. If the consideration of the appellant's knowledge was limited to what he knew in 1994, it could not be said that at that time he could reasonably have foreseen a claim. Accordingly, the extension of coverage clause applied.

The application judge erred in holding that the statement of claim alleged primarily deliberate conduct and that the allegation of negligent conduct was merely derivative. While the negligence claim was a bare pleading, and the [page797] force of the claim was for deliberate conduct, there was an alternative and independent claim that the appellant acted negligently. The respondent had a duty to defend the claim.

Cases referred to

Non-Marine Underwriters, Lloyd's of London v. Scalera, [2000] 1 S.C.R. 551, [2000] S.C.J. No. 26, 2000 SCC 24, 185 D.L.R. (4th) 1, 253 N.R. 1, [2000] 5 W.W.R. 465, J.E. 2000-935, 135 B.C.A.C. 161, 75 B.C.L.R. (3d) 1, 18 C.C.L.I. (3d) 1, 50 C.C.L.T. (2d) 1, [2000] I.L.R. I- 3810, 96 A.C.W.S. (3d) 479; Reid Crowther & Partners v. Simcoe & Erie General Insurance Co., [1993] 1 S.C.R. 252, [1993] S.C.J. No. 10, 99 D.L.R. (4th) 741, 147 N.R. 44, [1993] 2 W.W.R. 433, J.E. 93-230, 83 Man. R. (2d) 81, 13 C.C.L.I. (2d) 161, 6 C.L.R. (2d) 161, [1993] I.L.R. 1-2914 at 2206, 37 A.C.W.S. (3d) 1267

APPEAL from the order of Horkins J., [2006] O.J. No. 2002, 37 C.C.L.I. (4th) 273 (S.C.J.) dismissing an application for a

declaration that the insurer had a duty to defend an action against an insured.

Richard Macklin, for appellant.

Leslie Wright, for respondent.

The judgment of the court was delivered by

[1] FELDMAN J.A.: -- The issue on this appeal is whether the respondent has a duty to defend the appellant against a claim made against him in his capacity as a director of a condominium corporation.

[2] The respondent provided directors' and officers' liability insurance to the condominium corporation and to its directors and officers for claims made during the policy period for "wrongful acts" that occurred during the policy period. The policy period of the respondent's insurance policy was April 30, 2005 to April 30, 2006.

[3] The policy also contains an extension of coverage provision that covers: "any wrongful act which occurs prior to the Policy Period if claim or claims are made during the Policy Period and provided: (a) that the Directors and Officers of the Corporation, at the Effective Date of the Policy, had no knowledge of, and could not reasonably foresee, any circumstances which might result in a claim, and . . .".

[4] The events that led to the claims in this case occurred during the 1990s. The appellant was a developer of the condominium project along with Weldon. Each of them purchased a unit before the declaration date of the condominium. However, prior to the declaration, Weldon illegally enlarged his unit into the attic space as a third-floor living space, although this space was [page798] designated as part of the common area. Boland, who was a director of the corporation both in 1994 and again in 1997-1998, is alleged to have known about the illegal unit, failed to disclose it to the corporation and stood by in

January 1998, when Weldon sold the illegal unit to Orr.

[5] The corporation applied against Orr to direct her to comply with the declaration and return the unit to its original condition. Orr sued the corporation, Boland and others in 2001 for damages of $4.5 million.

[6] The corporation issued a statement of claim dated June 1, 2005 against Boland for a declaration that: (1) he intentionally or negligently breached his legal duties to the corporation while he was a director regarding the existence of the illegal unit, and (2) he is liable to indemnify the corporation in respect of the Orr claim. The statement of claim states that the Orr action is still ongoing and outlines allegations of fact based in large part on evidence Boland gave on his examination for discovery in the Orr action.

[7] Boland then brought an application for an order that the respondent insurer either underwrite his defence to the corporation's action against him or defend him in the action, based on the 2005 director and officers' liability policy. The application judge dismissed the application and found that the insurer had no duty to defend on two bases: (1) the extension of the insuring agreement was not triggered and, therefore, the claim was not covered; and (2) the statement of claim alleged primarily deliberate conduct and that the allegation of negligent conduct was merely derivative.

[8] I would allow the appeal. In my view, the insurer has a duty to defend in this case.

The Extension of Coverage Clause

[9] The initial insuring agreement requires that the claim be made during the policy period for a wrongful act that occurred during the policy period. In this case, the claim was made during the policy period, but the alleged wrongful act occurred during the 1990s.

[10] The extension insuring agreement also requires that the claim be made during the policy period but covers prior wrongful acts if, at the effective date of the policy, the

directors and officers "had no knowledge of and could not reasonably foresee, any circumstances which might result in a claim". The purpose of this condition is to allow directors and officers to be covered by insurance for claims that are made during the policy period for acts that occurred before the policy period, but at the same time, to preclude [page799] the corporation from obtaining insurance coverage for potential claims against a director that the director was aware may be made during the policy period. In other words, one obtains future coverage only for unexpected claims, not for known potential claims.

[11] Although the policy in issue on the application provides coverage for the 2005 policy year and the claim was made during that year, the appellant points to the record which shows that the 2005 policy was the next in a succession of policies with the same extension of coverage agreement, beginning with the first Allianz policy in September 1994. The issue for determining if the extension of coverage applies is, what is the "effective date of the policy" for the purpose of considering the knowledge of the insured director?

[12] In Reid Crowther & Partners v. Simcoe & Erie General Insurance Co., [1993] 1 S.C.R. 252, [1993] S.C.J. No. 10, the Supreme Court took the view [at para. 40] that where an insurer provides continuous coverage by one-year policies, this amounts to a "system of successive insurance coverage designed to provide liability coverage from year to year". Applying this approach, the effective date of the policy for the purpose of looking at the knowledge of the insured director that could preclude the extension of coverage is the effective date of the first policy in succession, in this case, September 1994.

[13] The application judge concluded that Boland had knowledge of the illegal use of the attic space and that he could reasonably foresee that the illegal space might result in a claim. However, part of the allegations in the statement of claim that the application judge relied on in reaching her conclusion were allegations of his knowledge and actions up to January 1998. If the consideration of his knowledge is limited to what he knew in 1994, the effective date of the policy, it

cannot be said that at that time he could reasonably foresee a claim. Although the statement of claim is not explicit on the date, it is a reasonable inference from the pleading that in 1994, during his first term as director, the appellant asked Weldon to correct the problem. He did not know then that Weldon would not do that before selling the unit in 1998.

[14] In my view, therefore, for the purpose of the duty to defend only, the allegations in the statement of claim, if taken to be true, are not sufficient to deny coverage under the extension of coverage clause.

The Application of the Scalera Case

[15] The application judge found that although the claim is framed both in negligence and for deliberate conduct, applying the Supreme Court of Canada decision in Non-Marine Underwriters, Lloyd's of London v. Scalera, [2000] 1 S.C.R. 551, [2000] S.C.J. No. 26, [page800] the negligence claim was merely derivative of the claim for deliberate conduct. Since the policy excludes coverage for deliberate conduct, the application judge found that there was no duty to defend based on the claims made against the appellant in the statement of claim.

[16] In my view, the application judge erred in her characterization of the negligence claims made in the statement of claim as derivative. The application judge concluded that there were no facts pleaded in support of the negligence aspect of the claim and that, effectively, that claim arose out of the same facts as the claim for deliberate conduct.

[17] I agree with the application judge that the negligence claim is a bare pleading. It possibly would not survive a pleadings motion without an order for particulars. However, when the issue is whether an insurer has a duty to defend, one must take the pleading as it stands and determine whether there is a viable claim for negligence. In this case, although the force of the claim is for deliberate conduct, there is an alternative and independent claim that the appellant acted negligently. As this claim is available as a basis for Boland's liability to the condominium corporation, the insurer has a

duty to defend that claim.

[18] The appellant also asks for the right to appoint counsel of his choice. This issue was never reached by the application judge because she dismissed the application. Although it is discussed in the factums, the issue was not addressed by counsel in oral argument. If the appellant wishes to pursue this request, and the parties cannot agree, it must be brought back on in the Superior Court.

[19] In the result, I would allow the appeal with costs of the appeal to the appellant, fixed at $15,000 inclusive of disbursements and GST, and costs below to the appellant in the amount fixed by the application judge.

Appeal allowed.

Zurich Insurance Company v. 686234 Ontario Limited*

[Indexed as: Zurich Insurance Co. v. 686234 Ontario Ltd.]

62 O.R. (3d) 447
[2002] O.J. No. 4496
Docket No. C37469

Court of Appeal for Ontario,
Abella, Moldaver and Borins JJ.A.
November 27, 2002

* Application for leave to appeal to the Supreme Court of Canada dismissed with costs April 24, 2003 (Iacobucci, Binnie and LeBel JJ.). S.C.C. File No. 29577. S.C.C. Bulletin, 2003, p. 695.

Insurance -- Commercial general liability insurance policy -- Interpretation -- Coverage -- Exclusions -- Insurer's obligation to defend insured -- Insurer's obligation to indemnify -- Insured owning apartment building -- Insured suing for negligence arising from carbon monoxide leak from apartment building furnace -- Pollution liability exclusion not excluding coverage for injuries from carbon monoxide that leaked from apartment building's furnace.

The owner of an apartment building, 686234 Ontario Limited (the "insured"), was the defendant in two proposed class actions in which it was alleged that the plaintiffs suffered injuries from carbon monoxide that leaked from the apartment's furnace. The plaintiffs pleaded that the insured had been negligent in maintaining, repairing and keeping the furnace in good condition. Zurich Insurance Company (the "insurer") had issued two commercial general liability insurance policies ("CGL policies") to the insured. The insurer applied for a declaratory judgment that it was not obliged to defend the

insured nor to indemnify it for the damages claimed, on the ground that the standard pollution liability exclusion contained in the policies applied. Rivard J. dismissed the application, reasoning that the exclusion vitiated coverage from injuries resulting from pollution to the natural environment but that it did not vitiate coverage from injuries resulting from pollution to the indoor environment. The insurer appealed.

Held, the appeal should be dismissed with costs.

In is a principle of the interpretation of insurance policies that coverage should be interpreted broadly in favour of the insured and that exclusion clauses should be strictly and narrowly interpreted against the insurer. A literal meaning should not be applied where it would bring about an unrealistic result or a result that would not be contemplated in the commercial atmosphere in which the insurance was contracted. An interpretation of an ambiguous contractual provision that would render the insured's efforts to obtain insurance protection nugatory should be avoided. An exclusion clause should not be interpreted in a way that is repugnant to or inconsistent with the main purpose of the insurance coverage but so as to give effect to that purpose and the reasonable expectations of the ordinary person as to the coverage purchased. The history of the insurance industry's standard pollution exclusion in CGL policies and the use of environmental terms of art in the exclusion clause showed that it was aimed at barring coverage for environmental contamination arising from the gradual or repeated discharge of hazardous substances into the environment but not to bar coverage for tort claims within the standard CGL coverage. The accidental release of carbon monoxide due to a broken furnace was not environmental pollution within the scope of the clause. Rivard J. correctly interpreted the pollution liability exclusion and was correct in holding that the insurer has a duty to defend and to indemnify the insured for any damages caused by the carbon monoxide leak. Accordingly, the appeal should be dismissed with costs.

Cases referred to

American States Ins. Co. v. Koloms, 687 N.E. 2d 72 (S.C. Ill. 1997); Amos v. Insurance Corp. of British Columbia, [1995] 3 S.C.R. 405, 10 B.C.L.R. (3d) 1, 127 D.L.R. (4th) 618, 186 N.R. 150, [1995] 9 W.W.R. 305, [1995] I.L.R. 1-3232, 13 M.V.R. (3d) 302; [page448] Brissette Estate v. Westbury Life Insurance Co., [1992] 3 S.C.R. 87, 96 D.L.R. (4th) 609, 142 N.R. 104, [1992] I.L.R. 1-2888, 47 E.T.R. 109 (sub nom. Brissette Estate v. Crown Life Insurance Co.); Commerce Capital Trust Co. v. Continental Insurance Co. (1982), 36 O.R. (2d) 38, 133 D.L.R. (3d) 459, [1982] I.L.R. 1-1508 (S.C.); Consolidated-Bathurst Export Ltd. v. Mutual Boiler & Machinery Insurance Co., [1980] 1 S.C.R. 888, 112 D.L.R. (3d) 49, 32 N.R. 488, [1980] I.L.R. 1-1176; Cory & Sons v. Burr (1882), L.R. 9 Q.B. 463; Cunningham v. St. Paul Fire & Marine Ins. Co. (1914), 16 D.L.R. 39, 5 W.W.R. 1098, 26 W.L.R. 870, 19 B.C.R. 33 (S.C.); Essex Insurance Company v. Tri-Town Corporation, 863 F. Supp. 38 (D. Mass. 1994); Excel Cleaning Service v. Indemnity Insurance Co., [1954] S.C.R. 169, [1954] 2 D.L.R. 721, [1954] I.L.R. 1-143; Great West Development Marine Corp. v. Canadian Surety Co., 2000 BCSC 806, 19 C.C.L.I. (3d) 52; Medicine Hat (City) v. Continental Casualty Co. (2002), 37 C.C.L.I. (3d) 48 (Alta. Q.B.); Pettit and Economical Mutual Ins. Co. (Re) (1982), 40 O.R. (2d) 344, 143 D.L.R. (3d) 752, [1983] I.L.R. 1-1616 (H.C.J.); Pier Mac Petroleum Installation Ltd. v. Axa Pacific Insurance Co. (1997), 41 B.C.L.R. (3d) 326 (S.C.); Reid Crowther & Partners Ltd. v. Simcoe & Erie General Insurance Co., [1993] 1 S.C.R. 252, 83 Man. R. (2d) 81, 99 D.L.R. (4th) 741, 147 N.R. 44, 36 W.A.C. 81, [1993] 2 W.W.R. 433, [1993] I.L.R. 1-2914; Sirois v. Saindon (1975), [1976] 1 S.C.R. 735, 10 W.B.R. (2d) 329, [1975] I.L.R. 1-669, 4 N.R. 343, 56 D.L.R. (3d) 556, revg (1973), 7 N.B.R. (2d) 280, [1974] I.L.R. 1-597, 44 D.L.R. (3d) 469 (C.A.) (sub nom Co-operative Fire & Casualty Co. v. Saindon); Stoney Run Co. v. Prudential-LMI Commercial Ins. Co., 47 F. 3d 34 (2nd Cir. 1995); Trafalgar Insurance Co. of Canada v. Imperial Oil Ltd. (2001), 57 O.R. (3d) 425, [2002] I.L.R. 1-4064 (C.A.); Weston Ornamental Iron Works Ltd. v. Continental Insurance Co., [1981] I.L.R. 1-430 (Ont. C.A.), revg [1980] I.L.R. 1-1265 (Ont. H.C.J.); Wigle v. Allstate Insurance Company of

Canada (1984), 49 O.R. (2d) 101, 6 O.A.C. 161, 14 D.L.R. (4th) 404, [1985] I.L.R. 1-1863, 30 M.V.R. 167 (C.A.), affg (1984), 44 O.R. (2d) 677, 5 D.L.R. (4th) 327, [1984] I.L.R. 1-1742 (H.C.J.)

Authorities referred to

Bick, T.K., and L.G. Youngblood, "The Pollution Exclusion Saga Continues: Does it Apply to Indoor Release" (1997), 5 S.C. Envtl. L.J. 119

Hilliker, G., Liability Insurance Law in Canada, 3rd ed. (Markham: Butterworths, 2001)

Stempel, J.W., "Reason and Pollution: Correctly Construing the 'Absolute' Exclusion in Context and in Accord With Its Purpose and Party Expectations" (1998), 34 Tort & Ins. L.J. 1.

APPEAL from a judgment interpreting the meaning of a pollution liability exclusion clause contained in a standard commercial general liability policy.

David Liblong and Vincent G. Burns, for appellant.
John A. Campion and C. William Hourigan, for respondent.

The judgment of the court was delivered by

[1] BORINS J.A.: -- The dispositive issue in this appeal is the scope of a pollution liability exclusion contained in two commercial general liability ("CGL") insurance policies issued by the [page449] appellant, Zurich Insurance Company ("Zurich"), to the respondent, 686234 Ontario Limited, the owner of an apartment complex. The issue is whether the exclusion bars coverage for damages caused by carbon monoxide poisoning. In two underlying proposed class actions brought against the respondent, the nominal plaintiffs allege that they suffered injuries from breathing carbon monoxide which leaked from the respondent's furnace. Against the respondent they allege negligence in maintaining the furnace and in failing to

keep it in good working condition, as well as failing to properly inspect repair work they say had been performed negligently by the company hired by the respondent to repair it, which is a defendant in one of the actions.

[2] Zurich applied for a declaratory judgment that it was not obliged to defend the respondent, nor to indemnify it for the damages claimed, on the ground that the pollution liability exclusion applied to the circumstances alleged in the underlying actions. In reasons found at (2001), 33 C.C.L.I. (3d) 267 (Ont. S.C.J.), Rivard J. dismissed the application. On his interpretation of the exclusion, he concluded that it was intended to vitiate coverage for injuries resulting from pollution of the natural environment and not the indoor environment.

[3] It is from this decision that Zurich has appealed. However, it concedes that if the decision is correct it is obliged to defend the underlying actions and to indemnify the respondent for any damages recovered in the actions.

[4] The pollution liability exclusion is a standard industry clause found in CGL policies in Canada and the United States of America. As it will assist in understanding the parties' positions and the reasons of the application judge, it is helpful to reproduce the exclusion in its entirety:

This insurance does not apply to:

1. Pollution Liability

a. "Bodily injury" or "property damage" arising out of the actual, alleged or threatened discharge, dispersal, release or escape of pollutants:

1. At or from premises owned, rented or occupied by an insured;

2. At or from any site or location used by or for an insured or others for the handling, storage, disposal, processing or treatment of waste;

3. Which are at any time transported, handled, stored, treated, disposed of, or processed as waste by or for an insured or any person or organization for whom the insured may be legally responsible; or

4. At or from any site or location on which an insured or any contractors or subcontractors working directly or indirectly on behalf of an insured are performing operations: [page450]

a. if the pollutants are brought on or to the site or location in connection with such operations; or

b. if the operations are to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize the pollutants.

b. Any loss cost, or expense arising out of any governmental direction or request that you test for, monitor, clean up, remove, contain, treat, detoxify or neutralize pollutants.

"Pollutants" means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapour, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed.

Sub-paragraphs 1 and 4(a) of paragraph a. of this exclusion do not apply to "bodily injury" or "property damage" caused by heat, smoke or fumes from a hostile fire. As used in this exclusion, a "hostile fire" means one which becomes uncontrollable or breaks out from where it was intended to be.

(Emphasis added)

The Positions of the Parties

[5] It is Zurich's position that the language of the

exclusion is clear and unambiguous, and in accordance with its plain meaning, it applies to the underlying claims against the respondent. It argues that any injury or damage caused clearly falls within the exclusion as there was a "discharge, dispersal, release or escape" of carbon monoxide, a "pollutant", "at or from premises owned" by the respondent. As the emission of carbon monoxide fumes from the furnace constituted the "release" of a "gaseous . . . irritant or contaminant", any "bodily injury" or "property damage" resulting from such emission is excluded from coverage.

[6] The respondent's position is that the purpose of the exclusion is to bar coverage only for damages resulting from the pollution of the natural outdoor environment resulting from industrial, commercial or large scale pollution, and not for damages resulting from indoor pollution due to routine commercial hazards such as a faulty heating system. The respondent relies on four arguments in support of its position:

(1) As the exclusion is inherently ambiguous as to whether it applies to indoor or outdoor releases, the ambiguity is to be resolved in favour of the insured.

(2) The historical purpose of the exclusion, which was drafted by the insurance industry, demonstrates that its drafters intended to exclude only damages resulting from releases to the natural environment. [page451]

(3) The terms used in the exclusion, such as "discharge, dispersal, release or escape of pollutants", "handling, storage, disposal, processing or treatment of waste", "transported, handled, stored, treated, disposed of or processed as waste" and "monitor, clean up, remove, contain, treat, detoxify or neutralize the pollutants" are terms of art in environmental law that are generally used in environmental protection legislation in reference to damage or injury to the natural outdoor environment caused by improper disposal or containment of hazardous materials.

(4) Even if it is found that the exclusion is unambiguous, it should nevertheless be interpreted in favour of the

> respondent on the ground that the reasonable expectation of the owner of an apartment building who has sought and paid for CGL insurance would be that the insurance policy protects it through coverage and indemnity for precisely the type of claims advanced in the underlying actions -- claims for damages for bodily injury and property damage incurred by its tenants from carbon monoxide poisoning resulting from a faulty furnace.

Reasons of the Application Judge

[7] The application judge referred to the principles that apply to the interpretation of insurance policies, noting that exclusion clauses are to be "construed narrowly" and where they are ambiguous, that "the doctrine of contra proferentum will be applied to construe the ambiguity against the drafter of the document." He also noted that the CGL policy provided broad coverage with respect to indemnity for compensatory damages for bodily injury or property damage.

[8] In dismissing the application, the application judge concluded in paras. 14-19:

> A reading of the Pollution Liability exclusion, construed narrowly, and in the context of the factual background of this case lead me to the conclusion that Zurich must defend or [sic] indemnify the respondent for the claims for damages made by its tenants.
>
> The Pollution exclusion clause in the insurance contract points to an environmental emphasis and application. It speaks of bodily injury or property damage "arising out of the discharge, dispersal, release or escape of pollutants". Reference is to "the handling, storage, disposal, processing or treatment of waste". It deals with "pollutants" . . . "which are at any time transported, handled, stored, treated, disposed of, or processed as waste".
>
> Paragraph a.(4)(a) of the exclusion refers to a situation "if the pollutants are brought on or to the site or location"; Paragraph a.(4)(b) speaks of a situation [page452]

"if the operations are to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize the pollutants"; Paragraph b. deals with "any governmental direction or request that you test for, monitor, clean up, remove, contain, treat, detoxify or neutralize pollutants".

All of this language used in the exclusion clause, when read together, points to a clear intention to exclude 'environmental' pollution damage from coverage under the policy, as opposed to the accidental discharge of carbon monoxide in the improper repair of a furnace system. I conclude that a proper interpretation of the policy as a whole, including the exclusion clauses does not entitle Zurich, at this stage to deny coverage.

The essence of the claim against the respondent is negligence due to the improper repair of a furnace. It does not arise from the discharge, release or escape of pollutants which were on the premises. The pollutant, carbon monoxide was the accidental result of the alleged negligent repair of the furnace.

This is not a situation where a pollutant was on the premises and escaped or was somehow released resulting in injury or damage. It is a case where, as a result of the alleged improper repair of a furnace, improper combustion occurred resulting in the creation of carbon monoxide. That carbon monoxide is then alleged to have caused injury to the plaintiff.

Analysis

I

[9] The pollution liability exclusion, while attracting little judicial scrutiny in Canada, has received considerable attention in the United States: G. Hilliker, Liability Insurance Law in Canada, 3rd ed. (Markham: Butterworths, 2001) at p. 198. Indeed, in two survey articles American commentators have said that over the past two decades the exclusion has been the subject of extensive and heated litigation: T.K. Bick

& L.G. Youngblood, "The Pollution Exclusion Saga Continues: Does it Apply to Indoor Release" (1997), 5 S.C. Envtl. L.J. 119; J.W. Stempel, "Reason and Pollution: Correctly Construing the 'Absolute' Exclusion in Context and in Accord With Its Purpose and Party Expectations" (1998), 34 Tort & Ins. L.J. 1.

[10] These articles, and the cases which they consider, focus on the positions taken by insurers and policyholders. Typically, insurers have urged a literal interpretation of the text of the exclusion to attempt to deny the sorts of claims traditionally covered under a basic CGL policy. Insurers have asserted that any liability claim against an insurer, whether it arises from a carbon monoxide leak from a faulty furnace or fumes from freshly applied paint, is excluded if it involves "vapour", "fumes" or "chemicals". Policyholders have urged that the exclusion be interpreted in the context of the policy and its purpose, the drafting history of the exclusion, its purpose from the perspective of the insurance industry, together [page453] with the objectively reasonable expectations of the parties. They assert that the exclusion was intended to exclude coverage for natural outdoor environmental pollution and not for routine occurrences that have received long-standing coverage under CGL policies simply because the cause of the damage fits within a hyperliteral application of the text of the exclusion.

[11] The background and purpose of the pollution liability exclusion is discussed in detail by Professor Stempel. For many years, CGL liability policies did not contain any exclusions designed to limit coverage for environmental risks. Traditionally, CGL policies generally provided coverage with respect to liability imposed by law to pay damages because of bodily injury or property damage caused by an accident or occurrence. Coverage under CGL policies for pollution-related claims depended upon whether the claim fell within the scope of the insurance contract.

[12] In 1970 in the United States the Insurance Rating Board, a predecessor of the Insurance Service Office, Inc. ("ISO"), in response to litigation that emerged from environmentally significant discharges of pollutants resulting in damage to the

natural environment, introduced by way of an endorsement attached to CGL policies, a specific exclusion with respect to environmental liability. By 1973, a pollution liability exclusion became part of the standard CGL policy. It was known as the "sudden and accidental" pollution exclusion because, by its language, it did "not apply if [the] discharge, dispersal, release or escape was sudden and accidental".

[13] In the early 1980s, following extensive litigation over the scope of the sudden and accidental pollution exclusion, the ISO introduced a new version of the exclusion, the "absolute" pollution exclusion. As Professor Stempel points out at p. 5: "All observers agree that the new exclusion was drafted to replace the 1973 'sudden and accidental' exclusion because insurers were distressed by judicial decisions holding that the 1973 exclusion did not preclude coverage for gradual but unintentional pollution." The absolute exclusion, therefore, was intended to preclude coverage for the cost of government-mandated environmental cleanup under existing and emerging legislation making polluters responsible for damage to the natural environment. Thus, as a practical matter, the absolute pollution exclusion, free of the "sudden and accidental" language, appeared to solve the insurance industry's problem in the industrial pollution context. By 1986 the absolute pollution exclusion became the insurance industry standard and is found in virtually every CGL policy issued since that time. It is this absolute pollution liability exclusion that is found in the respondent's CGL policy. [page454]

[14] As Hilliker points out at p. 197, it was in 1985, with the introduction of a new standard form CGL policy, that the Insurance Bureau of Canada changed the environmental liability exclusion then in use, to the absolute pollution exclusion that had been drafted in the United States by the ISO. Thus, with some minor variations introduced by individual insurers, the absolute pollution exclusion is now found in all CGL policies in the United States and Canada.

II

[15] Based on the evolution and the drafting history of the

absolute pollution exclusion, Professor Stempel has concluded that it bars coverage for classic environmental degradation pollution and not tort claims previously conceded to be within the scope of standard CGL coverage. Specifically, the exclusion does not bar coverage of the average tort incidentally accompanied by contaminants, such as coverage in a slip-and-fall action involving bleach. Many American courts have reached the same conclusion. One of the leading cases is American States Ins. Co. v. Koloms, 687 N.E. 2d 72 (S.C. Ill. 1997) which, like this case, involved carbon monoxide poisoning caused by a negligently maintained furnace. Justice McMorrow, who wrote the opinion of the court, reviewed the evolution and drafting history of the absolute pollution exclusion, and reached the same conclusion as that reached by Professor Stempel.

[16] I find the following passages from Justice McMorrow's opinion at pp. 81-82 both helpful and persuasive.

