LAW360™ Canada

Law360 Canada | 111 Gordon Baker Road, Suite 900 | Toronto, ON, M2H 3R1 Canada | www.law360.ca
Phone: (800) 668-6481 | customerservice@lexisnexis.ca

SCC gives guidance on interpreting insurance contracts, interplay of endorsements & exclusions

By **Cristin Schmitz**

Law360 Canada (January 30, 2026, 6:25 PM EST) -- Elaborating on how to interpret insurance contracts, the Supreme Court of Canada dismissed 7-2 the appeal of two homeowners who sought to compel their insurer to fully pay for rebuilding their flood-destroyed house, despite an exclusion for "compliance costs" and the ancillary exception that caps the compliance costs payout at $10,000 "for the increased cost of demolition, construction, or repair to comply with any law regulating the zoning, demolition, repair or construction of any insured buildings."

For the majority on Jan. 30, Justice Malcolm Rowe dismissed the appeal of Stephen and Claudette Emond, whose home by the Ottawa River was totally destroyed by spring floodwaters in 2019: *Emond v. Trillium Mutual Insurance Co.*, 2026 SCC 3.

Although the appellants are insured by respondent Trillium Mutual Insurance for a deemed total loss after flooding, under a standard-form residential "comprehensive" home insurance contract, which additionally contains a "guaranteed rebuilding cost" endorsement, the Supreme Court's interpretation of the policy's "compliance cost" exclusion leaves the Emonds on the hook to pay for hefty zoning and other compliance costs to rebuild their home (by some estimates as high as $500,000 to $700,000) that are imposed by the local Mississippi Valley Conservation Authority.

Supreme Court Justice Malcolm Rowe

"The language of the policy is unambiguous in excluding recovery of the increased costs of compliance, other than the $10,000 extended under a limited exception," Justice Rowe held.

The court's 267-paragraph (plus appendix) judgment impacts Canadian consumers and insurers more broadly, particularly for those with replacement cost insurance who own older homes, said the Emonds' counsel, Joseph Obagi of Ottawa's Connolly Obagi LLP.

Obagi, whose co-counsel were Elizabeth Quigley and Wayne Fryer, said the majority accepted that the increased costs of any laws that have been put into place "that impact on the rebuild of your home are not going to be covered by your insurer, even if you've purchased 'guaranteed replacement cost' coverage. And of course, if you rebuild your home today, you have to comply with today's building standards."

Joseph Obagi, Connolly Obagi LLP

"Homeowners need to be aware of this," he advised. "They may need to have very serious conversations with their insurance broker to find out: 'Do I have guaranteed replacement coverage in the sense that, if my home burns down to the ground today, will you rebuild it tomorrow without me having to self-insure anything?' And that's a conversation every Canadian should be having with their insurance broker because this is exactly the concerns that the Emonds had. They believed they had purchased the top-of-the-line policy of insurance that would cover them if they sustained a complete loss."

Obagi highlighted an issue raised by Justice Suzanne Côté in her partial dissent, saying that "this coverage could be illusory, especially if you own an older home. As one can expect, if your home was built 50 years ago, there are going to be a significant number of changes in the building code and guaranteed replacement cost doesn't mean you get a guaranteed replacement of that home."

In Obagi's view, the majority's judgment effectively encourages insurance companies "to continue … to put titles to their endorsements which suggest that the insured has certain coverages, and then take some of that coverage away in the body of the policy where the exclusions reside and where insureds and consumers generally don't dive into. I think the opportunity [highlighted] by the dissent was, essentially, if you want to use that language, then be very clear and include exclusion clauses in the endorsements themselves, so that people know what they're getting."

At press time, neither Trillium Mutual Insurance Company, nor its lead counsel Pat Peloso of Ottawa's Cavanagh LLP, who won the appeal with co-counsel Jaime Wilson, James Plotkin and Darren Johnston, were available for comment.

The intervener Insurance Bureau of Canada, the national industry association representing most of Canada's home, car and business insurance companies, welcomed the Supreme Court's decision.

"This ruling provides important clarity on how insurance policies are intended to operate," spokesperson Brett Weltman told Law360 Canada by email. "Guaranteed rebuilding cost endorsements are designed to protect homeowners against unexpected increases in construction costs — not to override compliance costs exclusions," he said.

"This decision reinforces the principle that insurance contracts must be interpreted as written, ensuring consistency, predictability and fairness for all policyholders," he said.

"Clear coverage boundaries help preserve the long-term sustainability of the insurance system and highlight the importance of homeowners fully understanding their policy's scope and limitations before a loss occurs."

The appeal featured five interveners — in addition to the Insurance Bureau of Canada, they included the Ontario Trial Lawyers Association, the Canadian Association of Mutual Insurance Companies, the Ontario Mutual Insurance Association and Farm Mutual Reinsurance Plan Inc. They asked the court to "provide guidance on the proper application of the interpretive framework for standard form insurance contracts" — including with respect to the order for interpreting insurance policy provisions, as was previously set out by the top court in *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co*., 2016 SCC 37.

