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Welcome to the third issue of The Practical Edge on Insurance, Theall Group's newsletter on important developments in insurance law. This issue reviews the application of territorial limitations in auto policies, the "Your Work" exclusion in a CGL policy, and a pollution exclusion clause in a directors' and officers' liability policy. In addition, we analyze the Ontario Court of Appeal decision declaring that an insurer had a duty to indemnify an insured who contracted West Nile virus from a mosquito bite. The Court's interpretation of "accident" is bound to have an important impact.

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Theall Group LLP was formed in 2002 and has grown steadily as we enter into our fifth year. We are, first and foremost, a litigation firm that specializes in commercial insurance law acting for policy holders and brokers. We also have expertise in the automobile industry, product liability, risk management and transnational disputes. Our goal is to provide service-oriented expertise that focuses on finding the most effective and efficient way to reach our client's goals. Working with our clients, and leveraging the firm's information technology, we strive to deliver practical solutions to the most difficult and complex problems. This is how we do business at Theall Group LLP, your practical edge.

Territorial Limitations for Underinsured Automobile Coverage

Case Review: *Sutherland v. Pilot Insurance Co.*

The Ontario Court of Appeal denied coverage for an insured's injuries suffered in an automobile accident in Jamaica, finding that the automobile policy's territorial limitations apply to the underinsured motorist endorsement. The Court found that the endorsement incorporated the Policy's territorial limitation, and that it did not conflict with the *Insurance Act*.

The policy contained an underinsured motorist endorsement (OPCF 44R), which limited indemnity to \$1,000,000. The alleged at-fault parties had coverage limits equivalent to CDN\$18,400.00 and, therefore, came within the endorsement's definition of an "inadequately insured motorist". The insured sought a declaration that he was covered under the endorsement.

The policy contained the following territorial limitation: "This policy covers you and other insured persons for incidents occurring in Canada, the United States of America and any other jurisdiction designated in the *Statutory Accident Benefits Schedule*..." Jamaica was not a jurisdiction listed in the *Statutory Accident Benefits Schedule*. The territorial limitation mirrored the language set out in the *Insurance Act*. Another section of the policy provided: "Except as otherwise provided in this change form, all limits, terms, conditions, definitions and exclusions of the Policy shall have full force and effect"

The insured argued that the endorsement was not subject to the policy's territorial limitation, that the *Insurance Act's* territorial limitation did not apply because it was not specific to underinsured coverage, and that the *Insurance Act's* territorial limitation was ambiguous and any ambiguity should be resolved in the insured's favour. The insurer contended that the territorial restriction

imposed on uninsured coverage in the *Insurance Act* applied because underinsured coverage is simply a subset of uninsured coverage.

The motion's judge considered the endorsement, for which the insured paid a separate premium, to be separate and apart from the policy. Therefore, the territorial limits from the main policy were inapplicable. Further, as the territorial limitation provision in the *Insurance Act* did not expressly apply to underinsureds, there was an ambiguity that ought to be resolved in the insured's favour.

The Court of Appeal disagreed, holding that the endorsement incorporated the policy's territorial limitation. The Court stated that endorsements are generally not understood to be self-contained policies that exist independent of an underlying policy. Moreover, the Court found that the *Insurance Act* does not address a territorial restriction for underinsured coverage directly or indirectly, so the policy did not conflict with the *Insurance Act* or raise any ambiguity. While the Court disagreed that underinsured coverage is a subset of uninsured coverage, given the insured's payment of an additional premium, it found no reason to infer that there was no territorial limitation for underinsured coverage simply because there was a territorial limitation for uninsured and unidentified coverage. Thus, the Court declared that the endorsement was inapplicable and the insurer had no duty to indemnify.

Read narrowly, this decision indicates that coverage under Ontario's underinsured motorist endorsements is limited to the jurisdictions listed in the policy. More broadly, it confirms that endorsements must be considered in the context of the entire policy, and that restrictions contained in the main policy wording may well apply to endorsements.

Illness caused by West Nile virus falls within definition of accident

Case Review: *Kolbuc v. ACE INA Insurance*

In a well-publicized decision, the Ontario Court of Appeal expanded the definition of "accident" in a group accident policy to include illness caused by the West Nile virus.

