IADC COMMITTEE NEWSLETTER

INSURANCE AND REINSURANCE

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IN THIS ISSUE

In the recent Supreme Court of Canada decision in Trial Lawyers Association of British Columbia v. Royal & Sun Alliance Insurance Company of Canada, 2021 SCC 47, the Court held that an insurer was not estopped from denying coverage to an insured for which it had extended a defence without reservation of rights for three years when it became aware of a breach by the insured. The case analyzes the requirements for promissory estoppel.

Promissory Estoppel in Canadian Insurance Law

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Is an insurer estopped from denying coverage to an insured where it defended an insured for three years without reservation and then denied coverage on the basis of a breach which was subsequently discovered by the insurer? The Supreme Court of Canada unanimously agreed in the decision of *Trial Lawyers Association of British Columbia v. Royal & Sun Alliance Insurance Company of Canada*, 2021 SCC 47, that no promissory estoppel could arise as the insurer did not have actual knowledge of the breach prior to denial of coverage.

Some of the relevant facts can be summarized as follows:

- D died in a motorcycle accident.
- RSA was his motor vehicle insurer and it proceeded to defend his estate against the claims of two injured parties. There was no reservation of rights by RSA.
- Three years later, and after litigation had commenced, RSA determined that D had consumed alcohol putting him in breach of his insurance policy and it then denied coverage.
- Pursuant to the Insurance Act in Ontario, this reduced the amount recoverable to the claimants from the policy limits of $1 million to $200,000 which was the statutory minimum.
- One of the claimants proceeded to judgment against D's estate. He did not accept RSA's denial of coverage on the grounds of waiver by conduct and promissory estoppel.
- The trial judge agreed that RSA had waived its right to deny full coverage.
- The Court of Appeal rejected both arguments presented by the claimant. RSA was not estopped from denying coverage as it had no knowledge of the breach at the relevant time notwithstanding that a full investigation would have provided it with knowledge.
- The claimant settled with RSA after the SCC granted leave to appeal. The SCC granted leave to the Trial Lawyers to be substituted as the appellant in view of the public policies involved notwithstanding that the appeal was moot.

It was agreed on appeal that the appellant could not rely on the argument of waiver. This was so as the Ontario Insurance Act at the time required that any waiver by in writing and RSA never waived its rights in writing. This left the argument of promissory estoppel in circumstances where the insurer denied coverage long after it could have discovered evidence of the breach.

The SCC suggested that the appellant's arguments were better analyzed as estoppel by representation rather than promissory estoppel, although the nuances were not fully argued. In brief, the Court said the former prevents "a promisor from denying the truth of a prior representation" while the

latter prevents "a promisor from reneging on an assurance to alter the parties' legal relationship." para. 17.

The Court summarized its dismissal of the appeal succinctly in paras. 18-19:

> [18] As we will explain, Trial Lawyers' estoppel argument must fail, primarily because RSA gave no promise or assurance intended to affect its legal relationship with Mr. Bradfield. RSA lacked knowledge, at the time it provided a defence to Mr. Devecseri's estate, of Mr. Devecseri having breached the policy by consuming alcohol. This is fatal to Trial Lawyers' position. Further, and even if constructive knowledge of the facts demonstrating a breach were sufficient for purposes of estoppel (which, as we will explain, it is not), RSA cannot be fixed with constructive knowledge of such facts in the circumstances of this case. RSA was under a duty to Mr. Devecseri to investigate the claim against him "fairly", in a "balanced and reasonable manner" (Fidler v. Sun Life Assurance Co. of Canada, 2006 SCC 30, [2006] 2 S.C.R. 3, at para. 63, citing with approval 702535 Ontario Inc. v. Lloyd's London, Non-Marine Underwriters (2000), 2000 CanLII 5684 (ON CA), 184 D.L.R. (4th) 687 (Ont. C.A.), at para. 29). It did so. RSA was under no additional duty to Mr. Bradfield or other third-party claimants to investigate policy breaches at all, much less on a different and more rigorous standard than that which it owed to its insured.
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> [19] These points are sufficient to dispose of this appeal. As indicated, however, we propose to canvass some additional difficulties that a third-party claimant like Mr. Bradfield must contend with in raising a successful estoppel argument against an insurer.

The parties agreed that for three years, from the time of the accident in May 2006 to the discoveries (depositions) in June 2009, RSA was ignorant of the evidence of alcohol consumption by the deceased insured. The issue was whether, absent actual knowledge, RSA could be held to an assurance by words or conduct that it would not deny coverage. The Court held that absence of knowledge was a fatal flaw to the appellants' argument.

