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Noteworthy

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The Ontario Court of Appeal addresses the limitation period for claiming defence costs

Overview

In *Daverne v. John Switzer Fuels Ltd.,* 2015 ONCA 919, *the Ontario Court of Appeal* dealt with the issue of what limitation period applies within the context of an insurer's duty to defend. The successful appeal found that the insured's claim was barred by the limitation found in the subject liability policy of one year. In rendering their decision, the three-person panel considered an issue that has not been comprehensively addressed in Ontario. The Court concluded that when an insurer denies the duty to defend, this is a "loss" for the purpose of the triggering of a limitation period. And, in arriving at their decision, the Court applied the "correctness" standard of review.

In light of the application of the limitation period, the Court held that the analysis at first instance of the duty to defend did not have to be considered.

Factual Background

The main action arose out of a leak from a fuel tank that caused damage to the Davernes' property. McKeown & Wood ("Mckeown") sold the fuel tank to the Davernes in 2000. At some point after the last fuel delivery was made on January 9, 2008, the tank began to leak. The Davernes discovered the leak after they returned from vacation in late January 2008. They started the main action against McKeown and others on December 31, 2009. They sought compensation for damage to their home and the additional living expenses they incurred because of the leak.

Federated Insurance Company of Canada ("Federated") insured McKeown until the last policy expired on October 24, 2007, just months before the leak occurred. On February 11, 2010, McKeown advised Federated of the Davernes' claim, but Federated denied coverage. Federated stated that because the occurrence took place in January 2008, Federated did not ensure McKeown on the date of loss. McKeown defended the main action (assuming its own legal costs) and brought a third party action against a number of insurers, including Federated on March 15, 2012 seeking a declaration that the insurers were required to provide a defence under three different policies.

The Summary Judgment Motion

Ontario Superior Court Justice Mew found that the defendant oil tank seller was owed a defence under one of three policies and the claim against Federated, the insurer with the defence obligation, was not limitation-barred.

On a motion for summary judgment, Federated argued that the third party claim was filed after the one-year limitation in the policy had expired. Federated relied on a statutory condition that was incorporated into the policy that stated an action against the insurer must be commenced within one year after the loss or

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Michael Teitelbaum & Stephen Hopkins

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damage occurs. Federated's position was that for the purpose of liability coverage, “loss or damage” equated to the “loss” that occurs when an insurer denies an insured’s claim for coverage.

Justice Mew held that Federated could not succeed on this limitation defence. He stated that the fire statutory conditions that were incorporated into the policy, and the one-year limitation period that the conditions contained, did not apply. Justice Mew cited *KP Pacific Holdings Ltd. v. Guardian Insurance Co. of Canada*, 2003 SCC 25. In *KP Pacific*, the Supreme Court of Canada considered statutory conditions that were essentially identical to those contained in the Federated policy. Writing for the Court in *KP Pacific*, Chief Justice McLachlin concluded that the comprehensive policy at issue on the appeal could not be “shoehorned” into the fire insurance section without “contrived reconstruction and anomalous consequence.” Justice Mew concluded that Federated should not be able to rely on a limitation defence because the result of including a statutory condition that was intended for first party insurance as a policy condition and applying it to cover third-party risks would yield an anomalous consequence akin to those envisioned by the Supreme Court of Canada in *KP Pacific*.

Justice Mew further stated that this approach is consistent with the principle that where there is doubt or ambiguity about the meaning or applicability of a limitation period, the ambiguity should be resolved in favor of the person whose right is being truncated. Therefore, His Honour held that the limitation period in the statutory condition did not apply to claims made under the commercial liability coverage provided by the policy and the applicable limitation period was the two-year limitation provided for in s. 4 of the *Limitations Act*, 2002. The third party claim had been commenced less than two years after Federated denied coverage and was not limitation-barred.

Issues on Appeal

The Court of Appeal set out three issues for the appeal, but only addressed the first two given its decision:

(1) What is the standard of review applicable to the motion judge’s interpretation of the policy?

(2) Did the motion judge err in finding that the one-year limitation period set out in Federated’s insurance policy was not enforceable against the insured McKeown & Wood?

