COURT OF APPEAL FOR ONTARIO

CITATION: Panasonic Eco Solutions Canada Inc. v. XL Specialty Insurance Company, 2021 ONCA 612
DATE: 20210910
DOCKET: C68282

Feldman, Paciocco and Coroza JJ.A.

BETWEEN

Panasonic Eco Solutions Canada Inc.

Applicant (Respondent/
Appellant by way of cross-appeal)

and

XL Specialty Insurance Company

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

W. Colin Empke and Anthony H. Gatensby, for the appellant

Jeffrey A. Brown and Callum J. Micucci, for the respondent

Heard: March 12, 2021 by videoconference

On appeal from the judgment of Justice Markus Koehnen of the Superior Court of Justice, dated March 9, 2020, with reasons at 2020 ONSC 1502.

Feldman J.A.:

A. INTRODUCTION

[1] The issue on this appeal is whether the appellant insurer, XL Specialty Insurance Company, has a duty to defend its insured, the respondent Panasonic Eco Solutions Canada Inc., against two claims for breach of contract brought

against Panasonic by a group of companies collectively operating as Solar Flow-Through Fund ("Solar") in an arbitration proceeding. The insurance policy is a professional errors and omissions policy that excludes contractual liability claims unless the insured would have had the liability in the absence of the contract.

[2] The application judge held that XL has a duty to defend one of the claims but not the other. XL appealed and Panasonic cross-appealed.

[3] I would allow the appeal and dismiss the cross-appeal. XL has no duty to defend either claim.

B. BACKGROUND FACTS PLEADED BY SOLAR IN ITS ARBITRATION CLAIM

[4] Panasonic entered into two agreements with Solar. The first was an Engineering, Procurement, and Construction Agreement (the "Engineering Agreement") that required Panasonic to procure, construct and install roof-mounted solar electricity generating systems. Solar planned to sell the generated electricity through 20-year contracts it had entered into with Ontario's Independent Electricity System Operator (the "IESO"). The Engineering Agreement required Panasonic to achieve substantial completion by a guaranteed date. Panasonic failed to do so, resulting in the IESO cancelling seven of its contracts with Solar.

[5] In the arbitration claim, Solar pleaded that Panasonic failed to achieve substantial completion "in breach of its contractual obligations" and claimed

liquidated damages of $92,309.62, the sole remedy provided in the Engineering Agreement for a contractor's failure to reach substantial completion by the guaranteed date.

[6] Solar further pleaded that following the cancellation, the three parties – Panasonic, Solar and the IESO – entered into negotiations that resulted in the IESO reinstating two of the seven cancelled contracts with Solar, and re-issuing the remaining five contracts, but to Panasonic.

[7] The re-issued contracts were part of an agreement between Solar and Panasonic, referred to as the Proceeds Agreement, although it was never finalized or signed. According to that agreement, Solar would provide its expertise for the five contracts that had been re-issued to Panasonic, and in exchange, Panasonic would pay Solar a portion of the proceeds from its sale of the projects. Solar anticipated that it would recover, at a minimum, its sunk costs of $1,300,000 on the re-issued contracts with the IESO.

[8] In the arbitration claim on the Proceeds Agreement, Solar claimed damages for breach of contract, or in the alternative for negligent misrepresentation, or in the further alternative, for unjust enrichment. The negligent misrepresentation claim was based on Panasonic's ongoing representations to Solar, in order to obtain its assistance with the re-issued projects, that it would pay Solar in accordance with the Proceeds Agreement, but Panasonic then failed to pay. The

unjust enrichment claim was based on Panasonic enriching itself at Solar's expense by retaining the full benefit of the sold re-issued projects and depriving Solar of compensation for its assistance.

C. FINDINGS OF THE APPLICATION JUDGE

[9] The application judge noted that Panasonic had already received invoices from its defence counsel on the arbitration for $492,965.25, that the arbitration was continuing and that the defence costs were continuing to increase.