Promissory estoppel requires that a promise must be intended to affect the legal relationship between the parties. This requires knowledge of both the legal relationship and its alteration. Thus, the question depends on what the promisor knows. Here, before RSA could be said to have intended to alter a relationship by any promise, it was required to have knowledge of the evidence of the breach.

As the appellant could not show actual knowledge, they had to rely on imputed or constructive knowledge. The witnesses initially denied any alcohol consumption by

the deceased. The police report did not reveal this fact either. The adjuster appointed concluded that further investigation would be required to determine whether alcohol or drugs played any role. Although RSA suggested to the adjuster that a coroner's report as a possible avenue of investigation. For reasons unknown, no one followed up on this. It was not until the discoveries that the witnesses gave evidence of alcohol consumption by the deceased prior to the accident. A coroner's report was then obtained which showed modest alcohol consumption, which was still a breach. The argument then was that a full and "proper" investigation would have provided RSA with knowledge of the breach at the outset.

The Court explained this argument could not succeed. While there was merit to the argument that failure to appreciate the legal significance of information could support imputed knowledge, this case did not involve a lack of the legal significance of evidence but a lack of any knowledge of any evidence that would have supported a breach.

The Court explained imputed knowledge in this fashion:

> [29] This point — that the provision of a defence by an insurer, despite its knowledge of a fact demonstrating a breach, supports an inference that the insurer intended to alter its legal relationship with the insured — is widely accepted in our law (see, e.g., Parlee v. Pembridge Insurance Co., 2005 NBCA 49, 283 N.B.R. (2d) 75, at para. 12; Fellowes, McNeil v. Kansa General International Insurance Co. (2000), 2000 CanLII 22279 (ON CA), 22 C.C.L.I. (3d) 1 (Ont. C.A.), at para. 69; Gilewich v. 3812511 Manitoba Ltd., 2011 MBQB 169, 267 Man. R. (2d) 40, at para. 42; Gillies v. Couty (1994), 1994 CanLII 960 (BC SC), 100 B.C.L.R. (2d) 115 (S.C.), at paras. 5 and 8; Federal Insurance Co. v. Matthews (1956), 1956 CanLII 261 (BC SC), 3 D.L.R. (2d) 322 (B.C.S.C.), at p. 345; see also Owen Sound Public Library Board v. Mial Developments Ltd. (1979), 1979 CanLII 1624 (ON CA), 26 O.R. (2d) 459 (Ont. C.A.), at p. 467). Also widely accepted is the proposition that, where an insurer knows of the facts demonstrating a breach, a failure to appreciate their legal significance as such — that is, as demonstrative of a breach — is irrelevant, so that such an appreciation may be imputed to the insurer, and the insurer estopped from denying coverage (see, for instance, Personal Insurance Co. v. Alexander Estate, 2012 NWTSC 19, 30 M.V.R. (6th) 282, at paras. 33-35 and 41-42; Snair v. Halifax Insurance Nationale-Nederlanden North America Corp. (1995), 1995 CanLII 4400 (NS SC), 145 N.S.R. (2d) 132 (S.C.), at para. 62; Rowe v. Mills (1986), 1986 CanLII 5596 (NB QB), 72 N.B.R. (2d) 344 (Q.B.), at para. 12; Hassan v. Toronto General Insurance Co. (1960), 1960 CanLII 400 (ON SC), 22 D.L.R. (2d) 360 (Ont. H.C.J.), at pp. 368-69).

> [30] In sum, where an insurer is shown to be in possession of the facts demonstrating a breach, an inference may be drawn that the insurer, by its conduct, intended to alter its legal relationship with the insured —— notwithstanding the fact that the insurer did not realize the legal significance of the facts or otherwise failed to appreciate the terms of its policy with the insured.

As stated, the flaw in the argument of the appellant was that RSA had no knowledge of alcohol consumption when it extended the defence. Without this knowledge of the breach, RSA could not be said to have intended to assure anyone that it would not be relying on that breach to deny coverage. As the appellant could not rely on imputed knowledge, they argued that it was possible to rely on "constructive knowledge", which may be another way of saying that you have to make it up. The basis for this was their argument that had RSA done more in its investigation, it would have had knowledge.