(3) If the one-year limitation period is not enforceable, did the motion judge err in his approach to ascertaining whether Federated owed McKeown & Wood a duty to defend the main action under the insurance policy

The Appeal Decision

Issue 1: Correctness

In addressing the first issue, the Court of Appeal concluded that the standard of review applicable to the motion judge’s interpretation of the insurance policy was correctness. Justice Lauwers, writing for the Court, stated that since this appeal was heard, the Court of Appeal in *MacDonald v. Chicago Title Insurance Company of Canada*, 2015 ONCA 842, determined that the correctness standard of review applies on standard form insurance contracts. In reiterating Macdonald, Lauwers J.A. cited the decision’s reasoning that it would “untenable” to give insurance policy wording different meanings by different judges. Because of the nature of insurance policies, with similar language and general principles of law, there is a public policy argument that the high degree of generality and precedential value justifies a standard of correctness.

Issue 2: Limitation Period

The Court of Appeal held that the one-year limitation period in the policy is enforceable. Justice Lauwers found that the third party claim for a declaration that Federated owes McKeown a duty to defend the main action should be dismissed.

The Limitation Period In The Policy

Justice Lauwers cited s. 148 of the *Insurance Act*, which makes certain conditions part of every fire insurance contract in Ontario. Statutory Condition 14 was included in Federated’s policy as clause 14 of the “Basic Policy Statutory Conditions” form that is included in the policy and provides a one-year limitation for action after the loss or damage occurs. He held that clause 8 of the “Additional Conditions” applies as a contractual limitation to the other perils insured against in Federated’s policy and to the liability coverage provided by it.

The Policy Is A Business Agreement

The *Limitations Act*, 2002 has a two-year limitation and s. 22(1) prohibits contracting out of the limitation period. However, a subsequent exception to the no-contracting-out rule was permitted in the case of “business agreements.” But for the amendments, the shorter period in statutory condition 14 would only apply to the fire insurance elements of Federated’s policy. The Court observed it is plain that none of the parties to Federated’s insurance policy is a consumer and the parties are business entities.

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The Policy Overrides The Statutory Two-Year Limit

Justice Lauwers held the combination of clause 14 and clause 8 clearly varies the two-year limitation period provided for in the Limitations Act, 2002. He referenced *Boyce v. Co-Operators General Insurance Co.*, 2013 ONCA 298, where the Court of Appeal found that nearly identical contractual limitation period language overrode the otherwise applicable statutory two-year limitation. According to Justice Lauwers, the motion judge incorrectly concluded that the phrase "loss or damage" in clause 14 did not include loss or damage suffered by a third party who then seeks compensation from the insured.

Incorrect Interpretation and Improper Application of the Jurisprudence

Justice Lauwers found that the motion judge did not apply the proper jurisprudence and, therefore, his interpretation was wrong. The Court held that the motion judge erred in rejecting Federated's argument that its denial of defence coverage could constitute loss or damage for the purpose of the limitation period in clause 14. The motion judge should have applied the basic principle that the insured "suffers a loss from the moment the insurer can be said to have failed to satisfy its legal obligations under the policy of insurance." Furthermore, Justice Lauwers disagreed that the difference between first party property claims and a third party claim for defence is a point of distinction that affects the application of the principle that the insured suffers a loss when the insurer fails to meet its obligation under the policy. Justice Lauwers further states that the motion judge erred when he failed to consider clause 8. He held that clause 8 is clear and unambiguous and it explicitly states that the statutory conditions apply to liability coverage under the policy. Because the insurance policy in this case is a business agreement for the purpose of s. 22 of the *Limitations Act*, 2002, the one-year contractual limitation period is enforceable by Federated.

Therefore, because the third party claim was issued nearly 2 years after Federated's letter denying coverage, the claim that Federated owed a contractual duty to defend McEwan is barred by the one-year contractual limitation period. Because of the court's holding in this connection, it was unnecessary to consider the third issue that was raised. That said, the Court noted that despite the fact Federated did not have a duty to defend the insured, this does not dispose of Federated's possible obligation to indemnify.