> Our review of the history of the pollution exclusion amply demonstrates that the predominate motivation in drafting an exclusion for pollution-related injuries was the avoidance of the "enormous expense and exposure resulting from the 'explosion' of environmental litigation." Weaver, 140 N.H. at 783, 674 A.2d at 977, quoting Vantage Development Corp. v. American Environment Technologies Corp., 251 N.J. Super. 516, 525, 598 A.2d 948, 953 (1991). Similarly, the 1986 amendment to the exclusion was wrought, not to broaden the provision's scope beyond its original purpose of excluding coverage for environmental pollution, but rather to remove the "sudden and accidental" exception to coverage which, as noted above, resulted in a costly onslaught of litigation. We would be remiss, therefore, if we were to simply look to the bare words of the exclusion, ignore its raison d'etre, and apply it to situations which do not remotely resemble traditional environmental contamination. The pollution exclusion has been, and should continue to be, the appropriate means of avoiding "the yawning extent of potential liability arising from the gradual or repeated discharge of hazardous substances into the environment". Tufco, 104 N.C. App. at 323, 409 S.E.2d at 699, quoting Waste Management of

Carolinas, Inc. v. Peerless Insurance Co., 315 N.C. 688, 698, 340 S.E.2d 374, 381 (1986). We think it improper to extend the exclusion beyond that arena. [page455]

Notwithstanding the above, ASI submits that the deletion of the requirement that the pollution be "[discharged] into or upon land, the atmosphere, or any watercourse or body of water" should be viewed by this court as a clear signal of the industry's intent to broaden the exclusion beyond traditional environmental contamination. We disagree. This same argument was rejected in West American Insurance Co. v. Tufco Flooring East, Inc., 104 N.C. App. 312, 409 S.E.2d 692 (1991), a case which involved the application of the pollution exclusion to damages caused by the release of fumes from a flooring sealant. In Tufco, the court noted that, even after its amendment in 1986, the absolute pollution exclusion continued to employ terms of art which bespeak of environmental contamination. The court reasoned:

> Because the operative policy terms 'discharge, dispersal, release, and escape' are environmental terms of art, the omission of the language 'into or upon land, the atmosphere or any watercourse or body of water' in the new pollution exclusion is insignificant. The omission of the phrase only removes a redundancy in the language of the exclusion that was present in the earlier pollution exclusion clause. Consequently, we find that any 'discharge, dispersal, release, or escape' of a pollutant must be into the environment in order to trigger the pollution exclusion clause and deny coverage to the insured. Tufco, 104 N.C. App. at 325, 409 S.E.2d at 700.

See also Center for Creative Studies, 871 F. Supp. at 946 ("the fact that the [former version] contained language relating to discharge 'into or upon land, the atmosphere . . .' is not significant"). We agree with this analysis. In our view, the deletion of the aforementioned language does not portend an expansion of the pollution exclusion beyond the context of traditional environmental contamination.

Given the historical background of the absolute pollution

exclusion and the drafters' continued use of environmental terms of art, we hold that the exclusion applies only to those injuries caused by traditional environmental pollution. The accidental release of carbon monoxide in this case, due to a broken furnace, does not constitute the type of environmental pollution contemplated by the clause. Accordingly, the judgment of the appellate court is affirmed.

[17] One of the many other cases that reached the same result as the Koloms court is Stoney Run Co. v. Prudential-LMI Commercial Ins. Co., 47 F.3d 34 (2d Cir. 1995), which also involved carbon monoxide poisoning due to a faulty heating and ventilation system. The District Court had dismissed two claims for indemnity brought by a policyholder against its insurer on the basis of the standard pollution liability clause in its CGL policy. The Court of Appeal reversed and entered judgment for the policyholder. The sole issue before the Court of Appeal was whether the underlying claims fell unambiguously within the exclusion. If not, any ambiguity was to be construed against the insurer.

[18] The court commenced its analysis by construing the exclusion clause in light of its general purpose. Applying earlier decisions, it found that the purpose of the clause was to exclude coverage for entities which knowingly pollute the environment. [page456] The court noted that in most cases the exclusion was found to be ambiguous in the sense that it could reasonably be interpreted as applying to pollution of either the natural outdoor environment or the indoor environment, such as the air in a building or a home. In such cases the ambiguity was resolved on the basis of the reasonable understanding of the insured in respect to whether the exclusion in the context of the CGL policy applied only to claims for injuries based on industrial environmental pollution, and did not exclude injuries caused by common irritants and contaminants such as carbon monoxide emitted from a faulty furnace. The court also noted that it was significant in interpreting the exclusion that it contained terms such as "discharge" and "dispersal", which are terms of art of environmental law used in reference to injuries caused by "disposal or containment of hazardous waste".

[19] At p. 39 the court concluded:

> We need not decide the precise scope of the pollution exclusion clause contained in Plaintiffs' policies. Instead, we need only determine whether the clause is ambiguous as applied to the facts of this case and subject to no other reasonable interpretation than the one advanced by Prudential. As noted above, the pollution exclusion clause can be reasonably interpreted as applying only to environmental pollution. A reasonable policyholder might not characterize the escape of carbon monoxide from a faulty residential heating and ventilation system as environmental pollution. Accordingly, we find the pollution exclusion clause ambiguous as applied to the Gruner and Schomer actions.

[20] There is, of course, considerable divergence in the American cases that have construed the exclusion, with the result that courts have not reached a clear consensus as to its proper interpretation. This is true even within the context of carbon monoxide poisoning. Cases which have held that the exclusion applies to instances of carbon monoxide poisoning have applied a literal construction to the exclusion, noting that its language is specific on its face even though a literal interpretation results in a broad application of the exclusion. However, as Professor Stempel observes at p. 48, the bulk of the carbon monoxide poisoning cases have held that the exclusion does not apply. At p. 121, Bick & Youngblood observe that a majority of the cases have concluded that damages arising from indoor pollution are not excluded from coverage by the absolute pollution exclusion.

[21] Typical of the cases which have held that the exclusion precludes coverage for damages caused by carbon monoxide poisoning is Essex Insurance Company v. Tri-Town Corporation, 863 F. Supp. 38 (D. Mass. 1994), in which several hockey players, spectators and referees were poisoned by carbon monoxide emitted from a Zamboni which had resurfaced the ice between periods of a [page457] hockey game. In granting the insurer's motion for summary judgment declaring that it had no

duty to defend or to indemnify the insured area under its CGL policy as to claims arising from the alleged poisoning, Judge Young held at pp. 40-41:

> Here the individual claimants seek damages for injuries caused by the discharge of carbon monoxide from a malfunctioning Zamboni. Although the injuries may be attributable in part to other causes, i.e., the ventilation in the arena or the negligence of the person who installed the catalytic converter, this does not obligate Essex to indemnify Rockland Rink. Once the carbon monoxide was released into the atmosphere causing injuries, the incident fell within the scope of the absolute pollution exclusion, and Essex' general indemnification obligation ceased.
>
> Although the Court is troubled by what appears to be Essex' ability continually to limit the scope of coverage while constantly increasing premiums, the Court is bound to interpret and enforce contracts to which both parties freely agree in accordance with their plain language. As this Court was one of the first so to interpret the old version of the pollution exclusion language, In re Acushnet River, 725 F. Supp. at 1267-68; see C.L. Hauthaway & Sons Corp. v. American Motorists Ins. Co., 712 F. Supp. 265, 267-69 (D. Mass. 1989) (Harrington, J.) (same), so too it is now obligated to interpret this new "absolute" version. Based upon the unambiguous language of the policy, the Court declares that the discharge of pollutants from the Zamboni falls within the absolute pollution exclusion.

III

[22] Before reviewing the few Canadian cases which have considered the absolute pollution liability exclusion, it is helpful to refer to the principles of construction that apply to the interpretation of an exclusion clause contained in an insurance policy.

[23] The Supreme Court of Canada provided a useful review of the principles of construction in Reid Crowther & Partners Ltd. v. Simcoe & Erie General Insurance Co., [1993] 1 S.C.R. 252 at

pp. 268-69, 99 D.L.R. (4th) 741:

> In each case the courts must examine the provisions of the particular policy at issue (and the surrounding circumstances) to determine if the events in question fall within the terms of the coverage of that particular policy. This is not to say that there are no principles governing this type of analysis. Far from it. In each case, the courts must interpret the provisions of the policy at issue in light of general principles of interpretation of insurance policies, including, but not limited to:
>
> (1) the contra proferentum rule;
>
> (2) the principle that coverage provisions should be construed broadly and exclusion clauses narrowly; and
>
> (3) the desirability, at least where the policy is ambiguous, of giving effect to the reasonable expectations of the parties.

[24] The principle that coverage should be interpreted broadly in favour of the insured and that exclusion clauses should be [page458] strictly and narrowly interpreted against the insurer was affirmed by Major J. on behalf of the Supreme Court of Canada in Amos v. Insurance Corp. of British Columbia, [1995] 3 S.C.R. 405 at p. 414, 127 D.L.R. (4th) 618. Citing as authority Excel Cleaning Service v. Indemnity Insurance Co., [1954] S.C.R. 169, [1954] 2 D.L.R. 721, Major J. added at p. 414 S.C.R. that "the construction given to a policy of insurance must not nullify the purpose for which the insurance was sold".

[25] Of particular significance to this appeal is the oft-quoted passage from the reasons of Estey J. in Consolidated-Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co., [1980] 1 S.C.R. 888 at pp. 901-02, 112 D.L.R. (3d) 49:

> Even apart from the doctrine of contra preferentem as it

> may be applied in the construction of contracts, the normal rules of construction lead a court to search for an interpretation which, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time of entry into the contract. Consequently, literal meaning should not be applied where to do so would bring about an unrealistic result or a result which would not be contemplated in the commercial atmosphere in which the insurance was contracted. Where words may bear two constructions, the more reasonable one, that which produces a fair result, must certainly be taken as the interpretation which would promote the intention of the parties. Similarly, an interpretation which defeats the intentions of the parties and their objective in entering into the commercial transaction in the first place should be discarded in favour of an interpretation of the policy which promotes a sensible commercial result. It is trite to observe that an interpretation of an ambiguous contractual provision which would render the endeavour on the part of the insured to obtain insurance protection nugatory, should be avoided. Said another way, the courts should be loath to support a construction which would either enable the insurer to pocket the premium without risk or the insured to achieve a recovery which could neither be sensibly sought nor anticipated at the time of the contract.

(Emphasis added)

[26] Helpful, also, is the decision of this court in Weston Ornamental Iron Works Ltd. v. Continental Insurance Co., [1981] I.L.R. 1-430 (Ont. C.A.). The plaintiff's business included the maintenance and welding of construction equipment. About 45 per cent of this work was carried out on the customer's job site. After the plaintiff was found liable for a fire that destroyed a bulldozer that was being repaired by its employee at a job site, its insurer refused to indemnify it on the basis of an exclusion in the CGL insurance policy that barred coverage for "loss of . . . any personal property . . . as a result of any work performed thereon by the Insured". The trial judge considered that as it was clear, plain and unambiguous, the exclusion clause barred coverage for the loss.

[27] In allowing the appeal, Lacourcire J.A. stated at pp. 479-80 I.L.R.: [page459]

> Having regard to the constant and primary risk of fire loss and damage to equipment being repaired by the use of a welding torch, it would be anomolous to exclude from coverage the principal liability risk facing Weston in its outside work. Damage or destruction by fire of the heavy equipment being repaired away from the shop was the appellant's main concern according to its witnesses and the agency's witnesses. The exclusion clause should not be interpreted in a way which is repugnant to or inconsistent with the main purpose of the insurance coverage but so as to give effect to it. Thus, even if the exemption clause were found to be clear and unambiguous it should not be enforced by the courts when the result would be to defeat the main object of the contract or virtually nullify the coverage sought for protection from anticipated risks. The doctrine that in construing a contract, one must look to the entire document and reject words or indeed provisions which are inconsistent with the main purpose of the contract, was enunciated by Lord Halsbury in the House of Lords as early as 1893 in Glynn v. Margetson & Co., [1893] A.C. 351. . . . The Supreme Court of Canada in Consolidated-Bathurst Export Limited v. Mutual Boiler and Machinery Insurance Company, supra, gave the doctrine its approval.
>
> . . . . .
>
> I am satisfied that the doctrine can properly be applied to the interpretation of the impugned clause now being considered. In entering into what was described as a comprehensive general liability insuring agreement, it could not have been the intention of the parties to practically render nugatory the "away from shop" liability coverage for the most obviously inherent risk of the appellant's business. In my view, the exclusion clause does not bar the appellant's right to be indemnified for its loss.

(Emphasis added)

[28] From Weston Ornamental Iron Works it is clear that this court has concluded that even though an exclusion clause may be clear and unambiguous, it will not be applied where: (1) it is inconsistent with the main purpose of the insurance coverage and where the result would be to virtually nullify the coverage provided by the policy; and (2) where to apply it would be contrary to the reasonable expectations of the ordinary person as to the coverage purchased. As I noted earlier in discussing the American authorities, these principles are used by American courts in interpreting the absolute pollution liability exclusion in CGL policies. See, also, Re Pettit v. Economical Mutual Ins. Co. (1982), 40 O.R. (2d) 344, 143 D.L.R. (3d) 752 (H.C.J.); Wigle v. Allstate Insurance Co. of Canada (1984), 49 O.R. (2d) 101, 14 D.L.R. (4th) 404 (C.A.), leave to appeal to S.C.C. refused (1985), 14 D.L.R. (4th) 404n; Brissette Estate v. Westbury Life Insurance Co., [1992] 3 S.C.R. 87, 96 D.L.R. (4th) 609.

IV

[29] Given the substantial litigation in the United States over the scope of the absolute pollution liability exclusion, surprisingly [page460] few Canadian cases have considered it. Although a number of cases have considered the earlier "sudden and accidental" pollution exclusion, I do not find them helpful in respect to the absolute exclusion under consideration in this appeal.

[30] In Pier Mac Petroleum Installation Ltd. v. Axa Pacific Insurance Co. (1997), 41 B.C.L.R. (3d) 326 (S.C.), the exclusion was held to preclude coverage for the cost of repairs caused by a petroleum leakage resulting from the negligent construction of a gas bar. It would appear that the court literally construed the exclusion.

[31] In Great West Development Marine Corp. v. Canadian Surety Co. (2000), 19 C.C.L.I. (3d) 52, 2000 BCSC 806, the insured was the owner and developer of a condominium project. Fill from the project was sold to a person who later sued the developer alleging that she had received poor quality soil

containing construction debris that would leach toxic chemicals and contaminate her crops and the groundwater. The court held that the insurer had a duty to defend as the underlying claim did not entirely rest upon the threatened escape of pollutants. As the thrust of the claim was that the fill was of poor quality, this by itself did not bring the claim within the scope of the exclusion.

[32] The exclusion was held not to apply in Medicine Hat (City) v. Continental Casualty Co. (2002), 37 C.C.L.I. (3d) 48 (Alta. Q.B.) in which employees of the city sustained neurological problems from the use of methanol and lubrizol in city buses. It was acknowledged that lubrizol and methanol were pollutants. After referring to American authorities, Foster J. held at para. 27:

> "Discharge, dispersal, release or escape of pollutants" is the language of improper or unintended events or conduct. It is not the language of intended use or consequences or of the normal operation of facilities or vehicles. In this case, the polluting substance or gas is part of and confined to the intended and normal operation of a transit garage and buses. This conduct and these events do not fall within the exclusion clause. In my view, the pollution exclusion clause is intended to protect the insurer from liability for the enforcement of environmental laws. The exclusion clause uses environmental terms of art because it is intended to exclude coverage only as it relates to environmental pollution and the improper disposal or contamination of hazardous waste.

[33] Like two of the three trial court decisions, the recent decision of this court in Trafalgar Insurance Co. of Canada v. Imperial Oil Ltd. (2001), 57 O.R. (3d) 425, [2002] I.L.R. 1-4064 (C.A.) does not assist in resolving whether the pollution liability exclusion applies in the circumstances of this case. Although the majority of the court considered the scope of the exclusion based on the assumption that an oil spill was a liquid contaminant within the meaning of the exclusion, it held on the facts of the [page461] case that the negligence alleged for which the insured was responsible was not an act that came within the exclusion. Consequently, the

exclusion did not provide any relief to the insurer.

Conclusion

[34] Clearly, there have been more cases in the United States than in Canada that have considered the absolute pollution liability exclusion clause generally and, more specifically, its application to carbon monoxide poisoning. The few Canadian cases that have dealt with the absolute pollution liability exclusion have not explored in depth its history and purpose. It is also evident that more academic commentary in the United States has considered this issue. As Hilliker notes at p. 32, where there is little or no Canadian authority on a point of insurance law, our courts have turned to American law for assistance. This is particularly so where the same provision, such as the absolute pollution liability exclusion in CGL policies, is in common use by the insurance industry in Canada and the United States and where the American authorities have applied rules of construction not materially different from our own.

[35] Over a century ago, in Cory & Sons v. Burr (1882), L.R. 9 Q.B. 463 at p. 469, Brett L.J. said the reason for resorting to American authorities in these circumstances is to ensure uniformity in the construction of provisions in insurance contracts that are in use in all countries. Lord Justice Brett's views were adopted in Cunningham v. St. Paul Fire & Marine Ins. Co. (1914), 5 W.W.R. 1098, 16 D.L.R. 39 (B.C.S.C.) at p. 1102 W.W.R. See, also, Commerce Capital Trust Co. v. Continental Insurance Co. (1982), 36 O.R. (2d) 38 at p. 42, 133 D.L.R. (3d) 459 (S.C.) per Callaghan J. In dissenting reasons in Co-operative Fire & Casualty Co. v. Saindon, [1976] 1 S.C.R. 735, 56 D.L.R. (3d) 556, at p. 740 S.C.R., Laskin C.J., in concluding that an insurer had not brought itself within an exclusion clause in a comprehensive liability policy, had this to say about adopting American authority:

> In accord with this view is a line of insurance cases in the American Courts dealing with exactly the situation that confronts us here. Cases in the United States on insurance

matters have been freely cited in Canadian Courts because form policies developed in the United States have found their way into policies issued by insurers here: see 11 C.E.D. (Ont.) (2nd ed. 1954), s. 44 (Title, Insurance); 13 C.E.D. (Western) (2nd ed. 1962), s. 42 (Title, Insurance); and see, for example, Caldwell v. Stadacona Fire and Life Ins. Co. [(1883), 11 S.C.R. 212] at p. 257; see also MacGillivray on Insurance Law (5th ed. 1961), passim.

[36] The American authorities that have interpreted the absolute pollution liability exclusion in cases involving claims arising [page462] from carbon monoxide poisoning have not reached a uniform interpretation. One line of cases, as exemplified by Essex Insurance Company, has construed the exclusion literally and held that it bars claims arising from common business hazards such as carbon monoxide poisoning claims not normally viewed as pollution. Another line of cases, as exemplified by Koloms and Stoney Run, has held that the exclusion does not bar such claims. In reaching this result, these cases have declined to focus hyperliterally on the text of the exclusion, and have applied various interpretative approaches including finding ambiguity in the exclusion, considering the history of the exclusion clause and its environmental context, the purpose of the CGL policy, and the objectively reasonable expectation of the parties. As I have pointed out, these are the essential grounds relied on by the respondent and, generally, applied by the application judge, for construing the exclusion against Zurich.

[37] I find the second line of American cases to be more persuasive than the line of cases that has literally interpreted the exclusion. In my view, in construing contracts of insurance, dictionary literalism is often a poor substitute for connotative contextual construction. When the full panoply of insurance contract construction tools is brought to bear on the pollution exclusion, defective maintenance of a furnace giving rise to carbon monoxide poisoning, like related business torts such as temporarily strong odours produced by floor resurfacing or painting, fail the common sense test for determining what is "pollution". These represent claims long covered by CGL insurance policies. To apply an exclusion

intended to bar coverage for claims arising from environmental pollution to carbon monoxide poisoning from a faulty furnace, is to deny the history of the exclusion, the purpose of CGL insurance, and the reasonable expectations of policyholders in acquiring the insurance.

[38] There is nothing in this case to suggest that the respondent's regular business activities place it in the category of an active industrial polluter of the natural environment. Put simply, the respondent did not discharge or release carbon monoxide from its furnace as a manufacturer discharges effluent, overheated water, spent fuel and the like into the natural environment. It was discharged or released as a result of the negligence alleged in the underlying claims, which remains to be proved. As I have pointed out, the history of the exclusion demonstrates that it would produce an unfair and unintended result to conclude, in the context of a CGL policy, that defective machinery maintenance constitutes "pollution", even when it gives rise to carbon monoxide poisoning. In this regard, it is necessary to understand that [page463] the exclusion focuses on the act of pollution, rather than the resulting personal injury or property damage.

[39] Accepting for the purpose of my conclusion that carbon monoxide is a "pollutant" within the meaning of the exclusion, although it is arguably clear in its plain and ordinary meaning, the exclusion is overly broad and subject to more than one compelling interpretation, as is evident from its construction by American courts. Given that the exclusion is capable of more than one reasonable interpretation, it is ambiguous and should be interpreted in favour of the respondent. The historical context of the exclusion suggests that its purpose is to bar coverage for damages arising from environmental pollution, and not the circumstances of this case in which a faulty furnace resulted in a leak of carbon monoxide. Based on the coverage provided by a CGL policy, a reasonable policyholder would expect that the policy insured the very risk that occurred in this case. A reasonable policyholder would, therefore, have understood the clause to exclude coverage for damage caused by certain forms of industrial pollution, but not damages caused by the leakage of

carbon monoxide from a faulty furnace. In my view, the policy provisions should be construed to give effect to the purpose for which the policy was acquired.

[40] In my view, the application judge correctly interpreted the pollution liability exclusion and was correct in holding that Zurich has a duty to defend the underlying claims against the respondent and to indemnify the respondent for any damages caused by the carbon monoxide leak. Therefore, I would dismiss the appeal with costs. If the parties cannot agree on the amount of costs, counsel may make written submissions on the scale and the amount thereof. The respondent's submissions, together with its bill of costs, are to be served and filed within 15 days from the release of the reasons for judgment. Zurich is to have ten days thereafter to respond.

Appeal dismissed with costs.

WDPH

Zucker v. United States Specialty Ins. Co.

United States Court of Appeals for the Eleventh Circuit

May 16, 2017, Decided

No. 15-10987

Reporter

856 F.3d 1343 *; 2017 U.S. App. LEXIS 8585 **; 26 Fla. L. Weekly Fed. C 1533; 2017 WL 2115414

CLIFFORD A. ZUCKER, not individually, but as Plan Administrator for BankUnited Financial Corporation, and as assignee of Humberto L. Lopez and Ramiro A. Ortiz, Plaintiff-Appellant, versus U.S. SPECIALTY INSURANCE COMPANY, Defendant-Appellee.

Prior History: [**1] Appeal from the United States District Court for the Southern District of Florida. D.C. Docket No. 1:14-cv-20893-UU.

Disposition: AFFIRMED.

Counsel: For CLIFFORD A. ZUCKER, not individually, but as Plan Administrator for BankUnited Financial Corporation, and as assignee of Humberto L. Lopez and Ramiro A. Ortiz., Plaintiff - Appellant: Caroline W. Spangenberg, Alfred S. Lurey, Todd C. Meyers, Kilpatrick Townsend & Stockton, LLP, ATLANTA, GA; Corali Lopez-Castro, Kozyak Tropin & Throckmorton, PA, CORAL GABLES, FL.

For U.S. SPECIALTY INSURANCE COMPANY, Defendant - Appellee: Douglas M. Mangel, Joseph Anselm Bailey, III, Joshua P. Mayer, Shipman & Goodwin, LLP, WASHINGTON, DC; Ira Scott Bergman, Lionel F. Rivera, Mound Cotton Wollan & Greengrass, FORT LAUDERDALE, FL; Mark K. Ostrowski, Shipman & Goodwin, LLP, HARTFORD, CT.

Judges: Before ED CARNES, Chief Judge, FAY and PARKER,* Circuit Judges.

Opinion by: ED CARNES

Opinion

[*1344] ED CARNES, Chief Judge:

For want of good corporate officers, BankUnited Financial Corporation engaged in risky lending practices before November 2008. For want of good lending practices, BankUnited became insolvent. For want of solvency, BankUnited's transfers of money to its subsidiary were fraudulent.

Wanting their money back, [**2] BankUnited's creditors sued its officers for authorizing those transfers. Wanting

* Honorable Barrington D. Parker, Jr., United States Circuit Judge for the Second Circuit, sitting by designation.

protection from the resulting liability, the officers asked their insurer — U.S. Specialty—to indemnify them. Not wanting to do that, U.S. Specialty refused based in part on a policy exclusion that barred coverage for claims "arising out of" conduct that occurred before November 2008. The question is whether the fraudulent transfers "arose out of" the officers' pre-November 2008 misconduct.

I. FACTS & PROCEDURAL HISTORY

BankUnited (the Parent Bank) was a holding company headquartered in Florida. Its wholly-owned subsidiary, BankUnited FSB (the Subsidiary Bank), was a federally-chartered savings bank. By November 2008 both of them were in serious financial trouble.[1]

A. The Banks' Fiscal Difficulties

The Treasury Department's Office of Thrift Supervision (OTS) began investigating the Subsidiary Bank in January 2008. By August, news reports were circulating that the Subsidiary Bank had engaged in risky lending practices during the housing boom that preceded the 2008 recession. The Parent Bank reported in a regulatory filing that, unless the Subsidiary Bank raised $400 million, OTS would downgrade its capitalization [**3] rating. The Parent Bank also announced that it was contributing $80 million in fresh capital to the Subsidiary Bank. This left the Parent Bank itself with only $40 million dollars to service [*1345] $125 million in debt, not a good situation for any financial institution to be in.

In September 2008 the Parent Bank's investors filed a class action against several corporate officers of the Parent Bank and the Subsidiary Bank, alleging that those officers had violated federal securities laws by knowingly or recklessly making "false and misleading statements about [the Parent Bank]." The investor plaintiffs based their allegations on, among other things, the Parent Bank's regulatory filings from 2006, which touted its "conservative underwriting standards that include evaluation of a borrower's debt service ability" and internal underwriting process. They also pointed to a 2007 filing by the Parent Bank that boldly asserted: "We expect that our historically conservative credit standards and relatively low loan to values will keep our loss experience well below industry averages." Even more boldly, the Parent Bank issued an April 2007 press release that included this statement by the company's CEO, [**4] Alfred Camner: "[O]ur levels came in better than we projected last quarter. This is because of our conservative underwriting. We do not engage in subprime lending and, as a portfolio lender, we treat each loan as if

[1] "We relate the facts — as we must at this stage of the litigation — in the light most favorable to" the plaintiff. *Goodman v. Kimbrough, 718 F.3d 1325, 1329 (11th Cir. 2013)*.

it is our own." And so on.

As it turned out (we are beyond mere allegations now), the Subsidiary Bank did engage in risky lending practices. Around the same time that the Parent Bank was being sued by its shareholders, the banks entered into agreements with OTS stipulating in September 2008 that they had "engaged in unsafe and unsound practices that . . . resulted in [the Subsidiary Bank] being in an unsatisfactory condition." This was "primarily due to the rising delinquencies and defaults in its payment option [Adjustable Rate Mortgage] loan portfolio."

B. The Parent Bank's Search for a New Insurer

By September 2008 St. Paul Mercury Insurance Company (Travelers) had declined to renew the Parent Bank's directors and officers (D&O) insurance policy, which is not surprising given the banks' fiscal difficulties. The Parent Bank began searching for a new insurer.

