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Insurance Observer

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FIRST PARTY CLAIMS AND SOLICITOR/CLIENT PRIVILEGE: A CASE COMMENT ON DAVIES V. AMERICAN HOME ASSURANCE COMPANY

Jess C. Bush

Over the last two years, two decisions have surprised the insurance defence litigation community by holding that certain legal opinions provided by defence counsel to an insurer were producible in first party claims alleging bad faith. The decisions were those of Madame Justice Kiteley in **Davies v. American Home Assurance Company** ("**Davis**") and Mr. Justice Brockenshire in **Samoila v. Prudential of America** ("**Samoila**"). The decisions created uncertainty for those of us involved in claims involving fire, disability and accident policies.

One of those decisions (**Davies**) was recently overturned by the Divisional Court. The second decision (**Samoila**) was commented upon by that Court in terms which seem to, at the very least, limit its applicability and, arguably, question its correctness. The Divisional Court decision has not been appealed so it represents the current law.

Solicitor/client privilege, of course, describes the privilege that exists between a client and his/her lawyer. At the heart of the privilege lies the concept that people must be able to communicate candidly with their lawyers to enable their interests to be fully represented. A legal opinion is the quintessential example of such a communication. The privilege has been called one of the corner-stones of our system of justice. It is the oldest and most established privilege in our law. It can be traced back some 400 years to English law. The privilege is not absolute, but it has always been regarded as being as close to absolute as possible. Solicitor/client privilege, of course, may be waived by the client.

Notwithstanding this tradition, the effect of **Davies** and **Samoila** called into question whether insurers, who were the subject of bad faith claims, would have the benefit of solicitor/client privilege and therefore legal advice.

The **Davies** case was a claim on an accidental death and dismemberment policy. The insurer, after some initial investigation, had suspicions about the case. The file was sent to legal counsel for an opinion. Prior to any denial of the claim, a Statement of Claim was issued and served that, among other things, sought damages for bad faith. A Statement of Defence was delivered that, in fact, denied the claim for the first time. In the context of the law suit, Plaintiff's counsel moved for production of legal opinions authored by defence counsel that were provided to the insurer prior to the denial set out in the Statement of Defence. In essence, Plaintiff's counsel was looking for a copy of the preliminary assessment that undoubtedly would have been provided by defence counsel to the insurer.

Madame Justice Kiteley heard the motion, felt that the opinions of legal counsel were relevant to the bad faith claim and ordered the legal

opinion, or opinions, produced, not on the basis that the insurer had waived its solicitor/client privilege, but rather because she found no solicitor/client privilege existed in this context with respect to legal opinions produced prior to the denial.

In July, 2002, the Ontario Divisional Court released its reasons addressing Madame Justice Kiteley's decision and also commenting upon the decision of Mr. Justice Brockenshire.

The unanimous court found that the fact an insurer sought and obtained a legal opinion for the purposes of assessing its liability to respond to an insured's claim, and presumably considered that opinion in deciding what to do, is not sufficient in and of itself to render the legal opinion producible in litigation - even bad faith litigation - at the instance of that insured. The court held that the assertion of a bad faith claim for punitive and exemplary damages, for breach of the insurer's obligation of good faith, may indeed affect the scope of what is relevant and what is not relevant in the proceedings. However, the nature of the claim did not change the analysis as to what is, or is not, protected by solicitor/client privilege.

What was interesting and helpful was not only that those comments were made in relation to the decision before them, but those comments were made following a discussion of the **Samoila** case as well, suggesting that the court had problems with the conclusions reached in both cases.

In **Samoila**, the court had ordered the production of legal opinions on the basis that solicitor/client privilege had been waived by virtue of answers given by the insurance representative on discoveries. The Divisional Court, in the **Davies** case and the judge who granted leave to appeal to Divisional Court in the **Davies** case - who total four justices of the same court as Mr. Justice Brockenshire - all expressed doubt that voluntary waiver of solicitor/client privilege could take place by cross examining the insurer's witness on discovery.

The Divisional Court, then, appears to have restored solicitor/client privilege as between counsel and the insurer with respect to legal opinions provided prior to the denial of a claim.

