Ontario Court of Appeal on Replacement Cost: *Carter v. Intact Insurance Company*

The Ontario Court of Appeal has clarified the law on replacement cost in *Carter v. Intact Insurance.* Property owners sought reimbursement for costs to replace property destroyed by fire. The property was a mixed-use residential/commercial series of buildings, ranging from 1 to 3 stories in height. The owners elected to rebuild an eight and a half story condominium building on the same site. They sought compensation for those costs from Intact.

The owners wanted the insurer to pay replacement cost based on the value of the original property. The dispute was about the dollar value between the actual cash value ("ACV") and the cost to rebuild the 1 to 3 story buildings as if new. The owners had purchased a replacement cost extension on their policy and the value in dispute had been fixed by an arbitrator. The question was whether that amount could be applied toward the building costs of the new condominium. In a nutshell, the old and new properties were quite dissimilar, and neither party argued that point.

The judge hearing the motion decided that the term "of like kind and quality" in the policy was of utmost importance in determining the insurer's responsibility. The Court of Appeal unanimously agreed. The need to rebuild premises which more closely resembled the original was fundamental to attract replacement coverage. The Court of Appeal ordered that only ACV costs were owed.

The Court of Appeal reiterated that this particular term was put in place to recognize "moral hazard." The hazard is one faced by insurers writing this kind of casualty policy. There is a risk that an insured will abuse the coverage. A property may be intentionally destroyed to capitalize on the fact that one's replacement-cost policy covers the depreciation 'gap.' This gap is created by the normal depreciation of a property over time and an owner faces out-of-pocket costs because standard ACV coverage only pays out the current value of the property. If an owner wants to build something brand new, it can be costly. Thus, there is some incentive, although morally reprehensible, to destroy a property and have an insurer pay for what essentially amounts to a renovation of an aging building.

The fact that the definition of "replacement" in the policy could have theoretically included building a brand-new building (such as the owners' condominium in this case) completely ignored the plain meaning of the terms "like kind and quality." And, further, insistence by Intact on the actual replacement of the property was in-line with an insurer's goals of putting "a brake on moral hazard."

More generally, the Court of Appeal reiterated that the interpretation of policy terms is based on the Supreme Court of Canada's guidance in the *Progressive Homes* decision. Additionally, the Court of Appeal recognized that the appropriate standard of review was correctness which affords a lesser degree of deference to the motion judge because they were looking at a "standard provision" in a property insurance policy.

Dutton Brock LLP
438 University Avenue, Suite 1700
Toronto, Canada M5G 2L9
Telephone: (416) 593-4411 Fax: (416) 593-5922
www.duttonbrock.com