It found one in U.S. Specialty.[2] At the time, U.S. Specialty was aware that "[b]ad loans were affecting [the banks'] financial [**5] performance," and that they were in a "distressed financial condition." It was also aware that OTS was threatening to downgrade the Subsidiary Bank's capitalization rating unless the Parent Bank raised $400 million. All of which made issuing a D&O policy covering the Parent Bank's officers a risky proposition.

Margaret Kingsley, an underwriter and U.S. Specialty's designee under *Rule 30(b)(6) of the Federal Rules of Civil Procedure*, testified at her deposition that around the time the policy was issued, she thought it was unlikely that the Parent Bank would survive. She noted in the underwriting file that U.S. Specialty might be able to make an "opportunistic play" if it agreed to provide D&O coverage to the Parent Bank. Kingsley later testified that note in the file meant that insuring the Parent Bank was "an opportunity for [U.S. Specialty] to write a very restrictive policy and get some premium for it." In considering whether to issue a D&O policy to the [*1346] Parent Bank, U.S. Specialty also considered that regulators would be watching the banks closely, which would "keep[ ] them honest."

U.S. Specialty offered the Parent Bank a choice between two policies: one with a Prior Acts Exclusion (barring coverage for losses attributable to conduct [**6] of the officers before November 10, 2008) and one without that exclusion. The policy with the exclusion would cost

[2] The Parent Bank actually obtained the insurance through a broker's negotiations with HCC Global Financial Products. Both U.S. Specialty and HCC Global are subsidiaries of HCC Insurance Holdings. HCC Global underwrites policies for a number of insurance companies that are subsidiaries of HCC Insurance, including U.S. Specialty. For simplicity's sake, and because this corporate structure has no bearing on the outcome of this case, we will refer to all of these entities collectively as "U.S. Specialty."

$350,000; the policy without it would cost $650,000. The policy without the Prior Acts Exclusion would provide coverage only after the Parent Bank's other insurance policies had been exhausted.

The Parent Bank decided to purchase the policy with the Prior Acts Exclusion, but asked U.S. Specialty to increase the coverage limit from $10 million to $20 million. The purchased policy included in addition to the Prior Acts Exclusion a Prior Notice Exclusion, which excluded coverage as to any losses reported to any insurers under earlier insurance policies. With those two exclusions, the one-year policy cost the Parent Bank $700,000. And, at U.S. Specialty's request, the Parent Bank purchased an extension of the discovery period on the pre-existing Traveler's policy, increasing the amount of time it had to report claims to Traveler's. The first day of coverage under the U.S. Specialty policy was November 10, 2008.

C. The Transfer of Two Tax Refunds to the Subsidiary Bank

While the Parent Bank and the Subsidiary Bank were struggling to come to terms with the 2008 financial crisis, [**7] the Parent Bank's officers approved two transfers of money to the Subsidiary Bank that are the subject of this lawsuit. In January 2009 the Parent Bank received a tax refund check from the U.S. Treasury for approximately $20 million. It transferred all of that refund to the Subsidiary Bank. In March 2009 an officer of the Parent Bank directed that a second tax refund check from the Treasury for approximately $26 million that was supposed to be issued to the Parent Bank be wired directly to the Subsidiary Bank. Those $46 million in transfers occurred after November 10, 2008 (the inception date for the U.S. Specialty policy).

D. The Bankruptcy Litigation

The Parent Bank's and the Subsidiary Bank's financial conditions did not improve. And in May 2009 OTS closed the Subsidiary Bank and appointed the FDIC as its receiver. One day later, the Parent Bank filed for bankruptcy under Chapter 11 of the Bankruptcy Code. And a few days after that, an official committee of unsecured creditors (the Committee) was appointed in the bankruptcy action and began investigating whether claims might exist against, among others, the Parent Bank's corporate officers — the idea being that those claims could [**8] be pursued for the benefit of the bankruptcy estate.

The Committee filed a derivative standing motion, seeking "an order granting the Committee standing to investigate, assert and prosecute any and all claims that [the Parent Bank might have] against [its] current and former officers and directors . . . ."[3] The

[3] Besides the Parent Bank, there were two other debtors in the bankruptcy action, but that fact is not relevant to our decision.

motion asserted that:

> Based on [the Parent Bank's] financial collapse, the issues raised in the [September 2008] Securities Litigation, and information obtained by its professionals, the Committee believes that Claims on behalf of [the Parent Bank's bankruptcy estate] may exist against certain of [its] current and former officers and [*1347] directors . . . including without limitation Claims arising from breaches of duties owed by [those insiders] to [the Parent Bank] or [its] constituents, misrepresentations, failures to disclose and other wrongful acts . . . .

The bankruptcy court granted the Committee's derivative standing motion.

In November 2009, the Committee sent demand letters to three former Parent Bank executives — Alfred Camner, Ramiro Ortiz, and Humberto Lopez— stating that it believed the Parent Bank's estate had claims against the three of them, "including without limitation [**9] claims arising from the breach of [their] fiduciary duties of care and loyalty . . . and [their] failure to perform [their] duties . . . in good faith" and from their violations of federal securities laws. U.S. Specialty was notified of those claims and issued a letter denying coverage based on the Prior Acts Exclusion, because the "Committee Demand Letters allege numerous Wrongful Acts occurring prior to November 10, 2008."

In December 2011, the Committee filed an adversary proceeding against Camner and Lopez in the bankruptcy court. It later sought to amend the complaint by substituting Ortiz for Camner as a defendant as to one count. Meanwhile, in June 2012, the bankruptcy court substituted Clifford Zucker, who had been appointed as the bankruptcy Plan Administrator, for the Committee as the plaintiff in the bankruptcy action. After the district court granted Zucker leave to do so, he filed an amended complaint against Camner, Lopez, and Ortiz.

The amended complaint had four counts. Count I sought to recover from Lopez and Camner for breaching their fiduciary duties by "fail[ing] to implement and maintain effective risk management procedures and internal controls," which caused the Subsidiary [**10] Bank to be placed into receivership and the Parent Bank to declare bankruptcy. Count II sought to recover from Lopez and Camner for breaching their fiduciary duties by providing inaccurate and incomplete information to the Parent Bank's board of directors "concerning the lack of internal controls and unreasonably risky lending practices," which Zucker alleged caused the board to authorize expenditures and the issuance of debt and artificially prolonged the existence of the company, causing more losses. Count III sought to recover from Camner alone for causing the Parent Bank's board to approve the infusion of $80 million into

the Subsidiary Bank without "investigating whether, or disclosing to [the Parent Bank's] board that, among other things, the capital infusion would not forestall regulatory seizure of the [Subsidiary Bank]." And Count IV sought to recover from Ortiz and Lopez based on the contention that approving the two tax refund transfers to the Subsidiary Bank in 2009 was a breach of their fiduciary duties because the transfers violated Florida's Uniform Fraudulent Transfers Act. The fraudulent transfer claims (Count IV) based on the 2009 tax refund transfers are the primary [**11] focus of this lawsuit.

In November 2012, Bankruptcy Plan Administrator Zucker sent a written settlement demand to Lopez and Oritz concerning the fraudulent transfer claims (Count IV). That demand was forwarded to U.S. Specialty, which again denied coverage.

Eventually, the fraudulent transfer claims settled for $15 million to be paid either by U.S. Specialty or by Lopez and Ortiz individually. The settlement agreement assigned Lopez's and Ortiz's rights under the U.S. Specialty policy to Zucker. The other claims were settled separately.

E. The Lawsuit against U.S. Specialty

After Zucker settled his fraudulent transfer claims against the banks' corporate [*1348] officers in the bankruptcy action, he filed this lawsuit in the district court against U.S. Specialty based on its denial of coverage as to those claims. In the complaint, he asserted claims for breach of contract, statutory bad faith, and common law bad faith. The district court bifurcated the proceedings so that it could decide whether denying coverage of the fraudulent transfer claims amounted to a breach of contract before considering whether U.S. Specialty acted in bad faith. The parties filed cross-motions for summary judgment, disagreeing [**12] primarily over whether the fraudulent transfer claims were covered by the U.S. Specialty policy.

The district court concluded that the Prior Acts Exclusion did bar coverage for the fraudulent transfer claims, and as a result, U.S. Specialty did not breach the insurance contract. On that basis it granted summary judgment in favor of U.S. Specialty. Because that decision also foreclosed Zucker's bad faith claims, the district court entered a final judgment against Zucker. This is his appeal.

II. ANALYSIS

We review de novo the district court's interpretation of the insurance policy and its grant of summary judgment in favor of U.S. Specialty. See *EmbroidMe.com, Inc. v. Travelers Prop. Cas. Co. of Am., 845 F.3d 1099, 1105 (11th Cir. 2017)*. In so doing, "we view all of the evidence in a light most favorable to the nonmoving party and

draw all reasonable inferences in that party's favor." *Procaps S.A. v. Patheon, Inc., 845 F.3d 1072, 1079 (11th Cir. 2016)* (quotation marks omitted).

The parties agree that Florida law applies to this case. "Under Florida law, insurance contracts are construed according to their plain meaning." *Taurus Holdings, Inc. v. U.S. Fidelity & Guar. Co., 913 So. 2d 528, 532 (Fla. 2005)*. "Ambiguities are construed against the insurer and in favor of coverage[,] . . . . [but] to allow for such a construction the provision must actually be ambiguous."[4] Id. While "insurance policies may be confusing to persons not [**13] trained or experienced in the form and language of insurance policies[,] . . . . that fact does not make such policies or language legally ambiguous." *Fla. Ins. Guar. Ass'n v. Sechler, 478 So. 2d 365, 367 (Fla. 5th DCA 1985)*. "[C]ourts may not rewrite contracts, add meaning that is not present, or otherwise reach results contrary to the intentions of the parties." *Taurus Holdings, Inc., 913 So. 2d at 532* (quotation marks omitted).

Zucker contends that the district court erred when it concluded that the fraudulent transfer claims in the bankruptcy complaint fell within the Prior Acts Exclusion in the U.S. Specialty policy. We disagree with him and agree with the district court.

A. Zucker's Claims Fall within the Prior Acts Exclusion

Zucker's claims against Lopez and Ortiz alleged that approving the 2009 tax refund transfers was a breach of their fiduciary duties because those transfers were fraudulent ones under Florida law.[5] [*1349] He alleged that they were fraudulent transfers because they "were made to the [Subsidiary Bank], an insider, for antecedent debt, . . . at a time when [the Parent Bank] was insolvent . . . . [and] the persons in control of [the Subsidiary Bank] had reasonable cause to believe [the Parent Bank] was insolvent."

As the district court explained: "This allegation parrots the language of [**14] Florida's Uniform Fraudulent Transfer Act . . . ." See *Fla. Stat. § 726.106(2)*. To sustain a fraudulent transfer claim under that statutory provision, a creditor must demonstrate that, among other

[4] U.S. Specialty contends that this rule of construction should not apply here because this was an insurance agreement between sophisticated parties. Because we conclude that the policy here was not ambiguous, we need not address that contention.

[5] Zucker has an alternative theory that, even if the district court were correct that his claim that transferring the entire $46 million in tax refunds arose out of pre-2008 conduct and was covered by the Prior Acts Exclusion, the transfer of $17.9 million of the amount did not and was not. We will not consider that alternative theory of coverage because Zucker did not adequately raise it in the district court. See *Reider v. Philip Morris USA, Inc., 793 F.3d 1254, 1258 (11th Cir. 2015)* ("[I]ssues raised for the first time on appeal are generally forfeited because the district court did not have the opportunity to consider them.") (quotation marks omitted); *Juris v. Inamed Corp., 685 F.3d 1294, 1325 (11th Cir. 2012)* ("[I]f a party hopes to preserve a claim, argument, theory, or defense on appeal, she must first clearly present it to the district court, that is, in such a way as to afford the district court an opportunity to recognize and rule on it.") (quotation marks omitted).

things, the debtor was insolvent at the time of the transfer. Id.

The U.S. Specialty policy's Prior Acts Exclusion reads:

> In consideration of the premium charged, it is agreed that the Insurer will not be liable to make any payment of Loss in connection with a Claim arising out of, based upon or attributable to any Wrongful Act committed or allegedly committed, in whole or in part, prior to [November 10, 2008].

And the policy defines a "wrongful act" as any:

> (1) actual or alleged act, error, misstatement, misleading statement, omission or breach of duty:
>
> (a) by an Insured Person in his or her capacity as such, including in an Outside Capacity, or
>
> (b) with respect only to Securities Claims, by the Company; or
>
> (2) matter claimed against an Insured Person solely by reason of his or her service in such capacity or in an Outside Capacity.

Zucker argues that because the tax refund transfers that form the basis of the fraudulent transfer claims occurred in 2009 and insolvency itself is not a wrongful act, those claims should [**15] not fall within the Prior Acts Exclusion of the policy.[6] U.S. Specialty responds that the claims do fall within the exclusion because what made the transfers wrongful was the Parent Bank's insolvency, which resulted from its officers' pre-November 2008 misdeeds, not their post-November 2008 conduct.

"When we address issues of state law, like the ones in this case, we are bound by the decisions of the state supreme court." *World Harvest Church, Inc. v. Guideone Mut. Ins. Co., 586 F.3d 950, 957 (11th Cir. 2009)*. The Supreme Court of Florida has concluded that the phrase "arising out of" is not ambiguous and has a broad meaning, even when used in a policy exclusion. *Taurus Holdings, Inc., 913 So. 2d at 539*. It "means 'originating from,' 'having its origin in,' 'growing out of,' 'flowing from,' 'incident to' or 'having a connection with.'" Id. While that standard "requires more than a mere coincidence between the conduct . . . and the injury[,] . . . . it does not require proximate caus[ation]." *Id. at 539-40*.

[*1350] Decisions of the Florida Supreme Court, the Florida Courts of Appeal, and this Court show that the "arising out of" standard is not difficult to meet. For instance, in *Hernandez v. Protective Casualty Insurance Co., 473 So. 2d 1241, 1242-43 (Fla. 1985)*, the court concluded that a driver's injuries did "aris[e] out of the ownership, maintenance or use of a motor vehicle"

[6] Zucker also makes much of the fact that the U.S. Specialty underwriter changed the title of the Prior Acts Exclusion on the quotes she sent to the Parent Bank from "Prior Acts Exclusion (Broad Form)" to "Prior Acts Exclusion (Policy Inception)," although the exclusion in the final policy still contained the "broad form" language. Zucker does not explain in his briefs to us how that change in the title could modify or clarify the meaning of the exclusion or mislead an insured. We are not persuaded that it could or did.

where he was injured by the police as they arrested [**16] him for a traffic violation. The Florida Supreme Court explained:

> It was the manner of petitioner's use of his vehicle which prompted the actions causing his injury. While the force exercised by the police may have been the direct cause of injury, under the circumstances of this case it was not such an intervening event so as to break the link between petitioner's use of the vehicle and his resultant injury.

Id. at 1243.[7]

Likewise, in *Acosta, Inc. v. National Union Fire Insurance Co., 39 So. 3d 565, 576-77 (Fla. 1st DCA 2010)*, the Florida First District Court of Appeal concluded that a lawsuit "arose out of" an earlier lawsuit and thus fell within a prior litigation exclusion.[8] The court explained that the later lawsuit "ha[d] a connection with" the earlier one because "all of the counts asserted against" the defendant in both the earlier and later lawsuits "center[ed] on its efforts to obtain contracts with [the plaintiffs'] clients." Id. Although the two lawsuits focused on different conduct, they shared a connection because the defendant's conduct giving rise to each lawsuit was part of the same "overall scheme." Id. And we have applied the Florida Supreme Court's definition of "arising out of" from Taurus Holdings in a similar fashion. *James River Ins. Co. v. Ground Down Eng'g, Inc., 540 F.3d 1270, 1276-77 (11th Cir. 2008)* (holding that a claim "arose out of" pollution, and therefore [**17] was covered by a pollution exclusion, where a negligent environmental site assessment that failed to detect the presence of pollution on the property led to lost profits, lost property value, and the need for environmental remediation).[9]

In light of the Florida courts' broad interpretation of the "arising out of" standard, we conclude that the Parent Bank's insolvency "arose out of" wrongful acts that occurred before November 10, 2008. After all, Zucker's complaint in the bankruptcy case alleged that the Parent Bank's corporate officers committed wrongful acts, some of which occurred before November 2008, that harmed the company financially. So Zucker has admitted that the wrongful conduct of the corporate officers contributed to the insolvency

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[7] Though Hernandez predates the Florida Supreme Court's effort in Taurus Holdings to define "arising out of," its decision in that case cited Hernandez — as well as several other older cases discussing the meaning of "arising out of" — approvingly. *Taurus Holdings, Inc., 913 So. 2d at 533-34*.

[8] "Federal courts sitting in diversity are bound to adhere to decisions of [Florida's] intermediate appellate courts, absent some persuasive indication that the state's highest court would decide the issue otherwise." *Winn-Dixie Stores, Inc. v. Dolgencorp, LLC, 746 F.3d 1008, 1025 (11th Cir. 2014)* (quotation marks omitted) (alteration in original).

[9] Our prior panel precedent rule requires us to follow a prior panel's binding interpretation of state law unless and until the state supreme court or a state intermediate appellate court issues a decision suggesting that our interpretation of state law was incorrect. *EmbroidMe.com, Inc., 845 F.3d at 1105*; *Roboserve, Ltd. v. Tom's Foods, Inc., 940 F.2d 1441, 1450-51 (11th Cir. 1991)*. That has not happened in this instance.

that made the 2009 tax refund transfers fraudulent under Florida law. And while Zucker is right to say that insolvency itself is not an inherently wrongful act, what matters here is that an essential element of his claim — the Parent Bank's insolvency — has [*1351] a connection to some prior wrongful acts of the Parent Bank's officers and directors that occurred before the policy's effective date. Given that, Zucker's fraudulent transfer claims do share [**18] "a connection with" wrongful acts covered by the Prior Acts Exclusion. *Taurus Holdings, Inc., 913 So. 2d at 539*.

Zucker attempts to get around that connection by emphasizing that he didn't incorporate the paragraphs describing the officers' misconduct into Count IV (the fraudulent transfer count) of his complaint. True, but irrelevant. The Parent Bank's insolvency is an element of his claim and that insolvency has a connection to misdeeds and misdealing of the Parent Bank's officers before November 2008.

Zucker also points out that he would not have had to prove that the officers engaged in misconduct in order to prevail on his fraudulent transfer claim. That does not, however, mean there was no causal connection between the officers' deeds and the demise of the Parent Bank. "[C]overage —and the accompanying duty to indemnify — is not determined by reference to the claimant's complaint, but rather by reference to the actual facts and circumstances of the injury." *Mid-Continent Cas. Co. v. Royal Crane, LLC, 169 So. 3d 174, 181 (Fla. 4th DCA 2015)* (quotation marks omitted). Zucker cannot plead himself around reality.

This is not a case where the causal connection between the prior wrongful acts and the loss was merely coincidental. See, e.g., *Race v. Nationwide Mut. Fire Ins. Co., 542 So. 2d 347, 351 (Fla. 1989)* (holding that a motorist's injuries did not arise out of the use of an automobile [**19] where he was attacked primarily because a fellow motorist, with whom he had collided, thought he was pulling a gun and the accident created, at most, "an atmosphere of hostility"); *Martinez v. Citizens Prop. Ins. Corp., 982 So. 2d 57, 59 (Fla. 3d DCA 2008)* (holding that an injury did not arise out of the "maintenance, use, loading or unloading of motor vehicles" where the insured was hurt when a driveway collapsed while he was changing the oil on his car because "it was pure chance that the object upon the driveway at the time of its collapse happened to be a car"); *Almayor v. State Farm Fire & Cas. Co., 613 So. 2d 526, 527 (Fla. 3d DCA 1993)* (holding that an injury did not arise out of the "ownership, maintenance or use of [a] motor vehicle" where plaintiff was injured in an explosion caused when a cigarette ignited gasoline fumes from gas that had been siphoned from a car, because the car "was merely the coincidental and legally remote source of a

component, the gasoline, which was itself harmless until acted upon by the insured's negligence").

It is no coincidence that insolvency and misconduct converged on the Parent Bank. Instead, the misconduct was a significant contributing cause of the Parent Bank's vulnerability to the 2008 financial crisis. For that reason, it is plain that Zucker's fraudulent conveyance claims "arose from" [**20] wrongful acts that predate November 10, 2008 and therefore fell within the scope of the Prior Acts Exclusion.[10]

[*1352] **B. The Policy's Terms are Unambiguous and Its Coverage is Not Illusory**

Zucker's final effort to get around the Prior Acts Exclusion is his argument that if we adopt U.S. Specialty's construction of the Prior Acts Exclusion, the policy's coverage is illusory. We don't think so.

Zucker relies primarily on *Purrelli v. State Farm Fire & Casualty Co., 698 So. 2d 618, 620 (Fla. 2d DCA 1997)*, which held that when an exclusion or limitation to an insurance policy "swallow[s] up the insuring provision" it "creat[es] the grossest form of ambiguity." As we mentioned earlier, when insurance policies are ambiguous, Florida courts construe them in favor of coverage. *Taurus Holdings, Inc., 913 So. 2d at 532*. So when a policy exclusion does swallow up an insuring provision, the Florida Courts conclude that the policy is ambiguous, *Purrelli, 698 So. 2d at 620*, and resolve that ambiguity by ignoring the exclusion, see *Tire Kingdom, Inc. v. First S. Ins. Co., 573 So. 2d 885, 887 (Fla. 3d DCA 1990)*. To quote Tire Kingdom, "[a]n insurance policy cannot grant [a] right[ ] in one paragraph and then retract the very same right in another paragraph called an 'exclusion.'" Id.

Zucker argues that Purelli is on all fours with this case, but it is not. The insurance policy in Purrelli had a provision explicitly providing coverage for invasion of privacy [**21] (an intentional tort), but also had an exclusion precluding coverage for "intended" injuries. *698 So. 2d at 619-20*. In that way the policy's exclusion expressly contradicted its coverage provisions, leaving the insured to wonder which provision correctly explained the scope of his coverage. Here, by contrast, the U.S. Specialty policy's Prior Acts Exclusion does not "grant [a] right[ ] in one paragraph and then retract the very same right" in a

[10] At one point in his brief, Zucker suggests that "arising out of" does not mean in this policy what the Florida Supreme Court has said it means in other policies. He points to other exclusions in the policy that use the "arising out of" language and emphasizes that they also include relatedness terminology. But Zucker makes this argument only in passing, provides no authority for it, and does not adequately explain why the use of relatedness terminology in other exclusions matters in this case. As a result, he has not properly presented this argument and we do not consider it. *Sapuppo v. Allstate Floridian Ins. Co., 739 F.3d 678, 681 (11th Cir. 2014)* ("We have long held that an appellant abandons a claim when he either makes only passing references to it or raises it in a perfunctory manner without supporting arguments and authority.").

later one. See *Tire Kingdom, Inc., 573 So. 2d at 887*. Instead, it simply excludes coverage for a subset of claims that would ordinarily fall within the policy's insuring provisions. For the same reason, Tire Kingdom doesn't support Zucker's position. In that case, the policy "attempt[ed] to provide coverage for certain advertising activities and then exclude those same activities." Id. The U.S. Specialty policy doesn't do that.

This also is not a case that falls within the common law "illusory coverage" doctrine that other jurisdictions have recognized and that we have indicated is part of Florida's insurance law. See *Interline Brands, Inc. v. Chartis Specialty Ins. Co., 749 F.3d 962, 966-67 (11th Cir. 2014)* (applying Florida law). In order for an exclusion to render a policy's coverage illusory it must eliminate all —or at least virtually all — coverage in a policy. See id. ("According to Interline, [**22] the Exclusion's broad scope reduces the coverage Chartis sold to Interline to a 'façade' . . . . Interline overstates the extent to which the Exclusion limits coverage. Even with the broad Exclusion, the policy still contains extensive coverage.") (quotation marks omitted); cf. *Great Am. E & S Ins. Co. v. End Zone Pub & Grill of Narragansett, Inc., 45 A.3d 571, 576 (R.I. 2012)* ("We will deem an exclusion to an insurance policy illusory only when it would preclude coverage in almost any circumstance.") (quotation marks omitted); *McGregor v. Allamerica Ins. Co., 449 Mass. 400, 868 N.E.2d 1225, 1228 (Mass. 2007)* ("As long as an insurance policy provides coverage for some acts, it is not illusory simply because it contains a broad exclusion."); *Point of Rocks Ranch, LLC v. Sun Valley Title Ins. Co., 143 Idaho 411, 146 P.3d 677, 680 (Idaho 2006)* ("An insurance policy's coverage is illusory if it appears that if any actual coverage does exist it is extremely minimal and affords [*1353] no realistic protection to any group or class of injured persons.") (quotation marks omitted).

U.S. Specialty overstates the case when it says that the policy "still provides coverage for a wide variety of Claims." We need not agree with that statement. It is enough that the policy provided coverage for claims that arose exclusively from conduct that happened after the effective date of the policy. The Prior Acts Exclusion excludes a lot of coverage, but not all coverage. And regardless of what [**23] the result might have been had this exclusion been included in an adhesion policy issued to a layperson, it was not. The Parent Bank entered into this insurance contract with its eyes wide open and with its wallet on its mind. U.S. Specialty offered the Parent Bank a policy without a Prior Acts Exclusion. After weighing that offer the bank decided to reject it, having calculated that its best interests would be served by using the money it would save by accepting the exclusion

to buy an increased total coverage limit. In hindsight, that decision did not work out well, but it was the decision of a sophisticated, fully informed party.

Zucker believes the Parent Bank did not get a good deal and wishes that it had paid a higher premium for a policy without a Prior Acts Exclusion. But after the fact wishes are not enough to change before the fact choices. Prior acts exclusions serve valid purposes when agreed to by consenting parties. Cf. *Interline Brands, Inc., 749 F.3d at 967* ("[E]xclusions are not necessarily harmful. Exclusions . . . allow creation of a policy that provides the insured the coverage it needs at a price it can afford. Without such exclusions, coverage would undoubtedly be more expensive."). The Parent Bank chose to rely [**24] on its old policies to cover claims against its officers connected to wrongful acts that occurred before November 2008. It chose to buy the policy that it bought. It cannot change that choice now, nor can its former corporate officers, nor can Zucker.[11]

AFFIRMED.

End of Document

[11] U.S. Specialty also contends alternatively that the fraudulent conveyance claims are barred by the policy's Prior Notice Exclusion. The district court rejected that contention. Because we conclude that the fraudulent conveyance claims do fall within the Prior Acts Exclusion and that the exclusion does not render the policy's coverage illusory, we need not address whether we would reach the same result based on the Prior Notice Exclusion.

Jayhawk Private Equity Fund II LP v. Liberty Ins. Underwriters, Inc.

United States District Court for the Central District of California

June 7, 2018, Decided; June 7, 2018, Filed

CV 17-5523-GW(RAOx)

Reporter
2018 U.S. Dist. LEXIS 250716 *; 2018 WL 11605692

Jayhawk Private Equity Fund II LP v. Liberty Insurance Underwriters, Inc., et al.

Counsel: [*1] Attorneys for Plaintiffs: Laurence M. Rosen.

Attorneys for Defendants: Jenni K. Katzer, Charles C. Lemley, Valerie D. Rojas, Randolph P. Sinnitt.

Judges: GEORGE H. WU, UNITED STATES DISTRICT JUDGE.

