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THE NEW IBC COMMERICAL GENERAL LIABILITY POLICY: BIG CHANGES FOR THE NEW MILLENNIUM

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INTRODUCTION: THE NEW IBC CGL FORM

The insurance industry is ever-changing, and 2005 was no exception in that it heralded the arrival of the 2005 IBC Commercial General Liability Form (the "New IBC CGL Form"). The New IBC CGL Form reflects an industry response to judicial developments in respect of the existing policy wordings. Simply put, the new policy wordings are Canadian liability insurers' response to changes in caselaw, and secondly, an attempt to bring more commercial certainty in the face of a constantly changing legal landscape.

To begin, two organizations were instrumental in the formulation of the New IBC CGL Form; the Insurance Services Office in the United States ("ISO") and its Canadian equivalent, the Insurance Bureau of Canada ("IBC"). Both of these industry bodies disseminate CGL wordings for use in the insurance industry.[1] IBC revised its commercial general liability policy four times before 1986, however, in the last 20 years the wordings had remained largely unchanged and the consensus in the insurance industry was that a major overhaul was needed to bring the wordings in line with the industry realities and developing jurisprudence over the last two decades.

To appreciate why the New IBC CGL Form and wordings appear as they do, a basic understanding of how the ISO modified the 2001 CGL policy in the United States is of assistance. The ISO 2001 CGL, which U.S. liability insurers adopted in 2002, was also an attempt to clarify wordings in light of developing legal caselaw. The American ISO 2001 CGL Form contained revisions to five primary areas:

- internet liability;
- continuous bodily injury;
- claims for negligent hiring or supervision of others arising out of the ownership, maintenance, or use of an auto;
- intellectual property liability; and
- volunteer workers.

The ISO is the entity responsible for submitting policy forms such as the CGL to government regulators on behalf of member companies. While individual insurers may submit a modified form of CGL for approval, the ISO 2001 CGL is used as a 'benchmark' by state regulators to ensure each form complies with basic coverage requirements. ISO's website states that the 2001 CGL "*simplifies claim settlements and*

[1] The ISO performs an industry function in the United States, and the IBC does the same in Canada.

reduce(s) costly litigation, because the meaning of coverage terminology becomes established and known."[2]

A working knowledge of IBC's committee work in Canada assists in understanding why the New IBC CGL Form was created. The IBC was founded in 1964. In 2002, the IBC gathered a committee of senior insurance personnel to study the 1986 IBC CGL Form (the "Former IBC CGL Form") and make recommendations particularly in light of developing "Judge made" coverage law. Not surprisingly, the perception in the industry was that developing caselaw was broadening coverage in ways not foreseen by the industry. The recommendations by the committee resulted in the New IBC CGL Form, which at this moment is being incrementally adopted by Canadian liability insurers across the country.

Are the recommended changes to the New IBC CGL Form a by-product of the current ISO CGL Form? In many instances the IBC has adopted language virtually identical to that contained in the American version. This is not surprising in light of the fact that the United States caselaw that resulted in the changes to the ISO CGL form was also under consideration by the IBC committee when drafting the New IBC CGL Form.

Clearly the scope of a paper that purports to review each and every difference between the Former IBC CGL Form, from 1986 and the New IBC CGL Form, released in 2005, would be far too broad. Instead, this paper highlights some of the areas where wording changes will significantly affect the scope of coverage and the Canadian liability insurer's indemnity obligations. We also offer our firm's predictions as to how the Courts may interpret the new policy wordings. Clearly, until our Courts begin handing down decisions based upon the wordings in the New IBC CGL Form, Canadian liability insurers face some uncertainty.

This paper contains 17 different segments covering select topics. Instead of endnotes, each segment of the paper has its own footnotes for the reader's ease of reference. The discussion is segregated as follows:

- New Wordings in The Grant of Coverage
- The "Known Loss" Rule
- "Property Damage" and "Electronic Data"
- A Narrow Definition of "Compensatory Damages"
- The Impact of the Derksen Decision: Concurrent Causes of Loss Language
- The Contract Assumed Exclusions
- The Employer's Liability Exclusion
- The Professional Services Exclusion

[2] http://www.iso.com/

- The Abuse Exclusion
- The Pollution Exclusion
- The Asbestos and Mould Exclusions
- The Terrorism Exclusion
- "Who is an Insured?"
- Limits of Insurance – The "General Aggregate Limit"
- Reporting and Co-operation Clause Requirements
- The "Other" Insurance Clause
- Coverage for "Personal Injury" and "Advertising Injury"

Logically, the initial review centres on the Grant of Coverage under the New IBC CGL Form. In this section we deal with the introduction of the "known loss" rule that has been introduced by IBC. We examine changes to certain definitions including "property damage" and "electronic data". Our review of the definitions also includes new wordings for the definition of "compensatory damages". We review the Supreme Court of Canada's 2001 decision in *Derksen v. 539938 Ontario Ltd.*[3] and the impact of certain language when there are two causes to a loss, one covered and one excluded.

The ensuing discussion focuses on the New IBC CGL Form Exclusions and changes to certain definitions. We examine the broadening of certain exclusions including, the "employer's liability" exclusion, the "own property" exclusion, the "professional services" exclusion, the "pollution" exclusion, and the "contract assumed" exclusion (including the expansion for coverage under the New IBC CGL Form for contractual indemnity claims made against an insured). Our review of the Exclusions in the New IBC CGL Form will canvas what coverage has been eliminated under the "sexual abuse" exclusion, and reviews the new "asbestos" "mould" and "terrorism" exclusions. Certain of these admittedly new exclusions restrict coverage now available to the insured under the New IBC CGL Form.

Finally, the paper will review some of the secondary provisions of the New IBC CGL Form. We will review the definition of "Who is an Insured" under the new wordings and the impact of changes to the Aggregate Limit on the insured and to Canadian liability insurers. The new and more strict requirements for an insured to report and co-operate with its' insurer are discussed. The "Other" insurance clause is the subject of a paper, of importance to both primary and excess Canadian liability insurers. Finally we will discuss changes to coverage for both "Personal Injury" and "Advertising Liability", which are liability exposures that do not involve the more traditional bodily injury or property damage.

The ultimate goal in the presentation of these topics is to provide advice and guidance in regard to the New IBC CGL Form policy wordings, and ultimately to assure

[3] [2001] 3 SCR 398 [hereafter "*Derksen*"].

Canadian liability insurers a little more certainty in the ever-changing landscape of insurance law.

Appendix A of this paper contains the New 2005 IBC CGL Form, as recommended by the IBC. Appendix "B" is a chart of the "Change Highlights" which summarizes the changes between the New IBC CGL Form and its predecessor.

THE GRANT OF COVERAGE

INTRODUCTION

The New IBC CGL Form contains two new and broad limitations to the basic Grant of Coverage in this section. The first is the "known loss" rule, which represents a significant reduction in the Grant of Coverage as compared with the traditional "occurrence" based approach inherent in existing general liability wordings. The second broad limitation is by reason of a more restrictive approach as to what constitutes "compensatory damages".

NEW WORDINGS IN THE INSURING AGREEMENT

In order to best understand these topics, the entire Insuring Agreement from the New IBC CGL Form is reproduced below, along with the relevant Definitions (with critical areas underlined for emphasis);

1. Insuring Agreement

a. *We will pay those sums that the insured become legally obligated to pay as "compensatory damages" because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend against any "action" seeking those "compensatory damages". However, we will have no duty to defend the insured against any "action" seeking "compensatory damages" for "bodily injury" or "property damage" to which this insurance does not apply. We may, at our discretion, investigate any "occurrence" and settle any claim or "action" that may result. But:*

(1) *The amount we will pay for "compensatory damages" is limited as described in Section* ***III*** *– Limits of Insurance; and*

(2) *Our right and duty to defend ends when we have used up the applicable limit of insurance in the payment of judgments or settlements under Coverages* ***A, B*** *or* ***D*** *or medical expenses under Coverage* ***C****.*

No other obligation or liability to pay sums or perform acts or services is covered unless explicitly provided for under Supplementary Payments – Coverages ***A, B*** *and* ***D****.*

b. *This insurance applies to "bodily injury" and "property damage" only if:*

(1) *The "bodily injury" or "property damage" is caused by an "occurrence" that takes place in the "coverage territory"; and*

(2) *The "bodily injury" or "property damage" occurs during the policy period; and*

(3) *Prior to the policy period, no insured listed under Paragraph* ***1****. of Section* ***II*** *– Who Is An Insured and no "employee" authorized by you to give or receive notice of an "occurrence" or claim, knew that the "bodily injury" or "property damage" had occurred, in whole or in part. If such a listed insured or authorized "employee" knew, prior to the policy period that the "bodily injury" or "property damage" occurred, then any continuation, change or resumption of such "bodily injury" or "property damage" during or after the policy period will be deemed to have been known prior to the policy period.*

c. *"Bodily injury" or "property damage" which occurs during the policy period and was not, prior to the policy period, known to have occurred by any insured listed under Paragraph* ***1.*** *of Section* ***II*** *– Who Is An Insured or any "employee" authorized by you to give or receive notice of an "occurrence" or claim, includes any continuation, change or resumption of that "bodily injury" or "property damage" after the end of the policy period.*

d. *"Bodily injury" or "property damage" will be deemed to have been known to have occurred at the earliest time when any insured listed under Paragraph* ***1.*** *of Section* ***II*** *– Who Is An Insured or any "employee" authorized by you to give or receive notice of an "occurrence" or claim:*

(1) *Reports all, or any part, of the "bodily injury" or "property damage" to us or any other insurer;*

(2) *Receives a written or verbal demand or claim for "compensatory damages" because of the "bodily injury" or "property damage"; or*

(3) *Becomes aware by any other means that "bodily injury" or "property damage" has occurred or has begun to occur.*

e. *"Compensatory damages" because of "bodily injury" or "property damage" include "compensatory damages" claimed by any person or organization for care, loss of services or death resulting at any time from "bodily injury".*

SECTION V – DEFINITIONS

…

5. *"Bodily Injury" means bodily injury, sickness or disease sustained by a person, including death resulting from any of these at any time.*

…

20. *"Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions.*

…

25. *"Property damage" means:*

a. *Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or*

b. *Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the "occurrence" that caused it.*

For the purposes of this insurance, electronic data is not tangible property.

As used in this definition, electronic data means information, facts or programs stored as or on, created or used on, or transmitted to or from computer software, including systems and applications software, hard or floppy disks, CD-ROMS, tapes, drives, cells, data processing devices or any other media which are used with electronically controlled equipment.

THE "KNOWN LOSS" RULE

The most significant change to the New IBC CGL Form in the Insuring Agreement are amendments that effectively transform the general liability policy from "occurrence based" coverage to a "hybrid claims made" form of coverage. Older forms of the Insuring Agreement for bodily injury and property damage have required the existence of four factors:

1. bodily injury or property damage;
2. occurring during the policy period;
3. caused by an occurrence; and
4. taking place in the coverage territory.

However, insurers have been plagued in the last few decades by "long tail" bodily injury and property damage claims. These claims typically arise when bodily injury is a long-term latent disease (*e.g.*, asbestosis or lead paint poisoning) or property damage is continuing and progressive in nature (environmental contamination or "leaky buildings"). In the context of claims evidencing progressive property damage or bodily injury, the issue that arises is which policy or policies, if any, are required to respond to claims or litigation that emerge years after the actual work of the insured who is implicated in the loss has been completed.

As discussed below, the amendments to the Insuring Agreement in the New IBC CGL Form for bodily injury and property damage attempt to limit and provide more

certainty about which policies must respond to "long tail" claims. The amendments have arisen largely in response to judicial decisions that have expanded the number of policies that must potentially respond in cases of continuing and progressive losses.

Judicial Trigger Theories

The judicial response to the uncertainty posed by former versions of the bodily injury and property damage insuring agreements in general liability policies has been to adopt various "trigger theories" to explain when an insurer must respond to a claim. These four theories can generally be described as:

(a) **"Exposure" Trigger -** The date of the first exposure to the condition that causes the harm triggers the policy in effect at that time.

(b) "**Manifestation" Trigger -** The date the damage is first discovered, or ought to have been discovered, triggers the policy in effect at that time.

(c) **"Injury in Fact" Trigger** - The date or dates that the damage actually occurred triggers the policy or policies in effect during that period of time.

(d) "**Continuous Trigger**" or "**Triple Trigger**" - The date from the first exposure to the condition that causes the harm to the date that the damage first manifests triggers the policy or policies in effect during that period of time.[4]

These various trigger theories have been thoroughly canvassed elsewhere and it is not within the scope of this paper to address each of them in detail.[5] Yet, both in Canada and the United States, it appears that the current judicial approach to "long tail" claims is to apply the "injury in fact" trigger theory as modified by the "continuous trigger" theory.[6]

The leading case in Canada on the applicable trigger to coverage in a continuous property damage claim is the Ontario Court of Appeal decision in *Alie v. Bertrand &*

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[4] See *e.g.*, G. Hilliker, *Liability Insurance in Canada*, Fourth Edition (Markham: LexisNexis Canada Inc., 2006) at p. 203 [hereafter "Hilliker"] and M. B. Snowden & M. G. Lichty, *Annotated Commercial General Liability Policy* (Aurora: Canada Law Book) Looseleaf: Updated Yearly, at p. 11-22 [hereafter "Snowden & Lichty"].

[5] *Ibid.*, Snowden & Lichty at pp. 11-19 – 11-50.

[6] M. G. Lichty, "The "New" Commercial General Liability Policy – A Selective Consideration of the 2005 IBC CGL Form" at p. 7 [hereafter the "Lichty Paper"].

Frere Construction Co.[7] This decision addressed the coverage issues arising from underlying litigation by homeowners for property damage due to the incorporation of fly ash into the ready-mix cement used in the construction of the foundations of a number of homes built by the general contractor. The concrete proved defective requiring complete replacement of the foundations.

The Ontario Court of Appeal was of the view that the continuous trigger theory applied in cases where property damage was ongoing over a number of years. The Trial Judge had canvassed the exposure, manifestation and injury-in-fact triggers and determined that each, on its own, was inapplicable since the damage was ongoing and each trigger was inconsistent with the policy wordings and the findings of fact made about when the loss occurred and when the damage had progressed to the point that the foundations had to be replaced. The Court of Appeal said this about the method for deciding which policies had to indemnify the insured for damages imposed in the underlying litigation:

> *If the injury in fact is found to have occurred at the date of exposure to the hazard, at the date of manifestation of the damage, or on a continuous and progressive basis, one might refer to the application of the exposure, manifestation or continuous trigger theories as descriptive of the timing of the damage as it actually occurred. However, the most straightforward and accurate nomenclature is injury in fact.*
>
> *If the full extent of the damage has become a certainty at a point in time before it is discovered, the injury in fact has occurred by that point in time. Consequently, the fact that there may be further deterioration after that point does not trigger any policies in place after that point, because the damage is already complete. It will be a matter of evidence at the trial as to when the damage is complete. The point when the full extent of the damage becomes known is the manifestation date. In this case, there was no evidence acceptable to the trial judge that the damage was complete before the experts did conclusive testing in 1992. Therefore that date was accepted as the date when the damage became complete.*
>
> *Because it was not possible on the evidence to determine how much of the damage occurred during any particular policy period, the application of the continuous trigger theory was appropriate in order to allow the trial judge to apportion the damage on a pro rata basis through the affected policy periods.*[8] *[emphasis added]*

Therefore, in the context of a property damage case, it is the injury-in-fact trigger which determines which policies must respond to the loss, and the duration of the damage is a matter for proof at trial. However, practically speaking, it will almost always be difficult, if not impossible, to determine how much damage arose at any given time. The continuous trigger theory allows a Court to assume that the damage occurred at a

[7] 62 O.R. (3d) 345 (C.A.), leave to appeal refused, August 28, 2003) [hereafter "*Alie*"].
[8] *Ibid.*, at paras. 141 – 143.

continuous rate during the implicated damage period with the result that all insurers on risk during that time must respond *pro rata* based on time on risk.

The continuous trigger theory has wide acceptance in the United States in cases of continuous property damage. One of the leading cases is the decision of the Supreme Court of California in *Montrose Chemical Corporation of California v. Admiral Insurance Company*[9] which arose from the insured seeking a defence stemming from environmental contamination. Following an exhaustive review of the case law, an assessment of the intention of the insurance industry in incorporating the concept of "occurrence" into the CGL insuring agreement for property damage and the reasonable expectations of the parties, the Court decided ongoing damage triggered all policies on risk during the time the damage occurred.

However, while the continuous trigger theory is frequently used in cases of continuous property damage, at least one Canadian case has applied the "injury in fact" trigger in the context of a bodily injury claim arising from alleged sexual abuse.

In *Synod of the Diocese of Edmonton v. Lombard General Insurance Co. of Canada*,[10] the claimant in the underlying action sued the insured because of sexual abuse he had suffered from 1978 to 1984 by one of its ministers. The claimant alleged that he only became aware of the full extent of damages from the sexual abuse in 1998. The insured sought a defence from two liability insurers, one on risk from April 1982 – December 1984 and the second on risk after December 1984. The Court decided that the "liability inducing event", being the alleged sexual abuse, was the event that triggered coverage, not the period of time over which the claimant's damages manifested. Since there was no allegation of sexual abuse during the period of time the second liability insurer was on risk, it did not have a duty to defend the insured.

American "Known Loss" Doctrine

Insurers have attempted to avoid liability for continuous bodily injury or property damage claims through the "known loss" doctrine, also called the "loss in progress" rule. The "known loss" doctrine is a common law concept that is based on the principle that insurance is predicated on the concept of fortuity.[11] Accordingly, insurance cannot be obtained for a loss that has already taken place.

The United States Court of Appeals, Fourth Circuit, stated the "known loss" doctrine in *Stonehenge Engineering Corporation v. Employers Insurance of Wasau*[12] as:

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[9] 10 Cal.4th 645, 913 P.2d 878 [hereafter "*Montrose*"].
[10] 2004 ABQB 803
[11] The "known loss" rule is codified in some states, including California.
[12] 210 F.3d 296.

> *As most often stated, the known loss doctrine in common law insurance jurisprudence excludes coverage of loss to the insured of which the insured had actual knowledge prior to the policy's effective date or knew was substantially certain to occur. … The known loss doctrine seeks to prevent the concept of an insurable risk from becoming a mere fiction when the insured knows there is a substantial probability that it has suffered or will suffer a loss covered by the policy. … Because the known loss doctrine is an affirmative defense, the burden of proving the doctrine's applicability rests with the party asserting it.*[13] *[Emphasis added. Citations omitted.]*

The Court of Special Appeals of Maryland has described the "known loss" rule as follows:

> *By its very nature, insurance is fundamentally based on contingent risks which may or may not occur… If the insured knows or has reason to know, when it purchases a CGL policy, that there is a substantial probability that it will suffer or has already suffered a loss, the risk ceases to be contingent and becomes a probable or known loss [which is ordinarily uninsurable].* [14] *[Emphasis added. Citations omitted.]*

There is little case law in Canada on the "known loss" rule but the doctrine has had wide judicial consideration in the United States. While the concept of "known loss" makes inherent sense, the emphasized words in the quote above from the United States Court of Appeals, Fourth Circuit provide insight into the success that U.S. insurers have had in arguing "known loss" as a bar to coverage. Characterized as an "affirmative defence", many U.S. Courts have found ways to limit the application of the "known loss" doctrine by developing stringent requirements for an insurer to prove that the loss was not fortuitous in view of the insured's knowledge prior to the inception of the policy.

In *Montrose*, *supra*, the Court addressed the liability insurer's argument that there was no coverage because the loss was known at the time the insurer's policies incepted. The insured had received a letter from the Environmental Protection Agency (the "EPA") prior to the inception of the insurer's first policy period indicating that the EPA considered the insured a potentially responsible party for environmental contamination from whom the EPA could recover remediation costs under U.S. environmental statutes. The Court decided that the receipt of this letter may have made inevitable an action to recover clean-up costs against the insured; however, *liability* was not a certainty. In order for a liability insurer to prevail under the "known loss" doctrine, the insured had to know both the existence and extent of prospective injuries and that it was liable for those injuries. Since a third party liability policy provides coverage for

[13] *Ibid.*, at para. 301.

[14] *Maryland Casualty Company v. Hanson et al.* 2006 WL 1805993 (Md.App.) at para. 20.

the sums that an insured becomes legally obligated to pay, the loss cannot be "known" until liability is known.[15]

In summarizing its decision on the application of the "known loss" rule, the Court stated:

> *We therefore hold that, in the context of continuous or progressively deteriorating property damage or bodily injury insurable under a third party CGL policy, as long as there remains uncertainty about damage or injury that may occur during the policy period and the imposition of liability upon the insured, and no legal obligation to pay third party claims has been established, there is a potentially insurable risk within the meaning of sections 22 and 250 [of the California Insurance Code] for which coverage may be sought. Stated differently, the loss-in-progress rule will not defeat coverage for a claimed loss where it had yet to be established, at the time the insurer entered into the contract of insurance with the policyholder, that the insured had a legal obligation to pay damages to a third party in connection with a loss.*[16]

"Known Loss" Rule in Bodily Injury Damage Claims

The "known loss" rule has also been applied narrowly in cases involving bodily injury. One example is *Maryland Casualty Company v. Phillip Hanson et al.*,[17] a case involving claims from numerous tenants against a landlord for injuries arising from exposure to lead based paint. The liability insurer argued, among other things, that coverage was barred by the "known loss" rule. This argument was based on the insurer's position that the manifestation trigger theory applied to trigger coverage. Since the injuries had been diagnosed and were known to the insured prior to coverage incepting, the insurer argued that the claims were "known losses" and no coverage was afforded. The Court endorsed the continuous trigger theory of coverage and concluded that continuous exposure to the lead paint led to the development of new injuries over time. Therefore, even if the insured had knowledge that some of the claimants had suffered some kind of injury from the initial exposure to lead paint, the ongoing exposure which continued after the policies at issue incepted meant that the insured did not know of the losses which arose from repeated exposure. Accordingly, the "known loss" defence was rejected.

In another lead paint case, *United States Liability Insurance Co. v Selman,*[18] the First Circuit determined that the "known loss" doctrine did not apply to preclude coverage, in spite of the fact that the landlord had prior warning of the dangers of the use of lead paint prior to the issuance of the policy. The Court determined that the test for "known

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[15] *Supra*, note 9, at para 8.
[16] *Ibid.*
[17] *Supra*, note 13.
[18] 70 F. 3d 684 (1st Circuit 1995) (Mass. 1st. Cir.) .

loss" was subjective, and the burden of proving the "known loss" was on the insurer. Actual knowledge was required on the part of the insured. The policy had been issued when the building was 95% lead-free, and the insured could have assumed there was no chance of further harm.

Finally, the "known loss" rule has been extensively reviewed in asbestos claims, which are synonymous in American jurisprudence with "long-tail" bodily injury claims. One earlier decision of note is the United States Court of Appeal case of *Stonewall Insurance Company v. Asbestos Claims Management Corporation et al.* [19] Here the Appellate Court determined that the "known loss" defence did not bar the insured manufacturer of asbestos-containing products from indemnification, despite its awareness of potential asbestos claims. The prospective number of injuries, the number of claims, the likelihood of successful claims and the amount of ultimate losses were highly uncertain. Although this was a coverage action under excess policies for asbestos-related personal injury claims, it was reasoned that the "known loss" defence did not bar indemnification. The liability insurer was perfectly entitled to replace the uncertainty of its exposure with the precision of insurance premiums, as determined by its underwriters.

"Known Loss" Rule in Property Damage Claims

An example of the successful application of the "known loss" rule can be found in the decision of the United States District Court, N.D. Illinois, Eastern Division in *Central Mutual Insurance Company v. Useong International, Ltd.*[20] In this case, the liability insurer sought a determination as to whether or not it had a "duty to defend" in arbitration proceedings arising from defective water valves installed in refrigerators. Prior to the inception of the policy in issue, the insured had entered into an agreement with the refrigerator manufacturer in which the insured agreed to indemnify the refrigerator manufacturer for claims arising from the defective water valves. In order for the liability insurer to successfully rely upon the "known loss" rule, the Court decided that it had to establish that the insured knew, or, had reason to know, at the time that it purchased the liability policy that claims related to its water valves had been made or would be made and the likely extent of its exposure. Since the insured had entered into the indemnity agreement with the refrigerator manufacturer, the insurer successfully established the "known loss" defence because:

> *… The increase in [the insured's] liability and risk exposure with regard to the valves had become a reality more than a year before the start of the [policy period]. ... Based on the claims then filed and its commitment to resolve all claims filed prior to December 2006, [the insured] had a specific*

[19] 73 F.3d 1178, 64 USLA 2447 (U.S.C.A., 2nd Cir.).
[20] 394 F.Supp.2d 1043.

understanding about the extent and scope of its liability that exceeds the substantial probability standard.[21]

The decision in *Montrose, supra* also illustrates the application of the "known loss" doctrine in environmental claims involving property damage.

In summary, American liability insurers have had limited success in relying on the "known loss" rule to resist both the duty to defend and duty to indemnify under a commercial general liability policy. Judicial results-based reasoning has narrowed the scope of the rule to the point that a judgment almost has to be outstanding against the insured in order for the liability insurer to be successful.

Canadian Treatment of the "Known Loss" Rule:

As previously stated, there is scant judicial consideration of the "known loss" rule in Canada. The leading case is the decision in *Alie, supra.*

In *Alie*, *supra*, the argument that coverage was defeated by the "known loss" rule was indirectly advanced by two of the liability insurers on the basis that the general contractor had failed to disclose material facts prior to the policies in issue coming into effect. Specifically, the liability insurers alleged that the general contractor failed to disclose its knowledge of the many homeowner complaints, its consultations with the concrete manufacturer, payments made to attempt repairs, its discontinuance of the use of fly ash, engineering reports from customers and letters threatening litigation from homeowners. The Trial Judge decided as a fact that, despite all of the foregoing, the general contractor did not appreciate the full extent of the problem with the ready mix cement until 1992. The Court of Appeal agreed that there was evidence to support the Trial Judge's findings.

Accordingly, the Court of Appeal, without specifically articulating the concept of "known loss", decided that the insurers could not avoid their indemnity obligations because the insured was not aware that damage to the foundations, and thus loss under the policies, was a "substantial certainty" at the time these policies incepted.

The New IBC CGL Form

In light of the inconsistent application of the four trigger theories to coverage, the move toward the injury-in-fact trigger theory as modified by the continuous trigger theory, and the lack of success of U.S. liability insurers in relying upon the "known loss" rule as a defence to coverage, the amendments to the insuring agreement for bodily injury and property damage in the new IBC CGL Form wordings are intended to inject an element

[21] *Ibid.*, at para. 1050.

of certainty into future coverage decisions for insurers considering continuous property damage or bodily injury claims. The New IBC CGL Form introduces wording which will restrict the number of policies that must respond to a loss in certain circumstances.

A "cut off" for an existing "occurrence" – Subsection 1.b.(3)

The effect of this new subsection is to exclude from coverage any bodily injury or property damage known by any insured, or employee authorized to give or receive notice of an occurrence or claim, prior to the inception of the policy. Further, this subsection "deems" an insured to have knowledge of all continuing property damage or bodily injury prior to the inception of the policy. Accordingly, the insuring agreement for bodily injury and property damage "cuts off" the spectre of a continuing "occurrence" at the date the insured has knowledge of bodily injury or property damage.

As discussed below, the threshold for knowledge is set fairly low. There is no requirement that the insured know the extent of the property damage or bodily injury, or that it is substantially certain that the insured will have liability for such property damage or bodily injury. Accordingly, the mere fact that an insured has been put on notice by a claimant prior to the inception of the policy should suffice to relieve an insurer of any duty to defend or indemnify.

Modified "manifestation" trigger theory – Subsection 1.c.

The effect of this new subsection is to "deem" all continuing, change or resumption of bodily injury or property damage caused by an occurrence to occur during the policy period in effect when the insured becomes aware of such bodily injury or property damage. Accordingly, the moment the insured has knowledge is the moment that all subsequent property damage or bodily injury is "deemed" to have manifested and the policy in effect at the time the insured obtains knowledge must respond to all ensuing damage. It compliments the exclusion from coverage in a subsequent policy in Subsection 1.b.(3) for any ongoing bodily injury or property damage after an insured has knowledge of bodily injury or property damage.

"Deemed" knowledge - Subsection 1.d.

Subsection 1.d. provides an expansive set of circumstances in which an insured is "deemed" to have knowledge of property damage or bodily injury. Knowledge is "deemed", first, if an insured reports all or any part of bodily injury or property damage to an insurer [Subsection 1.d.(1)]; second, if an insured receives a written or verbal demand or claim for compensatory damages because of bodily injury or property damage [Subsection 1.d.(2)]; and third, if an insured becomes aware "*by any*

other means" that bodily injury or property damage has occurred or has begun to occur [Subsection 1.d.(3)]. The last of the three "deeming" provisions is the broadest and appears to encompass a situation where an insured has a casual conversation with an acquaintance about a building that the insured worked on in which the acquaintance mentions that residents of the building are getting sick from mould exposure because of water ingress.

Additionally, since the burden is on the insured to prove that a loss is within coverage, and the "deemed" knowledge provisions are contained in the insuring agreement, the insured will have the burden of proving that it did not have prior knowledge of property damage or bodily injury for which it is currently seeking coverage.

Damage that occurs before the insured has knowledge

So, what effect, if any, do Subsections 1.b.(3) and 1.c. of the Insuring Agreement for bodily injury and property damage have on the obligation to respond to bodily injury or property damage that occurs *prior* to an insured obtaining knowledge of such bodily injury or property damage? At first blush, the new wording appears to impose the obligation to respond to all bodily injury and property damage, past and future, on the insurer on risk at the time the insured obtains knowledge of the bodily injury or property damage. However, and notably, the new subsections are silent on the obligation to respond to property damage or bodily injury that may have occurred prior the insured having knowledge of their existence.

The fact that the Insuring Agreement of the New IBC CGL Form is silent on past damage indicates that there will likely be no change to the current application of the continuous trigger theory of coverage to such prior damage.[22] To take the leaky building context as an example again, suppose the insured is the window installer for a building that is substantially complete in 2002. In 2006, the lawyer representing the owners of the building writes to the insured and advises it that the windows are demonstrating premature failure, water ingress has occurred, and the resulting mould growth in the building is causing bodily injury to the residents of the building and property damage to other building components. However, since the letter is silent as to whether or not the owners plan to seek compensation for such injuries from the insured, the insured does not give its current insurer notice. In 2007, the insured is sued for property damage and bodily injury caused by the alleged defective work of the insured on the building. The insured reports the litigation to its new insurer and seeks coverage.

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[22] Lichty Paper, *supra*, note 6, at pp. 14 – 15. See also S. M. Baldwin, "The 2001 Revisions to the ISO Commercial General Liability Coverage Form" presented at the DRI Insurance Coverage and Practice Symposium, December 2002, at p. 40.

Further assume that the policies in effect from 2002 – 2004 contain the existing insuring agreement for bodily injury and property damage but the policies in effect from 2005 – 2007 use the New IBC CGL Form, and each policy incepts on January 1st and expires on December 31st. The liability insurer pursuant to the 2007 policy will not have to respond because the insured first had knowledge of bodily injury and property damage in 2006 when the lawyer for the building owners sent it the letter. For the same reason, the 2006 policy will have to respond. What about the policies in effect from 2002 – 2005?

Since the New IBC CGL Form is silent on past damage, there is no bar to these prior liability policies responding to damage which occurred during those policy periods.[23] However, the policies on risk from 2002 - 2004 will not have to respond to damage occurring after 2006 by virtue of the "deeming" provision of Subsection 1.c. and the application of the continuous trigger theory. Accordingly, the New IBC CGL Form limits but does not eliminate the effects of the continuous trigger theory.

An interesting question, and likely to be the subject of much future litigation, is whether or not the 2005 policy must respond, in whole or in part, to damage caused after its issuance by virtue of the "deeming" provision of Subsection 1.c. It is likely in these circumstances, where two or more of the New IBC CGL Forms have been on risk prior to an insured obtaining knowledge of bodily injury or property damage, that a Court will adopt a *pro rata* sharing for future damage, subject to any "other insurance" clauses in each of the policies.

New Definition of "Property Damage"

What impact, if any, does the new definition of "property damage" have in light of the modified Grant of Coverage in the New IBC CGL Form? This topic is addressed more fully in the next section of our paper in the context of "electronic data", however certain "deeming" provisions must be addressed here.

The New IBC CGL Form definition of "property damage" is as follows:

> *25. "Property damage" means:*
>
> *a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or*
> *b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the "occurrence" that caused it.*
>
> *For the purposes of this insurance, electronic data is not tangible property.*

[23] Lichty Paper, *supra*, note 6, at p. 14.

As used in this definition, electronic data means information, facts or programs stored as or on, created or used on, or transmitted to or from computer software, including systems and applications software, hard or floppy disks, CD-ROMS, tapes, drives, cells, data processing devices or any other media which are used with electronically controlled equipment.

The new definition of "property damage" in the New IBC CGL Form has a "deeming provision" as to when "property damage" arises. The definition states in sub-section a) that "*[a]ll such loss of use shall be deemed to occur at the time of the physical injury that caused it*". Sub-section b) states that "*[a]ll such loss of use shall be deemed to occur at the time of the "occurrence*" that caused it. The practical impact of the "deeming provision" in sub-section a) is that the policy in effect on the date of the physical injury will be responsible for all loss of use. If the damage is continuous, then all the policies on risk up to the time that the insured had knowledge will be responsible for all loss of use. The new definition "deems" all loss of use resulting from physical damage to tangible property to occur at the time of the physical injury that caused it. It also "deems" all loss of use of tangible property that has not been physically injured to occur at the time of the occurrence that caused it.

To use the same example of the window installer, assume that instead of bodily injury claims resulting from mould, mould rots the building to the point that, in 2005, the municipal building inspector condemns the building and all the residents must move out. Further assume that the building remains condemned and could not be occupied until 2006 but the insured is not sued for property damage and loss of use until 2007. The letter sent by the lawyer representing the owners of the building to the insured in 2006 advises the insured that the building can now be occupied, after it was condemned. Lastly, assume that there was evidence that rotting ceased in 2004. Again, the insured reports the litigation to its 2007 insurer and there is no change to coverage from the prior example.

The New IBC CGL Form's definition for property damage would require the 2006 policy to respond to future damage, likely on a *pro rata* basis with the 2005 liability insurer. The 2007 liability insurer is no longer responsible to indemnify because of prior knowledge of the insured in 2006. Which policy or policies, if any, must respond to the loss of use claim?

Under the new definition of "property damage" in the New IBC CGL Form, neither the 2005 nor the 2006 liability insurers would have to respond to the loss of use claim, since each of their policies "deems" all loss of use to occur at the time of the physical injury, which ceased in 2004. The policies on risk from 2002 – 2004 will have to bear any damages arising from loss of use on a *pro rata* basis.

What is likely to be subject to future litigation is whether liability insurers that use the new definition of "property damage" will be able to avoid all indemnity for damages from loss of use when a liability insurer with a policy in a prior coverage year employs

the older form of wordings, which does not employ such a "deeming" provision, and the date of the physical injury or occurrence which causes such loss of use continues over the years both policies are in effect. Will a Court apply the exposure trigger, to deem all loss of use back to the prior policy using the older definition of "property damage" or will it use the continuous trigger theory to require both policies to respond on a *pro rata* basis, notwithstanding the later policy's use of the new definition of "property damage"? In light of the current trend in the case law, it is likely that the answer is the latter.

Summary

In summary, the revisions to the Insuring Agreement of the New IBC CGL Form for "property damage" and "bodily injury" will result in fewer policies responding to claims for continuing property damage or bodily injury. However, with the concurrent use of the Former and the New IBC CGL Forms containing different Insuring Agreements there is no doubt a new generation of coverage litigation is waiting to be determined by the Courts, especially in cases of loss of use caused by continuous property damage.

"PROPERTY DAMAGE" AND "ELECTRONIC DATA"

Introduction

In the past, Canadian liability insurers have had little guidance from the IBC CGL Form wordings or from Canadian Courts on the issue of whether and to what extent the loss of computer or electronic data (and the consequential loss of profits) could be covered under an insured's general liability policy. The issue has been addressed in the American Courts, however, even American liability insurers have struggled to define coverage in this emerging area. With the introduction of new definitions and an express exclusion in the New IBC CGL Form, the IBC is finally providing some guidance. In the broadest terms, insureds will no longer be covered for any loss of computer data under the New IBC CGL Form.

Property Damage

This portion of the discussion reviews the term "property damage" relative to coverage for electronic data, however the term "property damage" is used extensively throughout the New IBC CGL Form. The right of an insured to defence and indemnity under the New IBC CGL Form policy wordings is contingent upon there being "property damage" (in the absence, of course, of the existence of "bodily injury"). This issue awaits judicial determination.