Having restored the principle, Mr. Justice Hill, who granted leave to appeal in the **Davies** decision to the Divisional Court, reminded us all that such opinion letters would be producible, and the privilege would be regarded as waived, were the insurer to voluntarily plead a lack of bad faith or, more particularly, express any reliance on legal advice in its decision to deny the claim. Shortly put, if an insurer, to justify its decision, and to resist a bad faith claim, relies upon the legal opinions provided, those legal opinions will become producible.

That reality brings us to where this writer predicts bad faith litigation will ultimately find itself, and, that is, bifurcated actions

where the merits of a first party claim are dealt with in one trial and the bad faith claim is dealt with in another trial. While the law is still evolving in Canada with respect to bifurcation, certain American authorities have apparently adopted an automatic rule requiring divided trials in every case where a bad faith claim is pursued against an insurer so as to be able to deal with issues such as solicitor/client privilege. That subject will have to await further exploration on another occasion. ■

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ABSOLUTE POLLUTION EXCLUSION: ZURICH INSURANCE CO. V. 686234 ONTARIO LIMITED

Marcus B. Snowden

Marcus B. Snowden is a member of the firm's Coverage Counsel group. He and other members of the group provide coverage opinions, associated investigation and representation in litigation/dispute resolution for insurers as well as assisting underwriter clients of the firm's Corporate Insurance group in product revisions, development, and risk management.

Zurich Insurance Co. v. 686234 Ontario Limited constitutes the latest word from the Court of Appeal on absolute pollution exclusion clauses. In this case, the underlying proposed class action claim against the policyholder was for alleged injuries sustained when an apartment complex's allegedly faulty furnace emitted carbon monoxide fumes indoors. The insurer sought a declaration that it had no duty to defend based upon the so-called absolute pollution exclusion. The judge at first instance rejected the insurer's position based in part upon the reasonable expectation that the pollution exclusion would be confined to instances of outdoor "environmental" pollution by an active industrial polluter.

In upholding the trial level decision, Justice Borins, writing for the panel, appears to conclude that the pollution exclusion:

(1) should be interpreted consistently with a line of US cases which decline to take a literal approach to the wording;

(2) has a significant history in the US consistent with restricting the exclusion's application to the "active industrial polluter of the natural environment" or "environmental pollution" or "certain forms of industrial pollution";

(3) is drafted and should be interpreted to focus on the act of pollution rather than the resulting injury or damage;

(4) is overly broad in the indoor air context and is thus capable of more than one "compelling interpretation" based solely on divergent treatment by US courts; and

(5) should not, in this context, be construed so broadly as to be contrary to the reasonable expectation of commercial policyholders as purchasers of CGL coverage.

In the result, the Court accepted that carbon monoxide is a "pollutant" within the meaning of the clause. However, the panel concluded that, taking into account the historical context of the exclusion "suggests that its purpose is to bar coverage for damages arising from environmental pollution, ...not the circumstances of this case in which a faulty furnace resulted in a leak of carbon monoxide.".

This decision is the first appellate level case in Canada to deal somewhat extensively with the US-based history of the absolute pollution exclusion generally and with indoor pollution

issues in particular. Anyone still questioning whether the exclusion might apply to mould cases should now be satisfied that, at least with respect to the IBC Form 2100 version of the "absolute" wording as considered in Ontario, the answer appears to be "no", absent a further appeal to the Supreme Court of Canada.

This is the second case from the Ontario Court of Appeal which has placed limits on the "absoluteness" of the IBC Form 2100 version of the pollution exclusion. The first case is **Trafalgar Insurance Co. of Canada v. Imperial Oil Ltd.** released last year.

The appellate judicial climate in Ontario appears to be strongly in favour of both precise drafting from an underwriting perspective and avoiding literal interpretation. The Court of Appeal appears to have an healthy respect for reasonable expectations in the commercial insurance bargain and an overriding preference for what is referred to as a "connotative contextual" approach. Query whether the reasonable expectation doctrine can now be applied even in the absence of ambiguity?

