When an insurer is estopped from denying coverage, and other Supreme Court of Canada musings on the relationship between an insurer and insured

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Introduction

Given that insurance law cases from the Supreme Court of Canada are issued with about the same frequency as the appearance of a blue moon, it is noteworthy when such an event does occur, such as on November 18, 2021 when the SCC released its decision in *Trial Lawyers Association of British Columbia v. Royal & Sun Alliance Insurance Company of Canada*, 2021 SCC 47.

This case is important for insurers because of the many issues that the Court discusses surrounding the relationship between an insurer and insured, and the decision making process that an insurer goes through when deciding whether to defend a liability claim brought against its insured. The primary legal issue in the case was whether a liability insurer, who had already decided to defend its insured in a liability claim, could later take an off-coverage position after the discovery of new information that led to the conclusion the insured was in breach of his liability policy. In the course of concluding that the insurer was not estopped from withdrawing its defence, the SCC explored the relationship between insurer and insured, including the duty of utmost good faith owed between them, as well as the duty of the insurer to investigate a claim, and also whether the insurer owes any duty to the injured third party.

Facts

In 2006 Steven Devecseri died in a motorcycle accident when he rode into oncoming traffic and collided with a car being driven by Jeremy Caton. Caton was injured in the crash. Jeffrey Bradfield, who was riding a motorcycle in company with Devesceri, was also injured. Devesceri was insured by Royal & Sun Alliance Insurance Company of Canada ("RSA").

Bradfield and Caton commenced lawsuits against Devecseri's estate in 2007 and 2008, respectively. Pursuant to Devesceri's insurance policy, RSA provided a defense against these lawsuits on behalf of Devesceri.

Over a year later, in 2009, examinations for discovery were held. Another motorcyclist provided testimony upon examination that he had seen Devesceri and Bradfield consuming alcohol at a restaurant shortly before the accident. The coroner's report from 2006 was then quickly obtained. It revealed Devesceri had a modest quantity of alcohol in his system when he died, putting him in breach of his insurance policy with RSA.

After the accident, RSA had appointed an insurance adjuster to investigate. The adjuster interviewed Bradfield, who had accompanied Devesceri prior to the accident, but he failed to mention any alcohol being consumed by Devesceri. The adjuster's report to RSA concluded speed was a factor in the collision, but further investigation would be required to know whether drugs or alcohol played any role. The adjuster's report expressed confusion about who was responsible for requesting a coroner's report. Although RSA's initial instructions had noted a

coroner's report as a potential avenue of investigation, ultimately neither the adjuster nor anyone else at RSA took any steps to obtain the report prior to the examinations for discovery.

Less than two weeks after the examination for discovery (three years after the accident), RSA advised all parties it was taking an off-coverage position. As such, even if Bradfield and Caton's lawsuits succeeded, they would collectively be entitled to no more than $200,000 (the statutory minimum coverage) rather than the $1 million which would have been available under Devesceri's full policy.

Bradfield settled his action against Devesceri's estate almost three years later in May 2012. As part of the settlement, RSA paid him half its statutory minimum coverage ($100,000 plus costs) and paid the other half to Caton. This settlement also included a payment of $750,000 to Bradfield by his own insurer for underinsured coverage.

A month later, Caton obtained a judgement for $1.8 million against Devesceri's estate and Bradfield. In a cross-claim, Bradfield also obtained judgement for contribution and indemnity from Devesceri's estate.

Issues

Following the trial, Bradfield sought a declaration of entitlement to recover judgement against RSA on the basis that, by failing to take an off-coverage position and by providing a defense to Devesceri's estate as the litigation progressed over the intervening years, RSA had:

1. waived it's right to deny coverage; and/or
2. was estopped from denying coverage.

The Trial Judge's Decision

At trial (2018 ONSC 4477), the court found that RSA had indeed waived it's right to deny coverage by failing to take an off-coverage position and by providing a defense to Devesceri's estate as the litigation progressed. Having found waiver by conduct, the court did not consider the estoppel argument.

The Court of Appeal Decision

The Ontario Court of Appeal ("ONCA") overturned the trial judge's decision, allowing RSA's appeal. It rejected Bradfield's waiver argument, in part because s. 131(1) of the Ontario *Insurance Act* as it was in force at that time precluded recognition of waiver by conduct, providing that waiver could only be given in writing. The ONCA also held the promissory estoppel argument failed as RSA lacked actual knowledge of the policy breach, such knowledge could not be imputed to RSA, and Bradfield was unable to establish detrimental reliance.

It is important to note that s.131 has since been amended and no longer limits waiver to instances of waiver made in writing. The current BC and Alberta insurance legislation contains similar language, such that under all three provincial statutory regimes waiver can be found if there was behavior by the insurer which reasonably causes the insured to believe that their compliance with the requirement was excused in whole or in part, and the insured acted on that belief to their detriment.

After the SCC gave leave to appeal, Bradfield reached a settlement agreement with RSA and discontinued his appeal. The SCC allowed the Trial Lawyers Association of British Columbia ("TLABC") to be substituted as the appellant to hear the appeal on its merits, despite the fact that the appeal was moot.

The SCC Decision

The SCC agreed with the Court of Appeal that, at the relevant time, s.131 of the Ontario *Insurance Act* required that waiver be given in writing, and that RSA had not waived any rights in writing. Therefore, promissory estoppel was the only question remaining to be considered.