[10] The XL policy insuring Panasonic is an errors and omissions policy, formally named a Professional and Contractor's Pollution Legal Liability Policy. The policy covers monetary judgments that Panasonic becomes legally obligated to pay because of a claim "resulting from an act, error or omission in Professional Services". XL agreed that Solar's claim arises from the delivery of professional services.

[11] Under the policy, XL has a duty to defend any claim against Panasonic "to which this insurance applies" regardless of the merits of the claim. Whether the insurance applies depends on the interpretation of the following exclusion and exception to the exclusion clause:

> This Policy does not apply to any Claim … arising from the Insured's:
>
> 1. assumption of liability in a contract or agreement; or
>
> 2. breach of contract or agreement.

> This exclusion does not apply to: (i) liability that the Insured would have in the absence of the contract or agreement…

[12] The application judge referred to the four principles applicable to an insurer's duty to defend set out by the Supreme Court of Canada in *Monenco Ltd. v. Commonwealth Insurance Co.*, 2001 SCC 49, [2001] 2 S.C.R. 699, at paras. 28, 33. He summarized these principles as follows:

> (a) The duty to defend is distinct from, and broader than, the duty to indemnify. There may be a duty to defend even if the insurer may not ultimately be required to indemnify the insured.
>
> (b) The court assumes that the pleaded facts are true.
>
> (c) The court applies the pleaded facts to the policy wording.
>
> (d) The duty to defend arises if the underlying complaint alleges any facts that might fall within coverage under the policy.

[13] The application judge also referred to the principle that where the pleadings are imprecise, "the insurer's obligation to defend will be triggered where, on a reasonable reading of the pleadings, a claim within coverage can be inferred": *Monenco*, at para. 31.

(1) The Claim under the Engineering Agreement

[14] In its claim for liquidated damages under the Engineering Agreement, Solar relied on Article 13 of the Agreement which the application judge quoted in part:

> [I]f a system has not reached Substantial Completion by the Guaranteed Substantial Completion date solely due to Contractor's acts or omissions, Owner shall be entitled to receive as daily liquidated damages from Contractor…

[15] XL argued to the application judge that it had no duty to defend because Solar's claim for liquidated damages arose out of Panasonic's breach of contract in failing to achieve substantial completion by the guaranteed date in accordance with its contractual obligation, and was therefore excluded by the exclusion clause.

[16] The application judge rejected this argument. He reasoned that Solar's claim for liquidated damages arises out of Panasonic's "acts or omissions" in failing to meet the guaranteed date, and Panasonic's delay could have been caused by its negligence, in which case Solar's claims could fall within coverage. It depended on the cause of the delay. Further, the fact that Solar did not plead negligence did not undermine the analysis as long as it pleaded facts that were capable of supporting the tort of negligence: *Non-Marine Underwriters, Lloyd's of London v. Scalera*, 2000 SCC 24, [2000] 1 S.C.R. 551, at para. 83.

[17] The application judge was unable to determine on the record before him whether the damages Solar sought were attributable to negligence by Panasonic or to circumstances beyond Panasonic's control. He presumed that this may be one of the issues in the underlying arbitration. The application judge noted, as an aside, that if it turned out that the delay was due to deliberate acts or omissions by Panasonic, as opposed to negligence, then there would be no coverage.

(2) The Claim under the Proceeds Agreement

[18] In its Notice of Arbitration against Panasonic, Solar pleaded that Panasonic's failure to pay Solar's share of the sale proceeds from the reissued projects was "tactical and meant to sidestep its obligations to pay [Solar] anything for its work under the Proceeds Agreement."

[19] The application judge concluded that Panasonic's liability under the Proceeds Agreement was in effect a debt claim that arose under the contract and could not come within the exception to the exclusion. He also rejected the efficacy of the negligent misrepresentation and unjust enrichment claims. The negligent misrepresentation claim was based on representations by Panasonic that it would pay under the agreement, and was therefore based solely on Panasonic's breach of the Proceeds Agreement by failing to make payments under it. The application judge further found that the unjust enrichment claim is excluded under the policy because the policy does not cover claims for equitable remedies.

