Canadian Journal of Insurance Law

General Editor: Neo J. Tuytel, Clark Wilson LLP
Associate Editor: Krista Prockiw, Clark Wilson LLP

VOLUME 26, NUMBER 5 | Cited as 26 Can. J. Ins. L. | OCTOBER 2008

• INSURING TO VALUE; THE "MARGINS CLAUSE" •

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Editor's note: Materials prepared for the Pacific Business and Law Institute, June 2008, Canadian Insurance Coverage Symposium. (An earlier version of this paper was presented to the B.C. Society of Fellows, December, 2007)

While margins clauses of some form have been around for several years, use of the clause is undoubtedly going to increase substantially in the near future. There are a few reasons for this. First, the Insurance Services Organization ("ISO") is in the process of applying for general approval of margins clause wording for use throughout the U.S. Approval is expected in August 2008. That will almost certainly result in a substantial increase in use of the clause in the U.S., and Canada will inevitably follow. Second (though not unrelated), reinsurers are increasingly imposing limitations on facultative treaties, which effectively require insurers to impose limits on blanket cover, or risk being short reinsurance (with those limitations including tying of reinsurance to values declared under the original policy, regardless of the actual scope of cover under that policy).

A longer term historical trend is likely also at work here. At one time many property policies were either on some form of scheduled wording or included co-insurance. Certainly most "fire" policies at one time contained co-insurance provisions. Co-insurance provisions are now much less common; and scheduled or valued policies (at least outside the marine context) are increasingly rare.[1] More property policies are written as "all risks" cover on "blanket" wording, without co-insurance.

Insurers may have taken solace in the fact that those policies (at least larger multiple location policies) would almost invariably have some form of statement of values ("SOV") issued in connection with the policy. But in recent years there have been innumerable large and small losses in which values declared at the outset of the policy appear woefully inadequate when compared to the claim put forward after a loss, and on which the ability of insurers to restrict cover to the SOV values, where the policy is on blanket wording, was very limited.

In this paper I will: (a) briefly review what a margins clause is and what it is intended to do; (b) summarize Canadian law on the effect of the SOV in the absence of a margins clause; and (c) refer to some particular issues surrounding interpretation and application of the margins clause.

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CANADIAN JOURNAL OF INSURANCE LAW

The **Canadian Journal of Insurance Law** is published bi-monthly by LexisNexis Canada Inc., 123 Commerce Valley Drive East, Suite 700, Markham, Ontario L3T 7W8

ISBN: 409-89266-1 **ISSN: 0822-1090**
ISBN: 0-433-44377-4 (Print & PDF)
ISBN: 0-433-44645-5 (PDF)
Publications Mail Registration No. 185906

Subscription rates: $325 plus GST/year (Print or PDF)
$380 plus GST/year (Print & PDF)

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MARGINS CLAUSE — BRIEF DEFINITION

The key characteristic of a margins clause is that it imposes sub-limits equal to the declared value of the individual locations and/or items of property or coverage set out on the SOV, generally with an additional specified percentage, or "margin" of those values (hence the name). The clause is often headed "Occurrence Limit of Liability Endorsement" or "OLLE".

Margins clauses straddle the border between blanket and scheduled, or specific, cover. In theory, under blanket cover (and in the absence of an SOV) all property falling within the terms of the policy is covered, with the only limit being the policy's limit of liability. Under specific or scheduled cover, there is, in theory, a separate policy on each asset described on the SOV. Much of the U.S. litigation on margins clauses has concerned the question of whether the policy containing the clause is blanket or specific.

The following is a fairly standard margins clause wording:

> *Margins Clause*
>
> The premium for this policy is based upon the statement of values provided. In the event of loss under the policy, the liability of the Insurer(s) shall be limited to the least of the following:
>
> 1. The actual adjusted amount of loss, less applicable deductible(s).
>
> 2. The total stated value of the property involved, as shown on the latest Statement of Values on the file with the Company, less applicable deductible(s).
>
> 3. The Limit of Liability or Amount of Insurance shown on the face of this Policy or endorsed onto this Policy.

Materially identical wording has been considered in a number of U.S. cases.[2] While there is some variation in wording among margins clauses, all share the key feature that sub-limits are imposed in relation to values disclosed on the SOV filed in connection with the policy.

While by far the most common form of clause imposes limits equal to disclosed values of the property involved, plus a percentage, there are other possible variations. For example, rather than tying the sub-limit to the value disclosed for a specific location, the clause can impose a sub-limit equal to a specified percentage of the total values set out on the SOV (so, for example, if there are five locations of more or less equal value, the clause could impose a sub-limit per location of 20 per cent of total values disclosed).

It is worth noting here that minor variations in the wording can have a major impact on cover. For example, replacement of the words "total stated value of the property involved" at the start of para. 2 above with "100 per cent of the individually stated values" or words to that effect, will potentially have a significant impact on cover.[3] More on this below.

EFFECT OF THE STATEMENT OF VALUES IN THE ABSENCE OF A MARGINS CLAUSE

In this section I will summarize the present state of the law, in terms of the effect on cover of the statement of values, in the absence of a margins clause. This section will consider the effect of the SOV only in a policy, which (but for the SOV) would undoubtedly be a "blanket" policy. Different considerations obviously arise in connection with a scheduled policy.

In the absence of a margins clause, there are three ways in which values set out on (or omitted from) the SOV may be relevant to cover:

1. The SOVs may act as a "sub-limit", limiting property to the values disclosed.

2. The SOV may have the same effect precluding the insured, by virtue of the insured's duty of good faith, from making a claim for amounts beyond those set out in the SOV.

