Robinson Sheppard Shapiro

Recent cases regarding storage exposure

Conférencier :

Me Jean-François Bilodeau

Recent cases regarding storage exposure:

1. St. Paul Fire & Marine Insurance Company, v. Novus International, Inc., [*Novus*] 2011 WL 6937593 (S.D.N.Y.).

- Accumulation Clauses
- The perils of ambiguity

2. Kruger Products Limited v. First Choice Logistics Inc., 2013 BCCA 3 [*Kruger*] on appeal from the trial decision (2010 BCSC 1242)

- Tort Immunity & Bars to Subrogated Actions
- Insurance Covenants

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Accumulation Clauses

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Part I: The *Novus* Decision

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St. Paul Fire & Marine Insurance Company, v. Novus International, Inc.

[2011] WL 6937593 (S.D.N.Y.). [*Novus*]

This American decision may extend the application of Accumulation Clauses and thereby increase insurers' liability for losses covered claimed pursuant to Inland Marine Insurance Policies that contain certain Accumulation Clauses. Although *Novus* is an American decision, similar arguments may prove persuasive in Canada because we share similar laws in relation to contractual construction.

So what exactly are Accumulation Clauses?

The Accumulation Clause

St. Paul Fire & Marine Insurance Company, v. Novus International, Inc., 2011 WL 6937593 (S.D.N.Y.).

This is the Accumulation Clause that the Court considered in *Novus*:

"Should there be an accumulation of the interests insured hereunder beyond the limit(s) of liability expressed elsewhere in this policy by reason of any interruption of transit or circumstances beyond the control of The Insured's corporate risk manager or equivalent, or by reason of any casualty, or at a transshipping point, or on a connecting conveyance. This Insurer shall, provided notice of such accumulation is given to This Insurer as soon as practicable after it becomes known to The Insured's corporate risk manager or equivalent, hold covered such excess interest and shall be liable for the full amount at risk, but in no event shall This Insurer's liability exceed twice the limit of liability set forth in Sub–Clause 13.1"

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The Warehouse Endorsement

St. Paul Fire & Marine Insurance Company, v. Novus International, Inc., 2011 WL 6937593 (S.D.N.Y.).

The court also considered the following Insurance Clause in the Warehouse Endorsement:

"The policy to which this endorsement is attached is extended to cover goods and/or merchandise and/or property (i) of The Insured or (ii) held by it in trust or on commission or on consignment or sold but not delivered or removed or on joint account with or belonging to others for which The Insured may be liable in the event of loss pending shipment, transshipment, reshipment or otherwise, while stored at the locations identified herein, subject to a $25,000 deductible per loss for bulk liquid storage locations, and the following terms and valuation . . . This Insurer shall not be liable for more than $2,000,000 at any one location at any one time, except as specified below."

Facts: So what happened?

St. Paul Fire & Marine Insurance Company, v. Novus International, Inc., 2011 WL 6937593 (S.D.N.Y.).

- The insured was experiencing difficulties with its other warehouses. On their own initiative, the insured's employees decided to relocate a large amount of inventory to a particular warehouse.
- The decision to relocate the inventory and to thereby cause it to accumulate was taken without the knowledge or assent of the insured's "corporate risk manager."
- The warehouse flooded and the insured claimed more than $5,000,000, arguing that the Accumulation Clause was applicable to its warehouse coverage, and consequently, that the $2,000,000 limit contained within the warehouse coverage endorsement did not apply.

New York Insurance Law

St. Paul Fire & Marine Insurance Company, v. Novus International, Inc., 2011 WL 6937593 (S.D.N.Y.).

"It is well established under New York law that the insured bears the burden of showing that an insurance policy covers the loss."

MBIA Inc. v. Federal Ins. Co., et al., Nos. 10–0355–cv(L); 10–0386– cv(con); 10–0356–cv (XAP), 652 F.3d 152, 2011 WL 2583080 *1–17, *4 (2d Cir. July 1, 2011).

"In determining whether the insured has sufficiently met its burden, **the Court must itself interpret the insurance policy terms.** "The initial interpretation of a contract is a matter of law for the court to decide."

Morgan Stanley Group Inc. et al. v. New England Ins. Co. et al., 225 F.3d 270, 275 (2d Cir.2000) (citation omitted).