Underwriters, risk management personnel, claims handlers, adjusters, brokers and counsel should take guidance from Borins, J.A.'s cautionary note:

> In my view, in construing contracts of insurance, dictionary literalism is often a poor substitute for connotative contextual construction. When the full panoply of insurance contract construction tools is brought to bear on the pollution exclusion, defective maintenance of a furnace giving rise to carbon monoxide poisoning, like related business torts such as temporarily strong odours produced by floor resurfacing or painting fail the common sense test for determining what is "pollution". These represent claims long covered by CGL insurance policies. To apply an exclusion intended to bar coverage for claims arising from environmental pollution to carbon monoxide poisoning from a faulty furnace, is to deny the history of the exclusion, the purpose of CGL insurance, and the reasonable expectations of policyholders in acquiring the insurance. ■

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THE NEW LIMITATIONS ACT

Regina Lee

In an attempt to modernize and reform the law as it relates to limitation periods, the Ontario legislature has recently passed Bill 213, the **Justice Statute Law Amendment Act, 2002**, which enacts the new **Limitations Act, 2002** (hereinafter the "**Act**"). The new Act will come into force once it is proclaimed by the Lieutenant Governor and essentially rewrites the law as it relates to limitation periods. We have been informed by the Attorney General's office that, at this juncture, a proclamation date for the new **Act** has not yet been scheduled. The following discussion

serves as a brief overview and highlights only some of the implications of the new **Act** you should be aware.

BASIC LIMITATION PERIOD

The general limitation periods found in the existing **Limitations Act** and most of the special limitation periods found in individual statutes have been replaced, in most instances, by a two year limitation period that runs from the earlier of the day the person with the claim first knew or reasonably ought to have known the following:

1. that the injury, loss or damage had occurred,
2. that it was caused by or contributed to by an act or omission,
3. the person who caused the injury, loss or damage, and
4. that, a proceeding would be an appropriate means to seek to remedy it (section 5).

The new **Act** provides special recognition and safeguards for minors and persons who are incapable of pursuing legal action because of their physical, mental, or psychological condition ("incapable persons"). Minors and "incapable persons" must be represented by a litigation guardian in order for the basic limitation period to begin and the discovery rules would apply to the litigation guardian (sections 6-8).

If there is an agreement to have an independent third party resolve the claim or assist in resolving the claim, the limitation period does not run for the duration of the agreement (section 11).

The new **Act** also allows a person to serve a notice of possible claim, which may constitute discovery and start the limitation period (section 14).

ULTIMATE LIMITATION PERIODS

A claim may be barred after an ultimate limitation period of 15 years, which runs from the day the act or omission on which the claim is based takes place, regardless of the plaintiff's state of knowledge (section 15). Moreover, the ultimate limitation period does not run if the minor or incapable person is unrepresented, or when the person against whom the claim is made wilfully conceals facts or misleads the person with the claim. There is also an exception for a purchaser of personal property for value acting in good faith who must start a proceeding within two years of the property's conversion.

NO LIMITATION PERIOD

There are a number of proceedings in which there is no limitation period, including proceedings for declarations and proceedings to enforce court orders (section 16).

CONTRIBUTION AND INDEMNITY

In the case of a claim by one alleged wrongdoer against another for contribution and indemnity, the basic limitation period of two years and the ultimate limitation period of fifteen years run from the day on which the first alleged wrongdoer was served with the claim in respect of which contribution and indemnity is sought (section 18).

AGREEMENTS

Parties can no longer contract out of the limitation periods prescribed by the new **Act**. The new limitation periods will apply despite any agreement to vary or exclude them. However, agreements made before the new **Act** are still enforceable (section 22).

TRANSITION

No proceeding can be commenced for claims in which the former limitation period has already expired before the new **Act** comes into force. In contrast, if the former limitation period has not expired at the time the new **Act** comes into force and the claim was not discovered before the new **Act**, the new limitation period would start as of the date the new **Act** comes into force. Moreover, if the limitation period has not expired as of the date the new **Act** comes into force and the claim was discovered before the new **Act**, the former limitation period would apply (section 24).

SEXUAL ASSAULT

There are special rules for claims based on assault and sexual assault (section 10). Essentially, the limitation period does not run for "incapable persons" with assault or sexual assault claims. In addition, there are two presumptions with respect to assault and sexual assault claims that are worth mentioning. One presumption is that unless the contrary is proved, the person lacked capacity to start the sexual assault claim earlier. Moreover, section 16 provides that there is no time limit for bringing sexual assault claims that occurred in a relationship of trust or dependency.

TRANSITION

Special transition rules apply to assault or sexual assault that the defendant committed, knowingly aided or encouraged, or knowingly permitted the defendant's agent or employee to commit. These rules apply even if the former limitation period has expired before the new **Act** comes into force. First, the special rules in section 10 apply to assault or sexual assault claims that took place on or after the new **Act** comes into force. Second, if no limitation period under the new **Act** would apply to a sexual assault claim that took place on or after the new **Act** comes into force, there is no limitation period.