3. The values set out on the SOV or otherwise disclosed in connection with the policy may constitute a misrepresentation.

It is worth noting under scenarios 1 and 2 the result is just as if the policy contained a margins clause.

Only two Canadian cases have specifically considered these issues in connection with values set out on the Statement of Values. Both are British Columbia cases: *Barnet Properties Ltd. v. Commonwealth Insurance Co.*, [1996] B.C.J. No. 2657, 32 B.C.L.R. (3d) 39 (S.C.), and *Bell Pole Co. Ltd. v. Commonwealth Insurance Company et al.*, [2000] B.C.J. No. 720, 19 C.C.L.I. (3d) 13 (B.C.S.C.), affirmed, 10 B.C.L.R. (4th) 90. Discussion of the sub-limit and good faith issues is largely restricted to those cases. Discussion of the misrepresentation issue refers to those cases, as well as certain other decisions.

The cases show that, even in the absence of a margins clause courts will generally restrict the insured to recovery of values disclosed, where the insured is aware of the omission or under-valuation of property set out on the SOV. The primary difference where there has been knowing under-valuation or omission, between the situation with and without the margins clause, is the time and expense involved in getting to the proper result.

SCENARIO 1; SOV AS SETTING SUB-LIMITS AND/OR RESTRICTIONS ON COVER

The key case here is *Barnet Properties Ltd. v. Commonwealth Insurance Co., supra*. In *Barnet* the policy in question was an "all risks" policy on blanket wording, with a "stated amount" co-insurance clause. Each annual renewal of the policy was accompanied by a statement of values. There was no wording in the policy tying the cover to the statement of values.

The insured was carrying out a construction project. While the construction project could potentially have been covered under the all-risks policy, the insured made a decision (to save premium) to take out insurance for the project by having itself added as an additional insured under the general contractor's builders risk policy. Accordingly, no value was disclosed on the SOV filed under the all-risks policy for the property on which the project was being constructed. Due to an error, the project was not added to the contractor's policy as had been intended.

Following a collapse of the property under construction the insured made a claim under the all-risks policy. Insurers denied the claim on the grounds that the property in issue had not been disclosed on the SOV. The insured argued that the omission had been inadvertent, and that it had been the intention to cover the project under the property policy. The trial judge, Justice Braidwood, rejected that argument and rejected the evidence tendered in support of it. Justice Braidwood found that the insured had intentionally omitted the project from the all-risks policy SOV as the insured did not wish to insure the project under that policy.

The insured also argued that, regardless of its subjective intention, there was cover. The policy was on blanket wording, insuring "all property" of the insured, without any limitation dependent on or reference to the statement of values. Accordingly, regardless of the insured's subjective intention prior to the loss regarding cover for the property in question, the property was covered.

Justice Braidwood rejected that argument. Justice Braidwood said, at para. 103:

> I do not suggest in this analysis to go so far as to say that property which was overlooked at the time of filing a statement of values would not be covered. I need not go that far in this case. It is sufficient to say that the parties may decide and agree that some items will not be covered.

Justice Braidwood referred to several cases on interpretation of policy language, including *Consolidated Bathurst Export Ltd. v. Mutual Boiler & Machinery Insurance Co.*, [1979] S.C.J. No. 133, 112 D.L.R. (3d) 49 (S.C.C.) and *Scott D. Wawanessa Mutual Insurance Co.* (1989), 59 D.L.R. 460, as well as a line of marine insurance cases permitting evidence of the subjective intention of owners which had the effect of restricting those entitled to take the benefit of the broad words of the policy. In light of those cases the fact that the policy was on blanket wording and the fact that there was no specific connection between the SOV and the policy was not a barrier to limiting cover. The court found that the phrase in the policy "property of every description ... must be interpreted to mean property of every description intended to be insured" (para. 100).

Thus, even in the absence of a margins clause, and even where the policy is on blanket wording, cover will be restricted to those items on the SOV, to the extent that any items of property have been omitted from the SOV knowingly.

There are, however, restrictions on the ability of the SOV to restrict cover in this way. Where property is entirely omitted from the SOV, *Barnet* is clear authority for the proposition that there is no cover. Where the property is disclosed but at an inadequate value, the "sub-limit" approach may not be available, though the effect may be the same. This is the issue considered in *Bell Pole*.

SCENARIO 2; THE DUTY OF GOOD FAITH AS RESTRICTING THE CLAIM TO SOV VALUES

In *Bell Pole* the Court considered blanket "all risks" and "all property" policy wording virtually identical to that in issue in *Barnet*. The insured, "Bell" was in the business of manufacturing telephone poles. This involved treating the poles with chemical preservatives. Bell operated out of various locations in Western Canada and the U.S. For many years all of those locations had been insured under a subscription policy, renewed annually, with annual statements of values. The statements of values (quoted in the reasons for judgment of the Court of Appeal) insofar as they referred to Bell's key Carseland, Alberta location, were as follows:

BELL POLE CO. LIMITED
JANUARY 1995

Based on Insurance Appraisal Worksheet (May 1990 Valuation);
4 per cent Increase in January 1992 on Buildings/Equipment

	Replacement Cost		
Carseland, B.C.	Construction	Equipment	
Office	$ 313,825.	$ 91,605.	
General Plant		259,220.	
Millright Store	31,934.	5,476.	
Oil Pump House	749.	3,328.	
Propane Shed	640.	2,600.	
Storage Shed	1,456.		
Wire Shed	2,808.	1,092.	
Peeler	34,285.	231,038.	
Shavings Bin		29,640.	
Boiler House	38,736.	111,037.	
Butt Tank		244,774.	
CCA Plant	440,266.	558,873.	
Fixation Chamber		292,004.	
Full Length		457,138.	
Pentachlorophenol	6,987.		
Tank Farm		317,669.	
	$ 871,686.	$ 2,605,494.	
Logs and Poles			$1,000,000.
Profits			$7,325,000.