D. ISSUES ON THE APPEAL AND THE CROSS-APPEAL

[20] The question on the appeal and cross-appeal is the proper interpretation of the XL policy and its potential application to the arbitration claim, triggering the duty to defend. To answer that question, the following are the issues to be addressed:

1) The standard of review;

2) Principles of interpretation and application of insurance policies;

3) The proper interpretation of the exclusion clause;

4) Does Solar's claim under the Engineering Agreement give rise to a duty on XL to defend the claim?

5) Does Solar's claim under the Proceeds Agreement give rise to a duty on XL to defend the claim?

E. ANALYSIS

(1) The Standard of Review

[21] Both parties agree that the appeal involves the interpretation of a standard form policy of insurance. As a result, in accordance with the decision of the Supreme Court of Canada in *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.,* 2016 SCC 37, [2016] 2 S.C.R. 23, the standard of review to be applied by this court is correctness. The court summarized the principle at para. 4:

> 4 In my opinion, the appropriate standard of review in this case is correctness. Where, like here, the appeal involves the interpretation of a standard form contract, the interpretation at issue is of precedential value, and there is no meaningful factual matrix that is specific to the particular parties to assist the interpretation process, this interpretation is better characterized as a question of law subject to correctness review.

(2) Principles of Interpretation and Application of Insurance Policies

[22] The first substantive issue is the principles governing the duty of an insurer to defend claims brought against the insured. In *Monenco*, the Supreme Court

reviewed and restated the principles that govern the duty to defend. The first is the rule that the pleading by the claimant against the insured is what triggers the duty to defend. If the facts alleged in the pleading would, if true, require the insurer to indemnify, then the insurer has the duty to defend. The duty to defend is therefore broader than the duty to indemnify because it is triggered by the mere possibility of coverage: *Monenco*, at paras. 28-29. In addition, the pleadings themselves are to be interpreted broadly, with any doubt to be resolved in favour of the insured: *Monenco*, at para. 31. In that regard, where the claim alleges facts that might fall within coverage, the duty arises: *Monenco*, at para. 33. The required analysis is to determine the substance of the claim rather than merely the legal label chosen by the claimant.

[23] The Supreme Court reviewed and summarized the general principles of policy interpretation that had been set out in previous Supreme Court case law[1] in its decision in *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, 2010 SCC 33, [2010] 2 S.C.R. 245, at paras. 22-24:

> 22 The primary interpretive principle is that when the language of the policy is unambiguous, the court should give effect to clear language, reading the contract as a whole.

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[1] *Co-operators Life Insurance Co. v. Gibbens*, 2009 SCC 59, [2009] 3 S.C.R. 605, at paras. 20-28; *Jesuit Fathers of Upper Canada v. Guardian Insurance Co. of Canada*, 2006 SCC 21, [2006] 1 S.C.R. 744, at paras. 27-30; *Scalera*, at paras. 67-71; *Brissette Estate v. Westbury Life Insurance Co.*, [1992] 3 S.C.R. 87, at pp. 92-93; and *Consolidated-Bathurst Export Ltd. v. Mutual Boiler & Machinery Insurance Co.* (1979), [1980] 1 S.C.R. 888, at pp. 899-902.

> 23 Where the language of the insurance policy is ambiguous, the courts rely on general rules of contract construction. For example, courts should prefer interpretations that are consistent with the reasonable expectations of the parties, so long as such an interpretation can be supported by the text of the policy. Courts should avoid interpretations that would give rise to an unrealistic result or that would not have been in the contemplation of the parties at the time the policy was concluded. Courts should also strive to ensure that similar insurance policies are construed consistently. These rules of construction are applied to resolve ambiguity. They do not operate to create ambiguity where there is none in the first place.
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> 24 When these rules of construction fail to resolve the ambiguity, courts will construe the policy contra proferentem — against the insurer. One corollary of the contra proferentem rule is that coverage provisions are interpreted broadly, and exclusion clauses narrowly. [Citations omitted.]

