COURT OF APPEAL FOR ONTARIO

CITATION: James Dick Construction Limited v. Courtice Auto Wreckers Limited, 2024 ONCA 476
DATE: 20240614
DOCKET: C70794

Tulloch C.J.O., Lauwers and Miller JJ.A.

BETWEEN

James Dick Construction Limited and
Mara Limestone Aggregates Ltd.

Plaintiffs (Appellants/
Respondents by way of cross-appeal)

and

Courtice Auto Wreckers Limited* and
Courtice Industries Inc., Navis Pack and Ship,
David Norman Corneil, Nancy Anne Corneil and Flav Inc.

Defendants (Respondent*/
Appellant by way of cross-appeal*)

Jason Squire, Robert Bell and Rebecca Shoom, for the appellants/respondents by way of cross-appeal

David A. Zuber and James B. Tausendfreund, for the respondent/appellant by way of cross-appeal

Heard: September 14, 2023

On appeal from the judgment of Justice Carole J. Brown of the Superior Court of Justice, dated May 16, 2022, with reasons reported at 2022 ONSC 1611.

B.W. Miller J.A.:

OVERVIEW

[1] The respondent, Courtice Auto Wreckers Limited ("CAW"), leased two buildings from the appellant, James Dick Construction Limited ("JDC"), which it used to store newsprint for recycling. The larger of the two buildings was dome shaped, and the smaller building had an A-frame structure. Under the terms of the lease, the tenant CAW covenanted to insure the contents of the buildings and the landlord JDC covenanted to insure the buildings themselves. CAW also covenanted to pay the expenses required to maintain and repair the buildings' sprinkler systems. There is a dispute as to whether CAW additionally covenanted to undertake the maintenance of the sprinkler systems.

[2] The sprinkler system was old and prone to leaks. Although the leaks did not prevent the system from functioning, they were a problem for the newsprint stored in the buildings. In July 2009, when the sprinkler system again sprang a leak, CAW employees turned off the system while attempting repairs, and left it off in order to protect the newsprint inventory from water damage. A few days later, a fire broke out. Although the fire department was on scene within minutes of the fire being detected, the fire destroyed one building and damaged the other.

[3] JDC brought an action against CAW for breaching the lease by failing to maintain the sprinkler system. It sought damages for the cost of rebuilding the destroyed and damaged buildings. The trial judge dismissed the action.

She concluded that the lease allocated the risk of fire damage to the landlord JDC, and that the tenant CAW had not violated the terms of the lease.

[4] For the reasons that follow, I would dismiss the appeal.

THE TERMS OF THE LEASE

[5] CAW first entered into a lease for the buildings in 1995. It ceased leasing the buildings two years later, and then entered into a new lease in 2006.

[6] The terms of the two leases were nearly identical. Both contained a covenant to repair:

> All buildings are leased in *an as is condition* and the lessee has inspected [the] same and is satisfied that they are suitable for intended use. Minor repairs (i.e. Over-head doors on 6000 sq. ft. warehouse) are to be for the account of the lessee. Where major repairs or modifications are required both parties will meet and resolve, to their mutual satisfaction, as to who pays for what.

[7] The 2006 lease made a significant change to the covenant to repair, adding the following text:

> <u>The exception will be the maintenance of the dry fire system which shall be maintained and repaired at the Lessee[’s] expense</u>. Estimated costs for repair of the fire system are $3,000.00 for the 54,000.00 square foot building and $9,000.00 for the 42,000 square foot building. Heat must be maintained in the sprinkler rooms at all times.(Emphasis added.)

[8] Both leases contained the same insurance clause:

> The Lessor of the facility will at all times, for the life of this agreement, maintain general property insurance sufficient to cover the replacement costs of the buildings in the event of loss. The Lessee will at all times, for the life of this agreement, maintain warehousing and contents insurance in amounts sufficient to cover the value of stored product in the event of a loss. Both parties agree to maintain a minimum of $5,000,000.00 liability insurance and to name each other co-insured.

THE DRY FIRE SPRINKLER SYSTEM

[9] In November 2006, CAW made repairs to the sprinkler systems of both buildings. Each building had a separate “dry fire” sprinkler system. In a dry fire sprinkler system, the pipes leading to the sprinkler heads are filled with compressed air. The compressed air holds back the water from the municipal water supply. Heat generated from a fire causes a plug in the sprinkler head to burst, releasing the compressed air and, if the valves are open, allowing the water to flow through the pipes and out through the sprinkler heads.