Kolbuc was a plasterer who was bitten by a mosquito carrying the West Nile virus and was rendered a paraplegic. At that time, while mosquito bites were common to persons in his occupation, there had been no reported cases of the West Nile virus in Ontario. The insurer, ACE INA, denied coverage to Kolbuc on the grounds that his illness was not caused by an "accident" within the meaning of its policy. The word "accident" was not defined in the policy.

The sole issue at trial was whether Kolbuc's injuries were caused by an "accident". Noting that the term "accident" had generated considerable debate in case law, the Court said that the question was whether the fact that Kolbuc was bitten by a mosquito carrying the West Nile virus rendered what happened to him an "accident", as opposed to something that arose from "natural causes." The former would entitle him to benefits whereas the latter would not. The Court reasoned that West Nile virus is a disease that is typically transmitted to humans through mosquitoes; it was rare, but not unnatural, that the virus was transmitted to Kolbuc in that manner. Therefore, the Court concluded that the illness arose from natural causes, and Kolbuc was not entitled to coverage.

The Court of Appeal reversed the trial court's decision, ruling that the illness was

an "unforeseen, unexpected event" that was caused by an external source (a mosquito) and, thus, fell within the ordinary definition of an accident. The court stressed that the cause of the illness was an accidental event, and not the result of natural causes. Although mosquito bites were common to a person in his occupation, there were no reported cases of West Nile virus in Ontario, and Kolbuc had no reasonable expectation that he would get West Nile virus from the activity in which he was engaged.

Although the Court agreed with the insurer that a disease is not an accident, it nonetheless went on to state that an accident can cause a disease. It stressed that there need not always be an external source that triggers the disease or illness. It found that Kolbuc was engaged in work, without intending to cause himself harm, and the harm that resulted could not reasonably have been foreseen or expected. Accordingly, the Court allowed the appeal, holding that Kolbuc had suffered an accident and was entitled to coverage under the policy.

The decision by the Court of Appeal highlights the dilemma faced by courts in drawing the distinction between accidental injuries and injuries that are the result of natural causes, particularly in light of recent cases in Ontario that seem to contradict each other on this issue. To avoid this dilemma, insurers may feel compelled to provide a comprehensive definition of the term "accident" in their accident policies.

Court narrowly construes pollution exclusion clause in D&O policy

Case Review: *Boliden Ltd. v. Liberty Mutual Insurance Co.*

In the first Canadian case concerning the application of a pollution exclusion clause in a D&O policy in the context of securities litigation against directors and officers, an Ontario court demonstrated a willingness to interpret an insurance policy liberally to find coverage, despite the existence of what appeared to be a relevant exclusion.

A mine owned by Boliden's subsidiary was contaminated by toxic waste when a tailings pond dam on the property collapsed. Production at the mine ceased, and Boliden's shares plummeted in value. Boliden's shareholders, who had acquired shares less than a year earlier in an initial public offering, brought class action claims against the directors and officers of the company for alleged misrepresentations contained in the prospectus leading to the IPO. The damages sought were limited to the depreciation of the value of the shares. The class action settled and Boliden sued its insurer, Liberty Mutual, for the defence costs of the underlying litigation. Liberty Mutual denied coverage based on the D&O policy's exclusion for a "pollution loss".

The policy stated that if a claim was partly covered by the policy and partly not covered, 80% of defence costs would be allocated to the covered loss. Boliden argued that the wrongful acts pleaded in the class action claims were alleged failures to disclose a number of matters in the prospectus. Boliden claimed that the loss, which was a drop in the value of the shares, was covered by the policy because it resulted from the alleged misrepresentations in the prospectus rather than from the pollution. Liberty Mutual argued that liability for the drop in share value resulted, directly or indirectly, from

the discharge of pollutants and the anticipated expense of remedial work to be done.

The Court began its analysis from the well-established principles that the duty to defend is governed by the pleadings in the underlying action, and the "widest latitude" must be given to determine whether a duty is owed; that coverage provisions in insurance policies should be construed broadly in favour of the insured; that exclusions clauses should be interpreted strictly and narrowly against the insurer; and that any ambiguity should be resolved against the insurer. The Court defined "pollution loss" in the circumstances as "an amount which a Boliden director or officer becomes legally obligated to pay on account of each claim for misrepresentation 'resulting from or attributable to or in anyway involving, directly or indirectly' actual etc., discharge etc. of pollutants." It found that the policy covered a broad range of wrongful acts, and a misrepresentation involving pollution problems was one of many claims that could fall within the policy. The Court concluded that the class action consisted of both covered claims (alleged omissions in the prospectus about improper construction and maintenance of the tailings dam, construction defects, stability problems and structural defects) and excluded claims (alleged omissions in the prospectus about actual seepage from the tailings pond). Accordingly, the Court held that Boliden was entitled to payment of 80% of its defence costs.

