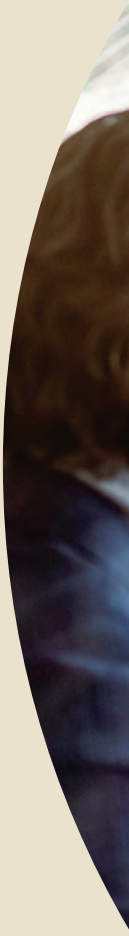
BY CHRISTOPHER OBAGI*

OVER LIMITS CLAIMS & BAD FAITH



The law in Canada on the good faith duties of insurers to settle third party claims within policy limits is sparse.[1] Unlike the legal landscape of our southern neighbour, the law in Canada continues to be underdeveloped in this area.

Various factors account for this difference. Firstly, there are a number of Canadian jurisdictions that have legislatively eliminated third party tort claims arising from motor vehicle accidents. These are the claims that dominate the case law in the area of over limits third party liability claims. Secondly, the policy limits carried by many drivers in the U.S. are extremely low (some states have minimums as low as $10,000) as compared to the average policy holder in Ontario, for example, where many drivers have either $1M or $2M liability limits. As such, there is a significantly higher volume of over limit claims in the U.S., putting pressure on insurers to quickly settle claims at policy limits (often at nuisance levels) in order to protect their insureds from personal liability.

While the Canadian jurisprudence on this issue is limited, it does impart good faith obligations onto insurers when they are faced with these types of claims. Even in the context of higher policy limits in Ontario, insurers do not have *carte blanche* with respect to their negotiation tactics in resolving claims. Third party claims that are assessed above limits trigger obligations on the insurer to act in good faith to protect the interest of its insured, who is at risk of personal exposure should there be a judgment that cannot be satisfied by the liability policy responding to the claim.

The issue of underinsured defendants is apparently more and more relevant in Ontario. The continued erosion of statutory accident benefits has created less credits and assignments available to the tort insurer, thus increasing the assessment of tort claims. Claims are also being assessed higher as plaintiffs are increasingly able to more accurately quantify future care costs and account for rising market value rates.

In the same vein, inflation has increased significantly over time but with many policy holders maintaining the same liability limits. Indeed, a plaintiff's claim in year 2000 worth $1.2M, would be worth just above $2M in today's dollars assuming the exact same injuries. As such, a defendant who was insured in year 2000 with a $2M policy limit faced no financial risks of going to trial on such a claim, giving the insurer full control by assuming all the risks of trial. That exact same claim today, with the same policy responding, now carries an over limits exposure risk.

In an over limits claim, the financial risk is shared between the insured and the insurer. The insurer, having control of nearly all aspects of the claim, including settlement, must consider how their conduct affects their insured. If insurers fail to act reasonably in protecting the interests of their insured, they may be found to have acted in bad faith. Drawing from three significant cases, the insurer's obligations when faced with third party over limits claims can be summarized as follows:[2]

1. Insurers must give as much consideration to the insured's interests as it does its own;
2. Insurers have a duty to disclose to their insured all material information related to the insured's position in the litigation and in settlement negotiations so that the insured knows the strategy and risks;
3. Insurers should consider the advice of counsel or other agents retained to assess risk;
4. Insurers have an obligation to make their best efforts at settling the claim within limits if there is a real risk the judgment will surpass the limits;
5. Insurers should participate in negotiations when reasonable to do so and they should be done in a timely fashion;[3]
6. Insurers have a positive obligation to pursue settlement offers that are within policy limits if a finding of liability against the insured is likely;
7. Should last minute negotiations arise, advance planning must be made to ensure that the insured's interests are given equal protection with those of the insurer;
8. Insurers have a duty to instruct counsel to treat the interests of the insured equally with its own, and if conflicting interests exist, the insurer and/or its counsel should advise the insured as to the nature and extent of the conflict; and
9. Upon any conflict arising, the insurer should recommend that the insured seek independent legal advice.