(3) The Proper Interpretation of the Exclusion Clause

[24] The policy begins with the coverage clauses and the duty to defend. Clause I.A.1 is the coverage clause that provides that XL "will pay on behalf of the Insured for Professional Loss which the Insured becomes legally obligated to pay because of a Claim resulting from an act, error or omission in Professional Services".

[25] The following are definitions of some of the terms referred to in the coverage clause:

> Professional Services: Value Engineering, Field Changes to Design, Design/Build or Design performed by or on behalf of the Named Insured, and project or construction management services in connection with Contracting Services;

> Contracting Services: Installation, maintenance, and repair of solar power arrays, commercial/residential battery storage, operation and maintenance services;
>
> Professional Loss: a monetary judgment, award or settlement of compensatory damages…

[26] Under Clause VII.C, XL "has the right and the duty to defend any Claim against the Insured seeking Professional Loss or Pollution Loss to which this insurance applies, including the right to select counsel, even if any of the allegations are groundless, false or fraudulent." In accordance with the case-law, XL has the duty to defend any claim if there is a possibility that there is coverage for it under the policy.

[27] The policy contains a number of exclusions. The issue on the appeal is whether the contractual liability exclusion in Section IV, including the exception to the exclusion, applies. The clause provides:

> This Policy does not apply to any Claim, Professional Loss…
>
> **B. Contractual Liability**
>
> arising from the Insured's:
>
> 1. assumption of liability in a contract or agreement; or
>
> 2. breach of contract or agreement.
>
> This exclusion does not apply to: (i) liability that the Insured would have in the absence of the contract or agreement…

[28] Applying the principles of interpretation from *Progressive Homes*, the first question for the court is whether this exclusion clause is ambiguous. If it is not, then the court is to give effect to the clear language, reading the contract as a whole. The clause contains both an exclusion and an exception to the exclusion. They form part of a whole clause and must be read together.

[29] Looking at the contractual exclusion first, I see no ambiguity. The policy does not cover a claim that arises from an insured's assumption of liability in a contract or from an insured's breach of contract. Panasonic argues that the meaning and effect of this exclusion, read literally, is to nullify the coverage under the policy, because the insured always provides its professional services under a contract, as it did here.

[30] This was the holding by the United States Court of Appeals for the Seventh Circuit in *Crum & Forster Specialty Insurance Company v. DVO, Inc.*, 939 F. (3d) 852 (7th Cir. Ct. App. 2019), where the court considered a similarly worded exclusion and concluded that it was so broad as to render coverage under the policy illusory. However, in that case, unlike in the XL policy, the insurance policy did not contain an exception to the exclusion. If there had been no exception to the contractual liability exclusion in the XL policy, then in accordance with *Cabell v. The Personal Insurance Company*, 2011 ONCA 105, 104 O.R. (3d) 709, if the exclusion rendered the coverage nugatory, the court may not give it any effect as it would not be within the reasonable expectation of the parties.

[31] The next issue, therefore, is to determine the meaning and effect of the exception. The first question is whether the wording of the exception is also unambiguous. It excepts from the exclusion "liability that the insured would have in the absence of the contract or agreement". In my view, read literally, the exception is ambiguous, because the insured would have no relationship with the claimant if there had been no contract or agreement between them under which the insured provided the professional services to the claimant. If they had no contractual relationship, no services would be performed, and there would be nothing to insure. That is clearly not what was intended.

