

CANADA / JUDGMENT

Pope & Talbot Ltd. (Re)

2011 BCSC 548

COURT

Supreme Court of British Columbia

DECIDED

28 April 2011

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2011 BCSC 548 Pope & Talbot Ltd. (Re)

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation:

Pope & Talbot Ltd. (Re),

2011 BCSC 548

Date: 20110428

Docket: S077839

Registry: Vancouver

IN BANKRUPTCY AND INSOLVENCY

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT,

R.S.C. 1985, C. C-36

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF POPE & TALBOT LTD., POPE & TALBOT, INC., MACKENZIE PULP LAND LTD., P&T FUNDING LTD., PENN TIMBER, INC., POPE & TALBOT LUMBER SALES, INC., POPE AND TALBOT PULP SALES U.S., INC., POPE & TALBOT RELOCATION SERVICES INC., P&T POWER COMPANY, AND P&T FINANCE THREE LLC

Before: The Honourable Mr. Justice Walker

Reasons for Judgment

Counsel for the Class Plaintiffs:

P. Roberts, J. Popp

Counsel for PricewaterhouseCoopers Inc.:

R.J.H. Berrow, K.M. Jackson

Counsel for Pope & Talbot, Inc.

G.C. Blanchard, H.L. Jones

Counsel for Lionel Dodd and certain other of former Directors of Pope & Talbot Ltd.:

J.I. McLean, Q.C.

Counsel for Ableco Finance LLC:

P.L. Rubin

Counsel for XL Specialty Insurance Company:

R.J. Kaardal, B.R.H. Johnston

J.D. Hughes

Counsel for Federal Insurance :

K. Kraft, H.D. Edinger

Counsel for National Union Fire Insurance Company:

G.M. Nijman

Counsel for Ace Insurance:

B.D. Rhodes

Place and Date of Hearing:

Vancouver, B.C.

March 14;

April 4, 5; 19, 2011

Place and Date of Judgment:

Vancouver, B.C.

April 28, 2011

Introduction

- [1] This application raises the question of when, and on what basis, if at all, a liability insurer should be permitted to participate in underlying litigation, either as an intervener, a party, or through its own counsel, when it is affording coverage to its bankrupt insured on a reservation of rights basis. As far as I am aware, it is a case of first instance in this province.
- [2] In its notice of application, XL Speciality Insurance Company ("XL") sought three declarations:

- (a) Pope [&] Talbot, Inc. ("P&T Inc.") and the [P&T Inc.] estate have no exposure or interest in S.C.B.C. Action No. S098167;
 - (b) XL is the only party in interest for the purpose of defending the claim against PTI because the plaintiffs assert that their claim against PTI may be covered under the A-Side Policy issued by XL; and,
 - (c) XL may appoint counsel of its choice to defend the claim against PTI.
- [3] When it argued its application, however, XL narrowed its position and sought the following relief:
- (a) an order that it be added as a party or an intervener (with the same rights as a party) to an underlying liability proceeding ("Harmac action") brought by former union and salaried employees ("Harmac employees") against the former directors and officers of Pope & Talbot Ltd. ("P&T Ltd.") and its parent company, Pope & Talbot, Inc. ("P&T Inc."); and
 - (b) an order that XL may defend itself and its insured, P&T Inc., in the Harmac action by the Vancouver law firm that has been acting as XL's coverage counsel.
- [4] The claim against the individual directors and officers of P&T Inc. and P&T Ltd. is for wages and vacation pay pursuant to s. 119 of the Canada Business Corporations Act, R.S.C. 1983, c. 4 ("CBCA"). A claim is also being advanced by the Harmac employees against P&T Inc. on the basis that it is liable as a de facto director of P&T Ltd. pursuant to the CBCA.

Issues

- [5] Three questions emerge on this application:
- (a) Should XL be added as a party or permitted to intervene in the underlying action (and, if the latter, on what terms)?
 - (b) If XL is added as a party or allowed to intervene, should it be permitted to defend itself or pursue its interests as an intervener by its coverage counsel?
 - (c) If XL is not added as a party and not permitted to intervene, should it be permitted to defend P&T Inc. by its coverage counsel?