Opinion by: GEORGE H. WU

Opinion

CIVIL MINUTES - GENERAL

PROCEEDINGS: DEFENDANT XL SPECIALITY INSURANCE COMPANY'S MOTION TO DISMISS PURSUANT TO RULE 12(b)(6) [57];

DEFENDANT LIBERTY INSURANCE UNDERWRITERS INC.'S MOTION TO DISMISS SECOND AMENDED COMPLAINT PURSUANT TO *F.R.C.P. 12(b)(6) [59]*

Court hears oral argument. The Tentative circulated and attached hereto, is adopted as the Court's Final Ruling. The Court GRANTS both motions, without leave to amend.

A status conference is set for June 28, 2018 at 8:30 a.m., with a joint report as to what remains to be filed by noon on June 26, 2018.

I. Background

Jayhawk Private Equity Fund II, L.P., on Behalf of a Certain Certified Class ("Jayhawk"), and ChinaCast Litigation Trust ("ChinaCast Trust" and, together with Jayhawk, "Plaintiffs"), filed a Second Amended Complaint ("SAC") in this action on April 2, 2018, asserting six claims for relief against Liberty Insurance Underwriters Inc. ("Liberty"), Berkley Insurance Company ("Berkley") and XL Specialty Insurance Company ("XL"): 1) breach of contract under securities claims [*2] insurance policies - payment of the judgment; 2) breach of contract under securities claims insurance policies - payment of the defense costs; 3) judgment creditor's action against insurer based on breach

of contract under securities claims insurance policies; 4) breach of the covenant of good faith and fair dealing; 5) declaratory judgment; and 6) breach of third party beneficiary contract. *See* Docket No. 54. ChinaCast Trust brings the first, second and fourth claims, while Jayhawk brings the third and sixth, with both Plaintiffs asserting the fifth. All six claims are pled against both Liberty and XL, who have now separately moved to dismiss pursuant to *Federal Rule of Civil Procedure 12(b)(6)*.[1]

The case involves the resolution - as the result of a default judgment - of a securities lawsuit brought against ChinaCast Education Corporation ("ChinaCast"), *In re ChinaCast Education Corporation Securities Litigation*, Case No. 2:12-cv-04621-JFWPLA ("the Securities Litigation"), and insurance policies Plaintiffs allege cover the $65.8 million judgment resulting from that lawsuit and the almost $7 million in legal fees incurred in the course of that lawsuit. *See* SAC ¶¶ 2, 4, 13. At issue on these motions are [*3] the 2011 policy Liberty issued to ChinaCast that originally covered the period of December 1, 2010 to December 1, 2011, but that was extended by way of a "Run-Off Endorsement" to also cover December 1, 2011 to December 1, 2012 ("the Liberty Policy"), and the 2012 policy XL issued to ChinaCast that covered the period of December 1, 2011 to December 1, 2012 ("the XL Primary Policy"). *See id.* at 9:19-10:14, 10:19-23, 11:10-13, 13:1-8.[2] Both are "primary" policies, though XL also issued an "excess" policy - in fact, a "second excess" policy - that covered the same time period as the Liberty Policy. *See id.* at 9:19-10:14, 11:10-13, 11:23-12:5, 13:1-8.

II. Analysis

A. Procedural Standard

Under Rule 12(b)(6), a court must (1) construe a complaint in the light most favorable to the plaintiffs, and (2) accept all well-pleaded factual allegations as true, as well as all reasonable inferences to be drawn from them. *See Sprewell v. Golden State Warriors, 266 F.3d 979, 988 (9th Cir.)*, *amended on denial of reh'g*, *275 F.3d 1187 (9th Cir. 2001)*; *Pareto v. F.D.I.C., 139 F.3d 696, 699 (9th Cir. 1998)*. The court need not accept as true "legal conclusions merely because they are cast in the form of factual allegations." *Warren v. Fox Family Worldwide, Inc., 328 F.3d 1136, 1139 (9th Cir. 2003)*.

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[1] Berkley's policy is excess to Liberty's primary policy, to which Berkley's policy "follows form." *See* Docket No. 56, at 1:10-19. Because Berkley's response to the SAC "will necessarily depend on the resolution of issues raised in Liberty's motion," *id.* at 1:22-23, the parties have stipulated that Berkley's response to the SAC will follow decision on Liberty's motion. *See generally id.* As such, Berkley has not moved to dismiss.

[2] Beginning at page 9, line 19 of the SAC, the paragraph numbering starts anew. As such, the Court refers only to paragraph numbers in the SAC when it is citing one of the first 37 paragraphs found in the first nine pages of the document. All other citations are to page and line numbers of the SAC.

Dismissal pursuant to Rule 12(b)(6) is proper only where there is either a "lack of a cognizable legal theory or the absence of sufficient facts alleged under [*4] a cognizable legal theory." Balistreri v. Pacifica Police Dep't, 901 F.2d 696, 699 (9th Cir. 1990); *Johnson v. Riverside Healthcare Sys., LP, 534 F.3d 1116, 1121-22 (9th Cir. 2008)*; *see also* Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 561-63 (2007) (dismissal for failure to state a claim does not require the appearance, beyond a doubt, that the plaintiff can prove "no set of facts" in support of its claim that would entitle it to relief). However, a plaintiff must also "plead 'enough facts to state a claim to relief that is plausible on its face.'" *Johnson, 534 F.3d at 1122* (quoting Twombly, 550 U.S. at 570); *see also* William O. Gilley Enters., Inc. v. Atlantic Richfield Co., 588 F.3d 659, 667 (9th Cir. 2009) (confirming that Twombly pleading requirements "apply in all civil cases"). A complaint does not "suffice if it tenders 'naked assertion[s]' devoid of 'further factual enhancement.'" Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009) (quoting Twombly, 550 U.S. at 556). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.*

A claim may be dismissed under Rule 12(b)(6) on the ground that it is barred by the applicable statute of limitations only when 'the running of the statute is apparent on the face of the complaint.'" *Von Saher v. Norton Simon Museum of Art at Pasadena, 592 F.3d 954, 969 (9th Cir. 2010)* (quoting Huynh v. Chase Manhattan Bank, 465 F.3d 992, 997 (9th Cir. 2006)). In this respect, "'a complaint cannot be dismissed unless it appears beyond doubt that the plaintiff can prove no set of facts that would establish the timeliness of the claim.'" *Id.* (quoting Supermail Cargo, Inc. v. United States, 68 F.3d 1204, 1206 (9th Cir. 1995)).

In its consideration of the motion, the court is generally [*5] limited to the allegations on the face of the complaint (including documents attached thereto), matters which are properly judicially noticeable and "documents whose contents are alleged in a complaint and whose authenticity no party questions, but which are not physically attached to the pleading." *See* Lee v. City of Los Angeles, 250 F.3d 668, 688-89 (9th Cir. 2001); Branch v. Tunnell, 14 F.3d 449, 453-54 (9th Cir. 1994), *overruling on other grounds recognized in* Galbraith v. County of Santa Clara, 307 F.3d 1119 (9th Cir. 2002). However, "[a] court may [also] consider evidence on which the complaint 'necessarily relies' if: (1) the complaint refers to the document; (2) the document is central to the plaintiff's claim; and (3) no party questions the authenticity of the copy attached to the 12(b)(6) motion." Marder v. Lopez, 450 F.3d 445, 448 (9th Cir. 2006).

Consistent with the foregoing principles, this Court concludes that it may, as part of its analysis of these motions,

consider both the Liberty Policy and the XL Primary Policy and the allegations made in the Securities Litigation. Plaintiffs have specifically referenced the allegations made in the Securities Litigation (indeed, the SAC specifically incorporates-by-reference the Consolidated Class Action Complaint filed in that action). *See, e.g.*, SAC ¶ 9; *id.* at 14:12-21, 14:27. They also have not objected to the requests for judicial notice both Defendants [*6] have filed seeking to have the Court take judicial notice of the Consolidated Class Action Complaint filed in the Securities Litigation. *See* Docket Nos. 58, 61. In addition, the terms of the policies are central to Plaintiffs' claims herein, and the SAC repeatedly refers to various provisions found in those policies.[3]

Two terms - both exclusions - are central to consideration of the motions before the Court. By way of a "Run-Off Endorsement," Liberty and ChinaCast added an exclusion to coverage for loss in connection with any claim "based upon, arising from or in any way related to any Wrongful Act committed or allegedly committed *on or after* December 1, 2011. Docket No. 54-2, at pgs. 7, 46 (emphasis added). The XL Primary Policy, meanwhile, contains a "Prior Acts Exclusion," excluding claims "based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any act, error, omission, misstatement, misleading statement, neglect, breach of duty, Wrongful Act, Company Wrongful Act or Employment Wrongful Act committed or allegedly committed *prior* to December 1, 2011. Docket No. 54-5, at pg. 19 (emphasis added).

B. Motion [*7] **One - Liberty's MTD**

Liberty moves to dismiss based on two theories: 1) that Plaintiffs' claims are time-barred because Liberty unconditionally denied coverage as to indemnity and advancement of defense costs almost five years before Plaintiffs filed this lawsuit; and 2) the language of the aforementioned "Run-Off Endorsement" - which extended the December 1, 2010 to December 1, 2011, policy period one year to December 1, 2012 - precludes coverage by having simultaneously put in place an exclusion indicating that Liberty "shall not be liable to make any payment for **Loss** in connection with any **Claim** . . . based upon, arising from or in any way related to any Wrongful Act committed or allegedly committed on or after December 1, 2011." Before considering those arguments, however, Plaintiffs specifically raise a choice-of-law issue in both the SAC and their Opposition to the two motions presently

[3] The SAC specifically lists the insurance policies at issue in this case. *See* SAC at 9:19-13:14. It admits that Defendants rejected Plaintiffs' request for payments of the amounts at issue here based upon "untenable and unreasonably expansive interpretations of the exclusion provisions." SAC ¶ 19; *see also id.* ¶¶ 21-22; *id.* at 17:14-16, 17:21-18:7. It also references (and attempts to reflect the contents of) the Endorsement No. 24 "Run-Off Endorsement" in the Liberty Policy and the "prior acts exclusion pursuant to the Endorsement No. 7" in the XL Primary Policy. *See id.* at 10:15-12:11, 27:18-20, 27:24-29:7.

before the Court.[4]

1. Choice of Law

Plaintiffs believe that Delaware's substantive law applies here, but "reference the law of both Delaware and California" because "the Court has not yet passed on the choice-of-law issue." Docket No. 64, at 3:15-23. As an initial matter, in the SAC, Plaintiffs [*8] asserted that Delaware law applies under California Civil Code § 1646[5]. *See* SAC ¶¶ 33-37. But Plaintiffs make no mention of Section 1646 in their Opposition. As such, the Court considers Plaintiffs to have waived that issue, at least for purposes of resolution of these motions.

Plaintiffs argue in their Opposition that California's governmental interest analysis is used to assess choice-of-law questions with respect to statutes of limitation, citing *Ledesma v. Jack Stewart Produce, Inc., 816 F.2d 482, 484-85 (9th Cir. 1987)*, and *Deutsch v. Turner Corp., 324 F.3d 692, 716 (9th Cir. 2003)*. *But see Frontier Oil Corp. v. RLI Ins. Co., 153 Cal.App.4th 1436, 1454 (2007)* (concluding that "the governmental interest analysis as developed by the California Supreme Court . . . does not supplant the legislative command of section 1646"); *Arno v. Club Med Inc., 22 F.3d 1464, 1468 n.6 (9th Cir. 1994)*. But Plaintiffs have not actually identified any way in which Delaware and California law differ with respect to any issue - statute of limitations or otherwise - relevant to either of the two motions.[6] That question of difference in law is the first step in the governmental interest approach, *see Ledesma, 816 F.2d at 484*, and "[t]he proponent of using foreign law" - here, Plaintiffs, apparently - "has the initial burden of showing material differences," *Carijano v. Occidental Petroleum Corp., 643 F.3d 1216, 1233 (9th Cir. 2011)*; *see also Wash. Mut. Bank, FA v. Superior Court, 24 Cal.4th 906, 919-20 (2001)*. Having not actually identified any difference in the two States' laws, Plaintiffs have failed to shoulder that burden.

It appears, therefore, that the choice-of-law issue [*9] Plaintiffs nominally present is, in fact, a non-issue here.

2. Statute of Limitations

Liberty asserts that California's four-year statute of limitations applies to each of Plaintiffs' claims (with the exception of a 2-year period applying to any *tortious* breach of the implied covenant claim alleged in the SAC), citing to *Cossman v. DaimlerChrysler Corp., 108 Cal.App.4th 370, 376 (2003)*

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[4] Plaintiffs have authored a single Opposition to both motions. *See* Docket No. 64, at 1 n.1. The Court's analysis of several of the arguments Plaintiffs raise in that Opposition is applicable to both Liberty's and XL's motions, and will not be revisited separately in the context of the Court's discussion of XL's motion.

[5] "A contract is to be interpreted according to the law and usage of the place where it is to be performed; or, if it does not indicate a place of performance, according to the law and usage of the place where it is made." *Cal. Civ. Code § 1646*.

[6] For instance, Liberty notes in its Reply that Plaintiffs have agreed that the applicable statute of limitations is four years.

and *Deutsch, 324 F.3d at 716*, among other cases. It then asserts that, for any breach of an insurance policy, the limitations period begins when the insurer unconditionally denies coverage, which Liberty asserts occurred here on August 23, 2012, as alleged in the SAC. *See* SAC at 17:14-16 & Exh. 6.

On this issue, Plaintiffs' response is to argue that Liberty has erroneously relied, for its argument, on cases dealing with *first-party* insurance policies, instead of the liability - or third-party - policies at issue here. It is when the default judgment became final - less than two years prior to the Complaint's filing - that the statutes of limitation began to run, in Plaintiffs' view. Liberty responds that the cases Plaintiffs cite make no distinction between first- and third-party insurance, and only provide limited exceptions for accruals (or apply equitable tolling) based on types of claims [*10] and/or policies that are not present here.

In the end, because (as addressed *infra*) Plaintiffs appear to clearly lose on the coverage issues posed by this case (or at least by these motions), it does not appear to the Court that it needs to reach, or resolve, the statute of limitations issue.[7] *See* *Moran v. Selig, 447 F.3d 748, 753 n.8 (9th Cir. 2006)* ("Appellees argue that appellants' Title VII claim is barred by the statute of limitations. The district court questioned the parties' counsel about this issue, but ultimately did not rule on it. Although we think it likely that appellees are correct on this point, we see no need to reach the statute of limitations issue because we agree with the district court's decision on the merits of the claim."); *Eichman v. Fotomat Corp., 880 F.2d 149, 159-60 (9th Cir. 1989)* ("We need not resolve the question of the applicable statute of limitations, because we conclude, *infra*, that the district court properly granted Fotomat summary judgment on the merits of this claim."). That being said, Plaintiffs appear to take the position that Defendants' *only* challenge to their declaratory relief action is a statute of limitations-based challenge. *See* Docket No. 64, at 6:1-2. But Plaintiffs' claim for declaratory relief concerns "whether Defendants have a duty to indemnify [*11] Plaintiff ChinaCast Trust for the judgment obtained by Jayhawk [in] the Securities Litigation,"

[7] Responding to an issue it believes was raised by one of the cases Plaintiffs cited in their Opposition, Liberty posits, for the first time in its Reply, that Jayhawk lacks standing to maintain this lawsuit as a plaintiff. *See* Docket No. 69, at 5:14-21. A moving party may not raise a wholly-new argument for the first time in a reply brief. *See* *Zamani v. Carnes, 491 F.3d 990, 997 (9th Cir. 2007)* ("The district court need not consider arguments raised for the first time in a reply brief."). Although standing is an issue that a court should analyze *sua sponte*, at this point in time the issue is not presented clearly enough for the Court to render an opinion on the issue. In any event, neither of the Defendants challenge the standing of ChinaCast Trust, and the merits of the coverage issues presented by these motions are clear enough. *See* *Bd. of Nat. Res. of State of Wash. v. Brown, 992 F.2d 937, 942 (9th Cir. 1993)* ("If any one of these three [plaintiff-appellants] has standing, we may reach the merits of the equal protection argument without considering whether the other two also have standing."); *see also* *City of Charleston v. Pub. Serv. Comm'n of W. Va., 57 F.3d 385, 390 (4th Cir. 1995)*. If this case continues on past the proceedings on these motions, however, Jayhawk's standing may be an issue worth exploring in further detail.

SAC at 38:3-6, and "the parties' respective rights and obligations under the Securities Claims Insurance Policies," *id.* at 38:14-16. If there is an angle to those issues that is not resolved by the Court's determinations on the coverage issue herein, it is not obvious. Indeed, the SAC elsewhere alleges that "[t]he controversy between the parties is likely to be resolved, and the need for further litigation limited or eliminated, by the Court's declaratory judgment on the issue of coverage under the Securities Claims Insurance Policies." *Id.* at 38:23-25. If Plaintiffs believe there is something more to their claims than what would be resolved by way of the Court's ruling on these two motions,[8] such that a resolution of the statute-of-limitations issue is truly necessary, they should make that clear at the hearing.

3. The Effect of the Run-Off Endorsement

Liberty notes that the Run-Off Endorsement effected multiple changes in the Liberty Policy. In addition to adding an exclusion for "**Loss** in connection with any **Claim** . . . based upon, arising from or [*12] in any way related to any Wrongful Act committed or allegedly committed on or after December 1, 2011" and extending the policy period to December 1, 2012, it also amended Insuring Agreements 1.1, 1.2 and 1.3 to cover Claims only for Wrongful Acts taking place *prior to* December 1, 2011. *See* Docket No. 54-2, at pg. 46. In other words, if there were no Wrongful Acts *prior to* December 1, 2011, there would be no coverage under the Liberty Policy to begin with.

An exclusion, of course, is an *exception* to coverage. *See, e.g.*, *Waller v. Truck Ins. Exch., Inc., 11 Cal.4th 1, 16 (1995)* (explaining that "exclusion clauses," at least in a commercial general liability policy, "remove coverage for risks that would otherwise fall within the insuring clause"); *see generally* Croskey, Heeseman, Ehrlich & Klee, CAL. PRAC. GUIDE: INSURANCE LITIGATION (The Rutter Group 2017), ¶¶ 3:127-134, at 3-44 - 46. Liberty therefore reasons that the Run-Off Endorsement's language which excluded coverage for all Loss resulting from a Claim "based upon, arising from or in any way related to any Wrongful Act committed or allegedly committed *on or after* December 1, 2011" must be taken to refer to "mixed" claims, *i.e.* claims that allege Wrongful Acts *both before and after* December [*13] 1, 2011. They argue that if it were to refer only to Wrongful Acts committed on or after December 1, 2011, there would be no coverage at all

[8] For instance, the declaratory relief claim also concerns the operation of exhaustion principles insofar it impacts the duties of excess insurance policies, and coverage under those excess policies. *See* SAC at 39:3-40:2. However, Plaintiffs admit that "the excess policies 'follow form' of the underlying 2011 Liberty Primary Policy and are subject to the same duties and defenses to coverage." *Id.* at 40:3-5. The declaratory relief claim also identifies a number of sub-issues Plaintiffs seek answers to, *see id.* at 40:15-44:19, but it is not at all entirely clear that those issues remain "live" issues if the Court determines there is no coverage under either the Liberty Policy or XL Primary Policy at issue in these motions.

to begin with. Moreover, if it were to accomplish only that which had already been accomplished by way of changes to the Insuring Agreements and Policy Periods, *see* Docket No. 60, at 12:18-19 ("Those two changes by themselves prevented a Claim solely about Wrongful Acts committed after December 1, 2011 from coming within the grant of coverage."), it would run afoul of basic rules governing contract/insurance policy interpretation: Liberty asserts - without challenge from Plaintiffs - that both California and Delaware law require that each word of an insurance policy's provisions must be given meaning. *See, e.g.,* *In re Crystal Props., Ltd., L.P., 268 F.3d 743, 748 (9th Cir. 2001)*; *Advanced Network, Inc. v. Peerless Ins. Co., 190 Cal.App.4th 1054, 1063 (2010)*.

Plaintiffs argue that even if an insurer's interpretation is reasonable, it still would not prevail without establishing that its interpretation is the only reasonable one, citing *MacKinnon v. Truck Ins. Exch., 31 Cal.4th 635, 655 (2003)* and *Penn Mut. Life Ins. Co. v. Oglesby, 695 A.2d 1146, 1149-50 (Del. 1997)*. But Plaintiffs have not pointed to any ambiguity,[9] or any other reasonable construction of its plain language. They merely insist that it cannot possibly mean what it plainly says because it would mean no coverage for the Securities Litigation.

Clearly, the allegations in the Securities Litigation presented a claim that was "based upon, arising from or in any way related to any Wrongful Act committed or allegedly committed on or after December 1, 2011." Liberty notes that the allegations in the Securities Litigation - which covered a class period extending to April 2, 2012 (i.e., *beyond* December 1, 2011) - included, at a minimum, assertions that ChinaCast made "materially false and misleading" statements in amendments to its 2010 10-K filed with the SEC on September 2, 2011, February 8, 2012, and February 24, 2012. *See* Docket No. 61-1, ¶¶ 62, 67; *see also id.* ¶ 121 (alleging that, "[d]uring the Class Period, Defendants engaged in a plan, scheme, conspiracy and course of conduct, pursuant to which they knowingly or recklessly engaged in acts, transactions, practices and courses of business which operated as a fraud and deceit upon Lead Plaintiffs and the other members of the Class . . . ."). Indeed, the SAC itself admits that the underlying lawsuit alleged wrongful acts during the period from February 14, 2011 through April 2, 2012. *See* SAC ¶ 9; *see also id.* at 14:12-15 ("The wrongful acts that Jayhawk alleges in [*15] the ChinaCast Securities Litigation were ChinaCast's issuance of misleading financial statements during

[9] Although exclusions are interpreted strictly so that any ambiguity therein is resolved against an insurer, *see, e.g., [*14]* *Morris v. Employers Reinsurance Corp., 84 Cal.App.4th 1026, 1029 (2000)*, and it is the insurer that bears the burden of proof with respect to application of an exclusion, *see, e.g.,* *Waller v. Truck Ins. Exch., Inc., 11 Cal.4th 1, 16 (1995)*, the language here is clearly expansive, and Plaintiffs offer no reason to believe that there is any ambiguity.

the Class Period. The financial statements were misleading for failing to disclose related party transactions and internal controls deficiencies during the Class Period."); *id.* at 19:13-16 ("The securities violations in the Securities Litigation were based on disclosure violations for issuing misleading financial statements, as well as other misleading public statements from February 14, 2011 through at least March 12, 2012."); *id.* at 28:15-19 ("The Wrongful Acts alleged in the Securities Litigation are the Disclosure Violations. These are the failure to disclose related party transactions and internal control deficiencies in ChinaCast's financial statements issued to shareholders during the Class Period in violation of Section 10(b) of the Securities Exchange Act of 1934.").

Plaintiffs are concerned that interpretation of Liberty's and XL's primary policies as argued by Defendants would leave ChinaCast without coverage precisely because of the fact that the allegations in the Securities Litigation concern acts taking place on both sides of the December 1, 2011, divide. That Defendants - according to Plaintiffs - may not have "cited [*16] a single case in which any [c]ourt has enforced such exclusions to bar coverage on a claim arising out [of] a continuing course of conduct that took place over the course of two coverage periods," Docket No. 64, at 19:1-3, is a somewhat empty observation (whether or not accurate) given the fact that all parties seemingly agree that language in an insurance policy - like any contract - is to be interpreted according to its plain meaning.

Liberty correctly observes that Plaintiffs never actually deal with the exclusion included in the Run-Off Endorsement, at least not in a way that responds to Liberty's point about its proposed construction of that language being the only one that gives the exclusion meaning/avoids surplusage. Instead, Plaintiffs first contend that the Liberty Policy and the XL Primary Policy must be "*jointly construed* to effectuate the intent of the parties." Docket No. 64, at 11:17-18 (emphasis added). They argue that this is necessary because, without doing so, ChinaCast's intent, as the insured, will not be recognized. Plaintiffs assert that it "is self-evident upon examining the Policies together, [that the provisions at issue in these motions] were negotiated for [*17] the purpose of facilitating the transfer of risk from the initial insurer, Liberty, to the successor insurer, XL." Docket No. 64, at 12:7-9; *see also* id. at 12:10-14:2 (presenting a further explanation of ChinaCast's intent in negotiating the two policies and asserting that "[t]he Run-off Endorsement was purchased for the 2011 Liberty Policy concurrently with the purchase of the XL 2012 Policy")). In contrast, Plaintiffs assert, "Defendants' proposed interpretation of the interaction between the policies would eviscerate [Plaintiffs'] reasonable expectation." *Id.* at 13:26-14:2.

But Defendants have *not* proposed an "interpretation of the interaction between the policies"; they have merely argued that the plain language of each of their policies clearly excludes coverage for the claims. Moreover, as both Defendants point out, not only have Plaintiffs failed to cite the Court to any case standing for their "joint construction" proposition,[10] *see, e.g.*, Docket No. 69, at 8:14-16 ("Plaintiffs cite no authority suggesting that two separate insurance policies, from different insurers, for different time periods, should be construed together."), there is nothing in the SAC alleging that there [*18] was any sort of coordinated negotiation of the Defendants' policies to accomplish what Plaintiffs now say was ChinaCast's intent. As such, even if Plaintiffs were correct in their legal proposition, the Court could not possibly deny Liberty's and XL's motion upon application of that proposition here.

But, as noted, Plaintiffs have not cited to any authority even suggesting that they are correct about their proffered "joint construction" rule. Indeed, both Defendants persuasively argue that the Liberty Policy (as to XL) and the XL Primary Policy (as to Liberty) would constitute extrinsic evidence, which could not be used to construe the single policy in question on each motion where the policy language is unambiguous. *See, e.g.*, *Adamo v. Fire Ins. Exch., 219 Cal.App.4th 1286, 1298 (2013)*. As such, while the Court might otherwise ordinarily be inclined to allow them an opportunity to amend to add allegations about the context in which they negotiated changes to the two relevant policies, there does not appear to be any purpose to allowing that opportunity here.

In their next attempt to sidestep the plain language of the policies, Plaintiffs argue that liability/loss should be allocated between the two insurer's policies according to their "time [*19] on the risk." But both Defendants sensibly point out that, without coverage, there is nothing to allocate amongst two or more insurers.

Plaintiffs also believe that the plain language of the policy provisions at issue here should not control because the policies could have used a separately-defined term - "Interrelated Wrongful Acts" - to make the intent behind Liberty's "Run-off Endorsement" exclusion and XL's "Prior Acts" exclusion (discussed *infra*) clear: "Had the Primary Insurer Defendants wished to exclude liability for Wrongful Acts on the basis that said Acts were factually or causally related to other acts outside the policy period, they could have done

[10] Plaintiffs offer that the recognized principle of contract interpretation that "'[a] writing is interpreted as a whole, and all writings that are part of the same transaction are interpreted together,' . . . permits the court to consider separate agreements entered into as part of a single overarching transaction in order to ascertain and effectuate the intent of the parties." Docket No. 64, at 11:25-12:2. For the quotation found within this proposition, Plaintiffs offer a citation to the RESTATEMENT (SECOND) OF CONTRACTS. For the seemingly-novel suggestion that comes after that quotation, Plaintiffs offer no citation whatsoever - not under California, Delaware, or any other law.

so - quite simply - by including the already-defined term 'Interrelated Wrongful Acts' in their respective exclusions." Docket No. 64, at 16:12-17:1. But the effect of those provisions is clear *without* use of that term. Defendants were under no obligation to use that term (which they have argued serves a separate purpose under the policies, in any event[11]) to accomplish that objective.