The new definition of "property damage" (provided earlier) makes clear that damage to electronic data does not constitute "property damage" and as such, will not be the subject of indemnity for the insured. Prior to this, Courts had to determine whether or not electronic data was "tangible property" and therefore covered under a commercial general liability policy.

There is a lack of Canadian jurisprudence with regard to the issues of electronic data. However American caselaw provides some insight into the direction our Courts may take faced with the issues that arise out of the wording in the New IBC CGL Form.

American Caselaw

Courts in the U.S. have reflected inconsistent and inconclusive approaches as to whether electronic data constituted "physical injury to tangible property" for the purpose of triggering an indemnity obligation under a general liability policy. For the most part, however, U.S. caselaw suggests that electronic data is not tangible property and will not as a result attract indemnity obligations.

For example, in the *Magnetic Data, Inc. v. St. Paul Fire & Marine Insurance Co*.[24] the Court found that the insured's liability policy did not extend coverage to the insured's erasure of information stored on its customer's computer disk cartridges while the insured serviced the disks on its premises. The Court determined that electronic data was "*intangible*" property:

> *The insured's comprehensive general liability policy does not cover loss-of-use claim arising from mistaken erasure of computer information because (a) the policy definition of "property damage" does not extend coverage to damages resulting from loss of use of intangible property and (b) even if computer information is tangible property, coverage is excluded because damaged property was on insured's premises "for the purpose of being worked on" by the insured.*

In *St. Paul Fire & Marine Insurance Co. v. National Computer Systems, Inc.*[25] the liability insurer brought an action for declaratory judgment seeking a determination whether it was obligated to defend and indemnify its insured. The lawsuit alleged that the insured misappropriated the confidential, proprietary information giving the insured a competitive advantage over it in bidding on a contract. At issue was whether the claim alleged damage to "tangible property."

The insured had coverage for "property damage", defined as follows:

> *Any damage to tangible property of others that happens while this agreement is in effect. This includes loss of use of the damaged property resulting from the damage. Property damage also includes loss of use of others' property that hasn't been physically damaged if caused by an accidental event that happens while this agreement is in effect.*

[24] 442 N.W. 2d 153 (Minn. 1989).
[25] 490 N.W.2d 626 (Minn. App. 1992).

The Court reasoned that the lawsuit alleging the misappropriation of confidential information did not entail "property damage". It determined that there was no allegation that the information was lost, or that the binders of information on which the information was stored were lost. The Court concluded that the information itself was not "tangible" and no coverage was available.

Other cases favour the liability insurer. In *Seagate Technology, Inc. v. St. Paul Fire & Marine Insurance Co.*,[26] the Court determined that incorporation of the insureds defective disk drives to the claimant's personal computers did not "*physically injure*" the host personal computers under the terms of the policy's definition of "property damage." Finally, in the case of *Lucker Mfg. v. Home Insurance Co.*[27] the U.S. Court of Appeals found that a design for a particular project rendered less valuable by the discovery of a defect in one of its planned components failed to constitute tangible property for the purpose of insurance coverage. The Court stated that "*[w]e are bound by the language of the policy and we cannot stretch it to include non-tangible property like the LMS design.*"

A minority of American cases have extended coverage for loss or damage to electronic data. For example, the Court of Appeals of Minnesota in *Retail Systems, Inc. v. CNA Insurance Companies*[28] addressed the issue of whether "*computer tapes and data are tangible property*" under a general liability insurance policy. In finding for coverage, the Court stated that:

> *At best, the policy's requirement that only tangible property is covered is ambiguous. Thus this term must be construed in favor of the insured. Other considerations also support the conclusion that the computer tape and data are tangible property under this policy. The data on the tape was of permanent value and was integrated completely with the physical property of the tape.*

In *Centennial Insurance Co. v. Applied Health Care Systems, Inc.*[29] the issue was whether loss of data constituted "property damage". The Seventh Circuit Court concluded that a liability insurer owed a duty to defend to the insured against a lawsuit claiming damages caused by faulty computer equipment sold by the insured. The defective equipment had resulted in the loss of data. The Claimant had purchased four controllers for its data processing system. It sued the insured arguing that the controllers were defective in that each of them had a wiring-connection defect that caused them to consistently malfunction through the random loss of customer billing and patient information stored in the system. The Court found that the insurer had an obligation to defend against the claim, reasoning that the lawsuit alleging computer malfunction and lost data created at least the possibility of "property damage" and thus

[26] 11 F. Supp.2d 1150 (N.D. Cal. 1998).
[27] 23 F.3d 808 (3rd Cir. 1994).
[28] 469 N.W.2d 735 (Minn. App. 1991).
[29] 710 F.2d. 1288 (7th Cir. 1983).

triggered a duty to defend. Some commentators argue that this case was wrongly decided because the Court failed to address fully the issues of whether the lost information was tangible property.[30]

The Electronic Data Exclusion

The Electronic Data Exclusion in section 2(l) of the New IBC CGL Form states as follows:

> *2. Exclusions*
> *This insurance does not apply to:*
>
> *l. Electronic Data*
> *"Compensatory damages" arising out of the loss of, loss of use of, damage to, corruption of, inability to access, or inability to manipulate electronic data*

It is worth repeating that the definition of "property damage" in the New IBC CGL Form states expressly that "*[f]or the purposes of this insurance, electronic data is not tangible property*" and states that for the purposes of the definition of "property damage" "electronic data" means:

> *…information, facts or programs stored as or on, created or used on, or transmitted to and from computer software, including systems and applications software, hard or floppy disks, CD-ROMS, tapes, drives, cells, data processing devices or any other media which are used with electronically controlled equipment.*

So, if a claim is made by a third party against an insured for compensatory damages arising out of the loss or damage of electronic data, the New IBC CGL Form specifically excludes coverage. Insureds will have to purchase special endorsements for this type of coverage and pay an additional premium. "Technology Liability" policies, discussed below, provide coverage for this kind of loss.

The Electronic Data Exclusion in the New IBC CGL Form states that the insurance will not cover any "compensatory damages" that are "*arising out of*" the loss of, or loss of use, or damage to electronic data. The use of the words "*…arising out of*" is critical. This language is used throughout the New IBC CGL Form Exclusions and it is distinct from the anti-concurrent cause language found in select Exclusions in the New IBC CGL Form (discussed at length later in the paper). The use of the wording "*arising out of*" is deliberate; as a result, the Exclusion is in no way "cause" related. Put plainly, there is no "causation requirement" in the Exclusion. In several recent British Columbia cases Courts considered the effect of exclusions beginning with the words "caused by"

[30] P. Yost, P. Glad and W. Barker, *Symposium on Insurance and Technology Article,* 54 SMU L. Rev. 2055.

and found for the insurer.[31] The very fact that the matters were litigated shows that cause-related language in exclusions in the Former IBC CGL Form can be problematic. The impact of the "*arising out of*" language in the New IBC CGL Form is that exclusions are not based on "cause" but rather based on the type of loss that occurs.

Technology Liability Policies

Since electronic data is excluded from coverage under the New IBC CGL Form, the commercial insured may elect to purchase a differing policy, the Technology Liability policy. These policies are the response of a number of Canadian liability insurers to emerging "e-commerce" perils. These policies are tailored to specifically address the reality of the role technology plays in the world of contemporary business. Some of these new policies afford simple and broadly worded coverage. Others afford a more complex set of coverages and defined terms. This species of policy provides an insured with protection, however varied, from a myriad of "e-commerce" related perils, including the storage and use of electronic data.

Under a typical Technology Liability policy, the insurer pays those amounts an insured becomes legally obligated to pay for wrongful acts:

> 1. *[in the insured's] performance of technology services; or*
>
> 2. *[resulting] in the failure of [the insured's] technology products to perform the function or serve the purpose intended.*
>
> *"Technology Services" means any computer or electronic information technology services performed by [an insured] for others, including system analysis, systems programming, data processing, system integration, outsourcing development and design and the management, repair and maintenance of computer products, networks and systems.*
>
> *"Technology Products" means any computer hardware, software or related electronic product, equipment or device that is created, manufactured, developed distributed, licensed, leased or sold by [an insured] to others, including training in the use of such computer hardware, software or related technology products.*

Conclusion

The Electronic Data Exclusion was added to the New IBC CGL Form to compliment the revised definition of "property damage" which now expressly states that electronic data is not considered tangible property. Until the Canadian Courts have opined definitively on the language in the Electronic Data Exclusion, including the definition of

[31] *Jordon v. CGU Insurance Co. of Canada* 2004 BCSC 402; *Leahy v. Canadian Northern Shield Insurance Co.* 2000 BCCA 408.

Electronic Data, Canadian liability insurers will continue to face some uncertainty on the extent of coverage available to insureds. In light of this uncertainty, it is strongly recommended to have insureds purchase a Technology Liability policy to respond to coverage needs, particularly as the storage, maintenance and use of electronic data now drives the modern commercial environment.

We now turn to another significant limitation on the Grant of Coverage in the New IBC CGL Form, namely the narrowing of the kinds of damage that attract indemnity, achieved through the use of the term "compensatory damages". This limitation is another example of how Canadian liability insurers and the IBC have reacted to the judicial results that broadened coverage beyond what was originally contemplated under Former IBC CGL Form wordings.

A NARROW DEFINITION OF "COMPENSATORY DAMAGES"

The Wordings

Under the Grant of Coverage in the New IBC CGL Form, the Insuring Agreement states:

> ***1. Insuring Agreement***
>
> ***a.*** *We will pay those sums that the insured become legally obligated to pay as "compensatory damages" because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend against any "action" seeking those "compensatory damages". However, we will have no duty to defend the insured against any "action" seeking "compensatory damages" for "bodily injury" or "property damage" to which this insurance does not apply. We may, at our discretion, investigate any "occurrence" and settle any claim or "action" that may result. But:*
>
> ***(1)*** *The amount we will pay for "compensatory damages" is limited as described in Section **III** – Limits of Insurance; and*
>
> ***(2)*** *Our right and duty to defend ends when we have used up the applicable limit of insurance in the payment of judgments or settlements under Coverages **A, B** or **D** or medical expenses under Coverage **C**.*
>
> *No other obligation or liability to pay sums or perform acts or services is covered unless explicitly provided for under Supplementary Payments – Coverages **A, B** and **D**.*

In the New IBC CGL Form, "compensatory damages" are defined as:

> *"Compensatory damages" means damages due or awarded in payment for actual injury or economic loss. "Compensatory damages" does not include punitive or exemplary damages or the multiple portion of any multiplied damage award.*

The term "compensatory damages" also comes into play in the Limits of Insurance Section of the New IBC CGL Form, discussed in the later section of this paper entitled "Limits of Insurance – The General Aggregate Limit".

Defining "Compensatory Damages"

The words "compensatory damages" play a pivotal limiting role in the New IBC CGL Form. The term is now a defined in the New IBC CGL Form, whereas the term was not defined in the Former IBC CGL Form. The word "damages" is not singularly defined, but rather only in the context of "compensatory damage" or "property damage" The step of defining "compensatory damages" in the New IBC CGL Form preserves the traditional indemnity aspects of general liability insurance. The definition recognizes that certain monetary exposures an insured confronts are personal and not transferable to an insurer. Examples of such personal liabilities include liability for punitive damages, criminal penalties, an order for specific performance under a contract, or, an order for restitution.[32] It can safely be assumed that the IBC decided to define the term "compensatory damages" to remove any uncertainty about the insurability of these other types of damages. The new definition will minimize the likelihood of any coverage dispute as to what kinds of damages are to be indemnified. There may still be issues of interpretation with older versions of the Former IBC CGL Forms, but going forward, the step of defining the term "compensatory damages" throughout the New IBC CGL Form should curtail much of the current debate.

Canadian Caselaw

It is helpful to distinguish how Canadian Courts have traditionally defined "compensatory damages". This is of particular importance because of the distinction between other kinds of damages awarded by the Courts, particularly aggravated or punitive damages.

"Compensatory damages" in the law of contract and tort compensate a party that has suffered loss or damage with an award of money. Under the New IBC CGL Form, an insured will receive "compensatory damages" for either "property damage" or "bodily injury". Courts have drawn a firm distinction between "compensatory damages" and punitive damages. A complete discussion of types of damages are beyond the purview of this paper, however, in general, punitive damages are based on the conduct of a

[32] C. Brown, J. Menezes, Cassels Brock & Blackwell, *Insurance Law in Canada*, vol. 2 (Toronto: Thomson Carswell, 2002) at section 18-62.

Defendant in a lawsuit, as opposed to the Plaintiff's loss. The aim of punitive damages is not to compensate a Plaintiff, but to punish the Defendant. The terms "punitive damages" and "exemplary damages" are often used interchangeably. Aggravated damages are also based on compensation. Aggravated damages will be awarded where the conduct of the Defendant heightens the loss of the Plaintiff. Aggravated damages are an "*…augmentation of an award*" of compensatory damages and compensate for intangible injuries such as distress or humiliation.[33]

Canadian caselaw illustrates how the Courts define and distinguish between types of damage. For example, in *Whiten v. Pilot Insurance Co.*,[34] the Plaintiff brought an action against the insurer for breach of contract. In its landmark 2002 decision, the Supreme Court of Canada distinguished punitive damages from damages that were compensatory in nature. The Court determined that punitive damages were awarded against the insurer in this breach of good faith case as a means of punishing the wrong doer for reprehensible or malicious conduct; punitive damages were not "compensatory" in nature.

In a tort case, the Manitoba Court of Queens Bench in *Victoria General Hospital v. General Accident Assurance Co. of Canada*[35] concluded that "[p]*unitive damages are not compensatory in nature.*" In this case, the insurer had issued a policy that stated it was liable only for compensatory damages. However, the Court found that punitive damages were not compensatory in nature – and the insurer had agreed, in a later section of its policy, to pay all sums which the insured became legally obligated to pay. The Court found that coverage was clearly broader than an obligation only to pay only "compensatory damages".

On the other hand, in *Vorvis v. Insurance Corporation of British Columbia*[36] (a breach of employment contract case) the Supreme Court of Canada determined that aggravated damages were compensatory in nature. The Court stated that

> *Aggravated damages are awarded to compensate for aggravated damage. As explained by Waddams, they take account of intangible injuries and by definition will generally augment damages assessed under the general rules relating to the assessment of damages. Aggravated damages are compensatory in nature and may only be awarded for that purpose. Punitive damages, on the other hand, are punitive in nature and may only be employed in circumstances where the conduct giving the cause for complaint is of such nature that it merits punishment.*

In *Thomson v. Zurich Insurance Co.*,[37] the Court was asked to award both punitive and aggravated damages against the insurer. The claim arose out of non-payment of accident benefits under a motor vehicle policy. The Court concluded that in order to

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[33] *Vorvis v. Insurance Corp. of British Columbia* [1989] 1 SCR 1085 [hereafter "*Vorvis*"].
[34] 2002 SCC 18.
[35] 1995 CarswellMan 54 at para 34.
[36] *Vorvis, supra*, note 32.
[37] 1984 CarswellOnt 649 (Ont. H.C.).

support an award of punitive damages, evidence of malice was required. The Court distinguished punitive damages from aggravated damages and noted that the latter was a form of compensatory damages.

In the case of *Palliser Regional Division #26 v. Aviva/Scottish & York Insurance Co.*[38] the Court found that the insurer had a duty to defend an insured in a claim for compensatory damages, but not for a claim for aggravated or punitive damages as they fell outside of the purview of the policy. It was not clear from the case whether compensatory damages was actually defined in the policy but the Court did not consider the *Thomson* or *Vorvis* cases, *supra*.

Canadian cases have generally followed the meaning of compensatory damages which is now codified by the New IBC CGL Form, namely that compensatory damages do not include punitive or exemplary damages.

In general, Canadian Courts have consistently determined that where policy wordings refer to "compensatory damages" there is no coverage for punitive or exemplary damages. In one case where the term "damages" was defined in a policy as "compensatory damages" but the word compensatory was not defined, the Court referred to the definitions of damages and compensatory damages in Black's Law Dictionary:

> *…damages is defined in Part I of the Policy as meaning "compensatory damages".*
>
> *15 Black's Law Dictionary, 6th ed. St. Paul, Minn: West Publishing Co. 1990 defines "damages" as :A pecuniary compensation or indemnity, which may be recovered in the courts by any person who has suffered loss, detriment, or injury, whether to his person, property or rights, through the unlawful act or omission or negligence of another. A sum of money awarded to a person injured by the tort of another*
>
> *16 It further defines "compensatory damages" as:*
>
> *Compensatory damages are such as will compensate the injured party for the injury sustained, and nothing more; such as will simply make good or replace the loss caused by the wrong or injury. Damages awarded to a person as compensation, indemnity or restitution for harm sustained by him. The rationale behind compensatory damages is to restore the injured party to the position he or she was in prior to the injury.*[39]

The Court used this definition to hold that the legal fees paid for a coroner's inquest were not akin to compensatory damages and not covered under the policy.

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[38] 2004 ABQB 781

[39] *Akey v. Encon Insurance Managers Inc.*, 2001 CarswellOnt 1996 (Ont. Sup. Ct.).

American Caselaw

A review of American coverage cases is helpful to illustrate the different approaches the U.S. Courts take when "damages" are a defined term in the liability policy, and when the term is undefined.

When the term "damages" is undefined, some American Courts have found that absent specific language, a liability policy should respond to an award of punitive damages.[40] For example, in *Philadelphia Indemnity Insurance Company v. Stebbins Five Companies*[41] the U.S. District Court found that where a liability policy does not specifically exclude coverage for punitive damages and where the policy stated that the liability insurer will pay "*those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury'*" there was coverage for punitive damages. The Court reasoned that the policy language did not provide coverage only for compensatory damages, and did not distinguish between compensatory and punitive damages. Finally the Court determined that coverage for punitive damages would not be contrary to public policy in the state of Texas, which did not prohibit coverage of a punitive damages award in a liability policy.

Like Canada, where the policy language refers to "damages" (but with no specific reference to "compensatory damages"), some U.S. Courts have concluded that "damages," as the word is ordinarily defined, was broad enough to encompass punitive as well as compensatory damages.[42] Other American cases show how the Courts have interpreted the term "compensatory damages". In *Willow Inn, Inc. v. Public Service Mut. Ins. Co.*[43] attorney's fees and costs were determined to be "compensatory damages" according to the United States Court of Appeal, Third Circuit. In *McMillian v. F.D.I.C.*[44], the United States Court of Appeals found that: "*compensatory damages" and "actual damages" are synonymous, and they include all damages other than punitive or exemplary damages*. Finally, in *Barnette v. Brook Road, Inc.*[45] the Court found that under Virginia law, "compensatory damages " are those "…*allowed as a recompense for loss or injury actually received and include loss occurring to property, necessary expenses, insult, pain, mental suffering, injury to the reputation, and the like.*". The conclusion to be drawn from these cases is the less ambiguity, and the more exact definitions in a liability policy, the better, not only for the sake of the insured and liability insurer, but particularly for the Courts when called upon to interpret the liability policy.

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[40] Snowden & Lichty, *supra*, note 4 at p. 8-1.
[41] Not Reported in F.Supp.2d, 2004 WL 210636 N.D.Tex., 2004.
[42] *Carroway v. Johnson* C 245 S.C. 200, 139 S.E.2d 908 and *South Carolina State Budget & Control Bd. v. Prince, 304* S.C. 241, 403 S.E.2d 643 (S.C. 1991*).*
[43] 399 F.3d 224 C.A.3 (Pa.), 2005.
[44] 81 F.3d 1041C.A.11 (Fla.), 1996.
[45] 429 F.Supp.2d 741 E.D.Va., 2006.

Conclusion

Based on the definition of "compensatory damages" in the New IBC CGL Form, Courts will not provide coverage for punitive damages. However, what remains to be seen is whether or not a Court award for aggravated damages, based on Canadian caselaw reviewed above, will be compensable under the New IBC CGL Form.

The paper now shifts focus from the new limitations in the Grant of Coverage under Section 1 of the New IBC CGL Form to address the extent to which the Exclusions act to impact on coverage. Exclusions in the New IBC CGL Form are as critical as the Grants of Coverage. We also examine the relevant definitions which have been expanded under the New IBC CGL Form.

EXCLUSIONS

THE *DERKSEN* DECISION: CONCURRENT CAUSES OF LOSS LANGUAGE

Introduction

In the broadest terms, this section outlines wording revisions that increase the operation of certain exclusions in situations where two or more consecutive or concurrent perils give rise to a liability exposure. The practical effect of these changes is to move the defence obligation from the liability insurer onto the shoulders of either an automobile liability policy, or, other more specialized forms of coverage such as marine liability, or aviation liability policies.

Historically, when faced with a claim for coverage under a liability policy, Canadian liability insurers looked to determine if there was a single, dominant, or "proximate" cause of the loss. If so, and that cause of the loss was an included peril of coverage, then coverage was granted. If that cause of the loss was an excluded peril, then coverage was not available.

However, the term "proximate cause" is a negligence law concept, and its application in an insurance policy analysis can be problematic. In the past decade there has been a shift away from the "proximate cause" approach to a more expansive approach to ascertain if a peril fits within the outer parameters of coverage. This issue was ultimately considered in 2001 by the Supreme Court of Canada in the *Derksen* case. The Supreme Court of Canada not only assumed the role of deciding if there could be more than one cause of a loss, but also outlined the method for determining the applicability of coverage when one of the losses was covered and one was excluded.

The liability insurance industry has typically taken the stance that exclusions are premised upon either the existence of another policy of insurance, or, because the loss was not fortuitous. However, our Courts are finding there can be many losses arising from a "mix" of perils, some of which are covered, others are not and the issue has become "*does the insured have coverage when one of the perils is excluded and yet another peril that contributed to the loss is covered under the policy*? "

Trial Courts have responded to the decision in *Derksen, supra* in unpredictable ways. Given the varied response, the IBC elected to include "anti-concurrent causation language" in the New IBC CGL Form Automobile Exclusion, and in other exclusions as well. The question becomes how will the Courts now respond to this new "anti-*Derksen*" language? What "post-*Derksen*" results will now be eliminated?

The Law Before Derksen

Thirty years ago Canadian Courts would have likely adopted the English Court of Appeal's practice that where two causes of a loss existed, one within coverage and one not, the Court would search to "…*determine which cause is the 'effective or dominant cause*'."[46] Fifteen years ago the Supreme Court of Canada stated that "…*it should not debate on which of various causes of a loss were proximate….scepticism is advised when addressing this metaphysical topic…*"[47] Then, ten years ago, the B.C. Court of Appeal spoke on this issue. It clarified that a very common cause of loss in B.C., namely water damage due to seepage and leakage, may in fact have a concurrent or second cause, namely a burst water pipe (one typically covered, the other typically excluded). [48] By this time, the judicial door was opened to a series of otherwise excluded claims against Canadian liability insurers, which caused great debate as to what constituted "concurrent causes of loss."

In the same time period the Supreme Court of Canada gave a broad interpretation to the words "*ownership, use or operation*" of a vehicle. In the case of A*mos v. I.C.B.C.*,[49] the Court concluded an injury arose out of the ownership, use or operation of a vehicle, after an individual had been attacked and shot through the window of his car by persons apparently attempting to gain entry to the car. The Court found the incident resulted from an "ordinary and well-known activity" to which motor vehicles are put and found a sufficient connection between the injuries and the use of the vehicle. In doing so, the Supreme Court considered the causation issue and noted that the words "*arising out of*" were viewed in certain cases as words of a much broader significance

[46] *Wayne's Tank & Pump Co. v. Employer's Liability Assurance Corp* [1974] Q.B. 57.
[47] *CCR Fishing Ltd. v. British Reserve Ins. Co.*, [1990] 1 SCR 814.
[48] *Pavlovic v. Economical Mutual Insurance Company* (1996), 99 BCLR (2d) 298 (C.A.).
[49] [1995] 3 SCR 405 [hereafter "*Amos*"].

than "*caused by*". It was decided that negligence or fault in the use or operation of the vehicle did not need to be the cause of the injury.

All of these rulings would ultimately play a role in the decision in *Derksen, supra.*

The Derksen Decision

In 2001 the Supreme Court of Canada considered the coverage issues that arose out of an accident in which one child was killed and three were injured. A steel base plate (part of a road sign assembly), which had been put on the defendant's truck by the defendant driver as part of the clean up at a work site, flew off the truck through the windshield of an oncoming school bus.

The Plaintiffs alleged negligence both at the work site and in the operation of the truck. The Ontario Trial Judge decided that the accident resulted from concurrent causes, negligent clean up and negligent operation of the truck, and that both the liability policy and the auto policies provided coverage. This finding was upheld by the Supreme Court of Canada. This conclusion was reached notwithstanding the standard exclusion in the liability policy of the "use or operation of an automobile".

The Supreme Court of Canada made the following broad findings

(a) *Derksen, supra,* was based on a series of events that were separate causes contributing to the same loss, as opposed to a series of events that were the same cause of the loss;

(b) Insurers may suggest there was an independent and intervening act (more proximate cause) that broke the chain of causation, but this is not correct. The operation of an intervening force will not ordinarily absolve a defendant of further responsibility if it can be considered a normal incident of the risk created by the harm;

(c) Where there are concurrent causes there is no presumption that all coverages are ousted if one of the concurrent causes is an excluded peril. This is a matter of interpretation and must be expressly stated in the insurance policy;

(d) As insurers have language available to them that would remove all ambiguity from the meaning of an exclusion clause in the event of concurrent causes, there was no reason to decide in favour of the insurer;

(e) The broad interpretation of the phrase "arises out of the use or operation of an automobile" did not apply. The broad meaning of the phrase "arises out of" applies in the context of a claim for coverage. In *Derksen*, the phrase "arises out of" was in the context

of an exclusion clause (in the CGL policy) which is given a narrow interpretation.

(f) There was nothing in the CGL policy to indicate there was no coverage for an insured risk if an expressly excluded risk was an additional cause of the injury. Therefore the exclusion clause was ambiguous with respect to losses from concurrent causes; and

(g) Each insurer was liable for coverage for only that portion of the loss attributable to their insured's risk.

The Application of Derksen in Motor Vehicle Cases

Despite what is described as a continuing shift toward a more expansive definition of the phrase "arising out of the use or operation of a motor vehicle" since the decision in *Amos, supra,* the ruling in *Derksen, supra,* has allowed Courts to look to other conduct which might have otherwise been included under an auto insurer's coverage. The following are some examples:

(a) Oil Leaked from a fuel truck and caused pollution to lands

Although a fuel leak is considered to be an "ordinary and well-known activity" to which vehicles are put, and was connected to the operation of the fuel truck, this was also a failure to inspect the fuel lines which was deemed to be covered under the CGL policy. Both the auto and CGL policies applied. [50]

(b) Motor vehicle accident caused during a sales demonstration of vehicle

The insured caused the accident while demonstrating an amphibious vehicle. There was an exclusion for the use and operation of a motor vehicle. The Court found a concurrent cause of the loss – the insured's allegedly defective salesmanship - which was covered under the policy. [51]

(c) Dog in back of open truck bites person

The allegation that the Defendant dog owner failed to keep his dog contained in the vehicle constituted a causal connection to the loss and therefore was a "use and operation". The failure to control the dog also called for coverage under the dog owner's liability policy.

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[50] *Harvey's Oil Ltd. v. Lombard General Insurance Co. of Canada,* 2003 NLSCTD 158, affirmed 2004 NLCA 9.
[51] *Neary v. Wawanesa Mutual Insurance Co.*, 2003 NSCA 66.

> Both the general liability insurer and the auto insurer were required to provide a defence and indemnity for the Defendant. [52]

Auto insurers and insureds will continue to rely on *Derksen* to try and stretch the web of coverage wide enough to find a second cause of a loss to obtain additional coverage. Fortunately for Canadian liability insurers, the Ontario Court of Appeal has offered some guidance on how to deal with pleadings that attempt to obtain dual coverage. In the Ontario Court of Appeal decision in *Unger (Litigation Guardian of) v. Unger*[53] an employee, while driving his work vehicle, injured the Plaintiff. The Plaintiff sued both the employee and the employer. The Ontario Court of Appeal determined that an allegation against the employer for negligent hiring, training or supervision of the employee may be germane to whether the defendant was negligent in the use or operation of a vehicle, but not a "stand alone ground for recovery". The Court stated that "*[T]he allegations, even if proved, without also proving negligent use of a motor vehicle would not allow the insured to succeed.*"

"Derksen" Wording in the New IBC CGL Form Exclusions

The New IBC CGL Form has six exclusions that contain "anti-concurrent cause of a loss" language. The purpose of the language is to avoid the judicial results created by *Derksen, supra*. The "anti-concurrent cause of a loss" language is also found in the Aircraft or Watercraft Exclusion (which is only briefly addressed here). There are also four so-called common exclusions in the New IBC CGL Form. These four exclusions are:

- the Mould Exclusion;
- the Nuclear Energy Liability Exclusion;
- the War Risks Exclusion; and
- the Terrorism Exclusion.

The exclusions for Mould and for Terrorism are dealt with at some length in other portions of this paper. Thankfully, Canadian caselaw on the interpretation of the exclusions for War Risks and for Terrorism is almost non-existent.

The Automobile Exclusion

> ***... 2. Exclusions***
> *This insurance does not apply to:*
> ***f. Automobile***

[52] *Taylor v. Maris*, 2004 BCCA 391.
[53] [2003] O.J. No. 4587 (Q.L.)(C.A.).[hereafter "*Unger*"].

> *"Bodily injury" or "property damage" arising directly or indirectly, in whole or in part, out of the ownership, maintenance, use or entrustment to others of any "automobile" owned or operated by or on behalf of or rented or loaned to any insured. Use includes operation and "loading or unloading". This exclusion applies regardless of any other contributing or aggravating cause or event that contributes concurrently or in any sequence to the "bodily injury" or "property damage."*

The new wording identifies an exclusion for any range of liability for property damage or bodily injury arising "*directly or indirectly, in whole or in part*" out of the ownership or use of an automobile (by the insured or anyone else the insured entrusted it to), "*regardless of any other contributing cause or aggravating cause or event that contributes concurrently or in any sequence.*" The italicized sections as noted are clearly designed to eliminate the expansive scope of coverage adopted in *Derksen, supra.* The exclusion also bars any indemnity exposure surrounding the "loading and unloading" of an automobile.

The Automobile Exclusion also applies if there are allegations arising from the employment law context, applying as follows:

> *even if the claims against any insured allege negligence or other wrongdoing in the supervision, hiring, employment, training or monitoring of others by that insured, if the "occurrence" which caused the bodily injury or property damage involved the ownership, maintenance, use or entrustment to others of any "automobile" that is owned or operated by or rented or loaned to any insured.*

This wording in the New IBC CGL Form Automobile Exclusion is designed to restrict coverage in situations where a negligent act is committed by an employee during the course of his or her employment, for instance, causing an accident whilst driving a vehicle owned by the insured; the accident allegedly caused by negligent business practices of the insured, such as poor training or supervision.[54]

There are three exceptions to the Automobile Exclusion which have the effect of admitting coverage in certain situations:

> *This exclusion does not apply to:*
>
> *1) "Bodily injury" to an employee of the insured…."*
>
> *2) "Bodily injury" or "property damage" arising out of a defective condition in, or improper maintenance of any "automobile" owned by the insured while leased to others for a period of 30 days or more provided the lessee is obligated under contract to ensure that the "automobile" is insured.*

[54] *Unger, supra.*

3) The ownership, use or operation of machinery, apparatus or equipment mounted on or attached to any vehicle while at the site of the use or operation of such equipment, but this exception does not apply when such equipment is used for the purpose of "loading or unloading."

These three exceptions to the Automobile Exclusion could give rise to coverage in any one of the following scenarios:

(a) An insured's employee sues his or her employer as a result of an accident occurring due to negligent maintenance while he or she is operating the insured's vehicle. Practically however, if the employee was working at the time of the accident the claim would be statute barred by workers compensation legislation and coverage would not be required.

(b) A defective vehicle the insured had leased on a long-term basis causes a loss and there was no provision in the lease requiring the lessee to obtain insurance. In practice, this will arise infrequently.

(c) An oil tank mounted to the back of an insured's vehicle springs a leak, damaging third party property. The exclusion would not apply in this situation. In one case, a Newfoundland Court found an oil leak was connected to the operation of the fuel truck, but was also a failure to inspect the fuel lines and was therefore deemed to be covered under the general liability policy. Both the auto and general liability policies applied. [55]

Several issues arise from the exclusionary language in the New IBC CGL Form Automobile Exclusion, namely, circumstances involving the loading and unloading of the automobile, supervision of employees and conduct in the course of employment, each of which is examined below.

First, "loading and unloading" is now a defined term in the New IBC CGL Form as follows:

"Loading or unloading" means the handling of property:

a. After it is moved from the place where it is accepted for movement into or onto an aircraft, watercraft or "automobile";
b. While it is in or on an aircraft, watercraft or "automobile" or
c. While it is being moved from an aircraft, watercraft, or "automobile" to the place where it is finally delivered;

but "loading or unloading" does not include the movement of property by means of a mechanical device, other than a hand truck, that is not attached to the aircraft, watercraft or "automobile".

[55] *Harvey's Oil Ltd., supra.*

The loading or unloading of people is *not* included in the definition of "loading or unloading". Arguably a person's exit or entrance on to a vehicle would fit within the definition of the "operation" of a vehicle, but it is not addressed. This could prove to be problematic for Canadian liability insurers. What about the storage of goods in a vehicle, or negligent placement of items in or on the vehicle? This "loading and unloading" addition to the exclusion was clearly designed to deal with the type of fact pattern in *Derksen*, where the accident was caused by the improper placement (or "loading") of a steel plate on a truck.

Is this definition of "loading or unloading" sufficient? In *Derksen* the Court concluded the accident occurred as the result of concurrent causes; negligent operation of the truck and negligent clean up of the work site. The Court did not describe this concurrent tort as one of negligent loading, although that was what had happened. Therefore, although the New IBC CGL Form purports to deal with the type of fact pattern set out in *Derksen*, a Court may or may not concur that this wording adequately addresses the issue. The IBC's concerns over the liability exposure from claims involving allegations of "loading and unloading" are reflected in the Aircraft and Watercraft exclusions as well.

Second, if an insured is alleged to have negligently supervised his salesman who injures a third party with the insured's vehicle, the claim is excluded. The Ontario Court of Appeal has already concluded that supervision is not a concurrent cause of a loss. Supervision claims were "deemed" a "*…legal characterization rather than a contributing cause of the injury*".[56]

The third issue is conduct that arises in the course of employment. In *Neary v. Wawanesa Mutual Insurance Co.*,[57] the Court concluded that the insured caused an accident while demonstrating an amphibious vehicle. The insured's general liability policy contained the standard exclusion for the use and operation of a motor vehicle. The Court held that another, concurrent cause of the loss – the insured's allegedly defective salesmanship – was a peril covered under the general liability policy.

This new exclusionary language is designed to exclude coverage in a situation like the *Neary* decision; "defective salesmanship". The new wording provides an exclusion for*"… the supervision, hiring, employment, training or monitoring of others by that insured…"* The term "employment" is a broad term and could encompass the situation in *Neary*. If so, then this language would eliminate any claims for "defective salesmanship". This has not yet been judicially considered, so it is also possible a Court might find "employment" does not mean conduct in the course of employment, such as negligent salesmanship.

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[56] *Thompson v. Warriner* 2002 CarswellOnt 1476 (Ont. C.A.).
[57] 2003 NSCA 66.

The Mould Exclusion

The New IBC CGL Form Mould Exclusion reads as follows:

> **2. *Fungi or Spores***
>
> a. *"Bodily injury", "property damage" or "personal and advertising injury" of any other cost, loss or expense incurred by others, arising directly or indirectly from the actual, alleged or threatened inhalation of, ingestion of, contact with, exposure to, existence of, presence of, spread of, reproduction, discharge or other growth or any "fungi" or "spores" however caused, including any costs or expenses incurred to prevent, respond to, test for, monitor, abate, mitigate, remove, cleanup, contain, remediate, treat, detoxify, neutralize, assess or otherwise deal with or dispose of "fungi" or "spores";*
> b. *Any supervision, instructions, recommendations, warnings, or advice given or which should have been given in connection with a. above or*
> c. *Any obligation to pay damages, share damages with or repay someone else who must pay damages because of such injury or damages referred to in a. or b. above.*
>
> *This exclusion applies regardless of any other contributing or aggravating cause or event that contributes concurrently or in any sequence to the "bodily injury", "property damage" or "personal and advertising injury".*

The final paragraph, containing the "anti-concurrent loss language" is common to the exclusions for Mould, Nuclear Energy Liability, Terrorism and War Risks. Once again, this anti-concurrent causation language is a direct result of *Derksen* and will likely have an impact on the insured which may have had the benefit of a "concurrent cause of loss" position. Mould claims are perhaps the most likely of all claims to invoke a debate over the origin or true cause when considering coverage.

