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A USEFUL APPLICATION OF THE RULES OF POLICY INTERPRETATION IN THE CONTEXT OF A CANADIAN COVID-19 BUSINESS-INTERRUPTION CLAIM

FOLLOW THE RULES:

Date: January 31, 2023
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Over the course of almost three years, the COVID-19 pandemic wreaked unparalleled, economic havoc across the world. Those in the insurance industry questioned, quite early on, how insurance products would respond.

Currently in Canada, one of the hottest insurance topics is the insurability of the economic fallout from COVID-19. American courts, both at the state and federal level, have routinely held that no coverage is afforded as a consequence of governmental shut-down orders and other health ordinances. However, it is only after three years since the World Health Organization declared the outbreak of a pandemic (in March 2020) that a Canadian court has rendered its first substantive decision on the subject. The decision is useful, not only because the issue of COVID-19 contamination and resultant business losses is addressed, but because the court provides useful guidance on the application of the principles of policy interpretation.

In *SIR Corp. v. Aviva Insurance Company of Canada*, 2022 ONSC 6929, SIR Corp. (a Canadian restaurant chain owner / operator) was insured under a manuscript commercial all-risks policy, issued by Aviva. The policy consisted of a binder, an insuring agreement and six endorsements related to certain exclusions. The binder referred to “Special Endorsements / Extensions”, which were contained in the policy itself.

The main insuring agreement covered “property”, as described in the policy, against the insured peril of ‘all risks of direct physical loss or damage except as excluded’.

Extension 14 provided:

This Policy insures loss, as covered herein, which is sustained by the Insured as a result of damage caused by order of civil or military authority to retard or prevent a conflagration or other catastrophe.

In March 2020, SIR Corp. was forced to close its chain of restaurants pursuant to a governmental order in response to the pandemic. It was contended by SIR Corp. that the various provincial orders constituted “civil authority orders”, as defined in the policy, which resulted in significant business losses to SIR Corp.

Aviva denied coverage on the basis that the COVID-19 virus did not constitute “direct physical loss or damage” or “destruction or damage” to property.

Analysis

It was agreed by the parties that none of the exclusions applied to the issues before the court. It was also conceded that the wording of the policy was not ambiguous.

In support of coverage, SIR Corp. relied on the following extensions:

i. Extension 14 (civil or military authority)

ii. Extension 15 (interruption by civil or military authority)

iii. Extension 16 (ingress/egress)

(For brevity, only Extension 14 is addressed in this article, although the same principles would apply to the two other extensions).

SIR Corp. submitted that Extension 14 served to broaden coverage to insure “…loss, as covered herein, which is sustained by the Insured as a result of damage caused by order of civil…authority to retard or prevent a conflagration or other catastrophe [i.e., the spread of coronavirus]”. Direct physical loss or damage was not required. In other words, SIR Corp. asserted that the various extensions ought to be read in isolation, divorced from the rest of the policy’s terms and conditions.

Aviva disagreed, countering that the necessary trigger for coverage, as both a matter of construction and common sense, was the occasion (real or threatened) of physical loss or damage to property. Therefore, there would be no coverage for SIR Corp. because the virus could not cause “direct physical loss or damage” or “destruction or damage” to property. Aviva reasoned that to trigger coverage under this extension, SIR Corp. must demonstrate that:

a. the orders are civil-authority orders to retard or prevent a conflagration or other catastrophe, and

b. the orders caused damage to SIR Corp.

Aviva argued that SIR Corp. could not establish the existence of an insured peril as the root cause or triggering event to the orders limiting access to SIR Corp.’s premises. The simple reality was that the orders were implemented to retard or stop the spread of COVID-19. Neither the orders nor COVID-19, however, had occasioned any physical harm to SIR Corp.’s property.

In order to trigger coverage under the extensions, the language contractually required a nexus between the orders and direct physical loss or damage to property, or the threat thereof.

