

# IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation: *Pope & Talbot Ltd. (Re)*,  
2009 BCSC 1552

Date: 20091112  
Docket: S077839  
Registry: Vancouver

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT,  
R.S.C. 1985, c. C-36

AND IN THE MATTER OF THE RECEIVERSHIP OF POPE & TALBOT LTD. and  
others

Before: The Honourable Mr. Justice Walker

## Reasons for Judgment

Counsel for Federal Insurance Company:

K.D. Kraft  
H.D. Edinger

Counsel for National Union Fire Insurance  
Company of Pittsburgh, PA:

G.M. Nijman

Counsel for XL Specialty Insurance  
Company:

D. Harris, Q.C.  
J.D. Hughes

Counsel for former Directors & Officers of  
Pope & Talbot

D.B. Kirkham, Q.C.

Counsel for PricewaterhouseCoopers Inc.

R.J.H. Berrow  
K. Jackson

Counsel for Ableco Finance LLC:

P. Rubin

Place and Date of Hearing:

Vancouver, B.C.  
October 14-15, 2009

Place and Date of Judgment:

Vancouver, B.C.  
November 12, 2009

**Introduction**

[1] Three insurers who issued Directors and Officers liability (“D&O”) policies in favour of directors and officers of Pope and Talbot Inc. (“P&T Inc.”) and its subsidiaries, including Pope and Talbot Ltd. (“P&T Ltd.”), seek a declaration that the proper law of those policies is the law of the State of Oregon.

[2] In addition, one insurer, National Union Fire Insurance Co. of Pittsburgh, Pennsylvania, maintains that a mediation and arbitration (“ADR”) clause contained in its policy, which is an excess policy, is a condition precedent to any determination of coverage by this Court. As a result, it seeks a stay of proceedings of the upcoming hearing regarding the insurers’ purported coverage obligations, insofar as its coverage obligations are concerned.

[3] The present application follows my decision concerning territorial competence and *forum conveniens* issued on July 27, 2009 and reported as *Pope & Talbot Ltd. (Re)*, 2009 BCSC 1014, 76 C.C.L.I. (4th) 212. The history of the insolvency proceedings, brought initially in Canada pursuant to the *Companies’ Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (“CCAA”), is also set out in those reasons for judgment.

[4] P&T Ltd. is currently in receivership. PricewaterhouseCoopers Inc. (“PWC”) is the receiver. Proceedings under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (“BIA”) are stayed. Previously, P&T Ltd. applied for and received protection from its creditors pursuant to the CCAA. The Directors Charge established by the Order of Chief Justice Brenner on November 21, 2007 (during the CCAA proceedings), to respond to certain types of claims that may be brought against the directors and officers of, *inter alia*, P&T Ltd. and its parent company, P&T Inc., remains to be drawn upon. Insolvency proceedings brought in Delaware on behalf of P&T Inc. have been deferred to the current Canadian insolvency proceedings by the US Bankruptcy Court for the District of Delaware. That insolvency is akin to Canadian CCAA proceedings as opposed to proceedings under the BIA.

[5] The Directors Charge may only be drawn upon “to the extent that they [directors and officers] do not have coverage under any directors’ and officers’ insurance policy, or to the extent that such coverage is insufficient to pay amounts indemnified” by, *inter alia*, P&T Inc. and P&T Ltd.

[6] PWC has asked for a determination of whether any of the policies cover certain wage claims made by former employees of P&T Ltd. pursuant to s. 119 of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (“CBCA”). That determination will be made at a subsequent hearing. The submissions made on behalf of P&T Inc. and P&T Ltd. on this application were made by PWC.

[7] The insurers assert that the proper law of the policies is the law of Oregon. The insureds, which in this case are P&T Inc., P&T Ltd., and the directors and officers of those companies, argue that the proper law of the policies is the law of British Columbia. They say that this a case where the language of the policies calls for the application of *dépeçage* (a principle which recognizes more than one proper law of a contract), or alternatively, if there is only one proper law of these policies, it is the law of British Columbia.

### **Background Facts**

[8] The insurers are Federal Insurance Company, National Union, and XL Specialty Insurance Company. They carry on business in the United States. They are not registered in BC as they do not directly carry on business in this province or elsewhere in Canada.

[9] Federal is incorporated in the State of Indiana, and has its head office in New Jersey. National Union is incorporated in the State of Pennsylvania; its principal place of business, as well as its head office for underwriting purposes, is located in New York City. XL is incorporated in the State of Connecticut; its head office is located in Stamford.

[10] The decision to underwrite the Federal policy was made by its underwriters who were, at the time, located in Portland and Los Angeles. As well, persons in

Federal's legal department (located in New Jersey) were consulted. Confirmation of coverage was sent by Federal out of its Portland office. Although the evidence does not disclose where its policy was actually issued, the Declarations page states the following address in its header:

Chubb Group of Insurance Companies  
15 Mountain View Road  
Warren, New Jersey 07059

[11] The National Union policy was underwritten in New York City and its policy was issued out of that office. XL's underwriting was done at its head office in Stamford; its policy was issued from there as well.

[12] Federal's D&O policy is primary. National Union's policy is follow form and sits as the first excess layer in a multi-layered tower. XL issued a form of drop down policy known as a "Cornerstone Policy", which drops down to respond if other underlying insurance does not cover or pay. Even where it does not drop down, that policy also acts as an excess policy.

[13] In addition, XL issued a follow form excess policy that sits in the coverage tower two levels above National Union's. That policy was not put in issue on this application.

[14] The premiums charged for each policy were in US dollars. The policies do not contain a choice of forum clause or a clause stipulating the proper law of the contract. They are all claims made policies, which means that coverage is provided for claims made during the policy term for a "wrongful act" (a defined term in each policy). This is in contrast to a comprehensive general liability policy, which usually provides coverage for fortuitous events that occur during the policy period as opposed to when the claim is made.

[15] The three policies were issued to be in force for one year, effective July 30, 2007. CCAA proceedings were first brought almost three months later, on October 29, 2007.

[16] Federal had provided coverage to P&T Inc. and its global operations (collectively, "Pope & Talbot Group") for some 22 years. Although its policy was issued as a renewal, it was not a simple renewal as it resulted from considerable negotiations. In fact, Federal (on the letterhead of its parent company Chubb Insurance) sent a notice of non-renewal to P&T Inc.'s risk manager on April 24, 2007. Ultimately, following negotiations, which included policy terms and endorsements, Federal went on risk again for a further one year period, although policy limits were reduced in half (to \$5 million) and the premium charged doubled (from \$17,500 to \$35,000 per million).

[17] P&T Inc. is a North American forest products company that sells wood products and pulp. It was founded in 1849. It was incorporated in the State of Delaware, and has its corporate headquarters in Portland, Oregon. It also has an office in Delaware.

[18] The majority of head office functions for both its wood products and pulp operations take place in Portland, Oregon. P&T Inc. is a public company that was, until July 2007, traded on the New York Stock Exchange.

[19] At the time the policies were made (which in this case means when they were issued), the bulk of P&T Inc.'s operations were located in BC, and were owned and operated by its subsidiary P&T Ltd. P&T Ltd. is a federally incorporated Canadian company. It maintains its registered and records office in Toronto, Ontario. Although P&T Inc. owned other subsidiaries, P&T Ltd. was the primary operating company for P&T Inc. at that time.

[20] The revenue stream for the Pope & Talbot Group was derived mainly from its pulp and wood products operations in BC. P&T Ltd. owned seven mills in BC and the US, for both its wood products and pulp operations. In respect of its pulp operations, P&T Ltd. operated three mills: two in BC (in Mackenzie and near Nanaimo) and one in Oregon (in Halsey). In respect of its wood products operations, it operated four mills: three in BC (in Fort St. James, Castlegar, and Grand Forks) and one in South Dakota (in Spearfish). The bulk of the employees

(the broker identified a total of 2,373 prior to the policies being issued) working for the Pope & Talbot Group did so for P&T Ltd. Federal's underwriters had this information available to them prior to issuing its policy in July 2007.

[21] In addition, and as a result of meetings and communications with representatives of P&T Inc. (that included the broker), underwriters were aware, at the time the insurers went on risk on July 30, 2007, of P&T Inc.'s Canadian subsidiary, P&T Ltd., including its various operations. The evidence shows that of the insurers, at least Federal's underwriters were also aware of:

- (a) the revenue and income of the Pope & Talbot Group, including the Canadian operations; and
- (b) the deteriorating financial condition suffered by the Pope & Talbot Group, particularly the revenue stream and indebtedness of the various Canadian operations, including:
  - (i) rapidly diminishing liquidity;
  - (ii) significant outstanding bond debt;
  - (iii) plunging stock price when it was announced that covenants relating to long term debt had been breached;
  - (iv) efforts made to sell assets to satisfy debt;
  - (v) the significant detrimental effect caused by a then strong Canadian dollar;
  - (vi) increasing inventory levels over the previous four years;
  - (vii) the costs of goods were \$1.13 for every \$1 collected;
  - (viii) gross and operating margins were at a five year low;

- (ix) the interest coverage ratio was negative for the first time since 2003;
- (x) debt/equity ratios were at a four year high; and
- (xi) bankruptcy had been considered (although it was reported to be “the last option”).