. . . [reference to other locations]…

Logs and Poles	$500,000
Bylaws	250,000
Extra Expense	200,000

The only limit set out expressly in the wording (apart from some irrelevant sub-limits for matters such as debris removal) was a $7 million-per-occurrence limit.

One of the assets disclosed on the SOV was the “full length tank” at Carseland, valued at $450,000. This was the primary tank in which poles were treated. In 1995 there was a fire in the tank and it was destroyed. At the time of the fire the tank was obsolete and an environmental liability to Bell. Following the fire, Bell replaced the tank with a “state-of-the-art” pole treating facility at a cost of $5 million. Bell claimed the entire cost of that facility under the policy. It was agreed that a direct replacement for the former tank would have cost $450,000 (the amount set out on the SOV as direct replacement cost). Bell claimed the balance of the cost of the new facility on the basis that the environmental regulator would not have permitted a direct replacement, so that the increased cost of the new facility was covered under the policy’s bylaw provision.

Insurers pointed out that Bell had disclosed only $250,000 of bylaw exposure on the SOV, about 5 per cent of the bylaw cover claimed, and denied cover for the upgrades. Insurers argued that Bell had disclosed $250,000 in bylaw cover knowing that its bylaw exposure was greater, because Bell intended to obtain and pay premium on only limited bylaw cover. In other words, insurers argued Bell intended the SOV essentially to create unwritten sub-limits (insurers also argued that Bell’s disclosure of only $250,000 in bylaw cover was, in the circumstances, a misrepresentation, an issue considered below).

Bell argued that the disclosure on the SOV was irrelevant. Because the policy was written on a blanket basis, with no sub-limits, and without tying cover specifically to the SOV, the SOV could not limit cover. So long as there was no fraud in the disclosure on the SOV (which it was admitted would void cover) Bell was entitled to full cover, up to the $7 million limit. Bell argued that it either had an honest belief that its bylaw exposure was $250,000, or that it had an honest belief that $250,000 was the only cover available. In other words, on the second branch, Bell argued that, even if it was found to have knowledge of a greater bylaw exposure, there was no need to disclose values that were beyond the coverage it mistakenly assumed was the highest available.

The trial judge, Justice Pitfield, dismissed Bell’s claims, essentially on a variation of the reasoning in *Barnet*. Justice Pitfield found that Bell had knowledge that its bylaw exposure was substantially more than $250,000, and rejected Bell’s evidence that it believed that was the maximum limits to which bylaw cover was available. Justice Pitfield found that Bell intended the $250,000 disclosure on the SOV essentially to act as a sub-limit with respect to bylaw cover. This was a unilateral intention, never communicated to insurers. Nonetheless, and notwithstanding lack of any express sub-limits in the policy, Pitfield J. found that the SOV created sub-limits, at least in terms of the bylaw cover. Accordingly, Pitfield J. limited Bell’s recovery to the $450,000 for direct replacement of the destroyed treating tank, plus $250,000 on account of increased cost to comply with current environmental regulations. This was an eminently sensible decision. Essentially, Pitfield J. provided the insured with precisely the amount of cover it had intended to receive and on which it had paid premium.

Bell appealed. The result at trial, was upheld, but for different reasons. The Court of Appeal rejected Pitfield J.’s conclusion that the policy could be interpreted to set out “unwritten” sub-limits. The Court distinguished *Barnet* on the grounds that it had involved property which was omitted altogether from the SOV. *Bell Pole,* on the other hand, involved property that was on the SOV, but was on at an under-valuation. The complete omission of the property from the SOV in *Barnet* allowed the court to get to the correct result simply by interpreting the words “property of every description” to mean “property of every description intended to be insured”. In *Bell Pole* however, this avenue of reasoning was not available. The property was on the SOV, and was intended to be insured. The issue was whether creation of unwritten sub-limits could be reconciled with the policy’s $7-million-per-occurrence limit. The Court held that it could not. Essentially, the Court concluded that to interpret the policy as creating unwritten sub-limits for property disclosed on the SOV would involve, not interpretation of existing policy language, but the creation of an entirely new clause. This could not be done in the absence of rectification. Rectification was not available because Bell’s intention to obtain limited bylaw cover was entirely unilateral. Insurers knew nothing of it.[4]

That however, was not the end of the matter. The Court of Appeal then went on to consider application of the doctrine of good faith. On this point the Court essentially found that, because Bell had disclosed $250,000 in bylaw cover with knowledge that this was not its full exposure, it would be a breach of Bell’s duty of good faith, in the event of a loss, to seek cover beyond the $250,000. As Bell was not entitled to make a claim which would involve breach of its duty of good faith, Bell’s cover was limited accordingly. The decision that Bell was entitled to bylaw cover limited to the $250,000 disclosed on the SOV was upheld.

The effect of *Barnet* and *Bell Pole* is that any omission or under-valuation of property on the SOV, known to the insured, will essentially act to create unwritten sub-limits or restrictions on cover. Where property is omitted altogether, this result is achieved directly, on the basis of the reasoning in *Barnet.* Where the property is on the SOV, but at an under-valuation, this result is achieved indirectly, through application of the doctrine of good faith. Of course, if insurers were aware of the omission or under-valuation, rectification would also be available.