"This case presents an opportunity to clarify when the language of an insurance contract is ambiguous and when the nullification of coverage doctrine would justify a departure from language that is unambiguous," Justice Rowe explained.

The nullification of insurance coverage doctrine provides that a policy provision should not be applied to the extent it would completely defeat the very objective of having purchased the relevant coverage and render it of no value.

On that point, the majority concluded that although the costs the Emonds will recover are less than they would have been without the compliance cost exclusion, this does not nullify the benefit under the policy's "guaranteed rebuilding cost" (GRC) endorsement, which allows them to recover amounts exceeding the clear upper limit set under the base policy.

In their separate partial dissents, Justice Andromache Karakatsanis (who previously sat on *Ledcor*) and Justice Côté disagreed that the Trillium policy is unambiguous.

"There is agreement with the majority on the principles governing the interpretation of insurance contracts outlined in *Ledcor* and that the compliance cost exclusion applies to the insureds' guaranteed rebuilding cost coverage," wrote Justice Karakatsanis. "However, there is disagreement on the application of the principles to interpret the effect of the compliance cost exclusion: applying the *Ledcor* framework, the compliance cost exclusion is ambiguous and must be interpreted in favour of the insureds."

For her part, Justice Côté said she agreed with the majority regarding the order and principles of interpretation applicable to standard form insurance contracts but disagreed with the majority's finding that Trillium's compliance cost exclusion applies to limit the GRC endorsement.

Under *Ledcor*, "the focus on an average insurance seeker is consumer-protective. It gives effect to a layperson's understanding of language in adhesive yet financially significant contracts," Justice Côté reasoned. "This court should not easily discard possible interpretations as unreasonable by strictly and legalistically construing contractual terms, because doing so risks undercutting that consumer-protective orientation."

Applying the *Ledcor* framework, Justice Côté argued that the compliance cost exclusion clause in the Trillium policy had to be interpreted in favour of the appellants because the Emonds reasonably understood that the "guaranteed" rebuilding endorsement covered all compliance costs, except "increased costs" to comply with laws that arose after they paid their premium and Trillium issued their policy.

Moreover, reasonable expectations pointed in their favour, she said. "Adopting Trillium's interpretation

and excluding all costs of complying with all laws that apply post-construction risks rendering coverage illusory, especially for older homes," Justice Côté contended. "Commercial reality also favours the Emonds: premiums are based on the insurer's expert assessment of its risk at the time of policy issuance and renewal. That means homeowners are entitled to assume that the costs of rebuilding at that time are covered. If the insurer does not intend to cover those costs, it must exclude them in clearer language."

She pointed out that guaranteed replacement cost insurance is meant to provide insureds with peace of mind. "They expect that in the event of loss or damage covered by the policy, they will receive not merely a portion of the funds needed to recover from their loss, but a replacement of what they lost. Insurers must meet these reasonable expectations; draft their policies and endorsements using clear, express, and easily intelligible terms; and work to confirm that their insureds understand not only their coverage but also its limitations and exclusions. Insurers bear the responsibility for drafting intelligible and accessible insurance contracts that are considerate of the unequal bargaining power in the standard form contract context."

However, Justice Rowe wrote for the majority that "even if one were to conclude, despite the clear language, that the words 'increased costs' were ambiguous, that ambiguity would necessarily be resolved against the insureds."

"Parties reading the broad language of this exclusion would not reasonably expect an insurer to have implicitly accepted liability for all pre-existing non-compliance with applicable law, which would require insurers to ascertain the state of compliance of the insured's property in each case or else bear indeterminate liability, and potentially to do so each time the contract is renewed," Justice Rowe explained. "Courts have generally avoided interpretations of this nature, which would transform the insurer into a guarantor for the insured's regulatory non-compliance and have long given effect to similar language in compliance cost exclusions without inquiring into when the relevant law came into force."

Justice Rowe elaborated on how to apply the three-step *Ledcor* framework, which sets out the "generally advisable order" for interpreting insurance contracts. Under this framework, first, the insured has the onus of establishing that the damage or loss claimed falls within the initial grant of coverage; second, the onus shifts to the insurer to establish that one of the exclusions to coverage applies; third, if the insurer is successful in demonstrating an exclusion, the onus then shifts back to the insured to prove that an exception to the exclusion applies.

"Where the language of the insurance contract is unambiguous, effect should be given to that clear language, reading the contract as a whole," Justice Rowe explained. "Other interpretive tools are only to be considered where the language is ambiguous. The words of the contract must be given their ordinary and grammatical meaning, as they would be understood by the average person applying for insurance, and not as they might be perceived by persons versed in the niceties of insurance law. The initial focus on the language should not be misunderstood as encouraging a reading of provisions in isolation."