"The threshold question that must be addressed by the Court as part of this inquiry is whether the terms of the insurance contract are *ambiguous*."

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New York State Ambiguity Test

St. Paul Fire & Marine Insurance Company, v. Novus International, Inc., 2011 WL 6937593 (S.D.N.Y.).

"[T]he language of a contract is not made **ambiguous** simply because the parties urge different interpretations." Safeway Envtl. Corp. v. American Safety Ins. Co., No. 08 Civ. 6977(WHP), 2010 WL 331693 *l–5, *3 (S .D.N.Y. Jan. 28, 2010).

"The Court must instead consider a word or phrase *ambiguous* when it "could suggest more than one meaning when viewed objectively by a reasonably intelligent person who has examined the context of the entire integrated agreement and who is cognizant of the customs, practices, usages and terminology as generally understood in the particular trade or business."

Parks Real Estate Purchasing Group, et al. v. St. Paul Fire and Marine Ins. Co., 472 F.3d 33, 42 (2d Cir., 2006).

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St. Paul Fire & Marine Insurance Company, v. Novus International, Inc., 2011 WL 6937593 (S.D.N.Y.).

- After holding that New York State Law applied, the court agreed with the insured:

  " [...] [A]s written, the Warehouse Endorsement and the Ocean Cargo Policy must be read together as a unified policy. [...] The first line of the Warehouse Endorsement is bold italicized text which states "Attached to and forming part of Policy No.: OC09000930" (emphasis in original). The wording of the Endorsement also refers to the Ocean Cargo Policy in language that can only be read as attaching the two policies to one another. (e.g. "The policy to which this endorsement is attached is extended […]"; "[…] Strikes, Riots and Civil Commotions Endorsement contained elsewhere in this policy"; "The deductible found elsewhere in this policy […]"; "[…] shall be valued as per Policy Clause No. 10".) Reading the Warehouse Endorsement as an extension to the Ocean Cargo Policy is additionally consistent with the plain language of the Ocean Cargo Policy itself. The Ocean Cargo Policy's "Attachment" clause references that there are storage locations insured under the Policy: "This policy is continuous and covers [...] on all goods and/or merchandise and/or property in storage at locations insured under this policy […]" (emphasis added). Since specific insured locations are mentioned nowhere in the Policy other than in the Warehouse Endorsement, the Ocean Cargo Policy's own terms support a reading of the policy and its endorsement as a single document."

St. Paul Fire & Marine Insurance Company, v. Novus International, Inc., 2011 WL 6937593 (S.D.N.Y.).

- "[…] [Novus] argues that the accumulation of product due to: (1) product being moved to the PDM Warehouse from poorly performing warehouses; and (2) Novus' failure to meet sales forecasts should be considered "circumstances beyond the control" of its corporate risk manager, John Wade. […] Novus further argues that, "[a]s Mr. Wade had no control over the factors that caused the accumulation of goods at the PDM Warehouse, the accumulation was by reason of circumstances beyond his control.
- […] Novus' interpretation conflates circumstances in which Wade did not exercise control with those that were "beyond his control." The fact that Novus operational employees failed to properly notify Wade of the accumulation, and that Wade himself did not pursue other avenues for obtaining this information, does not transform Novus' intentional accumulation of product into a fortuitous circumstance that the parties intended would be covered by the Policy. "

St. Paul Fire & Marine Insurance Company, v. Novus International, Inc., 2011 WL 6937593 (S.D.N.Y.).

- The court held that the insured could not rely on the accumulation clause to exceed the $2,000,000 limit Warehouse Policy Limit.
- Further, the court disposed of the matter by way of summary judgment, which represents an expedited and substantially less costly procedure than a trial.
- The Court held that the plain language of the Policy was unambiguous and it required the event that was to trigger the extended coverage pursuant to the Accumulation Clause to be “beyond the control” of the insured’s Corporate Risk Manager.
- **Accumulation Clauses** typically contemplate extended coverage triggered by the occurrance of fortuitous circumstances that arise during covered transit. Common examples include: interruptions in transit that are beyond the control of the insured and casualty on a conveyance or at transshipment points.
- This case underscores the critical importance of careful drafting to underwriters. Use of the terms “circumstances beyond the control of the insured” instead of “circumstances beyond the control of The Insured’s corporate risk manager,” and ensuring that those “circumstances” do not independently engage the accumulation clause would have protected the underwriter by reducing the instances where the accumulation clause would serve to increase warehouse coverage.

