

Interpreting an All Risks Property Policy: How Deranged must the circumstances be for the “Derangement” Exclusion to Apply?

HUGHES AMYS^{LLP}
BARRISTERS & SOLICITORS

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by Michael Teitelbaum

In *Caneast Foods Limited v. Lombard General Insurance Company of Canada*, 2008 ONCA 368, the Ontario Court of Appeal recently grappled with the meaning of “derangement” in an exclusion of an all risks property policy, and found that the facts were not sufficiently deranged for the exclusion to apply. As a result, the Court dismissed the insurer’s appeal and held that the insured, a pickle manufacturer, was entitled to coverage for spoilage of its pickles arising from the regional power blackout on August 14th, 2003 during which the supply of electricity to Caneast’s refrigeration equipment was interrupted for 27 hours.

At first instance, the motion judge, Justice Brown, ruled that the “change of temperature” and “mechanical or electrical breakdown or derangement” exclusion clauses did not apply. The appeal turned on the narrow ground that Brown J. erred in his interpretation of “derangement”.

The “mechanical breakdown or derangement” and

“temperature” exclusions provided that the policy “does not insure against loss or damage caused directly or indirectly . . . 4) by centrifugal force, mechanical or electrical breakdown or derangement in or on the premises . . .” or “5) by dampness or dryness of atmosphere, changes of temperature, freezing (except with respect to insured water pipes), heating, shrinkage, [etc.] . . . but this exclusion does not apply to loss or damage caused directly by a peril insured and not otherwise excluded under this form . . .”.

Justice Brown referred to two earlier Court of Appeal decisions that dealt with the August 2003 power blackout: *Fresh Taste Produce Ltd. v. Sovereign General Insurance Co.* (2005), 27 C.C.L.I. (4th) 7 and 94325 *Ontario Inc. v. Commonwealth Insurance Co.* (2006), 81 O.R. (3d) 399.

In *Fresh Taste*, the Court of Appeal upheld the motion judge’s decision there was no coverage because of the two aforementioned, identically worded, exclusions, but did so on the basis of the “temperature” exclusion,

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without specifically addressing the applicability of the “mechanical breakdown and derangement exclusion”.

The Court of Appeal in *Commonwealth* upheld the application judge’s finding that the blackout was the proximate cause of the loss. Insofar as the “temperature” exclusion was concerned, the Court distinguished *Fresh Taste* because the exclusion in *Commonwealth* had the additional wording providing that the exclusion does not apply to “loss or damage caused directly by a peril otherwise insured and not otherwise excluded under this section”. There, the loss was caused by the power outage, “a peril otherwise insured”, which was not “otherwise excluded” under the Section.

Given the *Commonwealth* case, Lombard’s counsel conceded no arguments could be made on proximate cause or the “temperature” exclusion, and relied on the “mechanical breakdown and derangement” exclusion.

The Court, (Borins J.A., speaking for a three-member panel which also included Rosenberg and Epstein J.J.A.), found that the motion judge applied the proper principles of interpret-

ing an insurance contract in construing the “mechanical breakdown and derangement” exclusion, and arrived at the correct result.¹

Before embarking on its analysis, the Court briefly summarized those principles at paragraph 23 of its Reasons, as follows:

The insurance policy is a contract. The ordinary rules applicable to the interpretation of contracts apply. The wording of the insurance contract must be given its plain and ordinary meaning. The insurer has received consideration for the coverage of stipulated risks. The promised coverage creates reasonable expectations on the part of the insured. If a loss falls within the ambit of the risks covered, the insurer must indemnify the insured for its loss, subject to the application of any exclusion clause. Coverage clauses should be construed broadly and exclusion clauses, narrowly. Since insurance policies are essentially adhesionary, the standard practice is to construe ambiguities against the insurer.

At paragraph 24, Borins J.A. agreed with Brown J. that both “breakdown” and “derangement” refer to an “internal problem or defect in a machine, and not to the machine’s failure to operate due to an interruption to its power supply caused by a regional blackout”. He continued:

Caneast’s refrigeration did not stop because of some internal defect; it stopped because the power to it was cut off. Moreover, I agree with the motion judge that had Lombard intended to exclude blackouts from the perils covered by the policy, it would have been a simple matter to do so.

In addressing the meaning of “derangement”, various dictionary definitions were cited to the Court. Borins J.A. noted that the motion judge correctly observed that the phrase “mechanical or electrical derangement in or on the premises” has received little judicial consideration. His Honour continued at paragraphs 25-26:

... “Derangement” is an odd word to be used in an exclusion clause in an insurance policy. It is generally used in respect

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1. In so doing, the Court stated that the decision of *Leo DeLuca Enterprises Inc. v. Lombard General Insurance Co. of Canada*, [2008] O.J. No. 1230 (S.C.J.), released three weeks before this appeal was argued, was incorrectly decided. Patterson J. relied on the same exclusion clauses to find no coverage was available in another August 2003 blackout case, disagreeing with Brown J.’s decision in this case, and finding that “the derangement exclusion will apply regardless of the cause, internal or external”. Borins J.A. stated: “Patterson J. erred in his interpretation of the derangement exclusion in holding, in effect, that a machine dependent on electricity that ‘operates’ as expected when the electricity is cut off is deranged. A further problem with DeLuca is that the motion judge appeared to find that the temperature exclusion also applied. It is unclear from his reasons whether he was referred to this court’s decision in *Commonwealth*.”