Finally, Plaintiffs argue that the policy interpretations Defendants argue for on these motions would lead to unconscionable results, and the [*20] Court therefore should decline to adopt their arguments. But as Plaintiffs themselves recognize, *see* Docket No. 64, at 20:8-10, unconscionability requires a lack of meaningful choice on the part of the party against whom the contract is sought to be enforced. The central point of Plaintiffs' Opposition, insofar as interpretation of the key provisions is concerned, is that ChinaCast was negotiating the end of one primary policy and the beginning of another, and according to Plaintiffs that negotiation was purposefully-structured in a particular manner that ChinaCast believed (wrongly, it appears[12]) would cover its exposure. There is no prospect of Plaintiffs making out a case for unconscionability given what they assert (outside of the SAC's allegations) occurred.

Unable to make out a case for coverage, Plaintiffs' claims for breach of the Liberty Policy must fail. With Plaintiffs having failed to viably plead a loss covered by the policy, Liberty then argues that Plaintiffs may not recover by way of a bad faith action, citing decisions to that effect under both California and Delaware law. *See, e.g.,* *Benavides v. State Farm Gen. Ins. Co., 136 Cal.App.4th 1241, 1250 (2006)*. Plaintiffs seemingly concede this point in their Opposition. *See* Docket No. 64, at [*21] 7:25 ("[I]f there is no breach of the policy, there can be no bad faith."). For good measure, Liberty argues that even if the Court were not able to dismiss the SAC based upon the coverage issue, any bad faith liability would be barred under both California and Delaware law because Liberty's coverage position was, at the least, not unreasonable - *i.e.*, because of application of the "genuine dispute" doctrine. *See* *Chateau Chamberay Homeowners Ass'n v. Associated Int'l Ins. Co., 90 Cal.App.4th 335, 347 (2001)*; Croskey, Heeseman, Ehrlich & Klee, CAL. PRAC. GUIDE: INSURANCE LITIGATION (The Rutter Group 2017), ¶¶ 12:618-618.1, at 12B-99 - 100. Again citing both California and Delaware law, Liberty concludes its motion by taking the position that, without a finding of bad faith, Plaintiffs cannot recover either attorney's fees or punitive damages.

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[11] *See* Docket No. 66, at 2:22-28, 10:13-22; Docket No. 69, at 11:28-12:6.

[12] XL somewhat accurately portrays Plaintiffs' position here (on ChinaCast's behalf) as a case of "buyers' remorse." Docket No. 66, at 3:9-10.

Plaintiffs appear to have no response to any of these follow-on points,[13] other than an apparent citation to *MacKinnon* for the proposition that if the policy's provisions are susceptible to any reasonable construction other than the one Liberty proposes, the motion to dismiss must be denied. As Liberty points out, however, *MacKinnon*'s discussion made no reference to the effect, if any, of its analysis on a *bad faith* claim. Plaintiffs' citation to its "reasonableness" [*22] discussion, therefore, is meaningless in this context.

For the foregoing reasons, Liberty's motion is granted in full. Plaintiffs having presented no basis in which they might conceivably amend as it relates to the claims and issues before the Court, the dismissal is without leave to amend.

C. Motion Two - XL's MTD

XL moves to dismiss all six claims against it (though, as to the fifth claim, only with respect to the XL Primary Policy[14]). Similar to one aspect of Liberty's motion, XL argues that an exclusion - in this case, a "Prior Acts" exclusion - bars coverage for the claims. Here, that exclusion excludes coverage for any claims "based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any act, error, omission, misstatement, misleading statement, neglect, breach of duty, Wrongful Act, Company Wrongful Act or Employment Wrongful Act committed or allegedly committed prior to December 1, 2011." Docket No. 54-5. XL notes that "ChinaCast was sued, and ultimately found liable, for issuing false and misleading statements from February 2011 to April 2012," Docket No. 57-1, at 2:4-5, and argues that it was the pre-December 1, 2011 fraudulent [*23] acts that caused each statement - even those made after December 1, 2011 - to be false and misleading. As the Court's discussion of Liberty's motion makes clear, this is an accurate characterization of the Securities Litigation's scope.

XL's motion is based on the same principles of interpretation that are key to resolving Liberty's motion - a plain reading of the policy's terms, including its Prior Act exclusion. The exclusion clearly excludes coverage for acts committed prior to December 1, 2011. But XL also convincingly argues that, even with respect to any post-December 1, 2011 Wrongful Acts alleged in the Securities Litigation, those acts would fall within the Prior Acts exclusion as well, because of its breadth.

The Court agrees. The language used in the Prior Acts exclusion is quite expansive. As XL puts it, "[h]ere, the

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[13] There is some debate whether the "genuine dispute" doctrine applies to third-party cases. *See* Croskey, Heeseman, Ehrlich & Klee, CAL. PRAC. GUIDE: INSURANCE LITIGATION (The Rutter Group 2017), ¶ 12:618, at 12B-99.

[14] XL does not seek dismissal of the cause of action against it for declaratory relief under its 2010-2011 excess policy. *See* Docket No. 57-1, at 3:10-11.

Lead Plaintiffs (and now the Plaintiffs) asserted that misstatements after December 1, 2011 were wrongful precisely because the statements perpetuated the same pre-December 1, 2011 myth that the company was financially stable and that its internal financial mechanisms were adequate." Docket No. 57-1, at 13:21-14:1; *see also* Docket No. 66, at 7:21-24 ("For the [*24] handful of wrongful acts after December 1, 2011, the connection to pre-December 1, 2011 misconduct is more than 'merely coincidental' and fits squarely within the broad parameters of the Prior Acts Exclusion."). The post-December 1, 2011 Wrongful Acts unquestionably "aris[e] out of," "directly or indirectly result[] from" or, at the very least, "involve[e]" "act[s], error[s], omission[s], misstatement[s], [or] misleading statement[s]" allegedly committed prior to that date.

In its Reply brief, XL joins Liberty in the observation that Plaintiffs never actually attempt to contend with the actual language used in the key provision at the heart of this motion - the Prior Acts exclusion. In the context of assessing Liberty's motion, the Court has already explained why the approaches Plaintiffs *have* chosen to take in response are unconvincing.[15] There is therefore no reason why Plaintiffs' contract-based claims would have any better success on this motion.

Like Liberty, XL also argues that because Plaintiffs' contract claims fail, they have no viable claim for breach of the implied covenant of good faith and fair dealing. And also like Liberty, it contends that even if the Court were to deny [*25] the motion as to the contract-based claims, the "genuine issue/dispute" doctrine would preclude Plaintiffs' bad faith claim because XL's coverage position was not "unreasonable." This, XL also contends, precludes any attorney's fee award as well. Again, as mentioned above, Plaintiffs have offered little apparent response, and none that is convincing.

As with Liberty's motion, therefore, the Court grants XL's motion, without leave to amend, leaving (as to this defendant) only Plaintiffs' fifth claim insofar as it applies to XL's 2010-2011 excess policy.

III. Conclusion

The Court grants both motions, without leave to amend.

End of Document

[15] With respect to Plaintiffs' loss allocation argument, XL argues that the "time on the risk" principle applies only to occurrence-based insurance policies, not claims-made insurance policies such as those at issue here. The Court need not reach that argument considering its earlier conclusion that Plaintiffs' argument necessarily presupposes coverage - a fact Plaintiffs have failed to demonstrate here.

Carolina Cas. Ins. Co. v. McGhan

United States District Court for the District of Nevada

March 12, 2008, Decided; March 12, 2008, Filed

2:07-CV-00949-PMP-GWF

Reporter
2008 U.S. Dist. LEXIS 143800 *

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Judges: PHILIP M. PRO, United States District Judge.

Opinion by: PHILIP M. PRO

Opinion

ORDER

Presently before the Court is Defendants Thomas R. Moyes, Samuel Clay Rogers, Paul R. Kimmel, [*4] Eugene I. Davis, Mark E. Brown, Thomas Y. Hartley, Robert Forbuss, and Ikram Khan's Motion for Summary Judgment (Doc. #64), filed on November 19, 2007. Plaintiff Carolina Casualty Insurance Company filed an Opposition (Doc. #74) and Cross-Motion for Summary Judgment (Doc. #75) on December 21, 2007. Defendants filed a Reply (Doc. #84) on

January 14, 2008. Defendants filed an Opposition (Doc. #87) to Carolina's cross-motion on January 15, 2008. Plaintiff filed a Reply (Doc. #99) on January 28, 2008.

Also before the Court is Plaintiff Carolina Casualty Insurance Company's Motion for Summary Judgment as to Donald K. McGhan, James J. McGhan, Marc S. Sperberg, and Theodore R. Maloney (Doc. #85), filed on January 14, 2008. Defendant Marc S. Sperberg filed an Opposition (Doc. #103) on February 1, 2008. Defendants Donald and James McGhan filed an Opposition (Doc. #105) on February 8, 2008. Defendant Theodore Maloney filed an Opposition (Doc. #107) on February 11, 2008. Plaintiff filed a Reply (Doc. #109) on February 22, 2008.

Also before the Court is Plaintiff Carolina Casualty Insurance Company's Motion to Dismiss Counterclaimants' Counterclaim for Breach of *NRS 686A.310* and Counterclaimants' Claims for [*5] Punitive and Special Damages (Doc. #65), filed on November 26, 2007. Defendants filed an Opposition (Doc. #73) on December 14, 2007. Plaintiff filed a Reply (Doc. #78) on December 28, 2007. The Court held a hearing on these motions on February 25, 2008. (Mins. of Proceedings [Doc. #110].)

I. BACKGROUND

This is a declaratory judgment action filed by Plaintiff Carolina Casualty Insurance Company ("Carolina") against Medicor Ltd. ("Medicor") and its officers and directors seeking a declaration that Carolina owes no coverage under a policy Carolina issued to Medicor. Carolina issued a Directors' and Officers' and Corporate Liability Insurance Policy ("Policy") effective from June 30, 2006 to June 30, 2007. (Decl. of Serge J. Adam [Doc. #76], Ex. A.) Defendants made a claim for coverage under the Policy after being named in a group of lawsuits the parties refer to as the "SWX Lawsuits." Carolina denied the claim under various exclusions in the Policy. Particularly at issue here is the "Past Acts Exclusion," which excludes coverage for what the Policy deems Wrongful Acts that occurred prior to June 30, 2004, as well as Wrongful Acts occurring after June 30, 2004 which are related to Wrongful [*6] Acts that occurred before June 30, 2004. Carolina contends the SWX Lawsuits allege Wrongful Acts occurred prior to June 30, 2004, that Defendants' alleged post-June 30, 2004 Wrongful Acts are related to the pre-June 30, 2004 Wrongful Acts, and therefore are not covered by the Policy.

The SWX Lawsuits allege that beginning as early as February 2003, Defendants Donald McGhan ("McGhan"), James McGhan, and Theodore Maloney ("Maloney") conspired with other individuals to steal the assets of Southwest Exchange, Inc.'s ("SWX") clients, who placed funds in trust with SWX as a Section 1031 intermediary for proceeds of real estate

transactions. (Pl.'s Mot. for Summ. J., Exs. B-1 to B-4 [Doc. #88], Ex. B-1 ["Third Master Compl."] at 1; Ex. B-2 ["Selakovic Compl."] at 7-14; Ex. B-3 ["Schott Compl."] at 6, 9-10; Ex. B-4 ["Sorrell Compl."] at 9, 19, 25-28, 38-39.) According to the SWX Plaintiffs, on June 15, 2004, McGhan and Maloney formed a new entity, Capital Reef, which purchased SWX from its prior owner, Betty Kincaid ("Kincaid") on June 24, 2004. (Third Master Compl. at 20; Selakovic Compl. at 29; Schott Compl. at 10-11, 28; Sorrell Compl. at 10-11.) On June 28, 2004, Capital Reef used loans from several [*7] individuals, including Defendants Maloney and Sperberg, to pay Kincaid $3,000,000 for her interest in SWX. (Third Master Compl. at 20; Sorrell Compl. at 34.) The SWX Plaintiffs allege these loans immediately were repaid to the lenders at exorbitant interest rates out of SWX funds. (Third Master Compl. at 20; Sorrell Compl. at 13, 38.)

The SWX Lawsuits allege that upon acquiring SWX, McGhan and his co-conspirators diverted funds from SWX for their personal use and to fund Medicor's operations. (Third Master Compl. at 3-7, 12-13; Selakovic Compl. at 16, 33; Schott Compl. at 15-16, 32; Sorrell Compl. at 19.) In addition to suing Medicor and its officers and directors who allegedly actively participated in the scheme (Donald and James McGhan, Maloney, and Sperberg), the SWX Plaintiffs also sued the other directors of Medicor, claiming they knew or should have known about the allegedly improper diversion of SWX client funds for Medicor's benefit. (Third Master Compl. at 12-13, 26; Selakovic Compl. at 19; Schott Compl. at 19.)[1] The SWX Lawsuits assert claims such as breach of contract, breach of the implied covenant of good faith and fair dealing, negligence, breach of fiduciary duty, conversion, [*8] civil Racketeer Influenced and Corrupt Organizations Act violations, negligence per se, unjust enrichment, elder abuse, fraud, and negligent misrepresentation. (Third Master Compl. at 34-50; Selakovic Compl. at 40-82; Schott Compl. at 39-73; Sorrell Compl. at 47-58.)

The parties in this action now cross move for summary judgment regarding whether the Policy covers the officers and directors for the claims asserted against them in the SWX Lawsuits. Additionally, Carolina moves to dismiss certain counterclaims.

II. MOTIONS FOR SUMMARY JUDGMENT

Summary judgment is appropriate if "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any" demonstrate "there is no genuine issue as to any material fact and . . . the moving party is entitled to a judgment as a matter of law." *Fed. R. Civ. P.*

[1] The Sorrell Complaint does not assert claims against Medicor officers and directors beyond those alleged to have participated in the scheme.

56(c). The substantive law defines which facts are material. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248, 106 S. Ct. 2505, 91 L. Ed. 2d 202 (1986). All justifiable inferences must be viewed in the light most favorable to the non-moving party. County of Tuolumne v. Sonora Cmty. Hosp., 236 F.3d 1148, 1154 (9th Cir. 2001).

The party moving for summary judgment bears the initial burden of showing the absence of a genuine issue of material fact. Fairbank v. Wunderman Cato Johnson, 212 F.3d 528, 531 (9th Cir. 2000). The burden then shifts to the non-moving party to go beyond the pleadings and set forth [*9] specific facts demonstrating there is a genuine issue for trial. Id.; Far Out Prods., Inc. v. Oskar, 247 F.3d 986, 997 (9th Cir. 2001).

A. Board of Director Defendants

Defendants Samuel Rogers, Paul Kimmell, Eugene Davis, Mark Brown, Thomas Hartley, Robert Forbuss, Ikram Khan, and Thomas Moyes were members of the Medicor Board of Directors who the SWX Plaintiffs do not allege to have been involved directly in the scheme, but who allegedly knew or should have known of McGhan's scheme. These Defendants ("BOD Defendants") move for summary judgment, arguing the Policy's Past Acts Exclusion does not apply to the BOD Defendants because the SWX Lawsuits do not allege they committed a Wrongful Act prior to June 30, 2004. The BOD Defendants argue that under the Policy, Carolina cannot impute one director's pre-June 30, 2004 Wrongful Acts to other directors. Consequently, the BOD Defendants argue Carolina cannot impute McGhan, Maloney, and Sperberg's Wrongful Acts that occurred prior to June 30, 2004 to the BOD Defendants. The BOD Defendants further argue that at a minimum, the Policy is ambiguous and must be read in favor of the insureds. Finally, the BOD Defendants argue allowing the Past Acts Exclusion to apply to every director based on one director's [*10] Wrongful Acts creates illusory coverage for the other directors.

Carolina responds that because the SWX Lawsuits allege Wrongful Acts occurred before June 30, 2004, and allege the BOD Defendants engaged in Wrongful Acts related to the pre-June 30, 2004 Wrongful Acts, the Past Acts Exclusion precludes coverage. Carolina argues it is undisputed that the SWX Lawsuits allege the corporate looting commenced prior to June 30, 2004, and that the SWX Lawsuits allege the BOD Defendants knew or should have known about this looting. Carolina thus contends the SWX Lawsuits allege the BOD Defendants engaged in Wrongful Acts related to Wrongful Acts that occurred before June 30, 2004. Carolina argues this does not constitute imputing a Wrongful Act of another director to the BOD Defendants. Rather, Carolina argues it is each BOD

Director's alleged Related Wrongful Act that precludes coverage. Further, Carolina argues the Past Acts Exclusion does not refer to the insured's Wrongful Acts, but Wrongful Acts generally. Carolina thus contends the exclusion is not particular to each insured. Carolina asserts the Policy is unambiguous. Finally, Carolina argues the illusory coverage doctrine does not apply [*11] because the Policy covers Wrongful Acts occurring after June 30, 2004 and throughout the policy period, so long as they are not related to a Wrongful Act which occurred prior to June 30, 2004.

The Policy is a "claims made" policy applying only to claims first made against the insureds during the policy period. (Compl., Ex. A ("Policy") at 1.) The Policy will pay the "Loss of each and every Director or Officer of the Company arising from any Claim first made against the Directors or Officers during the Policy Period or the Extended Reporting Period (if applicable) for any actual or alleged Wrongful Act, except and to the extent that the Company has indemnified the Directors or Officers." (Policy at 1, Section 1.) Insureds under the Policy include any Directors and Officers and the Company. (Policy at 2, Section III.G.) A "Loss" means "damages, judgments, settlements and Costs of Defense." (Policy at 3, Section III.I.) A Claim means:

> 1. a written demand for monetary or non-monetary relief, or
> 2. a civil, criminal, administrative or arbitration proceeding for monetary or non-monetary relief which is commenced by:
>
> a. service of a complaint or similar pleading, or
>
> b. return of an indictment (in the case of a criminal proceeding), or
>
> c. receipt or filing of a notice of charges. [*12]

(Policy at 2, Section III.A.)

Section IV of the Policy sets forth exclusions from coverage. Endorsement 214310 adds to Section IV the Past Acts Exclusion. (Policy, Endorsement 214310.) The Past Acts Exclusion excludes from coverage "any Loss in connection with a Claim made against an Insured"—

> based upon, arising out of, directly or indirectly resulting from or in consequence of, or in any way involving:
>
> 1. any Wrongful Act which occurred on or before June 30, 2004, or
>
> 2. any Wrongful Act occurring on or subsequent to June 30, 2004 which, together with a Wrongful Act occurring prior to such date, would constitute a Related Wrongful Act.

(Id.; Policy at 3, Section IV.) A Wrongful Act means:

> with respect to individual Directors or Officers, any breach of duty, neglect, error, misstatement, misleading statement, omission or act by the Directors or Officers of the Company in their respective capacities as such, or any matter claimed against

them by reason of their status as Directors or Officers of the Company, or any matter claimed against them arising out of their serving as a director, officer, trustee or governor of an Outside Entity in such capacities, but only if such service is at the specific written request [*13] or direction of the Company.

(Policy at 4, Section III.Q.) A Related Wrongful Act is a Wrongful Act which is "logically or causally connected by reason of any common fact, circumstance, situation, transaction, casualty, event or decision." (Policy at 3, Section III.N.) The Policy also contains an endorsement which states "The Wrongful Act of a Director or Officer shall not be imputed to any other Director or Officer for the purpose of determining the applicability of any Exclusion." (Policy, Endorsement 214012, "Imputation Endorsement.") Although Carolina owes a duty to indemnify the insured and will advance costs of defense under the Policy, Carolina owes no duty to defend. (Policy at 6, Section VI.A & B.)

Under Nevada law, an insurance policy is a contract the Court must enforce according to its terms to accomplish the parties' intent.[2] *Farmers Ins. Exch. v. Neal, 119 Nev. 62, 64 P.3d 472, 473 (Nev. 2003)*. The Court gives policy terms their plain and ordinary meaning and views the language from the perspective of "one not trained in law." Id. (quotations omitted). Because an insurance policy is a contract of adhesion, the Court must interpret the policy language broadly "to afford the greatest possible coverage to the insured." *United Nat'l Ins. Co. v. Frontier Ins. Co., Inc., 99 P.3d 1153, 1156 (Nev. 2004)* (quotation omitted). Restrictions on coverage must "clearly [*14] and distinctly communicate[] to the insured the nature of the limitation." Id. (quotation omitted). The Court may not rewrite unambiguous provisions, but the Court resolves any ambiguities in favor of the insured. *Id. at 1156-57*; see also *Keener v. Cal. Auto. Ass'n Inter-Ins. Bureau, 107 Nev. 504, 814 P.2d 87, 88 (Nev. 1991)* ("Where, as here, an insurance policy is subject to more than one interpretation, doubts must be resolved in favor of the insured."). "The question of whether an insurance policy is ambiguous turns on whether it creates reasonable expectations of coverage as drafted." *United Nat'l Ins. Co., 99 P.3d at 1156-57*. Additionally, "[w]hen a policy has been issued which purportedly provides coverage but whose exclusionary provisions as interpreted by the insurer would narrow the coverage to defeat the purpose of the insurance, the policy must be construed against the insurer." *Nat'l Union Fire Ins. Co. of State of Pa., Inc. v. Reno's Executive Air, Inc., 100 Nev. 360, 682 P.2d 1380, 1384 (Nev. 1984)*. Interpretation of an insurance policy is a question of law for the Court. *Farmers Ins. Exch., 64 P.3d at 473*.

[2] The parties agree Nevada law governs the Policy.

Nevada has not interpreted similar policy language. Where a state has not addressed a particular issue, a federal court must use its best judgment to predict how the highest state court would resolve it "using intermediate appellate court decisions, decisions from other jurisdictions, statutes, treatises, and restatements as guidance." *Strother v. S. Cal. Permanente Med. Group, 79 F.3d 859, 865 (9th Cir. 1996)* (quotation omitted); *Med. Lab. Mgmt. Consultants v. Am. Broad. Cos., Inc., 306 F.3d 806, 812 (9th Cir. 2002)*. [*15] In making that prediction, federal courts look to existing state law without predicting potential changes in that law. *Orkin v. Taylor, 487 F.3d 734, 741 (9th Cir. 2007)*. Although federal courts should not predict changes in a state's law, they "are not precluded from affording relief simply because neither the state Supreme Court nor the state legislature has enunciated a clear rule governing a particular type of controversy." *Air-Sea Forwarders, Inc. v. Air Asia Co., Ltd., 880 F.2d 176, 186 (9th Cir. 1989)* (quotation omitted).

The BOD Defendants liken the Imputation Endorsement to a severability clause and rely on a line of cases interpreting policy language which held the relevant insurance policy applied separately to each insured. For example, in Worcester Mutual Insurance Co. v. Marnell, the underlying action involved a negligent supervision claim against parents who allowed their son to throw a party at their house, drink alcohol, and then drive his friends home. *398 Mass. 240, 496 N.E.2d 158, 159 (Mass. 1986)*. The son crashed the car and killed a person. Id. The parents sought coverage under their homeowners policy. Id. The insurance company asserted the policy did not cover the parents based on an exclusion for bodily injury arising out of the use of a motor vehicle owned or operated by "any insured." Id. The policy contained a severability clause [*16] that stated the policy applied "separately to each insured." Id. The court held this clause required the insurer to treat each insured as having a separate insurance policy. *Id. at 161*. As a result, the court concluded the term "insured" as used in the motor vehicle exclusion referred only to the person claiming coverage under the policy. Id. Because the insured parents did not own or operate the motor vehicle their son drove, the provision excluding coverage for bodily injury arising out of the insured's ownership or use of a motor vehicle did not preclude the parents from being covered.[3] Id.

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[3] See also *St. Katherine Ins. Co. Ltd. v. Insurance Co. of N. Am., Inc., 11 F.3d 707, 710 (7th Cir. 1993)* (insurance afforded applies separately to each insured against whom claim is made or suit is brought); *FDIC v. Interdonato, 988 F. Supp. 1, 13 (D. D.C. 1997)* (stating policy's severability clause created a policy with each insured such that one insured's prior wrongful acts could not be used to deny coverage to another insured); *Shapiro v. American Home Assur. Co., 616 F. Supp. 900, 902 (D.C. Mass. 1984)* (policy contained language that insurance shall be construed as a separate contract with each insured so that "as to each Insured, the reference in this Insurance to the Insured shall be construed as referring only to that particular Insured, and the liability of the Insurer to such Insured shall be independent of its liability to any other

Worcester and the other cases upon which Defendants rely are distinguishable from the present case because the Policy here does not contain a severability clause stating that the Policy applies separately to each insured. Rather, the Imputation Endorsement states that the Wrongful Acts of one director may not be imputed to another director for purposes of determining the applicability of any exclusion. No Policy language states the Policy separately applies to each insured or treats the insured seeking coverage as the only named insured.

Further, many courts hold that even where a severability clause [*17] exists, if the policy refers to "an" or "any" insured's conduct, another insured's conduct can work to exclude coverage for the insured claiming coverage. For example, in American Family Mutual Insurance Co. v. Corrigan, the relevant insurance policy excluded coverage for bodily injury or property damage arising out of "violation of any criminal law for which any insured is convicted." *697 N.W.2d 108, 112 (Iowa 2005)*. The policy also contained a severability clause stating that the policy "'applies separately to each insured.'" Id. The Iowa Supreme Court held the exclusion's plain language applied to the criminal activity of "any" insured, despite the severability clause. *Id. at 116-17*. Consequently, the policy did not cover one insured for liability arising out of another insured's criminal violation. Id.

> "Courts construing similar [intentional acts exclusionary] policy language have concluded that, when a provision uses the article 'the, the [exclusion] applies only to claims brought against the particular insured named in the claim. Conversely, when the exclusionary language refers to intentional acts of 'an insured,' courts have uniformly concluded that the exclusion applies to all claims which arise from the intentional [*18] acts of any one insured, even though the claims are stated against another insured."

EMCASCO Ins. Co. v. Diedrich, 394 F.3d 1091, 1095 (8th Cir. 2005) (quoting *N. Sec. Ins. Co. v. Perron, 172 Vt. 204, 777 A.2d 151, 163 (2001)* (collecting cases) and citing *Am. Family Mut. Ins. Co. v. Mission Med. Group, 72 F.3d 645, 648 (8th Cir. 1995)* (collecting cases)).

The Nevada Supreme Court reached a similar conclusion, although whether the policy at issue contained a severability clause is unclear from the opinion. In *Fire Ins. Exchange v. Cornell*, the policy expressly excluded coverage for any actual or alleged injury related to child molestation by "any insured." *2004*

Insured"); *Tri-S Corp. v. Western World Ins. Co., 110 Haw. 473, 135 P.3d 82, 90 (Haw. 2006)* (containing policy language that the insurance applies "[a]s if each Named Insured were the only Named Insured; and . . . Separately to each insured against whom a claim is made or 'suit' is brought"); *Travelers Indem. Co. v. Bloomington Steel & Supply Co., 2006 Minn. LEXIS 517, 718 N.W.2d 888,894 (Minn. 2006)* (same); *L.C.S., Inc. v. Lexington Ins. Co., 371 N.J. Super. 482, 853 A.2d 974, 982 (N.J. Super. A.D. 2004)* (same).