The issue left unresolved by *Barnet* and *Bell Pole* is the effect of a mistaken omission or under-valuation. Where there is a pure clerical error or oversight resulting in the omission or under-valuation of property on the SOV, cover would presumably not be affected. That is certainly the result in a not entirely dissimilar context, mistaken under-reporting of values in stock reporting policies. A series of cases on those policies, including *Leepo Machine Products Ltd. v. Western Assurance Co. et al.*, [1972] S.C.J. No. 83, 31 D.L.R. (3d) 224 (SCC), make it clear that a clerical error in declaration of property to be insured does not affect cover. But the situation is not so clear in the case of other types of mistake. *Barnet,* of course, involved a "mistake" of one type in that the insured believed that it would be covered under another policy and so did not disclose the values for the purposes of the all-risks policy in issue. The key issue, and one that may well arise in the future (in a policy without a margins clause) is the effect of a property valuation that is mistaken, not through pure clerical error, but through a poor estimate of, say, replacement cost of the properties insured. The result in such a case remains to be seen. Certainly, application of the doctrine of good faith would potentially limit cover in such a case, if there was any negligence or "fault" on the part of the insured in connection with the under-valuation; *i.e.*, if the insured (at least without the knowledge of the insurer) set values for the SOV without taking reasonable and proper steps to determine the correctness of those values.

SCENARIO 3; VALUES AS A MISREPRESENTATION

The other way in which values on the SOV are relevant to cover is if those values amount to a misrepresentation. There is very little law on the question of whether values set out on the SOV can amount to a misrepresentation on the grounds that values are under-declared.[5]

In *Bell Pole* the Court also had to consider whether the intentional under-statement on the SOV amounted to a misrepresentation, so as to void cover with respect to the property in issue. The policy wording included a misrepresentation condition which was a variation on the wording of the fire statutory condition, and which provided that cover would be void where there was an "intentional" false description of the property to be insured or fraudulent omission to communicate material circumstances. Insurers did not assert fraud, but did assert that there had been an intentional false description of the property to be insured by way of intentional under-valuation of the bylaw exposure set out on the SOV.

The trial judge found that there was no intentional misrepresentation, because Bell's intention, at the time the policy was taken out, was to obtain only limited bylaw cover. In other words, the misrepresentation would only be "intentional" if the insured made limited disclosure, and intended, at the time of that disclosure, to obtain unlimited cover.

There is a recent British Columbia case that should be noted in the context of the issue of under-valuation as misrepresentation. The case is *Wells v. Canadian Northern Shield Insurance Co. et al.*, [2007] B.C.J. No. 2714, 2007 BCSC 1844. That case did not involve a statement of values, but did involve an allegation of misrepresentation (or potentially non-disclosure) regarding values. The insured had an extensive wine collection. The insured applied, through a broker, for household insurance, with contents cover of \$1.5 million. The insured's estimate of the value of the collection was \$10 million.[6] While the insurer had some knowledge that the insured had a wine collection, there was no disclosure to insurers of its value. The policy contained a misrepresentation condition (para. 30) which voided cover where there was a false description of the property to be insured, a misrepresentation of a material circumstance or a fraudulent omission to communicate a material circumstance (Reasons, para. 30). This was arguably a broader misrepresentation provision than that considered in *Bell Pole*, in that there was no requirement that there be an "intentional" misrepresentation.

The insurer argued that the application for \$1.5 million of total contents cover, in circumstances in which the insured was aware that the wine collection alone was worth approximately \$10 million, amounted to a misrepresentation. The Court rejected that argument. The Court found that, at least in the circumstances of that case, the insured was free to deliberately under-insure, with no disclosure to the insurer of that fact (paras. 48 to 51). Essentially, the Court held that it was not material to insurers whether the insured was insuring for full value, or for only a fraction of value. In support of that conclusion the Court referred to the policy's "flex limit" which provided that, while contents were insured to a limit of \$1.5 million, if there was a contents loss alone (without a building loss), the entire limits for both building and contents (\$2.3 million) would be available to pay the contents loss.

Wells highlights a question that did not have to be addressed in *Barnet* or *Bell Pole*, and that is not entirely answered by inclusion of a margins clause. In both *Barnet* and *Bell Pole* insurers were prepared to permit the insured to use the SOV to limit cover to an amount below actual values. Essentially, insurers on those policies were prepared to accept under-insurance. In fact, in both cases, insurers knew that the insured was using the SOV to create informal sub-limits of one kind or another on certain categories of property. But that will not always be the case. It is clear from *Wells* that, if the insurer is not prepared to permit the insured to unilaterally under-insure, whether by applying for sub-limits lower than actual value or disclosing property at an under-valuation, express language in the policy, the application, or the SOV will be necessary to achieve that result. For example, in *Wells*, had there been an SOV filed, stating a value for the wine collection of $1.5 million (the desired "sub-limit") and had the policy or the SOV contained some fairly standard SOV language (confirming, for example, that the SOV values were 90 per cent of actual values) the result may have been different.

COVERAGE ISSUES ARISING OUT OF THE MARGINS CLAUSE

In this section I consider some issues that arise in connection with interpretation and application of the margins clause. As there have been no cases in Canada, this analysis is based largely on U.S. case law, with some analysis as to how those cases may be applied in Canada.

1. HOW IS THE SUB-LIMIT CALCULATED; BY REFERENCE TO INDIVIDUAL ITEMS OR BY REFERENCE TO THE TOTAL LOCATION VALUES?

This is probably the most significant issue addressed in the U.S. cases, in terms of the practical effect on application of the margins clause. The typical SOV will set out several values applicable to each location. These will often include building values, equipment values, BI, bylaw exposure and possibly other exposures depending on the particular policy. Does the margins clause impose a single sub-limit per location, consisting of the total of the various amounts referred to for the items at that location, or a separate sub-limit for each specific item?