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to mental health and is synonymous for the impairment of bodily function. This is confirmed by a Quicklaw search of about 500 Canadian, American and English cases in which the word "derangement" is found. In virtually all of the cases, the word was used in respect to mental health or bodily function. Indeed, the only instances in which "deranged" is considered are those referred to in these reasons.

Both Caneast and Lombard relied on the same dictionary definition of "derange" - "to disturb the normal state, working, operation or functioning of." However, each party differed on the application of the definition to the power out-

age. In essence, Lombard's position was that there is a derangement if the power supply is not functioning properly. This is probably correct, and accords with the definition of "derangement". However, that is not what happened here. As the trial [sic] judge held, the electrical supply was not disturbed by the blackout. There was no electrical supply to be disturbed; because of the blackout there was no electrical supply. What happened was more than a disturbance of the electrical supply to Caneast's refrigeration equipment. There was no electrical supply, and, as a result, the refrigeration equipment failed to operate. It follows that the motion judge did not err in giving "derangement" its

plain and ordinary meaning and in finding that the electrical derangement exclusion did not apply.

Thus, the Court appears to find that if the power supply to the insured's location had ceased to function, it would have been deranged, and the exclusion would have apparently applied.² However, as there was no disturbance of the power supply, but rather a complete absence of electrical power, there was no "electrical . . . derangement . . . in or on the premises", and the exclusion was not engaged.

Ultimately, as this case demonstrates, even an unusual term can be interpreted, and if it is not precise enough to address the facts at hand, given it is part of an exclusion which must be interpreted narrowly, it will not be sufficient to avoid coverage.

Mustapha v. Culligan; Foreseeability and Ordinary Fortitude

by Richard F. Horak

Now that the furor over the Supreme Court of Canada's landmark decision in the "fly in the bottle" case, it is time to consider the significance of this decision. While we can expect the decision to be debated at length for years to come in law

schools across the country, its application in the courts may well be very limited.

The Supreme Court of Canada had no difficulty in concluding that the Defendant owed the Plaintiff a duty of care, that the Defendant's behaviour had breached the standard of care

and that the Plaintiff had sustained damages. However, the Plaintiff failed to establish that his damages were caused in law by the Defendant's negligence, as the damages were too remote to allow recovery.

In determining whether a harm

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2. Notwithstanding its earlier comment that the reference to derangement is to an internal problem or defect in a machine.

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was reasonably foreseeable, the Supreme Court of Canada made it clear that "possibility" was insufficient. An objective standard must be applied; the question is "what a person of ordinary fortitude would suffer ... unusual or extreme reactions to events caused by negligence are imaginable but not reasonably foreseeable".

No evidence was called at the trial by the Plaintiff to show that it was foreseeable that a

person of ordinary fortitude who saw flies in a bottle of water would suffer serious injury. Rather, the trial judge had applied a subjective standard, focusing on the individual Plaintiff. As a result, the Plaintiff's claim was dismissed.

The Supreme Court of Canada made it clear that, once a Plaintiff had passed this "threshold test" the Defendant must take the Plaintiff as it finds him for the purposes of damages. The "thin-skulled

Plaintiff" doctrine still exists.

As a practical matter, we question how many Plaintiffs will fail to satisfy the threshold test enunciated by the Supreme Court of Canada. It is only the most extreme and unusual situations which will likely fail to surpass this preliminary hurdle; while a new bar has been set, it is at such a low height that most Plaintiffs will overcome this with ease.

FIRM NEWS

We are pleased to announce that Vanessa Tanner will join the firm as of July 14. Vanessa was called to the bar in 2002 and has been practicing in the insurance field since then; she will continue her practice out of our Toronto office.

Jamie Trimble recently acted as the co-chair at an Ontario Bar Association Seminar entitled "The Jury Trial and You II: Unwrapping the Enigma."

TORONTO

48 YONGE STREET
SUITE 200
TORONTO, ONTARIO
M5E 1G6

TELEPHONE (416) 367-1608
TOLL-FREE (800) 565-1713
FACSIMILE (416) 367-8821

HUGHES AMYS^{LLP}

BARRISTERS & SOLICITORS

www.hughesamys.com

HAMILTON

25 MAIN STREET WEST
SUITE 2100
HAMILTON, ONTARIO
L8P 1H1

TELEPHONE (905) 577-4050
TOLL-FREE (877) 858-8234
FACSIMILE (905) 577-6301