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Settlement Privilege and Mediation Confidentiality

The Supreme Court of Canada considers what happens when a party wants to resile from a settlement apparently reached at a mediation.

Bombardier Inc. ("Bombardier") manufactured Sea-Doo personal watercraft and Union Carbide Canada Inc. ("Union Carbide") manufactured gas tanks for the Sea-Doos. Some of the gas tanks were defective, which allegedly caused explosions resulting in personal injury and property damage. Bombardier sued Union Carbide and the matter ended up in a mediation. At the mediation Dow Chemical (which had merged with Union Carbide after the action was commenced) made an offer to settle for $7.0 million. Counsel for Bombardier indicated that he had to obtain instructions with respect to the offer and asked that it be kept open for 30 days, to which Dow Chemical's counsel agreed.

Just before the 30 days expired, counsel for Bombardier wrote to counsel for Dow Chemical advising that the offer was accepted and that he would be forwarding a draft Release. A few days later, counsel for Dow Chemical emailed counsel for Bombardier stating that it was his client's understanding that this was a global settlement and that the expectation was that Bombardier would sign a Release absolving Dow Chemical "of liability in any future litigation not only in Quebec and with respect to the gas tank models at issue, but anywhere in the world and involving any gas tank models".

Counsel for Bombardier responded by saying that it was always the understanding that the settlement offer was in respect of the proceedings commenced in the Superior Court for the District of Montreal and not in respect of any other actual or potential litigation. He said that he would be bringing a motion to enforce the settlement, to which counsel for Dow Chemical responded that he would oppose the introduction of any evidence with respect to the settlement discussions because the mediation process was confidential and protected by the confidentiality agreement signed at the commencement of the mediation.

The dispute ended up in the Supreme Court of Canada where the Court had to consider the intersection of mediation confidentiality with the law of settlement privilege. Both concepts have the same purpose, which is to permit parties to resolve their disputes by negotiation.

The Court observed that the confidentiality is at the very essence of mediation, quoting one commentator who said:

"When [the parties] have resorted to mediation in an attempt to settle pending or threatened litigation, they will be particularly alert to the possibility that information they reveal to others in mediation may later be used against them by those others in that, or other, litigation. The parties may also be concerned that their communications might be used by other adversaries or potential adversaries, including public authorities, in other present or future conflicts.…Parties may also be concerned that disclosure of information they reveal in the mediation process may prejudice them in commercial dealings or embarrass them in their personal lives."

Settlement privilege, on the other hand, "…is a common law rule of evidence that protects communications exchanged by parties as they try to settle a dispute. Sometimes called the 'without prejudice' rule it enables parties to participate in settlement negotiations without fear that information they disclose will be used against them in litigation. This promotes honest and frank discussions between the parties, which can make it easier to reach a settlement: 'In the absence of such protection, few parties would initiate settlement negotiations for fear that any concession they would be prepared to offer could be used to their detriment if no settlement agreement was forthcoming'".

However, settlement privilege is subject to an important exception, which is that protected communications may be disclosed in order to prove the existence or scope of a settlement. "The rule is simple, and it is consistent with the goal of promoting settlements. A communication that has led to a settlement will cease to be privileged if disclosing it is necessary in order to prove the existence or the scope of the settlement. Once the parties have agreed on a settlement, the general interest of promoting settlements requires that they be able to prove the terms of their agreement."

In this case, the Court had to decide whether a confidentiality clause in a mediation agreement displaces the exception to settlement privilege that applies where a party seeks to prove the terms of a settlement. The Court reviewed the confidentiality agreement that had been entered into in this case and concluded that there was nothing therein which displaced the exception to the settlement privilege. Bombardier could lead evidence to

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Inside This Issue

Derivative Claims Considered Again

Claims against a bar whose employee discharged a handgun and injured a patron, were sufficiently distinct to trigger a duty defend, despite a policy exclusion for bodily injury arising out of the ownership or use of weapons.

In October, 2010, Johnathan Kinkade became involved in an altercation as he was leaving the Silver Dollar, an adult entertainment facility in Ottawa, Ontario. In the course of the scuffle, he was shot in the leg by Timothy Gray, an employee of the Silver Dollar.

Kinkade sued both Gray and the Silver Dollar. The allegations against Gray were:

(a) He accidently discharged a handgun in a crowded area;

(b) He was reckless as to the safety of those around him;

(c) He failed to warn the plaintiff before firing the handgun;

(d) He brought a handgun to his place of employment when he knew or ought to have known that doing so would place patrons of the Silver Dollar at risk of injury;

(e) He failed to call the police or other emergency services when the scuffle broke out;

(f) He failed to take sufficient or any steps to ensure that the handgun was not discharged accidently;

(g) He was intoxicated by alcohol or drugs;

(h) He did not have proper training for possession or use of a handgun; and/or

(i) In the alternative, he intentionally fired a warning shot but did so negligently and, in particular, in the direction of the Plaintiff.