In other words, assume the SOV sets out, for a particular location, the following:

Buildings	$1,000,000
Equipment	$1,000,000
Business Interruption	$1,000,000
Total	**$3,000,000**

Then assume that, following a loss, it turns out that buildings were inadvertently under-valued, and replacement cost is actually $2 million, but that there is no loss of equipment and no business interruption loss. Can the insured recover the full $2 million replacement cost for the building or only the $1 million set out on the SOV? Replacement cost is double the specific value attributed to the building on the SOV, but the claim is still less than the total values for the location. To put it another way, can the insured apply the 'unused' equipment and BI cover to the building, when it turns out that values disclosed for the building were too low.

There are two lines of authority in the U.S. Some cases have held that, so long as there is a margins clause and an SOV, the cover is specific to the individual items set out on the SOV (not to total location values). On those cases, on the example above, the insured would recover only $1 million. Those cases have largely approached this question by determining whether the effect of the margins clause is to convert the cover from blanket to scheduled or specific.[7] So, for example, in *Anderson Mattress Company Inc. v. First State Insurance Company*, 617 N.E. 2d 932, 1993 Ind. App. LEXIS 848, the policy included a margins clause on wording which defined the limits in terms of "total stated value of the property involved". The Court found that the policy, which would otherwise be a blanket policy, was a scheduled policy by virtue of the margins clause, and that the cover was therefore limited to the individual items. The Court said (Q.L. p. 8):

> Immediately below this clause [4 the limits clause] is a table listing the individual pieces of property comprising the business. One of the columns was capped with the heading "Limits of Liability" and contained monetary values for each piece of real property, for the contents of each piece of property, and for the cost of business interruption attributable to the loss of each piece of property. Viewed in light of *Vernon* and *Bratton*, these portions of the policy extend specific coverage because they clearly establish limits of liability for each specific piece of property comprising the business instead of a single limit liability for the business as a whole.

Similarly, in *Reliance National Indemnity Co. v. Lexington Insurance Co.* (2002), U.S. Dist. LEXIS 20629 (U.S. D.C., Northern District of Illinois, Eastern Division), the policy was on "total stated values" wording, and the SOV was broken down into building, personal property, contractors' equipment, and other items. The Court said:

> Because the Lexington policy separately scheduled different items of property, it is a scheduled policy with specific limits for particular items and not a blanket coverage policy

Cover was restricted to the individual items, not to the total location values.

However, some cases have taken a different approach to this issue. In *Berkshire Refrigerated Warehousing LLC v. Commercial Underwriters Insurance Co.* 2006 U.S. Dist. LEXIS 19602 (N.D. Ill.) March 27, 2006, the clause was on the "total stated value for the property involved" wording. The Court held this wording to be "unclear", saying:

> Specifically, the "total stated value of the property involved" conceivably could refer to three different figures: the total location value for the ... warehouse ... the value of each category of property at that location ... or the total value of each category of property located at all of Berkshire's locations ... The phrasing in the occurrence limit that gives rise to the ambiguity is the use of the term "*total* stated value" a term that appears no where in the Statement of Values. The use of the word "total" suggests that the term contemplates reference to a sum of more than one "stated value," which leads one to the only "totals" listed in the Statement of Values – either the "total location value" at the end of each row or the "total" at the bottom of each column. At a minimum, the court cannot say that the "total stated value of the property involved" clearly or unambiguously refers to the category--by--category figures listed in each box or cell of the Statement of Values chart ..."

The Court then construed the policy in favour of coverage in light of this ambiguity, and held that the limit was the total location value, with the result that the total location value was available to pay a loss in any one of the categories of property at that location.

In *Core-Mark International Corp. v. Commonwealth Insurance Co.*, 2006 U.S. Dist. LEXIS 61338, the policy was on similar wording ("total stated values of the property involved"). The SOV broke down the property insured into individual locations, with the relevant location being further broken down into several categories of property (including leasehold improvements, warehouse equipment, stock, vehicles, business interruption and extra expense). The insured argued that the cases holding that the margins clause gave rise to a scheduled policy were not determinative, because, among other things, the SOVs here were submitted "to facilitate the calculation of a premium, not to establish a scheduled policy". The court referred to *Berkshire* and certain other cases, held that the reference to "total stated values" and the question of whether the policy was to be blanket or scheduled gave rise to an ambiguity, and on the basis of that ambiguity the court denied the insurer's summary judgment motion.

Thus, on margins clause wording referring to "total stated values of the property involved" there are cases which both support restricting the claim to the value of the specific item set out on the SOV, and cases (particularly *Berkshire*) which support permitting the insured to claim the total location values to a claim for any one category of property at that location.

There is another version of the margins clause wording in common use that refers not to "total stated values of the property involved" but to "100 per cent of the individually stated value of each scheduled item of property" or words to that effect. On that wording, it is clear that it is only the specific items of property, not the total location values that can be applied to the claim. One case on that wording is *Knowlton Specialty Papers Inc. v. Oil Surplus Lines Ins. Co.*, No. 03 Civ. 705 (N.D. N.Y. October 14, 2003). That case, and the 'individually stated values' wording, were referred to in *Berkshire* and *Core-Mark.*

2. Does the Limit Include Additional Coverages?

The issue here is whether the sub-limit (whether for the individual items insured or the total value insured at each location) includes the typical "additional coverages" associated with such items of property, including such matters as debris removal, bylaw cover, etc. If no separate limits are stated for those additional coverages on the SOV, the total claim is presumably capped at the value set out on the SOV (either location values or individual item values, depending on the result on issue 1). But where the SOV also sets out separate sub-limits for the additional coverages, are those amounts available in addition to the sub-limit for the property in question? In other words, say the SOV discloses $10 million for a particular building, and also discloses, as a separate item on the SOV, $1 million in bylaw exposure. In the event of a total loss of the building, $10 million direct replacement cost and a requirement to incur $2 million in bylaw costs, is the insured entitled to; (1) $ 10 million (on the basis that the building values include associated bylaw values); or (2) $11 million (on the basis that the building sub-limit does not include the associated bylaw cover).