Nev. LEXIS 40, 90 P.3d 978, 979 (Nev. 2004). The insureds sought coverage under their policy to help defend the claim they were negligent in failing to supervise their adult son who had sexual intercourse with his twelve-year-old neighbor. Id. The Nevada Supreme Court rejected the argument that because the parents did not commit the sexual abuse, the provision excluding coverage for molestation was ambiguous and should be interpreted in their favor. Id. at 980. The Nevada Supreme Court ruled the exclusion applied to "the actions of any insured that results in child molestation, not just the person who actually touches the child." Id. The Court therefore held the exclusion unambiguously applied to the parents and the insurance company rightfully could deny coverage. Id.

Because the Past Acts [*19] Exclusion does not refer to the Wrongful Acts of "the," "an," or "any" insured, these cases are not directly on point. To the extent these cases shed light on the Policy's language, they support Carolina's interpretation. If an exclusion which refers to the conduct of "any insured" would operate to preclude coverage even considering a severability clause, then the Past Acts Exclusion's exclusion of coverage for "any" Wrongful Act would appear to include any Wrongful Act, regardless of whether it was committed by the insured seeking coverage or one of the other officers or directors.

The Past Acts Exclusion excludes "any" Wrongful Act and "any" Wrongful Act which, together with "a" Wrongful Act, would constitute a Related Wrongful Act. The Past Acts Exclusion does not base the exclusion on who committed the Wrongful Act. Consequently, cases interpreting policy exclusion language based on an event or circumstances are more analogous to the Policy language than cases involving the identity of who committed certain acts. For example, in Ristine ex rel. Ristine v. Hartford Insurance Co. of Midwest, the underlying action alleged that a woman knew her husband was a convicted sex offender but [*20] permitted her husband access to a child and left the child alone with her husband. 195 Ore. App. 226, 97 P.3d 1206, 1207 (Or. App. 2004). He abused the child, and the child's parents sued the wife for negligently failing to disclose to them that her husband was a sex offender and for allowing him to be alone with the child. Id. The wife requested coverage under her homeowners' policy, but the insurance company denied coverage. Id.

The policy excluded from coverage a claim for bodily injury or property damage "'[a]rising out of sexual molestation, corporal punishment or physical or mental abuse[.]'" Id. The policy also contained a severability clause which stated the policy applied "'separately to each insured.'" Id. The Oregon Court of Appeals held that the policy referred to claims arising out of sexual molestation without reference to

any limitation as to who committed the act of molestation, and thus the exclusion was "based on the nature of the act, not the identity of the actor." *Id. at 1208-09*. The court of appeals noted that elsewhere in the policy, it specified when coverages or exclusions applied to "the insured," but the sexual molestation exclusion applied without reference to who committed the act. *Id. at 1209*. The court also rejected the notion that [*21] the severability clause gave the wife coverage because she did not commit the sexual molestation: "the fact remains that the policy that separately applies to them contains an exclusion for bodily injury '[a]rising out of sexual molestation.' There is nothing in the wording of the severability provision itself that remotely suggests that it affects the substance of any provisions concerning coverage or exclusions." *Id. at 1209-10*; see also *Flores v. AMCO Ins. Co., 2007 U.S. Dist. LEXIS 86679, 2007 WL 3408255, at *7, No. CV F 07-1183 LJO DLB (E.D. Cal. Nov. 15, 2007)* (slip copy) ("The AMCO policy applies separately to Mr. and Mrs. Flores and contains a global sexual molestation exclusion which is not limited to an insured's conduct. As such, the exclusion applies to Ms. Flores, despite that she is not an alleged active participant in the sexual activity at issue here.").

The Past Acts Exclusion does not limit coverage based on the identity of who committed the Wrongful Acts or Related Wrongful Acts. Rather, it excludes coverage for "any" Wrongful Act. Moreover, the Past Acts Exclusion excludes coverage for "any" Wrongful Act occurring on or after June 30, 2004 which, together with "a" Wrongful Act occurring prior to June 30, 2004, would constitute a Related Wrongful Act. [*22] Consequently, so long as the particular insured seeking coverage committed any Wrongful Act that relates to "a" Wrongful Act occurring prior to June 30, 2004, the Past Acts Exclusion applies regardless of the identity of who committed the pre-June 30, 2004 Wrongful Act. The Imputation Endorsement does not alter the Past Acts Exclusion's language that a Related Wrongful Act constitutes "any" Wrongful Act related to "a" prior Wrongful Act without limitation as to the identity of the actor who committed the pre-June 30, 2004 Wrongful Act. Such an interpretation does not run afoul of the Imputation Endorsement because each officer and director must have committed either a pre-June 30, 2004 Wrongful Act or a post-June 30, 2004 Related Wrongful Act of his own to be excluded from coverage.

The BOD Defendants argue the Past Acts Exclusion's failure to indicate whose Wrongful Acts trigger the exclusion makes the exclusion ambiguous. The Past Acts Exclusion is not ambiguous. Rather, it unambiguously refers to any Wrongful Acts, not just the Wrongful Acts and Related Wrongful Acts of the insured seeking coverage. The Policy's other

exclusions contain instances where the Policy refers to "any of [*23] the Insureds," "an Insured," or "the Insured," and thus the Policy specified when coverages or exclusions applied to an insured as opposed to when it defined exclusions based on events or conduct generally. (See Policy at 4, Section IV.A, C, J, Endorsement 214025.) The Court will not write into the Past Acts Exclusion words the parties chose not to include in the Policy.

This interpretation does not render coverage under the Policy illusory. The Past Acts Exclusion excludes only each director's own Wrongful Acts prior to June 30, 2004 as well as each director's Wrongful Acts after June 30, 2004 if those acts are related to any other Wrongful Acts committed prior to June 30, 2004. The Policy still covers any Wrongful Acts a director may commit from July 1, 2004 through the policy period, so long as they are not related to a pre-June 30, 2004 Wrongful Act.

B. "Deal" Defendants

In opposition to Carolina's motion for summary judgment with respect to the defendants who allegedly engaged in the wrongdoing (the "Deal Defendants"), Defendants Marc S. Sperberg ("Sperberg"), Donald and James McGhan ("McGhans"), and Theodore Maloney ("Maloney") filed separate oppositions. The Deal Defendants join in the arguments [*24] above and raise three separate arguments. First, Defendant Maloney argues Carolina has failed to establish any of the acts which occurred prior to June 30, 2004 were wrongful. Maloney therefore argues his own acts are not related to any pre-June 30, 2004 Wrongful Acts. Specifically, Maloney argues that most of the pre-June 30, 2004 acts were innocuous, such as business meetings or buying SWX. According to Maloney, the Wrongful Acts, if any, are the alleged diversions of funds from SWX to Medicor. Maloney contends at least one SWX complaint alleges the sale for which Medicor used the diverted funds closed in July 2004, and therefore the first Wrongful Act occurred after June 30, 2004. Maloney argues Carolina must prove there was a pre-June 30, 2004 Wrongful Act to preclude coverage even under Carolina's interpretation of the Policy.

Second, the McGhans argue they could be liable in the SWX Lawsuits in some instances without the SWX plaintiffs presenting any evidence the McGhans committed Wrongful Acts prior to June 30, 2004. The McGhans therefore argue that unless and until a jury determines their liability, genuine issues of fact remain regarding whether they committed any pre-June [*25] 30, 2004 Wrongful Acts precluding coverage.

Finally, the Deal Defendants argue Carolina relies only on the contested pleadings in the SWX Lawsuits to assert Defendants engaged in Wrongful Acts. The Deal Defendants argue Carolina

must show they actually engaged in such Wrongful Acts to preclude coverage, and Carolina cannot make that showing at the summary judgment stage based only the SWX Lawsuits' unproven allegations.

1. Allegations of Pre-June 30, 2004 Wrongful Acts

Even accepting Carolina's interpretation, Defendant Maloney argues the SWX Lawsuits do not allege pre-June 30, 2004 Wrongful Acts. Defendant Maloney argues the only Wrongful Act is the diversion of funds, and it is not clear from the SWX complaints the diversion of funds occurred before June 30, 2004. Carolina responds that the SWX Lawsuits allege a conspiracy beginning prior to June 30, 2004 which intentionally sought to acquire the SWX funds for improper purposes. Carolina thus argues the SWX Lawsuits allege pre-June 30, 2004 Wrongful Acts.

The SWX Lawsuits allege wrongful conduct prior to June 30, 2004. For example, the Fourth Amended Master Complaint alleges "Don McGhan, Sperberg, Maloney, and Pomeroy, upon information [*26] and belief, took control of Southwest in 2004 . . . as part of a premeditated plan to gain access to the exchange funds entrusted to Southwest and then divert those funds to other business in which they hold ownership and/or pecuniary interests." (Def. & Counterclaimant Theodore R. Maloney's Opp'n to Carolina Casualty Ins. Co.'s Mot. for Summ. J. [Doc. #107], Ex. 1 ["Fourth Master Compl."] at ¶¶ 5-7, 391-96; see also Selakovic Compl. at ¶¶ 1, 19, 80-87, 119-30; Schott Compl. at ¶¶ 1, 19, 80-87, 121-31; Sorrell Compl. at ¶¶ 1, 25, 83-91.) Therefore, even the asserted "innocuous" acts of planning to take over SWX and effecting that takeover allegedly were part of a premeditated plan to divert the funds and thus are Wrongful Acts. Each of the SWX Complaints allege money started flowing out of SWX by June 30, 2004. (Fourth Master Compl. at ¶¶ 116, 128-31, 134; Selakovic Compl. at ¶¶ 87, 125; Schott Compl. at ¶¶ 87, 126; Sorrell Compl. at ¶¶ 26, 31, 58-60, 63, 90.) Consequently, the SWX Lawsuits allege Wrongful Acts occurred prior to June 30, 2004.

2. Necessity of Reference to Pre-June 30, 2004 Conduct

The Fourth Amended Master Complaint in one of the SWX Lawsuits alleges the plaintiffs entrusted [*27] money with SWX in September 2006. (Fourth Master Compl. at ¶ 224.) The Fourth Amended Master Complaint asserts claims for breach of contract (SWX and McGhan), breach of the implied covenant of good faith and fair dealing (Southwest and McGhan), negligence (SWX and McGhan), breach of fiduciary duties (all Defendants), conversion (all Defendants), civil RICO (all Defendants), negligence per se (SWX

and McGhan), unjust enrichment (all Defendants), civil conspiracy (all Defendants), and fraud (SWX and McGhan). Because these plaintiffs did not entrust funds with SWX until after June 30, 2004, it is possible the plaintiffs could prove a breach of contract without reference to pre-June 30, 2004 misconduct. These plaintiffs allege they entrusted money to SWX in September 2006 and SWX failed to return those funds, thereby breaching the parties' agreement.

However, the Policy excludes coverage for any Claim "based upon, arising out of, directly or indirectly resulting from or in consequence of, or in any way involving" any pre-June 30, 2004 Wrongful Act or a Related Wrongful Act. The Fourth Amended Master Complaint alleges a pre-June 30, 2004 conspiracy and also alleges the conspirators thereafter [*28] engaged in a ponzi scheme to draw in new investors to conceal the fact that they had diverted funds from SWX. (Fourth Master Compl. at ¶¶ 166-73; see also Selakovic Compl. at ¶ 95; Schott Compl. at ¶¶ 19, 29-30, 32-45, 47, 95; Sorrell Compl. at ¶¶ 25, 53, 72, 85, 90.) The SWX plaintiffs contend the reason SWX was unable to fulfill its contractual obligations was because of the alleged corporate looting. The plaintiffs' claims therefore are based upon, arise out of, directly or indirectly result from, or in some way involve the alleged pre-June 30, 2004 intentional conspiracy to pillage SWX funds, and the Past Acts Exclusion therefore applies.

3. Actual Versus Alleged Wrongdoing

The Policy covers Loss from any Claim against the Directors or Officers for any "actual or alleged" Wrongful Act. (Policy at 1, Section 1.) The Past Acts Exclusion excludes from coverage "any Loss in connection with a Claim made against an Insured"—

> based upon, arising out of, directly or indirectly resulting from or in consequence of, or in any way involving:
>
> 1. any Wrongful Act which occurred on or before June 30, 2004, or
>
> 2. any Wrongful Act occurring on or subsequent to June 30, 2004 which, together with a Wrongful Act occurring prior to such [*29] date, would constitute a Related Wrongful Act.

(Id.; Policy at 3, Section IV.)

An insurer's duty to indemnify is narrower than the duty to defend, and is determined differently. *United Nat'l Ins. Co., 99 P.3d at 1157-58*. The duty to defend arises where there is potential coverage under the relevant insurance policy, as determined by comparing the underlying complaint's allegations with the insurance policy's terms. *Id. at 1158*. In contrast, the duty to indemnify arises "when an insured 'becomes legally obligated to pay damages in the underlying action that gives rise to a claim under the policy.'" *Id. at 1157*

(quoting *Zurich Ins. Co. v. Raymark Indus., 118 Ill. 2d 23, 514 N.E.2d 150, 163, 112 Ill. Dec. 684 (Ill. 1987)*). Consequently, an insurer is obligated to indemnify an insured when "'the insured's activity and the resulting loss or damage . . . actually fall[s] within the . . . policy's coverage.'" Id. (quoting *Outboard Marine v. Liberty Mut. Ins., 154 Ill. 2d 90, 607 N.E.2d 1204, 1221, 180 Ill. Dec. 691 (Ill. 1992)* (emphasis in original)).

Because Carolina owes a duty to indemnify under the Policy, but owes no duty to defend, the relevant inquiry is whether Defendants' conduct actually falls within the Past Acts Exclusion, unless Policy language demonstrates Carolina excluded coverage for both actual and alleged Wrongful Acts. The Past Acts Exclusion itself does not indicate expressly whether it applies to both actual and alleged Wrongful Acts. However, it [*30] refers to Wrongful Acts "which occurred" prior to June 30, 2004 or "occurring" subsequent to that date. This language suggests that the exclusion is based on when Wrongful Acts actually occurred rather than on allegations alone.

Viewing the Policy as a whole, the Past Acts Exclusion is ambiguous regarding whether it applies to both actual and alleged Wrongful Acts. One endorsement, the Final Adjudication for Exclusions A., B. and C., provides certain exclusions "shall not apply unless a judgment or other final adjudication adverse to any of the Insureds in such Claim shall establish" that the Insured gained certain profits or committed a criminal or fraudulent act. (Policy, Endorsement 214025.) This endorsement arguably suggests that when the parties intended for a final judgment to be required, they indicated that intent expressly. This endorsement does not apply to the Past Acts Exclusion.

However, several other exclusions indicate they will apply to Claims "based upon, arising out of, directly or indirectly resulting from or in consequence of, or in any way involving any actual or alleged" acts or omissions by the officers or directors in their capacities at other corporations, or [*31] for "any actual or alleged" pollution. (Policy at 5, Section IV.I & K.) The parties' express reference to "actual or alleged" conditions excluding coverage suggests that when the parties intended the Policy to exclude both actual and alleged conduct they indicated that intent expressly in the specific exclusion. The Past Acts Exclusion does not refer to both "actual and alleged" Wrongful Acts. The definition of Wrongful Act does not clarify the matter. The definition of Wrongful Act includes "any matter claimed against [the officers and directors] by reason of their status as Directors or Officers of the Company." (Policy at 4, Section III.Q.) An insured reasonably could expect this language to be descriptive of a general category or type of matter which actually must fall within the exclusion's

language for Carolina to deny coverage.

The Policy does not specify expressly whether the Past Acts Exclusion applies to both actual and alleged Wrongful Acts. The Policy is ambiguous with respect to similar worded exclusions, sometimes expressly indicating a final judgment is required for the exclusion to apply, and other times expressly stating the exclusion applies to both actual and alleged circumstances. Because [*32] the Court construes all ambiguities in favor of the insureds, the Court concludes the Past Acts Exclusion applies only to actual Wrongful Acts and actual Related Wrongful Acts. Because neither party has presented evidence demonstrating no genuine issue of material fact remains regarding whether Defendants in fact engaged in Wrongful Acts or Related Wrongful Acts, the Court will deny the BOD Defendants' motion for summary judgment, Carolina's cross-motion for summary judgment, and Carolina's motion for summary judgment with respect to the Deal Defendants.

III. MOTION TO DISMISS

Also before the Court is Plaintiff Carolina's motion to dismiss (Doc. #65) the BOD Defendants' counterclaim for breach of *Nevada Revised Statute § 686A.310*, request for punitive damages, and request for special damages. Carolina moves to dismiss the BOD Defendants' claim for breach of *§ 686A.310*, Nevada's unfair claims practices statute, arguing the BOD Defendants make no factual allegations regarding how Carolina breached the statute. As to punitive damages, Carolina argues the BOD Defendants do not allege any conduct supporting punitive damages. Finally, Carolina argues the BOD Defendants do not plead special damages with specificity.

The BOD Defendants [*33] respond that they meet the pleading standard under Rule 8. As to punitive damages, the BOD Defendants contend their allegation is sufficient and "Carolina Casualty will have the opportunity during discovery to learn the factual and legal basis for the claim, and evaluate the merits of this claim." (Opp'n at 7.) Alternatively, the BOD Defendants argue Carolina's refusal to indemnify based on the Past Acts Exclusion was in conscious disregard of their rights, which supports punitive damages. The BOD Defendants do not respond to the argument regarding special damages.

In considering a motion to dismiss, "all well-pleaded allegations of material fact are taken as true and construed in a light most favorable to the non-moving party." *Wyler Summit P'ship v. Turner Broad. Sys., Inc., 135 F.3d 658, 661 (9th Cir. 1998)* (citation omitted). However, the Court does not necessarily assume the truth of legal conclusions merely because they are cast in the form of factual allegations in the plaintiff's complaint. See *Clegg v. Cult Awareness Network, 18 F.3d 752, 754-55 (9th Cir. 1994)*. There is a strong

presumption against dismissing an action for failure to state a claim. See *Gilligan v. Jamco Dev. Corp., 108 F.3d 246, 249 (9th Cir. 1997)* (citation omitted). The issue is not whether the plaintiff ultimately will prevail, but whether she may offer evidence in support of her claims. See id. (quoting *Scheuer v. Rhodes, 416 U.S. 232, 236, 94 S. Ct. 1683, 40 L. Ed. 2d 90 (1974)*). A plaintiff [*34] must make sufficient factual allegations to establish a plausible entitlement to relief. *Bell Atlantic Corp. v Twombly, 550 U.S. 544, 127 S. Ct. 1955, 1965, 167 L. Ed. 2d 929 (2007)*. Such allegations must amount to "more than labels and conclusions, and a formulaic recitation of the elements of a cause of action." *Id. at 1964-65*.

A. Counterclaim Two

Nevada Revised Statute § 686A.310(1) makes various activities unfair practices.[4] *Section 686A.310* "address[es] the manner in which an insurer handles an insured's claim whether or not the claim is denied." *Pioneer Chlor Alkali Co., Inc. v. Nat'l*

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[4] (a) Misrepresenting to insureds or claimants pertinent facts or insurance policy provisions relating to any coverage at issue.

(b) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies.

(c) Failing to adopt and implement reasonable standards for the prompt investigation and processing of claims arising under insurance policies.

(d) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss requirements [*35] have been completed and submitted by the insured.

(e) Failing to effectuate prompt, fair and equitable settlements of claims in which liability of the insurer has become reasonably clear.

(f) Compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds, when the insureds have made claims for amounts reasonably similar to the amounts ultimately recovered.

(g) Attempting to settle a claim by an insured for less than the amount to which a reasonable person would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application.

(h) Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of, the insured, his representative, agent or broker.

(I) Failing, upon payment of a claim, to inform insureds or beneficiaries of the coverage under which payment is made.

(j) Making known to insureds or claimants a practice of the insurer of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to [*36] accept settlements or compromises less than the amount awarded in arbitration.

(k) Delaying the investigation or payment of claims by requiring an insured or a claimant, or the physician of either, to submit a preliminary claim report, and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information.

(l) Failing to settle claims promptly, where liability has become reasonably clear, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage.

(m) Failing to comply with the provisions of *NRS 687B.310 to 687B.390*, inclusive, or 687B.410.

(n) Failing to provide promptly to an insured a reasonable explanation of the basis in the insurance policy, with respect to the facts of the insured's claim and the applicable law, for the denial of his claim or for an offer to settle or compromise his claim.

(o) Advising an insured or claimant not to seek legal counsel.

(p) Misleading an insured or claimant concerning any applicable statute of limitations.

Union Fire Ins. Co. of Pittsburgh, Pa., 863 F. Supp. 1237, 1243 (D. Nev. 1994). In contrast, an insurer is liable for the common law tort of violating the covenant of good faith and fair dealing (or "bad faith") if the insurer "denies a claim without any reasonable basis and with knowledge that no reasonable basis exists to deny the claim." Id. Consequently, a breach of the statute does not necessarily result in bad faith, and bad faith does not necessarily equate to a breach of statutory duties. *Id. at 1242*.

The BOD Defendants' Counterclaim regarding Carolina's alleged breach of *§ 686A.310* states: "Counterdefendant Carolina Casualty is [*37] in violation of multiple sections of *NRS 686A.310*, all to the damage and detriment of Defendants, and Defendants are entitled to an award of general, special, compensatory, and punitive damages." Defendants recite no facts in support of this claim other than Carolina's denial of coverage. Mere denial of a claim by itself does not violate any of the enumerated provisions of the statute. Under Twombly, the claim is insufficiently pled, as Defendants do not allege any facts establishing a plausible entitlement to relief. The Court will dismiss this claim without prejudice. Defendants must file an amended counterclaim within thirty (30) days of the date of this Order if they wish to assert a claim under *§ 686A.310*.

B. Punitive Damages

Under Nevada law, "bad faith, by itself, does not establish liability for punitive damages." *United Fire Ins. Co. v. McClelland, 105 Nev. 504, 780 P.2d 193, 198 (Nev. 1989)*. To recover punitive damages, a plaintiff also must show "'oppression, fraud, or malice, express or implied.'" Id. (quoting *Nev. Rev. Stat. § 42.001*). Oppression means "despicable conduct that subjects a person to cruel and unjust hardship with conscious disregard of the rights of the person." *Nev. Rev. Stat. § 42.001(4)*. Malice means "conduct which is intended to injure a person or despicable conduct which is engaged in with a conscious [*38] disregard of the rights or safety of others." Id. *§ 42.001(3)*. Fraud means "an intentional misrepresentation, deception or concealment of a material fact known to the person with the intent to deprive another person of his rights or property or to otherwise injure another person." Id. *§ 42.001(2)*.

The Counterclaim states no facts supporting a claim of oppression, malice, or fraud. All the Counterclaim alleges is that Carolina denied the claim. Mere bad faith denial of a claim does not support punitive damages. The Court will dismiss the request for punitive damages without prejudice. Defendants must file an amended counterclaim within thirty (30) days of the date of this Order if they wish to request punitive damages.

C. Special Damages

Pursuant to *Federal Rule of Civil Procedure 9(g)*, "[i]f an item of special damage is claimed, it must be specifically stated." The Counterclaim requests special damages but does not specifically state in factual terms what items are claimed or any basis therefor. Counterclaimants also do not respond to Carolina's arguments for dismissal of the request for special damages. The Court will dismiss the request for special damages without prejudice. Defendants must file an amended counterclaim within thirty (30) days [*39] of the date of this Order if they wish to request special damages.

IV. CONCLUSION

IT IS THEREFORE ORDERED that Defendants Thomas R. Moyes, Samuel Clay Rogers, Paul R. Kimmel, Eugene I. Davis, Mark E. Brown, Thomas Y. Hartley, Robert Forbuss, and Ikram Khan's Motion for Summary Judgment (Doc. #64) is hereby DENIED.

IT IS FURTHER ORDERED that Plaintiff Carolina Casualty Insurance Company's Cross-Motion for Summary Judgment (Doc. #75) is hereby DENIED.

IT IS FURTHER ORDERED that Plaintiff Carolina Casualty Insurance Company's Motion for Summary Judgment as to Donald K. McGhan, James J. McGhan, Marc S. Sperberg, and Theodore R. Maloney (Doc. #85) is hereby DENIED.

IT IS FURTHER ORDERED that Plaintiff Carolina Casualty Insurance Company's Motion to Dismiss Counterclaimants' Counterclaim for Breach of *NRS 686A.310* and Counterclaimants' Claims for Punitive and Special Damages (Doc. #65) is hereby GRANTED. The second count of Defendants' Counterclaim (Doc. #52) for breach of *Nevada Revised Statute § 686A.310*, Defendants' request for punitive damages, and Defendants' request for special damages are hereby dismissed without prejudice.

IT IS FURTHER ORDERED that Defendants shall have thirty (30) days from the date of this Order to amend their [*40] Counterclaim (Doc. #52).

DATED: March 12, 2008.

/s/ Philip M. Pro

PHILIP M. PRO

United States District Judge

End of Document

CITATION: Spinks v. Lloyd's Underwriters, 2024 ONSC 42
COURT FILE NO.: CV-22-00687267-0000
DATE: 20240102

ONTARIO

SUPERIOR COURT OF JUSTICE

RE: Jonathan Spinks, Sourced Group Inc., Sourced Group Worldwide Inc., Sourced (Singapore) PTE Ltd, Sourced Group Holdings Pty Limited ACN 144 751 422, Sourced Group Services Pty. Ltd ACN 607 300 685, Sourced Group PTY Limited ACN 606 436 033, Sourced Group Unit Trust and Wilson Lee, Applicants

-and-

Lloyd's Underwriters, Respondent

BEFORE: Robert Centa J.

COUNSEL: Denise Sayer and Adam Stikuts, for the applicants other than Wilson Lee

Aaron Gold, for the applicant Wilson Lee

Elizabeth K. Ackman, for the respondent

HEARD: November 2, 2023

ENDORSEMENT

[1] Jonathan Spinks and Gavin Dabron carried on business together through a significant number of companies located around the world. Their business relationship broke down and, in 2017, the parties engaged in litigation in Ontario and Australia. In the summer of 2018, Mr. Spinks, Mr. Dabron, and their companies signed minutes of settlement and resolved this litigation through a judicial mediation in Ontario. In the result, Mr. Spinks used one of his companies, Sourced Group Worldwide Inc., to purchase all of Mr. Dabron's shares at an agreed upon price, and the parties exchanged full and final releases.

[2] In January 2020, Sourced Worldwide purchased a management liability policy of insurance from the respondent, Lloyd's Underwriters.

[3] In February 2021, Mr. Dabron sued Mr. Spinks, Sourced Worldwide, and the rest of the applicants. Mr. Dabron pleaded that the defendants had breached the minutes of settlement, breached the common law duty of confidence, and committed the tort of intentional infliction of emotional harm. To oversimplify, Mr. Dabron alleged that someone had disclosed to his former wife the price Sourced Worldwide paid for his shares. In this

confidentiality claim, Mr. Dabron sought recission of the minutes of settlement and the share purchase agreement, or damages of $3 million.

[4] In June and August 2021, Mr. Dabron significantly amended the statement of claim. He now alleged that Mr. Spinks and Wilson Lee, the Chief Financial Officer for the corporate applicants, had made negligent or fraudulent misrepresentations to E&Y, the jointly retained expert that had prepared a valuation of the company that formed the basis of the resolution of the earlier litigation. In the valuation claim, Mr. Dabron sought recission of the minutes of settlement and the share purchase agreement, or $50 million in damages.

[5] The applicants turned to Lloyd's to defend the action under the management liability policy. Lloyd's declined and took the position that the policy covered neither the confidentiality claim, nor the valuation claim. In response, the applicants brought this proceeding seeking a declaration that Lloyd's has a duty to defend the action.