The Terrorism Exclusion

The Terrorism Exclusion is an entirely new exclusion that did not exist prior to the September 11, 2001 terrorist attacks. It was introduced into the New IBC CGL Form as a result of the monetary severity of terrorist acts, and because the Former IBC CGL Form exclusion for War Risks did not cover acts of terrorism. The Terrorism Exclusion reads as follows:

This insurance does not apply to:

> *"Bodily injury", "property damage" or "personal and advertising injury" arising directly or indirectly, in whole or in part, out of "terrorism" or out of any activity or decision of a government agency or other entity to prevent, respond to, or terminate "terrorism". This exclusion applies regardless of any other contributing or aggravating cause or event that contributes concurrently or in any sequence to the "bodily injury" "property damage" or "personal and advertising injury".*

Terrorism is a defined term in the New IBC CGL Form, as follows:

> *"an ideologically motivated, unlawful act or acts, including but not limited to the use of violence or force or threat of violence or force, committed by or on behalf of any group(s), organization(s) or government(s) for the purpose of influencing any government and/or instilling fear in the public or a section of the public."*

Specialized coverage is available for acts of terrorism. The Terrorism Exclusion itself is discussed at length in Section III.H. of this paper.

The War Risks Exclusion

The War Risks Exclusion reads as follows:

> *"Bodily injury, property damage, or personal and advertising injury arising directly or indirectly, in whole or in part, out of war, invasion, act of foreign enemy, hostilities (whether war be declared or not), civil war, rebellion, revolution, insurrection or military power. This exclusion applies regardless of any other contributing or aggravating cause or event that contributes concurrently or in any sequence to the "bodily injury", property" or "personal or advertising injury".*

One of the few cases Canadian cases to deal with the war risk exclusion arose out of the Oka crisis in 1990. The Quebec Superior Court ruled that the Oka crisis was not a rebellion or insurrection; the insured had to indemnify the Plaintiff for damage to property. Interestingly, the words insurrection and rebellion were not defined in the policy in question. These terms are not defined in the New IBC Form either.

The Nuclear Liability Exclusion

The Nuclear Liability Exclusion in the New IBC CGL Form reads as follows (with changes underlined for ease of reference):

> *a) Liability imposed by or arising from any nuclear liability act, law or statute, or any law amendatory thereof;*
>
> *b) "Bodily injury", "property damage" or <u>"personal and advertising injury"</u> with respect to which an insured under this policy is also insured under a contract of nuclear energy liability insurance (whether the insured is un-named in such contract and whether or not*

it is legally enforceable by the insured) issued by the Nuclear Insurance Association of Canada or any other insurer or group or pool of insurers or would be an insured under any such policy but for its termination upon exhaustion of its limit of liability.

c) "Bodily injury", "property damage" or "personal and advertising injury" resulting directly or indirectly from the "nuclear energy hazard " arising from:

1) The ownership, maintenance, operation or use of a "nuclear facility" by or on behalf of an insured;

2) the furnishing by an insured of services, materials, parts of equipment in connection with the planning, construction, maintenance, operation or use of any "nuclear facility";

3) the possession, consumption, use, handling, disposal or transportation of "fissionable substances: or of other "radioactive material" (except radioactive isotopes, away from a nuclear facility, which have reached the final stage of fabrication so as to be useable for any scientific, medical, agricultural, commercial or industrial purpose) used, distributed, handled or sold by an insured.

d) This exclusion applies regardless of any other contributing or aggravating cause or event that contribute concurrently or in any sequence to the "bodily injury", "property damage" or "personal and advertising injury".

The most significant changes to this exclusion are the inclusion of the "anti-concurrent loss language" and the inclusion of "personal and advertising injury". There is no Canadian case law on the Nuclear Liability Exclusion.

Conclusion

Derksen, supra, has created an opportunity for insureds seeking coverage that might otherwise have been denied. In those situations where the facts of the claim lend themselves to an argument that there was more than one cause of the loss, or more than one peril, the creative insureds can use the decision in *Derksen, supra,* to their advantage. However, the New IBC CGL Form essentially eliminates the spectre of two or more liability policies responding to the same loss.

Whereas the last paper on "anti-concurrent cause language" reviewed a broad based enhancement to some exclusions in the New IBC CGL Form wordings, the next two sections focus on more specific changes to two existing exclusions, namely, the "Contract Assumed Exclusion" and the "Employer's Liability Exclusion".

THE CONTRACT ASSUMED EXCLUSIONS: CHANGES TO THE TREATMENT OF "CONTRACTUAL LIABILITIES"

The New IBC CGL Form wording includes some significant changes to the treatment of contractual liabilities, including changes that:

1. impact the scope of coverage for contractual liabilities;
2. expressly provide for the assumption of the defence of a third party indemnified by the insured;
3. reverse a current and common assumption regarding treatment of contractually assumed defence costs; and
4. operate to reduce the calculation of policy limits.

In order to appreciate the true breadth and impact of these changes, a discussion is first required of what constitutes a contractual liability and how Canadian liability insurers have historically dealt with them.

Background

Coverage under the Former IBC CGL Form is typically invoked when an insured is careless and caused loss to a third party. However, being careless is not the only way for which an insured can find itself at the wrong end of a lawsuit.

"Created" and "Assumed" Contractual Liabilities

First, it is important to recognize that "contractual liabilities" is a term of art when used in the insurance context. As we all know, insurance is intended to provide protection for fortuitous risks, more commonly known as accidents.

Consider the case of a manufacturer suing a retailer "in contract" for payment of an overdue account. Clearly a insurer does not have to respond in such a situation, as it is not this type of "contractual liability" that the Former IBC CGL Form arguably covers. Rather, in the insurance context what is being considered here is a liability insurer's coverage obligations where the insured has assumed responsibility in a contract, whether expressly or implicitly, for the liability resulting from an unexpected or unintended event (*e.g.*, an accident).

This latter form of contractual liability has become ubiquitous in modern commerce. The example of a construction site can be used to explain the implicit adoption of a contractual liability. The general contractor contracts with the developer to build the project. Trades contract with the general contractor to complete specific aspects of the project. Each parties' specific responsibility is (or ideally should be) spelled out in the various contracts. With responsibility comes the potential for assignment of liability.

An accident at or problem at the construction site leaves each party pointing the finger at the other. Reference is made to the contracts and, again ideally, the contracts identify the party that was assigned responsibility for the problem area. The injured party, say the developer in this scenario, then can bring an action *in contract* against the general contractor who by virtue of its contract with the developer has overall responsibility for the project, and as well as *in tort* against those trades that may have been involved. We can term the general contractor's liability in this case to have been implicitly "created by contract" (though there may also be a co-extensive cause of action in tort). This is one common way in which an insured can be exposed to contractual liability.

The other "express" way in which an insured can accrue contractual liability is by "assuming by contract" the liability of a third party. Indemnities, "hold harmless" agreements and waivers are all means of "assuming" the liabilities of a third party. As the world (or at least the U.S.) becomes increasingly litigious, contractual indemnities in particular have become a standard fixture in commercial contracts.

Historic Treatment of Contractual Liabilities in a CGL Policy

Historically, Canadian liability insurers did not consider that contractually created or assumed liabilities should be covered by a CGL policy. There were good practical reasons for this position. Specifically, the business of underwriting risks involves an assessment of the risk. An underwriter can, theoretically at least, analyze and infer the risk of a claim against an insured arising as a result of the insured's own negligent acts. But this task, difficult at the outset, becomes mere guesswork if you allow the insured to take on unwarranted obligations via contract, or to assume any or all risks occasioned by the misadventures of a third party, and pass such contractual liabilities on to the insurer.

This position held through to at least 1953 and the Supreme Court of Canada's judgment in *Andrews & George Co. v. The Canadian Indemnity Co.*[58] In this case the Court found that the statement in the insuring agreement that the insurer would "*[I]ndemnify the Insured against the liability imposed by law*" (synonymous with the current term "*legally obligated to pay*"[59]) did *not* grant coverage for liability assumed by contract. *Andrews &*

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[58] [1953] 1 SCR 19 [hereafter "*Andrews*"].

[59] New IBC CGL Form:

> COVERAGE A. BODILY INJURY and PROPERTY DAMAGE LIABILITY
> Insuring Agreement
> *We will pay those sums that the insured becomes legally obligated to pay as "compensatory damages" because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend the insured against any "action" seeking those "compensatory damages". However, we will have no duty to defend the insured against any "action" seeking "compensatory damages" for "bodily injury" or "property damage" to which this insurance does not apply. [emphasis added]*

George, supra, involved a third party suing the insured for damages resulting from the insured's sale, by contract, of glue to the third party. On the insured seeking recovery from its insurer of the award made against it the Court found in favour of the insurer and concluded that "*liability imposed by law*" required that the underlying cause of action arise not merely from a contract but by operation of "law" (*e.g.*, tort or statute).

The Courts subsequently reversed their thinking, arguably in recognition of the ever-increasing importance and necessity of contractual liabilities to the proper functioning of commerce (and hence the necessity that there be insurance available to address such liabilities). The insuring agreement's key term, "*legally obligated to pay*", is now understood to encompass most, if not all, created and assumed "*contractual liabilities*". While the Courts went back and forth on this matter throughout the 1970s and '80s a defining judgment was that of the British Columbia Court of Appeal in *Cultus Lake Park Board v. Gestas Inc.:*

> *the plain meaning of such phrases [as "legally obligated to pay" and "liability imposed by law"] includes any liability imposed by court judgment, whether that liability arises out of tort or contract or any other cause of action.* [60]

In response to this emerging reality Canadian liability insurers inserted a Contractual Liability Exclusion into their policies. As is usual with new policy terms, competing interpretations of the standard form of this exclusion have arisen.

The Contractual Liability Exclusion, as it appeared in the 1978 form issued by the IBC, read as follows:

> *This insurance does not apply to:*
> *(a) liability assumed by the Insured under any contract or agreement except an incidental contract …*

The exclusion was designed to withdraw from coverage the insured's liabilities under indemnity (*e.g.*, "hold harmless") agreements but contrary to this intention the Courts took a strict interpretation of the exclusion and applied it to all liabilities the insured assumed under contract.

For example, in *Dominion Bridge Co. v. Toronto General Insurance Co.*,[61] the insured contractor's error caused the collapse of the Second Narrows Bridge. Under its contract with the owner, the insured had assumed liability for poor workmanship and faulty design. Although the Court found the contractor liable in tort, it concluded that the

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[60] (1992), 12 C.C.L.I. (2d) 1 (BCCA), at p. 22
[61] [1963] SCR 362.

exclusion clause applied to relieve the insurer from coverage since the tortious "*liability imposed by law*" was one and the same as the "*liability imposed by contract*", which was excluded. It mattered not whether the liability was in tort or contract but only whether the claim fit within the language of the exclusion clause.

Such a result certainly offends our current sensibilities. After observing cases going both ways on this issue the IBC expanded on this clause in the wording of the Former IBC CGL Form: [62]

> *This insurance does not apply to:*
>
> *…*
>
> *b. "Bodily injury" or "property damage" for which the insured is obligated to pay compensatory damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for compensatory damages:*
>
> *1) Assumed in a contract or agreement that is an "insured contract"; or*
>
> *2) That the insured would have in the absence of the contract or agreement.*
>
> *"Insured contract" means:*
>
> *a. A lease of premises;*
>
> *b. A sidetrack agreement:*
>
> *c. Pedestrian private railroad crossings at grade;*
>
> *d. Any other easement agreement;*
>
> *e. An indemnification of a municipality as required by ordinance, except in connection with work for a municipality;*
>
> *f. An elevator maintenance agreement; or*
>
> *g. That part of any other contract or agreement pertaining to your business under which you assume the tort liability of another to pay compensatory damages because of "bodily injury" or "property damage" to a third person or organization, if the contract or agreement is made prior to the "bodily injury" or "property damages". Tort liability means a liability that would be imposed by law in the absence of any contract agreement.*

Exclusion b.2 eliminated the problem exemplified by the *Dominion Bridge* case by instituting an exception to the exclusion where the contractual and tortious duties are co-extensive.

Further exceptions to the exclusion were also instituted, specifically for contractual liabilities assumed in an "*insured contract*".[63] The exceptions were primarily aimed at permitting businesses to assume, by way of indemnity, the tortious liability of third parties. Clauses a. to f. in the definition of "insured contract" address common indemnities that are well recognized in the commercial sphere and can be readily taken into account by an underwriter considering a risk. Clause g. opens the net wider and

[62] This extract comes from the wordings in Coverage A: Bodily Injury and Property Damage Liability.

[63] Some of these exceptions were included in the 1978 wording but were expanded and added to in the 1986 wording.

functions as a catchall for other indemnities that "*pertain to your business*". This exception was primarily directed at building contractors as construction is one area where indemnities are expected and commonly required, and hence can be factored in by underwriters, but that the earlier wording excluded from coverage.

However, while the Former IBC CGL Form worked to eliminate certain of the inconsistent judicial treatment of contractual liabilities, and specified in much greater detail the intended extent of the insurer's obligations, further problems with the exclusion arose. Hence, the changes to the New IBC CGL Form wording discussed below.

The New IBC CGL Form Wording

The Contractual Liability Exclusion

The New IBC CGL Form Contractual Liability Exclusion and the definition of "*insured contract*", with substantive changes from the Former IBC CGL Form underlined, are as follows:

This insurance does not apply to:

b. Contractual Liability

"Bodily injury" or "property damage" for which the insured is obligated to pay "compensatory damages" by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for "compensatory damages":

(1) That the insured would have in the absence of the contract or agreement; or

(2) Assumed in a contract or agreement that is an "insured contract", provided the "bodily injury" or "property damage" occurs subsequent to the execution of the contract or agreement. Solely for the purposes of liability assumed in an "insured contract", reasonable legal fees and necessary litigation expenses incurred by or for a party other than an insured are deemed to be "compensatory damages" because of "bodily injury" or "property damage", provided:

(a) Liability to such party for, or for the cost of, that party's defense has also been assumed in the same "insured contract"; and

(b) Such legal fees and litigation expenses are for defense of that party against a civil or alternative dispute resolution proceeding in which "compensatory damages" to which this insurance applies are alleged.

"Insured contract" means:

a. *A contract for a lease of premises. However, that portion of the contract for a lease of premises that indemnifies any person or organization for damage*

to premises while rented to you or temporarily occupied by you with permission of the owner is not an "insured contract";

b. *A sidetrack agreement;*
c. *An easement or license agreement in connection with vehicle or pedestrian private railroad crossings at grade;*
d. *Any other easement agreement;*
e. *An obligation, as required by ordinance or bylaw, to indemnify a municipality, except in connection with work for a municipality;*
f. *An elevator maintenance agreement;*
g. *That part of any other contract or agreement pertaining to your business (including an indemnification of a municipality in connection with work performed for a municipality) under which you assume the tort liability of another party to pay for "compensatory damages" because of "bodily injury" or "property damage" to a third person or organization, provided the "bodily injury" or "property damage" is caused, in whole or in party, by you or by those acting on your behalf. Tort liability means a liability that would be imposed by law in the absence of any contract or agreement.*

Paragraph g. does not include that part of any contract or agreement:

1. *That indemnifies an architect, engineer or surveyor for injury or damage arising out of:*
   (a) *Preparing, approving, or failing to prepare or approve, maps, shop drawings, opinions, reports, surveys, field orders, change orders or drawings and specifications; or*
   (b) *Giving directions or instructions, or failing to give them, if that is the primary cause of the injury or damage; or*
2. *Under which the insured, if an architect, engineer or surveyor, assumes liability for an injury or damage arising our of the insured's rendering or failure to render "professional services", including those listed in* ***(1)*** *above and supervisory, inspection, architectural or engineering activities.*

There are five substantive changes (two of which appear in clause b.2). The second of the changes, regarding the impact of costs of defence on policy limits, is addressed in a separate section below. The last of the changes, adding a further term regarding architects, engineers and surveyors will not be addressed other than to note it excludes coverage for contractual indemnities entered into by such professionals. The further three changes, as follows, will be addressed in turn:

1. *"provided the 'bodily injury' or 'property damage' occurs subsequent to the execution of the contract or agreement";*
2. *"However, that portion of the contract for a lease of premises that indemnifies any person or organization for damage to premises while rented to you or temporarily occupied by you with permission of the owner is not an 'insured contract'"*

3. *"provided the 'bodily injury' or 'property damage' is caused, in whole or in party, by you or by those acting on your behalf."*

In the Former IBC CGL Form it was only the clause g. catchall clause that required that an "*insured contract*" must be executed prior to the cause of action arising. The New IBC CGL Form wording moved this term to the preamble of the exclusion so that now it applies to each of the listed varieties of insured contract. Commentators had noted that the Former IBC CGL Form wording could arguably permit, for example, a landlord to suffer a loss and subsequently enter into a lease containing a retroactive contractual indemnity. Such an indemnity, with the tenant assuming liability for the landlord's ongoing claims, could then be used to trigger coverage on the part of the tenant's insurer even where the insured was entirely uninvolved in the loss.[64] This change was merely a fix to a drafting oversight.

This addition closes a large and unintended gap in the wordings of the Former IBC CGL Form policy that arguably granted tenants' legal liability coverage to insureds purchasing only bodily injury and property damage coverage.

In both the Former and the New IBC CGL Forms, under Coverage A – Bodily Injury and Property Damage Liability, there was a Grant of Coverage for "compensatory damages" arising from "bodily injury" or "property damage". Exclusion h. (in the Former IBC CGL Form wording) to Coverage A excludes from coverage "*property damage to property you own, rent or occupy*". The basis for such an exclusion is well understood; basic CGL policies are intended to serve only as liability policies and not as property policies. For businesses that own the land or building from which they operate, Canadian liability insurers expect the business to buy (and the insurer would therefore obtain a premium for) a property policy. For businesses that lease premises insurers expect the business to purchase a policy that includes, for an additional premium, Coverage D – Tenants' Legal Liability.

Coverage D – Tenants' Legal Liability (Former IBC CGL Form wording) states:

> *We will pay those sums that the insured becomes legally obligated to pay as compensatory damages because of property damage to which this insurance applies. … This insurance applies only to property damage … to premises rented to you or occupied by you.*

The problem inherent in the wording of the Former IBC CGL Form is that it did not reconcile the ambiguity between the coverage maintained for "*insured contracts*", which included a "*contract for lease of premises*" as a component of the Contractual Liability Exclusion, with the operation of the property damage exclusion. Where the insured had not purchased tenants' legal liability coverage it was nonetheless left open for an

[64] P. Willcock "The 'New' Commercial General Liability Policy: The Contractual Liability Exclusion in the 2005 IBC CGL Form" (March 2006).

insured to argue that Coverage A applied where a landlord sought recovery from the insured for damages to the leased premises under an indemnity contained in the lease.

It is a rule of construction regarding insurance policies that an exception to an exclusion clause can never be relied upon to create coverage. However, there is uncertainty as to how a Court would react to this situation where one exclusion clause specifically reasserts coverage for an indemnity contained in a lease while another exclusion clause removes coverage for damage to the leased property. It was to avoid the potential for this sort of argument that the drafters of the New IBC CGL Form redrafted the exclusion.

Again, this exception to the exception provides that a lease qualifies as an "*insured contract*" except insofar as it includes an indemnity for "*damages to premises while rented to you or temporarily occupied by you with permission of the owner*". As a practical example consider where an insured leases one unit in a multi-unit commercial complex and the insured's negligent act causes a fire to destroy both its own leased premises and the rest of the complex. The insured's property policy would respond to the damage to its own property (*i.e.*, its goods and equipment). Coverage A of the insured's general liability policy would respond to the claims brought by the other tenants in the complex in respect of the damage to their goods and equipment.

But what of the property owner's claim for the destruction of the building? Coverage A responds, just as it does for the other tenants, for that damage to the building that is not "*owned, rented or occupied*" by the insured. However, the Coverage A exclusion for property damage to property you rent or occupy excludes coverage under this head. Rather, it is contemplated that an insured would purchase a Coverage D Tenants' Legal Liability Policy and that it would be the policy to respond in respect of damage to that portion of the premises rented to or occupied by the insured. The premium for such coverage will, of course, depend on the size and value of the premises whereas in determining a premium for Coverage A it is the extent of the operation (e.g. revenue, number of employees) that the underwriter is focussed on.

So, again, what this addition to the "*insured contract*" language ensures is that no insured seek recovery under Coverage A for damage to the premises it occupies and instead prompts the insured to pay an extra premium to obtain Coverage D as well.

For ease of reference clause g. of the Contractual Liability Exclusion, New IBC CGL Form wording, states in part that an "*insured contract*" is:

> *That part of any other contract or agreement pertaining to your business … under which you assume the tort liability of another party … provided the "bodily injury" or "property damage" is caused, in whole or in party, by you or by those acting on your behalf.*

Under the wordings of the Former IBC CGL Form it was unclear whether the policy was meant to provide coverage for a third party's negligence in the event that such an indemnity was offered and found enforceable.[65] The addition to the wording makes it clear that the insured (or those acting on its behalf) must have some degree of direct liability for the loss for the insurer to provide an indemnity to the third party for its liability or costs. While reasonable from the insurer's point of view, reflecting the idea that insurers are only intending to insure one's own business, this can be problematic for insureds who carelessly enter into contracts without reading the indemnity fine print.

The use of the expression "*caused … by you or by those acting on your behalf*" results in some ambiguity and may well result in litigation in the future. Clearly the acts of the insured and its employees are included by this term. Further, the acts of independent contractors retained by the insured should come within this clause. However, what about a situation in which the insured general contractor, to go back to the construction industry example, has hired a trade and the loss was caused by the actions of the trade? While the rationale for the inclusion of this "*acting on your behalf*" term is not known, the use of this language will likely include trades and sub-trades on a construction site .

Duty to Defend

There are two issues here: first, is a Canadian liability insurer obligated to reimburse an indemnified third party for its defence costs, and second, is that same insurer obligated to actively defend the third party from the outset?

Any duty to defend a third party indemnitee, if it existed, was not clearly spelled out in the Former IBC CGL Form wording. To paraphrase, the Former IBC CGL Form wording did state "*we will have the right and duty to defend any 'action' seeking … those sums that the insured becomes legally obligated to pay as compensatory damages*".

It does not appear that the first issue, whether the insurer's obligations to an indemnitee include both reimbursement for defence costs as well as any compensatory damages the indemnitee was compelled to pay out, has been litigated in Canada. In our opinion, provided the terms of the indemnity were broad enough to encompass defence costs then reimbursement is owed. From a theoretical perspective the insured's exposure under the indemnity would be to compensate the indemnitee for its loss, which would include all expenses incurred in defending the underlying claim. Phrased in this way the amount owed by the insured to the indemnitee is purely in the nature of compensatory damages.

[65] The enforceability of such of provision is of some doubt. At the very least the Courts have held that a clause will not be construed so as to indemnify against one's own negligence without express words to that effect: *Powell Equipment Co. v. Lac Seul Land & Lumber Co.*, [1965] 1 O.R. 545 (H.C.J.).

On the second issue the language in the Former IBC CGL Form, referring to "*any action*" (as opposed to "*an action against the insured*"), suggests that the insurer would be obligated to defend the indemnified party. In practice, however, such an obligation is seldom acted upon. The problem facing an indemnified party is the reluctance of the Court to determine indemnity obligations in advance of the disposition of the underlying matter. Often Courts are required to making findings of fact about the loss itself in order to identify the relevant indemnity obligations and judges correctly refuse to make any such findings regarding the loss as to do so could bind the Judge in the underlying action. Accordingly, in our experience, the general practice in British Columbia is for each party (or party's insurer) to retain its own counsel and to defend its own interests and wait until the conclusion of the matter, either on settlement or following trial, to deal with the question of the indemnity as part and parcel of the settlement with the Plaintiff.

With the introduction of the New IBC CGL Form wording, this practice may change. You will recall from the prior discussion that "*insured contracts*" are excepted from the Contractual Liability Exclusion. Subsection 2. of the "*insured contract*" exception expressly contemplates the liability insurer assuming responsibility for the costs of the indemnified party's defence provided that the indemnity expressly includes a provision regarding defence costs.

Further, the New IBC CGL Form wording now expressly addresses the occasional practice of the insured indemnitor's counsel actively assuming the defence of the indemnitee. This is addressed in a significantly expanded section on Supplementary Payments:

> 2. *If we defend an insured against an "action" and an indemnitee of the insured is also named as a party to the "action", we will defend that indemnitee if all of the following conditions are met:*
>
> a. *The "action" against the indemnitee seeks "compensatory damages" for which the insured has assumed the liability of the indemnitee in a contract or agreement that is an "insured contract";*
>
> b. *This insurance applies to such liability assumed by the insured;*
>
> c. *The obligation to defend, or the cost of the defense of, that indemnitee, has also been assumed by the insured in the same "insured contract";*
>
> d. *The allegations in the "action" and the information we know about the "occurrence" are such that no conflict appears to exist between the interests of the insured and the interests of the indemnitee;*
>
> e. *The indemnitee and the insured ask us to conduct and control the defense of that indemnitee against such "action" and agree that we can assign the same counsel to defend the insured and the indemnitee; and*
>
> f. *The indemnitee:*
>
> *(1) Agrees in writing to: [various conditions]*
>
> *(2) Provides us with written authorization to: [various conditions]*

The principal terms to be taken from the foregoing are that the insurer "*will defend that indemnitee if … no conflict appears to exist between the interests of the insured … and the indemnitee and the insured … agree that we can assign the same counsel to defend the insured and the indemnitee*". We can expect counsel for indemnitees to actively push for their client's defence to be taken over, which given the use of the imperative word "*will*", the indemnitor's insurer must seriously consider.

Treatment of Indemnified Defence Costs of a Third Party

As for the treatment of the defence costs of a third party one might initially think that they should be given the same consideration as the costs of defending an insured; that is, they should be treated as being in addition to policy limits. The express clause regarding the treatment of defence costs incurred on behalf of an insured, appearing in both the Former and the New IBC CGL Form wordings,[66] as taken from the Supplementary Payments section is:

> *We will pay, with respect to any claim we investigate or settle, or any "action" against an insured we defend:*
> *a. All expenses we incur. …*
> *These payments will not reduce the limits of insurance.*

However, when duly considering the relevant sections of the Former IBC CGL Form, it becomes apparent that it is arguable, and perhaps a required interpretation, that all amounts payable under an indemnity including the costs to defend the indemnity are properly classified as compensatory damages and hence serve to erode the policy limit.

While uncertain to a degree under the wording of the Former IBC CGL Form, the wording of the New IBC CGL Form specifically addresses this issue. Subsection 2. to the Contractual Liability Exclusion states in part:

> *Solely for the purposes of liability assumed in an "insured contract", reasonable legal fees and necessary litigation expenses incurred by or for a party other than an insured are deemed to be "compensatory damages" because of "bodily injury" or "property damage", provided*:
> *(a) Liability to such party for, or for the cost of, that party's defense has also been assumed in the same "insured contract"; and*
> *(b) Such legal fees and litigation expenses are for defense of that party against a civil or alternative dispute resolution proceeding in which "compensatory damages" to which this insurance applies are alleged.*

[66] The 1986 wording is actually less specific, stating "we will pay, with respect to any claim or 'action' we defend", though in practice we know of no attempt by an insurer to saddle an insured with costs of a claim "investigated or settled" where no "action" was commenced.

This clause, in a straightforward manner, dictates the conditions under which the costs to defend an indemnitee will erode policy limits. In certain circumstances this is an important issue to have clarified. Consider for example how the defence costs in the case of *British Columbia v. Surrey School District No. 36*[67] would have impacted on limits and therefore the amount remaining to the insured for the purposes of indemnity:

> *[33] The root issue between the parties, an issue which went to arbitration, was whether under a scheme of indemnity the Crown is obliged to reimburse the respondent for the costs it was obliged to pay the petitioners in the cause célèbre known as* ***Chamberlain v. Surrey School District No. 36****, [2002] 4 SCR 710, 221 DLR (4th) 156, 2002 SCC 86, in which the Supreme Court of Canada held that certain resolutions of the respondent's Board of Trustees were not within the powers conferred on them by the* ***School Act****, R.S.B.C. 1996, c. 412, and for its own legal fees, a total sum, I understand, of approximately $1.2 million.*

In light of this consideration insurers must be cautious in determining whether an indemnity is indeed owed to a third party given the potential for such an indemnity to leave an insured without sufficient limits to pay out the underlying claim.

The New IBC CGL Form wording goes some way to answering this question. Under Supplementary Payments, and in respect of the discussion in the foregoing section on the potential for the insured's counsel to take on the defence of the indemnified party, the New IBC CGL Form wording includes the following:

> *So long as the above conditions are met, legal fees incurred by us in the defense of that indemnitee, necessary litigation expenses incurred by us and necessary litigation expenses incurred by the indemnitee at our request will be paid as Supplementary Payments. Notwithstanding the provisions of Paragraph 2.b. (2) of Section I – Coverage A – Bodily Injury and Property Damage Liability, such payments will not be deemed to be "compensatory damages" for "bodily injury" and "property damage" and will not reduce the limits of insurance.*

Accordingly, in situations where limits may become an issue there is a real incentive for both the insured and the indemnified party to comply with the stated conditions and permit the insurer to appoint a single counsel to represent both parties. Of course, one of the conditions is that no conflict of interests exists between these two parties to prevent the mounting of a common defence.

Conclusion

The changes regarding contractual liabilities embodied in the New IBC CGL Form wording have cleared up the major uncertainties remaining under the Former IBC CGL

[67] 2005 BCCA 106.

Form. Of course, we can still expect some litigation of these new terms to fully flush out their strength and extent.

For the most part the wording changes have only confirmed what has become practice in the industry though some changes (removing indemnities in leases from coverage; requiring that the insured bear some fault before coverage to a third party under an indemnitee is granted) actively modify the legal landscape. It will be particularly interesting to see if the express provision for the assumption of an indemnitee's defence and the impact of an indemnitee's defence costs on limits have any effect on the general practice. Of course, as with most things, the true consequences of these changes will only become apparent with time.

THE EMPLOYER'S LIABILITY EXCLUSION

Each of the provinces has a workers' compensation scheme, which is mandated by statute and funded by all registered employers in the province. For employment related injuries, the workers' compensation scheme will be the sole recourse for the worker. The New IBC CGL Form expressly excludes coverage for insureds for any obligation of that insured under workers' compensation law.

> *This insurance does not apply to:*
> ***C. Workers Compensation and Similar Laws***
> *Any obligation of the insured under a workers' compensation, disability benefits or unemployment or employment compensation law or any similar law.*

Canadian liability insurers have only rarely had to respond to claims for work related injuries, and under very limited circumstances. The wording of the New IBC CGL Form expands the Employer's Liability Exclusion. This section of the paper will describe the old and new wordings, and focus on several select areas: the additional restrictions in respect of claims of family members of an employee, the implications of the expansion of the definition of "employee" to include specific classes of individuals, and changes to the WCB exception to the exclusion.

Policy Wordings, Old and New

The Former IBC CGL Form Employer's Liability Exclusion read as follows:

> *This insurance does not apply to:*
> *d) "Bodily injury" to an employee of the insured arising out of and in the course of employment by the insured.*
> *This exclusion applies:*
> *1) Whether the insured may be liable as an employer or in any other capacity; and*

2) To any obligation to share compensatory damages with or repay someone else who must pay compensatory damages because of the injury.

This exclusion does not apply:

i) To liability assumed by the insured under an "insured contract"; or

ii) To employees on whose behalf contributions are made by or required to be made by the insured under the provisions of any workers compensation law

The New IBC CGL Form wording for the Employer's Liability Exclusion reads as follows (with changes underlined):

This insurance does not apply to:

d. Employer's Liability

"Bodily injury" to:

(1) An "employee" of the insured arising out of and in the course of:

(a) Employment by the Insured; or

(b) <u>Performing duties related to the conduct of the insured's business; or</u>

(2) <u>The spouse, child, parent, brother or sister of that "employee" as a consequence of Paragraph 2.d (1) above.</u>

This exclusion applies:

i) Whether the insured may be liable as an employer in any other capacity; and

ii) To any obligation to share "compensatory damages" with or repay someone else who must pay "compensatory damages" because of the injury.

This exclusion does not apply to:

(a) Liability assumed by the insured under an "insured contract"; or

(b) <u>A claim made or an "action" brought by a Canadian resident "employee" on whose behalf contributions are made by or required to be made by you under the provisions of any Canadian provincial or territorial workers' compensation law, if cover or benefits have been denied by any Canadian Workers' Compensation Authority.</u>

The most important question in interpreting the new wording is "who is an employee"? "*Employee*" is defined as including a "*leased worker*" and a "*temporary worker*" which, in turn, are defined as follows:

"Leased worker" means a person leased to you by a labour leasing firm under an agreement between you and the labour leasing firm, to perform duties related to the conduct of your business. "Leased worker" does not include a "temporary worker".

"Temporary worker" means a person who is furnished to you to substitute for a permanent "employee" on leave or to meet seasonal or short-term workload conditions.

Some legal experts have acknowledged that the wording of the previous Employer's Liability Exclusion was convoluted, to the point where it was difficult to understand exactly what was being excluded from coverage.[68] While increasing restrictions, the New IBC CGL Form has done little to improve the readability of the clause. Whether or not that difficulty will also be encountered by Canadian Courts when presented with the right facts and questions of interpretation is yet to be seen.

Caselaw and Coverage under the Former IBC CGL Form

There are very few cases in Canadian jurisprudence that consider employment related injuries. The cases below provide some guidance as to how the Courts will deal with the new Employer's Liability Exclusion and the interpretive analysis when faced with these circumstances.

In the case of *Stolberg v. Pearl Assurance Co.*,[69] a worker was killed on the job while under the direct supervision of the company president. The insurer had issued a comprehensive liability insurance policy which excluded injury or death sustained by "*any employee of the Insured*…". The worker's widow sued the company president who, in turn, sought a defence and indemnity pursuant to the policy. He had been added as a named insured in his personal capacity by endorsement the year before. The insurer denied coverage.

The Supreme Court of Canada reviewed the facts and the policy. The Court found that the deceased employee was not a direct employee of the company president, but rather an employee of the company. The Court determined that in order for the exclusion clause to be effective, the exclusion would have had to apply to "*any employee of any of the Insured*". As it was written, an employee with a claim against the employer would have to be a direct employee of the entity named in the claim for the exclusion to operate on the basis of the wording of the policy. The Court found that the company president was entitled to be indemnified.

Two more recent decisions of the B.C. Court of Appeal involved actions against film producers or production companies by performers in a production who were injured in the course of, or in relation to work performed for the production. In each case, the key issue was the nature of the employment relationship between the parties; these cases were decided under the former wordings.

In the first case, *MacKenzie v. Jevco Insurance Management Inc.*,[70] a stunt double was injured in a collision with another motorcyclist while the two were "between takes"

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[68] See Snowden & Lichty, *supra,* note 4 at section 16:10.
[69] [1971] SCR 1026, revg 13 DLR (3d) 215, [1970] I.L.R. 1092 (BCCA), affg 9 DLR (3d) 195, [1970] I.L.R. 975 (BCSC).
[70] (1986), 9 BCLR (2d) 127 (S.C.), affirmed (1988), 24 BCLR (2d) 360 (C.A.).

during a film production. The motorcyclist sued the production company. The Court reviewed the relationship between the parties and determined that, despite an assertion by the motorcyclist that he was an independent contractor, in substance, he was an employee of the production company. The exclusion applied; the attempt by the motorcyclist to recover judgment against the production company and its insurer failed.

In a later decision, *Walden v. Danger Bay Productions Ltd.*,[71] the Court again reviewed the terms of the contract between actors and a production company. In that case, the Court found that the actors operated as independent contractors, not employees and that their "acting" (i.e. the service contracted for) was not under the control of the production company. The insurer had to indemnify the insured.

Under the Former IBC CGL Form, coverage was excluded for employment related injuries, unless a claim arose in a) the context of liabilities assumed under an "*insured contract*" or b) if the claim was covered by workers compensation provisions. In those cases, the claim fell within exceptions to the Former IBC CGL Form Employer's Liability Exclusion.

The practical effect of the statutory workers' compensation exception to the exclusion has been that in jurisdictions where the circumstances of a loss arose within the context of a workers compensation scheme, the liability insurer still responded to the claim. However, the extent of the response typically involved an application to the relevant tribunal for a determination that the lawsuit against the insured fell within the ambit of the workers compensation legislation (i.e. the accident occurred to a worker in the course of employment), followed by dispensation of the claim against the insured directly. The only response required by Canadian liability insurers might be for defence costs, depending on the legislation in the relevant province.

Going forward, the change in wording in the New IBC CGL Form Employer's Liability Exclusion will not affect any disputes over whether an individual bringing a claim for bodily injury is an "employee".

