So You Think You're Insured? Think Again, Receivers: The Vacancy Exclusion in Insurance Contracts

By Rachel Bengino and Asim Iqbal, Thornton Grout Finnigan LLP

Receivers are apt to ensure that there is proper and valid insurance coverage over the debtor's property at the commencement of and during a receivership. Secured creditors similarly want to ensure that their borrower's insurance policy is in good standing in order to protect their collateral. This article highlights an important exclusionary provision in insurance contracts that might affect insurance coverage of a debtor's property and offers practical examples and solutions to mitigate this exclusionary provision. This article focuses on court-appointed receivers.

The Model Receivership Order of the Commercial List (Toronto) (the "**Model Order**") typically governs a receiver's appointment by the Court. The Model Order contains provisions that stay parties from taking actions against the debtor and prohibiting parties that contract with the debtor from terminating their respective contracts, which includes insurance contracts.[1]

However, commercial insurance policies typically exclude coverage for certain types of property, including property that is vacant or unoccupied for more than 30 consecutive days (a "**Vacancy Exclusion**"). Fundamentally, the cost of insurance policies is based on the level of risk assumed by the insurer. Vacant or unoccupied properties are considered to be at a higher risk for damage, attracting more costly insurance premiums. For this reason, common insurance policies exclude coverage for damage to vacant or unoccupied properties. The Courts have held that "vacant" or "unoccupied" are disjunctive terms and the insurer only needs to demonstrate that the property is either "vacant" or "unoccupied" to apply a Vacancy Exclusion.[2]

In receivership proceedings, it is common for the receiver to remove items from the premises and only make periodic site visits. Although an insurer cannot terminate an insurance policy pursuant to the Model Order, it may provide little protection for the debtor's property or building if the facts were such that the Vacancy Exclusion was triggered, either before or during the receivership.

The common law meaning of "vacant" and "unoccupied"

What does "vacant" or "unoccupied" property mean? The first question is whether the insurance policy itself has a specific definition that governs.[3] If the terms are not defined in the insurance policy, the common law meaning of these terms may apply. The Court in *528852 Ontario Inc. v. Royal Insurance Co.*,[4] ("**Royal Insurance**") held that in general terms, "vacant" means "empty, including no inanimate objects on the premises" and "unoccupied" means there is lack of habitual presence by human beings and the premises are no longer used for its ordinary purposes with no intention to return to the premises. The length of vacancy or inoccupation is also a factor in the analysis, for instance, in *Royal Insurance*, the Court noted that a temporary vacancy may not trigger a Vacancy Exclusion.

Courts have held that whether the Vacancy Exclusion applies depends on the unique facts of each case. The Court in *Shaeen v. Meridian Insurance Group Inc.*[5] ("**Shaeen**") provided a non-exhaustive list of factors to consider. The factors set out by the Court included (a) the frequency of visits, (b) the intention (or lack thereof) to abandon the property, and (c) the length of the vacancy.[6] In *Shaeen*, the Court held that the subject property was not "vacant" or "unoccupied" because the insured visited the property almost daily and clearly had no intention to abandon the property.

The *Insurance Act* and material change of risk

Section 148(4) of the *Insurance Act*[7] provides that insurance contracts may be voided if there is a material change in risk. In *Royal Insurance*, the Court held since the premises were unoccupied, the insurer was allowed to void the contract as it constituted a material change in risk under the insurance policy. Further, the Courts have held that "vacancy" constitutes a material change in risk.[8] Therefore, due to a vacancy or inoccupation, an insurer may apply to the Court to lift

1. Model Receivership Order of the Commercial List (Toronto), paras. 9, 10 and 12, http://www.ontariocourts.ca/scj/practice/practice-directions/toronto/#Commercial_List.
2. See *528852 Ontario Inc. v Royal Insurance Co.*, [2000] O.J. No. 4448, para 5 ["**Royal Insurance**"].
3. *Coburn v. Zorkin Insurance Brokers Inc.*, 2013 BCSC 2462.
4. *Royal Insurance, supra* note 1.
5. 2011 ONSC 1578.
6. *Ibid*, para. 50.
7. R.S.O. 1990, c. I.8.
8. See, for example, *Wu v Gore Mutual Insurance Co.*, 2009 CarswellOnt 7577.

the stay granted under the Model Order in order to terminate the insurance contract as a material change in risk occurred. This may be fettered by section 151 of the *Insurance Act*, which says that a Court has discretion to deny applicability of an exclusionary clause if is unjust or unreasonable. It is a well-established principal that the mere appointment of a receiver does not justify a material change in risk.[9]

Scenarios highlighting the impact of a Vacancy Exclusion

Here are some scenarios of potential problems that a receiver might face with a Vacancy Exclusion:

Scenario 1 – Unoccupied during receivership. A receiver is appointed to liquidate a debtor's assets and attends to the premises for a few hours on a weekly basis. The receiver is the only person on or attending the subject property. 60 days after the receiver has been appointed, there is a fire at the property and the receiver makes a claim against the insurance policy. In this scenario, the insurer may deny the claim under the Vacancy Exclusion, arguing that the attendances by the receiver were insufficient to constitute the subject property as "occupied". Alternatively, the insurance company may also argue that there was a material change in risk given the occupancy and seek to void the contract.

Scenario 2 – Unoccupied prior to receivership. A secured creditor wishes to appoint a receiver over a property on which a manufacturing plant is located. The secured creditor completed its standard due diligence and received confirmation from the insurer that the policy remains in place, is in good standing and the creditor was appropriately referenced as the first loss payee.

The secured creditor successfully obtains a receivership order, pursuant to which the receiver takes possession of the debtor's property. The receivership order includes the standard Model Order provisions prohibiting the termination of contracts, including insurance policies. However, when the receiver enters the debtor's manufacturing plant, the building is empty and the pipes have burst, which has caused significant water damage.

Typically in this scenario, the receiver would make a claim on the debtor's insurance policy and distribute the insurance proceeds to repay the first secured creditor. However, the Vacancy Exclusion might wholly disqualify any claim on the property insurance if there is evidence demonstrating that the property had been unoccupied by the debtor for 30 consecutive days prior to the receiver's possession of the premises.

A scenario like this could also significantly delay receiving a payout from the insurer, especially where communication with the debtor is limited and the receiver is unaware of whether the property had been "vacant" or "unoccupied" for more than 30 consecutive days before the receiver takes possession.

What are some possible solutions?

We've considered some practical tips that could be employed to help mitigate the risks associated with the Vacancy Exclusion:

- Keep a record of the amount of times the receiver visits the property, including activities conducted at the property and length of visit.
- Make thorough visits to the property several times per week in order to avoid the argument that the property was unoccupied.
- Maintain inanimate items at the premises to aid an argument that the property is not "vacant."
- Be proactive before the appointment and consider including a term in a forbearance agreement that the debtor represents and warrants that the premises will not at any time be unoccupied and vacant.
- Build a case to prove occupation of the property. Gather evidence of occupation by the debtor prior to the appointment of a receiver.

The Vacancy Exclusion can be a tricky provision in insurance contracts with significant implications for receivers and secured creditors. All should take note of this provision in their insurance contracts, consider its applicability prior to and during the course of a receivership, and, if possible, take steps to mitigate against the risk of being left "holding the bag" after falsely concluding the valid insurance coverage was in place. RS

Rachel Bengino and Asim Iqbal are restructuring, insolvency and commercial litigation lawyers at Thornton Grout Finnigan LLP in Toronto.

9 Re: *Village Green Lifestyle Community Corp.*, (2007), 45 C.C.L.I. (4th) 302 (OSCJ).