[6] For the reasons that follow, I dismiss the application. I find that both the valuation claim and the confidentiality claim fall within the policy's initial grant of coverage. However, I also find that the duty to defend is not triggered because since both claims are excluded from coverage by the prior and pending litigation exclusion clause. In my view, there is no doubt that both the confidentiality claim and the valuation claim they arise directly from the earlier round of litigation among Mr. Dabron and the applicants and are, therefore, excluded from coverage by the express terms of the policy.

The parties and other key figures

[7] The applicants comprise a group of related companies and two individuals with strong ties to those corporations. Sourced Worldwide is an Ontario-based company that runs a global software and cloud computing business. Sourced Worldwide has five relevant subsidiaries, each of which is an applicant. For convenience, I will refer to them collectively as the Sourced Group and as follows:

a. Sourced Ontario refers to Sourced Group Inc. and Sourced Worldwide;

b. Sourced Australia refers to Sourced Group Holdings Pty Limited ACN 144 751 422, Sourced Group Services Pty. Ltd ACN 607 300 685, Sourced Group PTY Limited ACN 606 436 033, and Sourced Group Unit Trust; and

c. Sourced Singapore refers to Sourced (Singapore) PTE Ltd.

[8] The applicant Jonathan Spinks was an officer, director, and shareholder of Sourced Worldwide.

[9] The applicant Wilson Lee was the Chief Financial Officer for Sourced Group.

[10] The respondent Lloyd's Underwriters issued a management liability policy of insurance to Sourced Worldwide that ran from January 15, 2020, to April 15, 2021, as extended. All the

applicants claim coverage under the policy either as the named insured, a subsidiary of the named insured, or an insured person.

[11] Gavin Dabron and Mr. Spinks co-founded the business underlying Sourced Group. The breakdown of their relationship, including their earlier litigation, will be discussed below. For now, it is enough to note that Mr. Dabron has sued the applicants in an action bearing court file number CV-21-00657188-0000. The applicants claim seek coverage under the insurance policy issued by Lloyd's for Mr. Dabron's claims against them.

Facts

[12] The business relationship between Mr. Spinks and Mr. Dabron broke down sometime in 2016. That breakdown spawned litigation in Ontario and Australia.

The 2017 actions in Ontario and Australia

[13] In 2016, Sourced Australia removed Mr. Dabron from his management role at Sourced Australia.

[14] In 2017, Mr. Spinks and Sourced Group Inc. commenced litigation against Mr. Dabron in Ontario. They sought relief under ss. 207 and 248 of the Ontario *Business Corporations Act*, including an order that Mr. Dabron sell his shares in Sourced Group Inc. to Mr. Spinks.[1] Mr. Dabron counterclaimed for relief as a shareholder, pursuant to s. 248 of the *OBCA*.

[15] In Australia, Sourced Australia commenced litigation against Mr. Dabron and his company, Skinny Dog.[2] Mr. Dabron billed Sourced Australia through Skinny Dog for the management services he had provided up to the date of his termination. In the litigation, Sourced Australia sought repayment of funds that it alleged Mr. Dabron or Skinny Dog took improperly from the Australian companies. The shares of Skinny Dog were owned by Mr. Dabron and his then wife, Leah Dabron.

[16] Mr. Dabron did not make a claim in respect of the termination of his executive role at Sourced Australia in either the Ontario or Australia legal proceedings.

[17] The parties to the 2017 actions agreed to try and resolve their differences. They jointly retained E&Y to prepare a valuation of the various entities in which Mr. Dabron claimed an interest. The parties settled all the litigation among them at a judicial mediation, and signed minutes of settlement on July 3, and August 30, 2018, which included a full and final release. The parties to the minutes of settlement and release were Mr. Spinks and his company Plan2 Consulting Inc., Mr. Dabron and Skinny Dog, Sourced Worldwide,

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[1] R.S.O. 1990, c. B.16.
[2] Skinny Dog Consulting Pty Ltd CAN 149 903 533.

Sourced Group Inc., Sourced Australia, and Sourced Singapore. In the result, Sourced Worldwide would purchase Mr. Dabron's ownership interest in the various entities.

[18] Well over a year later, Sourced Worldwide obtained the management liability insurance policy at issue in this application.

The current Dabron action

[19] In 2021, Mr. Dabron commenced the action that is the subject of this application. All of the applicants are defendants in the 2021 action, which has two primary components: a confidentiality claim and a valuation claim.

The confidentiality claim

[20] On February 18, 2021, Mr. Dabron issued a statement of claim naming Mr. Spinks and each of the Sourced Group entities as defendants.

[21] Mr. Dabron sought damages for breach of contract, breach of confidence, and intentional infliction of emotional harm. Mr. Dabron sought a declaration that the defendants breached the confidentiality provisions of the minutes of settlement as a result of the unlawful and unauthorized disclosure of the purchase price that Sourced Worldwide paid for his shares. Mr. Dabron sought $3 million in damages, $1 million in punitive damages, or recission of the minutes of settlement and share purchase agreement.

[22] Mr. Dabron pleaded that the minutes of settlement required the parties to maintain the confidentiality of the purchase price for his shares. Sections 15 and 17 of the minutes of settlement signed on August 30, 2018, provided as follows:

> 15. The parties agree that the fact that Worldwide has purchased Dabron's shares in Sourced Ontario and Sourced Australia is not confidential. Any Party can disclose that Dabron's shares were purchased for fair market value based on a valuation completed by an independent valuator as at April 30, 2018. No Party can disclose the quantum of the Final Settlement Amount except to their financial advisors, accountants and legal representatives that are under the same obligation not to disclose the Final Settlement Amount.
>
> 17. The Parties agree that save for the matters discussed in paragraph 14 above, the specific terms and content of these Minutes of Settlement (and those contained in the Short Minutes of Settlement, Share Purchase Agreement, and any other related document) are confidential, and shall not be disclosed except to immediate family, financial and other professional advisors (including for the purposes of Spinks raising funds to fulfil his commitments under these Minutes of Settlement), where such third parties are under the same obligation of confidentiality or with the consent of the Parties in writing, or as required by law.

[23] Mr. Dabron pleaded that during his divorce proceedings, he learned that in July 2019, his wife, Leah, "had been told the valuation of Sourced Group which she understood to be the basis of the amount [Mr. Dabron] received." Leah Dabron was a shareholder in Skinny Dog.

[24] Mr. Dabron did not plead that Ms. Dabron told him the specific source of the information she received. Instead, he pleaded as follows:

> 20. Leah deposed that she had been told the purchase price by "the other shareholders" of Sourced Group. The source of this information can only be Spinks or someone to whom Spinks disclosed this information, who is subject to the same obligations of confidentiality pursuant to the Minutes of Settlement.
>
> 21. Leah has refused to disclose the source of the information during the Australian divorce proceedings. She refused to confirm or deny that she had been in contact with Spinks.

[25] Mr. Dabron pleaded that the defendants were liable for breach of contract, breach of confidence, and Mr. Spinks was liable for intentional infliction of emotional suffering:

> 24. Spinks and the other defendants breached the Minutes of Settlement by improperly disclosing or causing to be disclosed the purchase price to Leah.
>
> 25. By disclosing the purchase price the defendants are also liable for breach of confidence. The purchase price was explicitly confidential. The parties were explicitly required to preserve the confidentiality of the purchase price.
>
> 26. Additionally, Spinks is liable for intentional infliction of emotional suffering. Spinks deliberately and intentionally disclosed the purchase price in order to cause harm to Dabron. This has resulted in emotional harm, including stress, anxiety, and distress.
>
> 27. Spinks provided information to Leah that Dabron himself was legally prevented from disclosing. Spinks acted in bad faith by taking advantage of this prohibition and using it to harm Dabron. The relationship between Dabron and Spinks, once best friends, ended in acrimony. The resolution of the litigation was meant to put an end to their relationship. Despite this, Spinks decided to breach the Minutes of Settlement to interfere in Dabron's most private personal affairs, with the intent to cause further harm to Dabron.

[26] Mr. Dabron pleaded that he had suffered significant financial damages from the "unauthorized disclosure." He also pleaded bad faith conduct by Mr. Spinks in support of his claim for punitive damages.

The valuation claim

[27] Mr. Dabron amended his claim on June 23, 2021, and amended it again on August 20, 2021. The most significant amendments added the valuation claim: a $50 million claim for fraudulent and negligent misrepresentation. Mr. Dabron also added Mr. Lee as a defendant.

[28] Mr. Dabron pleaded that, on May 12, 2021, Sourced Group announced that it had been acquired for more than $90 million, which was significantly higher than the high end of the range of values provided by E&Y ($8.4 million) before the parties settled their litigation in 2018.

[29] Mr. Dabron pleaded that Mr. Spinks and Mr. Lee were responsible for compiling and providing financial information about the Sourced Group to E&Y for its valuation exercise and that they were negligent, or committed negligent or fraudulent misrepresentations in the preparation and delivery that financial information. Mr. Dabron pleaded misrepresentations that included:

a. providing misleading or incomplete financial statements;

b. failing to disclose Sourced Group's pipeline, including its customers, potential customers and sales opportunities;

c. withholding projected revenues;

d. failing to disclose its business plan, investor exit plan, potential acquirers; and

e. failing to describe Sourced Group's goodwill accurately.

[30] Mr. Dabron pleaded that without these misrepresentations, E&Y would have ascribed a higher value to Sourced Group and that he would have obtained a higher price for his shares when the 2017 actions were settled at the judicial mediation.

[31] Mr. Dabron pleaded that Sourced Group was vicariously liable for the actions of Mr. Lee when he negligently prepared or misrepresented Sourced Group's financial information to E&Y.

Legal principles

[32] As mentioned above, the applicants seek a declaration that Lloyd's has a duty to defend Mr. Dabron's current action.

[33] The starting premise to determine whether or not Mr. Dabron's action has triggered Lloyd's duty to defend is the pleadings rule. If the statement of claim alleges facts that, if true,

would require Lloyd's to indemnify one or more of the applicants, then Lloyd's is obligated to provide a defence.[3]

[34] The duty to defend is broader than the duty to indemnify.[4] The applicants are not required to prove that the obligation to indemnify will in fact arise in order to trigger Lloyd's duty to defend. The mere possibility that a claim falling within the policy may succeed will suffice.[5] Put differently, the duty to defend arises when the statement of claim alleges any facts that might fall within the coverage of the policy.[6] The "mere possibility" test is the anchor for consideration in all duty to defend cases.[7]

[35] The pleadings, then, lie at the core of the duty to defend analysis. Where the pleadings are not framed with sufficient precision to determine whether the claims are covered by a policy, the insurer's duty to defend will be triggered where, on a reasonable reading of the statement of claim, a claim within coverage can be inferred.[8]

[36] Bare assertions advanced in the statement of claim are not necessarily determinative. I am required to look beyond the labels and assess the statement of claim to ascertain the substance and true nature of the claims.[9] As long as one theory of a plaintiff's claim against an insured might trigger policy coverage, there is a duty to defend.[10]

[37] After assessing the substance and true nature of the claim, I must interpret the insurance contract to see if those allegations raise a claim within the policy. Insurance contracts form a special category of contracts. Courts are to adopt a three-step approach when interpreting insurance contracts.[11] In a recent duty to defend case, the Court of Appeal for Ontario described the applicable three-step approach as follows:

> The principles of interpretation applicable to insurance policies are well settled. The primary principle is that when the language of the

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[3] *Monenco Ltd. v. Commonwealth Insurance Co.*, 2001 SCC 49, [2001] 2 S.C.R. 699, at para. 28; *Nichols v. American Home Assurance Co.*, [1990] 1 S.C.R. 801; *AIG Insurance Company of Canada v. Lloyd's Underwriters*, 2022 ONCA 699, at para. 44.
[4] *Monenco*, at para. 29;
[5] *Nichols*, at p. 810; *Monenco*, at para 29; *Demme v. Healthcare Insurance Reciprocal of Canada*, 2022 ONCA 503 at para. 29; *GFL Infrastructure Group Inc. v. Temple Insurance Company*, 2022 ONCA 390, at para 25.
[6] *Non-Marine Underwriters, Lloyd's of London v. Scalera*, 2000 SCC 24, [2000] 1 S.C.R. 551, at para. 78.
[7] *GFL*, at para. 25.
[8] *Monenco*, at para 31.
[9] *Monenco*, at para. 35; *Scalera*, at para. 84.
[10] *Thunder Bay Masonic Foundation v. Sovereign General Insurance Company*, 2014 ONSC 4142, at para. 12.
[11] *Jesuit Fathers of Upper Canada v. Guardian Insurance Co. of Canada*, 2006 SCC 21, [2006] 1 S.C.R. 744, at paras. 27-30; *Sky Clean Energy Ltd. (Sky Solar (Canada) Ltd.) v. Economical Mutual Insurance Company*, 2020 ONCA 558, 152 O.R. (3d) 159, at paras. 54-56; *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, 2010 SCC 33, [2010] 2 S.C.R. 245, at paras. 21-24; *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.*, 2016 SCC 37, [2016] 2 S.C.R. 23, at paras. 49-51; *Sabean v. Portage La Prairie Mutual Insurance Co.*, 2017 SCC 7, [2017] 1 S.C.R. 121, at para. 12; and Geoff R. Hall, *Canadian Contractual Interpretation Law*, 4th ed. (Toronto: LexisNexis Canada, 2020) at pp. 266-68.

> policy is unambiguous, the court should give effect to its clear language, reading the policy as a whole.
>
> Where the policy language is ambiguous, the general rules of contract interpretation provide guidance, including the rule that effect should be given to the reasonable expectations of the parties, as long as the interpretation is supported by the text of the policy. Similar insurance policies should be construed consistently. These rules should be applied to resolve an ambiguity, not to create one.
>
> Where ambiguity remains after the application of these rules, the contra proferentem rule applies to construe the policy against the maker, the insurer. This gives rise to the precept that coverage provisions are interpreted broadly and exclusions clauses narrowly.[12]

[38] The terms of the policy, considered as a whole, must be examined in light of the surrounding circumstances.[13]

[39] Given the positions of the parties, it will be necessary for me to answer the following questions:

a. Have the applicants satisfied me that there is a possibility that the insuring clauses in the policy provide coverage for the confidentiality claim and/or the valuation claim? This requires me to determine if:

    i. the claims arose from a "wrongful act" committed by an insured person; and

    ii. the insured person committed the wrongful act in their capacity as an insured person or in the normal course of business.

b. If the claims fall within the initial grant of coverage, has Lloyd's satisfied me that the confidentiality claim and/or valuation claim are excluded from coverage under the policy because of one of the following exclusion clauses:

    i. the breach of contract exclusion clause;

    ii. the known matters exclusion clause;

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[12] *SIR Corp. v. Aviva Insurance Company of Canada*, 2023 ONCA 778, at para. 40, citing *Sky Clean* at paras. 54 to 56 [internal citations omitted].
[13] *SIR Corp* at para. 41; *Jesuit Fathers*, at para. 27; *Carter v. Intact Insurance Company*, 2016 ONCA 917, 133 O.R. (3d) 721, at para. 28, leave to appeal refused, [2017] S.C.C.A. No. 53; and *MDS Inc. v. Factory Mutual Insurance Company*, 2021 ONCA 594, 465 D.L.R. (4th) 294, at para. 78, leave to appeal refused, [2021] S.C.C.A. No. 382.

iii. the professional services exclusion clause; or

iv. the prior and pending litigation exclusion clause.

[40] For the reasons that follow, I find that there is a good chance that the valuation claim and the confidentiality claim fall within the policy coverage, but that they are excluded from coverage by the prior and pending litigation exclusion clause.

Do Mr. Dabron's claims fall within the insuring clauses in the policy?

[41] The applicants bear the onus of demonstrating that Mr. Dabron's claims fall within one of the two applicable insuring clauses in the insurance policy held in the name of Sourced Worldwide.[14]

[42] Insuring Clause 1 provides directors and officers liability coverage:

> Insuring Clause 1: Directors and Officers Liability
>
> Section A: Individual Cover
>
> We agree to pay on behalf of the insured persons all sums they become legally obliged to pay as a result of any claim first made against them and notified to us during the period of the Policy arising out of any wrongful act committed or alleged to have been committed by the insured person acting in their capacity as insured persons or any matter claimed against them solely by reason of them serving in this capacity. [emphasis added]

[43] Lloyd's concedes that Mr. Spinks and Mr. Lee meet the definition of "insured persons" within Insuring Clause 1. Lloyd's also concedes that the claims were made during the period of the insurance policy.[15] The dispute between the parties with respect to coverage under Insuring Clause 1 arises from the underlined words above:

a. did the claims arise out any wrongful act?

b. did the insured person commit the wrongful act while acting in their capacity as an insured person?

[44] The second insuring clause provides entity coverage:

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[14] *Ledcor*, at para. 52

[15] Lloyd's initially took the position that the valuation claim was not first made within the policy period. However, while my decision was under reserve, the parties identified the existence of an applicable run-off endorsement. On November 14, 2023, counsel for Lloyd's advised the court that it was withdrawing its submission that the valuation claim was not first made during the life of the policy.

> Insuring Clause 2: Entity Cover
>
> We agree to pay on behalf of the company all sums it becomes legally obligated to pay as a result of any claim first made against it and notified to us during the period of the Policy arising out of any wrongful act committed by you or on your behalf in the normal course of your business activities. [emphasis added]

[45] Lloyd's concedes that each member of the Sourced Group meets the definition of company in Insuring Clause 2.[16] Lloyd's also concedes that the claims were made during the period of the insurance policy.[17] The dispute between the parties with respect to coverage under Insuring Clause 2 arises from the underlined words in each of the insuring clauses above:

a. did the claims arise out any wrongful act?

b. did the person commit the wrongful act while acting in their capacity as an insured person?

Do Mr. Dabron's claims arise from a wrongful act?

[46] Lloyd's submits that the confidentiality claim and the valuation claim do not arise from a wrongful act within the meaning of the insurance policy. The insurance policy defines wrongful act as follows:

> "Wrongful act" means any:
>
> a) negligent act, error, omission, advice, misstatement or misrepresentation; or
>
> b) breach of trust, neglect or breach of duty, including fiduciary or statutory duty.

[47] There are two branches to the definition of wrongful act. Given the use of the disjunctive "or" between clauses (a) and (b), I find that the confidentiality claim or the valuation claim will fall within the insuring clause if it falls within either clause (a) or (b). Mr. Dabron's claims do not need to meet both branches of the definition in order for the claims to fall within the meaning of "wrongful act."

Meaning of clause (a)

[48] With respect to clause (a), Lloyd's submits that the word "negligent" means only the absence of an intention to cause harm, it does not limit the acts to those within the tort of negligence. I agree. Lloyd's also submits that the word "negligent" not only modifies the

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[16] Company is a defined term meaning Sourced Worldwide or any subsidiary.
[17] As explained in footnote 15, this issue is no longer in dispute.

word "act," but all of the other words in the clause. Lloyd's submits that that clause (a), properly interpreted, means that "wrongful act means any negligent act, negligent error, negligent omission, negligent advice, negligent misstatement or negligent misrepresentation."[18] I will assume, without deciding, that Lloyd's proposed interpretation is correct.

Meaning of clause (b)

[49] With respect to clause (b), Lloyd's submits that it "makes clear that other non-negligent duties will be covered, but does not include harmful intent." I disagree.

[50] There is no basis to infer the absence of harmful intent into clause (b). Nothing in the text or structure of this clause supports Lloyd's submission. If Lloyd's wished to so dramatically limit the meaning of, for example, "breach of trust" to include only "breach of trust absent the intention to cause harm," it needed to include language in clause (b) to achieve that result. There is no reason to import the word "negligent" from clause (a) into clause (b) where that word does not appear in the text. I find that the insuring clause (b) includes within the meaning of "wrongful act" any breach of trust, neglect or breach of duty, including fiduciary or statutory duty without limitation.

[51] Lloyd's submits that phrase "breach of duty" in clause (b) does not include a breach of a contractual duty. Lloyd's submits that coverage arises from the act being wrongful and independently actionable and cannot include a contract breach. Lloyd's did not offer Canadian authority for this proposition.[19] I disagree with Lloyd's submission for three reasons.

[52] First, the policy does not include any language in the definition of "wrongful act" to limit the types of duties that could give rise to a "breach of duty." Contracts are an obvious source of duties that could be breached by insureds covered by the policy. Lloyd's could have expressly excluded contractual duties from the definition of breach of duty, but it did not do so.

[53] Second, considering the policy as a whole, several of the exclusions strongly support my conclusion that "breach of duty" in the insuring clause must include contract breaches. The policy expressly excludes breach of a securities contract from coverage under Insuring Clause 1.[20] Similarly, a breach of client contract is excluded from coverage under Insuring

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[18] *Coast Capital Savings Credit Union v. Liberty International Underwriters* 2016 BCSC 655, aff'd 2017 BCCA 362; *Doering v. Economical Insurance Group*, (2000), 20 C.C.L.I. (3d) 278 O.T.C. 579, at para. 6.

[19] Lloyd's cited a 2013 decision of the US district court in California, *Lion Corp. v. Navigators Insurance Co.* 2013 WL 11024960.

[20] The exclusion for acts covered by Insuring Clause 1 states: "1. **Breach of a Securities Contract** arising out of a breach of any contract relating to the purchase or sale of, or relating to an offer to purchase or sell, any securities, except for the loss the company would be legally liable to pay in the absence of the contract."

Clause 2.[21] In my view, these exclusions would be unnecessary if the definition of "wrongful act" did not include breaches of contract. I am not using these exclusions to create coverage.[22] I am simply interpreting the meaning of "breach of duty" in light of the entirety of the insurance policy, including the meaning to be given to those particular exclusions.

[54] Third, Canadian authority has held that the phrase "breach of duty," can include breach of contract. In *Peterborough (City) v. General Accident Assurance Co.*, the Court of Appeal for Ontario interpreted the meaning of wrongful act in an errors and omissions liability policy.[23] That policy defined wrongful act as follows:

> WRONGFUL ACT shall mean any actual or alleged error or misstatement or misleading statement or act or omission or neglect or breach of duty by the Insureds in the discharge of their duties individually or collectively including the administration of the Insured's employee benefit programmes.[24]

[55] The Court of Appeal held that the definition of wrongful act was very broad, and that "breach of duty" would include breaches of contractual duties:

> The policy definition of "wrongful act" is broad. In addition to referring to breaches of duty generally, it also refers to errors and omissions under workers' compensation and unemployment insurance legislation, and to breaches of duty connected with the administration of the City's employee benefit programmes. Thus, a breach of a common law, statutory, or contractual duty could constitute a "wrongful act" under the policy. In my opinion, the assistant city solicitor's error constituted a "wrongful act", as defined in the policy.[25]

[56] I find that in this policy, the phrase "breach of duty" in the definition of "wrongful act" includes breach of contractual duties.

Does the confidentiality claim allege a "wrongful act"?

[57] Lloyd's submits that the confidentiality claim does not arise from a "wrongful act" within the meaning of Insuring Clause 1. I disagree.

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[21] The exclusion for acts covered by Insuring Clause 2 reads "4. **Breach of client contract** arising directly or indirectly out of any unintentional breach of a written contract. However, this EXCLUSION shall not apply if you would be held liable if there was no written contract in place.
[22] *SIR*, at para. 92; *Progressive Homes*, at para. 27.
[23] *Peterborough (City) v. General Accident Assurance Co*. (1998), 108 O.A.C. 361.
[24] *Peterborough*, at para. 15.
[25] *Peterborough*, at para. 25.

[58] There is no doubt that Mr. Dabron alleges that Mr. Spinks deliberately set out to injure him by sharing the purchase price with Ms. Dabron. However, that is not the only way that Mr. Dabron has pleaded his claim.

[59] Mr. Dabron pleads that the source of the information provided to Ms. Dabron could be Mr. Spinks or someone with whom Mr. Spinks shared the information. Mr. Dabron also pleads that Ms. Dabron did not identify the source of her information:

> 30. …The source of this information can only be Spinks or someone to whom Spinks disclosed this information, who is subject to the same obligations of confidentiality pursuant to the minutes of settlement.
>
> 31. Leah has refused to disclose the source of the information during the Australian divorce proceedings. She refused to confirm that she had been in contact with Spinks.

[60] In addition to pleading that Mr. Spinks acted deliberately and with malice, Mr. Dabron has pleaded an alternative path to establishing the defendants' liability: disclosure of the purchase price to Ms. Dabron by someone other than Mr. Spinks who may not have been ill-motivated. There is a possibility that Mr. Dabron could prove that the purchase price was shared with him by a third party through a negligent act of Mr. Spinks.

[61] Moreover, Mr. Dabron asserts that he is entitled to damages either due to breach of the minutes of settlement or through a common law breach of the duty of confidence:

> 45. Spinks and the other defendants breached the Minutes of Settlement by improperly disclosing or causing to be disclosed the purchase price to [Ms. Dabron].
>
> 46. By disclosing the purchase price the defendants <u>are also liable for breach of confidence.</u> The purchase price was explicitly confidential. The parties were required to preserve the confidentiality of the purchase price.

[62] Mr. Dabron has, therefore, pleaded that the defendants are liable both for breach of contract (the minutes of settlement) and the common law of breach of confidence. To establish a breach of confidence, three requirements must be met: first, the information conveyed must be confidential; second, it must be communicated in confidence; and, third, it must be misused by the party to whom it was communicated.[26]

[63] A breach of the duty of confidence at common law falls within the meaning of "breach of duty" within the definition of "wrongful act." The duty of confidence owed by Mr. Spinks

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[26] *Lac Minerals Ltd. v. International Corona Resources Ltd*., [1989] 2 S.C.R. 574 at p. 608.

arises at common law, not solely from terms of the contract.[27] I find that Mr. Dabron has pleaded a breach of the duty of confidence separate and apart from the breach of the minutes of settlement. A breach of the duty of confidence falls within the meaning of "breach of duty" and, therefore, the definition of "wrongful act" for the purposes of Insuring Clause 1.

[64] Finally, I have found that a breach of contract falls within the meaning of "wrongful act". Even if Mr. Dabron had only pleaded that Mr. Spinks breached the minutes of settlement, that would fall within the meaning of "breach of duty" and, therefore, the definition of "wrongful act" for the purposes of Insuring Clause 1.

[65] For these reasons, I find that the confidentiality claim arises from a "wrongful act" within the meaning of Insuring Clause 1.

Does the valuation claim allege a "wrongful act"?

[66] Lloyd's submits that the valuation claim focuses on intentional harm and fraud and, therefore, does not arise from a "wrongful act" within the meaning of the policy. I disagree.

[67] Mr. Dabron has pleaded both fraudulent misrepresentations and negligent misrepresentations against both Mr. Spinks and Mr. Lee. The prayer for relief explicitly seeks "damages for fraudulent misrepresentation and negligent misrepresentation" in the amount of $50 million. Mr. Dabron pleads that there were "material misrepresentations and omissions made to E&Y by Spinks and others, which have had a material impact on the valuation of the Sourced Group."

[68] Mr. Dabron points to a series of representations made in the management representation letter to E&Y, dated June 12, 2018, all of which he says were untrue. These representations include that all available information was provided to E&Y and that the documents were complete and accurate, that the comments and estimates of management represented their best judgment, and that there were no undisclosed unusual contracts or material changes. Mr. Dabron expressly pleads material facts in support of his negligent misrepresentation claim:

> 40(a) In the alternative, Lee is liable for negligence and/or negligent misrepresentation in the preparation and delivery of Sourced Group's financial information to E&Y. Lee owed a duty of care to Dabron, among others, to ensure that the information provided was complete and accurate. Lee fell below the standard of care expected of an accountant providing services as a Chief Financial Officer, which caused Dabron harm.
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> 40(b) In the further alternative, Sourced Group is vicariously liable for the actions of Lee, who was an employee of Sourced Group

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[27] *Ticketnet Corp. v. Air Canada* (1997), 105 O.A.C. 87, at para. 48.

