What's guaranteed – and what isn't: The Supreme Court of Canada draws the line on GRC coverage in Emond v. Trillium Mutual Insurance

February 25, 2026

Overview

In its recent decision in *Emond v. Trillium Mutual Insurance*, the Supreme Court of Canada held that a homeowner's policy did not cover added costs to comply with conservation authority requirements in rebuilding a home following a loss, notwithstanding that the policy included a Guaranteed Rebuilding Cost endorsement.

The decision offers clarification on the scope and limitations of Guaranteed Rebuilding Cost (GRC) coverage specifically, while also providing further direction on how the Court approaches policy interpretation generally. The 7–1-1 decision reinforces the structured approach to insurance contract interpretation outlined in *Ledcor*, with the Court clarifying that **endorsements are interpreted within the policy as a whole**, **identifying when language in an insurance contract is ambiguous**, and **explaining when the nullification of coverage doctrine would justify a departure from language that is unambiguous**. The two dissents highlight tensions between principles of policy interpretation, with a focus on the reasonable expectations of insureds.

Background and procedural history

The litigation arose after the insureds' home suffered a total loss due to flooding.

Their homeowner policy had an exclusion for the increased costs of repair or replacement due to any law regulating the zoning, demolition, repair, or construction of buildings, except as provided for under the Additional Coverages. One of the Additional Coverage exceptions stated that the insurer would pay up to $10,000 for increased costs to comply with zoning and construction-related laws.

The policy also included a GRC endorsement, extending the amount payable under the policy beyond the limit stated on the declaration page in circumstances where the insureds repair or replace the damaged or destroyed home at the same location with materials of similar quality using current building techniques.

When the local conservation authority required upgrades during reconstruction, the insurer declined to cover the compliance costs, citing the exclusion for increased costs arising from compliance with by-laws or building codes. The insureds argued that the GRC endorsement expanded coverage sufficiently to override the exclusion.

The application judge found in favour of the insureds, but the Court of Appeal allowed the insurer's appeal. The matter proceeded to the Supreme Court of Canada, which upheld the Court of Appeal's decision.

The majority's decision

Justice Rowe, writing for the majority, reaffirmed the *Ledcor* three-stage framework for policy interpretation:

1. The insured bears the onus of establishing that the loss falls within the coverage grant. Aspects of the endorsement that affect coverage are considered as part of the coverage conferred by the insurance contract.
2. The insurer bears the onus of establishing that an exclusion or limitation applies.
3. The insured bears the onus of establishing an exception to the exclusion.

Building on *Progressive Homes* and *Sabean*, the decision also reiterates that the assessment of ambiguity is a threshold issue. Where the language of the insurance contract is unambiguous, effect should be given to that clear language, reading the contract as a whole. Interpretive tools should only be resorted to where the language is ambiguous. Ambiguity arises where there are multiple reasonable but different interpretations of the policy. In the face of ambiguity, the court cannot rely on the language alone and instead must move to the second stage – employing rules of contract interpretation to resolve the ambiguity, including:

1. the interpretation should be consistent with the reasonable expectations of the parties;
2. it should not give rise to results that are unrealistic or that the parties would not have contemplated in the commercial atmosphere in which the insurance contract was formed; and
3. it should be consistent with the interpretations of similar insurance policies.

If ambiguity still remains after the two first stages, the court must employ the *contra proferentem* rule, construing the provision against the drafter (insurer) and in favour of the insured.

Applying this approach, the majority held that the homeowners' property policy did not cover the insureds' increased costs of rebuilding their home in compliance with conservation authority requirements beyond the $10,000 in Additional Coverage. While the loss fell within the grant of coverage, the increased costs were ousted by the exclusion for by-law compliance costs, which was clear and unambiguous. Unlike the

dissenting reasons, the majority did not find that the language of the compliance cost exclusion injected a temporal dimension into the provision. Further, the GRC endorsement did not override the exclusion. The GRC endorsement simply amended the basis of claim payment by increasing the amount payable under the policy beyond the stated limit. The exclusions in the policy continued to apply, which was confirmed by language in the GRC endorsement, stating that in all other respects the policy provisions and limits of liability remained unchanged.

In addition to the oft-cited principles of policy interpretation, the Court also addressed the principle of nullification of coverage. The homeowners argued that applying the compliance cost exclusion would virtually nullify the coverage provided by the GRC endorsement. Courts in Ontario have accepted that a policy provision should not be applied to the extent it would completely defeat the very objective of having purchased the relevant coverage and render it nugatory.

The insurer disagreed, arguing that the noncompliance cost exclusion may limit what can be recovered under the GRC endorsement, but the endorsement still conferred a benefit such that it was not rendered nugatory. The Majority agreed with the insurer. The high bar to show nullification was not met and the compliance cost exclusion applied, despite the GRC endorsement.

Dissenting reasons

Karakatsanis J. agreed with the majority regarding the framework of the analysis but disagreed on its application to the facts. She found ambiguity in the interaction between the GRC endorsement and the compliance cost exclusion, noting that the insureds reasonably understood that the guaranteed rebuilding endorsement covered all compliance costs except increased costs to comply with laws that arose after they paid their premium and the insurer issued their policy. Both the insured and insurer interpretations were reasonable on the face of the contract, and the principles of policy interpretation were necessary to resolve the ambiguity. The principles of “reasonable expectations” and interpretation in light of “commercial realities” favoured the insureds. If ambiguity persisted beyond that stage of the analysis, the coverage provisions ought to be construed broadly and the exclusion clauses narrowing, meaning that the compliance cost exclusion only operated to exclude increased costs arising from laws enacted after the issuance of the policy.

Côté J. authored a second dissent, agreeing with the framework set out by the majority, but departing from the majority’s finding that the compliance cost exclusion applied to limit the GRC endorsement. Her Honour noted that such endorsements are intended to provide peace of mind and reasonably led the insureds to expect full coverage for all necessary rebuilding expenses after a total loss. In this case, the GRC endorsement was textually unclear and the compliance cost exclusion was structurally unclear. In the face of these ambiguities, Côté J. concluded, “the reasonable expectations of the insureds were that they were purchasing precisely what the GRC endorsement was labelled as: a guarantee that [the insurer] would pay for the cost of rebuilding their home.” Côté J. would allow the appeal in part, set aside the judgment of the Court of Appeal, and restore the application judge’s declaration – with the alteration that the coverage did not include increased costs resulting from the operation of any rule, regulation, by-law, or ordinance, not in effect at the time that the insurance policy was last renewed.

Conclusion

The Supreme Court's decision reinforces the structured approach to policy interpretation – with the majority and two dissents converging on the approach and diverging on its application. The majority's decision sharpens the boundaries of Guaranteed Rebuilding Cost coverage and highlights that endorsements must not be read in isolation, while the two strong dissents make clear that tensions may nevertheless arise between insurer and insured interpretations, with clarity being found through consideration of the parties reasonable expectations and the commercial realities but only after a threshold determination that ambiguity exists.

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