[22] As part of the application for coverage submitted by the broker (on behalf of the insureds) along with a formal request to renew the Federal policy, Federal’s underwriters were also advised of the nature of the business of the Pope & Talbot Group at that time:

Business Summary: Based in Portland, Or, Pope & Talbot is focused in two lines of business, market pulp and softwood lumber, and has industry leading earning leverage to price changes in both commodities. Pope & Talbot, Inc. operates in North America. The Pulp segment manufactures and sells northern bleached softwood kraft chip and sawdust pulp used in various end products, including newsprint, tissue, and coated and uncoated paper, as well as in specialty products, such as fiber cement siding for residential applications and non-woven fabric for surgical gowns. The Wood Products segment manufactures and sells specialty lumber for residential and light construction, and residential repair and remodeling; and produces machine stress rated, long-length, wide-width or premium pine appearance grade lumber. This segment also sells residual wood chips and other by-products from its lumber mill operations. The company sells its products to wholesalers, distributors, remanufacturers, and builders in the United States, Canada, Italy, northern Europe, China, and Japan.

[23] Federal asked some very pointed questions before deciding to go on risk again. The evidence discloses that in respect of one “D&O Underwriting Meeting” that was scheduled to take place on June 20, 2007 and postponed to July 3, 2007, Federal asked the following questions:

Please provide a business and financial overview for the pulp and wood products segment. What is the outlook for each business?

Please provide an overview of your discussions with your lenders. What changes, if any, will be made to the credit agreement? Have you talked to any outside lenders about the potential of opening a new credit facility?

Please give an overview of any discussion with the rating agencies.

Do you expect any changes to your weighted average cost of capital?

Has the board had any discussions about asset sales/ voluntarily going into bankruptcy?

What factors will keep the company from going into bankruptcy over the next 12 months. What does the company view as its risk of default over the same time period?

Have you entertained any offers to be purchased?

Please discuss the effects of the Canadian dollar on your business.

...

Please discuss the senior management and board changes that have occurred over the past 18 months. Are there any more expected changes in the next 12 months? What adjustments has the company gone through as a result of the management changes?

[24] Federal's underwriting analysis, prepared as part of its underwriters' analysis when considering whether to renew the policy (and if so, on what terms and price), reveals that Federal well anticipated the possibility of insolvency for the Pope & Talbot Group:

Pope and Talbot is a troubled company that is going through a very difficult time. There is significant concern that the company may go bankrupt [sic] in the next year. The company is seeking alternatives including the sale of a division and the taking on of a private equity interest. I view the private equity buy as the most likely (only because I think that is what management really wants) and the sale of the division as the second most likely outcome (because they have an offer on the table). Bankruptcy will only happen if/when the company makes a mistake and does not enter into one of the two above transactions quickly enough. Regardless, I feel that our risk has increased dramatically as a result of that we must reduce our capacity from 10 M to 5 M and increase [sic] the rate from \$17,500 per million to \$35,000 per million.

[25] As well, and prior to binding the risk, one of Federal's underwriters advised the broker that it was aware of the prospect of Canadian environmental claims and bankruptcy in the United States. With that knowledge, Federal was prepared to provide coverage to the directors and officers of the Pope & Talbot Group on a worldwide basis that included defence costs cover for Canadian claims and derivative securities coverage that was described by Federal's underwriter as "including the US". Materials presented on behalf of P&T Inc. to Federal's underwriters on July 3, 2007, disclose that there were seven directors of P&T Inc.

Evidence tendered by Federal and National Union show that two of them lived in BC. There were six directors of P&T Ltd., four of whom lived in BC.

[26] Following negotiations, Federal submitted an insurance proposal to P&T Inc. and the broker for the policy renewal. The premium to be charged by Federal was \$150,000.

[27] Coverage was ultimately provided on a worldwide basis to the directors and officers of the Pope & Talbot Group as well as to those companies in circumstances where they are required to indemnify the directors and officers.

[28] The evidence does not make clear the extent to which National Union and XL were aware of all of the information that Federal possessed concerning the risk. Those insurers did not argue that there was a disparity in knowledge or that the issue even mattered to them.

### **Determining the Proper Law of a Contract**

[29] The starting point is to determine the intentions of the parties by examining the contract as a whole: *Consolidated Bathurst Export Limited v. Mutual Boiler and Machinery Insurance Company*, [1980] 1 S.C.R. 888, 112 D.L.R. (3d) 49; and *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, 2009 BCCA 129, 90 B.C.L.R. (4th) 297.

[30] In *Progressive Homes*, at para. 45, the Court of Appeal adopted the approach to interpretation of insurance policies (which are, of course, contracts) described by Professor Denis Boivin in his text, *Insurance Law* (Toronto: Irwin Law, 2004), at p. 191:

The main rules of interpretation were established by the Supreme Court of Canada in *Consolidated Bathurst Export Ltd. v. Mutual Boiler & Machinery Insurance Co.* First, the words used in the contract must be given their ordinary meaning, with the exception of expressions that have acquired a technical meaning within the industry. ... Second, the contract must be interpreted contextually, having regard to all sections of the agreement. Third, the objective of interpreting the contract is to give effect to the parties' true intentions. Hence, courts should avoid using a literal approach when the result would frustrate the reasonable expectations of either the insurer or the

insured. Finally, any ambiguity must be resolved against the interests of the party that wrote the agreement – *contra proferentem*. In other words, ambiguities must be resolved in favour of the insured.

[31] Resort to the doctrine of “reasonable expectations” is made when there is an ambiguity in an insurance policy: *Non-Marine Underwriters, Lloyd’s of London v. Scalera*, 2000 SCC 24, [2000] 1 S.C.R. 551 at para. 71; *Reid Crowther & Partners Ltd. v. Simcoe & Erie General Insurance Co.* [1993] 1 S.C.R. 252, 99 D.L.R. (4th) 741; and *Progressive Homes*, at paras. 44 to 51. Where there is no ambiguity, courts should give effect to the clear language in the contract when reading it as a whole. In *Scalera*, Mr. Justice Iacobucci wrote, at para. 71:

Where a contract is unambiguous, a court should give effect to the clear language, reading the contract as a whole [citations omitted]. Where there is ambiguity, this Court has noted “the desirability...of giving effect to the reasonable expectations of the parties” [citations omitted].

[32] One way of considering the reasonable expectations of the parties is to take “industry practise” into account: *Progressive Homes*, at para. 51. No such evidence was adduced in this case.

[33] The proper law of the contract is determined by the expressed intention of the parties. When no express choice is made, courts determine whether the proper law of a contract can be inferred from the circumstances, or failing this, determine the system of law which has the closest and most substantial connection with the subject matter: *Herman v. Alberta (Public Trustee)*, 2002 ABQB 255, 2 Alta. L.R. (4th) 132, at para. 6; *Cansulex Limited v. Reed Stenhouse Limited* (1986), 70 B.C.L.R. (1st) 273, 18 C.C.L.I. 24 (S.C.); and J.–G. Castel, *Canadian Conflict of Laws*, 4th ed. (Toronto: Butterworths, 1997) at p. 593.

[34] The proper law of a contract is “the law that the parties intended to apply”: *Vita Food Products Inc. v. Unus Shipping Co. Ltd.*, [1939] 1 All E.R. 513, [1939] A.C. 277 (P.C.). According to Lord Wright, at p. 521, that intention “is objectively ascertained”.

[35] The proper law of a contract is determined as at the time the contract is made. Circumstances not existing at the time the contract is formed are not relevant to determining proper law: *Armar Shipping Co Ltd v. Caisse Algérienne d'Assurance et de Réassurance*; *The Armar*, [1981] 1 All E.R. 498, 1 WLR 207 (C.A. Civ. Div.); *Amin Rasheed Shipping Corp v. Kuwait Insurance Co*, [1983] 2 All ER 884, [1984] A.C. 50 (H.L.); and *Herman v. Alberta (Public Trustee)*.

[36] As Lord Diplock explained in *Amin Rasheed*, at p. 891, contracts do not exist in a “legal vacuum”:

My Lords, contracts are incapable of existing in a legal vacuum. They are mere pieces of paper devoid of all legal effect unless they were made by reference to some system of private law which defines the obligations assumed by the parties to the contract by their use of particular forms of words and prescribes the remedies enforceable in a court of justice for failure to perform any of those obligations; and this must be so however widespread geographically the use of a contract employing a particular form of words to express the obligations assumed by the parties may be.

[37] Where the choice of law is expressly made in the contract, courts may not interfere, unless that choice is unlawful or contrary to public policy. In *Vita Food*, Lord Wright explained, at p. 521:

That intention is objectively ascertained, and, if not expressed, will be presumed from the terms of the contract and the relevant surrounding circumstances ...but, where the English rule that intention is the test applies and where there is an express statement by the parties of their intention to select the law of the contract, it is difficult to see what qualifications are possible, provided the intention expressed is *bona fide* and legal, and provided there is no reason for avoiding the choice on the ground of public policy.

[38] In *Imperial Life Assurance Co. of Canada v. Colmenares*, [1967] S.C.R. 443, 62 D.L.R. (2d) 138, Ritchie J. stated, at p. 448:

[T]he problem of determining the proper law of a contract is to be solved by considering the contract as a whole in light of all the circumstances which surround it and applying the law with which it appears to have the closest and most substantial connection.