The Court's rejection of this argument is worthy of lengthy recitation as it may be useful in other cases:

> [33] First, this argument entails a significant — and, in our view, unwise and unnecessary — modification of the obligation an insurer owes to the insured in the context of a liability claim. This duty exists because insurers have strong economic incentives to deny coverage, which this Court has sought to moderate in the public interest. As claims arise under a policy of liability insurance, insurers are bound by a duty to the insured to investigate each claim "fairly", in a "balanced and reasonable manner", and not engage in a relentless search for a policy breach (Fidler, at para. 63, citing 702535 Ontario Inc., at para. 29). The point bears reiteration: this Court has sought to temper the incentives of insurers in order to protect the interests of insureds, who are vulnerable when insurers act with "wilful tunnel vision" to look for policy breaches where there is "nothing to go on" (Whiten v. Pilot Insurance Co., 2002 SCC 18, [2002] 1 S.C.R. 595, at paras. 102-3).
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> [34] The duty owed to the insured to investigate fairly, in a balanced and reasonable manner, as recognized by this Court is at odds with the duty to investigate "thoroughly" and "diligently" urged upon us by Trial Lawyers (A.F., at paras. 121 and 123). Apparently relying on Coronation Insurance Co. v. Taku Air Transport Ltd., 1991 CanLII 16 (SCC), [1991] 3 S.C.R. 622, Trial Lawyers submits that the insurer is bound by a duty to "know the things that were within [its] grasp" (transcript, p. 24; see also A.F., at para. 124; Coronation Insurance, at p. 640). But Coronation Insurance is of minimal assistance here. First, the

standard set in that case and in Canadian Indemnity Co. v. Canadian Johns-Manville Co., 1990 CanLII 78 (SCC), [1990] 2 S.C.R. 549, related to insurers' presumed knowledge of their own files and of issues of public notoriety. The coroner's report at issue in this case was neither in the possession of the insurer nor notorious. More fundamentally, those cases concerned an insurer's assessment of the risks associated with a prospective insured before even entering into an insurance contract. At that pre-contract stage, this Court's concern was to temper the insurer's incentives to enter into a contract while turning a blind eye to the risks posed by the insured, only to then use the non-disclosure of those risks as a basis for denying coverage as claims arose. The incentives operate differently where, as here, we are concerned with claims under an existing contract. At that stage, the insurer has every incentive to search for breaches in relation to a given claim. We fear that, far from tempering these incentives, Trial Lawyers' submission would augment them, pushing insurers to go the extra mile to find policy breaches. For this reason, the submission must be rejected.

[35] Secondly, there is no basis in law for a third-party claimant such as Mr. Bradfield to be able to ground an estoppel argument in any alleged breaches of an insurer's duty to its insured. In other words, the duty to investigate fairly, in a balanced and reasonable manner, is owed only to the insured, not third parties. Were such a duty owed to third parties, it would sit uneasily, and indeed would undermine, the duties of utmost good faith and fair dealing that govern the relationship between the parties to an insurance contract — in this case, between RSA and Mr. Devecseri. This is because the obligations between the insurer and the insured are reciprocal; while the insurer has the aforementioned duty to investigate fairly, in a balanced and reasonable manner, the insured is also under a reciprocal duty to disclose facts material to the claim (Whiten, at para. 83, citing Andrusiw v. Aetna Life Insurance Co. of Canada (2001), 2001 CanLII 61004 (AB QB), 289 A.R. 1 (Q.B.), at paras. 84-85; Bhasin v. Hrynew, 2014 SCC 71, [2014] 3 S.C.R. 494, at para. 55).

In other words, the appellant was attempting to extend duties owed to the insured to strangers to the insurance contract. This would indeed be a significant modification of the insurer's obligations in the context of a liability claim. The Court explained that this would essentially involve third party claimants to "piggy-back" onto the relationship between insurer and insured which involves quite different considerations such as the reciprocal

obligations of good faith between them. The Court concluded on this point as follows:

> [38] Viewed in light of the reciprocity of obligations between the actual contracting parties — the insurer and the insured — there is a certain absurdity to Trial Lawyers' position. It would effectively mean that a contract of liability insurance provides greater protection to, and imposes fewer (indeed, no) obligations upon, third parties like Mr. Bradfield than it provides to and imposes upon the first-party insured. This result effectively runs contrary to the clear expression of legislative intent in s. 258(11) of the Insurance Act, which provides that an insurer is entitled to assert any defences against the claimant as it could raise against the insured.

Decisions by the Supreme Court of Canada will usually set precedent for many years, and particularly for the foreseeable future. We can be confident that insurers and lawyers can rely on the principles expressed herein for years to come.

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