THIRD PARTY LIABILITY COVERAGE IN AUTOMOBILE INSURANCE CONTEXT: Key Concepts and Practical Strategies

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1. INTRODUCTION

Automobile coverage issues in Ontario include principles extending coverage (such as consent), and principles limiting coverage (such as breach of statutory conditions).

This article serves to explore a number of issues, including:

-when coverage will extend beyond the named insured;
-the concept of a breach of a condition;
-the relatively newly imposed concept of honest but mistaken belief; and
-resurfacing of the relief from forfeiture doctrine.

We will also consider practical strategies for insurers, such as reservation of rights letters and non-waiver agreements, and consider the related strategy of the insurer adding itself as a statutory third party to the litigation.

Lastly, we will consider the absolute liability provisions of the Ontario *Insurance Act*, including an indication of the coverage related circumstances when such liability be imposed and when it will not.

2. THIRD PARTY LIABILITY CONCEPTS: DRIVER

Third party liability coverage under an automobile policy may extend beyond coverage to the named insured, and may include coverage to another 'driver.' This extension of coverage, however, has limits, typically defined by the scope of 'consent.'

Consent

The Ontario *Insurance Act* provides that a driver (who is not the named insured on a motor vehicle policy) is only an insured on a policy if the driver had consent of the named insured to drive or be an occupant of, or be in possession of, or use, or operate the insured vehicle.

Generally speaking, where the owner of the vehicle has, either expressly or by implication, expressed confidence in a driver to be in charge of his/her vehicle on a highway, even for a limited purpose, that owner will be deemed to have provided consent to drive the vehicle. This is so even if the vehicle is being used for some other purpose when an accident takes place.

Once even limited consent is granted (e.g. consent to use the vehicle only to go to and from work, or to only drive during the daytime), the onus then shifts to the owner to prove that the driver did not have consent at the time of the accident. Controversies can arise, however, about whether the driver had consent, in instances where the owner had previously expressed clear limits on the driver's use of the vehicle, such as not driving on highways.

The proper approach is a subjective one from the point of view of the driver, namely whether the driver, under all the circumstances, would be justified in thinking that he or she had the implied consent to drive (or operate possess, occupy, or use) the insured automobile.

3. AUTHORITY TO DRIVE AND HONEST BUT MISTAKEN BELIEF

In Ontario, many drivers have restrictions in place on their driver's licence. This is especially true in the context of new drivers, who are subject to the province's "graduated licencing scheme," designed to delay receipt of a full driver's licence.

Drivers with restrictions may be found not to have been in compliance with the terms and conditions of their licence. Generally speaking, when an insured drives in contravention of a term of his/her license, this is considered a breach of the insuring agreement, requiring an insured to have the proper 'authority to drive' the automobile.

The inquiry for insurers considering whether such violations negate coverage under a policy of insurance, however, does not end with proving that a violation took place.

As discussed below, once coverage is extended it may prove difficult, absent the clearest of cases, for an insurer to successfully deny coverage. This is so even in circumstances where the insured has clearly committed a clear breach of the policy.

In *Tut v. RBC Insurance*, 2011 ONSC 823, a young driver drove his mother's vehicle the morning after a night of alcohol consumption. The mother consented to her child driving the vehicle in order to take some of his friends home after the party.

Under his G2 license, the young driver was to have zero alcohol in his blood at all times while driving. The Ontario Court of Appeal held that since the son (driver) was found to have had a reasonable belief that he had zero blood alcohol content, his onus was discharged such that he believed himself to be driving under the conditions of his licence. The court concluded that the son held an <u>honest but mistaken belief</u> that he had zero alcohol in his blood.

He was found not to have been in contravention of his licence restrictions, and he thus had the appropriate authority to drive.

This is clearly a problematic doctrine, as it is difficult to imagine how an insurer would, in certain circumstances, put forward evidence to rebut an allegation on the part of a driver that he had an honest but mistaken belief. The focus in instances such as this will be on the extent of the due diligence undertaken by the driver to satisfy himself/herself that he/she was in compliance with the terms of his/her licence.

Interestingly, even if it is found that the insured was in fact in breach of the terms of his license, and did <u>not</u> have a reasonable but mistaken belief regarding his conformity with the conditions of his license, that does not end the coverage analysis.