[39] Determining the circumstances which constitute the closest and most substantial connection is an inherently fact-specific exercise. Ritchie J. outlined a

number of factors that may assist a court in making this determination, citing *Cheshire on Private International Law*, 7<sup>th</sup> ed., at p. 448:

[T]he domicile and even the residence of the parties; the national character of a corporation and the place where its principal place of business is situated; the place where the contract is made and the place where it is to be performed; the style in which the contract is drafted, as, for instance, whether the language is appropriate to one system of law, but inappropriate to another; the fact that a certain stipulation is valid under one law but void under another; the economic connexion of the contract with some other transaction; the nature of the subject matter or its *situs*; the head office of an insurance company, whose activities range over many countries; and, in short, any other fact which serves to localize the contract.

[40] In *Cansulex*, however, McEachern C.J.S.C. placed less emphasis on the location where the insurance contract was made in determining the applicable law. In that case, the insurance policy was made in the United States on an American policy form, yet BC law applied, due primarily to the fact that the shipping operation was based in Vancouver. McEachern C.J.S.C. noted, at p. 18, that while older case law placed much weight on where the contract was formed, “modern law seems to focus more on other matters... What seems to be most important is the subject of the contract” (at p. 289). He concluded at p. 290 that the factors to be considered in determining the closest and most substantial connection are, in ascending order of importance:

- (a) the policy is deemed to be made in BC as a result of s. 5 of the *Insurance Act*, R.S.B.C. 1996, c. 226;
- (b) Aetna underwrote the risk on an American form;
- (c) both parties operate worldwide from their respective countries;
- (d) the subject matter of the contract is liability insurance; and
- (e) claims might be expected to arise for which coverage might be furnished by the policy in Alberta, BC, or worldwide, but not in the United States.

In that case, only factor (b) favoured the application of US law; the other factors were either equal or favoured BC law, particularly (d) and (e). Thus, BC was found to have a much closer connection with the contract than the US (or Alberta, which also was argued).

[41] Thus, the analysis prescribed in *Cansulex* is highly-fact specific and contextual. It will by necessity involve the weighing of unique factors in order to determine which system of law has the closest and most substantial connection to the contract in dispute.

[42] Section 5 of the *Insurance Act* deems a contract to be made in this province, and says that it must be construed accordingly where it insures a person domiciled or resident in BC at the date of it, or has as its subject matter, property, or an interest in property located in BC.

[43] Section 5 is not conclusive: *Cansulex*, at p. 288. It only provides that a policy insuring a person domiciled or resident in the province shall be deemed to be made in the province and shall be construed accordingly; that is to say, it shall be construed in accordance with the proper law of the contract, which may be the law of another jurisdiction. The place where a contract is made is but one of the factors to be considered in determining the proper law of the contract.

[44] Section 5 differs from its counterparts in some other provincial statutes. For example, in Ontario, s. 123 of its *Insurance Act*, R.S.O. 1990, c. I.8, makes application of Ontario law mandatory:

Where the subject-matter of a contract of insurance is property in Ontario or an insurable interest of a person resident in Ontario, the contract of insurance, if signed, countersigned, issued or delivered in Ontario or committed to the post office or to any carrier, messenger or agent to be delivered or handed over to the insured or the insured's assign or agent in Ontario shall be deemed to evidence a contract made therein, and the contract shall be construed according to the law thereof, and all money payable under the contract shall be paid at the office of the chief officer or agent in Ontario of the insurer in lawful money of Canada.

According to Janet Walker, *Canadian Conflict of Laws*, 6th ed., looseleaf (Markham, Ont.: LexisNexis, 2005) at 31.8.b, unlike s. 5 of the BC *Insurance Act*, this section “indicate[s] that the law of [Ontario] is the proper law a contract of insurance made or deemed to be made in that province, and in such a case the parties are not free to oust the application of that law by an express choice of law clause”.

[45] Normally, the obligations of parties to a contract will be governed by the same proper law. There are circumstances, however, where the proper law of a contract may be different for different contractual matters or issues. According to J.–G. Castel, at 607:

While most contractual issues are governed by the proper law, the parties can agree that different contractual issues may be governed by different laws. This is called *dépeçage*. There is no authority to prevent the court from deciding that the objectively ascertained proper law varies according to the contractual issues involved. However, the court will not do this readily or without good reason.

Apart from express or implied agreement to the contrary, the obligations of both parties will be governed by the same proper law.

[46] The insurers urge upon me the *obiter dicta* of Davies J. in *Teck Cominco Metals Ltd. v. Lloyd’s Underwriters*, 2006 BCSC 1276, 60 B.C.L.R. (4th) 261, aff’d 2007 BCCA 249, 67 B.C.L.R. (4th) 101, aff’d 2009 SCC 11, [2009] 1 S.C.R. 321, where he said, at para. 215, that the policy must expressly provide for application of more than one system of law:

... I agree with the submission of counsel for Lloyd’s that it would not be efficient to have contracts of insurance that may have application in more than one jurisdiction interpreted in accordance with more than one system of law unless the particular policy under consideration expressly provides otherwise.

[47] As I read these remarks, they come at the end of the decision and follow a detailed analysis of the issues before him, i.e., territorial competence and *forum conveniens*. It is noteworthy that the remarks of J.–G. Castel – that the agreement of the parties as to the proper law may also be implied – were not put before Davies J. nor were the decisions reached by other courts consistent with that approach.

[48] In *Gerling Global General Insurance Co. v. Canadian Occidental Petroleum Ltd.*, 1998 ABQB 714, 64 Alta. L.R. (3d) 174, the court looked at the policy “as a whole”. Romaine J. concluded that the policy did not disclose an intention that more than one law govern:

[68] ...Although there may be exceptional circumstances where it may be inferred that a contract is to be governed by the law of more than one jurisdiction, the courts in Canada are reluctant to split the proper law of a contract without good and compelling reason. Even in situations where the contract may be performed in more than one place, the more usual determination is that the substance of the contract is to be determined by one law only, although the method and manner of performance may be regulated by the law of the place of performance (*Montreal Trust Co. (supra)*, *Kenton Natural Resources Co. v. Burkinshaw* (1983), 47 A.R. 321 (Q.B.))...

[69] The Policy does not disclose an intention that more than one law govern the substantive obligations under it, although it anticipates in some clauses the effect of local government action. Nor does it disclose an intention that more than one law govern by providing for payment of premiums in different currencies or in expressing deposit premiums in Canada or U.S. funds. On the contrary, the Policy provides that all deductibles and liability limits are expressed in Canadian funds, regardless of the location of the risk. The mere fact that the locations of the insured properties are in different countries is no indication of an intention to split the proper law of the Policy.

[49] In *Commonwealth Insurance Co. v. Canadian Imperial Bank of Commerce* (2005), 21 C.C.L.I. (4th) 226, [2005] O.J. No. 1167 (QL) (S.C.J.), *aff'd* 142 A.C.W.S. (3rd) 72, [2005] O.J. No. 3656 (QL) (C.A.), at para. 68, Wilton-Siegel J. looked for and did not find an “indication in the Policy of an intention to split the proper law of the Policy” (at para. 68), and then proceeded to adopt the approach taken in *Gerling Global*.

[50] This same approach to determining if the parties intended more than one proper law, albeit in a banking as opposed to an insurance context, has been taken by the Queen’s Bench Division (Commercial Court) in England. In *Libyan Arab Foreign Bank v. Manufacturers Hanover Trust Co. (No. 2)*, [1989] 1 Lloyd’s L.R. 608, Hirst J. viewed the matter as a “question of mixed fact and law”. At p. 619, he said:

Since, however, this is a question of mixed fact and law, it is necessary for me to consider the proper law on the alternate hypothesis that there was one single contract. The legal position is well established that an English Court

will not split the proper law of a contract readily and without good reason, but that it is open for the parties to agree that one aspect be governed by the law of one country and another aspect by the law of another country (Dicey and Morris Conflict of Laws 11th ed., p. 1163). This is based on a very well-known passage in the dissenting judgment of Lord MacDermott in *Kahler v. Midland Bank Ltd.*, [1950] A.C. 24 at p. 42, as follows:

Though there is no authority binding your Lordships to the view that there can be but one proper law in respect of any given contract, it is doubtless true to say that the courts of this country will not split the contract in the sense readily and without good reason. In my opinion, however, there is a good ground for so doing in the somewhat unusual and, as I think compelling circumstances of the present case.

[51] In that case, the court implied the intention to split proper law, and distinguished between the law to be applied to a London bank account from the law to be applied to a bank account in New York, in determining the parties' obligations. Hirst J. then determined the proper law, which was not expressly stated, based upon a "substantial connection" test by application of factors similar to some applied in *Cansulex*.

[52] One English case has recognized that the proper law of a contract may be split even in the absence of express or implied intention, where a severable part has a closer connection with one jurisdiction than another. PWC cited the decision of the English Court of Queen's Bench in *Libyan Arab Foreign Bank v. Bankers Trust Co.*, [1989] 1 Q.B. 728. There, Staughton J. recognized, at p. 747, that, "It is possible, although unusual, for a contract to have a split proper law...: see *Dicey & Morris The Conflict of Laws*, 11th ed. (1987), p. 1163 and *Chitty on Contracts*, 25th ed. (1983), para. 2081", and went on to accept a European Economic Union Convention on the Law Applicable to Contractual Obligations:

Article 4 of the E.E.C. Convention of 19 June 1980 on the Law Applicable to Contractual Obligations (Official Journal 1980 No. L.266, p. 1) (as I write not yet in force) provides:

- "1. To the extent that the law applicable to the contract has not been chosen in accordance with article 3, the contract shall be governed by the law of the country with which it is most closely connected. Nevertheless, a severable part of the contract which has a closer connection with another country may by way of exception be governed by the law of that other country."

