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The Covenant to Insure: Two Recent Examples

An issue that comes up repeatedly is the effect of a covenant to insure, most commonly, in a construction contract or in a lease. The general principle is that where one party covenants in a contract to insure certain risks (property or liability), this represents an agreement by that party to assume the risk of loss for the insured subject matter. The other parties to the agreement are entitled to receive the benefit of that assumption of the risk, and of the insurance obtained, as are (sometimes) parties who are *not* privy to the contract, but who the contracting parties intend to get the benefit of the covenant to insure. This assumption of risk would exist even if the party who was supposed to get the insurance failed to do so. Such insurance provisions can be a quick and easy way to get out of a law suit on the basis that some other party agreed to accept the risks of loss. That being said, a contract must be considered on its own merits: just because a particular contract contains a covenant to insure does not necessarily mean that the party giving the covenant has agreed to assume *all* risk of loss: it is open to a party to agree to obtain insurance, while reserving rights of recovery as against the other party to the contract in the event of the latter's negligence. The devil is in the details. Two recent cases from Ontario illustrate these principles.

The first case is ***DCMS GP (Dufferin-Steeles) v. Caribbean Tower Cranes Limited, 2015 ONSC 4125***. This is a straightforward construction matter. DCMS was the owner and developer of a retirement residence. DCMS hired Outspan to supply labour and equipment. Outspan agreed to provide a construction crane to perform certain work. Under the applicable agreement between parties, DCMS covenanted to obtain an "all risks property insurance" policy for the project to cover "trade contractors, sub-contractors and others having an insurable interest in the work, engaged in or connected with the construction, site preparation and related operations". DCMS obtained this coverage. Meanwhile, Outspan hired a sub-contractor, CTC, to provide a crane and operator. CTC hired Magna and its owner, Perri, to inspect the crane before and after its erection. Magna hired Lee, a P. Eng, to review and certify the work. In 2009, the crane fell onto the partially completed residence causing damage. The insurer paid the claim and then sought to recover the losses.

The action was commenced against CTC, Outspan, Magna, Perri, and Lee. The defendants crossclaimed against one another. Outspan and CTC moved for an order dismissing the action against them on the basis that, in the contract at issue, DCMS had accepted the risk of loss *vis a vis* Outspan and CTC. Outspan and CTC also asked that the court dismiss the crossclaims brought against them by Magna, Perri and Lee. The Court considered several issues, among which were: (i) did the covenant to insure operate to bar DCMS from claiming against Outspan and CTC; and (ii) in the event that DCMS was not allowed to sue Outspan and CTC, could Magna, Perri and Lee nonetheless maintained their crossclaims against Outspan and CTC, each of which was based on a so-called "independent" cause of action as against Outspan and CTC (rather than being merely derivative of the main action).

The Court found that because DCMS covenanted with Outspan to obtain insurance, it thereby assumed all risk of damage caused by the insured perils *vis-a-vis* the parties who were entitled to the benefit of the covenant. In doing so, the Court accepted that CTC (which was not a party to the contract with DCMS) was able to satisfy the two part test in ***Fraser River Pile & Dredge v. Can-Dive Services***[1] that (i) the parties to the DCMS agreement intended to extend the benefit of the covenant to CTC; and (ii) the activities performed by CTC were within the scope of the DCMS agreement, as it supplied the crane. As such, DCMS was not entitled to commence an action against either Outspan or CTC. But what about the crossclaims brought by Magna, Perri and Lee? The Court held that these too must fail. Citing the SCC in ***Giffels Associates v. Eastern Construction***[2], the Court held that it is a precondition for the right to claim over for contribution that the party being sued (in the crossclaim) be liable to the plaintiff. Since Outspan and CTC could not be liable to the plaintiff (for the reasons stated above), Magna, Perri and Lee could not claim over as against them, even though they claimed for contribution on the basis of so-called "independent torts.

This is not a new development in the law: this jurisprudence has been around for a while. Still, ***DCMS*** provides a nice, and concise statement of the law and the various tertiary issues in this area.

We get a different result in the ONCA's decision is ***Royal Host GP v. 1842259 Ontario***.[3] In this case, the appellant Royal Host owned a building in which it operated a hotel. The respondent leased a portion of the building in which it operated a restaurant. A fire broke out in the respondent's kitchen causing some damage. The appellant was indemnified by its insurer and the insurer then commenced a subrogated claim. The respondents argued that even if the fire was caused by their negligence, the terms of the lease prevented the appellant from bringing the action. The lease contained a term that provided that the landlord was to "take out and maintain" fire insurance and the costs of the insurance was to be part of the common expenses paid by the tenants. The lease also provided for what I will call "limiting language" to the effect that the tenant "is not relieved of any liability arising from or contributed to by its acts, faults, negligence or omissions." The respondents moved to have the claim dismissed, and won at first instance. The motions judge relied on the trilogy of cases from the SCC from the 1970s (***Agnew-Surpass v. Cummer-Yonge***, et al) and found that this trilogy had created a rule of general application. As per the trilogy, the judge held that, since the landlord covenanted to obtain the insurance, and since the tenant helped pay for the insurance, the tenant should get the benefit of the insurance which meant that the landlord's insurer could not sue the tenant, since an insurer cannot sue its own insured. The motions judge found that in these circumstances, the limiting language did not create a right of subrogation for the landlord's insurer. The ONCA disagreed and found that the SCC trilogy did not create an iron-clad rule which would overrule the fundamental tenets of contract interpretation, one of which is that you look at the language of the contract in order to ascertain the intentions of the parties. In this case, the plain language of the contract provided that, even though the landlord was to buy insurance, the tenant was not to be relieved of its liability, if any, for negligent acts. In this case, therefore, the parties, in essence, contracted out of the normal rule, and they are allowed to do that.

R. Lester, February 21, 2020

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1 *Fraser River Tile & Dredge v. Can-Dive Services* [1999] 3 SCR 108

2 [1978] 2. SCR 1346 at 1354

3 2018 ONCA 467