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# GETTING AROUND THE PRINCIPLE OF IMMUNITY

We think it is time to return to our regularly scheduled programming and write about Lease Law, without everything having to be COVID related all the time.

Years ago (in 1975 and 1977), the Supreme Court of Canada ruled that a tenant could rely on its landlord's insurance policy in certain circumstances. Many a lawyer has tried to help their landlord clients to "contract out" of the law laid down by those cases, often referred to as the "Trilogy". The wording necessary to avoid the legal principle (called the "principle of immunity") was not clear. However, the recent Ontario Court of Appeal decision, *Royal Host Limited Partnership (General partner of) v. 1842259 Ontario Ltd.* clarified how to contract out of the principle of immunity – a relief to long-baffled landlords.

The principle of immunity is based on two fundamental concepts:

1) the landlord's covenant in a lease to insure the premises represents a contractual benefit for the tenant; and

2) if the tenant pays for the insurance coverage, it should get the benefit of it.

Thus, even if the tenant negligently causes damage, the landlord's insurance will respond. The Trilogy involved similar fact patterns: leases that included covenants by the landlord to insure the building, and damage or destruction to the building caused by the tenant's negligence. The landlord or the landlord's insurer sought to recover the cost of replacing or repairing the building from the tenant.

In the first case, *Cummer-Yonge Investments Ltd. v. Agnew-Surpass Shoe Stores Ltd.*, the Supreme Court made clear that, when examining liability, the determining factor is not the terms of the insurance policy, but rather, the terms of the lease. In *Cummer-Yonge* and in subsequent cases, courts have clearly held that results flow based on the contractual terms, not as a matter of insurance law.

In the second case, *Ross Southward Tire Ltd. v. Pyrotech Products Ltd.*, the Supreme Court held that the risk of loss by fire passed to the landlord upon the tenant's payment of the landlord's insurance premiums. The majority of the Supreme Court of Canada determined that the tenant's payment of the insurance premiums amounted to an implicit agreement between the landlord and the tenant that the insurance proceeds would cover the risk of loss.

In the final case, *T. Eaton Co. v. Smith*, the Supreme Court of Canada set out the principle of immunity with finality: "An insurer could not refuse to pay a claim for loss by fire merely because the fire arose from the insured's negligence. I can see no reason why its position can be any better against a tenant, whose negligence caused loss by fire, if the lease with the landlord makes it clear that a policy was to be taken out by the landlord to cover such fires, and a policy is written which does so".

Subsequently, several court decisions held that parties could contract out of the principle of immunity. For example, the Alberta Queen Bench in *Alberta Importers and Distributors (1993) Inc. v. Phoenix Marble Ltd.* made the following statement: "There is strong authority that where a lease contains an express covenant requiring a landlord to obtain insurance, the tenant is protected against subrogation *unless a contrary explanation can be found in the lease*".

And yet, a number of cases held that the parties had not included sufficient language in the lease to contract out of the principle. It was evident from the rulings that parties should be allowed to contract out of the principle of immunity, but the precise language required to achieve this end was elusive.

*Royal Host* has provided a clear answer.

In *Royal Host*, the tenant leased restaurant premises. A kitchen fire caused damage to the building. The lease obligated the landlord to take out fire insurance, to which the tenant contributed premiums through operating costs. The insurer

indemnified the landlord and brought a claim against the tenant through its right of subrogation, as the tenant had caused the loss. The tenant sought to avoid the insurer's claim by relying on the Trilogy.

Relying on the Trilogy, the Ontario Court General Division rejected the insurer's claim. It held that when a landlord covenants to obtain insurance for fire damage, the landlord is barred from recovering losses from its tenant absent clear, express, or unambiguous language in the lease stating otherwise.

The Ontario Court of Appeal found that the lower court judge erred in interpreting the lease and applying the Trilogy. It held that the lease contained clear and unambiguous language to rebut the principle of immunity.

The Ontario Court of Appeal pointed to the following provision in the landlord's insurance clause:

"Notwithstanding the Landlord's covenant contained in this Section 7.02, and notwithstanding any contribution by the Tenant to the cost of any policies of insurance carried by the Landlord, the Tenant expressly acknowledges and agrees that:

(i) the Tenant is not relieved of any liability arising from or contributed to by its acts, fault, negligence or omissions, and

(ii) no insurance interest is conferred upon the Tenant, under any policies of insurance carried by the Landlord, and

(iii) the Tenant has no right to receive any proceeds of any policies of insurance carried by the Landlord."

The Court held that this particular language was sufficient to allow the landlord's insurer to bring a claim against the tenant and in doing so, finally brought clarity to the precise language required to contract out of the principle of immunity.

Based on the Ontario Court of Appeal's decision in *Royal Host*, it seems that parties must take direct aim at the two elements of the principle of immunity in order to successfully contract out of the Trilogy. The wording used must point at the landlord's covenant to insure and the tenant's contribution to the cost, and explicitly override their implications. *Royal Host* gives landlords and tenants the tools required to draft effective insurance provisions and to determine whether the principle of immunity and the decisions of the Supreme Court of Canada in the Trilogy, will apply to their leases.

## *ANNOUNCEMENT*

***Daoust Vukovich LLP is pleased to announce that Dennis Daoust has been selected, by his peers, as a 15th edition Best Lawyers in Canada Lawyer of the Year for his work in Commercial Leasing Law in Toronto. Only a single lawyer in a specific area and location is so honoured. We congratulate Dennis for this well-deserved recognition.***

*Congratulations also go to* ***Francine Baker-Sigal, Dennis Daoust, Gasper Galati, S. Ronald Haber, Wolfgang Kaufmann, Melissa McBain, Jamie Paquin, Natalie Vukovich and Deborah Watkins****, who were selected by their peers for inclusion in the 15th edition of "Best Lawyers in Canada".*





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