This issue appears to have been considered in only one U.S. case, *First Centrum Corporation v. Landmark American Insurance Co.* 2007 U.S. App. LEXIS 14478

(U.S. C.A. – Fourth Circuit). In *Centrum* the policy insured a number of commercial properties. There was a loss at a Richmond, Virginia apartment complex. That complex was on the SOV at $3.4 million. The policy stated the sub-limit of $2.5 million for bylaw exposure. The insured argued that it was entitled to cover beyond the $3.4 million disclosed for the particular location on account of the bylaw cover and, specifically, for cover for cost of repair or replacement of undamaged property required to be replaced following a loss by operation of bylaws.

The insured argued that the sub-limit was not a sub-limit of the OLLE, but was a sub-limit of the overall limit of liability. The Court said, at p. 4:

> Contrary to this contention, the unambiguous language of the policy establishes that the Ordinance or Law limit is a sub-limit of the occurrence limit liability limit provided by the primary policy, not the total policy value.

The Court said that the clear intent of the contract was "to provide Ordinance or Law coverage as a sub-limit to the primary limit", "not an additional amount of insurance". In other words, the insured was entitled only to the $3.4 million. The $2.4 million could not be added to that amount.

Were a different result desired, this could obviously be achieved by appropriate language on the SOV.

3. Are all items set out on the SOV "property"?

The limit language in the clause refers to "property" or "items of property". An issue which could arise is whether the limit of liability applies to items such as debris removal and business interruption that appear on the SOV, but might arguably not constitute categories of "property". That issue was considered in *Knowlton*, *supra*, at the trial level. In *Knowlton* the latest SOV on file with insurers contained an entry for business interruption of $3 million. The insured argued, among other things, that its business interruption claim was not limited, by the OLLE/margins clause to the $3 million set out on the SOV, as BI was not an item of "property". The Court rejected that argument. Essentially, the Court found, all of the amounts set out on the SOV had to be treated as items of property for the purposes of calculating the available limits.

4. What is the effect of a mistaken valuation?

One issue that has not been considered in any of the U.S. cases, but which may well arise, is the effect of a mistaken valuation on the SOV. In the absence of a margins clause the result here is uncertain, as referred to in Section 2. Where the policy includes a margins clause, the result should be clear. The amount set out on the SOV is a sub-limit, and the fact that there may have been an error in valuing the property is irrelevant to cover (except, of course, in the case of a clerical type error known to the insurer, and supporting rectification). However, the other terms of the policy must be kept in mind. Virtually all property policies contain an "errors and omissions" clause, under which the insured is "not to be prejudiced by any inadvertent error or omission" (or words to that effect). In a policy containing a margins clause, as the values on the SOV expressly become incorporated into the policy as sub-limits, there should be no ability to "correct" values after a loss. However, the specific wording of the E&O clause must be considered. Some E&O wordings refer not only to "errors and omissions" generally, but specifically to "mistaken valuations". That wording would leave open an argument that values are subject to correction, after a loss, even if there is a margins clause in the policy. If it is intended to preclude post-loss correction for mistaken under-valuation the E&O clause should likely not refer to "mistaken under-valuation" or should clarify that the E&O clause does not allow revision of sub-limits. This may well be the result in any event, but is not entirely clear.

Of course, there may be a desire to ameliorate the strictness of the margins clause by allowing the insured some scope to correct values in the event that it turns out that a particular value on the SOV was the result of a pure error or mistake. There is already a built in "margin" of 10 per cent or 20 per cent. But if even more flexibility is desired in the case of a true mistake, one means to permit this, but to keep the scope of any "correction" subject to some limit, is to create a separate sub-limit on application of the E&O clause itself. That sub-limit could, for example, limit application of the E&O clause to a maximum of 20 per cent of the disclosed value at a particular location, or limit application of the E&O clause to a specific dollar amount. Such provisions are not uncommon in policies without a margins clause.

5. Effect of a Premium Adjustment clause

Another issue that often arises in under-valuation situations, and is not entirely resolved by the margins clause, is potential application of the premium adjustment clause. The policy wording will often provide for filing of revised statements of values at policy expiry, with additional or return premium to be paid on those values. It should seem obvious that the insured cannot, by submitting post-loss revised values for property that has been subject to a loss during the course of the year and tendering additional premium, thereby increase the values retroactive to the date of loss, and so affect values that are the subject of the claim. However, if the insured tenders additional premium, and the additional premium is accepted by insurers without comment, and arguably with knowledge that the insured was intending to impact cover the issue becomes more difficult. There was just such an attempt to retroactively increase cover this way in *Bell Pole, supra*. The trial judge found that, on the facts of that case, the tendering and acceptance of additional premium did not increase cover.

[*Editor's note*: Gregory Tucker is a shareholder with Owen Bird LC in Vancouver and has a broad insurance practice, including coverage, subrogation and defence.]

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1 In referring to co-insurance "stated amount co-insurance" is not included, as it is not true co-insurance and is irrelevant to cover.

2 See for example, *Anderson Mattress Company Inc. v. First State Insurance Company*, 617 N.E. 2d 932, 1993 Ind. App. LEXIS 848; *Reliance National Indemnity Company v. Lexington Insurance Company*, 2002 U.S. Dist. LEXIS 20629.

