CBA Insurance Section
Law Courts Inn

# Reasonable Expectations and Unjust Exclusions

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# 1. The Key Principles of Policy Interpretation

- Every coverage case invariably entails the Court reciting "general principles of insurance policy interpretation"
- In the most recent SCC case, *Progressive Homes v. Lombard Ins* (2010), the Court indicated that "principles of insurance policy interpretation have been canvassed by this Court many times…and a brief review of the relevant principles may be useful" (para. 21)

# 1. The Key Principles of Policy Interpretation (cont'd)

- The "relevant principles" included:

    1. "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";

    2. Where the language of the insurance policy is ambiguous, the Court's rely on general rules of contract construction [to try and resolve that ambiguity];

# 1. The Key Principles of Policy Interpretation (cont'd)

3. Such rules include,

   – "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" (i.e. mutual);
   – "Courts should avoid interpretations that would give rise to an unrealistic result or one that would not have been in the contemplation of the parties at the time the policy was concluded" (i.e. mutual);
   – "Courts should also strive to ensure that similar insurance policies are construed consistently";

# 1. The Key Principles of Policy Interpretation (cont'd)

4. "These rules of construction are applied to resolve ambiguity…they do not operate to create ambiguity where there is none in the first place".

5. "When these rules of construction fail to resolve the ambiguity, Courts will construe the policy contra proferentem – against the insurer";

6. "One corollary of the contra proferentem rule is that coverage provisions are interpreted broadly, and exclusion clauses narrowly" (paras. 21-24).

# 1. The Key Principles of Policy Interpretation (cont'd)

- Is there a ready bias against big insurance companies in favor of the insured consumer? Consider the following:
  - "In construing an insurance policy, the Courts must be guided by the reasonable expectations and purpose of an ordinary person in entering such a contract, and the language employed in the policy is to be given its ordinary meaning, such as the average policy holder of ordinary intelligence, as well as the insurer, would attach to it."

    (*Scott v. Wawanesa*, 1989, SCC)
  - "It is necessary to interpret insurance contracts 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."

    (*National Bank of Greece v. Katsikonouris,* 1990, SCC)

# 1. The Key Principles of Policy Interpretation (cont'd)

- "A policy of insurance constitutes a contract. Yet there are some significant differences between a contract of insurance and an ordinary commercial contract. It must be remembered that the policy itself is drawn by the insurance company. It is the insurance company that chooses the language which sets out the terms and conditions of the policy. That language is not always a model of clarity which can be readily understood by laypersons. The policy is not negotiated between the parties. Rather it is submitted to a potential policy holder on a take-it-or-leave-it basis with, I am sure, an emphasis by the insurance company representative on benefits that the purchaser will receive."

  (*Brissett Estate v. Westbury Life*, 1992, SCC)

# 1. The Key Principles of Policy Interpretation (cont'd)

- "One must always be alert to the unequal bargaining power at work in insurance contracts, and interpret such policies accordingly."

  (*Lloyd's v. Scalera*, 2000, SCC)

- "The Courts have developed a number of general interpretative principles that reflect a concern that customers not suffer from the imbalance of power that often exists between insurers and the insured," and "Ordinary words should be interpreted in the ordinary language of the people."

  (*Cooperators Life v. Gibbens*, 2009, SCC)

## 2. The Role of "Reasonable Expectations"

- Some courts in the U.S.A have ruled that even when an exclusion clause is clear and unambiguous, it should not be applied when it would be found contrary to the reasonable expectations of the ordinary person.

- The rationale is said to be as follows:

*"The reasonable expectations of a policyholder, having an ordinary degree of familiarity with the policy coverage, should be given effect for three reasons:*

*(i) Policy forms are long and complex and cannot be understood without detailed study;*

*(ii) rarely do policyholders read their policies carefully enough to acquire such understanding;*

*(iii) most insurance transactions are final before a policyholder has a chance to see the detailed policy terms."*

Holz, Drake Law Review, 1988

# 2. The Role of "Reasonable Expectations" (cont'd)

- In Canada, the courts ostensibly purport to apply mutual reasonable expectations of both parties as one of the rules of construction to resolve ambiguity;
- However, some courts appear to have endorsed the broader, controversial, unilateral expectations approach;
- In *Weston Ornamental Ironworks v. Continental Insurance (1981, Ont. CA)* a metal-working / welding business had been denied coverage for a fire caused by their welding operations which led to the destruction of a Caterpillar tractor on the basis of an exclusion for damage to property *"as a result of any work performed thereon by the insured"*. The Court of Appeal ruled that the exclusion was ambiguous, but given that this type of work (50% of their business was working on customer's machinery at job sites) was the principal liability risk facing the insured, also concluded:

  > *"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"*.



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# 2. The Role of "Reasonable Expectations" (cont'd)

- In *Chilton v. Co-operators General Insurance (1997 Ont. CA)*, the question was whether a standard form auto SEF 44 endorsement could be triggered even though the identity of the driver of a stolen car involved in the hit and run accident was never ascertained. The court in denying coverage held there was no ambiguity in the endorsement and no thwarting of any reasonable expectations but endorsed the possibility:

  "*in considering whether to apply the reasonable expectations principle to cases in which there is no ambiguity in the policy, first the court should consider whether a reasonable insured could have expected coverage. An arguable case for coverage may exist, for example, if the policy is difficult to read or understand and if the insurer, either by its marketing practices or by giving its policy a misleading name, created or contributed to a reasonable expectation of coverage. Coverage may also be warranted where the insurer's interpretation of the relevant policy privilege would virtually negate the coverage the insured expected by paying the premium. In these circumstances, the court may be justified in looking beyond the words of the contract and holding the insurer responsible for the insured's reasonable expectation of coverage*".