Law

Divergent Interests

- [6] In policies containing duty to defend language, which are typically comprehensive general liability ("CGL") policies, courts have stressed the importance of ensuring that a coverage neutral defence is afforded to an insured where the insurer has reserved its rights under the policy: *Laurencine v. Jardine* (1988), 64 O.R. (2d) 336 (Ont. H.C.J.); *Bliefernich v. Freeman* (1989), 60 D.L.R. (4th) 385 (C.A.); and *Carter v. Kerr* (1989), 39 B.C.L.R. (2d) 345 (S.C.), overturned on other grounds, 69 D.L.R. (4th) 542 (C.A.). In doing so, courts have applied

longstanding principles of insurance law from the United States: *San Diego Navy Fed. Credit U. v. Cumis Ins.*, 208 Cal. Rep. 494 at 502 (Cal. App. 4 Dist. 1984); *Nandorf Inc. v. CNA Ins. Companies*, 479 N.E. 2d 988 at 991 (Ill. App. 1 Dist., 1985); *E.F. Hutton & Company v. Brown*, 305 F. Supp. 371 at 393-394; and *Executive Aviation, Inc. v. National Ins. Underwriters App.*, 94 Cal. Rptr. 347 at 354. Although not binding, American insurance law decisions are carefully considered by our courts because insurance policies developed in the United States are quite often sold in Canada: *Co-operative Fire & Casualty Co. v. Saindon*, [1976] 1 S.C.R. 735; *Laurencine* at 339.

- [7] The principle that insureds should receive a coverage neutral defence where the insurer has reserved its rights under the policy arises from the conflict of interest that exists when an insurer defends on a reservation of coverage rights basis. Two conflicts are manifest in that context:
- (a) the insurer's natural desire to protect its own financial interests; and
 - (b) the lawyer defending the insured may, at the expense of the insurer, become privy to confidential information relevant to the coverage issue that is only disclosed as a result of the lawyer's solicitor-client relationship with the insured.
- [8] Thus, where an insurer affords a defence to its insured on a reservation of rights basis, divergent interests exist between them. Those divergent interests may create conflicts for defence counsel retained by an insurer to defend an insured. The existence of divergent interests does not allow an insurer to put its coverage interests ahead of its insured's liability exposure in an underlying action in British Columbia courts. Consequently, insurers are prohibited in British Columbia courts from having coverage issues determined in the underlying litigation.
- [9] By the very nature of its relationship in defending the insured, defence counsel, whose fees are being paid for by the insurer, will come into possession of privileged information that may impact on the coverage issues. The insurer is entitled to receive information and advice from defence counsel that bears on the merits of the underlying action and the costs of defence. Defence counsel is in conflict if it engages in the role of providing coverage advice or passing along confidential information that may be used by the insurer to deny coverage.
- [10] In *E.F. Hutton & Company*, the Court identified the duty of defence counsel in this way at 393-394:

The duty not to represent conflicting interests ... is an outgrowth of the attorney-client relationship itself, which is confidential, or fiduciary, in a broader sense. Not only do clients at times disclose confidential information to attorneys; they also repose confidence in them. The privilege is bottomed only on the first of these attributes, the conflicting interests rule, or both.

- [11] In *Szebelledy v. Constitution Ins. Co. of Canada* (1985), 11 C.C.L.I. 140, 3 C.P.C. (2d) 170 (Ont. Dist. Ct.), the Court said at 152:

The foregoing review of the case law suggests that while the "probability of real mischief" test survives, the trend in Ontario is to apply the less stringent "possibility of real mischief or prejudice" test or "the appearance of impropriety" test. The latter tests are based on the concept of the appearance of fairness and reflect the Courts' greater concern with upholding the integrity of the profession and protecting the public confidence in the administration of justice.

[12] Those words were adopted by Mr. Justice O'Driscoll in *Laurencine*.

[13] In a more recent case, *MacDonald Estate v. Martin*, [1990] 3 S.C.R. 1235, Mr. Justice Sopinka found the "probability of mischief test" to be too stringent of a test to apply in determining whether a conflict existed. At 1259, he framed the appropriate test in this way:

[T]he test must be such that the public represented by the reasonably informed person would be satisfied that no use of confidential information would occur.

[14] Thus, where defence counsel is appointed and paid for by the insurer, defence counsel must act as if it had been personally retained by the insured: *Nandorf* at 991; *Carter* at 8.