Effect of the New IBC CGL Form Employer's Liability Exclusion

General Scope

As already stated, the wording of the New IBC CGL Form expands the scope of the Employer's Liability Exclusion. Instead of excluding only "*bodily injury*" "*arising out of and in the course of employmen*t", the new wording also excludes "*bodily injury*" that arises out of the performance of duties "*related to the conduct of the insured's business*". Thus a claim by an "*employee*" (including a "*leased worker*" or "*temporary worker*") under circumstances that may fall outside the scope of his or her defined employment, but

[71] (1994), 90 BCLR (2d) 180 (C.A.).

whose injury occurs while performing duties related to the conduct of the insured's business, will now be excluded.

"Leased Worker" or "Temporary Worker"

The inclusion in the New IBC CGL Form of the wording of a "*leased*" or "*temporary worker*" in the definition of "*employee*" ensures that any bodily injury claim relating to those workers in the course of work done for the insured are excluded from coverage. In most cases, unless the insured is exempt from compulsory WCB coverage, "*leased*" or "*temporary workers*" are ones for whom a premium must be paid, if not by the insured, then by the outside employer providing the "*leased worker*" to the insured to undertake work in conjunction with the insured's business. The onus is on the insured to make sure that anyone who falls within the definition of "*leased*" or "*temporary worker*" is properly covered pursuant to applicable workers compensation provisions (the compulsory coverage), or that an EPL endorsement is in place in order to avoid any gap in coverage.

The Family Member Exclusion

The New IBC CGL Form Employer's Liability Exclusion specifically excludes any claim by an immediate family member of an "*employee*" as a consequence of "*bodily injury*" to that "*employee*". This sub-paragraph again relates to the interplay between the New IBC CGL Form and workers' compensation schemes. The intent of this expansion in wording is to clarify that the claim of consequential damage by any of the defined family members should be filed under the employer's liability portion of the workers' compensation scheme.

"Insured Contract" exception

In the New IBC CGL Form wordings, there are some changes to the definition of "insured contract" which may affect the circumstances in which coverage will exist for certain claims. The definition of Insured Contract is reproduced below for ease of reference, and this discussion of it only applies to the Employer's Liability Exclusion:

> *"Insured contract" means:*
>
> *g. That part of any other contract or agreement pertaining to your business (including an indemnification of a municipality in connection with work performed by a municipality) under which you assume the tort liability of another party to pay for "compensatory damages" because of "bodily injury" or "property damage" to a third person or organization, provided the "bodily injury" or "property damage" is caused, in whole or in part by you or by those acting on your behalf. Tort liability means a liability that would be imposed by law in the absence of any contract or agreement.*

The change in wording to the definition of "*insured contract*" affects the exception to the exclusion in paragraph 2.d.(1)(a) of the Employer's Liability Exclusion. The exclusion referenced (an obligation to share in or repay another who must pay "*compensatory damages*" because of the injury) is excepted where the liability is assumed by the insured pursuant to an "*insured contract*".

As with the previous wording of the Employer's Liability Exclusion, the contract in which tort liability of another is assumed must pertain to the insured's business. American cases have ruled that liability must be specifically assumed in the agreement, and indeed must be the subject matter of the agreement for it to be found to be an "*insured contract*".[72] In the New IBC CGL Form, the definition pursuant to clause g. of the definition of "Insured Contract" has been narrowed to stipulate that liability for bodily injury or property damage assumed has to be caused in whole or in part by the insured or those acting on behalf of the insured. A question the Courts will likely be called upon to decide at some stage is whether "*caused, in whole or in part, by you or by those acting on your behalf*" applies only to direct liability or whether it includes vicarious liability.

When the WCB "Tort Immunity" is Not Applicable

Historically, a general liability policy with a workers' compensation exclusion prevented duplication of coverage. It required an insured to a) determine whether it was an "employer" within the workers compensation scheme, then b) pursue any claim for bodily injury by an employee within the ambit of the workers compensation process. In instances in which the provisions of a jurisdiction's workers' compensation legislation did not apply to a particular insured, the Employer's Liability Exclusion operated to bar coverage for bodily injury to an employee. The gap in coverage for such an insured could then be remedied by the purchase of an Employment Liability Endorsement.

The scope of industries and employment relationships captured by workers compensation compulsory coverage requirements has typically expanded over time. Where an insured falls within a category requiring it to pay premiums for all of its employees, the insured has a reasonable expectation that it is protected against claims of bodily injury by an employee. In these circumstances, the purchase of an Employer's Liability Endorsement would function as an unnecessary duplication in coverage, unless, after consideration of the circumstances of the loss, a workers' compensation authority determines that the conditions of the scheme are not met. The New IBC CGL Form Employer's Liability Exclusion prevent an insured from being caught without coverage in those circumstances.

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[72] *West v. Jacobs*, 790 S.W. 2d 475 (Mo. App. 1990).

In the event a workers' compensation authority has denied benefits to an employee for whom the insured has paid or is required to pay premiums, the exception at Paragraph 2.d.(1)(b) operates to bring the claim back within coverage. Note, however, that the exception applies only to Canadian resident "employees" for whom the insured is required to pay premiums pursuant to Canadian provincial or territorial workers' compensation laws. Hence, for companies employing workers resident in foreign jurisdictions, the exception does not apply. In an era of globally operated companies, the restriction of the exception to Canadian resident employees is obviously necessary to permit a Canadian liability insurer to properly assess risk. Depending on the location of operations and the industry in which the insured is involved, exposure could vary significantly. In respect of non-resident employees, insured's may purchase separate Employment Liability Coverage.

The New IBC CGL Form Employer's Liability Exclusion clause has not been the subject of great judicial scrutiny to date. Whether this will change in light of the new wordings is yet to be seen.

THE PROFESSIONAL SERVICES EXCLUSION

Introduction

The New IBC CGL Form contains a Professional Services Exclusion which will result in an increased number of claims being excluded from coverage. The New IBC CGL Form Professional Service Exclusion makes it clear that claims arising from errors or omissions in services provided by even non-traditional professionals will be excluded from coverage if those persons were exercising specialized skill and training when the error or omission occurred. This is yet another example of how the New IBC CGL Form contains exclusions that have been broadened to further restrict coverage.

To put the Professional Services Exclusion in the New IBC CGL Form in context, it is helpful at the outset to review the Grant of Coverage in a typical Professional Liability Policy. A typical English policy offering errors and omissions coverage wording is as follows:

> ***INSURING CLAUSES***
>
> *NOW THEREFORE, the Insurer hereby agrees to pay on behalf of the Insured, all sums in excess of the deductible as set forth in Item 6 of the Schedule which the Insured becomes legally obligated to pay as compensatory damages in respect of any claim or series of claims from the same originating cause made against them as a direct result of any negligent act, error or omission in the performance or the failure to perform professional services usual to the Insured's Business as stated in Item 3 of the Schedule, provided any legal action, suit or arbitration proceeding to recover damages in respect of such claim is first made either …against the Insured within the Policy Period…or…against the Insured following termination…of the Policy…*

A typical American or Canadian liability policy for professionals has the following Grant of Coverage:

> ***1. Insuring Agreement***
>
> *To pay on behalf of the INSURED all LOSS in excess of the Retention amount stated in Item 4. of the Declarations as a result of Claims first made against the Insured and reported to the Company, in writing, during the Policy Period, Automatic Extended Reporting Period, or Optional Extended Reporting Period, by reason of any act, error or omission in professional services rendered or that should have been rendered by the Insured or any other person whose acts, errors or omissions the Insured is legally responsible…[p]rovided always that such act, error, or omission must have been committed or alleged to have been committed…during the policy period, or prior to the policy period and subsequent to the retroactive date…*

The Former IBC CGL Form Professional Services Exclusion

Prior to the issuance of the New IBC CGL Form, Canadian liability insurers commonly used a variety of wordings in CGL policies to exclude professional services from coverage, two examples of which are set out below:

> *Exclusion*
>
> *This policy does not apply to:*
>
> *9. Liability arising out of the rendering of or the failure to render professional services, or any error or omission, malpractice or mistake of a professional nature committed by or on behalf of the Insured in the conduct of any of the Insured's business activities, except that this Exclusion shall not apply to incidental medical first aid treatment…*
>
> *Exclusions – Professional Liability – Errors & Omissions*
>
> *It is understood and agreed that this policy excludes any liability arising directly or indirectly out of the performance or non-performance of professional services, including supervisory, inspection or engineering services, by or for the Insured, or out of any defects, errors, or omissions in any reports, specifications, maps, plans, permits, opinions, surveys, designs, or recommendations prepared, supplied or approved by or for the Insured, or the rendering or omission of professional services in connection therewith.*

The policies containing these exclusions do not define the term "professional services".

In an early, and important test case for what constitutes "Professional Services" the B.C. Supreme Court was asked to opine on another typical wording in the following exclusion, the outcome of which is discussed at length below:

> *This policy shall not cover the liability for claims arising out of bodily injury, sickness or disease including death at any time resulting therefrom sustained by any person or persons, nor for damage to or destruction of, or loss of use of property caused directly or indirectly by:*
>
> *(i) defects in maps, plans, designs or specifications prepared, acquired or used by the Insured;*

(ii) errors or omissions in the rendering of professional services

The Legal Test for "Professional Services" and Professionals

There are several vocations which have traditionally been recognized and labelled as "professions", namely doctors, lawyers, engineers and architects. However, the Courts have not resorted solely to these labels to determine whether a function performed by an individual amounts to a professional service. Rather the Courts examine the nature of a particular act or service to determine if it is a professional service.

In *Chemetics International Ltd. v. Commercial Union Assurance Co. of Canada*[73] the B.C. Supreme Court had occasion to consider what constituted a "professional service". In that case, a professional firm designed and supplied a pulp bleaching plant for a US-based customer. After construction was completed, the insured kept a supervisor on site to train the operators, and it also provided a training manual to the owner. The tower of the pulp bleaching plant was damaged when the operator failed to react properly to a pump failure. The owner successfully sued the insured in the United States having alleged that the insured had failed to warn it about pump failure and how to handle such a situation. The insured then brought an action in Canada against its' general liability insurer. The policy excluded:

> *…liability for claims…for damage to…property caused directly or indirectly by…errors or omissions in the rendering of professional services.*

The B.C. Supreme Court first addressed what activities fell within the meaning of the words "professional services". The Court said:

> *I adopt, as part of my concept of a professional service, the principle enunciated in the Marx case, where it was said…:In determining whether a particular act or omission is of a professional nature the act or omission itself must be looked at and not the title or character of the party who performs or fails to perform the act.*
>
> *…In other words, a professional service must embrace both a mental or intellectual exercise within a recognized discipline and the application of special skill, knowledge and training to the particular function in question.*

The Court determined that the exclusion did not apply because providing a warning about pump failure did not require a specialized skill. The Court said:

> *In my opinion, the function of giving warning of the risk which gave rise to this liability would not necessarily be a professional service. The person giving the warning would simply be telling experienced pulp operators that, if there is a temporary interruption in the removal of pulp stock from the tower but fresh pulp stock continues to enter the tower, dewatering will occur and a crust will form. He would also say that seal water entering the tower at the bottom would raise the*

[73] (1981), 31 BCLR 273 (S.C.).

> *plug, and care would have to be taken to ensure that the encrusted top of the plug, which they knew or ought to have known might not be level, did not rise enough to bear upon the roof. Such a warning required no special skill, learning, experience or training. It could have been given by a salesman, a tradesman or a technician, and it amounted to nothing more than ordinary common sense..* (emphasis added)

The Court's decision was upheld on appeal. The B.C. Court of Appeal dismissed the insurer's argument that the services in question had to be "professional" in nature because the individual who had supervised the writing of the manual was himself a professional engineer. The Court of Appeal said:

> *In the insurer's submissions, there is much emphasis upon the fact that Mr. Axen, the employee of Chemetics who supervised the writing of the manual and the provision of services called for in cl. 1.3, had the qualifications to be a professional engineer. He had qualified as such in his native Sweden and, after the completion of the Chesapeake project, qualified as a professional engineer in British Columbia but, at the time he was working on that project, was not formally qualified in either British Columbia or Virginia. I cannot agree that the fact that Chemetics, in providing services to Chesapeake, availed itself of the services of a person with professional qualifications is determinative of the question whether the services provided by Chemetics were professional services.* (emphasis added).

Coverage for Non-Professionals Providing Professional Services

As seen from the *Chemetics* case, Courts have determined that a professional services exclusion should not apply only to traditional professionals such as doctors and lawyers. However, there has likely been a reluctance to seek to enforce the exclusion against those providing services within certain recognized disciplines, even though they may be applying specialized skill and knowledge, because they are not in the classes that have traditionally been labelled "professionals".

Pharmacists, computer programmers, and insurance adjusters, for example, are all workers who provide services within a recognized discipline and apply specialized skill and knowledge in many of the functions they perform. However, because they have not traditionally been recognized and labelled as "professionals", the professional services exclusion has not routinely been applied to them to exclude CGL coverage for an error or omission when or if they provided a "professional service".

The Professional Services Exclusion

The New IBC CGL Form contains a Professional Services Exclusion, as follows:

> *2. Exclusions*
> *This insurance does not apply to:*
>
> *n. Professional Services*

"Bodily injury" (other than "incidental malpractice injury"), or "property damage" due to the rendering of or failure to render by you or on your behalf of any "professional services" for others, or any error or omission, malpractice or mistake in providing those services.

"Professional Services" are defined in the New IBC CGL Form as follows:

"24. "Professional services" shall include but not be limited to:

a. Medical, surgical, dental, x-ray or nursing service or treatment, or the furnishing of food or beverages in connection therewith;

b. Any professional service or treatment conducive to health;

c. Professional services of a pharmacist;

d. The furnishing or dispensing of drugs or medical, dental or surgical supplies or appliances;

e. The handling or treatment of deceased human bodies including autopsies, organ donations or other procedures;

f. Any cosmetic, body piercing, tonsorial, massage, physiotherapy, chiropody, hearing aid, optical or optometrical services or treatments;

g. The preparation or approval of maps, shop drawings, opinions, reports, surveys, field orders, change orders or drawings and specifications;

h. Supervisory, inspection, architectural, design or engineering services;

i. Accountant's, advertiser's, notary's (Quebec), public notary's, paralegal's, lawyer's, real estate broker's or agent's, insurance broker's or agent's, travel agent's, financial institution's, or consultant's professional advices or activities;

j. Any computer programming or re-programming, consulting, advisory or related services; or

k. Claim, investigation, adjustment, appraisal, survey or audit services.

Expansion of the Listing of Professional Services

The Professional Services Exclusion has greatly expanded the ambit of the former exclusion, which was most often applied in respect of traditional professionals such as architects and engineers. Recall that one of the commonly used professional liability exclusion wordings excluded coverage for *"…any defects, errors, or omissions in any reports, specifications, maps, plans, permits, opinions, surveys, designs, or recommendations prepared, supplied or approved by or for the Insured…"*. This language closely corresponds with the work product of architects and engineers. The new form of Professional Services Exclusion specifically excludes coverage for the professional services of the following classes:

1. medical professionals;
2. dentists;
3. dental hygienists;
4. x-ray technicians;

5. nurses;
6. pharmacists;
7. orthodontists;
8. massage therapists;
9. physiotherapists;
10. chiropractors;
11. chiropodist;
12. podiatrist;
13. cosmeticians;
14. barbers;
15. opticians;
16. optometrists;
17. cartographers;
18. architects;
19. engineers;
20. architectural and engineering technicians;
21. accountants;
22. advertising consultants;
23. notaries public;
24. lawyers;
25. paralegals;
26. real estate brokers;
27. real estate agents;
28. insurance brokers;
29. insurance agents;
30. travel agents;
31. financial consultants;
32. computer programmers;
33. insurance adjusters.

Is the Professional Services Exclusion Exhaustive?

The express naming of the professions in the definition of "professional services" is not exhaustive. In considering whether a class of worker that is not expressly mentioned in the exclusion is nonetheless embraced by it, the Court will have to weigh two competing rules of interpretation. On one hand, the Court must give effect to the intent of the parties at the time that the contract of insurance was entered into. This will ordinarily involve giving literal effect to the plain meaning of the words, "*shall include but not be limited to*".

On the other hand, there is the rule of interpretation of insurance contracts that requires exclusion clauses to be interpreted narrowly, and not in a way that is repugnant to or inconsistent with the main purpose of the insurance coverage but rather to give effect to it. This rule of interpretation will make the Court wary of significantly expanding the classes of professional services excluded by operation of the Professional Services Exclusion Clause.

Interpretations of "*Conducive to Health*"

The same tension will apply when Courts are called upon to interpret a phrase such as that in Section 24 b) "*any professional service or treatment conducive to health*". The phrase "*conducive to health*" can have very broad application. For example, one could conceivably argue that restaurant service is "*conducive to health*" since the provision of food provides nourishment to restaurant patrons. Will Courts interpret the phrase in such a broad manner? Probably not, we expect, because of the rule of interpretation requiring exclusion clauses to be interpreted narrowly.

Conclusion

The New IBC CGL Form contains a standard Professional Services Exclusion and definition whereas the previous form did not. Courts have stated that in determining whether a service is "professional", one must look at the act or omission itself and not the title or character of the person who performed the act. If an act involves a mental or intellectual exercise within a recognized discipline and the application of special skill or training, it will probably be considered a professional service. Consistent with the judge-made law, the new Professional Services Exclusion applies to numerous classes of workers and not just traditional professionals such as doctors, accountants, engineers and architects. However, the list of classes embraced by the exclusion is not exhaustive, and it remains to be seen whether Courts adopt an expansive or restrictive interpretation of the clause.

The broadening of the Professional Services Exclusion in the New IBC CGL Form underscores the need for those in more traditional professional occupations, such as doctors and lawyers, to ensure they have ample coverage. The Professional Services Exclusion also underscores the need for "soft" professionals, *i.e.*, professionals who would not in the past have purchased an errors and omissions policy, to ensure that they are adequately protected, especially now that they have been expressly excluded from coverage under the New IBC CGL Form.

THE ABUSE EXCLUSION

Introduction

In recent years, there has been an explosion in the number of civil sexual assault claims being made to insurers. These claims are made against parents, teachers, ministers, churches of all denominations, private and public schools, non-profit organizations providing services to youth, and governments responsible for residential and foster home placements. While the abuse has been occurring over the past several decades, the injuries and damages suffered by the victims, much like in environmental and toxic tort claims, takes years to emerge. It has only been since the mid to late 1990s that the Courts have been asked to grapple with issues of insurance coverage with respect to these types of claims.

This section of the paper touches upon the types of claims made against perpetrators of sexual abuse and other parties potentially liable for the perpetrator's conduct, and the way Courts have interpreted wordings in liability policies similar to the Former IBC CGL Form wordings. The paper will then discuss the extent to which traditional defining terms such as "occurrence" and the Former IBC CGL intentional act exclusion have been effective in responding to sexual abuse claims. The wording of the Abuse Exclusion in the New IBC CGL Form and the impact it will have on these claims will then be discussed. American caselaw is briefly reviewed to offer an insight into how Courts deal with the U.S. liability insurers' wordings. Finally, there will be a discussion on other policies and approaches to offering coverage for "sexual abuse" claims.

Causes of Actions against Perpetrators and Others

In bringing these claims, the most common causes of actions asserted against a perpetrator are assault, battery and breach of fiduciary duty. The causes of action alleged against other potentially liable parties, such as employers and supervisors are negligent hiring and supervision, vicarious liability and breach of fiduciary duty. Historically, insurers through their use of the Former IBC CGL Form wordings have attempted to limit coverage for these claims in various ways discussed below.

Must be an "Occurrence"

Many coverage claims currently being considered by the Courts involve historical cases arising from sexual abuse that occurred years ago at a time when there was little awareness of sexual torts, both by the public at large and by the insurance underwriting industry. Thus, Courts when faced with these coverage cases often interpret CGL policies written in the 1960s on an occurrence basis without the contemplation of sexual abuse claims. As such, Courts are interpreting general liability and homeowner policies

that provide coverage for claims in respect of "bodily injury" caused by an "occurrence" that took place during the policy period. "Occurrence" in these policies is defined as:

> *…an accident, including continuous or repeated exposure to substantially the same general harmful conditions.*

"Accident" is generally undefined in a CGL. It is not defined in the New IBC CGL Form. However, the Supreme Court of Canada has defined "accident" as "*…any unlooked for mishap or occurrence*".[74] Given the intentional nature of sexual abuse, the issue that has arisen before the Courts is whether an injury resulting from sexual abuse can ever be considered to be caused by an "accident".

Gordon Hilliker in his authoritative text, *Liability Insurance Law in Canada,* notes that in dealing with this issue there are two approaches taken by Courts in the United States.[75] The majority position is that when Courts are considering whether an "accident" took place it must determine this from the perspective of the insured. Thus, in considering the allegations against an employee who is the alleged perpetrator, there is no coverage for the employee since the committing of acts of sexual abuse is never an "accident" from the standpoint of the perpetrator.

When considering allegations against an employer of negligent hiring and supervision of an employee who allegedly engaged in the abuse, the B.C. Court of Appeal, like the majority approach in the US,[76] concluded that in determining whether the abuse is an "accident" it must be considered from the vantage point of the insured, namely the employer.[77] In *Bluebird Cabs, supra* the Court had to consider whether the employer was owed a defence for an action commenced by a passenger for assault and battery committed by its cab driver. At paragraph 8, page 5 the Court stated:

> *In my opinion this particular policy gives all the guidance that is needed in order to apply the word "accident" in this case. The chambers judge decided to apply a definition from Fenton v. J. Thorley & Co…per Lord McNaghten at p. 448: "an unlooked-for mishap or untoward event which is not expected or designed". Now that definition could be said to require that the event not be expected by anyone at all, or, alternatively, it might be said to require that the event not be expected by some particular person such as the victim or the perpetrator. But we know which of the meanings is the one intended in this policy from the fact that the relevant exclusions is for "Bodily injury…expected or intended from the standpoint of the insured"…So when the word "accident" is used in the policy it must be used in the alternative sense that I have mentioned, namely it applies not to events expected by nobody, but only to events not expected by a particular*

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[74] *Canadian Indemnity Co.* v. *Walkem* (1976). 53 DLR (3d) 1 (SCC).

[75] Hilliker , *supra* note 4 at p. 323.

[76] *Silverball Amusement Inc.* v. *Utah Home Fire Insurance Co.,* 842 F. Supp. 1151 (W.D. Ark. 1994), affd *per curiam,* 33 F.3d 1476 (8th Cir. 1994); *U.S. Fidelity & Guaranty Co.* v. *Open Sesame Child Care Centre,* 819 F. Supp. 756 (N.D. Ill. 1993); *Allstate Ins. Co.* v. *Patterson,* 904 F. Supp. 1270 (D. Utah 1995) all as cited by Hilliker, *supra* note 4 at p. 323. See also *King* v. *Dallas Fire Insurance co.,* No.00-1152 (Tex. August 29, 2002).

[77] *Bluebird Cabs Ltd.* v. *Guardian Insurance Co. of Canada*, 1999 CarswellBC 668 (C.A.) [hereafter "*Bluebird Cabs*"].

> *person, namely the insured. The fact that the event may have been expected by someone else is not a relevant consideration for the purposes of the policy.*

In *Bluebird Cabs, supra,* the CGL contained a "Separation of Insureds" clause (commonly known as a "severability clause"), which required the Court to read the policy as if it applied separately to the cab driver and to his employer. In considering the allegations of vicarious liability against the employer and the issue of whether the employer was owed a defence under its general liability policy, the Court stated:

> *On the basis of my conclusion that neither the acts of the cab drivers, nor the fault of the cab drivers, becomes the act or the fault of Bluebird Cabs Ltd., but, at most, it is the liability of the cab drivers which becomes the liability of Bluebird Cabs Ltd., it is my opinion that the separate application of the policy to Bluebird Cabs Ltd., in accordance with its terms…the bodily injury that has been suffered by the victims, as proven, cannot be regarded as bodily injury expected or intended from the standpoint of Bluebird Cabs Ltd.*[78]

The Court of Appeal concluded in *Bluebird Cabs, supra* that the liability insurer was obligated to defend the employer with respect to the Plaintiff's civil sexual assault action.

According to Hilliker, the minority position in the United States appears to be based on the theory that there can only be one proximate cause of the injury, that being the sexual abuse.[79] This analysis results in the Courts concluding that the negligent employer is not covered for the claims, as the negligent supervision was not the proximate cause of the injury.[80]

In Canada, the Supreme Court of Canada in *Scalera v. Non-Marine Underwriters*[81] applied a version of the minority analysis[82] to determine whether an insurer of a homeowner who allegedly sexually assaulted a young woman had to defend the homeowner in the civil sexual assault action brought against him. In the civil sexual assault action, the Plaintiff alleged a variety of causes of action including intentional and non-intentional torts. In determining that there was no coverage under the policy, the Supreme Court of Canada concluded that when pleadings allege both intentional and non-intentional torts, such as negligence, the Court, in determining whether there is coverage must:

> *…decide whether the harm inflicted by the negligent conduct is derivative of that caused by the intentional conduct. In this context, a claim for negligence will not be derivative if the underlying elements of the negligence and of the intentional tort are sufficiently disparate to render the two claims unrelated. If both the negligence and intentional tort claims arise from the same actions*

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[78] *Bluebird Cabs, supra,* para 17 at p. 7.
[79] S*upra*, note 4 at p.323.
[80] *Mutual of Enumclaw* v. *Wilcox,* 843 P.2d 154 (Idaho 1992) as cited by Hilliker, *supra* note 4 at p. 323.
[81] 2000 SCC 24 [hereafter "*Scalera*"].
[82] See Hilliker, *ibid.*, note 4 at p. 323.

> *and cause the same harm, the negligence claim is derivative, and it will be subsumed into the intentional tort for the purpose of the exclusion clause analysis…*[83]

In applying *Scalera, supra* in the context of a general liability clause, the Alberta Court of Appeal in *S. (J.A.)* v. *Gross*[84] considered a coverage action brought by a Church minister claiming coverage under his employer's policy for defence costs and indemnity for a claim brought by a Plaintiff who alleged that the minister sexually assaulted her during counselling sessions. The Statement of Claim contained allegations of negligence, breach of fiduciary duty and of an intentional tort.

The Court determined that the Chambers Judge erred in concluding that there was coverage for the minister. The Court applied *Scalera, supra* and rejected counsel for the minister's attempt to distinguish *Scalera, supra* on the basis of the principle that a Court should give effect to the clear language and the reasonable expectations of the parties. At paragraph 26 the Court stated:

> [Counsel for Gross] *argued that parties to the homeowner policies in those cases* [Scalera and Sansalone] *could not have intended the policies to cover intentional sexual assault…*
>
> *Counsel for Gross argued that the commercial general liability policy invoked in the present case was more "appropriate" to the situation, since the alleged abuse occurred in the context of counselling and therapy sought by the plaintiff and performed by Gross as part of his duties as pastor.*
>
> *We do not accept this distinction. It is no less repugnant to suggest that employers would seek to provide coverage for their employees who intentionally perpetrated sexual assaults than it is to suggest the same in the case of homeowners. While commercial general liability policies ordinarily provide coverage for losses arising out of incidents or occurrences during the course of employment, such policies generally seek to exclude intentional acts, as in this case. It cannot be said that parties to commercial insurance contracts anticipate that their policies will provide coverage for employees who intentionally commit sexual assault in the course of their employment. The fact that the plaintiff sought out Gross to counsel her with respect to sexual issues and to provide therapy provides no basis on which to distinguish Scalera and Sansalone. The underlying economic rationale for insurance discussed by Justice Iacobucci applies equally to general liability policies. Insofar as the alleged acts were intentional in nature, they were not, as a general rule, intended to be covered by any kind of insurance policy. As stated above, insurance covers fortuitous, contingent risks, not intentional acts.*

The Court in *Gross, supra* applied the reasoning in *Scalera, supra* (in the context of a general liability policy when considering coverage for an employee perpetrator of sexual assault), and ultimately concluded that there was no coverage for the employee. However, when considering coverage for an employer who is sued for vicarious liability for the acts of its perpetrator employee, the reasoning in *Scalera, supra* invites the reconsideration of the correctness of the decision in *Bluebird Cabs, supra.*

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[83] *Scalera*, s*upra*, note 80 at p. 31.
[84] 2002 ABCA 36 [hereafter "*Gross*"].

As is evident from the above discussion, the requirement that an allegation made against an insured be an "occurrence" in order to trigger coverage, only eliminates from coverage those claims made against the employee perpetrator. It does not eliminate negligent hiring and supervision and vicarious liability claims made against the employer.

The "Intentional Act" Exclusion

As discussed above, given that the insuring agreement provides coverage for loss or damages caused by an "occurrence" which is defined as an "accident", coverage is precluded for loss or damage that is caused intentionally. In addition to the definition of "occurrence", loss or damage that is caused intentionally is excluded in the Former IBC CGL Form by the Intentional Act Exclusion, which states:

> **2.** ***Exclusions***
>
> *This insurance does not apply to:*
> *a. "Bodily injury"…expected or intended from the standpoint of the insured. This exclusion does not apply to "bodily injury" resulting from the use of reasonable force to protect persons or property.*

The Abuse Exclusion in the New IBC CGL Form

As a result of the "long tail" nature of occurrence-based policies and the extraordinary number of sexual abuse claims made over the past decade, the IBC drafted the Abuse Exclusion for inclusion in the New IBC CGL Form. The problems faced by insurers with long tail nature of liability have been noted by the Supreme Court of Canada:

> *First, the "long-tail" nature of the liability…makes it likely that many claims will be made well after the policy has expired. Second, the ongoing developments in law and science make it difficult for the insurer to estimate the potential liability arising from claims made many years in the future. Finally, where an insured repeatedly changes insurance companies, a claim made in the future could result in legal battles between insurance companies where the exact timing of the negligence is unknown or where the negligence was of an ongoing nature. These problems increase the difficulty of assessing actuarial risk. As a result premiums may rise sharply. Coverage may even become unavailable on the market.*[85]

In drafting the Abuse Exclusion, the IBC is attempting to avoid having to respond to these types of claims which often result in significant defence costs being paid, in addition to indemnity for the claim.

The Abuse Exclusion in the New IBC CGL Form states:

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[85] *Jesuit Fathers of Upper Canada v. Guardian Insurance Company of Canada et al.,* 2006 SCC 21 at para.24.

2. Exclusions

This insurance does not apply to:

…

o. Abuse

a. Claims or "actions" arising directly or indirectly from "abuse" committed or alleged to have been committed by an insured, including the transmission of disease arising out of any act of "abuse".

b. Claims or "actions" based on your practices of "employee" hiring, acceptance of "volunteer workers" or supervision or retention of any person alleged to have committed "abuse".

c. Claims or "actions" alleging knowledge by an insured of, or failure to report, the alleged "abuse" to the appropriate authority(ies).

The word "abuse" is a defined term in the New IBC CGL Form, as follows:

> *any act or threat involving molestation, harassment, corporal punishment or any other form of physical, sexual or mental abuse.*

The Abuse Exclusion is predicated upon a "claim" or an action as opposed to an "occurrence". This is presumably because some acts of "abuse" could be an "occurrence" and thus otherwise within coverage. For example, if a Plaintiff was suffering emotional injuries, a "perpetrator" may have physically touched an individual but did not intend for the touch to result in the Plaintiff suffering emotional/psychological injuries.

The Abuse Exclusion excludes three types of claims or actions, namely those involving molestation, sexual harassment or corporal punishment:

a. those made against the perpetrator;
b. direct negligence claims made against an employer for negligent hiring, failing to supervise or dismiss an employee or volunteer who commits sexual assaults and vicarious liability claims made against the employer; and
c. direct negligence claims against an employer who has knowledge of the sexual abuse, or who fails to report the alleged abuse in circumstances where the employer has a statutory duty to report the abuse to the appropriate authority.

Only a few Canadian Courts have interpreted similar abuse exclusions to that in the New IBC CGL Form. In *Thompson* v. *Warriner*[86] the Ontario Court of Appeal declined to afford coverage to a group home facility. On appeal, the Court said:

[86] 2002 CanLII 44923, 2002 CarswellOnt 1476 (C.A.) [hereafter "*Thompson*"].

1. *[the liability insurer] may rely on the abuse and harassment exclusion clause which clearly and unambiguously excludes liability for "molestation" and "physical or mental abuse". This must encompass the sexual assault pleaded in this case.*

2. *The concurrent cause analysis in Derksen v. 539938 Ontario Ltd….does not apply in this case. In Derksen, the exclusion clause excluded one cause of the injuries but did not exclude a second cause of the injuries which was entirely separate and stood alone. The supervision claims are a legal characterization rather more than a contributing cause of the injury. The injury would have been the same with or without the allegedly negligent supervision because it was caused by the sexual assault. Here, the exclusion speaks to claims arising out of the event or occurrence and excludes them. The supervision claims derive from the claim for sexual assault. The underlying elements of these claims are insufficiently disparate to render them unrelated. The supervision claims are subsumed into the intentional tort claim for the exclusion clause analysis.*

3. *The claims in negligence, breach of fiduciary duty and other claims are based on the alleged abuses committed by the employee of [the insured]. The wording in Godonoaga (Litigation Guardian of) v. Khatambakhsh (Guardian of)…precludes coverage only for the criminal acts or omissions of the insured. Here, liability was excluded by any insured.*

As there are no claims that, if successful, could potentially trigger indemnity, [the insurer] has no duty to defend.

Similarly, in *Clausen* v. *Royal & Sun Alliance Insurance Co. of Canada*[87] the insured mother provided babysitting services in her residence. On two occasions, she left young children in the care of her teenage son, who sexually touched the children. The children brought actions against the boy's parents alleging that they knew of the son's aberrant behaviour, that they failed to warn the parents of the two young children of this behaviour and that the boy's parents failed to properly supervise him.

The parents of the victims commenced an action for coverage against their homeowner insurer. The policy contained the following relevant exclusion:

> *You are not insured for claims arising from actual or alleged sexual molestation, sexual harassment, corporal punishment or physical or mental abuse or harassment by any person insured by the policy.*[88]

The Court concluded that the exclusion applied and as such, coverage to the parents was denied.

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[87] 2004 CarswellOnt 4597 (S.C.J.) [hereafter "*Clausen*"].

[88] *Ibid.*, para. 23 at p. 5.

Although the abuse exclusions in *Thompson, supra*, and *Clausen, supra*, are similar to the one in the New IBC CGL Form, there is a difference. The exclusion in those cases applied to "any" insured, while the exclusion in the New IBC CGL Form applies to "an" insured. In *W.(T.) v. W. (K.R.J.)*[89] the Ontario Court of Justice discussed the use of "an" insured vs. "any" insured in an intentional act exclusion and concluded that the meaning of "an" and "any" are very similar:

> *After carefully considering the available jurisprudence, most of it American, I am of the view that there may be a difference between "an insured" and "the insured" in an exclusion clause. I will deal first with "an insured".*
>
> *I conclude that "an insured" must be given its ordinary, common-sense meaning. "An" is an indefinite article, and it means "any" insured. Therefore, intentional conduct by W., or any other insured, excludes the obligation to indemnify on the part of the insurer. There is abundant American jurisprudence to support this conclusion. (See Allstate Insurance Co. v. Mugavero, 79 N.Y.2d 153…Allstate Insurance Co. v. Gilbert, 852 F.2d 449 (9th Cir. Cal. 1988), Chacon v. American Family Mutual Insurance Co., 788 P.2d 748 (Colo. 1990), Allstate Insurance Co. v. Roelfs, 698 F.Supp. 815 (D. Alaska 1987).*
> *…*
>
> *The contract of insurance in Scott v. Wawanesa provided an exclusion for, "loss or damage caused by a criminal or wilful act or omission of the insured or of any person whose property is insured hereunder." This wording may arguably be equated to "an insured" or "any insured", and is quite different from the language used in the contract in issue in this case.*[90]

Based on the reasoning in *Thompson, supra* and *Clausen, supra*, the Abuse Exclusion will likely be effective in precluding coverage for employers who are sued for negligent hiring and supervising of any perpetrator employee, as well as for vicarious liability.

One additional point needs to be made. The Abuse Exclusion in the New IBC CGL Form does not define "harassment". No Canadian Court has considered whether the word "harassment" in the Abuse Exclusion includes "sexual harassment". However, in *Western Heritage Insurance Company v. Magic Years Learning Centers*[91] the insured sought coverage in relation to a sexual harassment suit brought by a former employee of the insured corporation. The Court determined that while it was arguable whether the sexual harassment constituted an "occurrence", the issue was "trumped" by the "Physical and/or Mental Abuse Limitation Endorsement" which provided:

> *In consideration of the premium charged it is hereby understood and agreed that Bodily Injury and Property Damage includes any act, which may be considered sexual in nature and could be classified as an Abuse, Harassment, Molestation, Corporal Punishment or an Invasion of an individual's right of privacy or control over their physical and/or mental properties by or at the*

[89] 1996 CarswellOnt 2516 (Gen.Div.).
[90] *Ibid.*, at p. 9.
[91] 45 F. 3d 85 (5th Cir.[Tex.] Feb. 16, 1995) [hereafter "*Western Heritage*"].

direction of an Insured, an Insured's employee or other person involved in any capacity of the Insured's operation….