That such a solution is not necessarily unacceptable to businessmen is shown by one of the Australian printed forms of charterparty, which adopts it.

Mr. Sumptom argues that difficulty and uncertainty would arise if one part of the contract was governed by English law and another by New York law. I do not see that this would be so, or that any difficulty which arose would be insuperable.

In essence, Staughton J. concluded that an English court may sever a portion of a contract and apply a different proper law to it than that which it found applies to the rest of the contract, on the basis that such portion has a “closer connection” to a different legal regime (as opposed to first trying to determine the contractual intent).

[53] Determination of proper law in the case at bar, however, may be made on a construction of the terms of the policies. Policy language contained in the instant policies shows that the parties intended the application of *dépeçage*.

### **Analysis and Disposition – Proper Law**

*Dépeçage:*

[54] This is not a case where previous insurance policies were simply renewed. The policies issued effective July 30, 2007 resulted from specific negotiations between the parties. The evidence also shows that in Federal’s case, significant adjustment was made to the premium and policy limits in view of the poor financial circumstances of the Pope and Talbot Group. In this case, the proper law of the insurance contracts must be determined based on the intention of the parties at the time the subject policies were issued and not in relation to pre-existing policies. Even if I were inclined to consider prior policies in determining proper law, I am not able to do so as none of them are in evidence.

[55] A careful review of each of the policies as a whole demonstrates that the parties allowed for the insurers’ various coverage obligations to be determined by different legal regimes. The contractual language makes it clear that the principle of *dépeçage* applies to the proper law issue. Each of the three insurance policies expressly provides for the application of different legal regimes to different matters

and issues. In fact, Federal and XL acknowledged as much at the conclusion of their oral submissions when they conceded that their policies split the proper law insofar as punitive and exemplary damages are concerned.

*Federal's policy:*

[56] Federal's policy contains two separate "coverage sections":

- (a) "Executive Protection Portfolio Executive Liability and Entity Securities Liability Coverage Section"; and
- (b) "Executive Protection Portfolio Outside Directorship Liability Coverage Section".

Specific endorsements were added to both sections; some were included in one coverage section but not in the other.

[57] Federal's coverage is liability coverage in favour of the directors and officers of the Pope & Talbot Group on a worldwide basis for claims for "wrongful acts" (a defined term) made within the policy period.

[58] Federal's policy contains choice of law language in a number of places.

[59] The first place it is found is in the definition of "Loss". Federal's obligation to pay punitive and exemplary damages is drafted in such a way as to favour the insureds. Further, Federal did not limit the proper law to that of one jurisdiction. It defined proper law in relation to the jurisdiction most favourable to the insurability of such damages that, at the same time, "has a substantial relationship" to "relevant insureds". The use of the plural is significant since there are multiple insureds residing or domiciled in different jurisdictions having their own legal regimes.

[60] The definition of "Loss" in the first coverage section provides, *inter alia*:

**Loss** means:

- (a) the amount that any **Insured Person** (for the purposes of Insuring Clauses 1 and 2) or the **Organization** (for purposes of Insuring Clause 3) becomes legally obligated to pay on account of any covered **Claim**, including but not limited to damages (including punitive or

exemplary damages, if and to the extent that such punitive and exemplary damages are insurable under the law of the jurisdiction most favourable to the insurability of such damages provided such jurisdiction has a substantial relationship to the relevant **Insureds**, to the Company, or to the **Claim** giving rise to the damages), judgments, settlements, pre-judgment and post-judgment interest and **Defense Costs**;

[Bold emphasis in original; underline emphasis added]

[61] In the first coverage section, an “Insured Person” is defined to mean a director, officer, manager, or in-house general counsel to any “Organization” that is “chartered in the United States of America” or “equivalent to any [such] position ... that is chartered in any jurisdiction other than the United States of America”. The definition in the second coverage section is somewhat broader as it includes an employee of an “Organization”.

[62] Contractual intent is clear – the parties intended a multi-faceted approach to the law applicable to Federal’s obligation to pay punitive and exemplary damages, one that permits various legal regimes to apply depending on the nature of the claim and the relationship of a jurisdiction to an “Insured Person”, as well as the law applicable to such damages in that jurisdiction.

[63] Federal’s policy language also acknowledges the potential for a different proper law to apply to each coverage section. Federal excluded from the definition of “Loss”, which is covered, any amount not insurable under the law pursuant to which the particular coverage section of the policy, as opposed to the policy itself, is construed:

**Loss** does not include:

... any amount not insurable under the law pursuant to which this coverage section is construed, except as provided above with respect to punitive or exemplary damages;

[Bold emphasis in original; underline emphasis added]

The definition of “Loss” in the second coverage section is the same in substance; notably, though, it does not provide coverage for “Organizations”.

[64] Thus, Federal's policy recognizes that more than one legal regime may govern the interpretation of the coverage sections therein.

[65] That Federal intended to distinguish between coverage sections and the whole of the policy is also demonstrated in the language contained in Endorsement no. 2 to the "General Terms and Conditions" (which are stated to apply to the entire policy). That endorsement concerns termination of the policy and purports to limit Federal's right to terminate the policy or either or both coverage sections for non-payment of premium. There, Federal wrote:

In consideration of the premium charged, it is agreed that, notwithstanding any provision to the contrary in this policy or any endorsement thereto, the Company [Federal] shall only have the right to terminate this policy or any coverage section for non-payment of premium; accordingly, any reference to paragraph (a) of Subsection 11, Termination of Policy or Coverage Section, in this policy or any endorsement thereto, is deleted. [Emphasis added]

[66] Federal added four endorsements to its General Terms and Conditions, as well as sixteen and three to its first and second coverage sections, respectively. They cover a wide range of subjects including waiver of subrogation, termination of policy or coverage section, compliance with applicable trade laws, whistleblowers, exclusion for non-common law countries, reporting, securities claims, public offerings, representations, changes in exposure, non-entity employment practices, bankruptcy, claims for bodily injury and mental anguish, other insurance, severability, and pollution.

[67] Federal specifically referred to the law of Oregon in three endorsements.

[68] The first one is Endorsement no. 3 to the General Terms and Conditions (which concerns termination of the policy or coverage sections). It states that it supersedes and takes precedence over other policy provisions unless they comply with applicable insurance laws of Oregon. The wording is not clear inasmuch as the endorsement could be interpreted to apply to policy provisions added by endorsement, or, to the policy as a whole:

**OREGON AMENDATORY ENDORSEMENT TO THE GENERAL TERMS  
AND CONDITIONS SECTION**

...

The regulatory requirements set forth in this Amendatory Endorsement shall supersede and take precedence over any provisions of the policy of any endorsement to the policy, whenever added, that are inconsistent with or contrary to the provisions of this Amendatory Endorsement, unless such policy or endorsement provisions comply with the applicable insurance laws of the state of Oregon.

[Bold emphasis in original; underline emphasis added]

I have underlined the words that create confusion.

[69] The heading to the endorsement offers no assistance by virtue of clause 14 of the General Terms and Conditions:

14. The descriptions in the headings and sub-headings of this policy are solely for convenience, and form no part of the terms and conditions of coverage.

[70] In addition, clause 2 of the General Terms and Conditions stipulates that where any provision in the General Terms and Conditions is inconsistent or in conflict with the terms and conditions of any coverage section, then the terms and conditions of “such coverage section shall control for the purpose of that coverage section”.

[71] The lack of clarity is amplified because Endorsement no. 3 immediately follows Endorsement no. 2. Endorsement no. 3 sets out a list of seven bases upon which Federal may terminate the policy or any coverage section. Yet, Endorsement no. 2, which does not mention Oregon law, confines the insurer’s right to termination (“notwithstanding any provision to the contrary in this policy or any endorsement thereto”) for non-payment of premium.

[72] Even though I was not, on the application, directed to or asked to resolve the possible inconsistency between the two endorsements, or the drafting issues arising from Endorsement no. 3, I point them out as instances where Federal turned its mind to the prospect of stipulating Oregon law as the proper law for the entire policy. If Endorsement no. 2 supersedes no. 3, which I think it does (especially given that

the language of no. 3 is so unclear), then Federal's right to terminate is limited to non-payment of premium and Oregon law does not apply.

[73] The second endorsement referring to Oregon law is no. 7 to the first coverage section. It is titled:

**OREGON AMENDATORY ENDORSEMENT TO THE EXECUTIVE  
LIABILITY AND ENTITY SECURITIES LIABILITY COVERAGE SECTION**

This endorsement concerns, *inter alia*, the effect of misrepresentations contained in the application for insurance. Unlike Endorsement no. 3 to the General Terms and Conditions, Federal made it clear that Oregon law applied to matters dealt with by this specific endorsement:

The regulatory requirements of this Amendatory Endorsement shall supersede and take precedence over any provisions of the policy or any endorsement to the policy, whenever added, that are inconsistent with or contrary to the provisions of this Amendatory Endorsement, unless such policy or endorsement provisions comply with the applicable insurance laws of the state of Oregon.