The allegations against the Silver Dollar included:

(j) They failed to properly or effectively screen Gray's background for a record of offences, particularly weapons offences, before hiring him;

(k) They failed to train or supervise Gray properly or at all;

(l) They failed to train or supervise their security staff, generally;

(m) They hired inadequate or incompetent employees or contractors, and/or failed to train or supervise such employees or contractors properly or at all in relation to proper security practices and protocols;

(n) They failed to call emergency services when the scuffle began;

(o) They asked or encouraged Gray to intervene when they knew or ought to have known that he lacked reasonable self-control, had a propensity for violence and/or was or might have been in possession of a firearm;

(p) They failed to take reasonable steps to ensure the safety of their patrons, including the Plaintiff;

(q) They knew of the danger posed by Gray and nevertheless failed to warn the Plaintiff;

(r) They tacitly or expressly endorsed Gray to bring a handgun onto the premises; and/or,

(s) They knew or ought to have known that Gray illegally possessed a handgun and failed to call the police.

The Silver Dollar had a comprehensive general liability policy issued by the Omega General Insurance Company ("Omega") which provided coverage, but for an exclusion which provided:

"2. Exclusions

This Insurance does not apply to:

b. 'Bodily Injury' …arising out of the ownership or use of:

(4) Guns, rifles, pistols, tasers, knives or other weapons."

Consequently, Omega denied coverage.

The Silver Dollar brought a motion for a determination that Omega had a duty to defend Silver Dollar and that Silver Dollar should have the right to control its defence by choosing and instructing counsel of its choice in the defence of the action.

The Court began by reviewing the law on the duty to defend setting out the principles as follows:

1. The insurer has a duty to defend if the pleadings filed against the insured allege facts which, if true, would require the insurer to indemnify the insured;

2. If there is any possibility that the claim falls within the liability coverage, the insurer must defend;

3. The court must look beyond the labels used by the plaintiff to ascertain the 'substance' and 'true nature' of the claims. It must determine whether the factual allegations, if true, could possibly support the plaintiff's legal claims;

4. The court should determine if any claims pleaded are entirely "derivative" in nature. A derivative claim will not trigger a duty to defend.

5. If the pleadings are not sufficiently precise to determine whether the claims would be covered by the policy, 'the insurer's obligation to defend will be triggered where, on a reasonable reading of the pleadings, a claim within coverage can be inferred';

6. In determining whether the policy would cover the claim, the usual principles governing the construction of insurance contracts apply, namely: the contra proferentem rule and the principle that coverage clauses should be construed broadly and exclusion clauses narrowly. As well, the desirability, where the policy is ambiguous, of giving effect to the reasonable expectations of the parties;

7. Extrinsic evidence that has been explicitly referred to in the pleadings may be considered to determine the substance and true nature of the allegations.

Omega argued that the exclusion clause was clear and unambiguous and that the injuries related to the use or operation of a gun. All of the other claims against the Silver Dollar derived from this cause of action.

Silver Dollar argued that only some of the allegations were related to the use or operation of the gun and that they were facing potential liability for failing to take reasonable steps to ensure the safety of their patrons,

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Derivative Claims (continued)

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failing to train or supervise Gray, and so on. These claims were separate and distinct from the allegations relating to injuries caused by the use of the gun and consequently had to be defended at the insurer's expense.

The Court reviewed the three part process identified by the Supreme Court of Canada in *Non-Marine Underwriters, Lloyd's of London, v. Scalera*, to determine whether there is a duty to defend:

"Determining whether or not a given claim could trigger indemnity is a three-step process. First, a court should determine which of the plaintiff's legal allegations are properly pleaded. In doing so, courts are not bound by the legal labels chosen by the plaintiff. A plaintiff cannot change an intentional tort into a negligent one simply by choice of words, or vice versa. Therefore, when ascertaining the scope of the duty to defend, a court must look beyond the choice of labels, and examine the substance of the allegations contained in the pleadings. This does not involve deciding whether the claims have any merit; all a court must do is decide, based on the pleadings, the true nature of the claims.

At the second stage, having determined what claims are properly pleaded, the court should determine if any claims are entirely derivative in nature. The duty to defend will not be triggered simply because a claim can be cast in terms of both negligence and intentional tort. If the alleged negligence is based on the same harm as the intentional tort, it will not allow the insured to avoid the exclusion clause for intentionally caused injuries.

Finally, at the third stage the court must decide whether any of the properly pleaded, non-derivative claims could potentially trigger the insurer's duty to defend…. "

The Court concluded that some of the claims against the Silver Dollar were sufficiently distinct as to not be entirely derivative. The Court referred to the case of *Durham District School Board v. Grodesky* (see Litigation Notes from April, 2012) where parents were sued for failing to supervise and discipline their son, who started a fire at his high school. In that case the insurer argued that the claims against the parents were derived from the son's actions, which were excluded by an "intentional or criminal act" exclusion. In that case the Court of Appeal for Ontario found that the elements of the intentional tort claim against the son and the negligence claim against the parents were entirely distinct.

