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NEVER FORGET THE BASICS

Richards Buell Sutton Insurance Law Newsletter

By RBS Lawyers

The Supreme Court of British Columbia recently reinforced the fundamental principal that for an insurer to face an indemnity obligation under a policy there must first be an obligation on the insured to pay by reason of liability imposed by law. In *Versacold Corp. v. Zurich Insurance Co., 2010 BCSC 23* the Court was asked to determine the propriety of an insurer's denial of the insured refrigerated storage company's claim for reimbursement of monies it paid to one of its customers. The payment was made by the insured following damage to the customer's meat products kept at the insured's cold storage facility. The insured claimed reimbursement under both the property and the warehouseman's liability sections of the policy but the Court's clarification of the test to be applied in determining coverage under the latter part of the policy is the focus of this article.

Factual Background

The insured operated a refrigerated warehouse which was insured under a subscription policy shared amongst a number of insurers (the "Policy"). Anhydrous ammonia escaped from a pressure regulation valve in the refrigeration system and contaminated meat belonging to a customer. The customer made a claim to the insured for the cost of the meat, the insured notified the insurers of the claim and filed proofs of loss and thereafter paid the entire amount claimed by its customer. Three of the subscribing insurers paid the insured their proportionate shares of the amounts claimed under the Policy but one of the subscribers declined to pay the claim. An action was commenced by the insured for the amount claimed from the declining insurer.

The Ruling

During the course of the five day trial the Court heard extensive evidence as to the cause of the ammonia leak. The Court determined that the leak was caused by a valve that had simply succumbed to age related wear and tear. This was an important finding for a number of reasons including the fact that the property portion of the Policy was ambiguous as to whether loss resulting from wear and tear was an included peril. To resolve this ambiguity the Court turned to a series of correspondence between the insured's broker and





the insurer in order to assess the factual matrix in which the contract came about. Following an extensive analysis of the pre-contractual correspondence the Court concluded that the insurer never intended for there to be coverage for damage to customers' products resulting from wear and tear of the insured's facility. The Court then turned its attention to the warehouseman's liability portion of the Policy.

That part of the Policy contained the ubiquitous language associated with most insuring agreements, namely, the insurer's agreement to pay to or on behalf of the insured "*all sums which the Insured shall become obligated to pay by reason of liability imposed by law upon the Insured*". It is also notable that this part of the Policy contained an exclusion rendering coverage inapplicable for loss or damage assumed by the insured under a contract in excess of liability imposed upon it by law as a warehouseman or bailee.

In furtherance of its argument on the insured's obligation to pay the insurer provided the Court with numerous authorities respecting the standard of care imposed by both tort and bailment law. After assessing the authorities as well as the differing onus of proof under each area of law the Court concluded it was unnecessary to consider whether the warehousing contract between the insured and its customer imposed liability in excess of obligations under the law because the insured had failed to demonstrate that it was obligated to pay its customer by reason of liability imposed by law. The evidence before the court proved that the insured had taken due care to protect its customer's property and that this evidence "*negatives a conclusion that the insured was obligated to pay its customer by reason of liability imposed by either the law of negligence or bailment.*"

Practical Considerations for Insurers

When making coverage decisions respecting liability policies in circumstances where an insured has taken it upon itself to pay a third party, it is imperative that claim handlers thoroughly consider whether the insured was actually obligated to make such a payment by operation of law. It is also imperative that claims handlers note the presence of any policy provisions which exclude coverage for excess contractual liability. Numerous reasons may exist for insureds to make payment to a customer including good will, excess contractual obligation or other business reasons that are simply not subject to insurance coverage. Claim handlers need to be wary of the possibility that payment was made for such reasons as opposed to a liability imposed by law.

It is also important to make the insured aware of this potential coverage problem from first notice so that insureds can make business decisions with full awareness of the insurer's position on coverage for third party losses. It is notable that in *Versacold* the insurer was very clear at the outset in its denial of coverage and that the insured had paid its customer prior to that denial. Had the insurer been in a position to advise





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the insured of a potential coverage concern prior to the payment such payment may not have been made and the coverage dispute avoided.

Finally, underwriters are well advised to make detailed notes of conversations with insureds and their agents and maintain such notes and other correspondence in their underwriting files. Versacold contains a good example of quality communications between the underwriter and agent and we recommend the text of this decision be reviewed by underwriters in furtherance of their practice. Had such detailed notes not been available the subject ambiguity would likely have been determined in favour of the insured with coverage being the result.



VANCOUVER OFFICE:
700 - 401 W GEORGIA STREET
VANCOUVER, BC CANADA V6B 5A1
TEL: 604.682.3664 FAX: 604.688.3830

SURREY OFFICE:
200 - 10233 153 STREET
SURREY, BC CANADA V3R 0Z7
TEL: 604.582.7743 FAX: 604.582.7753

RBS.CA