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The coverage lawsuit and bad faith claims



By Todd Davies

It has become almost commonplace for coverage lawsuits to include allegations of bad faith. Such allegations can result in the company having to produce and be examined on the entire claims file, the entire independent adjuster's file, the legal opinion on which the coverage decision was made, and in some cases the legal opinions relevant to policy wordings and corporate policies. This can sometimes result in the coverage case being coloured by the decision-making processes of the examiner, leaving one to wonder if this impacts a court's or jury's decision on whether there is or isn't coverage.

But should an insured be able to pursue a bad faith claim as part of the coverage lawsuit? There are several B.C. decisions which have found that a bad faith action doesn't arise until after the insured establishes coverage under the policy; in other words, coverage and bad faith claims are separate and independent issues so as to permit, although not mandate, severance of the claims.

Ordering severance remains an exercise of the court's discretion in balancing the interests of the parties. In weighing the interests of the parties, case authority in B.C. shows the protection of the insurer's solicitor/client privilege to be a pivotal factor.

Wonderful Ventures Ltd. v. Maylam is the leading case in B.C. in regards to severing coverage and bad faith claims. The court held that in circumstances where courts are persuaded on the evidence that the proper defence of the bad faith claim

may require the insurer to waive privilege over solicitor/client communications, the balancing of prejudice is in favour of severance of the bad faith claim.

It's common to have coverage decisions made and denials issued without any input from counsel. However, even in such circumstances, it's possible that solicitor/client privilege exists and may be a deciding factor upon which a court will order severance.

Such a situation was considered recently in *Brennard v. Sun Life Assurance Company*, a claim for long-term benefits under a group insurance policy. The



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plaintiff sought payment of benefits owing, as well as punitive damages for the insurer's alleged bad faith conduct.

The plaintiff alleged that the insurer utilized the policy term requiring "objective medical evidence" to wrongfully deny benefits at the initial adjudication state, not only to his claim but to "hundreds or thousands of legitimate claims." While counsel was not involved with the denial, the court accepted the insurer's evidence that, in order to defend its conduct in the initial adjudication stage, the insurer might need to waive privilege

over advice received from in-house legal counsel respecting the drafting of the actual policy terms. On that basis the court held that there was a real prospect of prejudice to the insurer, in that it could not defend the bad faith allegations without being required to waive privilege over certain solicitor/client communications. The court granted the insurer's application for severance.

There may be cases where the court is of the view that there is no merit to an insurer's assertion that solicitor/client communications will be revealed if severance is not ordered, given the specific nature of the allegations of bad faith being advanced. However, there are instances where relevant legal advice may have been sought by an insurer: during the denial stage, when drafting policy terms or when reviewing corporate policies. If a defence of the bad faith claim requires a consideration of any such situations, the courts will give much deference to the need to avoid the risk of disclosure of such solicitor/client communications. In such circumstances, it's likely a court would consider the balance of prejudice to favour severance of the bad faith claim from the coverage lawsuit.

When faced with a coverage lawsuit that includes allegations of bad faith, keep these principles in mind, and give consideration to the strategic benefits of severing the bad faith allegations from the coverage lawsuit.

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