The Court applied the same reasoning in this case saying that the allegations against the Silver Dollar "for failure to take reasonable steps to ensure the safety of patrons, by the hiring of incompetent staff, the failure to warn the plaintiff and the failure to call emergency services when the scuffle began were distinct from the use or ownership of a handgun".

The Court therefore concluded that the Silver Dollar was entitled to coverage. With respect to the right to control its own defence and chose instructing counsel of its choice, the Court made the same order as was made in the case of *PCL Constructors Canada v. Lumbermans Casualty Co. Kemper Canada* where the insurer was directed to appoint separate counsel for the defence and coverage issues with the following conditions:

(a) The insurer was to assign the claim to claims staff who had no previous involvement in the matter;

(b) Defence counsel must not have acted for either party in the past five years;

(c) There could be no discussions about the case between defence counsel and coverage counsel;

(d) Defence counsel was to provide identical concurrent reporting to both the insurer and the insured.

Kinkade v. 947014 Ontario Inc. (2014) 119 O.R. (3d) 536

Third Parties Hurt by Material Non-Disclosure

A couple sued their mortgage broker for fraud and also sued the mortgage broker's liability insurer. Material non-disclosure by the mortgage broker voided the policy.

The Lavoies sued their mortgage broker, T.A. McGill Mortgage Services Inc. ("MMSI") for fraud. MMSI had professional liability errors and omissions coverage provided by Echelon General Insurance Company ("Echelon").

The Echelon policy did not cover fraud, but as a result of amendments made to the *Mortgage Brokerages Lenders and Administrators Act, 2006* of the Province of Ontario, mortgage brokers were required to add a fraud endorsement to their policies. Echelon gave an undertaking to the Financial Services Commission of Ontario ("FSCO") to provide coverage for fraud and to provide that injured third parties would have a direct right of action against the insurer. The Policy was amended accordingly.

Echelon was added as defendant to the Lavoie action. However, after commencement of the action, Echelon became aware of information disclosed in an unrelated action, which caused it to conclude that MMSI's answers on its application for insurance had not been truthful. MMSI had confirmed that during the past three years, it was "…not aware of any circumstance, allegation, contention or incident which might potentially result in a claim…", when in fact before the application was completed, solicitors acting for David Lavoie had made a demand for payment and threatened to commence a lawsuit. In fact, offers of settlement had been exchanged.

Echelon therefore rescinded the policy on the basis of material non-disclosure and moved for summary judgment dismissing the Lavoies' action as against it.

The Lavoies argued that (1) The motion judge erred in holding that any misrepresentations or omissions relating to events before fraud coverage was in place were

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Settlement Privilege (continued)

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establish the terms of the settlement.

The Court expressly left it open for the parties to exclude the exception to settlement privilege in a confidentiality agreement entered into prior to mediation, but that such intention would have to be clearly expressed. One solution would be for the confidentiality agreement to require that any settlement be reduced to writing at the time that it is concluded.

Union Carbide Canada Inc. v. Bombardier Inc., 2014 SCC 35 (CanLII)

Material Non-Disclosure (continued)

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material; (2) Echelon's undertaking to the FSCO conferred rights that were not voided by the rescission of the insurance policies; (3) Echelon should be estopped from advancing a legal position that denied coverage; and (4) MMSI was entitled to relief against forfeiture pursuant to s. 98 of the *Courts of Justice Act*.

In support of the argument that the misrepresentations were non-material, it was argued that because fraud was not covered at the time of the application for insurance was made, an allegation of fraud was not material. The Court rejected this argument on the basis that the policy required notification of any circumstance that might give rise to a claim. Had the insurer known of the Lavoie action at the time that the application for insurance was made, it might have refused to provide the insurance or have charged a higher premium.

The undertaking given to the FSCO did not preclude the insurer from rescinding the policy. The undertaking was predicated on the existence of a valid policy and in this case due to the misrepresentations, the policy was void *ab initio*.

The insurer was not estopped from advancing a position that denied coverage by reason of Echelon's undertaking to provide fraud coverage to third parties. The plaintiffs had not relied on the actions or statements by the insurer and again, the undertaking was predicated on the existence of a valid policy.

Furthermore, relief from forfeiture was not available. "…When a breach constitutes imperfect compliance with a policy term, relief under s. 98 of the *Courts of Justice Act* is available. In contrast, if the breach amounts to non-compliance with a condition precedent to the insurance policy, relief under s. 98 is not available".

The Lavoies' action against Echelon was dismissed and an appeal to the Court of Appeal for Ontario was dismissed.

Lavoie et al v. T.A. McGill Mortgage Services Inc. et al, 2014 ONCA 257

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