AMENDMENTS AND REPEALS

Limitation periods set out in other statutes are of no effect unless they are preserved by being listed in the Schedule of the new **Act**. The specific amendments to the **Insurance Act** are summarized here:

Amendment

Section 148, statutory condition 14 in respect of fire insurance is preserved:

> 14. Action - Every action or proceeding against the insurer for the recovery of a claim under or by virtue of this contract is absolutely barred unless commenced within one year next after the loss or damage occurs.

The limitation periods for life insurance proceeds in section 206 are repealed.

The one year limitation period in respect of automobile insurance money in subsection 258(2) is repealed and replaced by section 259.1:

> **Limitation period (new)**
> 259.1A proceeding against an insurer under a contract in respect of loss or damage to an automobile or its contents shall be commenced within one year after the happening of the loss or damage.

The limitation period in respect of uninsured automobile coverage in section 272 is repealed.

Subsection 281(5), as re-enacted by the Statutes of Ontario, 1996, Chapter 21, section 37 is repealed and replaced by subsection 281.1(1):

> **Limitation period (new)**
> 281.1(1)A mediation proceeding or evaluation under section 280 or 280.1 or a court proceeding or arbitration under section 281 shall be commenced within two years after the insurer's refusal to pay the benefit claimed.
>
> **Exception**
> (2) Despite subsection (1), a proceeding or arbitration under clause 281 (1) (a) or (b) may be commenced,
>
> (a) if there is an evaluation under section 280.1, within 30 days after the person performing the evaluation reports to the parties under clause 280.1 (4) (b);
>
> (b) if mediation fails but there is no evaluation under section 280.1, within 90 days after the mediator reports to the parties under subsection 280 (8).

The one year limitation period in statutory condition 12 set out in section 300 in respect of Accident and Sickness Insurance is repealed, and subsection 301(6) is amended by striking out "and statutory condition 12 may be varied by lengthening the period of time prescribed therein" at the end.

In summary, the new **Act** has made sweeping changes to the law as it relates to limitation periods by replacing most existing limitation periods with the basic limitation period of two years and an ultimate limitation period of 15 years. The new **Act** provides special rules that apply to minors, "incapable persons," and persons with assault or sexual assault claims. ■

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NOTA BENE: APPEARING IN OUR NEXT ISSUE

Crystal O'Donnell

On December 6, 2002, the Ontario Court of Appeal released its decision in **Alie et al v. Bertrand & Frere et al** regarding the third and subsequent party claims (the "Insurance action") pertaining to the insurance issues. In the main action, 137 plaintiffs sued Bertrand & Frere and Lafarge for damages suffered as a result of defective concrete used in the construction of the foundations in their homes. In turn, Bertrand & Frere and Lafarge sued a combined total of 23 insurers for indemnity and defence costs.

At trial, Lafarge was found 80% liable to the plaintiffs and Bertrand & Frere were found 20% liable. The damages at issue totalled approximately $20 million dollars. Although the main and third party actions proceed together at trial, the appeals were dealt with separately. The issues on appeal in the Insurance action included the interpretation of coverage and exclusion clauses, trigger theories, whether excess insurers owe a duty to defend and liability for third party costs.

A full analysis of the decision and its implications will be provided in the next issue of the Insurance Observer. ■

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WE ARE PLEASED TO ANNOUNCE

Larry P. Reimer has been admitted into the partnership. Larry is a member of our Insurance Defence Group and has extensive litigation experience pertaining to claims including products liability, occupier's liability, personal injury, insurance benefits, disability coverage, defamation, and claims involving public authorities.

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Insurance Observer is a publication of the Insurance Law Group of Blaney McMurtry LLP. The information contained in this newsletter is intended to provide information and comment, in a general fashion, about recent cases and related practice points of interest. The information and views expressed are not intended to provide legal advice. For specific legal advice, please contact us.

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We welcome your comments. Address changes, mailing instructions or requests for additional copies should be directed to Chris Jones at 416 593.7221 ext. 3030 or by email to cjones@blaney.com. Legal questions should be addressed to the specified author.

EXPECT THE BEST

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