[32] Given that ambiguity, the court then applies the principles of contractual interpretation summarized in *Progressive Homes* to interpret the exception. Those principles direct the court to give the words the interpretation that accords with the reasonable expectations of the parties, and that provide a realistic result that is consistent with the interpretation given to similar policies.[2]

[33] Applying those principles, the meaning of the exception becomes clear. The policy continues to cover professional losses caused by the insured in performing its professional functions in its relationship with the claimant that arise in law, regardless of the terms of their contract. As the insurer XL submits, these would

[2] No case was brought to the court's attention where the same or a similar contractual liability exclusion and exception clause had been interpreted by a court.

include liability for losses that third parties may suffer as a result of an insured's negligence in performing the professional services contract, as well as liability to the claimant for negligence in performing the contractual obligations under the doctrine of concurrent liability in contract and in tort: see *Central Trust Co. v. Rafuse*, [1986] 2 S.C.R. 147; *B.G. Checo International Ltd. v. British Columba Hydro and Power Authority*, [1993] 1 S.C.R. 12; and *Winnipeg Condominium Corporation No. 36 v. Bird Construction Co.*, [1995] 1 S.C.R. 85.

[34] This interpretation makes sense from the point of view of both the insured and the insurer, and gives effect to both their reasonable expectations, in light of the purpose of the professional errors and omissions insurance contract. The insurer will be responsible for the losses caused by the insured's negligent performance of its professional obligations; but the insurer will not indemnify the insured for any extra obligations it undertakes in a contract, or for the breach of any extra obligations that it undertakes in a contract.

(4) Does Solar's claim against Panasonic under the Engineering Agreement give rise to a duty on XL to defend the claim?

[35] The claim by Solar is found in its Notice of Arbitration. The parties entered into the Engineering Agreement in January 2016. Panasonic agreed to procure, construct and install the solar electricity generating systems that were the subject of the agreements that Solar had with the IESO. Panasonic was responsible for achieving substantial completion of the projects by a guaranteed date, but it failed

to do so in respect of 18 of them, causing the IESO to terminate seven of its contracts with Solar, although it later reinstated two of them. An arrangement was made among the parties to allow Solar to recoup its costs of the other five. That arrangement was the Proceeds Agreement that will be discussed later in these reasons.

[36] Solar's claim against Panasonic under the Engineering Agreement is for liquidated damages in the amount of $92,309.62, based on Panasonic's obligation under Article 13 of the Engineering Agreement to pay liquidated damages "if a System has not reached Substantial Completion by the Guaranteed Substantial Completion Date solely due to Contractor's acts or omissions". Article 13 provides in part:

> The amounts payable under this Article 13 shall be [Solar]'s sole and exclusive remedy for [Panasonic]'s failure to achieve Substantial Completion of a System by the Guaranteed Substantial Completion Date.

[37] It goes on to state that the agreed amount of liquidated damages is not a penalty but represents a genuine pre-estimate of the damages that Solar would suffer as a result of the delay.

[38] Therefore, while Panasonic's delay was an act or omission in performing its professional obligations that caused loss to Solar that would have been covered by the XL coverage clause, by agreeing to the liquidated damages clause, Panasonic effectively contracted out of its insurance coverage. The exclusion excludes coverage for liability arising from breach of contract, and the exception

does not apply because the obligation to pay liquidated damages is purely contractual and does not otherwise arise. Furthermore, because the Engineering Agreement provides that liquidated damages are Solar's sole remedy, there is no way to read Solar's pleading to claim any other or additional remedy for the delay.

[39] A liquidated damages clause, such as this one, demonstrates the fairness of the contractual exclusion and exception clause of the insuring agreement, when it is interpreted in accordance with the reasonable expectations of the parties to that agreement. An insured is free to make whatever promises it wishes when it contracts to perform services, for example for remedies for its breach. Panasonic could have agreed to pay liquidated damages to Solar in any amount as part of the consideration for the contract. But it could not bind its insurer to that bargain. The insurer is only obligated to cover liability that the insured would have had without the contract.

[40] The application judge erred in his application of the test for determining the duty to defend. He focused on the fact that Panasonic could be liable for negligence in its delay, which would be within coverage, but he failed to apply the exclusion and the exception to the exclusion to his analysis of the liquidated damages clause. In particular, he failed to note that the claim for liquidated damages was Solar's sole remedy under its agreement. In other words, Solar had contracted out of any claim it may have had against Panasonic for damages for

negligence. Therefore, it could not make a negligence claim against Panasonic in the arbitration.

