

Some Insurance Coverage Subtleties and Practice Notes – Putting Some Shape to an Invisible Commodity

By: Dean P.J. Lawton & Christopher H. McDougall

It is a mistake to think of insurance as binary - or like an off/on switch - as either being there or not. There are subtleties to coverage that can change the way a claim ought to be pursued or defended to ensure insurance is available or to ensure useful provisions of an insurance contract are available for strategic use. It is important to everyone involved in the process of pursuing or defending claims to be mindful of coverage issues from the beginning of a claim through its conclusion.

Perhaps the most obvious questions about coverage are whether the event in question is an “occurrence” or whether it is fortuitous or whether the person affected is an insured; be it named or unnamed. Those questions however are not the focus of this paper. Rather, this paper will discuss some of the other coverage or interpretation issues that may arise, but should be in the minds of those whose work is influenced by the presence of insurance.

Specifically, this paper will discuss:

- 1) the duty to defend and its influence on the drafting of pleadings;
- 2) the existence and application of arbitration clauses in insurance policies;
- 3) settlement concerns where there are multiple potential claims that may exceed the Indemnity limits of a policy; and
- 4) the extent of the duty to disclose insurance documents and substantive issues relating to coverage in document production and oral examination for discovery.

1) The Duty to Defend

The duty to indemnify and the duty to defend are related. Unless otherwise stated in the contract, it is the duty to indemnify that determines the scope of the duty to defend.¹ The duty to defend, however, is broader than the duty to indemnify.² The Supreme Court of Canada in *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*,³ clearly outlined the broad duty at paragraphs 19 and 20 in the reasons. The relevant principles are as follows:

- a. The duty to defend is triggered if the facts in the pleadings, if true, would require the insurer to indemnify the insured.
- b. It is irrelevant if the allegations in the pleadings can be proven in evidence.

¹ *Non-Marine Underwriters, Lloyd's of London v. Scalera*, 2000 SCC 24 at para. 49.

² See note 1 at para. 76

³ 2010 SCC 33.

- c. Where it is clear the claim falls outside the policy, there is no duty to defend.
- d. The threshold requirement to trigger a duty to defend is “the *mere possibility* that a claim falls within the insurance policy”. (emphasis added)
- e. The parties to an insurance contract are not bound by the words used by the plaintiff in a pleading to determine whether a duty to defend arises.

The difference between the duty an insurer has to defend versus the duty to indemnify is significant. The duty to indemnify is a question of mixed fact and law that can be proved on a balance of probabilities based on the findings of fact surrounding the event that caused the loss and the interpretation of the contract of insurance. The duty to defend is different. It is triggered before the facts surrounding the event have been proved. In this sense, questions regarding the duty to defend are much like applications for summary judgment or to strike pleadings. The ability of the plaintiff to prove the factual allegations in a Notice of Civil Claim is irrelevant. The defendant seeking a defence under a liability policy is not required to show the merit of the claim for indemnity beyond a mere possibility based on the plaintiff’s pleadings. This is a low threshold; the benefit of the doubt for which I suggest will be exercised in favour of the insured.

The presence of an insurer defending a claim may have ramifications for how that claim is handled. From a plaintiff’s perspective, it can mean the difference between there being a lawyer on the other side at all, and it increases the likelihood of settlement. From the defendant’s perspective, it ensures there is legal representation and it presents an additional source of funds for potential settlement even if there is a question about the duty of the insurer to indemnify. This is so because insurers are sophisticated assessors of risk and are often prepared to eliminate or moderate risk through payment of insurance money in the appropriate circumstances.

Plaintiffs should be aware of common requirements for coverage and common exclusions in liability policies when drafting their pleadings. This is so because the allegations in the pleadings will form the basis of a determination of whether there is a duty to indemnify or if the claim is clearly outside the grant of coverage or falls within an operative exclusion.⁴ The insurer, however, is not at the mercy of the plaintiff’s pleading and it is proper to look behind the labels the plaintiff uses in the pleadings to consider the true nature of the claim.⁵ For example, pleading negligence (or breach of fiduciary duty) in circumstances where on its true construction the case is one of an intentional act will not trigger the duty to defend under a typical liability policy where the factual basis of the pleading does not support a claim in negligence; or the claim in negligence is a derivative of the intentional tort.⁶ Nevertheless, next to the insurance contract itself, the pleading is the most important document in determining whether a claim triggers the duty to defend. It may not be possible with some claims to plead them in such a way to trigger the duty to

⁴ See note 1 at para. 80.