Comment

The recent Ontario Superior Court decision of *Zochowski v. Security National Insurance*, 2015 ONSC 7881, is consistent with the Court of Appeal's Daverne decision. In this case, the Plaintiff, Mr. Zochowski ("the Plaintiff"), while riding a bicycle in July 2006, struck and injured a pedestrian, Sophia Tubis. Ms. Tubis sued the plaintiff for damages. The Plaintiff's insurer denied coverage and refused to fund his defence. The Plaintiff then sued the insurer but waited almost 3 years to do so. The insurer argued that the Plaintiff's action was time-barred. The motion judge dismissed the plaintiff's action as limitation-barred. The court held that the plaintiff suffered a loss because of the insurer's failure to defend, and the time for bringing an action ran from the date of denial.

In further reasons, reported at 2016 ONSC 553, Justice Belobaba stated that the limitation only applies to the defence obligation, and not any issue on the indemnity obligation.

Rolling Limitations

It should be noted that there is no discussion about "rolling limitations" in Daverne. As noted by *Craig Brown and Tom Donnelly in Insurance Law in Canada, Canada, vol. 1 (Toronto: Carswell, 1998)*:

> Causes for action for recovery of ongoing payments, such as income-replacement benefits under no-fault auto insurance or accident and sickness insurance, continually renew themselves each time an instalment becomes payable because the insurer is under a continuing liability for each succeeding benefit. Therefore, so long as entitlement to benefits continues (by continued disability), the limitation period only bars claims "originally more than [the prescribed period] before the commencement of an action." Each cause of action "originates" with each benefit as it becomes payable or, depending on the wording of the policy or regulation, when the application for benefits is denied.

In the "Issues in Focus – Limitation Periods and Liability Insurance in Ontario" section of the aforesaid text, the authors express the view that subject to the terms of the policy, the statutory two-year limitation period for the duty to defend begins with the denial of coverage, where there is a denial. However, there is a "good argument that the limitation renews itself with each dollar spent on defence". Thus, it may be arguable that the limitation begins to run with each defence costs account. However, with the Court's ruling in Daverne, the question is whether this possibility may no longer be viable. That said, we note that the Court's finding that the loss can be the damages claimed by the injured party, as opposed to the damages sustained by the insured when its

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defence accounts are not paid, is an interesting interpretation of what constitutes a loss. Having said that, it does appear to be consistent with recent decisions about when a limitation begins to run; namely, from the date of denial, (see, for example, *Schmitz v. Lombard*, 2014 ONCA 88).

However, all of that said, what is the effect of the Ontario Court of Appeal's very recent decision in *Pickering Square Inc. v. Trillium College Inc.*, 2016 ONCA 179? In that case, decided after Daverne, in the context of a commercial lease, the Court addressed the question: "When is a claim discovered for limitations purposes in the context of a continuing breach of contract?"

At para. 38 of the Court's reasons, it specifically endorsed the concept of a "rolling limitation". And, at paras. 24-25, the Court discusses the concept of a "breach of a continuing obligation under a contract". Would the obligation to pay defence costs qualify?

It remains to be seen whether the courts may be called upon to reconcile the *Daverne and Pickering Square* decisions at some point.

Finally, as can be seen from Daverne and Zochowski, and not surprisingly, there are two different limitations in respect of liability coverage, one for defence costs, and the other in respect of entitlement to indemnification, which would presumably run from when a determination is made of the damages an insured is obliged to pay.

Firm News

Mary Teal presented a paper entitled “The Sharing Economy—Insurance Exposures” at the 30th Annual Joint Insurance Seminar on April 19, 2016 in Hamilton.

Aleks Zivanovic will be Co-Chair of the CDL Annual Seminar on May 26, 2016 and will be chairing a panel discussion on drones and their usage in investigating and litigating claims.

Aleks will also be the Chair of the ARC Group’s Annual Seminar on June 2, 2016. Michael Teitelbaum will be part of the panel discussion on Technological Changes and Unintended Consequences.

Michael Teitelbaum also moderated a panel on Practical Considerations in Coverage Disputes at an OBA program held on May 12, 2016.

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