4. RELEIF FROM FORFEITURE

Recently, the Ontario Court of Appeal decided that relief from forfeiture can be applied to automobile insurance contracts where the exclusion is due to imperfect compliance with a statutory condition, rather than non-compliance with a condition precedent (eg. failure to renew driver's license vs. never having had a license)

In *Kozel v. Personal Insurance Co,* 2014 ONCA 130, a 77 year old woman was involved in a serious motor vehicle accident while driving with a license that had expired four months previously. The woman did not realize her license was expired, because she mistakenly believed the renewal form sent to her only pertained to her vehicle license plate renewal.

Despite concluding that the insured did not have a 'reasonable' but mistaken belief regarding licencing status, the court granted relief from forfeiture to the insured.

The court reiterated that, if a breach is substantial and prejudices the insurer, however, relief from forfeiture is not an available remedy for an insured. Where relief from forfeiture is available, the following factors will be considered by the court to determine if it should be granted:

- The conduct of the insured (in totality, before and after the incident):
  - In *Kozel,* breach had never happened before; the insured renewed her license without difficulty; the insured had always paid premiums in timely manner and acted in good faith on all occasions.

- The gravity of the breach (nature and impact):
  - The Court found that the breach in *Kozel* was minor in nature and had no impact on insured's ability to drive safely, and no impact on the contractual rights of the insurer.

- The disparity between the value of the property forfeited and the damage caused by the breach (i.e. prejudice to the insurer caused by the breach)
  - The Court, in *Kozel*, found that the insured stood to lose $1 million in coverage, whereas the breach caused no prejudice to the insurer.

As a result, insurers will need to consider much more than whether an insured has breached a condition of his/her driver's licence. An insurer must also consider whether an insured may be found to have an 'honest but mistaken belief' regarding compliance and/or whether the insured may be entitled to relief from forfeiture for any such breach of the policy.

5. PRACTICAL STEPS FOR THE INSURER

Ongoing Further Investigation

When a potential policy breach is found to exist, the insurer is put to an election of either:

- Refusing to defend the insured, thereby repudiating the contract; or

- Defending the insured in spite of the breach, thereby waiving the insurer`s right to deny liability on the policy.

The insurer's election can be made expressly or implicitly. An act or correspondence that suggests that a defence is being granted to the insured can be taken later by the court to have implied an election on the part of the insurer to affirm the contract. Accordingly, an insurer may be obligated to defend an insured, even where no explicit election to do so was communicated.

Advising Insured of Potential Off-Coverage Position: Non-Waiver Agreements

The usual approach is for an insurer to send to the insured a non-waiver agreement or a reservation of rights letter. A non-waiver agreement is preferable insofar as it is a signed agreement between the insurer and the insured. However, there are certain difficulties in completing a non-waiver agreement that must be considered as well.

A non-waiver agreement stipulates that the insured agrees that the insurer does not waive its rights to deny coverage when further steps, including investigation into details of the claim, are undertaken.

Advising Insured of Potential Off-Coverage Position: Reservation of Rights Letters

A reservation of rights letter is a letter to the insured that states that the insurer will proceed with the defence but reserves the right to deny coverage to the insured because of a potential policy breach. Such a letter can be sent before any meeting so that the insured is aware of the coverage situation. Fairness and transparency are key concepts when dealing with the insured and potential coverage problems. However, despite the foregoing, no reservation of rights letter is foolproof.

The courts in Ontario have held that, where an insurer is aware of coverage issues and sends a reservation of rights letter, but then later sends a letter confirming that the insured is covered up to the third party liability limits (an "excess letter"), the insurer is deemed to have elected to indemnify the insured, at least up to the limits of the policy.

Practical Steps to Take when Coverage Issues Arise:

Once an insurer becomes aware of a coverage issue, it must communicate clearly with the insured and continue to investigate until the facts are clear enough to make a coverage decision. It would be prudent to send a reservation of rights or non-waiver letter.

A non-waiver agreement or reservation of rights letter should not be indefinite. A sophisticated insured may demand an insurer make an election right away.

To the extent possible, keep defence and coverage issues separate.