# 2. The Role of “Reasonable Expectations” (cont’d)

- In *Cabell v. Personal Insurance (2011 Ont. CA)*, the court applied the “no nullification of coverage doctrine” to avoid application of the “settling/moving” exclusion to an endorsement specifically issued to cover an in-ground swimming pool. The endorsement provided that “all other policy terms remain unchanged”, including the standard exclusion which would have included the standard settling/moving exclusion. The insurer was “hard pressed to give an example of damage to the pool that would not be caught by the exclusion”. Given that the endorsement was specifically issued to cover the swimming pool, the court invoked the nullification of coverage doctrine saying that it was “an independent doctrine that applies even in the absence of ambiguity”.

# 2. The Role of “Reasonable Expectations” (cont’d)

- In *Perrault v. Encon Insurance (2011 Ont. SCJ)*, the court refused to apply the “bodily injury” exclusion to an officer of the Canadian Red Cross Society charged with criminal negligence causing bodily harm in relation to tainted blood supply. The insured was seeking recovery of $1.6 million in criminal proceeding defence costs under the Society’s Directors & Officers policy. The court cited *Zurich v. 6886234 Ontario* (*Ont. CA*):

  > *“even though an exclusion clause may be unclear and ambiguous, it will not be applied where it is consistent with the main purpose of the insurance coverage and where the result would be to virtually nullify coverage and where to apply it would be contrary to the reasonable expectations of the ordinary person as to the coverage purchased”.*

- The Court then went on to affirm coverage for the insured's defence costs on the basis that:

  > *“to find administrative tasks cause bodily injury to anyone would be contrary to the reasonable expectations of the ordinary person as to the coverage purchased”.*



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# 2. The Role of "Reasonable Expectations" (cont'd)

- In *Turpin v. Manulife (2011 BCSC)*, currently under appeal, the court refused to apply a "pre-existing medical condition" exclusion in a travel insurance policy. The insured had visited a clinic for abdominal pain which was treated with analgesics and antibiotics. She was free of pain when she applied for travel insurance three days later for the family vacation to Disneyland. The abdominal pain returned and eventually led to an appendectomy.
- Coverage was denied because of the exclusion relating to pre-existing medical conditions. The court invoked "the reasonable expectations principle" as follows:

> "*56. On the construction I have applied to the exclusion clause in this case, Ms. Turpin was not eligible for medical coverage because she suffered an irregularity in her health, three days before the policy issued. The medical coverage is nullified. That is not what the parties expected. I find they expected that Ms. Turpin would be so covered.*



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# 2. The Role of "Reasonable Expectations" (cont'd)

*56. Ms. Turpin applied to the defendants' agent for medical insurance, for a planned trip to Southern California. The defendants' agent presented a travel insurance policy, "off the shelf" as it were, without enquiry. Ms. Turpin paid the policy premium and left the agent's office without reading the policy, notwithstanding the caution on the policy cover that stated "PLEASE READ CAREFULLY".*

*57. I find however, that if she had read the policy, she would have found it difficult to understand, with its myriad of excluding conditions, variously applicable, or not applicable, to an infinite array of possible risks.*

*59. This is a proper case to apply the reasonable expectations principle. Accordingly, the plaintiffs will recover their expenses for medical services in Southern California".*

# 3. “Unjust Contract Provisions”

- Effective July 1, 2012, this provision of Insurance Act applies to liability as well as property insurance:

  S. 28.3 If a contract contains any term or condition . . . that is or may be material to the risk, including, but not restricted to, a provision in respect to the use, condition, location or maintenance of the insured property, the term or condition is not binding on the insured if it is held to be unjust or unreasonable by the court before which a question relating to it is tried.

# 3. “Unjust Contract Provisions” (cont’d)

- “Materiality” . . . objective test of whether any prudent insurer in the normal practice of the insurance business would be influenced whether to accept/decline the risk or to stipulate a high premium or other limitations

  *Kehoe v. BC Insurance Co.* (1993, BCCA)

- Aren’t all exclusions “material to the risk”? (Why else insert it!)

- Flood gates opening?

# 3. “Unjust Contract Provisions” (cont’d)

***Marche v. Halifax Insurance Co.* 2005 SCC 6**

- Statutory Condition 4: “Any change material to the risk and within the control and knowledge of the insured shall avoid the contract as to the part affected thereby . . . (unless prompt written notice)”

- House vacant for period of time, insurer not advised, therefore Statutory Condition 4 says policy void.

# 3. “Unjust Contract Provisions” (cont’d)

***Marche v. Halifax Insurance Co.* 2005 SCC 6**

- Tenant moved into house before loss, therefore breach “rectified”

- Issue: was it “unjust or unreasonable” to allow insurer to treat the policy as void for subsequent fire loss even though breach had been rectified?

- How can a statutory condition possibly be considered “unjust or unreasonable”?

# 3. “Unjust Contract Provisions” (cont’d)

***Marche v. Halifax Insurance Co.* 2005 SCC 6**

Ruling:

- Relief provision applies not only to policy terms that are unreasonable on their face but also to terms which are unreasonable in their application in the circumstances.
- Here, because vacancy (and material change in risk) had been rectified before loss, it was unreasonable to enforce Statutory Condition 4 to allow voiding of coverage



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# 3. "Unjust Contract Provisions" (cont'd)

- Query – if there is no nexus between exclusion/breach and the loss, would denial be "unjust or unreasonable"?
- Will unilateral reasonable expectations of coverage by the insured now make denials "unreasonable"?
- Can <u>every</u> denial of coverage now be disputed??!!

# THANK YOU

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