Principles of Contractual Construction: The Canadian Approach
Preliminary Matters - Insurance Policies are Contracts

Meredith J.A. in *Pense v. Northern Life Assurance Co.* at p. 137:

"**There is no just reason for applying any different rule of construction to a contract of insurance from that of a contract of any other kind**; and there can be no sort of excuse for casting a doubt upon the meaning of such a contract with a view to solving it against the insurer, however much the claim against him may play upon the chords of sympathy, or touch a natural bias. In such a contract, just as in all other contracts, effect must be given to the intention of the parties, to be gathered from the words they have used. A plaintiff must make out from the terms of the contract a right to recover; a defendant must likewise make out any defence based upon the agreement. The onus of proof, if I may use such a term in reference to the interpretation of a writing, is, upon each party respectively, precisely the same."

Principles of Contractual Construction: The Canadian Approach
Preliminary Matters - Insurance Policies are Contracts

In *Robertson v. French* Lord Ellenborough declared:

"In such a contract [of insurance], just as in all other contracts, effect must be given to the intention of the parties to be gathered from the words they have used." (1803), 7 R.R. 535 at 540, 4 East 130

This remains a valid expression of the Canadian law of contracts.

Principles of Contractual Construction: The Canadian Approach
Step 1 – Identification of the Contract

Consequently,

•**The first step** in the process of contractual construction is to identify the constituent parts of the contract itself. This, often difficult, exercise is undertaken with a view to ascertaining the intention of the parties or, to put it another way, what can reasonably be said to have been in the parties' contemplation, at the time that the contract was made.

•The common law approach to ascertaining the intention of the parties (and, thus, the substance and nature of the obligations flowing from the contract) is based on the **objective theory of contract formation**.

•The common law takes the position that the intent of the parties is disclosed by determining what an objective bystander would reasonably understand the parties' agreement to have been.

Principles of Contractual Construction: The Canadian Approach
Step 2 – Plain and Ordinary Meaning

"While we are here concerned with the construction of a contract of marine insurance, such a contract is to be construed in the same way as any other contract of insurance: *Robertson v. French* […] The primary objective is to discover and give effect to the intention of the parties *as disclosed by the words used by them*, the context in which those words appear and the purpose sought by the words employed at the time the contract was entered into." [1998] 1 F.C. 586 per Stone J.A. at 597

"The primary modern rule of construction is to focus on the words used by the parties to discern their "intent" (pp 32, Moore)

"[The] cardinal rule [in the interpretation of insurance policies is that the intention of the parties must prevail and that "particular consideration must be given to the terms used by the parties, the context in which they are used and finally the purpose sought by the parties in using these terms" (33, Moore)

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Principles of Contractual Construction: The Canadian Approach
Step 3 – Ambiguity

- Where there is more than one plausible interpretation of a contract the contract is said to be ambiguous.
- Where a contract is ambiguous, a court will endeavor to construct the contract.
- In so doing, the court will have regard to the contract as a whole and may admit parol evidence as well as rely on other extrinsic interpretive aids.
- The process of contractual construction is highly unpredictable as interpretation is an inherently subjective exercise.
- Underwriters must be especially wary of drafting defective instruments, as the consequences of an adverse decision may include unexpected situations such as tort immunity where the insured is estopped and the insurer, who seeks to recover through subrogation is barred from recovery – this will be discussed shortly.

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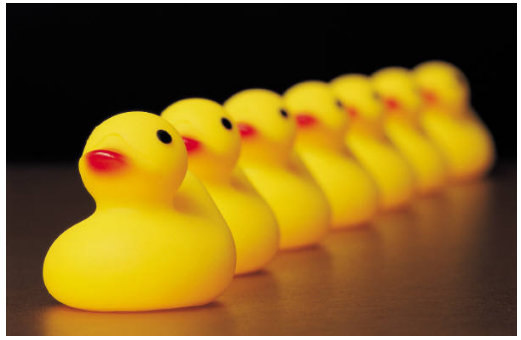
Principles of Contractual Construction: The Canadian Approach
Step 4 – *verba cartarum fortius accipiuntur* ***contra proferentum***