Because the endorsement specified coverage for acts "sexual in nature" and specifically, "harassment", the Court determined there was coverage for the sexual harassment suit, despite whatever ambiguity might exist with respect to the act being an "occurrence" or falling under an exclusion in respect of "assault and battery". Based on the reasoning in *Western Heritage, supra,* a Court will likely interpret that the Abuse Exclusion in the New IBC CGL Form eliminates coverage for "sexual harassment" claims.

Recent American caselaw on similar wordings is more abundant, but be careful when reviewing cases from different statutory jurisdictions. For instance, the Oregon Court of Appeals found that a policy may state that no coverage is provided to anyone who is connected with the insured who commits an act of sexual abuse and that even in these circumstances, a severability clause providing that each insured would be regarded as having separate coverage would not prevent a denial of coverage. [92] In Florida, the Court of Appeals determined that the sexual misconduct exclusion barring coverage for injuries arising out of sexual misconduct of any kind did not preclude coverage for negligence claims against the insured asserted by victims of a multi-crime incident.[93] In another appellate decision from Oregon, an insurer had no duty to defend an insured restaurant under a CGL policy covering damages for an employee's bodily injuries with exclusions for harassment or the termination of any employee. This finding was based on that fact that the claim for sexual harassment constituted harassment within the ordinary meaning of the term.[94]

Coverage for "Sexual Abuse" Claims

As seen in *Western Heritage, supra,* some liability insurers offer specialized coverage in a CGL for "sexual abuse" claims by the way of an endorsement. In doing so, some insurers accept coverage for these claims subject to a sub-limit. An example of one such now in the marketplace affords coverage on these terms:

Abuse Limitation Endorsement

It is agreed that insurance coverage provided under this form does not apply to, nor shall the Insurer have any duty to defend, any claims or "actions" made against any Insured directly or indirectly arising out of, or on account of, resulting from or relating to any actual or threatened "abuse" except as provided in this Endorsement:

1. ***Liability Arising Out of "Abuse"***

[92] *Ristine v. Hartford Insurance Company of the MidWest*, 97 P.3d 1206 (Court of Appeals of Oregon, 2004).
[93] *Guideone Elite Insurance Company v. Old Cutler Presbyterian Church*, 420 F.3d 1317 (U.S.C.A., 2005).
[94] *Holloway v. Republic Indemnity Company of America*, 201 Or.App 376, 119 P 3d 239 (C.A., 2005)

The Insurer agrees to pay on behalf of the Named Insured all sums which the Named Insured shall become legally obligated to pay for "compensatory damages" and Supplementary Payments because of "bodily injury", "personal injury" or "advertising injury" arising out of or on account of, resulting from or relating to any actual or threatened "abuse".

2. *Supplementary Payments*

It is agreed that Paragraph 1. of the provisions applicable to SUPPLEMENTARY PAYMENTS under Section 1, COVERAGES, of the Commercial General Liability Form are deleted and replaced with the following, but only with respect to the coverage provided under this Endorsement.

1. The Insurer will pay, with respect to any claim or "action" the Insurer defends

a. All expenses the Insurer incurs;
b. The cost of bonds to release attachments, but only for bond amounts within the applicable limit of insurance. The Insurer does not have to furnish these bonds;
c. All reasonable expenses incurred by the Insured at the Insurer's request to assist the Insurer in the investigation or defense of the claim or "action" including actual loss or earnings up to $250 a day because of time off from work;
d. All costs taxed against the insured in the "action" and
e. Any interest accruing after entry of judgment upon that part of the judgment which is within the applicable limit of insurance and before the Insurer has paid, offered to pay, or deposited in court the part of the judgment that is within the applicable limit of insurance.

These payments are included in and will reduce the Limit of Insurance shown in the Declarations for this Endorsement.

3. ***Limit of Insurance***

It is agreed that the Limit of Insurance applicable to this Endorsement is as specified in the Declarations and is the most that the Insurer will pay for "compensatory damages" and SUPPLEMENTARY PAYMENTS combined for all claims or "actions" because of "bodily injury", "personal injury" or "advertising injury" arising out of or on account of, resulting from or relating to any actual or threatened "abuse" in any one policy period.

For the purpose of determining whether coverage applies under this endorsement, continuous or repeated actual or threatened "abuse" of the same person by the same Insured (s) will be deemed to be a single "occurrence" or offence and to have taken place on the date that "abuse" first occurred.

The language of this endorsement is taken from the wording of the New IBC CGL Form, which expressly defines "abuse".

If coverage is not offered by way of a CGL, depending on particular insured, coverage may be provided by way of an Employment Practices Liability Policy ("EPL"). An EPL is an insurance product designed to respond to a broad range of employment related claims, ranging from sexual harassment to discrimination in hiring.

Conclusion

With the avalanche of sexual abuse claims confronting the insurance industry, it was motivated to take steps towards trying to eliminate exposure for these "long-tail" claims. This resulted in the Abuse Exclusion being incorporated into the New IBC CGL Form with brand-new wordings and a definition of the word "abuse". Although there have not been any Canadian cases interpreting this exclusion, based on the Court's reasoning in *Thompson, supra* and *Clausen, supra,* it appears the Abuse Exclusion will produce the intended results. In light of the Abuse Exclusion, coverage for sexual misconduct should now be offered as an optional liability Endorsement or separate policy; making it perfectly clear to prospective insureds that sexual misconduct of any kind, whether physical, mental or sexual, will not be covered under the New IBC CGL Form.

THE POLLUTION EXCLUSION

Introduction

This section of the Paper will address the Pollution Exclusion found in the New IBC CGL Form. In discussing the Pollution Exclusion we address its historical development and the manner in which U.S. and Canadian Courts have dealt with the its predecessor exclusion, more often called the "absolute pollution exclusion". We discuss what the IBC has done to "tighten" the language of the Former IBC CGL Pollution Exclusion from 1986, in the face of existing jurisprudence and also how the Pollution Exclusion has been "relaxed" in the New IBC CGL Form. Finally, we will discuss the Pollution Exclusion's extension to an insureds' liability arising out of government or regulatory "clean up" orders or demands.

Background and Jurisprudence

Historical Context of the Absolute Pollution Exclusion

Pollution liability exclusions have attracted little judicial scrutiny in Canada and accordingly our Courts have turned to American jurisprudence for assistance in the application of such exclusions. An analysis of U.S. cases reveals that since the introduction of pollution liability exclusions into commercial general liability policies in 1973 the focus of insurers has been to urge Courts to adopt a literal interpretation of the exclusion. On the other hand, policyholders have urged that such exclusions be viewed

from a broad constructive perspective that focuses the analysis on the commercial basis for insurance in general and the exclusion in particular. This type of analysis entails a review of the historical basis for the exclusion – a review which is necessary to understand the approach that many Courts have taken.

In the United States in 1970, the ISO recommended that U.S. liability insurers introduce a pollution liability exclusion endorsement on CGL policies. The recommendation was borne out of increasingly expensive litigation and stringent legislation involving the discharge of pollutants into the natural environment. The early form of the pollution exclusion precluded coverage for bodily injury or property damage arising out of the "discharge, dispersal, release or escape" of pollutants, however, the exclusion did not apply if such discharge was sudden and accidental.

This form of exclusion was subject of much judicial scrutiny in the U.S. where Courts narrowly construed the exclusion and often found in favour of policyholders on the basis that "sudden and accidental" was akin to "unexpected and unintended". Insurers were largely unable to satisfy the burden of proof regarding the knowledge of the insured necessary to trigger the exclusion. Thus, in early 1980s the ISO introduced a new version of the pollution exclusion to the industry dubbing it the "absolute pollution exclusion". By 1986 the Former IBC CGL Form Pollution Exclusion was standard fare in Canadian general liability policies. It typically read as follows:

> *This insurance does not apply to:*
>
> *1. Pollution Liability*
>
> *a. "Bodily injury" or "property damage" and "clean up costs" arising out of the actual, alleged or threatened discharge, dispersal, release or escape of pollutants:*
>
> *1) At or from any premises, site or location which is or was at any time, owned or occupied by, or rented or loaned to an Insured;*
>
> *2) At or from any premises, site or location which is or was at any time, used by or for any Insured or others for the handling, storage, disposal, processing or treatment of waste;*
>
> *3) Which are or were at any time transported, handled, stored, treated, disposed of, or processed as waste by or for any Insured or any person or organization for whom the Insured may be legally responsible; or*
>
> *4) At or from any premises, site or location on which any Insured or any contractors or subcontractors working directly or indirectly on any Insured's behalf are performing operations:*
>
> *a) if the pollutants are brought on or to the premises, site or location in connection with such operations by such Insured, contractor or subcontractor; or*
>
> *b) if the operations are to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize the pollutants.*

> *b. Any loss, cost or expense arising out of any governmental direction or request that an Insured test for, monitor, clean up, remove, contain, treat, detoxify or neutralize pollutants.*
>
> *"Pollutants" means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapour, soot, fumes, acids, alkalis, chemicals and waste. Waste includes material to be recycled, reconditioned or reclaimed.*
>
> *Sub-paragraphs 1) and 4) a) of paragraph a. of this exclusion do not apply to "bodily injury" or "property damage" caused by heat, smoke or fumes from a hostile fire. As used in this exclusion, a "hostile fire" means one which becomes uncontrollable or breaks out from where it was intended to be."*

Coverage litigation in the U.S. on the pollution exclusion raced ahead of any litigation in Canada. In considering the then new wording many American Courts and scholars relied on the history of the exclusion to find that it precluded coverage for acts of environmental degradation, the focus of environmental protection legislation, but not tort claims historically the subject of coverage under a CGL.

One of the leading cases is *American States Insurance Co. v. Koloms*[95] wherein the Court states:

> *Our review of the history of the pollution exclusion amply demonstrates that the predominate motivation in drafting an exclusion for pollution related injuries was the avoidance of the "enormous expense and exposure resulting from the explosion of environmental litigation. Similarly, the 1986 amendment to the exclusion was wrought, not to broaden the provision's scope beyond its original purpose of excluding coverage for environmental pollution, but rather to remove the "sudden and accidental" exception to coverage which, as noted above, resulted in a costly onslaught of litigation. We would be remiss, therefore, if we were to simply look to the bare words of the exclusion, ignore its "raison d'être", and apply it to situation which do not remotely resemble traditional environmental contamination. The pollution exclusion has been, and should continue to be, the appropriate means of avoiding "the yawning extent of potential liability arising from the gradual or repeated discharge of hazardous substances into the environment". We think it improper to extend the exclusion beyond that arena.* (Emphasis added)

This passage has been found to be both helpful and persuasive by the Ontario Court of Appeal in *Zurich v. 686234 Ontario Ltd.*,[96] one of the leading authorities in this area of the law, which is discussed further on in this section of the paper.

Against the backdrop of this judicial history, Canadian Courts have commenced their analysis of the exclusion within the framework established by the Supreme Court of Canada in *Reid Crowther & Partners Ltd. v. Simcoe & Erie General Insurance Co.*:[97]

> *In each case the courts must examine the provisions of the particular policy at issue (and the surrounding circumstances) to determine if the events in question fall within the terms of the*

[95] 687 N.E. 2d 72 (U.S. Ill. 1997).
[96] (2002) C.C.L.I. (3d) 174 (Ont.C.A.) at 182 [hereafter "*Zurich*"]
[97] [1993] 1 SCR 252.

coverage of that particular policy. This is not to say that there are no principles governing this type of analysis. Far from it. In each case, the courts must interpret the provisions of the policy at issue in light of general principles of interpretation of insurance policies, including, but not limited to:

1) the contra proferentem *rule;*
2) the principle that coverage provisions should be construed broadly and exclusion clauses narrowly; and
3) the desirability, at least where the policy is ambiguous, of giving effect to the reasonable expectations of the parties.

In addition to the foregoing it is clearly accepted that Canadian law requires a Court, even in the face of a clear and unambiguous exclusion clause, to not apply the exclusion where:

1) it is inconsistent with the main purpose of the insurance coverage and where the result would be to virtually nullify the coverage provided by the policy; and
2) where to apply it would be contrary to the reasonable expectations of the ordinary person as to the coverage purchased.

Canadian Jurisprudence on the Former IBC CGL Form Pollution Exclusion

Only recently have Canadian Courts examined whether the language used in the Former IBC CGL Form Pollution Exclusion truly does bar coverage for environmental contamination claims. The decided cases have primarily turned on either a specific interpretation of the language of the exclusion or, from a broader interpretive perspective, on the connection between the business activities of the insured and the mechanism of the loss.

As noted above, the applicability of the exclusion must be determined within the analytical framework set down by the Supreme Court of Canada. Two fairly recent cases have employed a narrow reading of the exclusion clause in affording insureds coverage.

What constitutes a "Discharge, dispersal, release or escape"

In *R.W. Hope Ltd. v. Dominion of Canada General Insurance Co.*[98] the Ontario Superior Court adjudicated a claim involving the improper remediation of contaminated property. Following the leakage of fuel from an oil tank buried in a home the remediation firm was retained by the property owner's insurer to correct the problem. The Statement of Claim filed alleged the insured had "*failed to properly recover the escaped*

[98] (2000), C.C.L.I. (3d) 38 (Ont. S.C.) [hereafter "*R.W. Hope*"].

fuel oil and to remove …the contaminated soil" and that it instead flushed the soil improperly thereby necessitating further remediation.

In granting coverage to the insured the Court stated:

> *In my opinion, the pollution exclusion does not apply to bodily injury or property damage arising out of the presence of a pollutant. As well, this exclusion does not apply to bodily injury or property damage arising out of the improper removal of a pollutant, unless the improper removal includes, or is alleged to include, discharge, dispersal, release or escape of the pollutant…The bodily injury and property damage for which the applicant is sued do not arise out of discharge, dispersal etc. of the fuel oil, but out of the failure to remedy its presence.*

On appeal, in spite of a vigorous dissenting judgment, the majority of the Court found that the pollution exclusion did not apply for two reasons:

1) the pollution exclusion speaks temporally to a new escape that occurs while the clean up operation is ongoing; and
2) the exclusion requires that the escape be from the site where the insured is working (i.e. while the insured is working on site) .

What is a "pollutant"?

The B. C. Supreme Court has occasionally resorted to American jurisprudence in determining this issue. *Great West Development Marine Corp. v. Canadian Surety Co.*[99] involved an underlying claim for breach of contract, misrepresentation and negligence against a number of parties. The Plaintiff alleged that she contracted for the delivery of soil for her farm but that instead of good top soil she received fill composed of gravel, clay, stones, boulders and assorted construction debris including plastic, wood, concrete, pipes, tar, metal, asbestos, wire, creosote wood and other unidentifiable materials. The fill was obtained from the policyholder's construction site and delivered by others. The claim against the insured was for negligence in not ensuring the proper disposal of its construction debris, nuisance and contravention of the *Waste Management Act* and the *Soil Conservation Act.* In the pleadings it was alleged that the fill "*constituted waste that is hazardous to health and which will cause the leaching of toxic chemicals into surrounding indigenous soil and ground water contaminating the Plaintiff's farm*".

In finding that the exclusion did not apply it appears that the Court was guided by the principle that the term "pollutant" must be given a restricted, common sense meaning. Since nearly any substance can be viewed, in certain circumstances, as a pollutant, U.S.

[99] (2000), 19 C.C.L.I. (3d) 52 (BCSC) [hereafter "*Great West Development*"].

Courts have narrowed the term. In *Pipefitters Welfare Educ. Fund v. Westchester Fire Ins. Co.*[100] the Court observed:

> *The terms "irritant" and "contaminant", when viewed in isolation, are virtually boundless, for "there is virtually no substance or chemical in existence that would not irritate or damage some person or property". [citing Westchester Fire Ins. Co. v. City of Pittsburgh, 768 F. Supp. 1463, 1470 (D. Kan. 1991)]. Without some limiting principle, the pollution exclusion clause would extend far beyond its intended scope, and lead to some absurd result. To take but two simple examples, reading the clause broadly would bar coverage for bodily injuries suffered by one who slips and falls on the spilled contents of a bottle of Drano, and for bodily injury caused by an allergic reaction to chlorine in a public pool. Although Drano and chlorine are both irritants and contaminants that cause, under certain conditions, bodily injury or property damage, one would not ordinarily characterize these events as pollution. To redress this problem, courts have taken the common sense approach when determining the scope of pollution exclusion clauses…The bond that links these cases is plain. All involve injuries resulting from everyday activities gone slightly, but not surprisingly, awry. There is nothing that unusual about paint peeling off a wall, or asbestos particles escaping during the installation or removal of insulation, or paint drifting off the mark during a spray painting job. A reasonable policyholder…would not characterize such routine incidents as pollution.*

In spite of the allegations that the soil deposited at the insured's farm was "contaminated" and that breaches of the *Waste Management Act* and *Soil Conservation Act* had occurred the Court did not find that the contaminants constituted "pollutants":

> *The gist of the [claimant's] lawsuit is that she expected topsoil but received a mix of gravel, clay, stones and construction debris, and that whatever its proper description, it was not topsoil.*
>
> *What must be considered under the terms of the policy is the nature and proper description of the excavated material leaving the construction site, without reference to any particular intended use to be made of it.*
>
> *The ingredients in the mix of excavated material in question might well contaminate topsoil but they are not necessarily contaminants in the abstract. The mix constituting the excavated material, for example, may well not qualify as an environmental pollutant.*
>
> *It is unclear to me on the pleadings that the fill from the construction site could reasonably be considered a pollutant in the general sense of being harmful, or having in any significant quantity components or ingredients that might be thought inherently harmful, dangerous or of likely deleterious effect.*

The apparent requirement that offending materials be present in "significant" quantity and be "inherently harmful or dangerous" in our view amounts to a very significant narrowing of the definition of "pollutant" and is consistent with the line of U.S.

[100] 976 F. 2d 1037 (U.S. 7th Cir. Ill., 1992).

authorities that limits the application of the exclusion to classic environmental degradation pollution.

The requirements for qualification as a pollutant as described in *Great West Development, supra,* were not considered in *Palliser Regional Division #26 v. Aviva/Scottish & York Insurance Co.*[101] In *Palliser, supra,* the Court found that coal dust blowing from the insured's property onto adjacent residences met the definition of pollutant, without making findings as to the quantity of the coal dust or its inherent effect on the property and persons whom it contacted. The basis for the Alberta Court not embarking on an assessment of the amount and effect of coal dust may be attributable to the notion that blowing coal dust is consistent with the wide ranging classic cases of pollution which led to the creation of the exclusion.

Activities of the Insured

In determining the applicability of the pollution exclusion many Canadian Courts have had recourse to the business activities carried on by the insured. This analysis is germane to a determination of the reasonable expectations of the parties to the contract. Courts readily refuse to apply the exclusion in cases where an insured's regular business activities can not be expected to lead to the discharge of pollutants. More troublesome for the Courts is the situation where the very nature of an insured's business activities leads to pollution. Below we examine decisions in both of these situations.

Activities Not Creating Expectation of Loss

The only appellate Court decision in Canada on the exclusion is that in *Zurich, supra*. In *Zurich, supra* the insured was the owner of a residential apartment building who was sued by residents of the apartment for negligently allowing the creation, and dispersal, of carbon monoxide throughout the building from a faulty furnace system. In finding for the insured the Court stated at p. 190:

> *There is nothing in this case to suggest that the respondent's* [owner's] *regular business activities place it in the category of an active industrial polluter of the natural environment. Put simply, the respondent did not discharge or release carbon monoxide from its furnace as a manufacturer discharges effluent, overheated water, spent fuel and the like into the natural environment. It was discharged or released as a result of the negligence alleged in the underlying claims.*

[101] 2004 ABQB 781 [hereafter "*Palliser*"]; see also *Dave's K. & K. Sandblasting (1988) Ltd. v. Aviva Ins. Co. of Canada*, 2007 BCSC 791.

In *Palliser, supra,* the Court noted that the parties to the contract could not have reasonably contemplated that the school board from whose property the blowing coal dust emanated would in effect be a polluter. At paragraph 46 the Court stated:

> *It is my view that the airborne coal dust is not industrial pollution or pollution to which the Pollution Exclusion clause should apply. The Pollution Exclusion clause is not directed at occurrences outside of those reasonably contemplated by the insurer and the insured arising from the operations and activity of the insured in operating the elementary school. The release of coal dust from the coal bed is not an occurrence to be expected or intended to be excluded from coverage.*

Finally, in *Medicine Hat (City) v. Continental Casualty Co.*[102] the Alberta Court of Queen's Bench considered coverage for bodily injury claims suffered by the City's employees because of exposure to methanol and Lubrizol from the operation of the City's methanol fuelled buses. At paras. 25 to 27 the Court stated:

> *It is acknowledged that Lubrizol and methanol are pollutants. The Statements of Claim do not refer to "discharge, release or escape of Lubrizol and methanol" but rather to "exposure" of the employees to the chemicals.*
>
> …
>
> *"Discharge, dispersal, release or escape of pollutants" is the language of improper or unintended events or conduct. It is not the language of intended use or consequences or of the normal operation of facilities or vehicles. In this case, the polluting substance or gas is part of and confined to the intended and normal operation of a transit garage and buses. This conduct and these events do not fall within the exclusion clause. In my view, the pollution exclusion clause is intended to protect the insurer from liability for the enforcement of environmental laws. The exclusion clause uses environmental terms of art because it is intended to exclude coverage only as it relates to environmental pollution and the improper disposal or contamination of hazardous waste.*

In oral reasons the Court of Appeal simply dismissed the insurer's appeal saying "*the allegations in the Statements of Claim are framed in sufficiently broad terms to allow for exposure or contact to have occurred without the discharge, dispersal, release or escape of pollutants*."

Activities Creating Expectation of Loss

Two cases, one from Ontario and the other from British Columbia, are in our view incompatible with respect to the approach taken toward the exclusion. The incompatibility of these cases may eventually lead to the issue being determined by the Supreme Court of Canada.

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[102] (2002), 37 C.C.L.I. (3d) 48 (Alta. Q.B.).

In *Pier Mac Petroleum Installation Ltd. v. AXA Pacific Insurance Co.*[103] the B.C. Supreme Court applied the exclusion where the insured's business activity, underground petroleum storage tank construction, negligently performed, resulted in the escape of gasoline into the environment. In applying the exclusion the Court implemented a literal interpretation of the exclusion's language and found that gasoline, a pollutant, was discharged or dispersed from the site of the insured's operations or work. The Court limited itself to a literal interpretation of the exclusion and undertook no analysis of its history or the reasonable expectations of the parties to the contract.

It is notable that in *Palliser, supra,* the Alberta Court specifically agreed with the approach taken in *Pier Mac, supra,* but distinguished it on the basis of a lack of connection between Palliser's activities as a school board and the pollution in question.

In circumstances similar to that in *Pier Mac, supra* the Ontario Superior Court in *Hay Bay Genetics Inc. v. MacGregor Concrete Products (Beachburg) Ltd.*[104] found that the exclusion did not apply. The Plaintiff's claim was against the insured manufacturer of septic tanks for property damage and remediation costs. The insured built a septic tank for the storage of pig manure at the plaintiff's hog production farm. The new concrete tank leaked leading to Environment Canada charges against the Plaintiff and the incursion of various clean up and business interruption claims. In holding for the insured the Court stated at paragraph 37:

> *Even accepting that waste covers animal waste, particularly "pig manure", it is against the interests of justice to apply "hyperliterally" the terms of the exclusion clause without taking into account the specifics of this situation, as stated by Justice Borins in Zurich, supra at paras 10 and 36. [The insured] would not have taken out this insurance coverage if it were not to cover potential pollution risks. Just as in the Zurich, supra situation, [the insured] is not in the business of polluting the environment as a result of the nature of its business. Pollution may have been a risk, but it was not a probable consequence of carrying out its business. The pollution that occurred here was unplanned and could have occurred for a variety of reasons.*

We respectfully disagree with the Court's assessment in *Hay Bay, supra* for two reasons:

1) In determining the expectations of the parties the Court applies a "probable consequence" standard when the measurement of risk on behalf of insurer and insured is surely something less; and
2) In highlighting the "unplanned" nature of this particular instance of pollution the Court reverts to the "sudden and accidental" language of the original pollution exclusion written out of Canadian policies twenty years ago. In doing so, the Court engages

[103] (1997), 41 BCLR (3d) 326 (S.C.) [hereafter "*Pier Mac*"].
[104] (2003), 6 C.C.L.I. (4th) 218 (Ont.S.C.) [hereafter "*Hay Bay*"]

in selective historical reconstruction to the potential detriment of the insurer.

It is our view that insureds whose business activities create a reasonable risk that pollutants may be discharged or dispersed directly into the environment should not be able to avoid application of the exclusion.

Summary of Jurisprudence

The Former IBC CGL Form Pollution Exclusion has been highly susceptible to attack by Canadian policyholders on the basis of its historical development as a response to mass toxic tort liability. Tools employed by Canadian policyholders in seeking to restrict the application of the exclusion have included narrow interpretation of what constitutes a "pollutant", a "broad dispersal" requirement and their status as "non-active" polluters. In addition, U.S. policyholders have successfully argued that the exclusion should not apply if the pollutant was the actual product manufactured or sold by the insured and that the exclusion is only to apply when the injury is caused by the toxic nature of the pollutant rather than by its presence. Further attacks have been brought on the exclusion based on the definition of "waste", the discharge of pollutants onto an insured's own premises and attempts to invoke coverage for "personal injury" since the exclusion did not apply to former Coverage C of the ISO approved form of commercial general liability policy.

The New IBC CGL Form Pollution Exclusion

In response to the development of largely unfavourable judicial treatment of the Former IBC CGL Form Pollution Exclusion the IBC has revised its wording. For ease of reference we reproduce the New IBC CGL Form Pollution Exclusion below, with the new wordings underlined for emphasis:

> ***4. Pollution***
>
> ***(1)*** *<u>"Bodily injury", "property damage" or "personal and advertising injury"</u> arising out of the actual, alleged or threatened spill, discharge, emission, dispersal, seepage, leakage, migration, release or escape of "pollutants":*
>
> ***(a)*** *At or from any premises, site or location which is or was at any time owned or occupied by, or rented or loaned to, <u>any insured</u>. However, this subparagraph does not apply:*
>
> ***(i)*** *<u>"Bodily injury" is sustained within a building and caused by smoke, fumes, vapour or soot from equipment used to heat, cool or dehumidify the building, or equipment that is used to heat water for personal use, b the building's occupants or their guests;</u>*

(ii) *"Bodily injury" or "property damage" for which you may be held liable, if you are a contractor and the owner or lessee of such premises, site or location has been added to your policy as an additional insured with respect to your ongoing operations performed for that additional insured at that premises, site or location and such premises, site or location is not and never was owned or occupied by, or rented or loaned to, any insured, other than that additional insured; or*

(iii) *"Bodily injury" or "property damage" arising out of heat, smoke or fumes from a "hostile fire";*

(b) *At or from any premises, site or location which is or was at any time used by or for any insured or others for the handling, storage, disposal, processing or treatment of waste;*

(c) *Which are or were at any time transported, handled, stored, treated, disposed of, or processed as waste by or for:*

(i) *Any insured; or*

(ii) *Any person or organization for whom you may be legally responsible; or*

(d) *At or from any premises, site or location on which any insured or any contractors or subcontractors working directly or indirectly on any insured's behalf are performing operations if the "pollutants" are brought on or to the premises, site or location in connection with such operations by such insured, contractor or subcontractor. However, this subparagraph does not apply to:*

(i) "Bodily injury" or "property damage" arising out of the escape of fuels, lubricants or other operating fluids which are needed to perform the normal electrical, hydraulic or mechanical functions necessary for the operation of mobile equipment or its parts, if such fuels, lubricants or other operating fluids escape from a vehicle part designed to hold, store or receive them. This exception does not apply if the "bodily injury" or "property damage" arises out of the intentional discharge, dispersal or release of the fuels, lubricants or other operating fluids, or if such fuels, lubricants or other operating fluids are brought on or to the premises, site or location with the intent that they be discharged, dispersed or released as part of the operations being performed by such insured, contractor or subcontractor;

(ii) "Bodily injury" or "property damage" sustained within a building and caused by the release of gases, fumes or vapours from materials brought into that building in connection with operations being performed by you or on your behalf by a contractor or subcontractor; or

(iii) "Bodily injury" or "property damage" arising out of heat, smoke or fumes from a "hostile fire".

(e) *At or from any premises, site or location on which any insured or any contractors or subcontractors working directly or*

indirectly on any insured's behalf are performing operations if the operations are to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of, "pollutants".

(2) *Any loss, cost or expense arising out of any:*

(a) *Request, demand, order or statutory or regulatory requirement that any insured or others test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of, "pollutants"; or*

(b) *Claim or "action" by or on behalf of a governmental authority for "compensatory damages" because of testing for, monitoring, cleaning up, removing, containing, treating, detoxifying or neutralizing, or in any way responding to, or assessing the effects of, "pollutants".*

However, this Section (2) does not apply to liability for "compensatory damages" because of "property damage" that the insured would have in the absence of such request, demand, order or statutory or regulatory requirement, such claim or "action" by or on behalf of a governmental authority.

Tightening of the Exclusion

The New IBC CGL Form Pollution Exclusion applies to all coverages afforded under the policy. Most importantly it now applies to "Personal and Advertising Injury" coverage. This type of coverage affords insurance for "consequential bodily injury" arising out of:

> *c. The wrongful eviction from, wrongful entry into or invasion of the right of private occupancy of a room, dwelling or premises that a person occupier, committed by or on behalf of its owner, landlord or lessor*

In the past it would have been open to insureds to allege that pollutants entering a tenant's premises as a result of the operations of a landlord or its agent constituted a "wrongful entry" occasioning bodily injury. The inclusion of the New IBC CGL Form Pollution Exclusion under "personal and advertising injury" seeks to address this type of situation.

The addition of "odour" to the definition of "pollutants" is meant to capture and thus exclude from coverage instances where an "industrial" polluter regularly produces a more ephemeral or less tangible irritant, such as an odour offensive to nearby dwellers. The previous definition of pollutant did not include irritants tangible by only our olfactory senses. Thus, the New IBC CGL Form Pollution Exclusion should now apply to instances where the only irritating element of the pollutant is its smell.

As seen in *R.W. Hope, supra,* the insured successfully argued that its spreading of an already present pollutant did not constitute a "*discharge, dispersal, release or escape*". The

addition of the words "spill", "emission", "seepage", "leakage" and "migration" to the mode of pollutant transmittal should provide more certainty as to the instances when the exclusion will apply.

Paragraph (e) of the New IBC CGL Form Pollution Exclusion also seeks to redress the limitation presented by *R.W. Hope, supra*. In particular, coverage for spreading already present pollutants is more clearly excluded in respect of activities such as testing, monitoring, cleaning, removing, containing, treating, detoxifying, neutralizing, responding to or assessing pollutants.

Expansion of Application to "Government Orders"

Paragraph (2) (a) of the New IBC CGL Pollution Exclusion expands on the application of former paragraph b. Both paragraphs seek to exclude from coverage any cost and expense flowing from governmental or regulatory orders to test for, or clean up pollutants from a site. The new language is more expansive as it applies to insureds "*or others*" and includes "*request, demand, order or statutory or regulatory requirement*", whereas the wording of the Former IBC CGL Form Pollution Exclusion pertained only to "governmental direction or request". The tightening of the language should work to limit an insured's ability to argue that a "clean-up order" is not "governmental" in cases where an order is made by a regulatory body or crown corporation and applicable to both the insured and/or a party for whom the insured may be vicariously liable, even though an independent contractor.

Relaxation of the Exclusion

The New IBC CGL Form Pollution Exclusion contains two exceptions that pertain to pollution "within a building". These exceptions assist in clarifying the application of the exclusion to what is often referred to as the "natural environment". The exceptions, at clauses (1)(a)(i) and (1)(d)(ii), are likely borne of the decision in *Zurich, supra,* wherein the Ontario Court of Appeal distinguished the dispersal of carbon monoxide within a building from discharges "*into the natural environment*". Now excepted are compensatory damages for bodily injury from smoke, fumes, vapour or soot from most types of building equipment. Also excepted are compensatory damage claims for bodily injury and property damage caused by the release of gases, fumes or vapours from materials brought into a building connected with an insured's operations.

Notable is that "gases", which would include carbon monoxide, are not excepted by paragraph (1)(a)(I). The lack of exception for gases seems to fly in the face of the Court's decision in *Zurich, supra*.

The New IBC CGL Form Pollution Exclusion also relaxes in respect of pollutants escaping from "mobile equipment". Accordingly, coverage for claims arising from the

escape of substances such as gasoline, motor oil or brake fluid from mobile equipment such as backhoes, graders or wood chippers will not be excluded. The intentional discharge of the specified substances from mobile equipment remains excluded. Future litigation may revolve around what constitutes "mobile equipment" and whether the specified substances (*i.e.*, "*fuels, lubricants or other operating fluids*") are "*needed*" by the mobile equipment.

Paragraph (1)(a)(ii) of the New IBC CGL Form Pollution Exclusion creates an exception for contractor's operations resulting in bodily injury or property damage at their job site provided:

1) the owner or lessee of the job site is named as an additional insured on the policy; and
2) the job site was never owned or occupied by the insured.

This exception allow insureds coverage for polluting their job sites likely at the cost of further premium for endorsing an additional insured on the policy. We believe that the creation of this exception and the option it affords an insured to obtain coverage for "job site liability" can be used to determine the reasonable expectations of the parties to the insurance contract (i.e. the scope of coverage for job site activities). This type of evidence could be used to avoid rulings such as that in *Hay Bay, supra,* wherein an insured polluted the job site of its customer and the Court determined that the insured would not have purchased general liability insurance if it were not to cover such risks.

Extension to "Orphan Sites"

Subparagraph (2)(b) of the New IBC CGL Form Pollution Exclusion removes from coverage any loss, cost or expense suffered by the insured as a result of a governmental authority claim or action for cleaning up or otherwise treating or responding to the effects of pollutants. These types of claims typically arise by statute directed at allowing the government to recover costs of remediating polluted land previously owned or occupied by the polluter. In our view this extension of the Pollution Exclusion results from U.S. jurisprudence that expands the meaning of the phrase "*legally obligated to pay as damages*" which is contained in most insuring agreements, to cover statutorily imposed pollution clean up costs. The U.S. authorities in this regard were recently relied upon in *Bridgewood Building Corp. (Riverfield) v. Lombard General Insurance Co. of Canada*[105] where the Ontario Superior Court of Justice determined:

> *that the plain meaning of "legally obligated to pay as damages", construed broadly, embraces the statutorily imposed warranty obligations* [of the Ontario New Home Warranties Plan Act].

[105] (2005), 26 C.C.L.I. (4th) 93; affirmed (2006), 79 O.R. (3d) 494 (C.A.), leave to appeal refused 2006 CanLII 38326 (SCC).

The extension of the New IBC CGL Form Pollution Exclusion to potential liability for governmental clean up costs of orphan sites represents a proactive step by IBC to limit insurers' exposure on an issue that has not directly been litigated in Canada.

Conclusion

With the addition of the Pollution Exclusion in the New IBC CGL Form, the IBC has addressed Canadian and U.S. jurisprudence in an attempt to create more certainty about the application of the Pollution Exclusion. However, the advancements brought by the IBC in exclusion language may not have the effect of limiting the longstanding judicial encroachment to its applicability. In our view the judicial pronouncements in *Zurich*, *supra* and the majority of other cases referenced in this section of the paper will continue to limit the application of the New IBC CGL Form Pollution Exclusion to instances of sustained industrial pollution into the natural environment. While this is likely true the Pollution Exclusion will, in our view, work to exclude from coverage insureds' legal liability for governmental remediation costs of orphan sites.

THE ASBESTOS AND MOULD EXCLUSIONS

Introduction

To address any ambiguity of wording which may be construed against the liability insurer, the IBC has provided an Asbestos Exclusion and a Mould Exclusion in the New IBC CGL Form (the New IBC CGL Form uses the language "Fungi or Spores"; for ease of reference this is referred to as the "Mould" Exclusion in this paper). As well, the New IBC CGL Form provides a definition for the terms "fungi" and "spores". These are entirely new additions to the New IBC CGL Form, and are as yet un-tested by Canadian Courts. These two exclusions are meant to complement the Pollution Exclusion, discussed in the last section. Faced with a rising number of claims, and the potential of more to come, the Asbestos and Mould Exclusions are an attempt to exclude both asbestos and mould claims from coverage under the New IBC CGL Form. As discussed earlier, even though the New IBC CGL Form wordings are "bench-marks" to be used wholly at the discretion of the insurance industry, liability insurers are well-advised to adopt the wordings of these exclusions in the New IBC CGL Form in their commercial general liability policies.

