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BCCA STEMS TIDE IN ATTACK ON SUBROGATION RIGHTS

Richards Buell Sutton's Insurance Law Newsletter

In the recent case of *Lafarge Canada Inc. v. JJM Construction Ltd.*, 2011 BCCA 453, the British Columbia Court of Appeal limited the application of what is sometimes referred to as the doctrine of "tort immunity". In *Lafarge* the Court of Appeal determined that a party that covenants to insure property cannot always shelter itself behind the existence of that insurance to deny responsibility for damage caused by its own acts.

Factual Background

Lafarge Canada Inc. ("Lafarge") chartered four large barges from JJM Construction Ltd. ("JJM"), entering into charter party agreements with JJM for each of the barges. Under the terms of the charter party Lafarge was to keep and maintain the barges in good and substantial condition, be responsible and liable to reimburse JJM for the cost of all necessary repairs resulting from damage to the barges and procure and maintain, at its own expense, insurance on the barges.

When Lafarge returned the barges to JJM they had been extensively damaged. JJM repaired three of the four barges at a cost of approximately $650,000 but did not have sufficient funds to repair the fourth barge. JJM made a claim on the insurance policy Lafarge had obtained on the barges but the insurer, after taking deductibles into account, agreed to pay only $54,000 toward the damage. While Lafarge accepted this assessment JJM did not and it sought damages from Lafarge for the repair costs that were not covered by the insurance policy.

At arbitration Lafarge motioned to have JJM's claim dismissed on the basis that the terms of the charter party barred the claim. In its motion Lafarge relied on the Supreme Court of Canada's decisions in *Agnew-Surpass Shoe Stores Limited v. Cummer-Yonge Investments Ltd.*, [1976] 2 S.C.R. 221, *Ross Southward Tire v. Pyrotech Products*, [1976] 2 S.C.R. 35 and *T. Eaton Company v. Smith*, [1978] 2 S.C.R. 749 (collectively the "Trilogy"). The Trilogy cemented the doctrine of tort immunity in Canadian jurisprudence in the context of claims by landlords against tenants for property damage caused by the tenant in circumstances where the landlord had previously covenanted to insure the subject property. Lafarge, in our view, in an attempt to expand the doctrine, argued that its covenant to pay, and subsequent payment of premiums to insure the barges, transferred to the insurance policy and JJM the risk of loss or damage. The arbitrator dismissed the

700 - 401 W GEORGIA ST.
VANCOUVER, BC V6B 5A1
CANADA
TELEPHONE 604 682 3664
FAX 604 688 3830
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motion and that dismissal was upheld by the British Columbia Supreme Court.

The Ruling

In *Lafarge* the Court of Appeal affirmed that the doctrine of tort immunity as established by the Trilogy applies where:

1. a landlord covenants with a tenant to obtain insurance against damage to property; or
2. a tenant contributes to the insurance taken out by a landlord for damage to property.

The rationale behind the doctrine is that if a landlord (or the landlord's insurer) was permitted to recover damages from a tenant where the landlord has covenanted to obtain insurance then the covenant, which is a contractual benefit accorded to the tenant, would have no benefit. The effect of the covenant therefore is that the landlord is assuming the risk of loss or damage caused by the peril insured against. Similarly the rationale for shielding a tenant from liability where that tenant has contributed to insurance taken out by a landlord is that those contributions would be rendered worthless should the landlord (or the landlord's insurer) be able to recover from the tenant. A tenant who has paid for an expected contractual advantage as between itself and its landlord should benefit from those payments.

Lafarge argued that it was entitled to the benefit of tort immunity on the grounds that *Ross Southward* stood for the proposition that if a party pays for insurance it is entitled to tort immunity for its own acts, regardless of which party is responsible for obtaining the insurance. Lafarge also argued that the doctrine of tort immunity established in the Trilogy was expanded by *Commonwealth Construction Co. Ltd. v. Imperial Oil Ltd.*, [1978] 1 S.C.R. 317 to encompass agreements that contain a covenant to insure in the joint names of parties, regardless of which party is responsible for obtaining that insurance.

The Court of Appeal rejected both of these arguments. The Court of Appeal concluded that the Trilogy had no application to the facts of the case because the covenant to obtain insurance was for the benefit of JJM and not Lafarge. The very rationale that underpins the application of tort immunity, that the covenant is for the benefit of the party seeking immunity, was absent in this case. As the Court of Appeal states "[b]y covenanting to obtain and pay for insurance, Lafarge did not thereby shift the risk of damages to the barges to JJM." Furthermore, permitting JJM to recover from Lafarge did not deprive Lafarge of the benefit of its insurance, as any payments made by the insurer would reduce the amount Lafarge would need to pay JJM.

The Court of Appeal also rejected Lafarge's argument that the principle in *Commonwealth Construction* expanded the doctrine of tort immunity. The Court of Appeal summarized the decision from *Commonwealth Construction* as being based wholly upon the principles of subrogation and not being determined by the

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TELEPHONE
604 682 3664
FAX
604 688 3830
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doctrine of tort immunity. *Commonwealth Construction* was decided upon the Supreme Court's interpretation of the terms of an insurance policy, specifically the conclusion that a general contractor qualified as an insured under the subject property policy and thus could not be sued by a subrogating insurer. Also forming part of the decision was the insurable interest of Commonwealth Construction in the construction site and the property therein that was damaged. In *Lafarge*, the Court of Appeal rejected the argument that *Commonwealth Construction* supported the general proposition that a covenant to insure jointly clothes the covenantor with immunity for its own tortious acts.

Practical Considerations for Insurers, Lessors and Lessees

Lafarge restricts the application of the doctrine of tort immunity and therefore is applicable in any potential claim of subrogation against a lessee who has caused damage to insured property. Insurers and their counsel must read covenants to insure carefully and consider which party the covenant was intended to benefit. If the covenant is for the benefit of the lessee subrogation will likely not be available however if the covenant is for the benefit the lessor the doctrine of tort immunity will have no application. *Lafarge* is significant as it clarifies the application of the doctrine of tort immunity by specifically focusing on the rationale that underpins the doctrine. Should the rationale be absent then a party who seeks the protection of the doctrine will be unable to do so.

Lessors and lessees must also be careful in crafting covenants meant to immunize tort liability for the subject property. It may be useful to include provisions in the covenant regarding the party benefiting from the covenant notwithstanding who is paying for or obtaining the insurance. Additionally, lessors and lessees must be careful in placing the insurance subject of the covenants. Possible savings on premium by attaching provisions to an existing policy may be more than off-set by the assumption of very substantial liability risks.

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VANCOUVER, BC V6B 5A1
CANADA
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604 682 3664
FAX
604 688 3830
RBS.CA