Focus INSURANCE

U.S. case clarifies 'voluntary payment' defence

Ryan Shaw

Insurance policies typically include a condition that the insurer will not cover losses if the insured settles the case or makes a "voluntary payment" without the insurer's consent. It is often not difficult to ascertain when a payment made by an insured is "voluntary"—however, questions of coverage can arise for payments made by insureds pursuant to, or in the context of, a particular legal obligation or statute.

The question is currently the subject of litigation in B.C., in a case where an insured incurred investigative and clean-up costs pursuant to American environmental legislation. *Underwriters, Lloyd's v. Cominco Ltd.* [2006] B.C.J. No. 1917, a decision on a separate issue, provides the background, but there has not been a final determination on the voluntary payment issue.

There is unfortunately a dearth of Canadian jurisprudence on this issue and American case law may determine the answer. In *Bridgewood Building Corp. (Riverfield) v. Lombard General Insurance Co. of Canada* (2005) O.J. No. 2083, the court considered whether payments made without notice to the insurer and pursuant to the Ontario Home Warranty Plan constituted voluntary payments, therefore precluding coverage. The court determined the payments were not voluntary due to the insured's obligation as a residential developer to take prompt action to remedy defects. In reaching its decision the court gave weight to the fact the insurer had been notified of the events at an early stage and did not object to the steps taken by the insured under the program to protect homeowners. The court also factored into the decision the fact that the insured would have more than likely lost its building licence, and its business in the process, had it not undertaken to make such payments.

VITAPIX / ISTOCKPHOTO.COM

> Even if there is something special about the Pennsylvania banking statute that compelled the result in First Commonwealth, the court's decision broadens the circumstances in which payments made by an insured fall outside the scope of 'voluntary,' therefore limiting the defence.
>
> **Ryan Shaw**
> Richards Buell Sutton

Given the paucity of Canadian authorities, a recent case from the District Court of the Western District of Pennsylvania may assist counsel in determining whether coverage is available for payments owed by law. In *First Commonwealth Bank v. St. Paul Mercury Insurance Co.*, No. 14-19 (W.D. Pa. Oct. 6, 2014), a First Commonwealth client was a victim of malicious malware which allowed an unknown third party access to its computer systems. The third party was able to ascertain the client's online banking user name and password and then use that information to initiate unauthorized wire transfers to banks in Russia and Belarus in the aggregate of US$3.508 million. After the transfers were discovered, the client demanded that the bank credit the account from which the funds had been withdrawn. After conducting a brief investigation to determine the funds were indeed transferred without proper authorization, the bank, using its own funds, refunded the client's account for the full amount of the transfers. Soon after refunding the wires, the bank notified its insurer of the loss and sought recovery under a liability policy. The insurer refused to provide coverage asserting a breach of the voluntary payment condition in the policy. Coverage litigation ensued.

The court determined that the refund payment was not "voluntary," as a Pennsylvania statute required the bank by law to refund the fraudulent wire transfers. Of interest is that the court spoke in fairly sweeping terms when dismissing the issue of the voluntary payment condition, suggesting that any situation "where the insured's act of paying a claim was compelled by law or other outside influences" would make the payment non-voluntary.

The U.S. reasoning above arguably goes further than *Bridgewood*, which is more constrained by its facts, and requires that all counsel advising on coverage consider any arguments on why a payment made by the insured, in various scenarios, was compelled by law or some other mandatory requirement. Even if there is something special about the Pennsylvania banking statute that compelled the result in *First Commonwealth*, the court's decision broadens the circumstances in which payments made by an insured fall outside the scope of "voluntary," therefore limiting the defence.

Counsel should consider the application of *First Commonwealth* when confronted with cases where seemingly voluntary payments were made by insureds without the consent of the insurer. It may well be that those payments were not so voluntary after all.

Ryan Shaw is an associate at Richards Buell Sutton in Vancouver practising in the areas of insurance litigation, personal injury and construction law.

Unreasonable: Disability benefits wrongly treated as taxable income

Continued from page 12

Bruce Brine was a police officer. In 1995, Brine was diagnosed with severe depression. He made a claim with his insurer for disability benefits. Brine's insurer paid benefits and for him to attend a vocational rehabilitation counsellor, something not covered by the policy but done at the discretion of the insurer. He was eventually found to be totally disabled.

In 1998, Brine's insurer alleged that over a period of years Brine had received undisclosed CPP and other disability benefits retroactive to 1996, resulting in a substantial overpayment. The insurer immediately halted ongoing benefit payments to offset his CPP payments, and also halted Brine's vocational rehabilitation services without explanation. In 1999, Brine filed for bankruptcy. Once discharged, he claimed that the overpayments relied upon by his insurer to offset his claim were wiped clean. Brine's insurer disagreed and only resumed benefit payments in 2003.

> Long-term disability insurers should take note that a single piece of surveillance evidence should not justify maintaining a denial of benefits in the face of unchallenged medical evidence demonstrating the insured's disability.
>
> **Matthew Pearn**
> Foster & Company

The disputes brought Brine and his insurer before the courts. At trial, Brine's insurer was found in the wrong for refusing to acknowledge that Brine's 1999 bankruptcy wiped clean most of the overpayment, and in any event should have prorated repayment between the date of discovery and Brine's 65th birthday.

However, the conduct of Brine's insurer before and at trial was found to violate its duty of good faith for the following reasons:

- Brine was forced to go to the Tax Court of Canada on several occasions because his insurer persisted in wrongly treating his disability benefits as taxable income. The insurer maintained this position up until the date of trial, causing Brine unreasonable financial hardship.
- Cancelling Brine's vocational rehabilitation services without considering what impact it might have upon Brine was unreasonable.
- The insurer failed to disclose a 2003 medical examination into Brine's psychiatric health until the week before his trial without providing explanation, which the court interpreted to be an attempt to obtain a better bargaining position.
- At trial, the insurer presented a witness who tried to "paint" Brine as having concealed his application for CPP benefits, despite the insurance file having shown otherwise.

The court ordered Brine's insurer to credit him with the overpayment equal to the amount expunged by his 1999 bankruptcy, and also awarded Brine damages for the mental distress. In addition, Brine was awarded $150,000 in aggravated damages and $500,000 in punitive damages to reflect the magnitude of the insurer's breach of its duty of good faith owed to a vulnerable insured suffering from mental illness.

Industrial Alliance Insurance and *Fernandes* highlight a number of actions which may prompt a trial judge to award mental distress damages as well as pecuniary damages.

Long-term disability insurers should take note that a single piece of surveillance evidence should not justify maintaining a denial of benefits in the face of unchallenged medical evidence demonstrating the insured's disability. Likewise, trial judges will disapprove of the insurer applying financial pressure and withholding evidence to incentivize an insured to settle.

Matthew Pearn (@PearnMatthew) is an associate lawyer with Foster & Company in Fredericton, N.B., practising in the areas of personal injury and insurance defence.