[10] In July 2009, a pinhole leak developed in the sprinkler system in the dome shaped building. CAW’s evidence was that it asked JDC to repair the leak, but did not receive an answer. The leak did not impair the operation of the sprinkler system, but the leaking water would have damaged the newsprint inventory. CAW employees closed the water valve that controlled the flow of water to the sprinkler heads and attempted to repair the leak. They were unsuccessful. They did not re-open the water valve, and locked the door to the sprinkler room where the water valves were located. CAW did not notify the fire department that it had disabled

the sprinkler system, which it was statutorily obligated to do. A few days later, a fire broke out in the dome shaped building, destroying it and damaging the A-frame building. The cause of the fire is unknown.

[11] The tenant CAW maintained sufficient insurance for its stored inventory. The landlord JDC maintained general property insurance in the amount of $700,000 for the dome building and $100,000 for the A-frame building. This was not sufficient to cover the replacement costs of the structures, which remain unrepaired.

[12] JDC sued CAW for damages for breach of contract. The action was dismissed.

THE REASONS BELOW

[13] The trial judge addressed four questions: whether the action was barred by JDC's covenant to insure; whether CAW breached the lease; whether CAW's actions caused the damage; and if so, what the measure of damages should be.

[14] There was a dispute at trial as to the interpretation of the lease's covenant to repair, particularly with respect to the maintenance of the dry fire sprinkler system. JDC's position was that the tenant CAW was responsible both for maintaining the system and paying for repairs. CAW's position was that it was only responsible to pay for the repairs.

[15] CAW took the position that the landlord JDC was contractually obligated to insure the buildings for the benefit of CAW and that, as a beneficiary of the insurance policy, JDC and the insurer were both precluded from seeking recovery from CAW for insured losses: *Madison Developments Ltd. v. Plan Electric Co*. (1997), 36 O.R. (3d) 80 (C.A.), at p. 84, leave to appeal refused, [1997] S.C.C.A. No. 659.

[16] The trial judge recited the general principles as follows:

> The effect of the covenant to insure is ultimately a matter of contractual interpretation that will be sensitive to the particular language of the agreement and the surrounding circumstances. In general, a covenant to insure will represent an intention by the parties to allocate the risk of the peril insured against to the covenantor. It is recognized that this is a presumption that may be rebutted by evidence of some other intention. [Citations omitted.]

[17] She summarized the relevant case law with the conclusion that "[w]hile the presence of a covenant to insure is not an absolute bar to claims by the covenantor against the covenantee, the covenant does have presumptive effect unless the covenantor is able to establish something specific that displaces it."

[18] The trial judge reasoned from principles established in *Eaton Company v. Smith et al.*, [1978] 2 S.C.R. 749, and other cases, that where a landlord covenants with a tenant that the landlord will insure the leased premises, the covenant is intended for the tenant's benefit, absent evidence of some contrary intention.

[19] Accordingly, the trial judge noted expressly that notwithstanding a covenant to insure, “parties may allocate risk differently through other terms of the agreement.” She found that the tenant’s covenant to repair the sprinkler system in the 2006 lease did not allocate the risk of loss by fire to the tenant. That risk remained with the landlord as a result of the landlord’s covenant to insure the buildings against loss by fire:

> In conclusion, the lease, when read as a whole, provides that the plaintiffs’ covenant to insure the buildings allocated to them the risk of loss, which would include loss by fire, the risk that ultimately materialized.
>
> …
>
> In my view, the proper interpretation of the repair provisions of the 2006 lease is that the defendants assumed responsibility for the cost of maintenance and repairs to the sprinkler system, but not responsibility for the consequences of a failure to maintain the sprinkler system, as urged by the plaintiffs. Previous decisions have rejected the argument that a repair provision alters the allocation of risk expressed by the covenant to insure. Accordingly, I find that the obligation on the defendants to assume responsibility for the expense related to the maintenance and repairs of the sprinkler system, contained in the lease, does not create an exception to the overall allocation of risk of loss of the buildings evinced by the covenant to insure.