The test for promissory estoppel has three requirements:

1. The parties are in a legal relationship at the time of the promise;
2. The promise is intended to affect that legal relationship and be acted on; and
3. The other party in fact relied on the promise to its detriment.

The SCC was unequivocal that a third-party attempting to rely on promissory estoppel to prevent an insurer from declining coverage will have an uphill battle. However, the SCC's discussion of promissory estoppel sheds light on important coverage issues for insurers.

1. The Parties are in a Relationship

Promissory estoppel generally requires the promisor and the promisee already have a legal relationship. The TLABC submitted that s.258(1) of the Ontario *Insurance Act* created such a relationship in providing:

> any person who has a claim against an insured for which indemnity is provided by a contract…even if such a person is not party to the contract, may, upon recovering a judgement…against the insured…may on [their own behalf or another's] maintain an action against the insurer to have the insurance money applied [towards any other judgements or claims against the insured covered by the contract]. *[emphasis added]*

The SCC dealt with this issue *obiter,* agreeing that the statutory language overrides the common law of privity of contract and creates the requisite legal relationship allowing third parties to assert a right of coverage as against insurers.

Despite that, the SCC's opinion was no relationship existed between Bradfield and RSA due to an issue of timing. The Court's opinion was the wording of the provision only creates the requisite legal relationship "upon [the third party] recovering a judgement" against the insured. Importantly, Bradfield had not obtained his cross-claim judgement against Devesceri until 2012, while RSA had abandoned their defense of Devesceri's estate back in 2009. Simply put, Bradfield was seeking to have conduct by RSA estopped which pre-dated the commencement of the statutorily created legal relationship by over three years.

Insurers should be mindful that once a judgement is awarded against the insured, a legal relationship is created between the insurer and third parties whom the insured is liable to.

2. Promise Intended to Affect the Relationship

The most significant issue was that RSA was ignorant of the fact Devesceri had alcohol in his system at the time of the accident. Simply put, one cannot intend to alter a legal relationship by promising to refrain from acting on information that it does not possess.

TLABC argued that RSA should not be permitted to deny coverage on a policy breach they could have discovered had they diligently investigated the claim. The SCC soundly rejected this position. Insurers have a duty to investigate claims in a fair, balanced and reasonable manner, and not engage in a relentless search for policy breaches. In order to moderate the strong economic incentive for insurers to deny coverage, the legal relationship between the insurer and insured must be guided by utmost good faith and fair dealings, with a goal of facilitating honest and expeditious resolutions to insurance claims.

However, an insurer's failure to appreciate the legal significance of a fact may prevent an insurer from later withdrawing coverage. Had RSA been aware Devesceri had alcohol in his system, but failed to appreciate that this was a breach of the policy, a court may conclude the insurer had imputed knowledge of the breach. This may prevent an insurer from denying coverage. While there is no duty to diligently investigate the facts of a claim, an insurer who neglects to diligently investigate the legal implications of those facts does so at their peril.

In addition, the act of an insurer fulfilling its duty to defend its insured is not a promise to indemnify. In providing a defense, RSA was not promising to Devesceri nor Bradfield that RSA would provide indemnification. Nevertheless, in order to remove any ambiguity, it is prudent for insurers to send reservation-of-rights letters or non-waiver agreements to the insured when coverage is uncertain.

3. Detrimental Reliance on the Promise

It remains an open question whether detrimental reliance can be presumed when litigation has progressed to an advanced stage. The SCC explicitly declined to comment on this point. However, insurers expose themselves to more risk the longer they take to finalize coverage.

Takeaways

Duty to Investigate Reasonably

Insurers should not be concerned that they may lose their right to decline coverage because of undiscovered facts. The SCC affirmed insurers have a duty to investigate claims in a fair, balanced and reasonable manner; investigations should not be a relentless search for a policy breach.

However, failure to appreciate the legal significance of a fact may prevent an insurer from denying coverage. Thus it is important that insurers obtain legal advice on coverage at an early stage in order to preserve their rights.

Limited Duty to a Third Party

Sensibly, an insurer should not owe more duties to a third party than it does to its own insured, especially given the fact that an insured owes its own duties to their insurer. While the court did not entirely answer whether insurers could ever owe a duty to a third party, it was firm that such

a duty could never exist in circumstances such as these, where it would imperil the existing duty of good faith and fair dealing to the insured.

The SCC noted that the duty of good faith has been carefully stated and developed with a view to facilitating 'the honest, fair and expeditious resolution of insurance claims'. Recognizing a duty to third parties to investigate assiduously would endanger an insurer's duty to the insured to investigate in a fair, balanced and reasonable matter.

The SCC clearly indicated that they were loathe to recognize any modifications to the law which would imperil the utmost duty of good faith and fair dealing of insurers towards insureds.

Reservation of Rights

The SCC's discussion of the doctrine of promissory estoppel demonstrates the importance of an insurer issuing a proper reservation-of-rights letter when coverage is uncertain. An insurer does not want to be prevented from declining coverage at a later point should it become clear the insured breached the policy. The dissenting judgment in the SCC decision leaves open the door that a court may determine that an insurer *should* have known of a fact that voided the policy. Thus an effective reservation-of-rights letter, or non-waiver agreement, can mitigate the risk of a dispute with the insured should a policy breach be discovered at a later point.

Please feel free to contact us if you have any questions, or wish to discuss further.

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