3 See for example, *Core-Mark International Corp. v. Commonwealth Insurance Co.* 2006, U.S. Dist. Lexis 61338; *Knowlton Specialty Papers Inc. v. Oil Surplus Lines Ins. Co.*, No. 03 Civ. 705 (N.D. N.Y.) October 14, 2003; *Berkshire Refrigerated Warehousing LLC v. Commercial Underwriters Insurance Co.* 2006, U.S. Dist. LEXIS 19602 (N.D. Ill.) March 27, 2006.

4 The parties had, over the years, actually discussed using the SOVs to create informal sub-limits for certain categories of property. The Court noted that, for those categories of property, had Bell made a claim in excess of the amount set out on the SOV, rectification would be available. But rectification was not available to add a term with respect to values which insurers did not know were under-disclosed.

5 There are a number of cases on marine policies considering the issue of values set out on the policy's schedule of values as a misrepresentation, but there, of course, with the policy being a valued policy, the issue is whether there has been a misrepresentation by way of over-valuation. The issue of under- valuation, as a misrepresentation, does not arise. Among the Canadian cases considering over-valuation as "speculative" and thus as a misrepresentation under a valued marine policy are *Fudge v. Charter Marine Insurance Co.*, [1992] N.J. No. 69, 8 C.C.L.I. (2d) 252 (Nfld. S.C.T.D.) and *Ultramar Canada Inc. v. The Mutual Marine Office Insurance* [1994] F.C.J. No. 1306

6 The insured did not testify, having passed away before trial. The $10 million valuation was referred to in a memorandum which did go into evidence. The judgment, while not referring specifically to the $10 million valuation, did refer to the collection being worth "several million dollars" (para. 48)

7 *Core-Mark International Corp. v. Commonwealth Insurance Co.*, 2006 U.S. Dist. LEXIS 61338; *Monumental Paving & Excavating, Inc. v. Pennsylvania Manufacturers' Association Insurance Company*, 176 F.3d 794, 1999 U.S. App. LEXIS 9362; *Fair Grounds Corp. v. Travelers Indemnity Company of Illinois*, 742 So. 2d 1069, 1999 La. App. LEXIS 2650; *Anderson Mattress Company, Inc. v. First State Insurance Company*, *supra*; *Berkshire Refrigerated Warehousing LLC v. Commercial Underwriters Insurance Company*, *supra*.

• CASE COMMENT ON THE *ANI-WALL* APPEAL DECISION *AXA INSURANCE (CANADA) v. ANI-WALL CONCRETE FORMING INC.*, [2008] O.J. No. 2843, 2008 ONCA 563 •

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Bad concrete was poured into the foundations of numerous homes in Eastern Ontario in the late 1980s and early 1990s, culminating in the Ontario Court of Appeal 2001 and 2002 decisions in *Alie v. Bertrand & Frère Construction Co.*, [2002] O.J. No. 4697. More recently, Ontario courts have been coping with approximately 60 lawsuits and third-party claims arising out of defective concrete supplied by Dominion Concrete in 2002 to homes throughout the Greater Toronto Area. On Friday, July 18, 2008 the Ontario Court of Appeal issued a significant decision in the Dominion Concrete litigation and held that there was coverage for the claims of the builders and owners against a forming contractor: *AXA Insurance (Canada) v. Ani-Wall Concrete Forming Inc.*, [2008] O.J. No. 2843, 2008 ONCA 563. The case will have a significant impact on the litigation and will also assist policyholders and consumers in other insurance claims.

In the spring, summer, and fall of 2002 Dominion Concrete sold what turned out to be defective concrete, to a number of concrete forming companies, which in turn formed the concrete into footings and foundations for dozens of residential buildings. The concrete, however, deteriorated prematurely and would not support the weight of the homes. The concrete had to be removed and replaced at considerable cost.

The Ontario Court of Appeal had previously heard two other cases arising out of the Dominion Concrete litigation. In *Bridgewood Building Corp. (Riverfield) v. Lombard General Insurance Co. of Canada (2006)*, [2006] O.J. No. 1288, 266 D.L.R. (4th) 182 (C.A.), the court held that two general contractors were covered under their own CGL policies for the cost of repairing the defective concrete. That case was precedential because the lower court held, for the first time in Canada, that statutory liability under Ontario's new home warranty legislation triggered CGL insurance coverage in the absence of a lawsuit. The Court of Appeal decision in the case was also significant as it ruled on the scope of broad-form CGL coverage and rejected a common defence used by insurers in construction defect claims. In *Mid-Park Construction (1995) Ltd. v. Conbora Forming Inc.*, [2006] O.J. No. 2018, 2006 CarswellOnt 3077 (C.A.), the Court upheld summary judgment motions by the builders against one of the forming contractors.

The most recent litigation arose out of a denial of insurance coverage by AXA Insurance (Canada) to its insured, Ani-Wall Concrete Forming Inc. Ani-Wall was one of the formers that had unknowingly formed the defective concrete supplied by Dominion Concrete, and was sued in a number of actions by the owners and builders. While AXA agreed to defend the claims against Ani-Wall, it refused to pay for the cost of removing or repairing the defective concrete.

AXA brought an application in the Superior Court on October 1, 2007 for a series of declarations to the effect that it had no obligation to indemnify Ani-Wall for the cost of removing or replacing the defective concrete. It relied on the "Your Work", "Your Product", and "Rip and Tear" exclusions in the policy. We acted for Ani-Wall and sued AXA to obtain coverage under the insurance policy. Justice Perell of the Ontario Superior Court agreed with Ani-Wall and held that none of the three exclusions applied.