- If ambiguity subsists after all other principles of construction have been applied, then the court will resort to the principle of contra proferentum.
- Contra proferentum resolves subsisting ambiguity by construing it against the party who inserted the term.
- "Even apart from the doctrine of contra proferentum as it may be applied in the construction of contracts , the normal rules of construction lead a court to search for and interpretation which, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time of entry into the contract. Consequently, the literal meaning should not be applied where to do so would bring about an an unrealistic result or a result that would not be contemplated in the commercial atmosphere in which the insurance was contracted. Where words may bear two constructions, the more reasonable one, that which produces a fair result, must certainly be taken as the interpretation which would promote the intention of the parties. Similarly, an interpretation which defeats the intention of the parties and their objective in entering a commercial transaction in the first place should be discarded in favour of an interpretation of the policy which promotes a sensible commercial result." Consolidated-Bathurst v. Mutual Boiler[1980]1 S.C.R. 888 D.L.R. (3d) 49

Principles of Contractual Construction: Avoiding ambiguity

- Insurance policies are *contractual* in nature
- Insurance policies, as contracts, are subject to substantially the same canons of construction and interpretation as other common law contracts, subject to certain exceptions.
- Ambiguity invites a Court to construe the terms of a policy *de novo* and leads to uncertainty.
- Effective risk allocation for underwriters is contingent on avoiding ambiguity to the greatest extent possible.



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Part II: The *Kruger* Decision

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The *Kruger* Trial Decision

Kruger Products Limited v. First Choice Logistics Inc., 2010 BCSC 1242

Facts:

- Kruger entered into a contractual relationship with a warehouse operator, First Choice, to store its paper products.
- First Choice leased forklifts from Mason, which were manufactured by Toyota, to operate its warehouse.
- First Choice noticed that the forklifts' exhaust was very likely to cause Kruger's paper inventory to catch fire. In response, First Choice modified its forklifts and instituted a policy of "blow outs" to regularly clear paper debris from the engine intake and the floor of the warehouse.
- When the modified forklift broke down First Choice leased a replacement. They did not modify the replacement forklift and this caused Kruger's paper products to catch fire.
- The fire totally destroyed Kruger's paper product inventory estimated at approximately 16,000,000.00$
- Kruger's insurer commenced subrogated actions against Toyota, Mason, First Choice and the driver of the forklift that caused the fire. The actions against Toyota and Mason were settled.
- First Choice defended on the basis that the Covenant to Insure in the Warehouse Management Agreement between itself and Kruger barred the insurer's subrogated action.

The *Kruger* Trial Decision

Kruger Products Limited v. First Choice Logistics Inc., 2010 BCSC 1242

First Choice's Defence:

- First Choice and Bodnar (the lift-driver) argued that Kruger had, through its conduct, accepted the terms of a Warehouse Management Agreement ('WMA') on February 1, 2000.
- The *WMA* contained terms that required Kruger to:

1. Independently insure its own inventory, and
2. Name First Choice as an additional insured.

- Consequently, First Choice maintained that Kruger was estopped from claiming what ought to have flowed from the requisite indemnity policy.

Kruger: Covenant to Insure

Kruger Products Limited v. First Choice Logistics Inc., 2010 BCSC 1242

- The Defendants state that the Warehouse Management Agreement included a provision requiring Scott to obtain insurance including "insurance of its inventory and property within the Warehouse" and that such insurance was to name First as an additional insured and was to stand as the primary insurance coverage. The Defendants state that, by the terms of the Warehouse Management Agreement, Scott is barred and otherwise estopped from claiming against First to the extent of the indemnity which would have been provided by such insurance. The Defendants state that it was an express or implied term of the Warehouse Management Agreement that the parties would restrict recovery between them for any loss or damage to the amount of available insurance and that Scott is therefore barred by the terms of the Warehouse Management Agreement and is otherwise estopped from claiming against the Defendants in total or, in the alternative, to the extent of the indemnity that would have been provided by the insurance that Scott was obliged to obtain and maintain under the terms of the Warehouse Management Agreement.