Arguably, regardless of whether an insurer breaches any of the above duties, a bad faith action would only crystalize once judgment is rendered above policy limits, thereby causing a financial detriment to the insured. Should the primary action against the insured fail, or settle at any stage prior to judgment within limits, the insurer would be shielded from a bad faith claim by its insured.

This begs the question of whether or not an insurer's obligations are altered when the insured party is impecunious and is unable to satisfy any judgment. In

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other words, if the over limits portion of the claim results in a "dry judgment", is the insurer still held to the same standard of good faith? The answer is YES.

One reason for this is because the impecunious insured may face other legal consequences of an unsatisfied judgment, such as having their driver's licence suspended.[4] Further, should the insured face bankruptcy, the trustee may pursue the bad faith action against the insurer in their own name. In *McEwan (Re)*, 2021 ONCA 566, the Court of Appeal found that an insured who had filed for bankruptcy prior to the trial of the main action, could bring a bad faith action through their trustee in bankruptcy following the trial of the main action where a judgment is rendered above limits. The insurer cannot shield itself from first party liability by hiding behind the impecuniosity of its insured:

> "Upon the McEwens' bankruptcy, their liability for the motor vehicle accident was transferred to the trustee and the bankrupt estate became liable for the damages caused by the accident. The McEwens' contract of insurance was also transferred to the trustee and the bankrupt estate became the insured and entitled to the proceeds of the insurance to satisfy the estate's liability to the Carrolls [...] An insurer generally has the duty to deal with an insured with the utmost good faith and the insured has a right of action for any breach of that duty. As the insured was the bankrupt estate, the trustee could take action to remedy any breach of the alleged duty of good faith."[5]

In cases where the plaintiff obtains an over limits judgment in the main action, an insurer may be found to have acted in bad faith in a subsequent action if it has **unreasonably failed to settle the main action within limits and if it prioritized its own interests above those of the insured.**

The next logical question is whether the insured (or the trustee as above) can assign its bad faith action to the plaintiff of the main action who obtained judgment above policy limits. The answer to this question is also a clear and resounding YES.

An insurer's duty of good faith is owed only to the insured person. This means that without an assignment of rights, third parties advancing liability claims against an insured have no cause of action against that insured's insurance company.[6] For this reason, third party claimants who receive an over limits judgment may seek an assignment of the insured party's right to sue the tort insurer for bad faith conduct. If successful in the bad faith action against the insurer, the insurer would likely be required to pay the amount of the judgment above policy limits. This strategy can be particularly useful when the insured party lacks the resources to pay the amount they owe on the judgment. Typically, the third party claimant seeking the assignment of rights will agree not to pursue the insured for their portion of the judgment in exchange for the assignment.[7] This makes the arrangement beneficial to both parties.

In *Fredrickson v ICBC* (1986), McLachlin J. (as she then was) conducted a thorough analysis of the issue of assignment. She was tasked with reconciling assignment in this context with the general rule that a bare cause of action in tort is not assignable. This rule comes from the common law rules against maintenance and champerty.[8] She went through the different exceptions to the general rule and concluded that assignment in this context would be permitted because the plaintiff has a pre-existing interest in the litigation, resolving any concerns of champerty or maintenance.[9] McLachlin J.'s analysis and conclusion was upheld and adopted by the Supreme Court of Canada.[10] As a result, there is no dispute that assignment is possible in this context.

Is assignment still available in cases where the insured dies? Yes, just as a trustee in bankruptcy can assume the rights of the insured vis-à-vis the insurer, presumably, the estate trustee of

a deceased insured would also assume these same rights. This proposition has not been tested in court. Nonetheless, it would be highly unusual to suggest that a duty of good faith on the part of an insurer would somehow be extinguished in an active and ongoing claim, simply because the insured has died, especially considering that the defendant's estate assumes the defence of the action in place of the deceased insured.