[41] The application judge therefore erred in law in his interpretation and, as a result, in his application of the exclusion clause by finding that XL has a duty to defend Panasonic against Solar's claim for liquidated damages for breach of the Engineering Agreement. No duty to defend arises in respect of this claim.

(5) Does Solar's claim against Panasonic under the Proceeds Agreement give rise to a duty on XL to defend the claim?

[42] The arbitration claim states that because of Panasonic's delay and IESO's cancellation of five of Solar's projects, Solar's pre-construction costs loss was $1.3 million. In order to recoup that loss, Solar agreed with Panasonic that if Panasonic entered into agreements with IESO to complete the projects, Solar would provide certain services to help achieve timely completion. In exchange, Panasonic would pay Solar a portion of the sale proceeds, which Solar anticipated would amount to at least $1.3 million. That was the Proceeds Agreement, although it was never finalized in writing.

[43] Panasonic completed and sold the projects, but it refused to pay Solar any portion of the proceeds of sale. Further, Solar claims that it worked in accordance with the Proceeds Agreement to help Panasonic achieve the sales, and that Panasonic "regularly represented to [Solar] that its efforts in this regard were subject to the Proceeds Agreement." Solar claimed negligent misrepresentation,

asserting that Panasonic owed it a duty of care and that it relied on Panasonic's representations that it would be paid under the Proceeds Agreement. It also claimed that Panasonic enriched itself at the expense of Solar amounting to unjust enrichment, as well as breach of contract and breach of its obligations to act in good faith.

[44] The application judge found that Panasonic's liability under the Proceeds Agreement arose out of its assumption of liability under a contract and out of its breach of that contract, thereby falling squarely within the contractual exclusion. The claim could not come within the exception because Panasonic would not have had the liability to Solar to pay it following the sale of the projects, except under the contract. It amounted to a debt.

[45] It was XL's position on the application that Solar's claims come within the coverage clause of the policy but are excluded from coverage by the contractual liability exclusion clause. In respect of the Proceeds Agreement, coverage would presumably be based on Panasonic's acts or omissions in carrying out its obligations under the Engineering Agreement that resulted in the delay and in Solar's loss of its $1.3 million in costs thrown away. However, Solar resolved any

claim it had in that regard by entering into the Proceeds Agreement.[3] It is the Proceeds Agreement that Solar seeks to enforce in the arbitration.

[46] I agree with the application judge that the claim under the Proceeds Agreement is essentially for a debt owing. It arises under the contract. There would be no claim without the contract. Therefore, if the claim came within the coverage under the policy, it is excluded by the contractual liability exclusion clause and is not saved by the exception to the exclusion.

[47] I also agree with the application judge that the claims for negligent misrepresentation and unjust enrichment do not give rise to a duty to defend. The negligent misrepresentation alleged against Panasonic is that it misled Solar into working on the promise that it would be paid under the Proceeds Agreement. This is based solely on Panasonic's failure to make payments under the Proceeds Agreement, in breach of that contract. The contractual liability exclusion is triggered, and the exception to the exclusion does not apply. As the application judge found, the unjust enrichment claim is an equitable claim that is specifically not compensable under the XL insurance policy.

[3] I also note that because the liquidated damages clause provides the sole and exclusive remedy for Panasonic's delay, it appears Solar has no claim for the $1.3 million lost costs under the Engineering Agreement if they arose from Panasonic's delay in completion.

F. CONCLUSION

[48] I would allow the appeal and set aside the order of the application judge that found a duty on XL to defend the claim under the Engineering Agreement. I would dismiss the cross-appeal and uphold the order of the application judge that there is no duty on XL to defend the claim under the Proceeds Agreement. XL is entitled to its costs of the appeal fixed in the agreed amount of $12,500 inclusive of disbursements and HST.

Released: September 10, 2021 “K.F.”

“K. Feldman J.A.”
“I agree. David M. Paciocco J.A.”
“I agree. S. Coroza J.A.”