⁵ See note 1 at para. 81.

⁶ See note 1 at para. 85. A claim for negligence or breach of fiduciary is derivative of an intentional tort if it relies on the same facts and the same resulting harm that could sustain the intentional tort.

defend.⁷ However, there will also be instances where poorly drafted pleadings, or pleadings that omit a valid alternative pleading, do not trigger the duty to defend where properly pleaded facts could have the opposite result.⁸ I must also regrettably report that I have been involved in cases where I have been suspicious that pleadings have been drafted for the intentional purpose of creating an off coverage response from insurers thereby causing expense and grief for insureds.

Note too cases where there may be sufficient facts to link a tortious act with the use and operation of an automobile and also the occupation of a premises thus potentially involving two or more insurers, or in other circumstances where there may be more than one species of insurance that may be called upon to respond.⁹

2) Arbitration Provisions

Many contracts of insurance and statutory indemnities contain an arbitration provision. These provisions, which are governed by Section 15 of the *Commercial Arbitration Act*,¹⁰ are very strong mechanisms to keep the coverage dispute out of Court. Coverage counsel for the insurer needs to pay attention to those provisions immediately because it is very easy for an insurer to submit to the jurisdiction of the Court perhaps without intending to do so.

The proper way to challenge an insurer denying coverage is by petition,¹¹ though occasionally a defendant insured will add its insurer as a third party in the existing action. Regardless of what occurs, the response of the insurer must be an immediate application to stay the coverage proceedings if it intends to rely on an arbitration provision in an insurance contract. If a defendant insured attempts to add an insurer as a third party after the 42 day limit imposed by Rule 3-5(4) - where leave of the Court is required - the insurer can oppose the application on the basis of the arbitration provision, but should also ask for a stay of proceedings in the alternative.

⁷ See note 1 and 2 generally. Also see *Corbould v. BCAA Insurance Corp.* 2010 BCSC 1536.

⁸ See *Derksen v. Ontario Ltd.*, 2001 SCC 72 as a case where multiple particulars of negligence required both an automobile insurer and a CGL insurer to respond in contrast with *V-Twin Motorcycle School Ltd. v. Insurance Corp. of British Columbia*, 2010 BCSC 725 where the pleadings required the automobile insurer to respond but not the CGL insurer. This is not to say the pleadings in *V-Twin Motorcycle School Ltd.* could have been drafted as to require the CGL insurer to respond, but counsel should be aware of the possibility. Also see *Economical Mutual Insurance Co. v. Doherty*, 2009 BCSC 959 where a tort that occurred in a soccer game was characterized as intentional based on the pleadings in contrast to *Unruh (Guardian ad litem of) v. Webber* (1994), 112 D.L.R. (4th) 83 (BCCA) and *Condon v. Basi*, [1985] 2 All E.R. 453 (C.A.) where similar torts were considered negligent.

⁹ See *Citadel General Insurance v. Vytlingam*, 2007 SCC 46 and *Lumbermens Mutual Casualty Co. v. Herbison*, 2007 SCC 47 for unsuccessful attempts to link a tortious act to an automobile and *Whitehead v. Whitehead* (1984), 7 C.C.L.I. 299 (B.C.S.C.) where homeowner insurer and automobile insurer were held 50/50 liable to indemnify an insured.

¹⁰ RSBC 1996, c. 55. The *Commercial Arbitration Act* applies to arbitration agreements generally, see Section 2.

¹¹ See *Axa Pacific Insurance Co. v. Elwood*, 2000 BCSC 1248 and *Blieferrich v. Freeman* (1989), 38 B.C.L.R. (2d) 128 (C.A.).

The test to determine if an action ought to be stayed under section 15 is set out in *Prince George (City) v. McElhanney Engineering Services Ltd.*¹² at para. 22:

- a. the applicant must show that a party to an arbitration agreement has commenced legal proceedings against another party to the agreement;
- b. the legal proceedings must be in respect of a matter agreed to be submitted to arbitration; and
- c. the application must be brought in a timely way, i.e. before the applicant takes a step in the proceeding.

