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## DOES YOUR EXCLUSION CLAUSE LEAK?

### Court of Appeal Interprets Water Ingress Exclusion

#### Richards Buell Sutton's Insurance Law Newsletter

By RBS Lawyers

The Manitoba Court of Appeal recently reversed a lower court decision that extended coverage to damage caused by mould despite the existence of a water ingress exclusion. In *Minox Equities Ltd. v. Sovereign General Canada Co*, 2010 MBCA 63, the Court of Appeal confirmed the test for determining whether an exclusion clause extends to concurrent and consequential loss. In determining that the exclusion clause did apply, the court ruled on the meaning of the exclusionary phrase "caused directly or indirectly" used in many insurance policies.

#### Factual Background

The insured owned a multi-unit condominium complex for which the insurer issued a broad form, all-risk policy of insurance in 1993. The complex was built for the insured in 1977 and within 2 years of construction there were reports of water leakage. From 1979 to 2002 the complex had continued problems with water leaks, moisture, mould and high humidity. The insured initially treated these issues as maintenance items and unsuccessfully tried to repair the problems. In 2002, an investigation determined that there was toxigenic and non-toxigenic mould requiring significant remediation and prevention work. The insured filed two proof of losses for cost of remediating the mould damage.

The insurer denied the coverage on a number of different bases including the build up of humidity leading to mould was not a covered risk and the application of exclusions for latent defect, improper design and damage from water ingress.

The insured brought a successful action against the insurer for the costs of mould remediation and prevention. The trial judge concluded, amongst other things, that the exclusion for water ingress did not apply as the occurrence of mould was a "fortuitous" event and not an "inevitable". In determining that the exclusion clause did not apply, the trial judge relied on evidence that other factors such as spores and the appropriate acidity of the water were needed to produce mould. The court was unable to conclude that excessive moisture was either a direct or indirect cause of mould. The trial judge interpreted the exclusion





clause in a way that required the insurer to prove damage must inevitably be caused by seepage, rain or humidity and required the insurer to not only prove that these perils caused the damage but also that these perils would always cause that loss or damage.

The question addressed on appeal was whether a clause excluding “loss or damage caused directly or indirectly” by water ingress could be relied upon to exclude damage caused by mould.

### **The Ruling**

The Court of Appeal overturned the trial judge’s decision and found that the exclusion clause did apply. To determine the matter, the court reviewed the causal language of the exclusion clause. The subject exclusion clause read:

#### **5.B. PERILS EXCLUDED**

This form does not insure against loss or damage *caused directly or indirectly:*

(c) (i) by seepage, leakage or influx of water derived from natural sources...

(ii) by the entrance of rain, sleet or snow...

(e) by dampness or dryness of atmosphere, changes of temperature freezing, heating, shrinkage, evaporation, loss of weight, leakage of contents ...

In its analysis, the court compared the interpretation of exclusion clauses in two Supreme Court of Canada cases with respect to consequential and concurrent losses. The same causal language was present in one case and absent in the other. The review of these cases led the court to conclude that the use of the phrase “directly or indirectly” is generally interpreted to capture both the “direct and consequential losses of an event.” Furthermore, such causal language would also capture loss caused by “concurrent causes”.

The court determined that the trial judge erred in his interpretation of the exclusion clause when he said it applied only when that damage was “inevitably” and “always” caused by the seepage rain or humidity. Despite the other prerequisite factors for mould, the evidence presented showed that the seepage, rain and humidity undeniably contributed to the growth of mould. As such, the contribution was enough to be captured by the exclusion clause.

The court determined that equating “directly or indirectly caused” with “inevitability caused” was not consistent with the intent or reasonable expectations of the parties. The court also found that such an interpretation could lead to the absurd result of an insurer having to prove that seepage of water through a





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window would always cause damage before the exclusion could be deemed operative.

#### **Practical Considerations for Insurers**

In this case, the insurer tendered expert reports providing evidence that the various water leakage issues contributed to the instances of mould. This evidence of contribution was enough to bring the loss within the ambit of the exclusion and was key to the Court of Appeal's decision that the exclusion clause applied.

When considering exclusion clauses, underwriters and claims examiners are advised to note that such clauses containing causal language and the words "directly and indirectly" will operate to exclude consequential and concurrent losses. This language will alleviate the need to prove the "inevitability" of the loss from the instigating events; contribution to the loss by the instigating event is enough to trigger the exclusion clause. When there is a dispute on the applicability of such clauses after loss has occurred, insurers are well advised to tender expert evidence that the instigating event was at least a contributory cause of the loss.



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