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## **REPLACEMENT OF DESTROYED BUILDINGS**

### **Richards Buell Sutton Insurance Newsletter**

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#### **INTRODUCTION**

In the wake of the destruction caused by the Fort McMurray wildfire many insureds will look to utilize the replacement cost endorsement in their insurance policies to assist in their rebuilding efforts. Insurers are undoubtedly familiar with the replacement cost endorsement however some may be unaware of the jurisprudence related to its operation. This article will address two issues of particular concern to insurers when dealing with claims under the endorsement: 1) what constitutes “replacement”; and 2) how long does an insured have to replace insured property?

#### **WHAT CONSTITUTES “REPLACEMENT”?**

Most if not all replacement cost endorsements stipulate that the replacement building be of “like kind and quality”. The courts have interpreted these words to require the following:

- (a) the same amount of usable area;
- (b) substantially the same utility;
- (c) equivalence of heating, lighting, plumbing, electrical and other facilities; and
- (d) that the previous style, construction and finish be comparable.

As a result, an insured cannot utilize insurance proceeds from the endorsement to complete construction of a partially finished building or construct a new building on the same site if the new building constitutes a largely different structure. Examples from two cases, one old and one more recent, illustrate this principle.

In the 1987 case of *Andriash v. Canadian Northern Shield Insurance Co.* the insureds had taken out permits to build a log house and to renovate a barn on their property. The barn was to be used a dwelling during construction of the log house. A fire destroyed the barn before the log house was completed. The insureds sought to apply the costs of barn replacement under an endorsement in their fire insurance policy toward finishing construction of the log house. The Court found that such a replacement was not contemplated by the replacement cost endorsement. The policy required replacement or rebuilding of like kind and quality to



the building which was the subject matter of the loss and the log house was an entirely different structure than the barn.

In the 2015 case of *Carter v. Intact Insurance Co.* a fire caused significant damage to the insureds' income generating property. At the time of the fire, the property totalled 51,930 square feet comprised of 3 separate structures which were one, two and three storeys respectively. The buildings housed 28 units and had neither underground parking nor elevators. Following the fire, the insureds proposed building an eight storey building that would be more than 193,000 square feet comprised of 129 residential units a two-level underground parking garage and two elevators. The insureds sought a declaration that they were entitled to the full replacement cost endorsement (up to the policy limits) contained in the policy. The court denied this extent of coverage finding that the construction of a significant condo development of the size, utility and design proposed was not sufficiently similar to the characteristics of the insured property destroyed by the fire.

In certain cases, the purchase of an existing building on a different site may constitute replacement. Courts in both BC and Alberta have permitted this, but only where the endorsement in question did not require replacement on the same site or specifically allowed replacement on another site. *Chemainus Properties Ltd. v. Continental Insurance* is an example of the former, where the Court found that the insured's purchase of an existing building of equivalent use on a different site constituted replacement. In that case, "replacement" was not defined in the policy and language limiting replacement to the same site had been expressly deleted from the policy wording. An example of the latter situation is found in *319107 Alberta Ltd. v. New Hampshire Insurance Co.* where the Court held that the insured's purchase of a similar hotel in a different town constituted replacement.

When assessing whether new construction constitutes a "replacement" of old, insurers are well advised to remember that courts will likely require a "significant" difference between the two structures before allowing an ACV payout given, amongst other things, the time of construction, evolving building codes and the fact the endorsement insures depreciation.

#### **HOW LONG DOES AN INSURED HAVE TO REPLACE INSURED PROPERTY?**

The replacement cost endorsement will invariably require the insured to replace the property with "due diligence and dispatch" or "within a reasonable time". Obviously, the obligation to replace in a timely manner is suspended or postponed in cases where the insurer denies a claim, on the grounds of arson for example. In such cases the obligation is postponed until the insurer's liability is determined, either by admission or by a court.



The question of whether the insured was diligent in pursuing replacement most often arises when there is no denial of coverage. The courts have determined the answer is purely a question of fact and will depend on the circumstances of the case.

In 319107 Alberta Ltd. v. New Hampshire Insurance Co. the Court articulated three principles that insurers ought to be mindful of when considering whether the insured was diligent in pursuing replacement:

- (a) the insured should have a fair opportunity of deciding what to do in the light of the funds which will be available;
- (b) the insurers refusal to agree to pay the full sum when confronted with a specific proposal to purchase a replacement building may impair the ability of the insured to effect replacement; and
- (c) the insured need not go ahead with a purchase when faced with a disputed interpretation of coverage.

The Court also found an implied term in this type of policy: The insurer must engage in meaningful dialogue with the insured on the question of replacement. The Court noted the effect of this implied term was that an insurer cannot rely on a lack of diligence by an insured if it has “failed to cooperate with the insured in a substantive way to determine whether a proposed replacement might or would qualify under the contract”.

The insured was unable to build on the same site as a result of bylaw restrictions. It sought confirmation from the insurer that the purchase of an existing, similar hotel on a different site would satisfy the replacement provisions in the policy. The insurer contributed to the lengthy delay by refusing to state whether the proposed purchase would constitute replacement. The Court found that the insurer’s failure to cooperate precluded any allegation of a lack of due diligence on the part of the insured.

Insurers should also be mindful that the Insurance Act in most provinces, including Ontario, BC and Alberta, provides the court with an added discretion to grant relief to insureds that are found to have breached the duty to replace within a reasonable time. The legislation enables the court to grant relief from forfeiture where an insured has acted bona fide without deliberate misrepresentation and the delay did not prejudice the insurer.

## CONCLUSION

Efforts to rebuild damaged and destroyed property in Fort McMurray are already underway. The reconstruction will take years, during which time insurers will be faced with a diversity of claims under the replacement cost endorsement contained in their policies. Though addressing all of the issues that insurers will face in the course of such claims is impossible the principles addressed above will assist insurers as they





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