[20] Having found that the covenant to insure barred the landlord JDC from bringing an action against the tenant CAW, and that this was dispositive of the action, the trial judge nevertheless addressed the subsequent issues. She held that the obligation to maintain the dry fire sprinkler system was allocated by the

contract to the landlord JDC and not the tenant CAW, and that CAW therefore did not breach the contract by failing to maintain the system. She further held that on the evidence before her she was unable to conclude that the damage was caused by the actions or omissions of CAW, and specifically was unable to conclude that the loss would not have occurred had the sprinkler system been operational. The trial judge also provided an assessment of the damages that would have been owed had JDC been successful. She then dismissed the action.

ISSUES ON APPEAL

[21] The landlord JDC raises the following issues on appeal:

1. The trial judge erred in interpreting the contract by failing to apply the correct authority;
2. The trial judge erred in failing to apply the proper principles of causation; and,
3. The trial judge erred by failing to apply the correct legal test for assessing damages.

[22] The tenant CAW cross-appealed on the basis that the trial judge erred in not deducting $800,000 from the assessment of damages, being the sum that the appellants received under its policy of insurance.

ANALYSIS

(1) Standard of Review

[23] At issue in this appeal is whether the trial judge adopted the correct legal test to interpret the landlord JDC's covenant to insure the leased buildings. Additionally, the covenant to insure is drafted using language that is standard form in commercial tenancy agreements. Accordingly, the review of the trial judge's interpretation of the clause comes within the *Sattva Capital Corp. v. Creston Moly Corp*., 2014 SCC 53, [2014] 2 S.C.R. 633, exception, making that issue reviewable on a standard of correctness: *Royal Host GP Inc. v. 1842259 Ontario Ltd.*, 2018 ONCA 467, 422 D.L.R. (4th) 661, at paras. 12-13, leave to appeal refused, [2018] S.C.C.A. No. 316. If the trial judge adopted the correct test, then her application of it to these facts is a question of mixed fact and law that is reviewed using the standard of palpable and overriding error: *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co*., 2016 SCC 37, [2016] 2 S.C.R. 23, at para. 21.

(2) Interpreting the contract - the covenant to insure

[24] Contractual interpretation is a matter of ascertaining the rights and obligations the parties agreed to undertake. In understanding what parties intended when including a covenant to insure in a lease agreement, as with any contractual covenant, "it is necessary to discern the intentions of the parties in accordance with the language they have agreed to in the contract": *Royal Host*, at

para. 16; *Sanofi Pasteur Limited v. UPS SCS, Inc.*, 2015 ONCA 88, 124 O.R. (3d) 81, at para. 48, leave to appeal refused, [2015] S.C.C.A. No. 152.

[25] Reflecting on more than 50 years of jurisprudence interpreting covenants to insure, this court noted in *Capital Sewer Servicing Inc. v. Crosslinx Transit Solutions Constructors*, 2022 ONCA 10, 30 C.L.R. (5th) 249, at para. 26, that "[i]n many, if not most circumstances, a promise to insure against a certain risk will lead to the logical conclusion that the party undertaking to insure against the risk had agreed to be responsible for any damages should the risk ensue." But "that inference can only properly be drawn after a reading of the contract as a whole in the factual context of the particular circumstances": *Crosslinx*, at para. 26. This court repeated the holding from *Royal Host*, that "there is no legal rule that a party's covenant to insure against a risk must mean it was intended that the party undertaking to insure assumed the risk of the harm insured against": *Crosslinx*, at para. 26, citing *Royal Host*, at para. 16.

[26] In this case, alongside a survey of the relevant Supreme Court jurisprudence interpreting the effect of covenants to insure, the trial judge quoted a passage from *Madison Developments*, at p. 84, that stated in part that "[a] contractual undertaking by the one party to secure property insurance operates in effect as an assumption by that party of the risk of loss or damage caused by the peril to be insured against." Drawing from this passage, the trial judge concluded that: "[w]hile the presence of a covenant to insure is not an absolute bar to claims by the

covenantor against the covenantee, the covenant does have presumptive effect unless the covenantor is able to establish something specific that displaces it."

[27] The focal point of the appellants' argument is that *Crosslinx*, which had not been decided at the time of trial, constitutes a change in the law respecting the meaning of covenants to insure, a change which has flowed from more general developments in the law of contractual interpretation from cases such as *Sattva*. The appellants argue that the trial judge erred by treating the existence of the covenant to insure like a 'decoder ring' that translates that obligation directly to an obligation to assume the risk of the peril insured against, without any further consideration of what the other textual provisions of the agreement or contextual circumstances may have to say about the matter.