[74] The third endorsement referring to Oregon law is no. 2 to the second coverage section, which also deals with the effect of misrepresentations in the application, and contains the same reference to Oregon law as in Endorsement no.7.

[75] Federal's policy also shows that Federal contemplated different types of claims being made against directors and officers as well as "Organizations" (their companies) in various jurisdictions (including non-common law jurisdictions). For example, in the first coverage section:

- (a) the definition of "Insured Person" shows that Federal contemplated claims against directors, officers, or managers of an "Organization" "chartered in any jurisdiction other than the United State of America";
- (b) the definition of "Securities Claim" includes a claim that "alleges that an **Organization** or any of its **Insured Persons**...violated a federal, state, local or foreign securities law" [Emphasis in original];

- (c) Federal excluded coverage for violations of certain statutes such as the Employee Retirement Income Security Act of 1974, claims made for an account of profits from the purchase or sale of securities within the meaning of “Section 16(b) of the Securities Exchange Act of 1934 or...any similar provision of any federal, state, or local statutory law or common law anywhere in the world”, and the “Sarbanes-Oxley Act of 2002, or any similar ‘whistleblower’ protection provision of an applicable federal, state, local or foreign securities law”;
- (d) in Endorsement no. 6, Federal agreed not to seek allocation of defence costs arising from a “Securities Claim” attributable to alleged violations of ss. 11 or 12 of the Securities Act of 1933; and
- (e) separate treatment is given, in Endorsement no. 2 (concerning “non-common law countries”) to claims “not venued in the United States of America, Canada, Australia or any other common law jurisdiction”.

[76] In summary, contemplating claims made in jurisdictions beyond the US and Canada, Federal turned its mind to the proper law governing different provisions and coverage sections of its policy, including those added by endorsement. It specifically added three endorsements referring to Oregon law, yet chose not to include a choice of law clause to govern the entire policy. Instead, Federal used contractual language that demonstrates the parties’ intention that the laws from various jurisdictions could govern their rights and obligations under the policy.

[77] In my opinion, Federal’s submission that its Oregon Amendatory Endorsements show contractual intent that Oregon law is the proper law of the policy is undermined by Federal’s specific treatment of punitive damages, the definition of “Loss” in its policy, the effect of Endorsement no. 2 of the General Terms and Conditions, the lack of clarity in Endorsement no. 3 to the General Terms and Conditions, clause 2 of the General Terms and Conditions, and the specific language set out in Endorsements no. 7 and no. 2 to the first and second coverage sections, respectively.

*National Union's policy:*

[78] National Union's policy is follow form to Federal's, which means that the provisions contained in Federal's policy are also contained in National Union's policy. As a result, my determination of the proper law issue for Federal's policy applies to National Union's policy unless National Union has specifically added language that expressly or impliedly stipulates a different result.

[79] Even though National Union added specific endorsements that identify a legal regime, it did not add a choice of law clause.

[80] National Union added nine endorsements dealing with cancellation of the policy, reliance on representations contained in the application for underlying insurance, exhaustion of limits and erosion, notice of change in circumstances (e.g., receivership or sale), when underlying coverage is no longer in effect, and payments. Of those, only two refer to specific jurisdictions.

[81] The first, Endorsement no. 1, contains a reference to a jurisdiction, and only in its heading, which reads:

**OREGON CANCELLATION/NON-RENEWAL AMENDATORY  
ENDORSEMENT**

There is no reference to choice of law, nor does that endorsement include the type of language used by Federal in its two endorsements (nos. 7 and 2 to the first and second coverage sections, respectively).

[82] The second endorsement, no. 8, stipulates that performance of one of its obligations, i.e., payment of loss, "shall only be made in full compliance with all United States of America economic or trade sanction laws or regulations, including, but not limited to, sanctions, laws and regulations administered and enforced by the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC")".

[83] The drafters of the National Union policy intended the application of a specific legal regime – the rules of the American Arbitration Association – to apply to the performance of mediations and arbitrations of disputes under the ADR clause. As

well, National Union turned its mind to and added a choice of forum clause stipulating that mediation or arbitration may be held in any one of several jurisdictions.

[84] In its ADR clause, National Union's policy stipulates that non-binding mediation is to be administered by the American Arbitration Association, and that arbitration conducted pursuant to the policy is also to be submitted to that Association and conducted in accordance with its "then-prevailing commercial arbitration rules".

[85] With the exception of the ADR clause contained in its policy, National Union's policy is silent as to the choice of any legal regime governing the contract or performance of its obligations.

[86] National Union relies upon the ADR clause to stay determination of its coverage obligations. The clause is lengthy. In it, National Union sets out the law to be considered by the mediator or arbitrator when construing or interpreting the policy. As well, the ADR clause contains a choice of forum in respect of mediation or arbitration. It provides, *inter alia*:

It is hereby understood and agreed that all disputes or differences which may arise under this policy, whether arising before or after termination of this policy, including any determination of the amount of Loss, shall be subject to the dispute resolution process ("ADR") set forth in this clause.

Either the Insurer and the Insureds may elect the type of ADR discussed below; provided, however, that the Insureds shall have the right to reject the Insurer's choice of ADR at any time prior to its commencement, in which case the Insured's choice of ADR shall control.

The Insurer and Insureds agree that there shall be two choices of ADR: (1) non-binding mediation administered by the American Arbitration Association, in which the Insurer and Insureds shall try in good faith to settle the dispute by mediation under or in accordance with its then-prevailing Commercial Mediation Rules; or (2) arbitration submitted to the American Arbitration Association under or in accordance with its then-prevailing commercial arbitration rules, in which the arbitration panel shall be composed of three disinterested individuals. In either mediation or arbitration, the mediator(s) or arbitrators shall have knowledge of the legal, corporate management, or insurance issues relevant to the matters in dispute.

The mediator(s) or arbitrators shall also give due consideration to the general principles of the law of the state where the Named Insured is incorporated in

the construction or interpretation of the provisions of this policy; provided however, that the terms, conditions, provisions and exclusions of this policy are to be construed in an even-handed fashion in the manner most consistent with the relevant terms, conditions, provisions or exclusions of the policy. In the event of arbitration, the decision of the arbitrators shall be final and binding and provided to both parties... In the event of mediation, either party shall have the right to commence a judicial proceeding; provided, however, that no such judicial proceeding shall be commenced until the mediation shall have been terminated and at least 120 days shall have elapsed from the date of the termination of the mediation...

Either choice of ADR may be commenced in either New York, New York; Atlanta, Georgia; Chicago, Illinois; Denver, Colorado; or in the state indicated in Item 1 of the Declarations page as the mailing address for the Named Insured [P&T Inc].

[Emphasis added]

[87] That clause means, therefore, that a mediator or arbitrator involved with or hearing a dispute pursuant to the ADR clause would have to, when considering the construction of the insurance policy, give “due consideration” to the law of the State of Delaware since that is where P&T Inc. was incorporated, unless the laws of that State were not even-handed or consistent with the relevant terms of the policy.

*XL’s policy:*

[88] XL’s Cornerstone Policy expressly provides for the application of different legal regimes to determine its coverage obligations.

[89] The starting point is the definition of “Loss”, which is one of the bases for XL’s obligation to pay claims. XL’s obligation is to pay for “Loss resulting from a Claim” made during the policy period “for a Wrongful Act”. The obligation to pay the various items comprising “Loss” is determined on the basis of their insurability.

[90] XL’s definition of “Loss” is more expansive than Federal’s: it speaks of awards that include pre- and post judgment interest and multiplied damage awards as well as punitive and exemplary damages. The awards set out in the parenthetical expression below are included in the definition of “Loss” where “insurable by law”:

“**Loss**” means damages, judgments, settlements or other amounts (including pre- & post-judgment interest, punitive or exemplary damages, or the

multiplied portion of any damage award, where insurable by law) and **Defense Expenses** that the **Insured Persons** are obligated to pay.

[Bold emphasis in original; underline emphasis added]

[91] XL makes it clear, in a “Note” contained within the definition of “Loss”, that the law governing its obligation to pay punitive, exemplary, or multiplied damages, fines, penalties, or taxes, but not pre- and post judgment interest, is the law of the jurisdiction most favourable to insurability (it “shall control”):

Note: With respect to coverage for punitive, exemplary or multiplied damages or fines, penalties or taxes, the law of the applicable jurisdiction most favourable to the insurability of such amounts shall control.

[92] There is also a category excluded from the definition of “Loss” – “matters” uninsurable by the law “pursuant to which the policy is construed”:

**Loss** will not include:

- (1) matters which are uninsurable under the law pursuant to which this Policy is construed;

[Bold emphasis in original; underline emphasis added]

[93] “Matters” is not defined in the policy. Dictionary definitions show that this word has a broad meaning. *Black’s Law Dictionary*, 8th ed. (2004) defines “matter” as follows:

**matter**, *n.* **1.** A subject under consideration, esp. involving a dispute or litigation; ... **2.** Something that is to be tried or proved; an allegation forming the basis of a claim or defense.

The *Shorter Oxford Dictionary*, 6th ed. (2007) defines the word to mean, *inter alia*:

**matter**, *noun*, ... **14 a** An event, circumstance, question, etc., which is or may be an object of consideration or practical concern; in *pl.*, events, circumstances, etc., generally... **15** A thing or things collectively of a particular kind or related to a particular thing, *Usu. foll. by for or of*, or with specifying word. ... **16** Material cause; elements of which something consists or out of which it arises.

