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PUBLICATION

It Says what it Says: Pre-Tender Defence Costs should not be Covered under the Policy

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The British Columbia Court of Appeal has now set the record straight about pre-tender defence costs: If a policy expressly states that an insured must not incur expenses without the insurer's consent, then the insured will not be entitled to reimbursement for any expenses that were incurred on its behalf prior to notifying the insurer of a claim[1].

In June 2012, the U.S. affiliates of Blue Mountain Log Sales Ltd. ("Blue Mountain") were involved in litigation in Washington State. On August 29, 2013, Blue Mountain tendered the claim to Evanston Insurance Company. On October 25, 2013, Evanston agreed to defend the affiliates, subject to a reservation of rights, and retained defence counsel. Subsequently, the claimants added Blue Mountain and its principal, Scott Clarke (collectively, the "Clarke Group"), as defendants to the proceeding.

The Clarke Group was insured by Lloyd's under several Commercial General Liability policies. Blue Mountain did not notify Lloyd's of the claim until April 18, 2014. Upon notification, Lloyd's conceded that there was a duty to defend (it did not deny coverage on the basis of late notice), but that the duty was not triggered until April 18, 2014. It did not take issue with the steps already taken by defence counsel retained by Evanston to defend the affiliates and, in fact, agreed that the affiliates' counsel should jointly defend the Clarke Group and the affiliates. Lloyd's refused, however, to reimburse for the defence costs (nearly $600,000) that the Clarke Group had incurred prior to April 18, 2014.

Lloyd's petitioned the British Columbia Supreme Court for a declaration that it did not have a duty to reimburse for the Clarke Group's pre-tender defence costs[2], taking the position that notice to an insurer is a prerequisite to its assumption of the duty to defend, and, on a proper interpretation of the insurance contract, the pre-tender defence costs incurred without Lloyd's

consent are the Clarke Group's responsibility to pay. In particular, Lloyd's relied on the following policy condition ("Voluntary Payments clause"):

Assumption of Liability

The Insured shall not, except at his own cost, voluntarily make any payment, assume any obligation or incur any expenses other than for first aid or other medical, dental or surgical relief to others at the time of accident.

Conversely, the Clarke Group argued that Lloyd's duty to defend arose at the same time as the cause of action, that Lloyd's failure to reimburse for pre-tender defence costs was a denial of coverage, that the Clarke Group's breach of the Notice provision was imperfect compliance, and that it was entitled to relief from forfeiture[3] and thus reimbursement.

Rather than relying solely on the plain meaning of the Voluntary Payments clause (which expressly disqualified reimbursement for pre-tender defence costs), the Court agreed with the Clarke Group, holding that Lloyd's duty to defend arose as soon as the claim fell within the ambit of the policies, that Lloyd's failure to pay pre-tender defence costs amounted to a denial of coverage, and that the Clarke Group was entitled to relief from forfeiture, as the breach of the Notice condition was imperfect compliance and Lloyd's had not suffered prejudice.

Lloyd's appealed[4]. The Court of Appeal rejected the analysis of the lower court, and overturned its decision. It considered both Canadian and American cases, but did not find them particularly helpful. Instead, it adopted the analysis of Lichty[5] and Snowden, and held that the wording of the Voluntary Payments clause was unambiguous, and had the effect of holding the Clarke Group responsible for all costs incurred prior to notification of the claim.

The Court reasoned that CGL policies provide a contractual duty to defend an insured, and that this duty and right arise when the threatened proceeding engages claims that, if proven, would potentially fall within the scope of the policy. Implicit in this principle is that notice is a necessary and logical trigger to activating the duty and right to defend, as an insurer cannot ascertain whether the claims fall within the four corners of the policy until it becomes aware of them. In other words, there is only something to defend once it is established that the nature of the claim attracts coverage.

The Court held that the CGL policies gave the Clarke Group a contractual right to demand that Lloyd's provide a defence, and Lloyd's was contractually bound to do so. The right and duty to defend could not vest, however, until the Clarke Group made that demand by tendering the claims, thereby enabling Lloyd's to determine whether the claims potentially fell within the scope of the policy.

The Court held that the principle of relief from forfeiture did not apply because such relief can only be sought when an insured has breached the insurance contract. As Lloyd's had forgiven any potential breach of the Notice clause, and had immediately acknowledged its obligation to provide coverage and a defence going forward (Lloyd's never denied coverage), there was no

breach of the policy, so there was no relief to award. The issue for the Court was solely the interpretation and effect of the Voluntary Payments clause; the issue of late notice and relief from forfeiture was irrelevant.

This decision is good news for insurers. By upholding the plain meaning of the Voluntary Payments clause, the British Columbia Court of Appeal gave effect to the plain meaning of the wording of the policy, and the mutual obligations of the parties: the insurer has a duty to defend the insured for potentially covered claims. In exchange, the insurer has the right to control the insured's defence and to undertake its own investigation. The result of those two obligations, being part of the bargain struck by the parties, is that the insurer should not be held responsible for pre-tender defence costs. The message of the Court of Appeal is clear: give effect to the plain meaning of the wording of the policy.

As an aside, this decision emphasizes that Canadian courts, even in the absence of relevant Canadian jurisprudence, while acknowledging that American jurisprudence can be instructive, will not necessarily follow it, especially when there is an absence of cohesion in the cases.

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[1] *Lloyd's Underwriters v. Blue Mountain Log Sales Ltd.*, 2016 BCCA 352 (CanLII). This is an appellate decision of British Columbia. In our view, it would be highly persuasive in other Canadian common-law provinces.

[2] Evanston added itself to the proceeding to preserve its claim against Lloyd's for contribution or indemnity.

[3] Pursuant to section 13 of British Columbia's *Insurance Act*, a court may set aside a denial or avoidance of coverage where an insured's breach of a condition of a policy is "imperfect" (i.e. relatively minor) and the insurer has not suffered prejudice. Other provinces, including Ontario, have similar statutory provisions.

[4] Evanston subsequently withdrew from the appeal, as a U.S. court found that it owed no duty to defend.

[5] *Annotated Commercial General Liability Policy* (2015: Canada Law Book, Toronto). Mark Lichty is a partner at Blaney McMurtry LLP.