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## THE THREE E'S - EXTENSIONS, EXCLUSIONS AND EXCEPTIONS

### Richards Buell Sutton Insurance Newsletter

By: RBS Lawyers

The Supreme Court of British Columbia recently dismissed an insured's claim for pollutant cleanup under an all-risk property insurance policy (the "Property Policy"). This decision highlights important principles regarding the construction of insurance contracts that can be applied equally to property and liability policies.

#### The Facts

The insured in *Whitworth Holdings Ltd. v. AXA Pacific Insurance Company*, 2014 BCSC 1696 commenced an action (the "Action") for all losses duly covered under a commercial insurance policy (the "Policy"). The Policy included both the Property Policy as well as CGL coverage. A fire then damaged several buildings covered under the Policy, one of which contained a tenant ("Univar") that stored chemicals. Those chemicals, as a result of the fire, escaped causing pollution damage.

The Property Policy contained a pollution exclusion clause that excluded claims for the cleanup of pollutants (the "Pollution Exclusion Clause"). The Pollution Exclusion Clause had an exception for physical loss or damage to insured property caused "directly by an insured peril" (the "Exception"). There was also an extension of coverage up to \$25,000 in respect of on-premises pollutant clean-up that applied if the release of pollutants arose out of damage to insured property (the "Pollution Extension Clause").

After the fire the insured was paid \$5.2 million under the Policy which included \$25,000 for pollutant clean-up. The insured refused, however, to discontinue the Action because it was concerned about the scope of pollution coverage afforded to it under the Policy. In an action it had commenced against Univar for damages caused by the release of chemicals, Univar claimed as a defence that the insured failed to claim under the Policy. As a result the insured demanded that the scope of pollution coverage under the Policy be determined by the court.

#### The Parties Positions

The insured's position was that on-premises pollution damage was excluded by the Pollution Exclusion Clause, but reinstated by the Exception and that, in these circumstances, the Pollution Extension Clause did





not operate to limit coverage to \$25,000.

The insured argued that because the pollutants would never have escaped but for the fire the Exception to the Pollution Exclusion Clause was triggered. The insured also argued that the Pollution Extension Clause was not applicable to its claim because it was either ambiguous or a “limit masquerading as an extension of coverage”.

The insurer argued that the Exception did not create coverage but rather brought an otherwise excluded claim back within coverage where the claim fell within the initial grant of coverage. The Exception operated to ensure that there was still coverage for fire damage, but it did not create coverage where there was no direct damage caused by fire.

The insurer also took issue with the “proximate cause” analysis advanced by the insured citing several decisions of the BC Court of Appeal and the Supreme Court of Canada which expressed doubt about the utility of such an analysis.

Finally, the insurer took the position that the Pollution Extension Clause provided limited coverage for on-premises pollutant clean-up where there was no direct physical loss caused by an insured peril. The insurer argued that this interpretation was unambiguous and that the insured’s interpretation of the Pollution Exclusion Clause would render it meaningless. The insurer also argued that the cases cited by the insured for the proposition that the Pollution Extension Clause was a limit masquerading as an extension of coverage were distinguishable.

### **The Ruling**

As per *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, 2010 SCC 33 the court stated that exclusions do not create coverage but rather bring an otherwise excluded claim back within coverage where the claim fell within the initial grant of coverage. The court also followed the *Progressive Homes* method of analysis by interpreting the Property Policy in the order of coverage, then exclusions, and then exceptions. Utilizing this analysis the court concluded that the principal issue was whether the insured’s claim for on-premises pollution damage was reinstated by the Exception.

The court concluded that, being an all-risk policy, the pollution damage fell within the initial grant of coverage. It preferred, however, the insurer’s interpretation of the Exception finding that its interpretation did not render it redundant. The court pointed out that if the facts were reversed (i.e. if the escape of pollutants had caused the fire) then the fire damage would be excluded but then reinstated by the Exception.





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The court also stated that any interpretation of the Exception had to take into account the word “direct” in the phrase “caused directly by an insured peril”. The court cited *Canevada Country Communities Inc. v. GAN Canada Insurance Co.*, 1999 BCCA 339 for the proposition that the word “direct” captured “the sense in which an event leads straight or immediately to its consequence”. In this case the court concluded that characterizing the fire damage but not the pollution as “direct” would not result in a specious distinction because the fire and the pollution damage were “two distinct, albeit causally related, events”.

As a result, the court concluded that the Exception operated to ensure that there was still coverage for fire damage, but it did not create coverage for the clean-up of pollutants. Rather it was the Pollution Extension Clause that operated to provide on-premises pollution clean-up costs for fire damaged property up to the \$25,000 limit.

#### **Practical Considerations for Insurers, Claims Examiners, and Brokers**

*Whitworth* reminds us how principles of interpretation of insurance contracts can be applied in a fair and logical manner in order to give effect to the intentions of the parties. It also serves as a reminder that exclusions do not create coverage but rather bring an otherwise excluded claim back within coverage and provides some authority for the distinctions between the direct and indirect causes of a loss.

It is recommended that insurance industry personnel peruse *Whitworth* specifically considering its analytical framework and that they apply this framework when determining the issue of coverage in the context of complex, multi-faceted policy wordings.



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