[94] A third category relates to fines, penalties, or taxes imposed by law. They are not covered, as they are specifically excluded by the definition of “Loss”, except

where they are insurable by law and imposed in connection with an “Insured Person’s” service to an entity that is financially solvent:

**Loss** will not include:

...

- (2) fines, penalties or taxes imposed by law; provided, that this DEFINITION (K)(2) will not apply to fines, penalties or taxes that an **Insured Person** is obligated to pay if such fines, penalties or taxes are insurable by law and are imposed in connection with such **Insured Person’s** service to an entity included within the definition of **Company** that is financially solvent.

[Bold emphasis in original; underline emphasis added]

[95] XL’s policy also shows that the insurer contemplated different types of claims being made against the insureds in various jurisdictions. In fact, with the exception of coverage for “Defence Expenses” (a defined term), XL’s policy excludes coverage for “Loss” in connection with any claim, *inter alia*, “brought and maintained in a non-common law jurisdiction outside the United States of America or its territories or possessions”.

[96] Comparing all of the language contained in the definition of “Loss” makes it clear that the parties intended that while one legal regime would apply to the policy, other legal regimes may apply to XL’s obligations to pay interest, punitive and exemplary damages, the multiplied portion of any damage award, and fines, penalties, and taxes.

[97] XL’s policy also contains a term described as a “no action” clause, which purports to operate as a condition precedent to an “Insured Person” bringing an action against XL. Although XL previously relied on this clause as a basis to stay a coverage determination by this Court, during the hearing XL abandoned its reliance on that clause in this case for practical reasons. XL prefers to participate in the looming coverage determination hearing rather than sit on the sidelines; if it won its stay application, XL could be faced with allegations of *res judicata* and issue estoppel from its insureds.

*Disposition:*

[98] A careful review of the insurance policies shows that the parties anticipated *dépeçage*. The parties had ample opportunity to select one proper law, especially the law of Oregon. They chose not to do so. This fact alone, however, does not lead to the conclusion that the proper law of the policies is BC law.

[99] From examining each policy as a whole, and in particular, contractual language allowing for different policy sections, claims, and “matters” to be interpreted according to different legal regimes, it is clear that the parties intended the proper law to be determined in connection with the substance of the claim made (including relief sought) or matter at issue.

[100] The instant case is an exceptional one, created by the parties’ contractual intent, which is expressed through the use of specific language drafted by underwriters following lengthy negotiations.

[101] For example, in the Federal policy, the parties agreed that avoidance of the policy for misrepresentation on the application for insurance is governed by the “applicable insurance laws” of Oregon.

[102] Another example is Federal’s obligation to provide coverage for punitive and exemplary damages is to be construed in accordance with a legal regime that may be different than the law which governs the coverage section within which that obligation is found.

[103] XL’s policy, for example, incorporates a definition of “Loss” that states its obligation to provide coverage for “matters” and certain specified claims (set out in the definition of “Loss”) is determined on the basis of their insurability by law. The drafters of its policy contemplated, at least for certain specific claims, that a legal regime (most favourable to insurability) may apply that is different than the legal regime by which the rest of the policy is construed.

[104] My determination regarding the parties' intent does not mean that the policies exist in a vacuum. This is not a case, as was posited in *Armar Shipping* (at p. 505) where the proper law "float[s] until the carrier, unilaterally, makes a decision". Nor is this a situation like that in *Amin Rasheed* (at p. 895), where the court was being asked to determine, based on the use of a Lloyd's form much used on an international scale, that the contract is "an internationalised, or floating, contract, unattached to any system of law". The policies in this case are, in fact, connected to more than one jurisdiction and legal regime, e.g., British Columbia, Ontario, Delaware, Oregon, Indiana, New Jersey, Pennsylvania, New York, and Connecticut. In my opinion, this is an extraordinary case, one where the parties intended that a court having taken jurisdiction over the claim or matter in dispute would determine the proper law according to its own laws.

[105] The facts in this case are more compelling than those in *Libyan Arab Foreign Bank (No. 2)*: here, the parties' intention to apply *dépeçage*, and to which subject matters, is manifest. Except for the application of Oregon insurance law to deal with misrepresentations contained in the application submitted to Federal, the parties did not specifically set out the laws from a specific jurisdiction(s) to govern their obligations. Proper law is left to be determined by the court hearing the dispute to find based on application of its own laws, taking into account directing language in the policies (e.g., concerning punitive and exemplary damages in Federal's policy and those same damages along with multiplied damage awards, fines, penalties, and taxes in XL's policy).

[106] Simply because a court takes jurisdiction, it does not necessarily follow that such jurisdiction's legal regime will be applied as the proper law. Nor does the prospect that more than one court can or does take jurisdiction to determine coverage obligations in the policies affect the analysis. Principles of conflict of laws are flexible enough to deal with fact patterns where more than one forum can take jurisdiction. In *Amin Rasheed*, at p. 888, Lord Diplock said:

One final comment on what under English conflict rules is meant by "proper law" of a contract may be appropriate. It is the substantive law of the country which the parties have chosen as that by which their mutual legally

enforceable rights are to be ascertained, but excluding any renvoi, whether of remission or transmission, that the courts of that country might themselves apply if the matter were litigated before them. For example, if a contract made in England were expressed to be governed by French law, the English court would apply French substantive law to it notwithstanding that a French court applying its own conflict rule might accept a renvoi to English law as the *lex loci contractus* if the matter were litigated before it.

Thus, proper law may always be ascertained. Moreover, application of repugnant laws from a legal regime arguably connected to the policies may be avoided on the ground of public policy: *Vita Food*, p. 521.

[107] That the parties in the instant case intended a multi-faceted approach to the proper law of the contract at the time the policies were issued, tied to the substance of the claims, matters, or coverage sections in issue, is demonstrated by the circumstances existing at the time.

[108] D&O liability coverage was being provided on a worldwide basis at a time when the bulk of P&T Inc.'s revenue (and debt) was generated by its Canadian operations, through its subsidiary P&T Ltd. Although the majority of claims could thus be expected to arise from the Canadian operations, underwriters also expressed concern over possible bankruptcy proceedings in the US. Financial insolvency loomed large. An approach to proper law that is claim or matter dependent allowed the insurers to provide worldwide D&O and "Organization" liability coverage in a manner that made commercial sense to the parties having regard to the particular circumstances existing at the time the policies were issued. This does not mean that the policies exist in a legal vacuum until a claim is made against any or all of the insureds. For example, a dispute between Federal or National Union, on the one hand, and any or all of their insureds, on the other, concerning voidance for misrepresentation in the application will be determined by Oregon law (as per Endorsements no. 7 and no. 2). For the XL policy, the definition of "Loss" mandates that such a dispute would be determined according the law to which the entire policy is construed.

[109] Having taken jurisdiction, I must now determine the proper law to be applied. In BC, the approach to determining the proper law of a contract is set out in

*Cansulex.* I propose to review the factors outlined by Chief Justice McEachern, in ascending order of importance, to determine the proper law to be applied to the policies:

(a) *Where the policy was made:*

The insurers did not suggest that each policy was made in a different jurisdiction, and instead asserted Oregon was the place where the policies were made. For the reasons set out in (c) below, I cannot find that the policies were made in Oregon. The mere fact that the head office of P&T Inc. and the broker's office were located in Portland and that Federal had an office in Oregon, does not mean that the contracts were made in Oregon. Section 5 of the *Insurance Act* deems them to have been made in BC, a presumption that I find the insurers have not rebutted. This factor favours BC law.

(b) *The form of the policy:*

No evidence was tendered to show that the insurance forms, all written in English, are American, or for that matter, unique to or derived from any particular jurisdiction. The liability concepts expressed in the policies are well known and widely used in D&O and organization claims made insurance policies issued in Canada.

The premium amounts and payment obligations of the insurers are expressed in US dollars, although the latter is expressed in terms of a conversion from foreign currency to US currency. It is not unheard of for non-American companies to do business in US currency.

In my opinion, this factor is neutral.

(c) *Where the parties' operations are located:*

The insurers' head offices and principal places of business are located in States other than Oregon (New York, New Jersey, Indiana,

Pennsylvania, and Connecticut). Apart from Federal, there is no evidence to show that the other insurers had offices in Oregon. Federal's decision to accept the risk was made in several jurisdictions: Los Angeles, Portland, and New Jersey. National Union's decision to go on risk was made in New York City. All of XL's underwriting was carried out in Stamford, Connecticut. National Union's policy was issued out of its office in New York City; XL's policy was issued out of its office in Connecticut.

The bulk of the operations of the Pope & Talbot Group were located in British Columbia. Most of its employees were located, and I infer worked, in this jurisdiction. The head office of the parent, P&T Inc., was located in Portland. It was incorporated in Delaware, where its insolvency proceedings were commenced.

In its application for insurance, the strength of the Canadian dollar was cited as a significant reason for its adverse financial position. The remarks made by Federal's underwriters in their underwriting analysis demonstrate that the insurer was aware that the proportion of P&T Inc.'s operations in BC (through its Canadian subsidiary) were significant enough to result in considerable loss to the company when the high Canadian dollar made its products from BC less competitive.