The *Kruger* Trial Decision

Kruger Products Limited v. First Choice Logistics Inc., 2010 BCSC 1242

- The Agreement between the parties provided for full indemnification of losses by the negligent party. The Agreement also stated that it prevailed over other documents and could not be amended without written and signed documentation. No other documents met this standard. The liability limiting clauses in Appendix C relied on by the defendant were incoherent and incapable of overriding the Agreement. There was no bar to subrogation as to find that the plaintiff could not claim losses that would be covered by insurance would impair the duty of care owed by the defendant and render the indemnification clause of the Agreement meaningless.

The *Kruger* Appeal (Reversal)

*Kruger Products Limited v. First Choice Logistics Inc., 2013 BCCA 3 (*CanLII)

Was the Subrogated Claim Barred? The Court of Appeal reversed the court below in holding that it was.

Paragraph 17 of the WMA contained covenants on the part of both parties with respect to insurance. Paragraph 17 stated:

INSURANCE

A. Liability Insurance

The Contractor [FCL] will maintain, throughout the Term of this Agreement, and any Extension Term, comprehensive general liability insurance and industry standard warehouseman's legal liability insurance. Scott will maintain general liability insurance, tenant's legal liability insurance, and insurance of its inventory and property within the warehouse.

All insurance shall name Scott or the Contractor as applicable as an additional insured against all liability for bodily and/or personal injury and property damage, arising from the insured's fault or negligence, or the fault or negligence of any of its or their shareholders, directors, officers, employees, servants and agents, its and their affiliated, related, parent and subsidiary companies, and its and their appointees, successors and assigns, in connection with the Management Services hereunder.

If the comprehensive general liability policy contains a general aggregate, that aggregate limit shall apply separately, per location, so that the Warehouse will have its own aggregate limit. **All insurance policies contemplated hereunder shall constitute and respond as primary coverage to any insurance otherwise available** Scott and any of its shareholders, directors, officers, employees, servants and agents, its affiliated, related, parent and subsidiary companies, or its and their appointees, successors and assigns.

Kruger The Insurance Clause

Kruger Products Limited v. First Choice Logistics Inc., 2013 BCCA 3 (CanLII)

The BCCA cited: *Madison Developments Ltd. v. Plan Electric Co.* 1997 CanLII 1277 (ON CA), (1997) 36 O.R. (3d) 80 (Ont. C.A.), where Carthy J.A. stated:

"[...] The law is now clear that […] **A contractual undertaking by the one party to secure property insurance operates in effect as an assumption by that party of the risk of loss or damage caused by the peril to be insured against.** […] This is a matter of contractual law, not insurance law, but, of course, **the insurer can be in no better position than the landlord on a subrogated claim. The rationale for this conclusion is that the covenant to insure is a contractual benefit accorded to the tenant, which, on its face, covers fires with or without negligence by any person. There would be no benefit to the tenant from the covenant if it did not apply to a fire caused by the tenant's negligence.** [At 84; emphasis added.]"

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Kruger: Risk to Underwriters

***Kruger Products Limited v. First Choice Logistics Inc., 2013 BCCA 3 (*CanLII)**

In overturning the court below, the BCCA held that:

"With respect, it appears the trial judge **erred in failing to apply the trilogy and *North Newton*, among other authorities, to the WMA**. Paragraph 17A, like the insurance clauses in those cases, went much farther than the terms of the receipt, which contained no relevant covenants regarding insurance. Paragraph 17A required Scott to maintain "insurance of its property and inventory within the warehouse" and to name FCL as an additional insured under this "primary coverage". The terms of the agreement itself were to prevail over those in Appendix C in the event of a conflict."

"I see no inconsistent wording in the WMA, and indeed the parties' express acknowledgement that insurance obtained under para. 17A would "respond as primary coverage" strengthens the case for tort immunity on FCL's part. I conclude that Scott's obligations under para. 17A were clearly intended for the benefit of FCL. Paraphrasing *Madison*, there would be no benefit to FCL from the provision if it did not apply to a fire caused by FCL's beach of the applicable standard of care. In the result, I find that the trial judge did err in proceeding on the basis that the various Canadian authorities discussed above were not applicable to this case. I would allow the appeal, grant a declaration that Scott's subrogated claim against the defendants is barred, and dismiss the action."

Any questions ?

Robinson Sheppard Shapiro