There are lessons to be learned for plaintiffs from these situations. The potential exposure on the insurer to pay the above-limits judgment (if a bad faith claim is successful) can and should be used by plaintiffs to bolster their negotiation strategies prior to trial of the main action. Plaintiffs and their lawyers would be mistaken to dismiss an insured party's potential exposure as immaterial or irrelevant to their case. The difficulty is that the plaintiff has no direct rights under the policy without a judgment. How then can the plaintiff from the main action actively participate in this relationship in order to obtain a positive settlement?

In order to answer this question we must consider the obligations of insurers to recommend that their insureds seek independent legal advice ("ILA"). In *Fredrikson*, the SCC allowed a bad faith claim to be assigned to the plaintiffs. Subsequently, the bad faith action proceeded to trial on its merits. At trial, the insurer was successful in having the case dismissed.[11] ILA was one factor considered by the court when analyzing whether the insurer had acted in good faith despite having failed to settle within limits. Indeed, the insurer had advised the insured on numerous occasions to seek ILA. It did so again following the trial but prior to the assessment of damages when a further within limits offer was made by the plaintiff. Unfortunately, by the time the insured finally sought ILA, the offer had expired.

More often than not, it is the plaintiff who indirectly reaps the benefits of a tortfeasor seeking ILA in the context of above limits claims. Obtaining ILA may create more pressure on the insurer to settle within policy limits. What can a plaintiff do prior to the trial of the main action to facilitate ILA for the benefit of the tortfeasor (and the plaintiff)? One strategy is for the plaintiff to simply make a without prejudice offer, to the defendant through defence counsel, to pay for the tortfeasor to obtain ILA (up to a certain amount). Once received, such an offer must be communicated by defence counsel to the tortfeasor.

At a minimum, this ensures that a discussion between the insurer and the insured is had surrounding ILA. Should the defendant accept the offer, the plaintiff can now be certain that independent counsel has been sought on behalf of the tortfeasor and that any over limits exposure will be discussed between the insurer, the insured and both sets of counsel. Even if not accepted, it may serve to put additional pressure on the insurer to at least match the offer made by the plaintiff and reimburse their own insured for ILA.

This simple and low-cost gesture may have been the catalyst required in *Fredrikson* to settle and avoid the high cost and time consuming litigation that ensued.

In summary, in cases where the plaintiff obtains an over limits judgment in the main action, an insurer may be found to have acted in bad faith in a subsequent action if it has unreasonably failed to settle the main action within limits and if it prioritized its own interests above those of the insured. Prior to the main action going to trial, the plaintiff (who has no direct relationship with the third party liability insurer) may encourage the insured to seek ILA by offering to cover the cost. In the case of an over limits judgment, a tort defendant can assign their bad faith cause of action to the plaintiff. This is true even if the insured was impecunious, bankrupt, or deceased during or after the litigation of the main action.

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*Special thanks to Emily Bordin and Esmé Ariss for their invaluable assistance.

NOTES

[1] For an exhaustive review on the topic see *Refusal to Settle Within Limits,* OTLA 2010 Spring Conference by Tom Connolly.

[2] *Shea v. Manitoba Public Insurance Corp.,* 1991 CanLII 616 (BCSC), *Fredrikson v Insurance Corporation of British Columbia,* 1990 CanLII 3814 (BCSC), *Dillon v Guardian Insurance Co,* [1983] OJ No 2534 (QL).

[3] See also *Insurance Act,* R.S.O. 1990, c. I.8 at s 258.5(1).

[4] *Highway Traffic Act,* R.S.O. 1990, c. H.8 at s 198.

[5] *McEwan (Re),* 2021 ONCA 566 at para 55.

[6] Gordon G Hilliker, *Insurance Bad Faith,* 3rd Ed. "Third Party Bad Faith" (LexisNexis Canada, 2015) at 3.71.

[7] *Ibid* at 3.72.

[8] *Fredrickson v I.C.B.C.,* 1986 CanLII 1066 (BCCA) at para 21.

[9] *Ibid* at para 37.

[10] *Insurance Corporation of British Columbia v Fredrikson*, [1988] 1 SCR 1089.

[11] *Fredrickson v ICBC,* 69 DLR (4th) 399 (BCSC).