Aviva submitted that the policy was a commercial-property one, which was organized around twin pillars:

I. indemnifying an insured for direct physical loss or damage to property; and

II. indemnifying the insured for lost business income and extra expense, which it sustained as a result of direct physical loss or damage to property.

Extension 14 operated to extend this coverage for damage caused by civil orders issued to retard or prevent a conflagration or other catastrophe. In the overall context of the policy, however, coverage would be engaged only if the order resulted in physical damage to the insured's property.

The court concluded that none of the extensions was triggered because there was no coverage under the policy for the loss sustained by SIR Corp. as a result of the governmental orders being issued to retard the coronavirus. In that regard, the court stated:

[103] The Oxford Concise Dictionary (Oxford: Clarendon Press, 1995)…defines "herein" as follows: "…in this matter, book, etc." Extension 14 is clear on its face that the Policy will extend to a loss "as covered herein". **There must first be a "loss" covered under the Policy.** The second requirement is that the insured's loss is caused by "order of civil or military authority to retard or prevent a conflagration or other catastrophe." SIR Corp has ignored the causation factor. For SIR Corp to be afforded coverage, the loss must be as a direct loss or damage. Courts will apply the usual rules of causation, which require the loss to be as a result of "direct physical loss or damage". **The COVID-19 virus, even if it meets the definition of being a catastrophe would not cause direct "physical" loss or damage. The government orders did not result in "direct physical loss or damage" to the insured's property.** [emphasis added]

In other words, the endorsements cannot be interpreted in isolation, but are subject to the grant of coverage contained in the insuring agreement.

The court reiterated that an insurance policy may consist of a binder, insuring agreement, endorsements or riders, and policy wordings and conditions. All of these components constitute the policy, and are to be read and construed together. A rider or endorsement is a "writing added or attached to a policy or certificate of insurance which expands or restricts its benefits or excludes certain conditions from coverage": L.R. Russ, *Couch on Insurance* 3d (West Group, 1997) at pp. 18-24. In particular, an endorsement does not serve as a standalone policy. While it may be comprehensive in terms of the particular coverage granted, it does not have an independent existence.

In reaching its conclusion, the court reiterated a number of fundamental principles regarding contractual interpretation:

- In matters of insurance, as well as in other areas of civil law, the principle of freedom of contract applies. Generally, therefore, it is for parties to an insurance contract to define the limits of risk covered, and the conditions under which indemnity is payable: *Caisse Populaire des deux Rives v. Société Mutuelle d'Assurance Contre l'Incendie de la Vallée du Richelieu*, [1990] 2 S.C.R. 995 at p. 1003.
- Insurance policies must be read as a whole. This includes endorsements, which can be comprehensive, but are not standalone policies - they are built on the foundation of the policy itself: *Pilot Insurance Co. v. Sutherland*, 2007 ONCA 492 at para. 21.
- The court must give effect to the intention of the parties, and produce a fair and commercially sensible result. It must determine the parties' objective intentions and their reasonable expectations with respect to the meaning of the contractual provisions. The reasonable expectations can often be gleaned from the circumstances surrounding the contract's formation: *Sattva Capital Corp. v. Creston Moly Corp*., 2014 SCC 53; *Consolidated-Bathurst v. Mutual Boiler*, [1980] 1 S.C.R. 888; *Eli Lilly & Co. v. Novopharm Ltd*., [1998] 2 S.C.R. 129.
- In construing the policy, the issue is not the meaning of the words or the meaning of the writer, but the meaning of the words as used by the writer. Therefore, the policy must be examined in light of the surrounding circumstances, or the factual matrix in which it was formed. This will vary from case to case, but has limits. The interpretation should be consistent only with the objective evidence of the foundational facts at the time the parties entered into the contract (which is the information that was, or reasonably ought to have been, within the knowledge of both parties at or before the date the parties entered into the contract).
- Where the language of the policy is unambiguous, effect should be given to the clear language, reading the contract as a whole. Words are to be given their ordinary meaning, not that which might be specifically given in the insurance context: *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance*, 2016 SCC 37 at para. 49; *Non-Marine Underwriters, Lloyd's of London v. Scalera*, 2000 SCC 24.
- Where there are two reasonable interpretations, the more reasonable one ought to be adopted, consistent with a fair result and promotion of the intention of the parties: *Consolidated-Bathurst*, *supra* at p. 901.
- Where there are two or more reasonable interpretations, but they are both ambiguous, the doctrine of *contra proferentem* (i.e. construed against the drafter) should be applied.
- Courts should not impute ambiguity where none exists: *Consolidated-Bathurst*, *supra* at p. 901, citing *Cornish v. Accident Insurance Co*. (1889), 23 Q.B. 453 (C.A.) at p. 456.
- The normal rules of construction lead a court to search for an interpretation that, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time they entered into the contract. Consequently, literal meaning should not be given where to do so would bring about an unrealistic result, or one that would not be contemplated in the commercial context in which the insurance was contracted. Courts should be loath to support a construction that would either enable the insurer to pocket the premium without risk, or the insured to achieve recovery that could neither be sensibly sought nor anticipated at the time the parties entered into the contract.
- Consideration of extrinsic evidence to assist with interpretation may be considered only if there is ambiguity after considering the contract's written text and factual matrix. This includes evidence regarding the parties' subsequent conduct, such as how the insurer investigated the claim: *Eli Lilly & Co*., *supra* at para. 55; *Shewchuk v. Blackmont Capital Inc*., 2016 ONCA 912 at para 56. Otherwise, such evidence is not relevant.