Moreover, in determining whether the language of a provision is ambiguous, the court must still read the contract as a whole, he advised. "Ambiguity arises where there are multiple reasonable but differing interpretations of the policy. For example, a provision that appears unclear in isolation may continue to admit of more than one reasonable meaning when read in light of the contract as a whole," he continued. "Or a provision that appears clear in isolation may be capable of holding more than one reasonable meaning when the contract is read as a whole. Insurance policies often contain overlapping coverages, exclusions, conditions, and endorsements and reading the contract as a whole is an exercise in searching for harmony rather than discord between its provisions."

Justice Rowe said that in the face of ambiguity, the court cannot rely on the language alone and must move instead to a second stage and employ other rules of contract interpretation to resolve that ambiguity, including: the interpretation should be consistent with the reasonable expectations of the parties; it should not give rise to results that are unrealistic or that the parties would not have contemplated in the commercial atmosphere in which the insurance contract was formed; and it should be consistent with the interpretations of similar insurance policies. "If ambiguity still remains after the two first stages, the court must have resort to the *contra proferentem* rule at a third stage, which provides that the ambiguity must be resolved in a manner favourable to the insured," he said.

Reading the contract at bar, as a whole, "it is unambiguous that the compliance cost exclusion applies despite the GRC endorsement," the majority concluded. "Whether an exclusion applies to limit the insurer's liability for compliance costs cannot be understood in the abstract, but must be grounded in the language of the specific insurance contract at issue."

Eugene Meehan, Supreme Advocacy LLP

Eugene Meehan of Ottawa's Supreme Advocacy, who won the *Ledcor* appeal on behalf of a builder contesting the meaning of a "faulty workmanship" exclusion clause in a standard form "all risks" builders' insurance policy, said the Supreme Court's majority used its decision in *Emond* "to cement further its approach to the interpretation of insurance contracts set out in *Ledcor*."

Emond "offers a step-by-step guide on the approach to interpreting insurance contracts," commented Meehan. "The key takeaway is that nothing in the contract can be read in isolation."

He advised insurance lawyers to pay close attention to two key areas: "First, the court addresses when language is truly ambiguous and second, when the nullification of coverage doctrine applies."

Meehan predicted the *Emond* decision "will give pause to trial judges in the future when they are asked to find that certain provisions of an insurance contract are ambiguous. The Supreme Court is sending the message that ambiguity doesn't arise easily and that overlap doesn't automatically result in ambiguity."

He suggested there is room to improve the policy wording, despite the insurer getting strong confirmation that its current policy wording works in court. "Whether that works in public with consumers is another question," he noted, albeit the insurer might be hesitant to change it given that the Supreme Court found the wording to be unambiguous.

"But I would imagine more effort will be made by insurers in using plain language to explain exactly what replacement insurance means," Meehan remarked. "In particular, guaranteed rebuilding cost endorsements and compliance cost exclusions can be better, and more simply, explained."

The appellants' insurance policy, with a "guaranteed rebuilding cost" endorsement, is similar to endorsements found in homeowner policies across Canada that provide replacement coverage.

The insureds claimed that the endorsement fully guaranteed their rebuilding costs. The insurer acknowledged that the GRC coverage applied to replace the insureds' home, but took the position that the costs to be incurred to comply with the local conservation authority's regulation policies and other bylaws and regulations enacted after the home was originally built were excluded from coverage by the exclusion in the policy.

The application judge held that the GRC coverage was intended to guarantee the costs of rebuilding the home, without any limitation of coverage resulting from the operation of any rule, regulation, bylaw or ordinance: *Emond v. Trillium Mutual Insurance Co.*, 2022 ONSC 5519.

However, the Ontario Court of Appeal reversed unanimously, holding that the exclusion excluded coverage for increased costs to comply with any law, including the applicable bylaws and regulations: *Emond v. Trillium Mutual Insurance Co*., 2023 ONCA 729.

The appellants contended in their factum that "sophisticated insurance companies should not be permitted to mislead their insureds by deliberately deploying tantalizing and sensational language designed to lead the average person to believe they had purchased peace of mind insurance, only to invalidate that same coverage by way of a buried exclusion clause. … Any limitation on expanded coverage should be set out in the endorsement in clear and easily intelligible terms, otherwise no limitation to the expanded coverage can or should apply."

The respondent Trillium argued in its factum that the appellants have not fallen prey to the acknowledged imbalance between insurers and their insureds. Rather, applying the Supreme Court's teaching in *Ledcor* — that absent ambiguity, a court should give the insurance terms their ordinary meaning, reading the contract as a whole — "the Court of Appeal correctly found that the policy's exclusion of 'increased costs of repair or replacement due to operation of any law regulating the zoning, demolition, repair or construction of buildings' … captured the costs of complying" with the regulations. The Appeal Court below "reached this conclusion by reading the policy as a whole and giving its unambiguous terms their ordinary meaning," Trillium argued.

Photo of Justice Malcolm Rowe: Andrew Balfour Photography, SCC Collection

If you have any information, story ideas or news tips for Law360 Canada, please contact Cristin Schmitz at cristin.schmitz@lexisnexis.ca or call 613-820-2794.