Even an excess letter can be deemed to be evidence of an election to affirm the contract, despite the presence of a clear policy breach. Accordingly, such a coverage limiting communication should be sent along with all other coverage issues. If defence counsel sends an excess letter, it may paper over any and all coverage issues and defences raised in previous correspondence sent by the insurer.

It is probably best if the insurer sends all coverage limiting communications to the insured, including the standard 'excess letters' as it it relates to claims in excess of the policy limits.

When and why an Insurer should add itself as a Statutory Third Party

An insurer may wish to deny coverage to an insured defendant in a law suit, but may still wish to participate in the defence of the law suit in order to defend and limit the damages being claimed by the plaintiff, as well as defend liability, all "in the best interests" of the putative insured.

In such instances, Ontario law permits an insurer to add itself as a party to the litigation. The insurer would then be considered a "statutory third party" in the proceedings.

An insurer may want to add itself as a statutory third party when it is taking an off-coverage position with respect to its insured for a breach of statutory condition, failure to cooperate, or a material misrepresentation or fraud. By alleging a policy violation and adding itself as a statutory third party, the insurer who takes an off-coverage position merely preserves its position. The coverage dispute will then be an issue to be determined in any subsequent litigation as between the insurer and its putative insured.

6. CONSEQUENCES OF COVERAGE BREACH

The Absolute Liability Provisions

Section 258 of the Ontario *Insurance Act* enables injured parties to recover damages in an action, and not be deprived of a remedy based solely on the conduct of the defendant insured. Accordingly, if a defendant insured is in breach of an expressed or implied term of the insuring agreement, the insurer is still 'absolutely liable' to the plaintiff. The insured, however, may forfeit entirely his/her right of indemnity with the insurer.

Indemnity can be denied by an insurer based on a finding that the insured breached a statutory condition, or made a material misrepresentation to the insurer.

In cases where an insurer is required to pay a plaintiff based on the absolute liability provisions, the insurer may then pursue the insured for reimbursement of any amounts that it was required to pay to the plaintiff, as a result of section 258(13).

When it applies, an insurer may only raise policy defences to claims in excess of the minimum limit for coverage in Ontario ($200,000 (CAD)). Hence, an insurer is considered to be 'absolutely liable' to the plaintiff upon judgment against its putative insured for amounts up to $200,000 (CAD).

For amounts in excess of $200,000 (CAD), the insurer may avail itself of any defence it is entitled to set up against the insured.

Given the consequences associated with the application of section 258, of particular importance is the question of which coverage related circumstances give rise to 'absolute liability' and which do not. There appears to be no clear demarcation at law. However, appellate level authority in Ontario has determined the outcome with respect to a number of common situations, as follows:

When do Absolute Liability Provisions Apply?

Section 258 has been held to apply in the following cases:

- Breach of Condition
- Intentional (Criminal) Act

- Material Misrepresentation

Section 258 has been held NOT to apply in the following cases:

- Breach of "Other Automobile" Coverage
- No Consent
- Excluded Driver

As a result, it will be important to be aware of the nature of the coverage limiting conduct of the putative insured, and whether such conduct will negate entirely the coverage under the policy, or whether the insurer will remain 'absolutely liable' to the plaintiff up to the minimum limits.

7. CONCLUSION

In sum, we have canvassed a number of coverage concepts under the automobile policy, including common breaches and coverage exclusions, and court created exceptions to those exclusions.

Automobile Coverage Issues: this paper has canvassed coverage issues which typically arise with respect to drivers and owners, particularly as they relate to issues of consent and breach of statutory conditions. Further, it also has considered when an insurer is made aware of potential breaches of the policy or other coverage issues. Those include communications with the insured.

Fairness and transparency emerge as the key concepts. Insurers should make their insureds aware of potential coverage issues, and of the insurer's position and decision regarding coverage.

Non-Waiver Agreements and Reservation of Rights Letters: the insurer often knows early on that there is a coverage issue, but does not have enough information and is not ready to make a firm and final decision on coverage. In those situations, strategies such as a Non-Waiver Agreement and/or Reservation of Rights letter can be employed.

Statutory Third Parties once the insurer has decided what should be communicated to the insured, the insurer should consider whether to add itself as a Statutory Third Party.