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COURT AFFIRMS INSURER'S RIGHT TO RETAIN AND INSTRUCT COUNSEL

Richards Buell Sutton's Insurance Law Newsletter

By RBS Lawyers

The Ontario Superior Court of Justice in *137328 Canada Inc. v. Economical Mutual Insurance Company*, (2011) ONSC 1085 (*Alliance v. Economical*) recently canvassed the rarely considered right of insurance companies to appoint and instruct liability defence counsel. The case presents a valuable opportunity for insurers to understand what courts will consider when determining an insurer's right to appoint counsel to defend a claim that involves a significant uninsured component.

Background

The insured was sued by one of its customers for negligent installation of an alarm system in a warehouse. The negligence was said to have caused \$7,000,000 in damage to the customer's warehouse and the inventory therein (the "Underlying Action").

The insured held a \$2,000,000 liability policy (the "Policy") and the insurer advised it would appoint defence counsel and provide indemnity up to Policy limits. It also advised that there was a possibility that evidence could surface during litigation which would raise a coverage issue but that it was presently unaware of any coverage issues and the defence proceeded without a reservation of rights.

The Policy was silent on the insurer's right to appoint counsel but did provide that it shall defend any suit commenced against the insured alleging property damage; the insured shall cooperate with the insurer with regards to the resolution of any suit brought against it and that the insured shall not, except at its own cost, voluntarily make any payment, assume any obligation or incur any expense other than that which is imperative to the medical or surgical relief of others.

At the pleadings stage the insured's solicitor advised the insurer it was in a conflict of interest with the insured given the claim exceeded limits. This conflict, in conjunction with lack of Policy language affording the insurer the right to appoint counsel was said to entitle the insured to appoint its own counsel at insurer's expense. The insurer denied there was such a conflict and refused to compensate the insured's counsel. Shortly thereafter insured's counsel demanded that defence counsel cease and desist further representing the insured, pleaded the case on behalf the insured and commenced proceedings against the insurer





claiming indemnity for all claims in the Underlying Action and its costs of defending same.

The Ruling

In determining the matter the court considered three issues:

- 1) Do the terms of the Policy allow the insurer to retain and instruct lead counsel to defend the Underlying Action?
- 2) Is there a reasonable apprehension of conflict of interest due to the fact that the amount of the claim for damages exceeds the policy limits, such that it requires the insurer to pay the legal costs of counsel chosen by the insured?
- 3) Had the insured forfeited its right to coverage by appointing its own counsel and advising defence counsel to cease and desist in defending the Underlying Action?

While there was no language in the Policy specifically stating the insurer had the right to choose and instruct counsel to represent the insured the Court followed a line of cases that found where a policy states that the insurer has a duty to defend there was an implied corresponding right to control the defence. This right to control could be lost if there was a sufficient conflict of interest between the insurer and insured. The insurer's right to control the defence was bolstered by wording in the Policy that it "may make such investigations, negotiation and settlement of any claim."

The fact that there was a large uninsured claim and that new information *may* arise that *may* affect coverage did not raise a sufficient conflict of interest. Had the defence been afforded pursuant to a reservation of rights there may have been grounds for a conflict if coverage issues conflated with defence issues. In such a case the insurer may lose its right to control the defence and must surrender control of the defence to an insured who wishes to retain its own counsel paid for by the insurer. Absent a reservation that puts defence counsel in a position of having conflicting mandates the insurer will retain control of the defence. The existence of significant uninsured claims does not create such a conflict. Nor does an insurer's refusal to waive the possibility of contesting coverage if new information is discovered. The issue could be canvassed again if such information came to light in the future.

In this case the insured had not forfeited coverage by instructing defence counsel to cease and desist in defending the Underlying Action and commencing an action against the insurer but the court did not rule out that possibility if those instructions and the action were not discontinued within 30 days.

Practical Impact for Insurers





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Alliance v. Economical takes a small step toward reversing a judicial trend of limiting insurers' rights to control the defence of their insureds. In taking this step the court affirms that the existence of uninsured claims alone will not preclude the right.

In determining their right to control the defence insurers and their counsel need to assess not only the specific wording of the policy but whether there exists a degree of divergence of interest between insurer and insured. A large uninsured component will not be enough to create a divergence. Even in cases defended under a reservation of rights courts will look to whether the coverage issues have anything to do with the issues being litigated and if these issues are distinct there will likely be no requirement to pay for the cost of an insured's own appointed defence counsel.

The insured is always able to retain independent counsel at its own expense to advise the insured on the risk associated with the uninsured portion of the claim and consult with insurer appointed defence counsel respecting strategy and settlement. In cases where there is an uninsured claim it is advisable to act as the *Economical* did in this case and recommend that the insured consider retaining independent counsel at its own cost.



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