Any action other than bringing an immediate application for a stay of proceedings can be interpreted as “a step” submitting to the jurisdiction of the Court, and will prevent the insurer from relying on the arbitration provision.¹³ For example, filing a defence has been held to be submitting to the jurisdiction of the Court¹⁴, as has sending the insured a letter stating the insurer intends to file a defence and other preliminary steps¹⁵. It is therefore very important for counsel for the insurer to be alive to these provisions and seek instructions on them before any action is taken on the file.

3) Multiple Claims and Impending Policy Limits

Single insured occurrences can cause loss to multiple parties. In many of these cases the sum of the potential losses may threaten, or exceed, the policy limits available. In those circumstances, it is very important for both plaintiff and defence counsel to be aware of the consequences of settling or delaying litigation or settlement.

There are differences between claims that are governed under the *Insurance (Vehicle) Act*¹⁶ and the *Insurance Act*.¹⁷

For claims governed under the *Insurance (Vehicle) Act*, a plaintiff (or potential plaintiff) is *entitled* to have insurance money applied toward a judgment or settlement.¹⁸ This has been interpreted to mean, in the case of multiple claims or potential claims that could exceed the policy limits, the insurer must distribute the available insurance funds *pro-rata* amongst the claimants or potential claimants.¹⁹ A failure to do so could result in the insurer having to pay claims beyond the stated indemnity limits of the policy.²⁰

¹² 1995 CanLII 2487 (BCCA).

¹³ Under the old rules, an appearance could be filed without submitting to the jurisdiction of the Court. Also, steps taken to ‘parry or smother’ an action do not constitute steps in the proceeding, such as defending a certification application in a class action. See *Bodnar v. Payroll Loans Ltd.*, 2009 BCSC 1205.

¹⁴ *Friesen v. Lam*, 2007 BCSC 1124.

¹⁵ See *Larc Developments Ltd. v. Levelton Engineering Ltd.*, 2010 BCCA 18 where a demand for particulars by the defence was held to be a step in the proceeding.

¹⁶ RSBC 1996, c. 231 (formerly the *Insurance (Vehicle) Act*)

¹⁷ RSBC 1996, c. 226

¹⁸ Section 76(1) and (2).

¹⁹ *Henry v. Zurich Insurance Co.*, 1998 CarswellBC 431 (S.C.).

²⁰ *Bartkow v. Merit Insurance Co. (No. 1)*, [1962] I.L.R. 1-068 (BCCA).

In motor vehicle cases counsel for the insurer must be aware when a motor vehicle collision may have created other potential claims yet to surface. Paying a judgment or settling a claim in such a case where there are limits issues does not deprive the right of the other potential claimants to share in the insurance proceeds and the result is the insurer will be liable for more than the limits of the policy. In such a case settlement is to be avoided unless that settlement includes all potential claimants. If a judgment is rendered, the insurer must use Section 78 of the *Insurance (Vehicle) Act* and pay the judgment (or the limits) into Court. This provides a statutory discharge to the insurer from the burden of claims made by future potential claimants.²¹

Claims that are governed under the *Insurance Act* are subject to Section 24 which gives a judgment-holder a right of action directly against an insurer to recover an amount that the insurer is obligated by contract to indemnify the insured. There is no provision in the *Insurance Act* that entitles claimants or potential claimants to insurance proceeds as under the *Insurance (Vehicle) Act*. This difference was analyzed in *Re: Aviva Canada Inc.*,²² where the Court held that absent the statutory scheme in the *Insurance (Vehicle) Act*, a situation with multiple potential claimants and a policy limit issue was governed by the “first past the post” principle. This means an insurer has the ability to settle claims and pay judgments until the policy limits are exhausted to the potential prejudice of those who claim subsequently should the insured lack other insurance or the independent means to pay monetary judgments beyond insurance indemnity limits.²³

Motor vehicle claims and non-motor vehicle claims are subject to different public policy concerns. For the risks associated with motor vehicle use, the legislature has implemented a system to ensure those who are injured have a remedy by creating a mandatory insurance scheme and, in furtherance of that goal, by creating the provisions entitling a potential claimant to share in insurance proceeds. Non-motor vehicle claims do not share these same policy concerns and thus the legislature has not created a similar system. In that situation, the “first past the post” system is preferable because it encourages early settlement and rewards claimants who pursue their claims early and diligently, as stated by the court in dicta in *Re: Aviva Canada Inc.* above.