- The only extrinsic evidence that is generally permitted is that of the surrounding circumstances in which the contract was executed. This is basically limited to the general commercial atmosphere and reasonable commercial expectations, which are objective: *Surespan Structures Ltd. v. Lloyds Underwriters*, 2021 BCCA 65 at para. 94.

The court in *SIR Corp. v. Aviva* concluded that the parties had agreed to an all-risks insurance policy. Since any endorsement or extension would be built on the foundation of that policy, the starting point is the perils insured, as set out in the binder. It was specified in the binder that the perils insured were "All Risks of Direct Physical Loss or Damage (except as excluded)". Therefore, the presence of the peril insured was a condition precedent to triggering the extensions. The extensions do not independently expand the nature of the perils insured. In that regard, the court concluded,

[109]…the court does not accept that Extension 14 (or any of them) is independent from the rest of the Policy. The Policy must be read as a whole to ascertain the intention of the parties…I do not accept SIR Corp's argument that the Policy extends coverage to insure the COVID-19 virus, even if the court accepts that the pandemic may meet the definition of a catastrophe…

…

[111] Reading the entire Policy as a whole and giving effect to the plain meaning of the words used by the parties, I find that there is no coverage under the all-risk policy for the loss sustained by SIR Corp as a result of the government orders issued to manage the coronavirus.

Authors' closing comments

In some respects, *SIR Corp. v. Aviva* is unremarkable: the court reinforced the basic principles that one has to interpret a policy holistically and without contorting the ordinary meaning of the words, and that individual terms, conditions, extensions etc. cannot be read in isolation unless expressly mandated by the wording. Nevertheless, the decision is insightful. It is not only well-reasoned in the context of COVID-19, but offers extensive guidance to lawyers and the insurance industry regarding the interpretation and enforcement of insurance policies, generally. Also, it provides a cogent overview of *how* the principles of contractual interpretation are to be applied, as well as their proper sequence. Furthermore, the relatively narrow scope of the use of extrinsic evidence in the interpretive exercise is discussed with clarity.

With the *SIR Corp. v. Aviva* decision now joining the zeitgeist of Canadian common law, Canada appears to be following in the footsteps of its southern US neighbours by concluding that the economic consequences of the pandemic, absent unique language, are not insured.

SIR Corp. v. Aviva is currently under appeal. We will keep you posted...

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