[28] The appellants argue that the trial judge, in effect, stopped reasoning once she read the covenant to insure, and then placed an onus on the landlord to disprove that the intention of the parties was that the landlord carry the risk of loss by fire. What the trial judge ought to have done, the appellants argue, is read the agreement as a whole – relating all of the relevant clauses to each other – along with the surrounding circumstances, and only then come to a conclusion about how the parties agreed to allocate risk.

[29] I do not agree that the trial judge made the error complained of. The trial judge framed the analysis of the "the effect of the covenant to insure" as "ultimately

a matter of contractual interpretation that will be sensitive to the particular language of the agreement and the surrounding circumstances." The appellants agree with this statement of the law. The trial judge continued: "[i]n general, a covenant to insure will represent an intention by the parties to allocate the risk of the peril insured against to the covenantor." Again, this is unobjectionable. It describes what parties to this type of contract usually intend to accomplish when they use this type of clause. Finally, the trial judge noted that "[i]t is recognized that this is a presumption that may be rebutted by evidence of some other intention", a statement drawing on *Deslaurier Custom Cabinets Inc. v. 1728106 Ontario Inc*., 2016 ONCA 246, 130 O.R. (3d) 418*,* and stated:

> While the presence of a covenant to insure is not an absolute bar to claims by the covenantor against the covenantee, the covenant does have presumptive effect unless the covenantor is able to establish something specific that displaces it.

[30] There is reason to avoid the language of presumption used by the trial judge; although this language has been used by this court in several decisions, including *Deslaurier*, it carries a connotation of an exclusionary rule that is not intended. But what is genuinely at issue in this appeal is not the terminology used in the case law but the reasoning process of the trial judge. When one attends to the 12 paragraphs the trial judge devotes to the interpretation of the clause in the context of the agreement as a whole, it is abundantly clear that the trial judge was not approaching the interpretation of the contract as though she were applying an

exclusionary rule. She was attentive to the text of the clause, the broader text of the contract as a whole, and the factual context in which the agreement was made. Her focus throughout was on ascertaining what agreement the parties actually reached. To be sure, she treated the covenant to insure as a significant datum in ascertaining how the parties had allocated risk between themselves, which it was. She did not, however, treat it as determinative in isolation from the rest of the contract and therefore did not apply an incorrect principle.

[31] Any substantive difference between what the trial judge – following Cronk J.A. in *Deslaurier* – refers to as a presumptive interpretation, and what Doherty J.A. refers to in *Crosslinx* as "the logical conclusion" of the choice to include a covenant to insure would have to be exceedingly subtle. Neither embrace what *Crosslinx* was at pains to reject: that there is a rule of law that a covenant to insure indefeasibly allocates risk.

[32] The live issue, then, is not so much that the trial judge made an extricable error of law, which she did not, but whether she made an error in how she applied the law to the facts. That question is assessed using the standard of palpable and overriding error.

[33] The appellants argue that the trial judge erred in concluding that the landlord JDC agreed to bear the risk of loss of fire given that: the respondent tenant CAW had an obligation to heat the premises; CAW undertook to maintain the fire

suppression system; CAW did not notify JDC that it was shutting off the fire suppression system; JDC covenanted to pay for the maintenance of the fire suppression system; and the parties agreed to indemnify each other from third party suits.

[34] Some of these submissions – such as that the tenant CAW undertook to maintain the fire suppression system – contradict findings of the trial judge that are supported in the record. Others relate to provisions of the contract that the trial judge canvassed and that she concluded did not displace the inference that the agreement allocated risk of fire to the landlord JDC. It is not the role of this court on a question of mixed fact and law to redo factual findings and findings applying the facts to the law. I would reject the submission that the trial judge made a reviewable error in her interpretation of the agreement.

[35] It is accordingly not necessary to address the remaining issues of causation and the appeal and cross-appeal on damages.

DISPOSITION

[36] I would dismiss the appeal. The respondent is entitled to costs of the appeal in the amount of $20,000, inclusive of HST and disbursements, as agreed between the parties.

Released: June 14, 2024 “M.T.”

“B.W. Miller J.A.”
“I agree. M. Tulloch C.J.O.”
“I agree. P. Lauwers J.A.”