The Asbestos Exclusion

The New IBC CGL Form Asbestos Exclusion provides as follows:

> *This insurance does not apply to:*
>
> ***1. Asbestos***

> *"Bodily injury," "property damage" or "personal and advertising injury" related to or arising from any actual or alleged liability for any legal remedy of any kind whatsoever (including but not limited to damages, interest, mandatory or other injunctive relief, statutory orders or penalties, legal or other costs, or expenses of any kind) in respect of actual or threatened loss, damage, cost or expense directly or indirectly caused by resulting from, in consequence of or in any way involving asbestos or any materials containing asbestos in whatever form or quality.*
>
> *This exclusion applies regardless of any other contributing or aggravating cause or event that contributes concurrently or in any sequence to the "bodily injury," property damage" or "personal or advertising injury".*

Particularly after the huge losses on asbestos exposure claims suffered by American liability insurers in the early 1990s, asbestos has become an omen of risk amongst Canadian liability insurers. Health risks associated with asbestos are widely known in both the insurance industry and in the general public.

While there are fewer cases involving asbestos-related injury in Canada than in the U.S., several benchmark decisions illustrate the need for carefully worded policies. In the 1996 case of *St Paul Fire & Marine Insurance Co. v. Durable Canada Ltd.*[106] the insurer was found liable for coverage under several comprehensive general liability policies for fifty claims or actions against the insured, involving third parties who alleged deleterious effects of exposes to asbestos fibres in products it manufactured. On appeal to the Ontario Court of Appeal, the Court stated that even if the insured did not have insurance coverage throughout the entire period covered by the claims, the insurer was to bear the entire cost of discharging its' duty to defend. This allocation of defence costs to the insurer was subject to the insurers' entitlement to recover their costs of defence from the insured following the ultimate disposition of the underlying actions. Obviously there were no asbestos exclusions in the policies in question.

By comparison, *Privest Properties Ltd. v. Foundation Co. of Canada*[107] case in British Columbia illustrated that the Courts will not always follow American jurisprudence favouring Plaintiffs in asbestos related actions. In that case, a building owner sued various parties for damages arising out of removal and replacement of asbestos-containing fireproofing. The B.C. Court of Appeal dismissed an appeal by the Plaintiffs because they had failed to prove that any exposure or workers to asbestos would result in injury.

The need for an Asbestos Exclusion is made even more critical as insureds search for new, peripheral defendants, and the so-called "litigation net" becomes more widely spread to include companies that used asbestos-containing material on their premises or even in the production process. That leads to a greater exposure on a larger number of industries that do not appear, at first blush, to have significant exposure. The

[106] 1996 CarswellOnt 2350 (C.A.).
[107] 1997 CarswellBC 897 (C.A.) [hereafter "*Privest Properties*"].

growing popularity of class actions means even more exposure to Canadian liability insurers for asbestos related injuries. On the other hand, many bodily injury asbestos–related claims will be handled through the workers compensation schemes, and most Canadian provinces have detailed guidelines with regard to the handling and removal of asbestos.

Although it is untested in the Courts, the wording of the Asbestos Exclusion in the New IBC CGL Form is another example of the introduction of the anti-concurrent language to avoid the impact of the *Derksen* decision, discussed earlier in this paper. By inserting the phrase, "*…regardless of any other contributing or aggravating cause or event that contributes concurrently or in any sequence to the "bodily injury," property damage" or "personal or advertising injury"* the IBC is attempting to eliminate the potential that a Canadian Court may find for coverage after a causation analysis of two separate causes, if one peril is covered and one excluded.

The Mould Exclusion

Introduction

Mould claims are similar to environmental or other toxic torts claims. These claims are not confined to the "leaky building" scenario; problems have been reported across the country at schools, hospitals, even courthouses, and are not confined to the wet climates of British Columbia; mould claims are made in more traditionally dry climates like Calgary. Mould litigation is prevalent in the U.S. and threatens to become a serious issue for Canadian liability insurers.

In October 2002, the IBC released fungi and fungal derivative endorsements. Now the New IBC CGL Form expressly excludes coverage for mould claims. For the sake of clarity, the word "mould" is the commonly used term to describe these types of claims; all moulds are fungi and the mould life cycle begins with airborne spores; thus the language used in the Mould Exclusion. By way of explanation, mould is a fungus, and is able to grow in most man-made environments where there is adequate heat and moisture. The mould life cycle begins with airborne spores, which are present in most indoor environments. Spores are released into the air by existing mould colonies, and can last for months and even years. When a spore finds the correct level of humidity, ambient temperature, and a carbon substrate (like wood) it germinates much like a seed. Spores grow micro-filaments called hyphae, which in turn release an enzyme used by the fungus to break down and absorb the carbon substrate.

The Mould Exclusion Wording

The New IBC CGL Mould Exclusion provides:

*2. **Fungi or Spores***

a. *"Bodily injury," "property damage" or personal and advertising Injury" or any other cost, loss or expense incurred by others, arising directly or indirectly from the actual, alleged or threatened inhalation of, ingestion of, contact with, exposure to, existence of, presence of, spread of, reproduction, discharge or other growth of any "fungi" or "spores" however caused, including any costs or expenses incurred to prevent, respond to, test for, monitor, abate, mitigate, remove, cleanup, contain, remediate, treat, detoxify, neutralize, assess or otherwise deal with or dispose of "fungi" or "spores";*

b. *Any supervision, instructions, recommendations, warnings, or advice given or which should have been given in connection with **a**. above; or*

c. *Any obligation to pay damages, share damages with or repay someone else who must pay damages because of such injury or damage referred to in **a**. or **b**. above.*

This exclusion applies regardless of any other contributing or aggravating cause or event that contributes concurrently or in any sequence to the "bodily injury", "property damage" or "personal or advertising injury"

Both "Fungi" and "Spores" are now defined terms in the New IBC CGL Form:

11. "Fungi" includes but is not limited to, any form or type of mould, yeast, mushroom or mildew whether or not allergenic, pathogenic or toxigenic and any substance, vapour or gas produced by, emitted from or arising out of any "fungi" or "spore" or resultant mycotoxins, allergens or pathogens.

26. "Spores" includes, but is not limited to, any reproductive particle or microscopic fragment produced by, emitted from or arising out of any "fungi".

Analysis

The analysis of the impact of this exclusion must begin with the need for the defined terms in the New IBC CGL Form, which are brand new. The definitions were added to the New IBC CGL Form to provide clarity to the Mould Exclusion, and to lessen the risk of other interpretations that may foster arguments and varying coverage results. The definitions are not closed, but imply that both fungi and spores include, *but are not limited to* what is contained in the definition. According to established legal principle, general words used in an enumerated list with specific words should be construed in a manner consistent with the specific words. It is assumed that the IBC drafted the definitions, with the help of both the legal and scientific communities, in order to bar coverage for any potential mould claim, whether an identified fungi or spore or not.

Once again the IBC has included the anti-concurrent cause language, discussed earlier in this paper, in the wording of the Mould Exclusion. The fact that the Exclusion

applies "*regardless of any other contributing or aggravating cause or event that contributes concurrently or in any sequence*" to any damage or injury is an attempt to prevent a Canadian Court from finding for coverage in the event that the damage or injury was caused concurrently by a second cause, not covered under the CGL.

Secondly, the Mould Exclusion specifically excludes clean up and remediation costs. Commercial insureds need to appreciate that the Mould Exclusion eliminates coverage for any costs or expenses incurred to "*…prevent, respond to, test for, monitor, abate, mitigate, remove, cleanup, contain, remediate, treat, detoxify, neutralize, assess or otherwise deal with or dispose of "fungi" or "spores."* The IBC has included remediation costs because the cost to remediate and repair mould infected structures is potentially enormous. For example, in a notable Florida case, a courthouse was infested with two forms of mould owing to numerous building defects which led to severe water ingress.[108] Because the mould growth was so severe, and the defects were so large, the Court ordered that the structure be demolished and rebuilt, at a cost of $26,000,000. At trial the Court found that the construction manager had breached his duty of care to the county, and ordered him to pay over $14,000,000 in damages, interests, and costs.

A host of mould related remediations have occurred in Canada as well, among them:[109]

- The Ontario government expects to spend almost $90 million per year to repair over 58 mould infested buildings including police detachments, courthouses, and jails;
- The Royal Victoria Hospital at McGill University replaced a mould infested operating room ventilation system at a cost of over $100,000;
- The Province of Ontario paid $40 million to school boards in grants to correct "mould contamination problems" in schools;
- Mould infestation led to the remediation of two nursing homes in Halifax, with a cost of over $1 million.
- In 2000 in Newmarket, Ontario the 165,000 square foot Provincial Court building had all of its walls and ceilings replaced to eliminate traces of mould;
- The cost of building a new Court of Appeal facility in Alberta is estimated at $250 million, and the Alberta government is currently paying $1.7 million per year to lease alternate space, as the courthouse is not in use due to mould contamination.

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[108] *Centex-Rooney Construction Co. v. Martin County*, 706 So. 2d 20 (Fla. App. 1997).

[109] See D. Liblong "Insurance Coverage Issues in Mold Claims" and P. Chapman "What's Green, Gross, and Attracts Liability?"– Canadian Litigation Counsel," Mold: The Emerging Enemy"; G. Gibson & D. Pym Sr., "Toxic Mould Claims in Canada" Crawford Adjusters Canada; August 2002.

Clearly the potential cost of mould remediation is staggering, and poses significant risks to insurers from both a third party and first party perspective. The IBC has excluded the cost of "dealing with" fungi or spores as a result, by using a wide variety of terms in the Mould Exclusion language. This wording is especially crucial in light of the example of the *Privest Properties, supra.* Finally, this portion of the wording in the Mould Exclusion dealing with cleanup, containment and remediation matches the wording of the New IBC CGL Form Pollution Exclusion.

Following the example of the Pollution Exclusion in the New IBC CGL Form, the Mould Exclusion addresses issues of the mode of transmittal of the fungi and spores. The language used in the Mould Exclusion includes "*inhalation*", "*ingestion of*", "*contact with*", "*spread of*", and "*discharge*". This language should provide more certainty as to instances when the Mould Exclusion will apply.

However, unlike the Pollution Exclusion, the Mould Exclusion does not define or in any categorize or limit the location of mould. It may be that the drafters of the New IBC CGL Form realized that mould is ubiquitous and can grow almost anywhere, including most building surfaces. Potential mould hazards are found mostly in indoor environments where the spores circulate in a contained environment, instead of dispersing in the open air.

Conclusion

To date no Canadian Courts have considered the exact wordings of the New IBC CGL Form Asbestos and Mould Exclusions. It was only recently that the ISO introduced a specific exclusion dealing with mould, and the IBC followed suit within the New IBC CGL Form. American Courts have litigated mould issues, but more often than not under language similar to the Former IBC CGL Form Pollution Exclusion. Until the wording of these new exclusions are tested through the Courts, Canadian liability insurers continue to face some uncertainty about this rapidly evolving area of coverage and claims.

THE NEW TERRORISM EXCLUSION:

Introduction

The tragic events of September 11, 2001, have had an unprecedented impact on insurance companies in the United States and around the world. The insured losses resulting from the September 11th attacks on the World Trade Center and the Pentagon

are estimated to exceed thirty billion US dollars.[110] These attacks have brought to light the enormous potential exposures that insurers face in the event of further terrorist attacks.

In response to the September 11th attacks, the IBC established a special terrorism task force to address Canadian liability insurers' concerns regarding future exposure for terrorism related losses.[111] Part of its mandate was to develop a definition of "terrorism" that would be incorporated into a new exclusion for damage and loss resulting from acts of terrorism. Now, the wordings in the New IBC CGL Form provide an entirely new Terrorism Exclusion for Canadian liability insurers, to avoid loss occasioned by terrorist activity.[112]

The New Terrorism Exclusion

The New IBC CGL Form Terrorism Exclusion now excludes coverage for loss and damage caused by terrorism, as follows:

> *Bodily injury", "property damage" or "personal and advertising injury" arising directly or indirectly, in whole in part, out of "terrorism", or out of any activity or decision of a government agency or other entity to prevent, to respond or terminate "terrorism". This exclusion applies regardless of any other contributing cause or event that contributes concurrently or in any sequence to the "bodily injury", "property damage" or "personal and advertising injury".*

Terrorism is defined as follows:

> *"Terrorism" means an ideologically motivated unlawful act or acts, including but not limited to the use of violence or force or threat of violence or force, committed by or on behalf of any group(s), organization(s) or government(s) for the purpose of influencing any government and/or instilling fear in the public or a section of the public.*

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[110] S. Plitt, "The Changing Face of Global Terrorism and a New Look at War: An Analysis of the War-Risk Exclusion in the Wake of the Anniversary of September 11, and Beyond"(2003), 39 *Willamette L. Rev*. 31 at 35.

[111] IBC: "*Terrorism – Insurance and Reinsurance*", online: http://www.ibc.ca/

[112] In the United States, following the September 11th terrorist attacks, many insurers adopted terrorism exclusions in a broad range of insurance policies. Congress enacted the *Terrorism Risk Insurance Act* ("*TRIA*") in 2002, which voids terrorism exclusions but only requires insurers to pay a fixed percentage of annual premiums on terrorism related losses. The federal government will pay 90% of the remainder of the claim. For a discussion of *TRIA*, see Insurance Information Institute, "*Terrorism and Insurance*", July 2004, online: http://www.iii.org/.

Judicial Consideration of Acts of Terrorism

Prior to the introduction of specific terrorism exclusions in commercial policies, Courts have considered terrorism within the context of exclusions for war and military action. American Courts have followed British decisions dealing with acts of terrorism, and have concluded that terrorist acts do not fall within the scope of war-risks.[113]

In *Pan American World Airways, Inc. v. Aetna Cas. & Sur. Co.*,**[114]** the U.S. District Court considered whether war-risk exclusions applied to the hijacking and eventual destruction of an airplane by individuals acting for the Popular Front for the Liberation of Palestine (the "PFLP"). The aircraft was insured under all-risk and war-risk policies provided by private insurers, while the United States government provided excess insurance. The all-risk and war-risk policies contained exclusions for losses arising from "*war*" and "*warlike acts*". The issue for the Court to determine was whether these exclusions applied in the circumstances of the case.**[115]** If the exclusion was applicable, the private insurers would not be liable for the loss resulting from the destruction of the aircraft.

In this case, the Court decided that the war-risk exclusions did not apply. He described the FPLP's actions in the following manner:

> ***...the hijacking was the work of a relatively miniscule, militarily impotent, essentially isolated group of dedicated revolutionists pursuing long-range objectives. The hijacking of interest here, like other acts of terrorism, was designed to serve as a spectacular display, as a round of "symbolic blows" as propaganda of a vividly compelling sort. The central and overriding effect was to be a spiritual lift for Palestinians generally and, more importantly, a demonstration of the "heroism" of the PFLP...*** [116]

In a footnote to this passage, the Court stated that the terms "*terrorist*" and "*terrorism*" were adequate to describe the actions of the PFLP.[117]

According to the Court, the definition of "*war*" did not apply under the circumstances, even though there may have been an insurrection taking place in Jordan that was related to the hijacking, as this was not the proximate cause of the destruction of the aircraft. The Court also found that the term "*warlike operations*" did not apply in the circumstances, stating that:

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[113] For a thorough discussion of the judicial consideration of war-risk exclusions in the context and terrorism and otherwise, see Lichty & Snowden, *supra* note 4 at chap. 33.
[114] 368 F.Supp. 1098 (S.D. N.Y.) 1973; aff'd 505 F.2d 989 (1974, 2nd Cir.) [hereafter "*Pan American*"].
[115] The court also considered whether the terms "riot", "insurrection", and "civil commotion" applied in the facts of the case, and found that they did not.
[116] 368 F.Supp. 1098 (S.D. N.Y.) 1973 at p. 1115-1116.
[117] Ibid, at p. 1116, footnote 18.

> *…there is no warrant in the general understanding of English, in history, or in precedent for reading the phrase "warlike operations" to encompass the infliction of intentional violence by political groups (neither employed by nor representing governments) upon civilian citizens of non-belligerent powers and their property at places far removed from the locale or the subject of any warfare.*[118]

Finally, the Court noted that the concept of terrorism was known to insurers and was could have been described in plain language. As the American liability insurers did not specifically describe terrorist acts within any exclusions in their policies, they could not avoid liability for the loss of the aircraft.

The insurers launched an appeal in the U.S. Court of Appeals for the Second Circuit, but were not able to persuade the Court that the war-risk exclusions applied. In its decision, the Court reviewed a wealth of British and American cases dealing with war-risk exclusions and stated that:

> *Cases have established that war is a course of hostility engaged in by entities that have at least significant attributes as sovereignty: under international law, war is waged by states or state-like entities… In the present case, the loss of the Pan American was in no sense proximately caused by any 'war' being waged by or between recognized states. The PFLP has never claimed to be a state. The PFLP could not have been acting on behalf of any of the states in which it existed when it high jacked the 747, since those states uniformly opposed hijacking.*[119]

After *Pan American*, *supra*, Courts have refused to apply war-risk exclusions in cases where a loss has occurred as a result of a terrorist act. In *Holiday Inns, Inc. v. Aetna Insurance Company*,[120] a hotel building located in Beirut, Lebanon, which was leased by the insured, was severely damaged in fighting between rival politically motivated factions. The Court concluded that at least one of these factions was not a sovereign entity, and therefore the fighting that led to the insured's loss could not be considered an act of war.

What emerges from the case law is a clear distinction between acts of war and acts of terrorism. War has been defined as hostility engaged in by sovereign states or state like entities. Terrorism, on the other hand, has been defined as the politically motivated infliction of intentional violence by groups who do not represent sovereign states upon civilian citizens and their property.

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[118] Ibid, at p. 1130.
[119] 505 F.2d 989 (1974, 2nd Cir.) at p. 1012-1013.
[120] 571 F.Supp. 1460 (S.D.N.Y. 1983).

The Definition of "Terrorism" in the New IBC CGL Form

In light of the September 11th attacks, the IBC treated as imperative that Canadian liability insurers adopt a clearly worded exclusions for loss arising from acts of terrorism and to define the term "terrorism" with sufficient precision to avoid liability in the event of future terrorist attacks. The definition of "terrorism" set out in the New IBC Form is broad in scope and is intended to preclude the possibility of coverage in relation to occurrences like those of September 11, 2001.

The New IBC CGL Form definition of "terrorism" is more expansive than the definition of terrorism arising from the case law. The definition does not provide an exhaustive list of acts that qualify as terrorism, but provides that:

> *"Terrorism" means an ideologically motivated unlawful act or acts, including but not limited to the use of violence or force or threat of violence or force, committed by or on behalf of any group(s), organization(s) or government(s) for the purpose of influencing any government and/or instilling fear in the public or a section of the public.*

The definition of "terrorism" provides several examples of types of ideologically motivated unlawful acts that would constitute "terrorism" for the purpose of the Exclusion, but it does not close the door to other possibilities. The definition is also broader in scope than the definition of terrorism arising from the case law as it covers acts that may fall short of violence or force, where violence or force is merely threatened. Further, this definition includes acts that are merely intended to instil fear in the public.

Concurrent Causation Language in the Terrorism Exclusion

The decision of the Supreme Court of Canada in *Derksen* has brought to light the need to expressly exclude all concurrent causes of terrorism related losses. As discussed earlier in this paper, the Supreme Court of Canada clarified the law on concurrent causes of loss, and decided that where a loss results from multiple causes, the loss will not be excluded from coverage unless all concurrent causes are excluded. The Court suggested that insurers adopt the following language to avoid the possibility of coverage in such circumstances:

> *"We do not insure for such loss regardless of the cause of the excluded event, other causes of the loss, or whether other causes acted concurrently or in any sequence with the excluded event to produce the loss…"*

In response to the decision in *Derksen*, the Terrorism Exclusion in the New IBC CGL Form contains similar wording, stating:

> *This exclusion applies regardless of any other contributing cause or event that contributes concurrently or in any sequence to the "bodily injury", "property damage" or "personal and advertising injury".*

This wording should act to preclude coverage for losses caused by terrorism in addition to some other cause, such as negligence for example, that contributes to a loss.

Conclusion

In order to avoid enormous losses that could potentially cripple the insurance industry in the event of a terrorist attack on the scale of the September 11th attack on the World Trade Center, the New IBC CGL Form contains a Terrorism Exclusion and defines "terrorism" in a broad manner. The IBC has attempted to curtail the possibility of coverage for damage caused by a terrorist act where another otherwise covered cause exists. Canadian liability insurers that provide commercial general liability insurance would be well advised to ensure that their policies contain a terrorism exclusion and that the term "terrorism" is defined according to wordings in the New IBC CGL Form.

This paper will now review a select number of topics in the New IBC CGL Form, including the "building block" concepts of who is an insured, aggregate limits, the duties of an insured, the so-called "Other" insurance clause and coverage for "Personal Injury" and "Advertising Injury".

FOCUS – CRITICAL AREAS OF THE NEW IBC CGL FORM

BROADENING WHO IS AN "INSURED" AND IMPACT ON THE FORM'S EXCLUSIONS

Introduction

A commercial general liability policy is unlike a personal lines policy as it is issued to "for profit" and "not-for-profit" business organizations. This type of policy deals with the ever broadening range of legal structures used for business purposes. For that reason, the section of the New IBC CGL Form entitled "Who is an Insured" is of vital importance to the overall policy, and to the insurer and the insured. Overall, the New IBC CGL Form broadens the range of coverage available. The preamble to the New IBC CGL Form is the first mention of "Who is an Insured" and sets the tone for what is to follow. The preamble immediately identifies the "players" in the insurance contract (the insured and the insurer) and references the section later in the New IBC CGL Form called "Who is an Insured":

> *Throughout this policy the words "you" and "your" refer to the Named Insured shown in the Declarations, and any other person or organization qualifying as a Named Insured under Paragraph 3. of Section II – Who is an Insured. The words "we", "us" and "our" refer to the company providing this insurance.*

The word "insured" means any person or organization qualifying as such under Section II – Who is An Insured.

In this portion of the paper, we summarize the wordings of the New IBC CGL Form in the section "Who is an Insured" and review how the wordings now modify the delineation of who is an insured, and in doing so, alter the scope of coverage in three basic respects, namely:

1. by specifically including increasingly common forms of business organizations, and their principals, as potential insureds;
2. by adding volunteer workers as insureds, in addition to employees; and
3. by expanding the exclusion of employee coverage for bodily injury and property claims by other insureds.

Each of these changes in the New IBC CGL Form wordings and their impact on insureds and insurers alike will be discussed below.

The Wordings : "Who is an Insured"

The Former IBC CGL Form wordings described named insureds as follows:

1. NAMED INSURED
The Named Insured is as stated in the Declarations.

2. INSURED
The unqualified word "Insured" includes the Named Insured and also includes:

(a) any partner, officer, director, employee or shareholder with respect to acts performed on behalf of the Named Insured in that capacity.

(b) any owner, person, firm, organization, trustee, estate or governmental entity to whom or to which the Named Insured has contracted to effect insurance by virtue of a contract of agreement or by the issuance or existence of a permit. But the Insurance provided for such additional Insured is restricted to apply solely to liability arising out of operations performed under said contract and only to the extent required by such contract;

It is understood and agreed however that the above extension (b) does not apply to subcontractors or contractors working on behalf of the Named Insured.

(c) co-owners, joint ventures or partners having a non-operating interest with the Named Insured in the operations insured hereunder.

(d) all employee social clubs which manage, operate, control, or supervise recreational activities under the auspices of the Named Insured.

(e) any organization you newly acquire or form other than a partnership or joint venture, and over which you maintain ownership or majority interest will be deemed an Insured.

However;

(a) The Insurance granted to such organization is excess to, and shall not contribute with, previously arranged insurance of such organization;

(b) Coverage under this provision is afforded only until the 90th day after you acquire or form the organization or the end of the policy period, whichever is earlier;

(c) Coverage does not apply to "personal injury" or "property damage" that occurred before you acquired or formed the organization.

(d) Coverage does not apply to "personal injury" arising out of an offense committed before you acquired or formed the organization.

No person or organization in an Insured with respect to the conduct of any current or past partnership or joint venture that is not shown as a Named Insured in the Declarations.

Nothing in this definition relieves the Named Insured of its obligation to make a full disclosure of matters material to the risk and to report to the Insurer material change in the risk during the currency of the policy.

The wordings of the New IBC CGL Form "Who is an Insured" are reproduced below (please note that since most of the wording is changed from the Former IBC CGL Form, underlining is omitted).

Section II – Who is an Insured

1. *If you are designated in the Declarations as:*
   - *a. An individual, you or your spouse are insureds, but only with respect to the conduct of a business of which you are the sole owner.*
   - *b. A partnership, limited liability partnership or joint venture, you are an insured. Your members, your partners, and their spouses are also insureds, but only with respect to the conduct of your business.*
   - *c. A limited liability company, you are an insured. Your members are also insureds, but only with respect to the conduct of your business.*
   - *d. An organization other than a partnership, limited liability partnership, joint venture or limited liability company, you are an insured. Your "executive officers" and directors are insureds, but only with respect to their duties as your officers or directors. Your shareholders are also insureds, but only with respect to their liability as shareholders.*
   - *e. A trust, you are an insured. Your trustees are also insureds, but only with respect to their duties as trustees.*

2. *Each of the following is also an insured:*

   - *a. Your "volunteer workers" only while performing duties related to the conduct of your business, or your "employees", other than either your "executive offices" (if you are an organization other than a partnership, limited liability partnership, joint venture or limited liability company) or your managers (if you are a limited liability company), but only for acts within the scope of their employment by you or while performing*

duties related to the conduct of your business. However, none of these "employees" or "volunteer workers" are insured for:

(1) Bodily injury or "personal advertising injury":

(a) To you, to your partners, or members (if you are a partnership, limited liability partnership or joint venture), to your members (if you are a limited liability company), to a "co-employee", while in the course of his or her employment or performing duties related to the conduct of your business, or to your other "volunteer workers" while performing duties related to the conduct of your business;

(b) To the spouse, child, parent, brother or sister of that co-employee or "volunteer worker" as a consequence of Paragraph ***1(a)*** *above:*

(c) For which there is any obligation to share "compensatory damages" with or repay someone else who must pay "compensatory damages" because of the injury described in Paragraphs ***(1)(a)*** *or* ***(b)*** *above:*

(d) Arising out of his or her providing or failing to provide professional health care services; or

(e) To any person who at the time of injury is entitled to benefits under any workers' compensation or disability benefits law or a similar law.

(2) "Property damage" to property:

(a) Owned, occupied or used by

(b) Rented to, in the care, custody or control of, or over which physical control is being exercised for any purpose by

You, any of your "employees", "volunteer workers", any partner or member (if you are a partnership, limited liability partnership or joint venture) or any member (if you are a limited liability company).

b. Any person (other than your "employee" or "volunteer worker"), or any organization while acting as your real estate manager.

c. Any person or organization having proper temporary custody of your property if you die, but only:

(1) With respect to liability arising out of the maintenance or use of that property; and

(2) Until your legal representative has been appointed.

d. Your legal representative if you die, but only with respect to duties as such. That representative will have all your rights and duties under this policy.

3. *Any organization you newly acquire or form, other than a partnership, limited liability partnership or joint venture or limited liability company, and over which you maintain ownership or majority interest, will qualify as a Named Insured if there is no other similar insurance available to that organization. However,*

   a. *Coverage under this provision is afforded only until the 90th day after you acquire or form the organization or the end of the policy period, whichever is earlier;*
   b. *Coverage **A** and **D** does not apply to "bodily injury" or "property damage" that occurred before you acquired or formed the organization; and*
   c. *Coverage **B** does not apply to "personal and advertising injury" arising out of an offense committed before you acquired or formed the organization.*

   No person or organization is an insured with respect to the conduct of any current or past partnership, limited liability partnership, joint venture or limited liability company that is not shown as a Named Insured in the Declarations.

Broadening the Forms of Business Organization that are "Insureds"

Summary of the Changes

The Former IBC CGL Form recognized the following types of insureds, as designated in the Declarations:

1. individuals;
2. partnerships and joint ventures; and
3. organizations other than partnerships and joint ventures.

To this, the New IBC CGL Form adds the following:

1. limited liability partnerships;
2. limited liability corporations (called "company" in the New IBC CGL Form in keeping with the "plain English" format) ; and
3. trusts.

In order to best understand these additions in the New IBC CGL Form, it is helpful to provide a brief review of the legal entities described as limited liability partnerships and limited liability companies. Neither term is defined in the New IBC CGL Form. Briefly, a limited liability partnership (known as a LLP) is a type of partnership entity in which each general partner has unlimited liability, while limited partners have limited liability in a capacity akin to shareholders. In B.C. a limited liability partnership is defined by

statute and governed by Part 6 of the *Partnership Act,* R.S.B.C. 1996, c. 348. On the other hand, a limited liability company is a hybrid business vehicle offering limited liability to its owners or members and is a more flexible form of ownership, especially suitable for smaller companies with restricted numbers of owners. A limited liability company is more a status than an entity, as it can be taxed like a partnership or corporation.

The New IBC CGL Form continues to include a "catch-all" phrase, stating that you are an insured if you are "*[a]n organization other than a partnership, limited liability partnership, joint venture or limited liability company*". Paragraph 3 of Section II of the New IBC CGL Form, which provides temporary coverage for newly acquired or formed companies in certain circumstances, remains unchanged, except to reflect the new forms of business organization outlined above.

Impact of the Changes

The wording in the New IBC CGL Form reflects the different forms of business organization which are becoming increasingly common. These forms of legal entity would – if named in the Declarations – have been captured by the "*organizations other than partnerships and joint ventures*" language of the Former IBC CGL Form. In that sense, the changes can be viewed as a consolidation of the language used in the Form. However, along with the addition of these new business forms, the language in the New IBC CGL Form adds individuals, namely individual principals and managers. These types of individuals may have been encompassed by the language in the Former IBC CGL Form under the word "employee" or could have been expressly named in the Declarations if not.

As with the Former IBC CGL Form wording, the New IBC CGL Form includes additional insureds for each category of named insured (in italics):

(a) Individual: *individual and spouse with respect to the conduct of the business*;
(b) Partnership, limited liability partnership or joint venture: *members, partners and their spouses, with respect to their conduct of the business*;
(c) Limited liability company: *members, with respect to their conduct of the business, and managers with respect to their duties as managers*;
(d) Organizations other than a partnership, limited liability partnership, joint venture or limited liability company: *executive officers and directors, with respect to their duties as officers and directors, and shareholders with respect to their liability as shareholders*; and
(e) Trusts: *trustees, with respect to their duties as trustees*.

By bringing limited liability partnerships, limited liability companies and trusts into the specific categories of named insured, the wording of the New IBC CGL Form ensures that managers and members of limited liability companies, partners of limited liability partnerships and trustees are also insured along with the entity with which they are associated.

Continuing Need for Certain Entities to be Named in the Declarations

A review of the old wording under the Former IBC CGL Form reveals that no insured has coverage with respect to the conduct of any undisclosed partnership or joint venture. This clause remains, but has been changed to encompass limited liability partnerships and limited liability corporations. The New IBC CGL Form reads as follows:

> *No person or organization is an insured with respect to the conduct of any current or past partnership, limited liability partnership, joint venture or limited liability company that is not shown as a Named Insured in the Declarations.*

This provision has effectively precluded coverage for claims arising from an insured's participation in an undisclosed partnership or joint venture. In the 2004 decision from the B.C. Court of Appeal, *Kingsway General Insurance v. Lougheed Enterprises Ltd.*,[121] this issue was reviewed. In that case, companies were named as insureds on an insurance policy, but the partnership that the companies formed when they worked together on a condominium construction project was not named. The Court determined that when an individual or corporate insured becomes a partner, it is likely to increase an insurer's risk materially. At both trial and on appeal, the Courts found that while the insurance contract did not exclude any acts committed by the insured in an unnamed partnership, it did exclude acts undertaken by the partnership. The policy in question specifically stipulated that no partnership was covered unless specifically named.

As a result, the Court of Appeal declared that the insurer did not have to defend any action against individual partners for damages arising from a fire at the condominium project. In the New IBC CGL Form, that has now been expanded to include participation in a limited liability partnership or limited liability corporation. Under the New IBC CGL Form wordings, an insured does not lose coverage altogether for participating in an undisclosed partnership, limited liability partnership, limited liability corporation or joint venture. It simply has no coverage for claims that relate to the conduct of such undisclosed entities.[122] The rationale for the exclusion is that

[121] 2004 BCCA 421.
[122] *Ibid.*

participation in such entities entails additional risk for which the insurer should not be responsible unless they were aware of it.

The new wording expands the "*undisclosed entity*" clause to encompass undisclosed limited liability partnerships and limited liability corporations, as well as undisclosed partnerships and joint ventures. The result is that insureds will not be covered in relation to the conduct of any limited liability partnerships or limited liability corporations in which they are involved, unless such entities are listed in the Declarations.

Volunteer Workers and Employees

The wordings of the New IBC CGL Form with regard to volunteers will be most important to organizations that rely on volunteer time and efforts. The wording will significantly broaden coverage for not-for-profit organizations who could not exist without volunteers and their efforts. Specifically, paragraph 2 in both the Former IBC CGL Form and also in the New IBC CGL Form defines various categories of additional insureds, including employees and real estate managers. These provisions have been modified in two key respects: (a) by adding "volunteer workers" as additional insureds, and (b) by expanding the scope of the bodily injury and property damage exceptions to coverage for employees and volunteer workers.

Volunteer Workers

The wording of the Former IBC CGL Form included "*employees*" of the named insured, other than executive officers, as additionally insured for acts within the scope of their employment. "*Employee*" is not a defined term. The wording of the New IBC CGL Form adds "*volunteer workers*" as additional insureds, along with employees. "*Volunteer worker*" is now a defined term in the New IBC CGL Form, as follows:

> *"Volunteer worker" means a person who is not your "employee", and who donates his or her work and acts at the direction of and within the scope of duties determined by you, and is not paid a fee, salary or other compensation by you or anyone else for their work performed by you.*

The named insured's "*volunteer workers*" are insureds only while performing duties related to the conduct of the business of the named insured, acting at the direction of the insured and not paid for these efforts. Therefore, a "*volunteer worker*" would have no coverage if acting in a personal capacity. It is assumed that the definition of "*volunteer workers*" was added to the New IBC CGL Form because volunteers do not have employment contracts.

Employees

The scope of coverage for "*employees*" is also modified in the New IBC CGL Form wordings, in the following two respects:

(a) coverage for managers of limited liability corporations is specifically excluded under this paragraph;[123] and
(b) in addition to being covered for "acts within the scope of their employment" – which is carried over from the old wordings – employees are insured "*while performing duties related to the conduct of*" the business of the named insured.

The first revision simply brings the wordings in line with the realities of new forms of business vehicles, namely limited liability corporations, while the second revision arguably extends the scope of coverage for employees. This expanded definition is consistent with the treatment of volunteer workers. The provisions taken together more fully embrace coverage for workers acting on the insured's behalf, as long as they are acting within the scope of their employment or if they are performing duties related to the conduct of their employment. This expansion is meant to clarify that broader coverage will be offered to employees of the insured entity provided they act in the manner expressly described and not in a personal capacity.

Bodily Injury and Property Damage Exception

Whereas the changes outlined above largely expand the range of insureds under the New IBC CGL Form wordings, other changes to the "Who is an Insured" section, namely in paragraph 2.a, serve to restrict coverage for employees and volunteer workers. The wording changes are to the exceptions to coverage for certain bodily injury, personal injury and property damage claims. In essence, these exceptions are designed to exclude coverage for claims *between* employees and volunteer workers and their co-workers, the insured and their principals. By expanding the range of claims for which employee/volunteer worker coverage is excluded, the wording in the New IBC CGL Form narrows the scope of coverage for these categories of insured.

Bodily Injury and Personal and Advertising Injury

The New IBC CGL Form wording has combined "personal injury" and "advertising injury" into one definition – "Personal and Advertising Injury" – which essentially combines both of these existing Grants of Coverage. This new definition is reflected in

[123] They do however have coverage under Paragraph 1.c. "with respect to their duties as" managers.

the exceptions to coverage contained in paragraph 2.a. of the New IBC CGL Form. This effectively adds infringement of copyright and advertising ideas in advertising to the types of excluded claims. However, this change is not significant because these types of claims between insureds are unlikely.

These wording changes and coverage overlaps are more fully discussed in the later section of this paper called "Coverage for Advertising and Personal Injury".