The facts surrounding this factor favour British Columbia law. Nothing other than the location of an office for Federal, some aspect of underwriting by Federal, the location of P&T Inc.'s head office in Oregon, and a mill operated by P&T Ltd. in Halsey favours Oregon law. Having turned their minds to proper law, none of the parties chose Oregon law as the law of their contracts. This omission is telling.

- (d) *The subject matter of the contract:*

The subject matter of the contract is worldwide liability insurance for the directors and officers of the Pope & Talbot Group as well as direct coverage for the “Organizations” comprising that Group. Without considering the nature and location of the operations of the Pope & Talbot Group, this factor is neutral. Once they are considered, the law of BC is favoured as the proper law since the majority of the operations of the Pope & Talbot Group, including its employees, were located in BC at the time the policies were made.

(e) *Where claims might be expected to arise:*

The nature and location of the operations of the Pope & Talbot Group at the time the policies were issued shows that, with the possible exception of bankruptcy proceedings in the US, most of the claims could be expected to arise from Canadian operations. This factor favours BC law.

[110] In the circumstances, I find that the policies have the closest and most substantial connection with BC.

[111] In my respectful view, it would be a facile approach to conclude there is only one proper law governing each policy, given the extraordinary language used in the policies. If I had to, then upon the application of the *Cansulex* factors, I would find the proper law of the policies to be BC law at the time they were made.

[112] As McEachern C.J.S.C. said in *Cansulex*, at p. 290: “This is not really a case like *Colmenares* because it was a reasonable inference in that case that a person applying in Toronto to an Ontario corporation for a policy on a Canadian form would be governed by Canadian law”. The facts of this case are more complex than in *Colmaneres*, where a standard form life insurance policy issued by a Canadian insurer was in issue.

[113] In this case, the *CBCA* s. 119 claims, which have no equivalent in Oregon, are unique to the Canadian operations of the Canadian subsidiary of P&T Inc. They

are brought pursuant to a Canadian statute. The proper law of the policies to determine the insurers' coverage obligations for those claims is BC law.

[114] During submissions, the parties referred to the doctrine of reasonable expectations of the parties to support their position on the proper law. I have determined that the policies are not ambiguous in terms of proper law. PWC argued that the policies were ambiguous insofar as the proper law issue is concerned. Even if it could be said that they are ambiguous – with the exception that in the Federal policy Oregon law is stipulated as the proper law for Endorsements nos. 7 and 2, which govern the consequences of misrepresentation – application of the doctrine of reasonable expectations of the parties leads to the same result in respect of the s. 119 claims.

[115] In terms of reasonable expectations, the circumstances extant at the time the policies were issued (which I have set out in these reasons for judgment) leads me to conclude that the parties expected BC law to apply to claims flowing out of the operations of P&T Ltd. For claims arising from operations of P&T Inc., the parties expected the proper law would be determined by the State in the United States taking jurisdiction. Federal and National Union are each part of a different group of companies having at least one other insurance company that carries on business in Canada. XL also has a related company that carries on business in this country. In my respectful view, the insurers, having chosen to underwrite coverage for P&T Ltd. and its directors and officers, must be taken to have been aware of s. 5 of the BC *Insurance Act* and other like provisions in other provincial insurance statutes, including Ontario (where P&T Ltd.'s registered and records office is located).

[116] The s.119 claims are unique to Canada and arise solely out of the BC operations. The parties would reasonably have expected BC law to apply to determine the insurers' coverage obligations under the policies.

**Analysis and Disposition – ADR clause**

[117] National Union seeks to stay these proceedings until mediation takes place pursuant to the ADR clause. During submissions, National Union conceded that the clause was procedural and did not affect substantive rights, so that its application can be determined by the *lex fori*.

[118] In my previous decision (2009 BCSC 1014, 76 C.C.L.I. (4th) 212, at paras. 147 to 150), I referred to several decisions holding that the *BIA* confers jurisdiction on Canadian Superior Courts to disrupt private contractual rights: e.g. *GMAC Commercial Credit Corporation – Canada v. T.C.T. Logistics Inc.*, 2006 SCC 35, [2006] 2 S.C.R. 123, rev’g in part (2004), 71 O.R. (3d) 54, 238 D.L.R. (4th) 677 (C.A.); and *Sam Lévy & Associés Inc. v. Azco Mining Inc.*, 2001 SCC 92, [2001] 3 S.C.R. 978.

[119] The rationale underlying that point is well set out in the decision of Topolniski J., whose reasoning was affirmed by the Alberta Court of Appeal in *Residential Warranty Co. of Canada Inc. (Re)*, 2006 ABQB 236, 62 Alta. L.R. (4th) 168, aff’d 2006 ABCA 293, 65 Alta. L.R. (4th) 498:

[25] A significant objective of the *BIA* is to ensure that all of the property owned by the bankrupt or in which the bankrupt has a beneficial interest at the date of the bankruptcy will, with limited exceptions, vest in the trustee for realization and ratable distribution to creditors. To further this objective, the *BIA* provides for practical, efficient and relatively inexpensive mechanisms for asset recovery, determination of the validity of creditor claims, and distribution of the estate. A fundamental tenet of *BIA* proceedings is that fairness should govern.

[120] Resort to inherent jurisdiction may be made to further the objects of the *BIA* where the *Act* does not provide a specific mechanism. In essence, failing specific provision in the statute, the “gap” may be filled by statutory construction, or failing that, then by resort to inherent jurisdiction. According to Topolniski J., the *BIA* expressly preserves the Bankruptcy Court’s equitable and ancillary powers. Resort to inherent jurisdiction is “maintained and available as an important but sparingly used tool”. At para. 26, he wrote:

The *BIA* expressly preserves the Bankruptcy Court's equitable and ancillary powers. Accordingly, inherent jurisdiction is maintained and available as an important but sparingly used tool. There are two preconditions to the Court exercising its inherent jurisdiction: (1) the *BIA* must be silent on a point or not have dealt with a matter exhaustively; and (2) after balancing competing interests, the benefit of granting the relief must outweigh the relative prejudice to those affected by it. Inherent jurisdiction is available to ensure fairness in the bankruptcy process and fulfilment of the substantive objectives of the *BIA*, including the proper administration and protection of the bankrupt's estate.

[121] Topolniski J. also remarked that solutions to *BIA* issues will require judges to consider the realities of commerce and business efficacy:

[27] Solutions to *BIA* concerns require consideration of the realities of commerce and business efficacy. A strictly legalistic approach is unhelpful in that regard. What is called for is a pragmatic problem-solving approach which is flexible enough to deal with unanticipated problems, often on a case-by-case basis.

[122] The same point was made by Farley J. in *Canada (Minister of Indian Affairs and Northern Development) v. Curragh Inc.* (1994), 114 D.L.R. (4th) 176, 27 C.B.R. (3d) 148 (Ont. Ct. J. (Gen. Div.)) at p. 185:

While the *BIA* is generally a very fleshed-out piece of legislation when one compares it to the *CCAA*, it should be observed that s. 47(2)(c): "The court may direct an interim receiver ... to ... (c) take such other action as the court considers advisable" is not in itself a detailed code. It would appear to me that Parliament did not take away any inherent jurisdiction from the court but in fact provided, with these general words, that the court could enlist the services of an interim receiver to do not only what "justice dictates" but also what "practicality demands". It should be recognized that where one is dealing with an insolvency situation one is not dealing with matters which are neatly organised and operating under predictable discipline. Rather the condition of insolvency usually carries its own internal seeds of chaos, unpredictability and instability.

[123] Section 183(1) of the *BIA* invests Bankruptcy Courts with equitable jurisdiction:

The following courts are invested with such jurisdiction at law and in equity as will enable them to exercise original, auxiliary and ancillary jurisdiction in bankruptcy and in other proceedings authorized by this Act during their respective terms, as they are now, or may be hereafter, held, and in vacation and in chambers: ...

...

(c) in the Provinc[e] of...British Columbia, the Supreme Court[.]

[124] Although the *BIA* permits Bankruptcy Courts to interfere with leases and creditor agreements in some circumstances, it makes no specific mention of interference with conditions precedent to an insurer's coverage obligations. Nor does the *Act* define what is meant by "auxiliary" or "ancillary" jurisdiction.

[125] Dictionary definitions offer little guidance. *Black's Law Dictionary* defines "auxiliary" to mean: "The incidental aid by an equity court to a court of law when justice requires both legal and equitable processes and remedies". The *Shorter Oxford Dictionary* defines it as: "Helpful: giving support or succour; ...subsidiary, additional, ancillary." The word "ancillary" is defined in *Black's Law Dictionary* to mean: "A court's jurisdiction to adjudicate claims and proceedings related to a claim that is properly before the court". The definition contained in the *Shorter Oxford Dictionary* reads: "Subservient, subordinate; auxiliary, providing support".

[126] I view the question, in the circumstances of this case, in terms of the Court's inherent jurisdiction to control its own process in order to promote the objects of the *BIA* rather than gap filling through statutory interpretation.

[127] The Alberta Court of Appeal, in *Residential Warranty*, added its own remarks concerning the scope of the Bankruptcy Court's reliance on inherent jurisdiction:

[20] Inherent jurisdiction is not without limits, however. It cannot be used to negate the unambiguous expression of legislative will and moreover, because it is a special and extraordinary power, should be exercised only sparingly and in a clear case. ...