> and/or acting on behalf of Sourced Group and/or acting on behalf of Sourced Group when he negligently prepared and/or misrepresented Sourced Group's financial information to E&Y. The losses suffered by Dabron arose directly as a result of the negligence, vicariously or otherwise, of Sourced Group.
>
> 41. These misrepresentations, whether negligent or fraudulent, were directly relied on by Dabron and caused him to enter into an agreement to sell his interest based on the E&Y valuation. Had Dabron known that his shares were significantly undervalued due to Spinks' and Lee's actions, he would not have agreed to the purchase price.

[69] Mr. Dabron pleads that Mr. Spinks and Mr. Lee provided misleading financial information to E&Y and/or withheld material information including that they:

a. provided misleading and/or incomplete financial statements that misrepresented the financial position of Sourced Group;

b. failed to disclose Sourced Group's true pipeline, including all customers, potential customers, and sales opportunities;

c. withheld projected revenues;

d. failed to disclose its business plan, investor exit plan, potential acquirers; and

e. failed to provide an accurate description of Sourced Group's goodwill.

[70] I do not accept Lloyd's submission that there is a stark contrast between the pleading of negligent misrepresentation in paragraphs 40(a) and (b) and the rest of the claim. There is no doubt that Mr. Dabron has pleaded a case of fraudulent misrepresentation against Mr. Spinks and Mr. Lee. However, there is equally little doubt that Mr. Dabron could establish negligent misrepresentation against Mr. Spinks and Mr. Lee on these pleadings, even if he cannot make out the intent required for a finding of fraudulent misrepresentation. No amendment to the pleading would be required for Mr. Dabron to succeed establishing liability for negligent misrepresentation. He has clearly pleaded a negligent misrepresentation case against Mr. Spinks and Mr. Lee.

[71] Even if the fraudulent misrepresentation claims are not covered, that does not oust Lloyd's obligation to defend or indemnify for the covered claims where, as here, there is no explicit exclusion of all coverage in the event of concurrent claims.[28]

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[28] *Derksen v. 539938 Ontario Ltd.*, 2001 SCC 72, [2001] 3 S.C.R. 398, at para. 48.

[72] In my view, at least some of the allegations in the valuation claim fall within the meaning of "wrongful act" for the purpose of Insuring Clause 1.

Were the wrongful acts committed by insured persons in their capacity as insured persons or in the normal course of business?

[73] Even if Mr. Dabron's statement of claim alleges "wrongful acts," there is no coverage under the policy for those wrongful acts unless the applicants demonstrate that the wrongful acts:

a. were committed by an insured person in their capacity as insured persons (Insuring Clause 1); and

b. were committed by Sourced Group or on its behalf in the normal course of their business activities (Insuring Clause 2).

[74] Lloyd's submits that there is no possibility the wrongful acts alleged by Mr. Dabron could be found to have been committed by the insured persons in their capacity as insured persons or in the normal course of business. For the reasons that follow, I disagree.

<u>The wrongful acts pleaded in the confidentiality claim</u>

[75] Lloyd's submits that Mr. Spinks entered into the minutes of settlement in his personal capacity and that if Mr. Spinks breached the minutes of settlement, that is by definition a personal contractual breach and not one as an insured person in the normal business of the companies. I disagree.

[76] It is true that Mr. Spinks signed the minutes in his personal capacity. However, that does not reflect the substance of the minutes of settlement. First, the final minutes of settlement are among the following parties: Mr. Spinks and his consulting firm Plan2 Consulting Inc., Sourced Worldwide, Sourced Group Inc., Sourced Australia, Sourced Singapore, Mr. Dabron and Skinny Dog.

[77] In the final minutes of settlement, the parties agreed that Sourced Worldwide would purchase Mr. Dabron's shares in Sourced Group Inc. and his shares in an Australian entity. By signing the minutes of settlement, Mr. Spinks released all claims that the Sourced Group entities could have against Mr. Dabron. The minutes of settlement contained a share purchase agreement obliging Sourced Worldwide to purchase Mr. Dabron's shares and a detailed mutual full and final release that released all of Sourced Groups claims against Mr. Dabron and vice versa.

[78] Regardless of the form of the signature block, it seems apparent that both Mr. Dabron and Mr. Spinks were signing on their own behalf and on behalf of the corporate entities that made up the "Spinks parties" and the "Dabron parties" as they were defined in the minutes of settlement. Each of the corporate entities obtained benefits and provided consideration for what it received through the minutes of settlement. There is no allegation that any of

the corporate entities do not consider themselves bound by the minutes of settlement or that their subsequent conduct suggests that they are not bound.

[79] In my view, the fact that the signature block indicates that Mr. Spinks signed on his own behalf and on behalf of Plan2 Consulting is not determinative of whether or not there is a possibility that the confidentiality claim arises out of his conduct in his capacity as an insured person.

[80] At this stage, there is at least a possibility that the disclosure of the information took place in Mr. Spinks' capacity as an insured person. Mr. Dabron has pleaded that the source of the information provided to Ms. Dabron was Mr. Spinks or someone to whom Mr. Spinks disclosed the information. Mr. Dabron pleaded that during his divorce proceedings, he learned that in July 2019, his wife, Leah (a Skinny Dog shareholder), "had been told the valuation of Sourced Group which she understood to be the basis of the amount [Mr. Dabron] received." Ms. Dabron refused to disclose the source of her information.

[81] Based on the pleading, it is possible that Mr. Spinks disclosed the information to someone in his capacity as an officer of Sourced Group and for a business purpose, only to have that person disclose the information to Ms. Dabron. That determination must await trial.

[82] There is also the complicating feature that Ms. Dabron was a shareholder in Skinny Dog. Whether or not sections 15 and 17 of the second minutes of settlement preclude giving the minutes of settlement to a shareholder of a party to the settlement, who may also fall within the meaning of an "immediate family member" of a signatory to the minutes of settlement, is a matter for trial.

[83] For now, I am satisfied that there is a possibility that the wrongful acts pleaded in the confidentiality claim may have been committed by an insured person in the normal business of the companies.

The wrongful acts pleaded in the valuation claim

[84] Lloyd's submits that Mr. Spinks and Mr. Lee were not acting in their capacity as insured persons when they committed the wrongful acts pleaded in the valuation claim. Lloyd's submits that because the statement of claim alleges that Mr. Spinks and Mr. Lee made the misrepresentations for the predominant purpose of undervaluing the share price and lowering the price that Mr. Dabron would receive for his shares, such actions can only have been taken in their personal capacities. I disagree.

[85] There is no doubt that Mr. Dabron has pleaded that Mr. Spinks and Mr. Lee acted outside of their duties. As set out above, however, Mr. Dabron has also pleaded that Mr. Lee, Mr. Spinks, and the Sourced Group made negligent misrepresentations. Some of the representations relied on by Mr. Dabron appear in the management representation letter, which can only have been signed by Mr. Spinks in his capacity as an officer. Mr. Dabron pleads that Mr. Lee was "providing services as [the Sourced Group's] Chief Financial Officer" when Mr. Lee negligently harmed him.

[86] Mr. Dabron has pleaded that Mr. Spinks and Mr. Lee caused him harm in the negligent discharge of their duties to Sourced Group. At trial, Mr. Dabron could prove that Mr. Spinks and Mr. Lee acted negligently, or made negligent misrepresentations, while acting solely in their capacity as an insured person.[29] Sourced Worldwide was a named party in the 2017 litigation. Attempts to settle that litigation were clearly in the company's interests. All members of the Sourced Group had an interest in that litigation being resolved consensually and the E&Y report was prepared on behalf of each member of the Sourced Group and Mr. Spinks. It seems clear that such conduct could be found to be in the ordinary course of business of the Sourced Group.

[87] In my view, the pleading explicitly addresses conduct of Mr. Spinks and Mr. Lee in their capacity as insured persons providing services to Sourced Group in the normal course of their business, even if there are alternative pleadings that, if established at trial, may mean that Lloyd's is not required to indemnify for that loss.

Conclusion

[88] I find that the applicants have demonstrated that there is a possibility that the valuation claim and the confidentiality claim allege "wrongful acts" within the meaning of the insuring clauses, that those wrongful acts were committed by insured persons, and that they committed those wrongful acts in their capacities as insured persons and in the ordinary course of business.

[89] I find, therefore, that Lloyd's would be required to defend the confidentiality claim and the valuation claim unless it can demonstrate that the coverage is excluded by one of the exclusion clauses.

Is there an exclusion from coverage?

[90] Since I have found that the applicants demonstrated that there is an initial grant of coverage for the claims, the onus now shifts to Lloyd's to establish that there is no coverage available by operation of an exclusion clause.

Does the breach of contract exclusion clause exclude coverage for the confidentiality claim from Insuring Clause 2?

[91] Lloyd's submits that the insurance policy contains an explicit exclusion for breach of contract claims from coverage under Insuring Clause 2. I disagree because I find that this exclusion only applies to claims arising out of the breach of a client contract.

[92] The exclusion, which only applies to Insuring Clause 2 (entity coverage) and does not apply to Insuring Clause 1, reads as follows:

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[29] *Onex Corp v. American Home Insurance Co.*, 2013 ONCA 117, 114 O.R. (3d) 161, at para. 143, leave to appeal ref'd [2013] S.C.C.A. No. 178.

> 4. **Breach of client contract**
>
> > Arising directly or indirectly out of any unintentional breach of a written contract.
> >
> > However, this EXCLUSION shall not apply if you would be held liable if there was no written contract in place.[30]

[93] The policy itself specifies how headings shall be used to interpret the policy. The preamble to the management liability policy states:

> The Sections of this Policy are identified by the **BLUE LINES** across the page with the **WHITE UPPER CASE PRINT**. Clause headings in **BLUE UPPER CASE PRINT** are for information only and do not form part of the cover given by this Policy. Other terms in **bold lower case print** are defined terms and have a special meaning as set forth in the **DEFINITIONS** section and elsewhere.

[94] The introductory words of Exclusion 4 are "Breach of client contract." Those words are not rendered in white upper-case print within a blue horizontal band, so they are not a section heading. The words are not printed in blue print or upper case print, so they are not a clause heading that is included "for information only." I accept that in some policies, a clause heading that that is included for information purposes should not be used to interpret the meaning of a policy.

[95] Lloyd's submits that the heading is not an operative part of the contract. I do not accept this submission. Lloyd's submission requires me to ignore the word "client," but Lloyd's cannot point to any provision of the policy that directs me to do so. Had Lloyd's wished to achieve this result, it should have printed the heading in blue upper-case print. Moreover, because the policy indicates that certain clause headings are for information purposes only, in my view, clause headings that are not expressly limited in that fashion may be used to interpret the exclusion.

[96] I also do not accept Lloyd's submission that if the minutes of settlement are not a "client contract" then it cannot be said that the minutes of settlement are part of the Sourced Group's ordinary course of business. There is no reason to believe that Sourced Group does not enter into a wide variety of contracts that are not client contracts. Commercial leases, agreements for the purchase or rental of equipment, employment contracts, and independent consulting contracts are examples of contracts that would be executed in the ordinary course of business but would not fit within the meaning of client contract.

[97] In my view, it is far from certain that Exclusion 4 excludes a breach of any contract from coverage. I find that the inclusion of the word "client" to modify the word "contract" limits the scope of the exclusion. Lloyd's has not demonstrated that it is clear from the pleadings

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[30] All bolding and full caps text is as it appears in the policy.

that Mr. Dabron's action falls outside policy coverage because of the breach of client contract exclusion clause.[31]

Does the known matters exclusion clause exclude all coverage for both claims?

[98] Lloyd's submits that its duty to defend is not triggered because the claim falls outside of coverage because of the known matters exclusion clause. I disagree.

[99] The known matters exclusion clause applies to both Insuring Clauses 1 and 2, and states:

> It is understood and agreed that the following **EXCLUSION** is added to this Policy:
>
> **Known matters**
>
> Arising directly or indirectly out of the following matters disclosed to **us**:
>
> Regarding the termination of the business development manager in Australia
>
> **SUBJECT OTHERWISE TO THE TERMS AND CONDITIONS OF THE POLICY**

[100] The parties have sensibly agreed that Mr. Dabron is "the business development manager in Australia" referred to in the exclusion clause. I do not think that fact alone, however, answers the question regarding whether or not the exclusion applies.

[101] Lloyd's submits that the known matter "is clearly a reference to the ongoing dispute with Dabron and the [2017 litigation]." Lloyd's points out that the statement of claim contains a number of references to Mr. Dabron's termination. Therefore, Lloyd's submits, the statement of claim arises directly or indirectly out of Mr. Dabron's termination.

[102] It is necessary to interpret the meaning of this exclusion in light of the rest of the policy. Sourced Worldwide purchased worldwide coverage for "employment practices liability" in its policy with Lloyd's. That insuring clause reads as follows:

> Insuring Clause 3: Employment Practices Liability
>
> **We** agree to pay on **your** behalf all sums **you** become legally obliged to pay as a result of any **claim** first made against **you** and notified to **us** during the **period of the policy**, brought by an

[31] *Monenco*, at para. 29.

employee, a prospective employee or an independent contractor arising out of any actual or alleged:

a) wrongful dismissal, discharge or termination of employment whether actual or constructive, including breach of hand express or implied contract; or

b) employment related misrepresentations; or

c) sexual or other harassment in the workplace (including the creation of a hostile working environment); or

d) wrongful deprivation of a career opportunity, employment or promotion or failure to grant tenure; or

e) wrongful demotion, evaluation or failure to adopt adequate employment or workplace policies and procedures; or

f) breach of, violation of or non compliance with data protection laws relating to employee data; or

g) retaliation; or

h) infliction of emotional distress; or

i) employment related libel, slander, humiliation or defamation; or

j) disciplinary action; or

k) negligent evaluation; or

l) discrimination; or

m) invasion of privacy; or

n) violation of any law concerning employment or discrimination in employment.

[103] Although the known matters exclusion is not limited to Insuring Clause 3: Employment Practices liability, it seems to me that the interpretation of the language chosen to describe the known matter, namely, "the termination of the business development manager in Australia" should be informed by the worldwide protection for employment practices liability that Sourced Worldwide purchased.

[104] Even if I set aside the language of Insuring Clause 3, I do not see Mr. Dabron's allegations in the statement of claim as arising directly or indirectly out of his termination or that his termination is synonymous with the 2017 litigation. The earlier litigation was shareholder and corporate litigation. It was not a typical employment law dispute.

[105] As set out above, in 2016, Sourced Australia removed Mr. Dabron from his management role at Sourced Australia. In 2017, Mr. Spinks and Sourced Group Inc. commenced litigation against Mr. Dabron in Ontario. They sought relief under ss. 207 and 248 of the *OBCA*, including an order that Mr. Dabron sell his shares in Sourced Group Inc. to Mr.

Spinks. Mr. Dabron counterclaimed for relief as a shareholder, pursuant to s. 248 of the *OBCA*.

[106] In Australia, Sourced Australia commenced litigation against Mr. Dabron and his company, Skinny Dog.[32] Mr. Dabron billed Sourced Australia through Skinny Dog for the management services he had provided up to the date of his termination. In the litigation, Sourced Australia sought repayment of funds that it alleged Mr. Dabron or Skinny Dog took improperly from the company.

[107] In my view, the earlier litigation arose out of and focussed on the shareholding and corporate governance issues among the parties. They did not engage matters related to Mr. Dabron's employment or its termination.

[108] All the alleged misconduct in the current statement of claim relate to actions or statements that took place in June 2018 or later, which was two years after the end of Mr. Dabron's management role at Sourced Australia.

[109] Mr. Dabron did not make a claim in respect of the termination from his executive role at Sourced Australia in either the Ontario or Australia legal proceedings. He also does not advance any claims connected with his employment in the confidentiality or valuation claims. The damages he seeks in his current action have nothing to do with the termination of his role as an executive.

[110] Mr. Dabron has pleaded certain facts relating to his employment and his termination, but those facts are included to provide narrative and context for the reader. If he excised those paragraphs, his claim would stand on exactly the same footing. The facts related to his termination are unnecessary and mere surplusage.[33] Mr. Dabron does not need to prove any of those facts to be successful in this action.

[111] In order to meet the standard of "arising directly or indirectly out of" a matter, it must be possible to trace a continuous chain of causation unbroken by the interposition of a new act" between the wrongful act and the plaintiff's injury.[34] I find that Mr. Dabron's current action is independent of the termination of his employment. The valuation claim arises from an act independent of his employment relationship, namely, the negotiation and resolution of his shareholding relationship with the companies. Similarly, the valuation claim arises of an act independent of the termination of his employment, namely, the alleged breach of duties of confidence owed to him that post-date the resolution of his shareholding. With respect to the claim against Mr. Lee, it relates to the provision of information to E&Y for the purposes of valuing the companies. None of these claims arise directly or indirectly out of the termination of Mr. Dabron.

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[32] Skinny Dog Consulting Pty Ltd CAN 149 903 533.
[33] *The Hearing Clinic (Niagara Falls) Inc. v. 866073 Ontario Limited, et al.*, 2014 ONSC 5831, at para. 1308.
[34] *Lumbermens Mutual Casualty Co. v. Herbison*, 2007 SCC 47, [2007] 3 S.C.R. 393, at paras. 1-14; *Citadel General Assurance Co. v. Vytlingam*, 2007 SCC 46, [2007] 3 S.C.R. 373, at paras. 2, 3, 35.

[112] The current claim is not causally connected, directly or indirectly, with Mr. Dabron's employment or its termination. The termination of his employment is not a link in an unbroken chain leading to this claim.

[113] I find that Lloyd's has not demonstrated that it is clear from the pleadings that Mr. Dabron's action falls outside policy coverage because of the known matters exclusion clause.[35]

Does the professional services exclusion clause exclude coverage for the claim against Mr. Lee?

[114] Lloyd's submits that the claim against Mr. Lee is excluded by the professional services exclusion clause. I disagree.

[115] The professional services exclusion clause, which applies only to Insuring Clause 1, reads as follows:

> 2. Professional services
>
> arising directly or indirectly from carrying out, or failing to carry out, professional services for a fee or any act, error or omission relating to a professional service.

[116] Lloyd's submits that coverage is precluded because Mr. Dabron's claim "is a claim of professional liability for his failures as an accountant in the services he provided." Lloyd's submits that "professional services" means a service "arising out of a vocation or occupation involving specialized knowledge or skills, and the skills are mental as opposed to manual."[36] Lloyd's submits that accounting services are professional services and, therefore, there is no coverage of the claim against Mr. Lee. I do not accept Lloyd's submissions.

[117] First, it is important to start with the policy's definition of insured persons. It is clear that the policy is designed to provide insurance coverage for professionals and managers, including an in-house general counsel (if one exists):

> 17. **"Insured persons"**
>
> means:
>
> a) any past, present or prospective director, officer, general manager, in-house general counsel or manager of the **company** (or equivalent position in any jurisdiction) including de facto directors; and

[35] *Monenco*, at para. 29.
[36] *Monenco Ltd. v. Commonwealth Insurance Co.* (1997), 42 B.C.L.R. (3d) 280.

b) any employee:

i) acting in a managerial or supervisory capacity or
ii) in an outside directorship position; or
iii) when named as a co-defendant.

[118] Given this definition of insured persons, and given that the policy is a management liability policy, I would be reluctant to adopt Lloyd's proposed definition of "professional services." In a policy that is designed to provide coverage to executives and directors of a cloud computing and software business, it makes little sense that coverage would be available for someone exercising their manual skill but not for one exercising mental skill. Such a narrow interpretation would almost completely defeat the purpose of the coverage, which was to protect directors, officers, executives, managers, and supervisors in a software business. All of those persons, presumably, would be providing services using specialized knowledge and mental skills.

[119] It also seems odd that a management liability policy would expressly extend coverage to a person fulfilling the role of in-house counsel, only to then exclude coverage for any work for the business that built on the in-house counsel's legal training.

[120] It does not appear to be disputed that Mr. Lee acted as the part-time Chief Financial Officer of the Sourced Group or that he did so first through a consultancy agreement and, after 2018, as an employee. He was also a director of the Sourced Group. The mere fact that he was also a Chartered Professional Accountant is not, in my view, sufficient to exclude the claim against him based on the professional services exclusion.

[121] Moreover, I do not accept that Mr. Dabron's claim against Mr. Lee is fairly described as a claim of professional liability for his failures as an accountant. Mr. Dabron alleges that Mr. Lee was negligent in matters lying at the heart of the role of a Chief Financial Officer, rather than as an accountant. Mr. Dabron has alleged that Mr. Lee is responsible for misrepresentations in the information provided to E&Y including incomplete financial statements; failing to disclose an accurate picture of the sales pipeline; withholding projected revenues; failing to disclose a complete or accurate business plan, investor exit plan, list of potential acquirers, or Sourced Group's goodwill. Moreover, Mr. Dabron pleads that Mr. Lee was responsible for compiling and providing Sourced Group's business and financial information to E&Y. This information would have informed the content of the management representation letter dated June 12, 2018. These representations included that all available information was provided to E&Y and that the documents were complete and accurate, that the comments and estimates of management represented their best judgment, and that there were no undisclosed unusual contracts or material changes.

[122] Mr. Dabron alleges that Mr. Lee was negligent in the discharge of a fairly wide range of executive functions and services provided by a Chief Financial Officer. Mr. Dabron's claim is not limited to an allegation that Mr. Lee committed negligent errors while performing a narrow or technical accounting function.

[123] I find that Lloyd's has not demonstrated that it is clear from the pleadings that Mr. Dabron's action falls outside policy coverage because of the professional services exclusion clause.[37]

Does the prior and pending litigation exclusion clause exclude all coverage for both claims?

[124] Finally, Lloyd's submits that its duty to defend is not triggered because the claim falls outside of coverage by reason of the prior and pending litigation exclusion clause. I agree.

[125] Among the general insurance exclusions, Exclusion 31 excludes coverage under both Insuring Clauses 1 and 2 for claims arising from prior or pending litigation as of June 7, 2018, and reads as follows:

> 31. **Prior and pending litigation**
>
> Arising directly from any prior and pending litigation as of [June 7, 2018], or alleging or deriving from the same or generally the same facts as alleged in the prior and pending litigation. For the avoidance of doubt, litigation as used in this exclusion includes administrative or regulatory proceedings or official investigations.

[126] Mr. Spinks and Sourced Group Inc. commenced their application against Mr. Dabron in Ontario on May 1, 2017. Among other things, Mr. Spinks sought an order compelling Mr. Dabron to sell his shares and a declaration that the value of the shares was $10, or $422,000 valued as of August 31, 2016. In his responding pleading, Mr. Dabron asserted that, if he was compelled to sell his shares, the court should order them to be purchased at current fair market value.

[127] The Ontario action (and the Australian action) were resolved when the parties signed minutes of settlement on July 3, 2018, and August 30, 2018. I find that the earlier actions were prior or pending litigation on June 7, 2018.

[128] There are two branches to this exclusion, Mr. Dabron's current claim will be excluded from coverage if it:

a. arises directly from the prior and pending litigation; or

b. alleges or derives from the same or generally the same facts as alleged in the prior and pending litigation.

[129] I accept Sourced Group's submissions that the language in the first branch is narrowed by the use of the words "arises directly." The connection between events required by the words "arises directly" must be stronger than if the policy used the words "arising directly or indirectly" or "in connection with."

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[37] *Monenco* (SCC), at para. 29.

[130] In my view, however, even if I interpret this exclusion clause as narrowly as the text will allow, the valuation claim and the confidentiality claim arise directly from the earlier litigation among the parties and are excluded from coverage.

[131] The applicants submit that Mr. Dabron's allegations that Mr. Spinks and Mr. Lee negligently or fraudulently provided misinformation to E&Y is an intervening act that breaks the chain of causation between the prior litigation and the current proceeding. I disagree.

[132] In the prior litigation, Mr. Spinks and Sourced Group sought orders compelling Mr. Dabron to sell his shares at a fixed price or, in the alternative, at a price set by the court. Mr. Spinks asked the court to determine the value of companies and, therefore, the value of Mr. Dabron's shares. As part of this litigation, Sourced Group would have been required to retain an expert to prepare a valuation of the companies and to provide that expert with accurate and complete information to permit that valuation to be completed. The Sourced Group would have been required to produce all relevant documents associated with its value. The completeness and the accuracy of the information provided to the experts would have been the subject of examinations for discovery and cross-examination at trial. After completion of the trial, Mr. Dabron would have the right to seek to have the judgment set aside or varied on the ground of fraud or of facts arising or discovered after it was made.

[133] Mr. Dabron pleads that the parties jointly retained E&Y "in an effort to resolve the dispute" and that "the parties settled the litigation on the basis of the E&Y report." The fact that the Sourced Group and Mr. Dabron jointly retained E&Y to prepare the valuation of the companies for the purposes of attempting to resolve the dispute does not make that project any less an integral part of the litigation. The *Rules of Civil Procedure* require mandatory mediation for many proceedings in Ontario.[38] Moreover, mediation is a central feature of the litigation landscape in Ontario. In this case, the parties were able to resolve their disputes through a judicial mediation. The involvement of a judicial mediator, in this case Hainey J., makes crystal clear how the consensual resolution of the dispute is linked to the litigation. Far from being an intervening act, the E&Y report was an integral part of the prior litigation and its resolution.

[134] The fact that Mr. Dabron seeks rescission of the minutes of settlement, release, and share purchase agreement in the current action is also a factor that demonstrates how his current action arises directly from the prior litigation.

[135] Each of the E&Y report, the judicial mediation, and the settlement itself arose directly out of the prior litigation. In my view, the valuation claim arises directly out of the prior litigation.

[136] Similarly, the confidentiality claim arises directly out of the prior litigation. The confidentiality claim is predicated on a breach of the minutes of settlement or a breach of

[38] R.R.O. 1990, Reg. 194, Rule 24.1.

a duty of confidence that arose out of the negotiations leading to the minutes of settlement. In my view, the action for breach of confidence arises directly out of the prior litigation.

[137] To change the context slightly, if Sourced Group had failed to pay the amounts owing to Mr. Dabron for his shares under the minutes of settlement, Mr. Dabron could have commenced an action for breach of the minutes of settlement. It seems to me that such an action would arise directly out of the prior litigation. In my view, the fact that Mr. Dabron's confidentiality action arises out of a different clause in the settlement, or is for breach of a common law duty arising out of the settlement, does not change that analysis. As discussed above, the act of settling litigation is integrally linked to that litigation. It is not an intervening act.

[138] I find that Lloyd's has met its burden to show that the duty to defend is not triggered because both the valuation claim and the confidentiality claim are excluded from coverage by virtue of the prior and pending litigation exclusion clause.

[139] The application is dismissed.

Costs

[140] If the parties are not able to resolve costs of this application, Lloyd's may email its costs submission of no more than three double-spaced pages to my judicial assistant on or before January 9, 2024. Mr. Lee may deliver his responding costs submissions and the remaining applicants may deliver their responding submissions of no more than three double-spaced pages on or before January 16, 2024. No reply submissions are to be delivered without leave.

Robert Centa J.

Date: January 2, 2024

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF 14487893 CANADA INC.

Court File No. CV-21-00658423-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

PROCEEDING COMMENCED AT TORONTO

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