The inclusion of "*volunteer workers*" in the Grant of Coverage also carries into the exception. As such, employee coverage is also reduced in that claims by "*volunteer workers*" for bodily, personal and advertising injury are also excluded, in addition to such claims by co-employees. As noted earlier, volunteer workers do not have employment contracts, and are not employees.

A more significant change is the expanded scope of individuals in relation to whom the employees and volunteer workers will be insured. The Former IBC CGL Form wording excluded employee coverage for bodily injury and personal injury claims by co-employees acting within the course of their employment. Such claims – expanded to include advertising injury – are now also excluded in the New IBC CGL Form where the injured party is:

(a) The named insured and its partners or members;
(b) A volunteer worker or co-employee while performing duties relating to the conduct of the named insured's business; and
(c) The spouse, child, parent, brother or sister of that co-employee or volunteer worker as a consequence of the co-employee's or volunteer worker's injuries.

The key practical impact of these changes is that the employee is not covered for bodily, personal and advertising injuries suffered by (a) the insured entity and certain owners/principals, or (b) family members of co-employees or volunteer workers, derivative of injury to the co-employees or volunteer workers. This wording is more restrictive, in order to reduce any ambiguity in either interpretation or coverage.

Property Damage

The wording of the Former IBC CGL Form excluded employee coverage for damage to property owned, occupied, or used by or rented to the named insured, employees, partners or members. This exception to employee coverage continues in the New IBC CGL Form, but is now expanded in terms of the nature of both the possession and the party possessing the property.

The character of the possession or control that will exclude coverage is broadened in the New IBC CGL Form through the adoption of very wide language designed to encompass all forms of possession or control. The new clause reads as follows (with modified provisions underlined):

> *"Property damage" to property:*
> *(a) Owned, occupied or used by,*
> *(b) Rented to, in the care, custody or control of, or over which physical control is being exercised for any purpose by*
>
> *You, any of your "employees", "volunteer workers", any partner or member (if you are a partnership, limited liability partnership or joint venture), or any member (if you are a limited liability company).*

This modified exception to employee coverage reflects in part the expanded scope of business organizations specifically enumerated in the new wordings. However, other changes reflect an intention to expand the property damage exception to embrace virtually all forms of ownership, use, possession or control of property. This change should clarify the scope of the exception and reduce the possibility of such claims being successfully advanced. The exception was augmented to prevent insureds from claiming for damage to their own property caused by either workers or volunteers (or other members of the enumerated class as described in the wordings); insureds should purchase property policies to cover damage to their own property and not rely on a commercial general liability policy to provide coverage for that risk.

Conclusion

There are a number of changes to the classification of "Who is an Insured" in the New IBC CGL Form wordings. The variety of business forms which can become a named insured are expanded, as are the principals (i.e. the individuals), who are now defined as additionally insured. The denial of coverage for claims arising from undisclosed partnerships and joint ventures is expanded to include limited liability partnerships. This change in wording reflects developed caselaw and makes it imperative that all such entities in which the insured participates be named as insureds if the named insured is to have coverage relating to the conduct of these businesses. Finally, employee coverage is expanded to include "volunteer workers" and the exceptions to employee/volunteer worker coverage are also expanded to more fully exclude claims against employees/volunteer workers by other insureds and claims arising from property connected to the insureds. All in all, these changes provide greater clarity for both the insurers and the insured, and ultimately for the Courts, with regard to who and what is afforded coverage under the New IBC CGL Form.

LIMITS OF INSURANCE: THE GENERAL AGGREGATE LIMIT

Introduction

Under any policy of insurance, the provisions setting out and defining the monetary limits for which the insurer will be responsible are of importance in setting the premiums. There will be monetary limits in the Declarations Page, and further constraints through, for example, the 'Each Occurrence Limit' or 'Medical Expenses Limit'. It is the Aggregate Limit, however, which draws the final line beyond which the insurer will not exceed for indemnity. The Aggregate Limit establishes the ultimate monetary limit, for which the insurer is responsible under the policy to indemnify the insured during a specified time period notwithstanding the number of claims in that policy year. It is important to remember that the Aggregate Limit is constant; it applies regardless of how many claims are made, or regardless of who makes the claims. It applies regardless of how many individuals or entities are Named Insureds.

The purpose of this section of the paper is to discuss how the New IBC CGL Form has substantially changed the Aggregate Limits by creating what is a second aggregate limit, which, in certain circumstances, may expand the total amount the insurer is liable to indemnify the insured under certain types of claims or occurrences.

Aggregate Limits Generally

The policy wording of the Former IBC CGL Form dealt with the issue of Aggregate Limits in the following manner:

> *Section III – Limits of Insurance*
>
> *1. The Limits of Insurance stated in the Declarations and the rules below fix the most we will pay regardless of the number of:*
> *a. Insureds*
> *b. Claims made or "actions" brought; or*
> *c. Persons or organizations making claims or bringing "actions".*
>
> *2. The Aggregate Limit is the most we will pay for the sum of:*
> *a. Medical expenses under Coverage C; and*
> *b. Compensatory damages under Coverage A, Coverage B, and Coverage D*
>
> *The Limits of Insurance of this policy apply separately to each consecutive annual period and to any remaining period of less than 12 months, starting with the beginning of the policy shown in the Declarations, unless the policy period is extended after issuance for an additional period of less than 12 months. In that case, the additional period will be deemed part of the last preceding period for purposes of determining the Limits of Insurance.*

In essence, the Aggregate Limit establishes that no matter how many claims may be brought against the insured, under any or all of the various coverages available under the Former IBC CGL Form, the insurer is only liable to pay claims on behalf of the insured up to the Aggregate Limit as set out in the Declarations. As stated earlier, the Aggregate Limit applies regardless of the number of insureds, claims, or persons making the claims. The Aggregate Limit operates outside of the context of any other coverage limit in the policy in the sense that while ambiguity or dispute may arise in terms of a particular coverage limit, the Aggregate Limit always applies and establishes the upper limit that the insurer will pay.

The Aggregate Limit operates independently of the 'Each Occurrence Limit', in that an insured may face many occurrences throughout the policy year which may be subject to their own limits, but "*…once the Aggregate Limit is exhausted there are no further funds available regardless of the number of subsequent occurrences*".[124]

Finally, the Aggregate Limit only imposes a "cap" on the indemnity exposure of the insurer whereas the cost of any defence obligation is in excess of the Aggregate Limits and potentially unlimited in amount.

Products-Completed Operations Aggregate Limit

The New IBC CGL Form has introduced a second aggregate limit which operates in addition to, and exclusive of the Aggregate Limit provided for in the wordings of the Former IBC CGL Form. The wording for the New IBC CGL Form Aggregate Limits clause are as follows, with the new sub-section underlined for ease of reference:

> *Section III – Limits of Insurance*
>
> *1. The Limits of Insurance shown in the Declarations and the rules below fix the most we will pay regardless of the number of:*
> *a. Insureds*
> *b. Claims made or "actions" brought; or*
> *c. Persons or organizations making claims or bringing "actions".*
>
> *2. The General Aggregate Limit is the most we will pay for the sum of:*
> *a. "Compensatory damages" under Coverage A, except "compensatory damages" because of "body injury" or "property damage" included in the "products-completed operations hazard";*
> *b. "Compensatory damages" under Coverage B; and*
> *c. Medical expenses under Coverage C.*
>
> *3. **The Products-Completed Operations Aggregate Limit is the most we will pay under Coverage A for "compensatory damages" because of***

[124] Snowden & Lichty, *ibid.*, at p. 36-4.

> ***"bodily injury" and "property damage" included in the "products-completed operations hazard"….***
>
> *…[T]he Limits of Insurance of this policy apply separately to each consecutive annual period and to any remaining period of less than 12 months, starting with the beginning of the policy period shown in the Declarations, unless the policy period is extended after issuance for an additional period of less than 12 months. In that case, the additional period will be deemed part of the last preceding period for purposes of determining the Limits of Insurance.*

The most significant change that in the New IBC CGL Form is the addition of the separate clause describing the 'Products-Completed Operations Aggregate Limit'. The fact that the New IBC CGL Form defines another aggregate limit suggests that this other limit should operate exclusive of the General Aggregate Limit, and therefore act as its own limit on the maximum liability for the insurer for that particular coverage. Indeed, the General Aggregate Limit explicitly states that it applies as a limit to all "compensatory damages" *except* those included in the "products-completed operations hazard", which limits are referenced in the separate clause describing the Products-Completed Operation Aggregate Limit. In general, "Products-completed operations hazard" refers to liability arising out of the insured's products or business operations conducted away from the insured's premises once those operations have been completed or abandoned. It is intended to provide coverage for an insured for liability which arises out the insured's "faulty workmanship".[125]

Exhausting the Aggregate Limits

As a result of the additional wordings in the New IBC CGL Form, the key issue is how each of these aggregate limit categories are exhausted. Subject to the insurance limits as set out in the Declaration and as defined by the "Each Occurrence Limit", the "Personal and Advertising Injury Limit" and the "Medical Expense Limit" (all contained in the same section), the insurer is only liable to indemnify the insured to the General Aggregate Limit for "compensatory damages" under the four different coverages offered by the New IBC CGL Form. Those four coverages are Coverage A – Bodily Injury and Property Damage Liability, Coverage B – Personal Injury and Advertising Injury, Coverage C – Medical Payments and Coverage D – Tenants Legal Liability.

The Aggregate Limit created by the New IBC CGL Form is significant because an insurer could be liable to indemnify an insured to both the General Aggregate Limit and the Products-Completed Operations Aggregate Limit. The Products-Completed Operations Aggregate Limit may be exhausted by payments made pursuant to

[125] "Insurance Recovery Seminar Paper", Washington, D.C., Morgan, Lewis & Bockius LLP, January 17, 2001 - Moderated by: Howard T. Weir, III and John E. Failla (New York), p. 32.

Coverage A for "compensatory damages" because of "bodily injury" and "property damage" included in the "Products-completed operations hazard".

"Products-completed operations hazard" is a defined term in the New IBC CGL Form:

> *a. Includes all "bodily injury" and "property damage" occurring away from premises you own or rent and arising out of "your product" or "your work" except:*
> *(1) Products that are still in your physical possession; or*
> *(2) Work that has not yet been completed or abandoned. However, "your work" will be deemed completed at the earliest of the following times:*
> *(a) when all of the work called for in your contract has been completed.*
> *(b) When all of the work to be done at the job site has been completed if you contract calls for work at more than one job site.*
> *(c) When that part of the work done at a job site has been put to its intended use by any person or organization other than another contractor or subcontractor on the same project.*
>
> *Work that may need service, maintenance, correction, repair or replacement, but which is otherwise complete, will be treated as completed.*
>
> *b. Does not include "bodily injury" or "property damage" arising out of:*
> *(1) The transportation of property, unless the injury or damage arises out of a condition in or on a vehicle not owned or operated by you, and that condition was created by the "loading or unloading" of that vehicle by any insured; or*
> *(2) The existence of tools, uninstalled equipment or abandoned or unused materials.*

In essence then, the "Products-completed operations hazard" carves out a specific portion of Coverage A, subject of course to the exclusions in Coverage A – Bodily Injury and Property Damage Liability, and makes that one particular portion subject to its own aggregate limit.

"Bodily injury" or "property damage" which would otherwise be afforded coverage under the New IBC CGL Form, Coverage A, but which falls within the "products-completed operations hazard" defined term, will not be subject to the General Aggregate Limit. The result is that the New IBC CGL Form provides that an insured has two aggregate limits to claim indemnity from, though only in a defined way for indemnity falling within the Products-Completed Operation Aggregate Limit.

Of interest, American courts faced with similar wording in terms of policies with either a products or operations completed aggregate limit have noted that by the nature of being an aggregate limit the clause must be treated in the form of a coverage clause, and

not an exclusion.[126] The importance of this characterization arises in situations where an insured faces claims which in the aggregate will exceed the Products-Completed Operation Aggregate Limit and the insured wants to bring it under the General Aggregate Limit. By characterizing the limit as a term of coverage, the burden of showing that the claim falls under the General Aggregate Limit and not the Products-Completed Operation Aggregate Limit lies on the insured.[127] Thus, one can foresee potential litigation in the future in Canada under the New IBC CGL Form where insureds face a situation where the "Products Completed Operation Aggregate Limit has been exhausted and they seek to define the claim in such a way so as to receive coverage under the General Aggregate Limit.

CONCLUSION

To summarize, the New IBC CGL Form has been modified to include a second aggregate limit from which an insured may claim. Losses paid which are subject to either the General Aggregate Limit or the Products Completed Operation Aggregate Limit reduce the amounts that are available to be paid out for future claims arising during the term of the policy. These claims remain subject to the other limits imposed in the policy, such as the 'Each Occurrence Limit'. The Products-Completed Operation Aggregate Limit applies only to "bodily injury" and "property damage" included in the "products-completed operations hazard" and will not expand the available aggregate limit for any remaining claims subject to the General Aggregate Limit.

An unintended consequence of the wordings in the New IBC CGL is the potential for future litigation over this new aggregate limit, where the insured has exhausted the Products Completed Operations Aggregate Limit and makes a claim for coverage under the General Aggregate Limit for losses which arguably are now specifically excluded from that limit. The door may be open to insureds to make a claim under both limits of insurance now potentially offered under the New IBC CGL Form.

REPORTING AND CO-OPERATION CLAUSE REQUIREMENTS

Introduction

Historically, general liability policies have contained varying requirements concerning both notice and the requirement that the insured assist the insurer. These requirements help the insurer to fully investigate any claim in a timely manner. This section of the

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[126] *Fibreboard Corp. v. Hartford Accident & Indem. Co.*, 20 Cal. Rptr. 2d 376 (Ct. App. 1993).

[127] J.C. Yang, "Aggregate Limits: Addressing Arguments Advanced by Policyholders in Asbestos Claims" August 2003, *The Insurance Coverage Law Bulletin,* Vol. 2, No. 7.

paper summarizes the changes to the requirements of the insured under the New IBC CGL Form and how wording changes broaden the insureds' obligations and introduce, among other things, new requirements for reporting by the insured. We review the wordings of the Former IBC CGL and the New IBC CGL Forms and the changes between the two.

Two general concepts must be considered to put the discussion that follows in perspective. First, although one would think that an insured's failure to comply with the terms and conditions of the insurance contract would constitute a breach of the policy and leave the insured without coverage for the claim, that is not the case. This is because the triggers for coverage are the existence of an "occurrence" and "property damage" and notice provisions are merely a condition subsequent. The Courts generally treat a breach of the condition(s) by an insured as a nominal infraction unless the insurer demonstrates real prejudice to the insurer as a result of the insured's breach.[128] Second, one of the most important conditions in a liability insurance policy is the insured's duty to give the insurer timely notice of an accident, occurrence, claim or suit. This is because the notice provides the insurer with the opportunity to conduct an investigation while the evidence is still fresh and to potentially mitigate damages.[129] Furthermore, the fact of an accident, occurrence, claim or suit is usually exclusively within the knowledge of the insured vis-à-vis the insurer.

Reporting Requirements under the Former IBC CGL Form

The insured's duties and obligations to the insurer were found in the "General Conditions" portion of the Former IBC CGL Form, are provided as follows:

> ***5. Duties in the Event of Occurrence, Claim or Action***
>
> *a. You must see to it that we are notified promptly of an "occurrence" which may result in a claim. Notice should include:*
>
> *1) How, when and where the "occurrence" took place; and*
>
> *2) The names and addresses of any injured persons and of witnesses.*
>
> *b. If a claim is made or "action" is brought against any insured, you must see to it that we receive prompt written notice of the claim or "action".*
>
> *c. You and any other involved insured must:*
>
> *(1) Immediately send us copies of any demands, notices, summonses or legal papers received in connection with the claim or "action";*
>
> *(2) Authorize us to obtain records and other information;*
>
> *(3) Cooperate with us in the investigation, settlement or defence of the claim or "action"; and*

[128] Lichty & Snowden, *ibid.*, note 4 at p. 37-1
[129] Hilliker, *ibid.*, note 4 at p.44

(4) *Assist us, upon our request, in the enforcement of any right against any person or organization which may be liable to the insured because of injury or damage to which this insurance may also apply.*

d. No insureds will, except at their own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than first aid, without our consent.

The purpose behind the notice requirements in the Former IBC CGL Form, in paragraphs (a) and (b) above (which call for "prompt" notice of the occurrence or claim/action and surrounding facts), was to allow an insurer to conduct an investigation while the evidence was still fresh, to control the litigation and to potentially mitigate damages.[130] The insured's obligation to provide notice is linked to the insurer's obligation to defend the insured and is reasonable considering that the insurer must carry out an investigation of the claim as soon as possible.[131]

When faced with the issue of notice under the wording of the Former IBC CGL Form, the Courts generally asked three questions: [132]

1. Should notice have been given?
2. Was notice given promptly, if it was given? and
3. If notice was not given, should the Court grant relief?

Caselaw decided under the Former IBC CGL Form reveals that the judicial test to determine if an insured failed to satisfy the notice or reporting requirements contains both subjective and objective elements. The subjective element is that the insured must actually be aware of the claim. The objective element is the "reasonable" person standard that is applied to the insured in determining if the claim ought to have been reported.[133] In other words, if the accident or occurrence would be covered under the insurance policy, the insured must give notice of a known claim if a reasonably prudent insured would foresee that a claim could arise.

The key point when the notice requirement is triggered is when a claim *could* reasonably arise, not whether liability would attach to the insured. Consequently, the insured's "good faith" belief is not a relevant factor is determining if notice ought to

[130] Hilliker, *ibid.*, note 4 at p.44.
[131] *Marcoux v. Halifax Fire Insurance Co* (1926), 31 O.W.N. 59 (Ont. H.C.) [hereafter "*Marcoux*"]
[132] Lichty & Snowden, *ibid.*, note 4 at p. 37-8.
[133] *Marcoux* , *supra*, at p.149.

have been provided to the insurer.[134] There is also a duty on an insured to take reasonable steps to obtain the necessary information to make a reasoned decision.[135]

The reported cases are of little assistance in establishing any general rule as to what constituted prompt notice under the wordings of the Former IBC CGL Form. The Courts found that "prompt" is a relative term that depends upon the circumstances in each case. That notice can be properly given by the insured by notifying either the insurer or the insurer's authorized agent, such as the broker.

Non-Compliance by the Insured under the Former IBC CGL Form

In an "occurrence" based policy, three things must occur to "trigger" the insurers' response, namely, there must be an "occurrence" which resulted in either "property damage" or "bodily injury". The insured also had ensuing obligations, namely to provide "prompt" notice and co-operate with the insurer. If the Court determined that prompt notice ought to have been given by the insured, and the insured did not, in fact, provide it, an insured's claim for coverage had to be dismissed unless the Court found it appropriate to grant equitable relief.[136]

However, failures to satisfy notice requirements on the part of the insured were considered by the Courts to be trifling and generally excused. Furthermore, in cases involving more serious failures by the insured, Section 10 of the *Insurance Act* [137] in British Columbia provided the Courts with the power to relieve an insured from the consequences of imperfect compliance:

> ***10. Court may relieve against forfeiture***
>
> *If there has been imperfect compliance with a statutory condition as to the proof of loss to be given by the insured or other matter or thing required to be done or omitted by the insured with respect to the loss, and a consequent forfeiture or avoidance of the insurance in whole or in part, or if there has been a termination of the policy by a notice that was not received by the insured owing to the insured's absence from the address to which the notice was addressed, and the court deems it inequitable that the insurance should be forfeited or avoided on that ground or terminated, the court may, on terms it deems just, relieve against the forfeiture or avoidance or, if the application for relief is made within 90 days of the date of the mailing of the notice of termination, against the termination.*

There is a difference between imperfect compliance and non-compliance. Relief from forfeiture can only be granted in cases of imperfect compliance, not in situations of non-

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[134] *Glenburn Dairy Ltd. v. Canadian General Insurance Co.*, [1953] 4 DLR 33. (BCCA)
[135] *Marcoux, supra*, note 4 at p.149.
[136] Hilliker, *ibid.*, note 4 at p. 46.
[137] *Insurance Act*, R.S.B.C. 1996, c. 226, s. 10.

compliance. The Supreme Court of Canada addressed this difference in *Falk Bros. Industries v. Elance Steel Fabricating Co.*[138] as follows:

> *The distinction between imperfect compliance and non-compliance is akin to the distinction between breach of a term of the contract and breach of a condition precedent. If the breach is of a condition, that is, it amounts to non-compliance, no relief under s. [10] is available.*

In general, failure to give notice under an occurrence based policy is treated as imperfect compliance whereas failure to give notice during the policy period under a claims-made policy is considered non-compliance. In the latter case, relief from forfeiture is not available to an insured. The reason for this distinction is that, unlike in an occurrence based policy, coverage under a claims-made policy is triggered by the claim being made during the policy period. As a result, failure to give notice during the policy period in a claims-made policy amounts to non-compliance with a condition precedent to coverage.[139]

Note that the legislative relief from forfeiture does not apply to the insured's failure to commence an action against the insured within the limitation period under either a claims-made or occurrence-based policy. It has been judicially determined that this failing is a "pure default". In other words, failing to commence an action against the insurer within the prescribed limitation period is a failure to exercise a contractual right of action that cannot be cured with reference to the statutory relief.[140]

In addition, relief from forfeiture will not be granted to a non-party to the contract in circumstances where the policyholder has clearly failed to satisfy the requirements of the policy. The relevant consideration in such an application is the balance of equities between the insured and the insurer, as opposed to the insured and the non-party.[141] However, it has been determined that an insurer cannot avoid indemnity merely by accepting the policyholder's decline for further assistance as this amounted to collusion against the innocent victim.[142]

The test the Courts applied in determining whether or not to grant relief from forfeiture was whether it is just and equitable to do so in all of the circumstances. The two factors

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[138] [1989] 2 SCR 778

[139] Hilliker, *ibid.*, note 4 at p.69.

[140] Lichty & Snowden, *ibid.*, note 4 at p. 38-7 referring to *Wilson v. Zurich Insurance Co.*, [1981] I.L.R. pg 1-1447, 11 Sask. R. 141 (Q.B.) and *National Juice Co. v. Dominion Insurance Co.* (1977), 81 DLR (3d) 606 (Ont C.A.).

[141] *Perry v. General Security Insurance Co. of Canada* (1984), 47 O.R. (2d) 472 (C.A.)

[142] *Azevedo v. Markel Insurance Co. of Canada* (1999), 180 DLR (4th) 193, leave to appeal to SCC refused 191 DLR (4th) 424.

most often considered by the Courts were first, the insured's conduct and second, whether there was any prejudice to the insurer .[143]

The burden of proof was on the insured on all counts to prove that it was just and equitable to grant relief from forfeiture. However, as a practical matter, the onus to demonstrate prejudice to the insurer generally fell to the insurer as the knowledge was within their domain. Generally the insurer needed to show either an "actual proven prejudice" or a "potential prejudice which could not be quantified".[144] If necessary, the insured can demonstrate that there has not been prejudice to the insurer by conducting an examination for discovery of the insurer's claims examiner or manager and reviewing the claim file documents and manuals.[145] However, absent an intentional act on the insured' s behalf, relief from forfeiture will rarely be refused if the insurer does not call evidence demonstrating prejudice to it.[146]

New Requirements under the New IBC CGL Form

The New IBC CGL Form describes the insured's duties in Section 4 of the General Conditions, as follows (with changes underlined for ease of reference):

> ***4. Duties in the Event of Occurrence, Offense, Claim or Action***
>
> *You must see to it that we are notified as soon as practicable of an "occurrence" or an offense which may result in a claim. To the extent possible, notice should include:*
>
> *(1) How, when and where the "occurrence" or offense took place;*
> *(2) The names and addresses of any injured persons and witnesses; and*
> *(3) The nature and location of any injury or damage arising out of the "occurrence" or offense.*
> *a. If a claim is made or "action" is brought against any insured, you must:*
> *(1) Immediately record the specifics of the claim or "action" and the date received; and*
> *(2) Notify us as soon as practicable.*
> *b. You and any other involved insured must:*
> *(1) Immediately send us copies of any demands, notices, summonses or legal papers received in connection with the claim or "action";*
> *(2) Authorize us to obtain records and other information;*
> *(3) Cooperate with us in the investigation or settlement of the claim or defence against the "action'; and*
> *(4) Assist us, upon our request, in the enforcement of any right against any person or organization which may be liable to the*

[143] *Saskatchewan River Bungalows Ltd. v. Maritime Life Assurance Co.*, [1994] 2 SCR 490.
[144] *Can. Equipment Sales & Service Co. v. Continental Ins Co* (1975), 59 DLR (3d) 333 (Ont. C.A.).
[145] Lichty & Snowden, *ibid.*, note 4 at p 37-12.
[146] Lichty & Snowden, *ibid.*, note 4 at p. 38-7.

insured because of injury or damage to which this insurance may also apply.

c. *No insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense, other than first aid, without our consent.*

Reporting Requirements

Under the New IBC CGL Form, the wording in paragraph (a) above, dealing with notification of an incident that may lead to a claim or action, requires that the insured must notify the insurer "*as soon as practicable*". This is in contrast to the wording in the Former IBC CGL Form which stated "*promptly*"; that wording defied a solid judicial meaning, and was instead "*dependent upon the circumstances of each case*".[147] The requirement to notify "*as soon as practicable*" is more onerous than notifying "*promptly*".

Another change from the Former IBC CGL Form wording is that the insured must now provide notification of both an "occurrence" and an "offense" (under the previous version, the insured only had to notify of an occurrence). This addition was implemented as coverage is now broadened under the New IBC CGL Form for "Personal and Advertising Injury" Liability (under Coverage B); both of which apply to "offenses" not "occurrences".

Finally, under the New IBC CGL Form, the insured must notify the insurer of the nature and location of any injury or damage arising out of the "occurrence" or "offense". This is entirely new wording, meant to put the onus on the insured to report even more details of the "occurrence" or "offense". In summary, the New IBC CGL Form entails more rigorous reporting requirements for the insured.

Notification of a Claim or Action

Under the New IBC CGL Form, the terms of the condition in paragraph (b) above, dealing with notification of a claim or action, are also broadened. As noted above, whereas the insured formerly needed to "*promptly*" notify the insurer in writing of a claim or action, now the insured must also "*immediately record the specifics of any claim or action*" brought against them and the date received, and to notify the insurer "*as soon as practicable*". Pursuant to the Grant of Coverage in the New IBC CGL Form, as soon as an insured becomes aware of "property damage" or "bodily injury" it is "deemed" to have occurred. Again, while the onus is on the insured to provide as much information as possible to the insurer at the earliest opportunity, the introduction of the "Known Loss" Rule and certain "deeming" provisions (discussed at length earlier in this paper) mean that the insurer will not be prejudiced by later reporting.

[147] *Hogan v. Kolisnyk*, [1983] 3 WWR 481 (Alta.Q.B.), at p. 499.

Co-operation Clause

Under the New IBC CGL Form, the cooperation requirements under paragraph (c) above, and the restrictions on the insured's ability to make decisions concerning a claimant contained in paragraph (d) above, are similar or identical to the wording of the Former IBC CGL Form.

Revised Definition of "Action"

The New IBC CGL Form contains a revised definition of the word "action". Again, this broadens the insureds requirements pursuant to this section. "Action" now includes an "*arbitration proceeding*" and "*any other alternative dispute resolution proceeding in which such "compensatory damages" are claimed and to which the insured submits with our consent*." This change resulted from the fact that more lawsuits are now being resolved through alternate dispute resolution, rather than going to Court.

Failure to Adhere to the Form's Requirements

If an insured resorts to litigation to determine its entitlement under the New IBC CGL Form, it is unlikely that the Courts' position will deviate substantially from the one maintained under the wording of the Former IBC CGL Form. In other words, under an occurrence based policy, an application pursuant to the relief from forfeiture section of the *Insurance Act* will continue to offer relief to an insured for imperfect compliance with the notification conditions where the Court think it is "just and equitable" in the circumstances. However, insureds will not be able to avail themselves of relief from forfeiture for a failure to file a claim against the insured within the limitation period.

The Impact of the "Known Loss" Rule

Earlier in this paper, the impact of the "known loss" rule on the wordings in the New IBC CGL Form was discussed in terms of continuous property damage or bodily injury claims. As discussed in Section II. of this paper, these claims normally arise when bodily injury is a longer term, latent disease (like asbestosis or repetitive strain injury) or when property damage is continuing and progressive in nature (such as environmental contamination or leaky buildings). The claims are commonly referred to as "long tail" claims because the insurer has a potentially long-term exposure.

To briefly summarize the earlier discussion, the new wordings of the Insuring Agreement in the New IBC CGL Form have a multiple "deeming" effect. The new wording of the Insuring Agreement "deems" an insured to have knowledge of all continuous "property damage" or "bodily injury" which occurred prior to the inception of the policy. Next, the new wording "deems" all continuing, change or resumption of "bodily injury" or "property damage" caused by an occurrence to occur during the

policy period in effect when the insured "becomes aware" of the injury or damage. Finally, the knowledge of the insured is "deemed" to occur in three instances; first if an insured reports all or any part of the bodily injury or property damage to an insurer; second if an insured receives a written or verbal demand of claim for damages due to the bodily injury or property damage; and third, if an insured becomes aware by any other means that the bodily injury or property damage has occurred. The overall impact of these provisions is that the insured will have the burden of proving it did not have prior knowledge of "property damage" or "bodily injury" for which is it seeks coverage.

The effect of the insured giving notice and providing particulars of an occurrence or an offense which may result in a claim, pursuant to the notice requirements in the New IBC CGL Form, is that coverage may be "cut-off" for claims which are continuous, or long-tail. That is to say, once the insured becomes aware of "property damage" or "bodily injury" which might result in a claim, coverage will available up to the Aggregate Limit for that policy period, but not on a going-forward basis. The insured must look to the insurer that provided coverage as of the date the damage was discovered by the insured.

Two scenarios may result from the convergence of the new reporting requirements and the "known loss" rule in the New IBC CGL Form. First, what happens if an insured does not report an "occurrence" (or "offense") which may result in a claim, and applies for and obtains relief from forfeiture under the *Insurance Act* because of imperfect compliance with the reporting requirements under the New IBC CGL Form? The question is whether or not the "Known Loss" Rule would apply in those circumstances. Second, what if an insured gives notice, but the details of the notice are deemed inadequate and relief from forfeiture is not granted by the Courts? Can future liability insurers in subsequent years use the "Known Loss" Rule to avoid coverage? These two scenarios have not yet been tested by the Courts. However, Courts will <u>not</u> re-write a Grant of Coverage in any policy, including a general liability policy. The "known loss" rule is now an integral part of the New IBC CGL Form. Insureds will not be able to use any relief from forfeiture to get around the "deeming provisions" in the Grant of Coverage.

THE "OTHER INSURANCE" CLAUSE

Introduction

The New IBC CGL Form is intended to provide some clarity to Canadian liability insurers in light of recent judicial pronouncements. This fact is particularly true in the context of the "Other Insurance" provisions. This section of the paper will review the changes in wording between the Former IBC CGL Form and the New IBC CGL Form "Other Insurance" clause and addresses several issues, including the issue of "overlapping" coverage between primary and excess insurers, and whether an excess insurer continues to be obligated to pay a portion of the defence costs of the "primary" insurer. The language of the New IBC CGL Form "Other Insurance" clause specifically addresses caselaw from the Supreme Court of Canada (namely, *Alie, supra* discussed earlier in this paper under the "Known Loss" Rule).

The "Other Insurance" Clause in Perspective

It is helpful to review the basic principles of primary and excess insurance prior to reviewing the wordings of the "Other Insurance" Clause in both the Former and New IBC CGL Form.

Primary v. Excess Policies

Simply put, primary insurance coverage is coverage for which liability attaches immediately upon the happening of the occurrence that gives rise to liability. The policy stipulates a level of coverage for a specified occurrence. In contrast, excess policies, by definition, are excess to whatever coverage is offered by another policy. Liability attaches only after whatever predetermined amount of primary coverage has been exhausted. Excess insurance is a separate policy which is intended to "stack" on top of the existing primary policy and does not come into play until the primary limits have been exhausted. Obviously, for a policy to be "excess" a "primary" policy must exist upon which to "stack" the excess policy. In most cases, excess policies are written with the expectation that the primary insurer will conduct the investigation, negotiation, and defence of the underlying insurance claim until the primary limits are depleted.

"Other Insurance" Clauses

Most liability insurance policies contain an "other insurance" clause. A conflict arises when two competing liability insurers have issued primary policies that cover the same loss, and one of the policies contains a "other insurance" clause. A typical example of the wording of an "other insurance" clause is:

This insurance does not cover any loss, which at the time of the happening of the loss, is insured by or would but for the existence of this Policy, be insured by any other existing Policy or Policies except in respect of any excess beyond the amount which would have been payable under such other Policy or Policies had this insurance not been effected.

Which Policy is Primary and Which Policy is Excess?

The question of which policy is excess and which is primary is critical because the primary policy responds first to the claim. To understand the impact of the New IBC CGL Form wordings, it is important to understand how the Courts have historically dealt with this threshold question. The implications of the Courts' decision as to which, if any, competing liability policy is found to be primary or excess has profound implications for an insurer.

In the case of *Family Insurance Corp. v. Lombard Canada Ltd.*[148] the Supreme Court of Canada addressed this issue between two competing liability insurers who each relied on "other insurance" clauses as a means of raising a shield to primary indemnity. Two liability insurers each argued that their individual polices only provided excess coverage. The Court acknowledged that to find that both policies were excess would have the effect that the insured had no primary coverage. The Court reasoned that because the two competing "other insurance" policies could not be read in harmony, the provisions were irreconcilable and therefore rendered inoperative. The Court determined that its first duty was to review and consider the policy wordings to arrive at its' conclusion.

The "Duty to Defend" of Excess Liability Insurers

Two critical areas of dispute between primary and excess liability insurers arise when the indemnity exposure may be in excess of the primary liability policy limits. In such circumstances, does the excess liability insurer have a "duty to defend" the underlying claim or action in whole or in part? That is, when does the excess liability insurer have an obligation to "step up" and contribute to defence costs, and if so, how much?

The leading case on this issue is *Alie, supra* (discussed earlier in the "Known Loss" Rule section of this paper). At trial, a concrete supplier and a producer were found liable for damages to homes negligently constructed with defective foundations. Damages in the case were found to be over $20 million with legal costs estimated in the same range. In effect, the Court imposed a defence obligation on the excess insurer based upon the clear risk of the claim exceeding the primary policy limits. The Court further stated that

[148] [2002] 2 SCR 695.

"…it is always open to the excess insurer to alter the nature of the duty to defend by including appropriate language in the policy."

Also of note is the recent Ontario Court of Appeal decision of *ING v. Federated Insurance Company*,[149] where the Court found that the allocation of defence costs arose only if the excess insurer was given notice, pursuant to the policy, that the claim may exceed limits, in which case the duty to defend of the excess insurer arose.

Changes to the "Other Insurance" Clause

The Wordings

Under the Former IBC CGL Form, the wording of the "Other Insurance" Clause was as follows:

> ***9. Other Insurance***
>
> *If other valid and collectible insurance is available to the insured for a loss we cover under Coverages **A, B,** or **D** of this policy our obligations are limited as follows:*
>
> ***a. Primary Insurance***
>
> *This insurance is primary except when b. below applies. If this insurance is primary, our obligations are not affected unless any of the other insurance is also primary. Then, we will share with all that other insurance by the method described in c. below.*
>
> ***b. Excess Insurance***
>
> *This insurance is excess over any of the other insurance, whether primary, excess, contingent or on any other basis:*
>
> *1) That is Property Insurance such as, but not limited to, Fire, Extended Coverage, Builder's Risk, Installation Risk or similar coverage for "your work" or for premises rented to you; or*
>
> *2) If the loss arises out of the maintenance or use of watercraft to the extent not subject to Exclusion f. of Coverage A (Section 1).*
>
> *When this insurance is excess, we will have no duty under Coverage **A, B** or **D** to defend any claim or "action" that any other insurer has a duty to defend. If no other insurer defends, we will undertake to do so, but we will be entitled to all the insured's rights against all those other insurers.*

The remaining language in the Former IBC CGL "Other Insurance" Clause is exactly the same in the New IBC CGL Form, which is reproduced below, with changes between the two underlined for ease of reference:

> ***8. Other Insurance***
>
> *If other valid and collectible insurance is available to the insured for a loss we cover under Coverages **A, B** or **D** of this policy, our obligations are limited as follows:*
>
> ***a. Primary Insurance***

[149] [2004] O.J. No. 2876 (Q.L.)(Sup.Ct.); reversed (2005), 75 O.R. (3d) 457 (C.A.).