[21] Further limitations are based on the nature of the *BIA* – it is a detailed and specific statute providing a comprehensive scheme aimed at ensuring the certainty of equitable distribution of a bankrupt's assets among creditors. ... However, inherent jurisdiction has been used where it is necessary to promote the objects of the *BIA*: [citations omitted]. It has also been used where there is no other alternative available: [citations omitted] and to accomplish what justice and practicality require: [citation omitted].

...

[37] Generally, inherent jurisdiction should only be exercised where it is necessary to further fairness and efficiency in legal process and to prevent abuse.

[128] In deciding whether inherent jurisdiction should be exercised, the Court of Appeal in *Residential Warranty* considered a number of factors at para. 37, including:

- (a) the stage of the proceedings and the effect of such an order on them – “for example, the ability of the trustee to make distributions and their amount may depend on the determination of the issue”;
- (b) the need to maintain the integrity of the bankruptcy process – “[t]he equitable distribution of the bankrupt estate must remain at the forefront”;
- (c) the realistic alternatives in the circumstances;
- (d) the impact on the trust claimants and the trust property as well as on other creditors; and
- (e) the anticipated time and costs involved.

[129] Since my previous decision was handed down, Burnyeat J. of this Court has issued reasons for judgment in *Hayes Forest Services Limited (Re)*, 2009 BCSC 1169, [2009] B.C.J. No. 1725 (QL) where, at para. 22, he confirmed the broad jurisdiction of the Court in CCAA proceedings to “decide a dispute...under a [c]ontract...despite the provincial statutory authority and the terms of the [c]ontract”. Burnyeat J. also reviewed other decisions from this Court, the Court of Appeal, and various provincial Superior Courts, all of which are to the same effect – a very broad discretion is afforded to courts dealing with CCAA proceedings to interfere with private contractual or statutory rights: *Luscar Ltd. v. Smoky River Coal Ltd.*, 1999 ABCA 179, 175 D.L.R. (4th) 703; *Landawn Shopping Centres Ltd. v. Harzena Holdings Ltd.* (1997), 44 O.T.C. 288, [1997] O.J. No. 4457 (QL) (Ont. Ct. J. (Gen. Div.)); *Re T. Eaton Co.* (1997), 46 C.B.R. (3d) 293, [1997] O.J. No. 6411 (Ont. Ct. J. (Gen. Div.)); *Re Dylex Ltd.* (1995), 31 C.B.R. (3d) 106, [1995] O.J. No. 595 (Ont. Ct. J. Gen. Div.); *Re Philip’s Manufacturing Ltd.* (1991), 60 B.C.L.R. (2d) 311, 9 C.B.R. (3d) 1 (B.C.S.C.); *Re Playdium Entertainment Corp.* (2001), 31 C.B.R. (4th) 302, 18

B.L.R. (3d) 298 (Ont. S.C.J.), add'l reasons at (2001), 31 C.B.R. (4th) 309, [2001] O.T.C. 828 (Ont. S.C.J.); *Armbro Enterprises Inc.* (1993), 22 C.B.R. (3d) 80, [1993] O.J. No. 4482 (QL) (Ont. Ct. J. (Gen. Div.)); *Skeena Cellulose Inc. v. Clear Creek Contracting Ltd.*, 2003 BCCA 344, 13 B.C.L.R. (4th) 236; *Gauntlet Energy Corp. (Re)*, 2003 ABQB 718, 336 A.R. 302; *Doman Industries Ltd. (Re)*, 2003 BCSC 376, 14 B.C.L.R. (4th) 153; and *Backbay Retailing Corporation v. Gray's Apparel Company Ltd.*, 2008 BCSC 1876, [2008] B.C.J. No. 2784 (QL).

[130] In *Skeena*, the Court of Appeal noted, at para. 37, that in the “exercise of their ‘broad discretion’ under the CCAA, it has become common for courts to sanction the indefinite, or even permanent, affecting of contractual rights”.

[131] The approach taken by Burnyeat J. in *Hayes Forest Services*, and in the other cases he reviewed, is not confined to CCAA proceedings. Courts have interfered with private contractual rights in insolvency cases involving the *Winding-up and Restructuring Act*, R.S.C. 1985, c. W-11: *Canada (Attorney General) v. Reliance Insurance Co.* (2007), 87 O.R. (3d) 42, 36 C.B.R. (5th) 273 (S.C.J.); and *GMAC*. The rationale is explained in the text *Commercial Insolvency in Canada* by Kevin P. McElcheran (Markham, Ont.: LexisNexis Canada Inc., 2005) at p. 4:

The primary statutory and judicial tool used to preserve value and promote order in the insolvency process is the stay of proceedings to suspend the exercise of individual creditor rights. Stays of proceedings are necessary to achieve many of the objectives of commercial insolvency law. Even in the context of a liquidation of the debtor's assets for distribution to its unsecured creditors under the *BIA* or *WURA*, the statutory stay of proceedings permits the orderly and efficient realization of the debtor's assets, the judicial determination of creditor claims and priorities and the fair distribution of proceeds to creditors by reference to their legal rights.

[132] National Union has neither denied nor confirmed coverage despite a demand being made in July 2008, yet wishes to pursue its contractual right to mediate. At one point in the proceeding, National Union submitted that because the claim value does not encroach upon its policy layer, is not necessary for it to provide its coverage position. At another point in the proceeding, National Union submitted that it wished to mediate with its insureds as it was concerned that the claim value might

well exceed Federal's limits and encroach into its policy. In a brief written submission provided later, National Union said if there are s. 119 claims the value of which exceed Federal's layer (which, it said, "does not appear certain"), it would deny coverage "for the same reasons as stated by Federal".

[133] National Union has been provided with information concerning the underlying claims. Its decision to wait upon the value of the claims made against its insureds before taking a position on cover, especially in view of its potential obligation to advance defence costs in the event Federal's layer is exhausted, should not, in my respectful view, allow it to rely on its ADR clause which would, in effect, stand in the way of the resolution of the Pope & Talbot insolvency.

[134] Given National Union's position concerning coverage, there is no good reason for the ADR clause to stand in the way of an orderly and expeditious resolution of the insolvency proceedings.

[135] National Union's position is that it is not bound by this Court's determination of the coverage obligations of the other two insurers. PWC and the directors and officers disagree; they submit that National Union would be bound by the doctrine of issue estoppel. If National Union's position is correct, then forcing the parties to mediate will only add to the costs of the proceedings and cause delay. If the Federal and XL policies are found to respond to the s. 119 claims, then an additional hearing will be required to determine National Union's coverage obligations.

[136] If there is no coverage afforded by National Union's policy, then to adopt the words of Campbell J. at para. 39 of *Fiber Connections Inc. v. SVCM Capital Ltd.* (2005), 10 C.B.R. (5th) 192, [2005] O.J. No. 3899 (Ont. S.C.J.), leave to appeal to Ont. C.A. granted (2005) 10 C.B.R. (5th) 201, 139 A.C.W.S. (3d) (Ont. C.A.), appeal abandoned August 5, 2005, the resolution of the Pope & Talbot insolvency is "held hostage" by purported rights where there is no economic benefit to the party asserting them:

For the purposes of this case, it is not in my view an extension of the concept of inherent jurisdiction, but rather the prevention of one shareholder, with no economic value of his equity, holding all the stakeholders hostages. In this respect, I conclude that the considerations expressed for the exercise of the

Court's inherent jurisdiction under the CCAA are applicable under the BIA to the facts of this case. See *Algoma Steel Inc., Re* (2001), [2002] O.J. 66 (ont. S.C.J. [Commercial List]) at paragraph 5; *Doman Industries Ltd., Re.*, [2004] B.C.J. No. 1402

[137] At this stage of the proceedings, all of the parties and participants involved in the Pope & Talbot insolvency need to know whether D&O insurance coverage is available, and if so to what extent, in order to determine what amounts may be paid to claimants from the Directors' Charge (since that Charge is drawn upon only after claims are paid by existing insurance coverage). The integrity of the bankruptcy process is maintained through a stay order.

[138] National Union submits that its policy is with the directors and officers, who are not insolvent, so that there is no basis to interfere with private contractual rights. With respect, that submission overlooks the fact that coverage is also afforded to P&T Inc. and P&T Ltd. in circumstances where they indemnify directors and officers (and are permitted by law to do so). It also overlooks the fact that the s. 119 claims made against the directors and officers of P&T Ltd. arise from the insolvency of P&T Ltd., which is an insured under National Union's policy.

[139] I was told, during submissions, that National Union wishes to mediate its dispute with its insureds even though the value of the s.119 claims may not exceed Federal's or XL's policy limits. This presumes it will make an offer to its insureds. There is nothing to prevent National Union from doing that or from engaging in settlement discussions with its insureds at any time.

[140] In the circumstances, the operation of the ADR clause is stayed.

### **Summary**

[141] The parties expressly intended the proper law of their policies to be determined in relation to the substance of the claims or matters in dispute, by the court that has taken jurisdiction doing so in accordance with its own laws. The insurers have drafted their policies in such a way as to incorporate the principle of *dépeçage*. Here, application of the *Cansulex* factors shows that BC law is the proper

law to be applied to determine the insurers' coverage obligations in relation to the CBCA s. 119 claims.

[142] National Union's ADR clause is stayed in order to permit the orderly, expedient, and effective resolution of the insolvency surrounding the Pope & Talbot Group.

[143] The parties may speak to the issue of costs.

"The Honourable Mr. Justice Paul Walker"