AXA appealed, and the Court of Appeal upheld the decision on July 18, 2008. The two main issues on appeal were the scope of the "Your Work" and "Rip and Tear" exclusions. The "Your Work" exclusion applied to work performed by or on behalf of Ani-Wall, and included materials supplied in connection with such work. However, there was an exception for work performed by a "subcontractor". At issue was whether Dominion Concrete was a "subcontractor" of Ani-Wall, as argued by Ani-Wall, or whether it was merely a supplier and not a subcontractor, as argued by AXA.

Justice Moldaver of the Court of Appeal wrote the decision in *Ani-Wall*. He had also written the Court's decision in *Bridgewood* which dealt with the same subcontractor exception. He commented on the similarity of the two cases, but ultimately distinguished *Bridgewood*:

> *Bridgewood*, of course, is not a full answer. The application judge's reference to two of the American authorities cited by AXA on appeal indicates that he may have recognized this. Whether he did or not, it is worth clarifying that although the facts in *Bridgewood* bear many similarities to the facts of this case, including Dominion's involvement as the supplier of defective concrete, this court in *Bridgewood* did not address (nor was it asked to address) the issue of Dominion's status. Rather, the case was argued on the basis that the "Your Work" exclusion applied even if the defective work was attributable to a subcontractor employed by the insured. By contrast, this case raises four-square the issue of Dominion's status.

While no Canadian cases had previously set out a test for determining whether a party was a "subcontractor" within the meaning of the exception to the "Your Work" exclusion, there was a series of American cases on point. The American cases held that, to be a subcontractor, three elements had to be satisfied: (a) The product supplied should be custom made according to specifications identified in the prime contract; (b) The supplier should provide on-site installation or supervision services; and (c) The product supplied should form an integral or substantial part of the prime contract. AXA argued that these elements were not met and, accordingly, Dominion Concrete was not a "subcontractor".

In a significant decision, however, Moldaver J.A. declined to import the American criteria into Canadian law and stated that it was necessary to retain more flexibility when dealing with denials of coverage. He commented:

> ... I return to AXA's submission that this court should transpose into our law the three criteria identified in the American authorities . . . by which subcontractors are distinguished from mere suppliers. With respect, I would not do so. I come to this conclusion not because I reject the criteria outright or find

> them unhelpful in differentiating a subcontractor from a mere supplier for insurance purposes, but rather because I am reluctant to carve them in stone. Instead, I prefer to retain a degree of flexibility in the realm of insurance coverage, especially in cases like this, where coverage is acknowledged but the insurer seeks to rely on exclusionary provisions to limit its scope. As Ani-Wall points out, if insurers want to lay down hard and fast criteria, they can do so by defining the word "subcontractor" to their choosing. Insured persons who pay substantial premiums would then know where they stand and would not be left guessing about the extent of the coverage available to them. To date, for reasons unknown, AXA has chosen not to define the word "subcontractor" in the policy. Unless and until it does so, I believe the word should be construed broadly, lest it become a trap for the unwary.

Although Ani-Wall's contracts with the builders referred to the "supply" of concrete by Ani-Wall, they also stated that Ani-Wall reserved the right to "sublet" any part of the work to a reputable contractor. Moldaver J.A. commented:

> I think it can reasonably be said that Ani-Wall subcontracted to Dominion its contractual obligation to *supply* concrete to the builders. In doing so, it triggered the "subcontractor" exception to the "Your Work" exclusion. At the very least, AXA has not met its burden of showing otherwise. For that reason, it follows that the "Your Work" exclusion is ousted by the "subcontractor" exception.

He also held, in the alternative, that Dominion Concrete would have met the three criteria set out in the American cases.

With respect to the "Rip and Tear" exclusion, he agreed with Ani-Wall and the lower court that it was poorly drafted and unenforceable. Importantly, he confirmed that the Court will not rewrite incomprehensible exclusion clauses in favour of the insurer:

> AXA acknowledges that the "Rip and Tear" clause is badly drafted and that read literally, it is difficult to comprehend. AXA nonetheless urges a less-literal interpretation and submits that when the clause is read purposefully, its meaning is plain and obvious — AXA will not indemnify Ani-Wall for the cost of tearing down and removing the defective footings and foundation walls.
>
> AXA's proposed interpretation is not illogical. It presumably reflects the limitation on coverage that AXA sought to achieve. But AXA cannot get out from under the wording it chose to use, at least not without having this court rewrite the clause. That is not our function.
>
> I agree with Ani-Wall that in its present form, the clause is incomprehensible, a view that was shared by the application judge. As counsel for AXA fairly concedes, that is fatal to its applicability. AXA, of course, is at liberty to rewrite the clause in a manner that makes sense. It cannot, however, look to this court to correct the problem.

The appeal was dismissed, and the Court thereby confirmed that the claims against Ani-Wall were covered by the insurance policy.

The decision in *AXA v. Ani-Wall* is significant in a number of respects. It clarifies the scope of coverage for builders involved in construction defect litigation, and should help resolve the massive *Dominion Concrete* litigation. However, the decision will have a wider impact in favour of policyholders and consumers in their claims against insurers. Insurance is often written so that it is incomprehensible to someone who is not in the insurance industry. The Court held that such policies should not become a "trap for the unwary", and that policyholders should not be "left guessing" about the scope of their insurance coverage. If insurers want to be able to deny coverage successfully, they must use plain and clear language to do so.

[*Editor's note:* Tom Donnelly, Catherine Clark and Bruce A. Thomas of Thomas Gold Pettingill LLP represented Ani-Wall. Tom and Catherine had also represented Bridgewood in the *Bridgewood v. Lombard* case.]