[15] At the same time, insurers whose policies contain duty to defend language do have a say in the choice of counsel and the nature of the defence to be mounted: e.g., *Continental Insurance Co. v. Dia Met Minerals Ltd.* (1996), 20 B.C.L.R. (3d) 331 (C.A.) at para. 24. This protects an insurer from paying for an unchecked defence, financial mismanagement, and an insured's choice of counsel not competent to defend the case. It also ensures that insurers have the information that they require in order to assess the merits of the case, appropriate defence expenses to be incurred, and the reserve to be posted (as required by the provincial Superintendents of Insurance). In this case, even though XL's policy is a duty to fund policy, the policy wording affords XL financial protection since each insured must obtain XL's consent before defence expenses are incurred and before any settlement is reached.

[16] Whether the insured may choose its defence counsel over the objection of the insurer depends on the divergence of interests that exist in the case: *Brockton (Municipality) v. Frank Cowan Co.* (2002), 57 O.R. (3d) 447 (C.A.); *Coakley v. Allstate Insurance Company of Canada* (2009), 73 C.C.L.I. (4th) 113 (Ont. S.C.J.); and *Appin Realty Corp. v. Economical Mutual Insurance Co.*, 2008 ONCA 95. In *Brockton*, the Ontario Court of Appeal characterized the issue in this way at para. 43:

The issue is the degree of divergence of interest that must exist before the insurer can be required to surrender control of the defence and pay for counsel retained by the insured. The balance is between the insured's right to a full and fair defence of the civil action against it and the insurer's right to control that defence because of its potential ultimate obligation to indemnify. In my view, that balance is appropriately struck by requiring that there be, in the circumstances of the particular case, a reasonable apprehension of conflict of interest on the part of counsel appointed by the insurer before the insured is entitled to independent counsel at the insurer's expense. The question is whether counsel's mandate from the insurer can reasonably be said to conflict with his mandate to defend the insured in the civil action. Until that point is

reached, the insured's right to a defence and the insurer's right to control that defence can satisfactorily co-exist.

- [17] In summary, counsel defending the insured on a coverage reservation must do so without regard to the coverage issues. Privileged information passed along to defence counsel must not be provided to the insurer to be used in respect of its coverage denial. The principle is to avoid the "possibility of real mischief or prejudice" or the "appearance of impropriety" due to an inherent conflict of interest: *Laurencine; Szebelledy*.
- [18] In my opinion, it flows as a matter of general principle from the case law that a liability insurer should not be permitted to participate in the defence of the underlying action as a party or through its coverage counsel because this could permit the insurer, even unwittingly, to sculpt the case in a manner that vitiates coverage.
- [19] The underlying action is not the forum to determine coverage issues. There is no provision in the Rules of Court that permit an insurer to add itself as a party or intervene in an underlying action.
- [20] Nor does a plaintiff in an underlying action have standing to participate in coverage litigation between an insured and insurer.
- [21] There are a few exceptional instances where courts have permitted coverage issues to be determined in advance of the determination of the issues in the underlying action. It is rarely done and only when there is a complete absence of a factual controversy in the underlying litigation: *Bridgewood Building Corp. (Riverfield) v. Lombard General Insurance Co. of Canada* (2005), 7 B.L.R. (4th) 46 (Ont. S.C.J.), *aff'd* (2006), 266 D.L.R. (4th) 182 (Ont. C.A.); *942324 Ontario Inc. v. Commonwealth Insurance Co.* (2005), 75 O.R. (3d) 653 (S.C.J.), *aff'd* (2006), 81 O.R. (3d) 399 (C.A.); and *Markham General Insurance Co. (Liquidator of) v. Bennett* (2006), 81 O.R. (3d) 389 (S.C.J.).
- [22] The automobile insurance regime in British Columbia is an exception to this rule: *Insurance (Vehicle Act)*, R.S.B.C. 1996, c. 231. It permits automobile insurers to add themselves as third parties to an underlying action where there is an actual or alleged coverage breach because automobile insurers face an absolute liability to plaintiffs even where an insured is in breach of the policy: ss. (1), 76(6), 77(3). Even when an insurer adds itself as a third party, coverage issues are not to be determined in the underlying action. In *Bliefernich, Southin J.A.* made the following point at p. 8 when dealing in the context of that statutory regime:
- But, it is not, under this rule, [Rule 22 of the previous Rules of Civil Procedure], or any other rule or statute, open to the insurer to have coverage issues determined in the victim's action.
- [23] The same view was taken in *AXA Pacific Insurance Co. v. Elwood*, 2000 BCSC 1248 at para. 35 and *East Kootenay Realty Ltd. v. Gestas Inc.* (1986), 21 C.C.L.I. 230 (S.C.).

