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• CAN A POLICY BREACH RESULT IN A DENIAL OF COVERAGE EVEN WHEN DISCOVERED LATE IN THE LITIGATION? •

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The Supreme Court of Canada has ruled that insurance companies with no previous knowledge of a policy breach may deny coverage to their insureds once knowledge of the breach comes to their attention, no matter how late that may be.

In *Trial Lawyers Association of British Columbia v. Royal & Sun Alliance Insurance Company of Canada,*[1] *("Trial Lawyers"),* the Appellant sought to set aside the Court of Appeal's decision which found that the insurer was not estopped from relying on the breach and denying coverage.

The Supreme Court dismissed the appeal.

BACKGROUND

Steven Devecseri ("D") died in a motorcycle accident on May 29, 2006.

D's insurer, Royal & Sun Alliance ("RSA") defended his estate in two actions commenced by Jeffery Bradfield ("B") and Jeremy Caton ("C"), who were injured in the accident.

Three years after the accident and one year after litigation was commenced, RSA discovered that D had breached his standard motor vehicle insurance policy by consuming alcohol shortly before the accident.

RSA stopped defending D's estate and denied coverage.

C obtained a judgment against D's estate and B. B obtained judgment on a crossclaim against D's estate.

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PROCEEDINGS

B commenced an action seeking a declaration of entitlement to recover judgment against RSA. He took the position that RSA had waived its right to deny coverage to D's estate or was estopped from doing so.

The Trial Judge decided in favour of B. Since RSA failed to take an off-coverage position and defended D's estate, this amounted to waiver by conduct.

The Ontario Court of Appeal reversed the Trial Judge's finding. Section 131(1) of the *Insurance Act*,[2] at the time, excluded waiver by conduct. Further, the Court did not accept B's argument on promissory estoppel, finding that RSA was unaware of the policy breach when it defended D and that there was no detrimental reliance.

The Supreme Court granted leave to appeal.

SUPREME COURT'S REASONING

The parties agreed that section 131(1) of the *Insurance Act*, at the time, excluded waiver by conduct. Further, RSA did not waive its rights in writing.

That left the issue of promissory estoppel.

The doctrine of promissory estoppel prevents a party from reneging on a promise or assurance where it was "relied upon to the detriment" of the party to which it was aimed.

At paragraph 15, the Supreme Court recognized that promissory estoppel is an equitable defence requiring three elements:

(1) the parties be *in a legal relationship* at the time of the promise or assurance;
(2) the promise or assurance be *intended* to affect that relationship and to be acted on; and
(3) the other party in fact *relied* on the promise or assurance to their detriment.

The Supreme Court was not convinced by the Appellant's estoppel argument.

It reasoned that RSA lacked knowledge of the breach when it provided a defence on behalf of D's estate. This lack of knowledge was fatal to the estoppel argument.

RSA could not have expected to modify its legal relationship with B, as it cannot promise to resist from acting on information that it does not have, i.e. that D had consumed alcohol.

In other words, if an insurer has knowledge of the facts supporting a breach, an inference may be made that "the insurer, by its conduct, intended to alter its legal relationship with the insured".

The Appellant further argued that RSA had constructive knowledge of the breach "arising from a breach of duty to diligently investigate the claim". The Supreme Court declined to find that RSA had constructive knowledge of the breach, reasoning that this duty is owed by an insurer to its insured, but not to third parties like B. Further, there is a reciprocal duty on an insured towards an insurer to divulge any information in their possession that may void coverage.

As there was no promise or assurance intended to affect the legal relationship, the Court did not consider whether the element of detrimental reliance was met.

Prior decisions have considered whether an insurer was estopped from denying coverage.[3] In these decisions, the insurer was aware of the breach and proceeded to tender a defence.

Trial Lawyers is therefore distinguishable on the basis that RSA had no knowledge of the breach when it defended D.

Further, what was interesting about *Trial Lawyers* is that the Trial Lawyers Association of British Columbia was substituted as the Appellant after B came to a settlement with RSA and withdrew his appeal. While this rendered the appeal moot, the Supreme Court exercised its discretion to hear it on the merits.

This decision presents important considerations for insurers who proceed to defend their insureds, and then subsequently discover a policy breach. While there is a duty on insurers to investigate fairly, this does not amount to a ruthless search for policy breaches.

The insured is also under a duty to disclose information that is material to the claim.

This decision also raises considerations for insureds who wish to assert an estoppel argument to prevent their insurer from denying coverage. The key shield to an estoppel argument in this context is if the insurer lacked knowledge of the facts demonstrating the breach.

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[1] [2021] S.C.J. No. 47, 2021 SCC 47.

[2] R.S.O. 1990, c I.8.

[3] *Western Canada Accident and Guarantee Insurance Co. v. Parrott*, [1921] S.C.J. No. 11, 61 S.C.R. 595, 1921 CanLII 66 (SCC); *Rosenblood Estate v. Law Society of Upper Canada*, [1989] O.J. No. 240, 37 C.C.L.I. 142 (Ont. H.C.), aff'd [1992] O.J. No. 3030, 16 C.C.L.I. (2d) 226 (Ont. C.A.); *Commonwell Mutual Assurance Group v. Campbell*, [2019] O.J. No. 4357, 2019 ONCA 668.