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COVENANTS TO INSURE: A BENEFICIARY'S FIREPROOF PROTECTION FROM LIABILITY

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In the early hours of February 13, 2008, a Vancouver restaurant exploded causing damage through the building's entire ground floor and parking garage and even shattering windows across the street. It was apparent that the fire leading to the explosion was deliberately set and as it turned out, it was done so at the request of the tenant restaurant's operator.

The restaurant operator had conspired with her friend to set fire to the restaurant in order to rid herself of the responsibility of managing it. The insurer of the landlord's property paid \$3 million to repair damages caused by the arson and looked to the operator and the company through which she owned the restaurant to recover the amount that it paid.

Austeville Properties Ltd. v. Josan, 2019 BCCA 416 demonstrates the limits under which a company can be found liable for a director's actions and the powerful liability protection created by a contractual covenant to insure.

THE FACTS

Mr. and Ms. Nandha were a married couple who owned Nandha Enterprises Ltd. ("the **Tenant**") which in turn owned two restaurant franchises, one in Delta and one in Vancouver. The Nandhas were the only owners and directors of the Tenant, and each had equal shareholdings in that company, although Ms. Nandha was primarily responsible for the day-to-day operations of the two restaurants.

The Tenant entered into a lease agreement with Austeville Properties Ltd. (the "**Landlord**") to lease premises for the Vancouver restaurant. Mr. Nandha and Ms. Nandha signed the lease as authorized signatories of the Tenant and personally as indemnifiers.

The lease contained a landlord's covenant to insure and a tenant's obligation to reimburse. The lease also permitted either party to terminate the lease in the event that damage by fire could not be repaired within 120 days.

As required by the covenant to insure, the Landlord insured the premises.





Over time, the Tenant's financial position declined and Ms. Nandha wanted to rid herself of the responsibility of managing the Vancouver restaurant in order to spend more time with her children. After unsuccessfully trying to sell the restaurant, she took the extreme step of engaging Mr. Josan, a family friend, to set it on fire.

The fire that Mr. Josan set to the Vancouver restaurant caused extensive damage to the building. Mr. Josan was criminally charged. Ms. Nandha was found deceased two days later, having taken her own life.

Crucially, there was no evidence that Mr. Nandha knew about or was in any way involved with the scheme.

THE RULING

The insurer for the Landlord brought a subrogated claim against Mr. Josan, the estate of Ms. Nandha, Mr. Nandha and the Tenant, seeking recovery of \$3 million paid for loss and damage resulting from the arson.

The Landlord argued that the Tenant was liable for Ms. Nandha's criminal act based on the corporate identification doctrine. If the arson was attributable to the Tenant, the Landlord contended that it was a breach of the Tenant's obligation to reimburse the Landlord for property damage and that the covenant to insure did not relieve the Tenant of this obligation.

The corporate identification doctrine operates to attribute to a corporation the actions of its directing mind where: the action taken by the directing mind of a corporation was within the field of operation assigned to him or her; and was by design or result partly for the benefit of the corporation. In applying these criteria, the court accepted that Ms. Nandha could be considered one of the directing minds of the Tenant but held that her actions could not be considered to be within the scope of her authority.

The trial judge concluded that Ms. Nandha's primary motive for acting as she did was personal: she wanted to rid herself of the responsibility of managing the restaurant. He also found that the evidence did not establish Ms. Nandha's actions were designed to benefit the company, nor did they result in any proven benefit to it. Accordingly, the corporate identification doctrine did not apply to attribute Ms. Nandha's actions to the Tenant and she was therefore not a beneficiary of the covenant to insure. The Court of Appeal agreed.

Given his conclusion that the corporate identification doctrine did not apply, the trial judge did not need to decide whether, in any event, the covenant to insure in the lease barred a subrogated claim against the Tenant. Nevertheless, he expressed the view that even if the corporate identification doctrine did apply, the covenant to insure would protect the Tenant from a subrogated claim regardless of whether the fire was caused by negligence or an intentional tort.





The Court of Appeal agreed that as a beneficiary of the covenant to insure, the Tenant was protected from liability for the fire damage caused by a criminal act by a non-beneficiary.

In the result, the trial judge dismissed the Landlord's claims against the Tenant and Mr. Nandha and held Mr. Josan and the estate of Ms. Nandha jointly and severally liable for damages of \$3 million resulting from the fire based on the tort of conspiracy. The Court of Appeal upheld the trial judge's decision and dismissed the Landlord's appeal.

PRACTICAL CONSIDERATIONS FOR INSURERS

Covenants to insure have powerful implications. A covenant to insure precludes the party obligating itself to obtain insurance from successfully suing the other party to the contract for losses arising from risks covered by such insurance. It further operates to override an indemnity provision in a contract.

Because the Court of Appeal affirmed that Ms. Nandha was not acting in the scope of her corporate authority and was therefore not a beneficiary of the covenant to insure, the court did not consider whether a covenant to insure could extend to a loss intentionally caused by a beneficiary of it. While the courts have held that covenants to insure will relieve the beneficiary of the covenant from liability caused by negligence, whether a covenant to insure could extend to a loss intentionally caused by the beneficiary of the covenant is an unresolved question in the law.

As this case demonstrates, in assessing risks, underwriters are well advised to consider the very strong, special immunity created by covenants to insure.

