Ontario Court of Appeal addresses available insurance coverage and additional insured

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In *Sky Clean Energy Ltd. v. Economical Mutual Insurance Company*, 2020 ONCA 558, the Ontario Court of Appeal (the Court) discussed the availability of insurance coverage to an additional insured. The appeal concerned the interpretation of a common insurance term that requires liability to "arise out of the operations" of a named insured. The Court considered the requisite connection between the contractor's operations and the additional insured's liability. The Court upheld the traditional limits to the term "arising out of the operations," requiring more than a "but for" analysis in order to establish the connection between the liability of the additional insured and the operations of the named insured. In the context of this case, it was not enough that the contractor had installed the equipment at issue.

Background

The project owner (the Owner) was a developer of solar energy projects and the contractor was an electrical contracting company. The Owner entered into contracts with the contractor to install a solar power system that the Owner designed, using equipment selected and sourced by the Owner. The Owner contracted with equipment suppliers to provide the main components of the system, including the inverter and transformer. It was the contractor's responsibility to install the components.

Before beginning to install the first transformer, the contractor discovered that the transformer delivered by the Owner's supplier did not conform to the Owner's design specifications. Due to time restrictions, the Owner asked the contractor to help source new transformers. The contractor's supplier located a transformer manufactured by a third party. It was the Owner's decision to accept the third party transformer, and the contractor was not asked to provide an opinion on the suitability of the transformer. Upon completing the first project, representatives of both the Owner and contractor observed an anomaly in the power flow and recommended shutting down and investigating the system. The Owner's representative decided to leave the system energized for "observation" and the Owner formally took control of the facility.

Three days later, the transformer overheated and caught fire.

After investigating the fire, the Owner determined that the third party transformer was suitable for the projects, as long as a technical adjustment was made to one of the connections. The Owner approved the change and authorized the contractor to proceed with the installation at the second site (and replace the transformer at the first site). Soon after, a fire broke out at the second project site and the transformer destroyed. As a result, both systems were shut down temporarily and replacement transformers installed. The Owner paid for the remediation and lost revenue of just under $600,000.

The Owner commenced various proceedings against the insurer (under which it was an additional insured), the contractor and the manufacturer of the transformer.

The contract

Under the contract between the Owner and the contractor, the contractor agreed to indemnify the Owner against the contractor's failure to perform its contractual obligations and for its negligent acts. The contractor also agreed to name the Owner as an insured under its Commercial General Liability insurance policy with its insurer, but only with respect to liability arising out of its operations.

The interpretation of "arising out of"

In interpreting the policy language "arising out of," the Court reiterated that courts consistently interpret language such as "arising out of" or "arising from" as requiring more than a "but for" connection between the liability of the additional insured and the operations of the named insured. There must be an "unbroken chain of causation" and a connection that is more than "merely incidental or fortuitous."

The interpretation of "operations"

The Court also considered the meaning of "operations," which was said to include "the creation of a situation, or circumstance, that is connected in some way to the alleged liability." It does not necessarily imply an "active" role by the named insured in the creation of the liability.

Findings of the Court of Appeal

The Court agreed with the trial judge and found that the contractor's connection with the failure of the transformer was "merely incidental." The trial judge found that the failure of the transformer caused the fire. Though the fire would not have occurred "but for" the fact that the contractor ordered and installed the transformers in the course of its operations under the contracts, the contractor's "operations" under the contract did not require it to select the transformers to be installed in the projects. That was up to the Owner.

Takeaway

Consideration as to the underlying obligations between the parties necessarily informed the Court's decision in this case. While the Court rejected the argument that the

language of the contract between the Owner and the contractor should affect the interpretation of policy of insurance (other than to explain the commercial context), central to the Court's decision was that the contractor was not responsible to choose the transformer. The Court noted that the Additional Insured Endorsement provided insurance with respect to the liability arising out of the "operations" of the named insured. The contractual obligations, including the scope of work, therefore formed part of the inquiry.

The Court upheld the traditional limits to the term "arising out of the operations," requiring more than a "but for" analysis in order to establish the connection between the liability of the additional insured and the operations of the named insured. Despite the finding that the failed transformer caused the fire, the transformer was chosen by the Owner and thus it was not enough that the contractor installed the equipment at issue.

By

Laura M. Day, Kevin McGivney

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BLG Offices

Calgary
Centennial Place, East Tower
520 3rd Avenue S.W.
Calgary, AB, Canada
T2P 0R3

T 403.232.9500
F 403.266.1395

Ottawa
World Exchange Plaza
100 Queen Street
Ottawa, ON, Canada
K1P 1J9

T 613.237.5160
F 613.230.8842

Vancouver
1200 Waterfront Centre
200 Burrard Street
Vancouver, BC, Canada
V7X 1T2

T 604.687.5744
F 604.687.1415

Montréal
1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4

T 514.954.2555
F 514.879.9015

Toronto
Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3

T 416.367.6000
F 416.367.6749

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