IN FACT AND IN LAW

Insurance Law

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The obligation to defend in liability insurance: a motion can be made for specific performance

by Odette Jobin-Laberge and Michèle Bernier

On February 19, 1999[1], the Court of Appeal allowed a motion by an insured asking the court to order its insurer to take up its defence in an action for damages taken against it. The court held that the insured is entitled to immediate specific performance of the obligation without waiting for the final judgment on its liability.

The Court thus confirmed the Superior Court's interlocutory judgment which allowed the insured's motion to compel its insurer to take up its defence. It should be noted that the motion was based on articles 2 and 20 of the Code of Civil Procedure.

The Facts

The Respondent, M.E.C. Technologie Inc., is specialized, in among other things, supervising the installation of wood dryers. After supplying and installing a wood dryer for a sawmill which asked for «turn-key» service, the Respondent had to make certain adjustments to the dryer. A few months later, the machine was the source of a fire which caused extensive damage to the sawmill ($636,790.14).

Even before any legal proceeding was filed, the insurer sent its insured, Respondent M.E.C. Technologie, a notice denying coverage for the loss, stating that the policy covered the Respondent's liability for its activities related to the design and supervision of the installation of the wood dryers, but that it excluded all liability relating to installation by or on behalf of the insured. According to the insurer, the loss in this case was attributable to an installation carried out on behalf of the insured because, under the «turn-key» contract, the latter had almost all of the construction work performed by sub-contractors.

Sued for damages by the sawmill, the Respondent appeared through its own attorneys and filed a motion under articles 2 and 20 C.C.P. to compel the insurer to intervene and take up its defence. According to the insured, the decision of the insurer to deny coverage was premature because, when it sent its notice, no action had been taken and the insurer could not have been aware of the allegations contained in the declaration.

Superior Court Decision

Mr. Justice Jean Babin of the Superior Court analyzed the major decisions[2] dealing with the obligation of an insurer to defend its insured and adopted the principle, among others, that the insurer's obligation to defend should be analyzed in view of the allegations contained in the declaration, and that

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[1] *Compagnie d'assurance Wellington* v. *M.E.C. Technologie Inc.*, Q.C.A., 200-09-001957-981, Justices Dussault, Otis and Pidgeon, February 19, 1999 (Reasons given by Justice Dussault)

[2] *Nichols* v. *American Home Assurance Co.* [1990] 1 S.C.R. 801; *Boréal Assurances Inc.* v. *Réno-Dépôt Inc.* (1996) R.J.Q. 46 (C.A.); *Zurich du Canada, compagnie d'indemnité* v. *Renaud & Jacob* (1994) R.J.Q. 46 (C.A.) and Parizeau v. Fonds d'assurance responsabilité du Barreau du Québec (1997) R.J.Q. 2184 (S.C.)

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the mere possibility that a claim could be covered by insurance is enough to trigger the obligation to defend, even if certain types of damage claimed are not covered.

Examining the allegations in the declaration, Justice Babin held that the insurer must take up the defence of its insured since, even if the declaration mentions certain faults relating to the construction and installation of the dryer, one must also take into consideration the presence of allegations of fault on the part of the Respondent involving the design of the dryer and its supervision of the installation. These alleged faults are *prima facie* covered by the insurance.

Court of Appeal Decision

The obligation of the insurer to defend its insured

Mr. Justice René Dussault wrote the Court of Appeal opinion, which confirmed the Superior Court decision and reiterated that the obligation to defend is enforceable even where the obligation to indemnify is not. The obligation to take up a defence exists from the moment the policy appears to cover the damage. The mere existence of this obligation implies that its beneficiary can insist on specific performance, otherwise it would be of no value. The insured is therefore not required to wait for final judgment to be rendered on the principal action before demanding performance of this obligation by the insurer.

Appropriate procedure to enforce performance

The question of procedure was also raised by the Appellant, which argued before the Court of Appeal that the appropriate recourse was an action in warranty, not a motion under articles 2 and 20 C.C.P. Justice Dussault decided, on the contrary, that the action taken was appropriate and that the recourse in warranty provided by article 216 C.C.P. would be unsuitable to enforce specific performance of the obligation to defend. In fact, an action in warranty is only intended to allow a final judgement rendered on the principal action to be invoked against the insurer, whereas a motion filed under articles 2 and 20 C.C.P. is aimed at forcing the insurer to take up its obligation to defend immediately. A distinction should be made between the right of an insured to claim the reimbursement of costs incurred to defend itself and the right to insist on being defended immediately by attorneys whose fees are paid by the insurer.

According to Justice Dussault, the action in simple warranty provided at article 219 C.C.P. leaves it to the insurer to decide whether or not to contest the principal action, and it therefore does not allow a party to demand specific performance of the obligation to defend.

Finally, the recourse in mandatory interlocutory injunction would also be inappropriate since it requires an action to which it can attach, which implies the taking of a parallel dispute procedure detrimental to the exercise of the principal recourse.

Article 20 of the Code of Civil Procedure is therefore the only recourse, according to Justice Dussault, which would allow an insured to obtain specific performance of the obligation of the insurer to take up the defence of an insured who is sued for damages.

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Theoretically, the insurer is bound by the obligation to defend for the duration of the trial

In conclusion, Justice Dussault held that the obligation to defend the insured continues as long as there is a possibility that the final decision will hold the insured liable. Apart from very limited cases where the obligation to defend is extinguished during trial because of new facts, this obligation should not be questioned where it appears *prima facie* that the risk is covered by the policy.

Conclusion

According to Justice Dussault, this is the first decision rendered under the authority of the current Code of Civil Procedure requiring an insurer which provides liability insurance to pay the costs of defending an insured as of its appearance. While he recognized that his decision went against the trend in liability insurance, he maintained that the fear of difficulties in performing the obligation should not override the principle that the obligation to defend can exist and be complied with even where the obligation to indemnify is not enforceable at the outcome of the case. The situation is certainly easier in cases where the insured assumes its own defence and is reimbursed by the insurer *a posteriori*, but the fact remains that an insured that wishes to be defended by its insurer for various reasons (ex. lack of financial resources) should be able to make this choice as of its appearance.

It should be noted that, on the one hand, this judgment is silent as to how to put this obligation into practice. Insofar as we are dealing with specific performance, the insurer may certainly demand compliance with the clause in the contract which gives it the right to supervise the file and appoint the attorneys of its choice[3].

On the other hand, the judgement does not contain any mention of the fact that certain faults in the installation work would probably not be covered, whereas such a distinction was allowed by the Supreme Court in the Nichols decision[4]. In fact, in the latter case, the Supreme Court discussed how to manage a file where the obligation to defend does not cover all the allegations in the proceeding — several attorneys, outside counsel, cost sharing, etc.

This decision by Justice Dussault is important but its application could well give rise to problems. To be continued...

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[3]This right has also been recognized by the Court of Appeal in *Zurich du Canada, compagnie d'indemnité* v. *Renaud & Jacob* (1996) R.J.Q. 46 (C.A.)

[4] *Nichols* v. *American Home Assurance Co.* [1990] 1 S.C.R. 801

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