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Liability limited by covenant

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The Court of Appeal for Ontario's Feb. 9 decision in *Sanofi Pasteur Ltd. v. UPS SCS Inc.* [2015] O.J. No. 577 affirmed that a covenant to insure will operate as a transfer of risk, and that non-contracting parties can be protected by this transfer, despite the lack of privity. The case also marks the continued "culture shift" contemplated by *Hryniak*, as interpretation of the complex insurance contract was held to be a suitable issue for summary judgment.

The *Sanofi* case centred on a covenant to insure the full value of the appellant's vaccines stored at a warehouse owned by the defendant, UPS. The warehouse's cooling system failed, rendering over $8 million worth of vaccines unsaleable. Sanofi recovered in full from its insurer, which subrogated the claim and sued UPS in negligence, as well as other defendants, including the manufacturer and installer of the cooling system.

The task of the court was to determine to what extent Sanofi had contractually assumed all risks of damage to the vaccines by signing the covenant to insure. On whether this issue was appropriately determined on summary judgment, the Court of Appeal agreed with the motion judge that the "full factual matrix" of a trial was not necessary in order to determine the intentions of the parties and the meaning of the insurance covenant.

The circumstances of the loss of the vaccines would not have been known to the parties at the time of contracting, and therefore were not part of the "factual matrix." Interpretation of the insurance covenant hinged almost entirely on the language of the agreement itself, which could properly be dealt with on a summary judgment motion.

In addition to the court's affirmation that summary judgment was appropriate, the *Sanofi* case is important for two substantive findings. First, the court held that a covenant to insure may operate as a transfer of risks to the party contracting to secure insurance, although the provision limiting UPS's liability for negligence to $100,000 also had to be considered.

Interpreting these provisions together, the court held that the covenant to insure the full value of the vaccines did not preclude $100,000 in recovery from UPS and the other defendants, but that the covenant barred liability for all claims in excess of the $100,000 liability cap. In other words, UPS could be liable in negligence up to $100,000, but was protected by the covenant to insure thereafter.

Second, the court held that the other defendants, including the manufacturer and installer of the warehouse's cooling system, were entitled to rely on the insurance covenant to limit their liability, despite not being parties to the contract.

Applying the privity of contract exception in *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.* [1999] S.C.J. No. 48, the court noted that the third-party defendants were all engaged in the manufacture, installation or maintenance of the warehouse's cooling system, which was the very reason for the storage contract and the activities contemplated by the insurance covenant.

Further, by covenanting to obtain an all-risk policy, Sanofi must have intended to assume the risk of the other defendants, as the assumption of risk contemplated by the covenant would otherwise be rendered meaningless. A finding of liability against the other defendants would leave them exposed to the entire amount of the claim by virtue of joint liability. And, as UPS was protected by the insurance covenant and limitation of liability clause, the other defendants could not claim contribution from UPS, the much larger public company. In these circumstances, the covenant to insure would operate to protect the non-parties.

The *Sanofi* litigation continues to develop following the defendants' success at the Court of Appeal. In *USP Supply Chain Solutions Inc. v. Airon HVAC Service Ltd.* [2015] O.J. No. 1360, Justice Wendy Matheson considered whether the other defendants have a duty to defend and indemnify the main defendant in the matter.

In interpreting the service contracts between UPS and the other defendants, Justice Matheson held that the standard for service contracts were to be interpreted based on the principles in *Sattva*: they were to be read by their plain language in context, with consideration given to the surrounding circumstances.

Notably, courts in Alberta take a different approach to the interpretation of certain standard form contracts, including insurance agreements. In *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.* [2015] A.J. No. 338, the Alberta Court of Appeal distinguished *Sattva* in cases interpreting a contract of adhesion, holding that where the terms of the contract were boilerplate and never negotiated, consideration of the surrounding circumstances is a mere legal fiction. The court in *Ledcor* held that priority should be given to commercial certainty by interpreting standard form insurance clauses consistently across multiple judgments.

It remains to be seen how these two competing approaches to interpretation of insurance contracts will be reconciled.

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