*This insurance is primary except when **b.** below applies. If this insurance is primary, our obligations are not affected unless any of the other insurance is also primary. Then, we will share with all that other insurance by the method described in **c.** below.*

b. Excess Insurance

This insurance is excess over:

(1) Any of the other insurance, whether primary, excess, contingent on or any other basis:

(a) That is Fire, Extended Coverage, Builder's Risk, Installation Risk or similar coverage for "your work";

(b) That is Fire Insurance for premises rented to you or temporarily occupied by you with permission of the owner; or

(c) If the loss arises out of the maintenance or use of watercraft or "automobile", to the extent not subject to Exclusion e. or f. of Section I – Coverage A – Bodily Injury and Property Damage Liability.

(2) Any other primary insurance available to you covering liability for "compensatory damages" arising out of the premises or operations or products-completed operations for which you have been added as an additional insured by attachment of an endorsement.

*When this insurance is excess, we will have no duty under Coverage **A, B** or **D** to defend the insured against any "action" if any other insurer has a duty to defend the insured against that "action". If no other insurer defends, we will undertake to do so, but we will be entitled to the insured's rights against all those other insurers.*

When this insurance is excess over other insurance, we will pay only our share of the amount of the loss, if any, that exceeds the sum of:

(1) The total amount that all such other insurance would pay for the loss in the absence of this insurance; and
(2) The total of all deductible and self-insured amounts under all that other insurance.

We will share the remaining loss, if any, with any other insurance that is not described in this Excess Insurance provision and was not bought specifically to apply in excess of the Limits of Insurance shown in the Declarations of this policy.

c. Method of Sharing.

If all of the other insurance permits contribution by equal shares, we will follow this method also. Under this approach, each insurer contributes equal amounts until it has paid its applicable limit of insurance or none of the loss remains, whichever comes first.

If any of the other insurance does not permit contribution by equal shares, we will contribute by limits. Under this method, each insurer's share is based on the ratio of its applicable limit of insurance to the total applicable limits of insurance of all insurers.

Primary v. Excess

The wording of the New IBC CGL Form delineates the rights and obligations as between primary and excess insurers. Although the language is unchanged from the

Former IBC CGL Form, it is still worth review. The New IBC CGL Form is *"primary"* and the obligations under the policy are *"not affected unless any other insurance is primary"*. The wording then provides for two *"Method[s] of Sharing"* should there be found to be two competing primary policies, as follows:

> *If all of the other insurance permits contribution by equal shares, we will follow this method also. Under this approach, each insurer contributes equal amounts until it has paid its applicable limit of insurance or none of the loss remains, whichever comes first.*
>
> *If any of the other insurance does not permit contribution by equal shares, we will contribute by limits. Under this method, each insurer's share is based on the ratio of its applicable limit of insurance to the total applicable limits of insurance of all insurers.*

The effect of these provisions is to "codify" the principles as stipulated in *Family v. Lombard, supra,* as outlined above. That is, with respect to the available limits of indemnity, if both policies are read to be "primary" and they can not be reconciled, insurers will share equally. This method of sharing is logically referred to as the "equal shares" method and is, by the language used in the New IBC CGL Form, assumed to be the preferred method of sharing. A second method of sharing is described in both the Former and New IBC CGL Form "Other Insurance" Clause, which is commonly called the "maximum liability" approach. That is, if the equal share approach is not permitted under the other insurance, each insurer's share is based on the ratio of its applicable limit of insurance to the total applicable limits of insurance of all insurers.

Clause 8(b)(1)(c) of the New IBC CGL Form effectively means that the CGL is "*excess over*" any other insurance *"…if the loss arises out of the maintenance or use of watercraft or 'automobile…'"*. The purpose of this provision is to respond to *Derksen, supra* (discussed earlier in this paper). This wording is meant to protect the excess liability insurer from being called upon by the primary insurer in the context of an automobile loss to share in both the defence and indemnity obligations of the claim when there may be found to be concurrent causes for the loss.

This exclusion, on its face, excludes all coverage where the liability is caused in part by a peril within the scope of the Automobile Exclusion. The wording acts to exclude bodily injury or property damage arising *"directly or indirectly, in whole or in part"* out of the ownership or use of an automobile *"regardless of any other contributory cause or aggravating cause or event that contributes concurrently"*.

Payment and Allocation of Defence Costs

As discussed above, the effect of the *Alie, supra,* was that an excess insurer can be called upon to share in the defence costs of an action in the event there is a reasonable prospect that the claims will exceed the policy limits. Hence, if an excess insurer was

notified of the possibility that the matter could exceed limits the excess insurer was obligated to share in the costs of the investigation and defence of the claim.

The new wording deals with the decision in *Alie, supra*. Specifically, the wording states that when a policy is clearly excess, the excess CGL insurer has "*no duty…to defend the insured against any 'action' if any other insurer has a duty to defend the insured against that 'action'*". Put simply, the suggestion that an excess insurer must contribute to the defence costs of the action along with the primary insurer has effectively been eliminated. This provision provides a degree of certainty to excess insurers when confronted with a case that may exceed the primary limits and pierce the excess layer. The excess insurer can rely on this provision in the New IBC CGL Form as a "shield" to any such demands from the primary insurer.

Additional Named Insured

The modifications to the wording in the New IBC CGL Form clause 8(b)(2) stipulate that the policy of insurance is excess in all circumstances where there is primary insurance available covering liability for "*compensatory damages*" arising out of "*the premises or operations or products-completed operations for which you have been added as a additional insured by attachment or endorsement.*" The purpose of these new wordings is to render a person's or an organization's "own" CGL policy excess over the policy modified by the endorsement. Therefore, an additional insured is covered on a primary basis on the policy to which the additional insured endorsement is attached. The effect of this change is that the CGL policy which creates coverage for the additional insured (who has their own CGL policy) will be considered the primary policy. If an insured has coverage under its' own CGL policy (which uses the language of the New IBC CGL Form) and has coverage as an additional named insured under another CGL policy, the language of the New IBC CGL Form makes it clear that the CGL policy for which the insured is an "additional insured" will be primary to an excess policy, containing the wording of the "Other Insurance" clause in the New IBC CGL Form.

Premises Temporarily Rented or Occupied by the Insured

The wording of the New IBC CGL Form in clause 8(b)(1)(b) provides that coverage under the new wordings is excess over Fire Insurance for premises rented or temporarily occupied by the Insured. The New IBC CGL Form provides that it will only be excess to the extent that the insured may have "*rented or temporarily occupied*" premises covered by another policy.

Conclusion

The issues between primary liability insurers and excess liability insurers are complex and are understandably beyond the purview of this part of the paper. However, we have provided a primer on issues of concern which arise under the New IBC CGL Form. It is worth repeating that whether or not the insurer under the New IBC CGL Form is primary or excess, the insured must still pay either its' deductible, or other self-insured amount first. The wording of the New IBC CGL Form will provide more clarity for Canadian liability insurers in that it clearly demarcates the insurers responsibilities as excess or primary, in terms of defence costs, method of sharing, and in regard to the automobile exclusion and the availability of other forms of insurance.

COVERAGE FOR PERSONAL INJURY AND ADVERTISING INJURY

Introduction

The New IBC CGL Form wording packages "Personal Injury and Advertising Injury" liability together under Coverage B of the New IBC CGL Form. Traditionally, "Advertising Injury" coverage could be added to a general liability policy by endorsement; some insurers provided the coverage, but not automatically. This type of coverage provided indemnity for specified offenses which could result from the advertising activities of the insured. It was not included in the Former IBC CGL Form. On the other hand, coverage was provided for "Personal Injury" under the Former IBC CGL Form for claims against the insured generally described as intentional torts, like defamation, breach of privacy and false imprisonment.

The wording of the New IBC CGL Form, combining "Personal Injury" and "Advertising Injury" liability now incorporates, or in some instances, closely parallels many of the provisions of the U.S. ISO 1998 and 2001 CGL revisions. It is critical to note, right at the outset, that this form of coverage for "Personal Injury and Advertising Liability" is triggered by an "offense", not by an "occurrence" which triggers coverage under the "Bodily Injury and Property Damage Liability" under Coverage A of the New IBC CGL Form.

Highlights of the New IBC CGL Form wording include a definition of the term "Advertisement" as well as a definition of "Personal and advertising injury" that lists 7 specific offenses, as below:

1. False arrest, detention or imprisonment;
2. Malicious prosecution;
3. Wrongful eviction or entry of a landlord;
4. Publication of libellous or slanderous material;

5. Publication of material that violates privacy;
6. Use of another's advertising idea in your advertisement; and
7. Infringing on copyright in your advertisement.

These specified "offenses" are inherently intentional forms of conduct, whereas the "occurrence" which triggers coverage for "property damage" or "bodily injury" is unintentional, in other words, an "accident".

The addition of "Advertising Injury" liability in the New IBC CGL Form also necessitated adding new exclusions, many of which were inserted to address emerging e-commerce issues. They are discussed at length towards the end of this paper. The IBC's goal in creating a new combined section of coverage for "Personal and Advertising Injury" is to bring some clarity to coverage dilemmas, particularly in "Advertising Injury" liability, a section historically fraught with coverage uncertainty.[150]

This paper will begin by providing the reader with a summary of the new "Personal and Advertising Injury Liability" wording. It will then turn to a discussion of some of the typical coverage problems encountered by both Canadian and U.S. Courts in determining first, what constitutes "advertising" and second, what is the required nexus between the insured's advertising activities and the alleged injury. It will conclude with a discussion of how the "Personal and Advertising Injury" liability Grants of Coverage have been restricted in scope by some of the new exclusions and limiting language.

The Wordings in the New IBC CGL Form

In the New IBC CGL Form "Personal and Advertising Injury Liability" covers liability for a group of specifically named offenses, which do not involve bodily injury or property damage, are not caused by an accident, but nonetheless are liability exposures common to many organizations. Again, the trigger under this coverage is "offense" related, versus the "occurrence" trigger under the coverage for "bodily injury" and "property damage" provided for under the earlier section of the New IBC CGL Form.

The Insuring Agreement for this section of the New IBC CGL Form states:

> *a. We will pay those sums that the insured becomes legally obligated to pay as "compensatory damages" because of "personal and advertising injury" to which this insurance applies…*

[150] See the American Law Report Advertising Injury Insurance database cited as 98 A.L.R. 5th 1, specifically Section I(2), p. 35, for a summary of US cases that have construed and applied similar "advertising injury" provisions in seemingly irreconcilable ways.

b. This Insurance applies to "personal and advertising injury" caused by an offense arising out of your business but only if the offense was committed in the "coverage territory" during the policy period.

"Personal and advertising injury" and "Advertisement" are now specifically defined terms in the New IBC CGL Form, as follows:

> *"Personal and advertising injury" means injury, including consequential "bodily injury", arising out of one or more of the following offenses:*
>
> *a. False arrest, detention or imprisonment;*
> *b. Malicious prosecution;*
> *c. The wrongful eviction from, wrongful entry into, or invasion of the right of private occupancy of a room, dwelling or premises that a person occupies, committed by or on behalf of its owner, landlord or lessor;*
> *d. Oral or written publication, in any manner, of material that slanders or libels a person or organization or disparages a person's or organization's goods, products, or services;*
> *e. Oral or written publication, in any manner, of material that violates a person's right of privacy;*
> *f. The use of another's advertising idea in your "advertisement"; or;*
> *g. Infringing upon another's copyright, trade dress or slogan in your "advertisement".*

> *"Advertisement" means a notice that is broadcast or published to the general public or specific market segments about your goods, products or services for the purpose of attracting customers or supporters. For the purposes of this definition:*
>
> *a. Notices that are published include material placed on the Internet or on similar electronic means of communication;*[151] *and*
> *b. Regarding web-sites, only the part of a web-site that is about your goods, products or services for the purposes of attracting customers or supporters is considered an advertisement.*

The definition of "*Coverage Territory*" in the New IBC CGL Form is changed from the Former IBC CGL Wordings to include injury or damage arises out of offenses that take place through the "*Internet or similar electronic means of communication*", as underlined below:

> *"Coverage Territory" means*

[151] See *Canadian Reform Conservative Alliance v. Western Union Insurance Co.* (2001), 89 BCLR (3d) 299 (C.A.) which held that websites are a form of "publishing" though expressed doubt as to whether they were also broadcasting [hereafter "*Canadian Reform*"].

a. Canada and the United States of America (including its territories and possessions).
b. International waters or airspace, but only if the injury or damage occurs in the course of travel or transportation between any places included in a. above; or
c. All other parts of the world if the injury or damage arises out of:

(1) Goods or products made or sold by you in the territory described in a. above;
(2) The activities of an insured person whose home is in the territory described in a. above, but is away for a short time on your business; or
(3) "Personal and advertising injury" offenses that take place through the Internet or similar electronic means of communication

provided the insured's responsibility to pay "compensatory damages" is determined in an "action" on the merits, in the territory described in a. above or in a settlement we agree to.

In the New IBC CGL Form, the following "offenses" are specifically excluded from coverage under "Personal and Advertising Injury", namely:

a. Knowing Violation of Rights of Another
"Personal and advertising injury" caused by or at the direction of the insured with the knowledge that the act would violate the rights of another and would inflict "personal and advertising injury".

b. Material Published with the Knowledge of Falsity
"Personal and advertising injury" arising out of oral or written publication of material, if done by or at the direction of the insured with knowledge of its falsity.

c. Materials Published Prior to Policy Period
"Personal and advertising injury" arising out of oral or written publication of material whose first publication took place before the beginning of the policy period.

d. Criminal Acts
"Personal and advertising injury" arising out of a criminal act committed by or at the direction of the insured.

e. Contractual Liability
"Personal and advertising injury" for which the insured has assumed liability in a contract or agreement. This exclusion does not apply to liability for "compensatory damages" that the insured would have in absence of contract or agreement.

f. Breach of Contract
"Personal and advertising injury" arising out of a breach of contract, except an implied contract to use another's advertising idea in your "advertisement".

g. Quality or Performance of Goods – Failure to Conform to Statements
"Personal and advertising injury" arising out of the failure of goods, products or services to conform with any statement of quality or performance made in your "advertisement".

h. Wrong Description of Prices

"Personal and advertising injury" arising out of the wrong description of the price of goods, products, or services stated in your "advertisement".

i. Infringement of Copyright, Patent, Trademark or Trade Secret
"Personal and advertising injury" arising out of the infringement of copyright, patent, trademark, trade secret or other intellectual property rights. However, this exclusion does not apply to infringement in your "advertisement", of copyright, trade dress or slogan.

j. Insureds in Media and Internet Type Businesses
"Personal and advertising injury" committed by an insured whose business is:

(1) *Advertising, broadcasting, publishing or telecasting;*
(2) *Designing or determining content of web-sites for others; or*
(3) *An Internet search, access, content or service provider.*

However this exclusion does not apply to Paragraphs 21. a., b. and c. of "personal and advertising injury" under the Definitions section.

For the purposes of this exclusion, the placing of frames, borders or links, or advertising, for you or others anywhere on the Internet, is not by itself, considered the business of advertising, broadcasting, publishing or telecasting.

k. Electronic Chatrooms or Bulletin Boards
"Personal and advertising injury" arising out of an electronic chatroom or bulletin board the insured hosts, owns, or over which the insured exercises control.

l. Unauthorized Use of Another's Name or Product
"Personal and advertising injury" arising out the unauthorized use of another's name or product in your email address, domain name or metatag, or any other similar tactics to mislead another's potential customers.

m. Asbestos *– common exclusion*
n. Fungi or spores *– common exclusion*
o. Nuclear *– common exclusion*
p. Pollution *– common exclusion*
q. Terrorism *– common exclusion*
r. War Risks *– common exclusion*

The impact of some of these exclusions is discussed later on in Section 4 of this part of the paper.

The "Personal Injury" aspect of the coverage under the New IBC CGL Form encompasses torts that fall outside coverage for bodily injury and property damage in Coverage A, as they largely result in damage other than bodily injury or property damage. As mentioned in the Introduction, the enumerated offenses include false arrest, detention or imprisonment, malicious prosecution, wrongful eviction and entry, invasion of right of occupancy, and oral or written publication of material that slanders, libels, disparages or violates privacy.

It is important to note that there is a difference between the terms "bodily injury" and "personal injury". These phrases have a specific meaning within the context of the New IBC CGL Form. As per the definition above, "personal injury" in this section includes "bodily injury". At the risk of repeating an earlier discussion, "bodily injury" is defined in the Definitions section of the New IBC CGL Form as:

> *"Bodily injury" means bodily injury, sickness or disease sustained by a person, including death resulting from any of these at any time.*

The next section of this paper will focus on how the Advertising Injury provisions have been interpreted by Canadian and U.S. Courts in the past.

Caselaw re: Advertising Injury Coverage

In determining whether there is a duty to defend or indemnify for advertising injury, two questions unique to this coverage arise. First, what constitutes "advertising", and second, what is the required nexus between the insured's advertising activities and the alleged injury?

What Constitutes Advertising?

Advertising injury is a statement made in the course of "advertising" activities that causes loss to another person or business by libel, slander, disparagement, misappropriation of ideas, violation of a right of privacy, or infringement of copyright, trade dress or slogan. For the sake of clarity, the term "trade dress" refers to the total image of a product or service including product features such as design, size, shape, colors, packaging, labels, graphics or business features such as decor, architecture, uniforms, layouts and styles of service.

In the past, the caselaw has been less than clear as to the nature or amount of activity necessary to constitute advertising and as a result this question has provoked a great deal of litigation, particularly in the US. Many hope that the New IBC CGL Form will avoid or reduce litigation by providing a definition of the term. The definition of "Advertising" is broken down into the following components:

(i) notice that is published or broadcast;
(ii) to the general public or specific market segments;
(iii) about your goods, products or services; and
(iv) for the purpose of attracting customers or supporters.

which are discussed in detail below.

"Notice that is published or broadcast"

In construing the first element of the definition, Courts have struggled with the question whether advertising constitutes an activity separate and apart from the mere sale of a product. The following two cases, which deal with allegations of trade dress and trademark infringement, are illustrative of the seeming incompatibility of the two interpretative approaches to this question that emerge from a review of the case law.

In *Corel Corp. v. Guardian Insurance Co. of Canada*[152] the underlying U.S. action alleged copyright infringement, breach of a non-disclosure agreement, unfair competition and breach of confidence. Specifically, the pleading alleged that Corel was using, marketing, selling and displaying publicly the final version of a program called CorelDraw 8 in a manner that resulted in continuing copyright infringement. The complaint involved images sent to Corel under a non-disclosure agreement for licensing evaluation and possible inclusion into the program. Corel ultimately declined the licensing agreement, however, admitted to distributing a number of the images internally to its testers. Neither party alleged that the test version of the program, the only version containing the actual copyrighted images, was advertised. The U.S. Court granted summary judgement dismissing the breach of copyright claims against Corel with the exception of the portion of that claim pertaining to internal dissemination of the images. Corel subsequently applied for a declaration that the insurer was required to defend the action pursuant to the advertising injury liability coverage contained in its general liability policy.

In this case, the policy covered advertising injury arising out of specific offenses, including misappropriation of advertising ideas, and infringement of copyright, title or slogan. The policy limited coverage to advertising injury caused by an offense committed "in the course of advertising" goods, products or services. The Trial Judge relied on broad definitions of "marketing" and "public display" in holding that both could be construed as "advertising". At paragraph 19 of the decision, the Court stated:

> *It is alleged by [the Claimant] that [the insureds] marketing and displaying of CorelDraw 8 contributed to or added to [the Claimant's] copyright injuries. As such, the allegations involve a legal claim of copyright infringement arising out of and in the course of marketing (i.e. advertising [the insureds] goods, products or services). These allegations, in my view, create a sufficient connection between [the insureds] alleged advertising conduct and [the Claimant's] damages to meet the test of a mere possibility of coverage creating a duty to defend.*

[152] (2001), 26 C.C.L.I. (3d) 39 (Ont. Sup. Ct.).

The U.S. decision *EKCO Group Inc. v. Travelers Indemnity Co. of Illinois* [153] reached the opposite conclusion, despite involving the consideration of similar wording. In this case, the underlying action involved alleged loss arising from the physical reproduction and sale of a look-alike teapot. The Court held that actionable trade dress infringement necessarily entailed some degree of advertising activity and affirmed the insurer's duty to defend. However, the Court of Appeals, First Circuit disagreed and reversed this decision, preferring a more conventional reading of the term "advertising" when determining a duty to defend:

> *In the end we are left to chose between two different concepts of "advertising": the familiar bundle of business activities associated with that term and the far broader concept of inviting public attention, deliberately or not and by any means. Although the bare language of the policy is not conclusive, the more natural reading and the only one that avoids outlandish results is the former. It is worth adding that if the latter, open-ended definition were employed, it is hard to see how an insurer could even begin to calculate risks and set premiums.*

This case endorses a narrow interpretive approach that does not consider trade dress infringement as a misappropriation of an advertising idea while the decision in *Corel Corp.* endorses a broader view of "advertising" as encompassing the mere sale or distribution of the product. The requirement under the New IBC CGL Form that advertisements be "*broadcast or published*" will hopefully lead to greater consistency in the judicial approach to this issue in Canada, now that mere sale of the product *per se* cannot constitute an advertisement unless the product itself is advertised in a broadcast or in print.

"To the general public or specific market segments"

Another thorny coverage issue that arose under Former IBC CGL Form wording was whether the "advertising activity" needed to be directed towards a sufficiently large body of potential customers.[154]

Some U.S. case law determined that advertising must be of a public nature and that consequently, individual, one-to-one solicitations, although they may be widespread, are clearly not advertising within the normal meaning of the word.[155]

Other U.S. decisions have recognized that the nature of a particular insured's business activities may preclude broad dissemination of advertising material. In *New Hampshire*

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[153] 273 F.3d 409 (Illinois Court of Appeals).

[154] Note the "public notice" requirement referred to by the BCCA in *Canadian Reform, supra*, note 150 at p. 2.

[155] *Monumental Life Ins. Co. v. U.S. Fidelity and Guar. Co*. 94 Md. App. 505 (1993); *Tschimperle v. Aetna Cas. & Sur. Co*., 529 N.W..2d. 421 (Minn. Ct. App. 1995).

Inc. Co. v. Foxfire Inc.[156] the Court concluded that advertising activity must be examined in the context of the overall universe of customers to whom a communication may be addressed; where the audience may be small, but nonetheless comprises all or a significant number of a competitor's client base, the advertising activity requirement is met.

In *OMI Holdings, Inc. v. Chubb Ins. Co. of Canada*[157] the Court concluded that under advertising injury insurance coverage, the plain, ordinary meaning of the term "advertising activity" is not narrowly confined to widespread dissemination through a public medium and is not inconsistent with person-to-person or word-of-mouth communication, where the speaker's intent is to call attention to a given product. The Court stated that if person-to-person contacts are the only effective form of "advertisement" available in a certain type of market, then the broader definition of "advertising activity" applies.

A number of U.S. decisions have determined that "advertising activity" can constitute one-on-one or targeted group solicitations.[158] In some cases the U.S. Courts have held that if an insurer wants to limit "advertising activity" to widespread dissemination of materials, it should do so expressly in the policy, otherwise, the ambiguity will be construed in favour of the insured.[159]

Recently, a Canadian Court expressed sympathy for the broader view in holding that the communication in issue need not be to the public as a whole in order to constitute "advertising" and that the determination of whether an adequate amount of dissemination has occurred is a question of fact to be decided based on the special circumstances of each case.[160]

The wording of the New IBC CGL Form, which requires that the notice be published or broadcast to the "*general public*" or "*specific market segments*", appears to respond to those decisions that have held that the "*advertising activity*" does not necessarily need to be directed towards a large body of potential customers to attract coverage.

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[156] 820 F. Supp. 434 (1988).
[157] 1997 WL 30861.
[158] See *Tri-State Ins. Co. v. B&L Products, Inc.*, 61 Ark. App. 78 (1998*); American States Ins. Co. v. Canyon Creek*, 786 F. Supp. 821 (1991) .
[159] *Attorney's Title Guar. Fund, Inc. v. Maryland Cas. Co.* 1991 WL 171339.
[160] P*rairieFyre Software Inc. v. St. Paul Fire & Marine Insurance Co.*, (2003) 66 O.R. (3d) 331 [hereafter "*PrairieFyre*"].

"About your goods, products or services for the purpose of attracting customers or supporters"

There is little judicial consideration in Canada of these last two elements of the "Advertising" definition, however American caselaw is instructive.

In *Stenbock v. Hartford Fire Ins. Co.*[161] a U.S. Court concluded that there was no coverage where the alleged offense arose from advertising the claimant's goods, products or services, not the insured's. However, this decision must be compared with *Platinum Technology, Inc. v. Federal Ins. Co.*[162] where use of another's trademark to advertise the insured's goods and services fell within coverage.

One author[163] suggests that on plain reading, the second half of the definition in the New IBC CGL Form of may have the effect of eliminating or restricting the availability of coverage for injuries arising out of "institutional advertising" and "competitive advertising" the two forms of advertising discussed in the *Canadian Reform, supra,* decision.[164] Certainly, it is difficult to imagine that a Court would construe a negative advertisement that focuses entirely on the deficiencies of a competitor's products as being about the insured's "goods, products or services."

What Causal Connection is Required?

A key issue in the interpretation of advertising injury provisions in the Former and New IBC CGL Form is the required nexus between the alleged injury and the insured's advertising activities. The majority of the related litigation has centred on whether intellectual property infringement necessarily occurred within or outside of advertising.

The majority of U.S. Courts require a direct causal connection between the advertising and the alleged injury. The leading California Supreme Court decision *Bank of the West v. Superior Court*[165] is illustrative of that approach. At issue in this case was whether the advertising injury endorsement covered claims against the bank for unfair competition in advertising. The endorsement employed the typical language requiring injury resulting from "advertising activities" arising out of the conduct of the insured's business. The insurer argued that the activities that led to the injury were not performed in the course of advertising activities and that they did not constitute unfair competition. The Appeal Court concluded that the definition of unfair competition as contemplated in the insurance policy was sufficiently broad to include all unlawful,

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[161] 217 F.3d 846 (9th Cir., May 4, 2000) .
[162] 2000 U.S. Dist. Lexis 9509 (N.D. Ill., June 27, 2000).
[163] A.J. Saunders, "Personal and Advertising Injury Coverage: New Wordings, Same Old Problems?", Canadian Defence Lawyers Institute Seminar, February 2005
[164] *Canadian Reform, supra*, note 150.
[165] 833 P.2d 545 (Cal. 1992).

unfair, or fraudulent business practices. In reaching this decision the Court below preferred the broad statutory definition of "*unfair competition*" to the narrower common law definition.

The Supreme Court of California reversed the decision concluding that:

> *An objectively reasonable insured would not expect "advertising injury" coverage to extend as far as the Bank argues it should extend. Virtually every business that sells a product or service advertises, if only in the sense of making representations to potential customers. If not causal relationship were required between "advertising" activities" and "advertising injuries", then "advertising injury" coverage, alone, would encompass most claims related to the insured's business.*[166]

The direct causal connection requirement espoused by *Bank of the West* and other decisions has frustrated attempts by many insured's to secure coverage for claims alleging patent infringement.[167]

Still, a number of U.S. cases have required only a bare minimum connection between the advertising and the alleged injury[168] and there are others that maintain that while the advertising need not be a proximate cause of the alleged injury, it still must have contributed materially.[169]

Unfortunately, there is also a divergence of judicial opinion regarding the causation issue in Canada. The question was first tackled by a Canadian appellate court in *Grayson v. Wellington Insurance Company*.[170]

In *Grayson, supra,* the underlying claim involved patent and copyright infringement. The insurer contested the claim on various grounds, but raised a narrow issue for summary determination, namely, whether the allegations in the underlying action constituted conduct that occurred in the course of advertising activities. The summary Trial Judge dismissed the claim.

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[166] *Supra*, p. 560

[167] See *National Union Fibre Ins. Co. v. Siliconix Inc.* 729 F. Supp. 77 (N.D. Cal. 1989) and *Iolab Corp. v. Seaboard Surety Co.*15 F.3d 1500; 1994 U.S. App. Lexis 1354; However, also see *Amazon.com Int'l Inc. v. American Dynasty Surplus Lines* 85 P.3d 974 (Wa. Ct. App., 2004) where the Washington appellate court noted the usual distinction between advertising injury and patent infringement, however, found that the causal connection was clearly met.

[168] *John Deere Ins. Co. v. Shamrock Industries,* 696 F. Supp 434 (D. Minn. 1988).

[169] *Fireman's Fund Ins. Co. of Wis. V. Bradley Corp.,* 261 Wis. 2d 4, 2003 WI 33, 660 N.W.2d 666 (2003). In this decision the court found that the insured engaged in "advertising" when it allegedly created promotional brochures for its thermostatic mixing valves and displayed products at a trade show; this involved the widespread announcement or distribution of promotional materials and called the attention of the public to the emergency shower systems by proclaiming their qualities in order to increase sales or arouse a desire to buy.

[170] (1997), 37 BCLR (3d) 49 (C.A)

On appeal, the Court concluded that the language "*arising out of an offence occurring in the course of the Named Insured's advertising activities*" did not necessarily imply a stringent causation requirement. In doing so, the Court attempted to reconcile the U.S. lines of authority:

> *…it may be possible to reconcile them on the following basis: first, the fact that a product manufactured in breach of patent or copyright happens to have been advertised will not by itself bring the injury within the definition – the advertising will be regarded as merely "coincidental" to the wrong. Where, however, the plaintiff in the underlying action alleges that it has suffered injury as a result of the infringer's advertising activities, or where one of the remedies sought is the cessation of the Defendant's advertising activities, those activities may be seen as causally linked to the Plaintiff's injury, and the requirements of the definition will be met.*
>
> *Even if the American cases may not be reconciled in the manner I have suggested, I am not convinced that in Canadian law, the phrase "in the course of" does require a causal link, at least in a narrow or technical sense. The phrase is ordinarily used to refer not to causation but to context, especially, temporal context…*

Ultimately, the Court found that an insured must merely show that the advertising activities "*contributed or added to the injuries alleged in the underlying action*."

The approach in *Grayson, supra* decision must be contrasted with the relatively recent 2004 Ontario Court of Appeal decision in *PrairieFyre, supra*, which required a direct causal link. In overturning the lower Court's interpretation of the insuring agreement, the Appeal Court found:

> *Contrary to the application judge's finding that it is unnecessary to find a "direct nexus" between [the Plaintiff's] allegations of advertising activity and its alleged injuries in order to trigger a duty to defend, the coverage clause in the 1998 policy stipulates that advertising injury coverage applies only to "injury…caused by an offence…committed in the course of advertising." Accordingly, the policy specifically requires a direct causal link between the advertising activity and "an offence"…*
>
> *…the June 29, 2001 action focuses on [the insureds] alleged misuse of confidential and proprietary information in the development and sale of its software. [The Plaintiff's] allegation that prairieFyre and Mr. LaPrairie "exhibited in public by way of trade, unauthorized copies of the Taske ACD Toolbox software, or substantial parts thereof, within the prairieFyre software product" falls short of asserting that the appellants actually displayed any portion of the product as a form of advertising. On a generous reading, [the Plaintiff's] statement of claim fails to make any allegations of copyright infringement or misappropriation of style of doing business committed in the course of advertising.*

Limits on Coverage for "Personal and Advertising Injury"

As indicated in the opening section of this paper, the combining of "Personal and Advertising Injury" in this coverage in the New IBC CGL Form necessitated adding a number of exclusions that significantly restrict the Grant of Coverage in this section. There are now 18 exclusions limiting coverage; in the Former IBC CGL Form there were only 4 exclusions under the Personal Injury section. We briefly review the impact of several of those exclusions below.

Exclusion for Infringement of Copyright, Patent Trademark or Trade Secret

Now included in the wording of the New IBC CGL Form is Exclusion l which states for injury arising out of the infringement of copyright, patent, trademark, trade secret or other intellectual property rights is explicitly excluded unless the infringement occurs within the advertisement itself. Furthermore, the new wording requires that the offense be "*in your advertisement*" as opposed to the former wording which required that the offense be committed "*in the course of advertising the named insured's goods, products or services*." These two changes to the New IBC CGL Form will hopefully resolve much of the controversy surrounding the causation requirement and presumably will lead to more Canadian courts applying the direct causal link analysis found in *PrairieFyre, supra.*

Exclusions for Knowing Violation and Knowledge of Falsity

Under the New IBC CGL Form, Exclusions a. and b. exclude coverage in specific circumstances involving the knowledge of the insured. Injury caused by or at the direction of the insured with the knowledge that the act would violate the rights of another and would inflict personal and advertising injury is now excluded. This exclusion encompasses intentional conduct for the full range of covered personal and advertising injuries and supplements the "*Knowledge of Falsity*" exclusion which is limited to false statements made in written publications. These new exclusions have yet to be judicially considered, however, a review of the case law interpreting the "*Knowledge of Falsity*" exclusion suggests that it will only apply where the underlying pleading expressly alleges that the insured committed the offense with the knowledge that it would cause injury. Alleging that the insured "ought to have known" will not result in a denial of coverage.

It remains to be seen how Canadian Courts will interpret the "*Known Violation of Rights of Another*" exclusion. As always, each case will turn on its own unique facts. That said, a carefully drafted pleading will likely trigger a duty to defend even where there is little

ambiguity that the alleged wrongdoing arose out of a "*Known Violation*". Proving knowledge may prove a high evidentiary hurdle for the insurer in these circumstances.

Exclusion for Insureds in Media and Internet Type Businesses

It is also worth noting that while the definition of "Advertisement" specifically includes "*material placed on the Internet or on similar electronic means of communication*", coverage for insured's engaging in media and Internet type business is specifically excluded. This exclusion applies to an insured whose business is "*advertising, broadcasting, publishing or telecasting…designing web-sites or Internet searches, access, content or service providers*."

Conclusion

The combining of "Personal and Advertising Injury" coverage in one section in the New IBC CGL Form is meant to provide more commercial certainty for both Canadian liability insurers and insureds. Coverage for "Advertising Injury" liability, previously available only by endorsement, has not been well-litigated in Canada. Likewise, "Personal Injury" coverage, even under the Former IBC CGL, has received very little judicial attention. However, the number of exclusions now relevant to this coverage has been increased and it remains to be seen how insureds will attempt to obtain coverage under this section of the New IBC CGL Form now that coverage has been further restricted.

CONCLUSION

This paper selectively considers portions of the New IBC CGL Form. There is no question that the New IBC CGL Form provides greater commercial certainty to Canadian liability insurers, in the following general ways:

- Revisions to the Insuring Agreement, including the introduction of the "Known Loss" Rule and certain "deeming" provisions guard against the spectre of what would otherwise involve "long-tail" liability;
- Coverage will no longer be provided for loss of "Electronic Data";
- The narrow definition of "Compensatory Damages" eliminates coverage for punitive or exemplary damages;
- The introduction of "anti-concurrent cause of a loss" language in some Exclusions eliminates potential coverage where there are two

or more independent or concurrent causes for the liability exposure;

- The scope of coverage for contractual liabilities is reduced through a clarified definition of "insured contract", and express provision is made for the assumption of the defence of third parties indemnified by the insured;
- The enhanced Employer's Liability Exclusion, and the revised definitions of "employee" will act to restrict coverage;
- A new and broadly worded Professional Services Exclusion, will serve to restrict coverage to insureds that engage in semi-professional services beyond the ambit of the traditional professional callings such as an architect, engineer, lawyer, doctor and accountant;
- The Abuse Exclusion, and the definition of "abuse" will specifically exclude coverage for any kind of sexual misconduct either by the perpetrator or the insured that has liability by reason of the perpetrator's conduct;
- The more expansive Pollution Exclusion and definition of pollutants create more certainty about the application of the Exclusion;
- The introduction of the Mould and Asbestos Exclusions (and express definitions) will curtail coverage in these two areas of growing claims;
- The new Terrorism Exclusion, a sign of the times, will curtail coverage for claims due to terrorist activity;
- A broader definition of "Who is an Insured" expands the range of business organizations and individuals who can seek coverage under a commercial liability policy;
- Two aggregate limits now exist in the New IBC CGL Form, in very specific circumstances, which may act to expand indemnity obligations;
- More rigorous reporting requirements in the event of an "occurrence" or "offense" enhance the duties and responsibilities of an insured in the event of a claim;
- The "Other" Insurance Clause more clearly delineates the relationship between overlapping policies;

- The combining of "Advertising and Personal Injury" coverages and a more comprehensive set of exclusions expand the scope of these coverages.

The overall effect of the enhancements and changes to the New IBC CGL Form is to introduce greater commercial certainty for insurers and insureds alike. Just as important, the New IBC CGL Form will result in less ambiguity if Courts are called upon to interpret the wordings. Among other things, the New IBC CGL Form introduces language in areas where there was no language before, and now provides more guidance for insureds, insurers and the Courts. In doing so, the New IBC CGL Form introduces a greater measure of exactness and definition for all concerned.