This decision is particularly well-reasoned as the Court had to define pollution loss in order to ensure that coverage was not illusory. By applying the principles outlined above, the Court came to the correct conclusion and the insured received coverage for a substantial portion of its claim.

A Reconsideration of the “Your Work” Exclusion

Case Review: *Hipperson Construction (1966) Ltd. v. H.J.H. Steel Erectors Inc.*

The last issue of The Practical Edge on Insurance reviewed the lower court decision in *Hipperson Construction (1966) Ltd. v. H.J.H. Steel Erectors Inc.* The Saskatchewan Court of Appeal recently overturned the decision, finding that the lower court justice misinterpreted the “Your Work” exclusion. Arguably, the Court of Appeal changed the policy wording in order to deny coverage as it accorded with the Court’s interpretation of what the exclusion was supposed to achieve.

The plaintiff had contracted with the defendant insured for the installation of a pre-engineered metal building, and during construction, two steel support rafters collapsed. The plaintiff brought an action against the insured, alleging that the collapse occurred because the insured negligently failed to support the rafters during construction. The insured brought an application before the Saskatchewan Queen’s Bench for a declaration that its insurer owed a duty to defend.

The insurer relied on the “your work” and “your product” exclusions, which read as follows:

This insurance does not apply to ... property damage to ... that particular part of any property that must be restored, repaired or replaced because “your work” was incorrectly performed on it.

This insurance does not apply to ... property damage to “your product” arising out of it or any part of it.

In the policy, “Your Product” was defined to mean “any goods or products ... manufactured, sold, handled, distributed or disposed of by ... you”. “Your Work” was defined to mean “a. Work or operations performed by you or on your behalf; and b. Materials, parts or equipment furnished in connection with such work or operations.”

The lower court found that since the rafters were furnished by the plaintiff, they were not “materials, parts or equipment furnished” by the insured, and could not fall within the policy’s definition of “your work”. The insurer also argued that the rafters fell within the definition of “your product”, on the grounds that the insured worked on them and therefore “handled” them. The Court rejected this argument, finding that the definition of “your product” refers to “goods or products supplied by an insured, either as principal or agent”.

The Court discussed the “basic purpose” of the exclusions, and found that the “your work” exclusion was intended to prevent the insured from recovering cost of correcting its own deficient work, while the “your product” exclusion was intended to prevent its supplier from recovering the cost of replacing its own defective product. The Court held that the insurer was seeking a broader interpretation, which would require the insured to not only bear the cost of correcting its own defective work and/or repairing or replacing his own defective product (which costs could be insured by a performance bond), but also to

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A Reconsideration of the “Your Work” Exclusion

Case Review: *Hipperson Construction (1966) Ltd. v. H.J.H. Steel Erectors Inc.*

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bear the unknown cost of consequential damage caused by the insured's negligent work or defective product. The Court opined that this was exactly the type of risk which the insured expected would be covered. As a result, the Court ordered the insurer to defend the action.

On appeal, the Court held that the lower court judge misinterpreted the “your work” exclusion, effectively holding that the conjunction “and” in the definition should be read as “or”, because “the coincidence of all circumstances would be virtually impossible.” The Court held that the “clear meaning” is that the policy does not cover damage to any property when it must be replaced because “your work” was incorrectly performed, whether or not the property was owned by the insured or a third party. The Court rejected the insured's argument that this interpretation makes the policy illusory,

because the policy would cover damage to property other than that on which the insured's work is performed.

The contrast between the lower court and the appeal court decisions illustrates two different approaches to policy interpretation. The lower court reviewed the policy wording in order to determine whether there was coverage. The appeals court considered what it believed was the purpose for the exclusion when making its coverage determination. The Supreme Court of Canada has repeatedly cautioned our courts against this approach, stating that the wording of the policy should govern. Unfortunately, the approach taken by the Court of Appeal will create great uncertainty, to the disadvantage of all parties.