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Supreme Court of Canada: Exclusion Clauses Should Not Nullify the Benefit of Insurance

In *Emond v Trillium Mutual Insurance Co*, the Supreme Court of Canada confirmed that exclusion clauses should not be applied in a way that would nullify the insurance coverage purchased, even when the provision's language is unambiguous.

The decision makes clear that insurers cannot offer coverage in one part of a policy only to negate it through exclusions elsewhere, even if the exclusion language is unambiguous. Exclusion clauses may operate to limit or reduce coverage, so long as the exclusion does not entirely nullify the benefit the policy provides.

The Interpretation of Insurance Contracts

The three-step process for courts interpreting insurance contracts is well-settled:

1. Courts must give effect to unambiguous language.
2. If the contract contains ambiguous language, courts must resolve the ambiguity using the rules of contractual interpretation, including determining the reasonable expectations of the parties and considering commercial realities.
3. If ambiguity remains, it must be resolved in favour of the insured, interpreting coverage provisions broadly and exclusion clauses narrowly.

The Nullification of Coverage Doctrine

The nullification of coverage doctrine prevents insurance contracts from being interpreted in a way that would defeat the coverage provided and the very objective of the insurance contract.

Emond addresses how this doctrine should fit into the established three-step process for interpreting insurance contracts:

- On one side of the debate, the Emonds argued the doctrine is a freestanding rule that applies regardless of the clarity of the policy language. Insurers cannot be allowed to sell insurance products that are rendered valueless by exclusions buried elsewhere in the policy.

- On the other side, Trillium argued the doctrine should apply only where there is ambiguity in the contract, and that an insurer may both offer coverage and eliminate that coverage, so long as it uses unambiguous language.

The Court agreed with the Emonds, holding that the nullification of coverage doctrine applies even when the language in the exclusion clause is unambiguous. An exclusion “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 Court Splits on the Result in This Case

This case concerned a home insurance policy which included additional “Guaranteed Rebuilding Cost Coverage” (the GRC endorsement). At the same time, the policy excluded from coverage the increased costs of compliance with legal requirements, save for \$10,000 for increased costs to comply with certain regulations.

Following a flood that severely damaged their home, the Emonds claimed the GRC endorsement entitled them to full rebuild costs of their home, including costs of compliance with building requirements imposed by the local conservation authority. They argued that the exclusion for increased costs of compliance with legal requirements did not apply as this would nullify the purchased coverage.

Majority: Nullification of Coverage Doctrine Does Not Apply

The majority of the Court held that while the nullification doctrine could apply even in the absence of ambiguity, it did not apply here. The exclusion language was clear in excluding recovery of increased compliance costs beyond the \$10,000 exception. It operated to reduce the costs recoverable, but it did not nullify the benefit of the GRC endorsement, which provided additional recovery over and above the base policy.

Dissent: Ambiguity Should Be Resolved in the Emonds’ Favour

In dissent, Justice Karakatsanis found that, while the exclusion applied, it was ambiguous as to whether it excluded increased costs of compliance before the policy’s issuance, and this ambiguity should have been resolved in favour of the Emonds (such that the exclusion clause excluded only those legal compliance costs that arose after the policy’s issuance).

Writing separately in dissent, Justice Côté found that the policy and GRC endorsement were “replete with unclear language” regarding whether the exclusion applied to the GRC

endorsement, and that this ambiguity should be resolved in the Emonds' favour (to require Trillium to cover increased costs with compliance with legal requirements).

Key Takeaways

- **Exclusion clauses cannot nullify coverage.** Where an insurance policy provides coverage, the policy cannot completely eliminate that coverage through an exclusion clause, even if the language doing so is unambiguous.
- **Exclusion clauses can limit coverage.** Although insurers cannot use exclusion clauses to nullify coverage, the nullification doctrine does not extend so far as to preclude exclusion clauses from reducing or limiting coverage.
- **Consumer context matters.** Both dissenting justices emphasized that insurers must draft policies in a way that meets the reasonable expectations of average policyholders.