Counsel acting for an insurer in a non-motor vehicle context where there are multiple claims and potential limits issues can settle claims and pay judgments as they are presented. The concept is that if insurers give notice to claimants or potential claimants, those claimants may have a stronger incentive to settle quickly and on favourable terms to the insured. Counsel for a potential claimant in such circumstances must be aware of the risks of delaying advancing a claim including inadequate or no insurance money being available after indemnity limits are eroded or exhausted by “early bird” claimants.

²¹ *Regency Plymouth Chrysler Inc. v. Insurance Corp. of British Columbia*, 1999 CarswellBC 585 (S.C.) and *Aviva Canada Inc., Re*, 2006 BCSC 1578.

²² 2006 BCSC 1578.

²³ The first past the post method is also used in Ontario (*Solway v. Lloyd's Underwriters* (2005), 22 C.C.L.I. (4th) 138 (Ont. S.C.J.), Alberta (*Commerce & Industry Insurance Co. Canada v. Singleton Associated Engineering Ltd.*, 2005 ABQB 500) and England (*Cox v. Bankside Members Agency Ltd.*, [1995] Lloyd's Rep. 437 (Eng. CA)).

4) Discovery Rights

The Supreme Court Civil Rules provide a right to insurance information through document production and in an oral examination for discovery, but these rights are not identical. The oral examination right is broader than the document production right.

Document production is set on in Rule 7-1(3) which states that a party must produce any insurance policy under which an insurer may be liable to satisfy any part of the judgment or to reimburse any party for any portion of a satisfied judgment. However, there are many potential issues – some subtle and some significant - including full on coverage disputes that may be going on behind the scenes about which plaintiff counsel and counsel for cross claiming third parties will wish to be informed. The plaintiff may be initially proceeding on the assumption that there is valid insurance responding to the claim which will ultimately indemnify the defendant in the event of a settlement or judgment. This assumption may be disconcertingly false.

Examination for discovery gives plaintiff's counsel a broader opportunity to ask the defendant questions about coverage issues. This may shed light on additional coverage issues outside what is discoverable merely on document production. Rule 7-2(19) requires a party to answer any question in his or her knowledge relating to the existence of an insurance policy that an insurer may be liable as outlined in Rule 7-1(3). However, Rule 7-2(19)(b) goes on to allow questions regarding "any communication from an insurer denying or limiting liability under the policy."²⁴ If the presence of a coverage issue is of concern to the plaintiff, then discovery is a helpful and relatively new procedural tool to gain insight into that matter, and to assess the advisability of a compromised settlement and other potential remedies.

Conclusion

The presence of insurance is an important consideration for anyone working on a claim at both the adjustment and litigation stages; whether claiming or defending. Besides the general principles relating to coverage and exclusions, there are additional nuanced points of law that should be considered when planning how to prosecute or defend a claim. This paper has attempted to illustrate examples of some of these matters; but readers should be aware that questions and issues relating to insurance coverage and their impact on

²⁴ As a side note, if you were to look at McLachlin & Taylor's *British Columbia Practice*, or BClaws.ca or QP Legaleze, you will see Rule 7-2(19)(b) does not talk about questioning a party on communications from an insurer. Rather, it says: "if the hearing of the application is adjourned to a date later than the following business day, after the hearing is adjourned." Read in the context of the section, this line makes absolutely no sense. If you were to trace the history of the legislation, it appears section 7-2(19)(b) was modified twice by regulations 119/2010 and 241/2010. Those regulations actually modify rule 8-1(19)(b) which deals with returning an application record. The text from rule 8-1(19)(b) has, in error, been transplanted onto rule 7-1(19)(b) in the Queen's Printer version of the Rules. The true reading of rule 7-1(19)(b) is found in the current White Book and the actual history of the rule shows that it has not been modified in the manner found in the Queen's Printer version.

proceedings can be multilayered and occasionally ethereal requiring a reflective look at the relationship between legal principles and the facts in a particular case.