- [24] Cases decided under the former Rules of Court did not interpret Rule 15-5, now Rule 6-2(7), to allow insurers to be added as parties to an underlying action in order to determine coverage issues.
- [25] According to AXA Pacific at para. 26, "[f]or a person to be joined as a party to a proceeding, that person must have a legal or equitable interest in the subject matter of the proceeding. A commercial interest is not sufficient". The same approach was taken in *British Columbia Development Corp. v. Spun Cast Industries Ltd.* (1977), 5 B.C.L.R. 94, 26 C.B.R. (N.S.) 28 (S.C.).
- [26] In *Schiffskommerz GmbH. i.L. v. "Moraca" (The)* (1994), 99 B.C.L.R. (2d) 102 (C.A.), Southin J.A. held at para. 29 that intervener status should not be granted when the applicant seeks to advance a purely private commercial interest:

As to intervention, I am of the opinion that such ought not to be permitted when the would-be intervener seeks to advance a purely private commercial interest in circumstances where the Rules of Court do not enable him to be added as a party. To permit such an intervention would be to subvert the Rules.

- [27] The plaintiffs in the Harmac action have no right to participate in any coverage dispute between the insured directors and officers and their liability insurers. Those plaintiffs do not have any beneficial interest in the insurance policies. The rights they may enjoy, if any, are contingent, and predicated on them first successfully obtaining a judgment against the directors and officers. Once that judgment is obtained, the plaintiffs would then be judgment creditors and, accordingly, in a position to sue the insurers on the policies pursuant to s. 24 of the Insurance Act, R.S.B.C. 1996, c. 266. That contingent right has not been viewed by courts in British Columbia as affording an equitable or legal interest to an insurer sufficient to participate as a party in an underlying action: AXA Pacific at paras. 29-32; Bliefernich at 8; and East Kootenay Realty Ltd.

- [28] Section 24(1) of the Insurance Act confers the right of action to a judgment creditor:

24(1) If a judgment has been granted against a person in respect of a liability against which the person is insured and the judgment has not been satisfied, the judgment creditor may recover by action against the insurer the lesser of

- (a) the unpaid amount of the judgment, and
- (b) the amount that the insurer would have been liable under the policy to pay the insured had the insured satisfied the judgment.

- [29] Section 24(2) provides that the claim of the judgment creditor against the insurer is subject to the same equities that the insurer would have against the insured if the insured had satisfied the judgment and then looked to the insurer for reimbursement under the policies:

- (2) The claim of a judgment creditor against an insurer under subsection (1) is subject to the same equities as would apply in favour of the insurer had the judgment been satisfied by the insured.
- [30] Where a judgment creditor, which the Harmac employees seek to be, pursues an insurer for judgment pursuant to s. 24, the issues in the underlying action do not need to be retried unless further evidence is required to determine the insurer's liability: *Carwald Concrete & Gravel Co. of Canada v. General Security Insurance Co. of Canada et. al* (1985), 24 D.L.R. (4th) 58 (Alta. C.A.) at 68; and *Qualiglass Holdings Inc. v. Zurich Indemnity Co. of Canada*, 2004 ABQB 577 at para. 98.

Where Courts Have Permitted Intervention by a Liability Insurer in an Underlying Action

- [31] Counsel for XL brought three cases to my attention where courts in Ontario and Alberta have permitted insurers to add themselves as parties or to be represented by their own counsel in underlying litigation.
- [32] The two cases from Ontario are *Uniroyal Chemical Ltd. v. Kansa General Insurance Co.*, [1992] O.J. No. 4003 (C.J.), *aff'd* (1996), 89 O.A.C. 311, 33 C.C.L.I. (2d) 165 (C.A.), and *Hedrich v. Kitchener Public Library Board* (2005), 39 C.C.E.L. (3d) 262, [2005] O.T.C. 117 (C.J.).
- [33] In *Uniroyal*, at para. 1, Mr. Justice Blair (as he then was) permitted Kansa (the insurer) to intervene in the underlying action "for the purposes of protecting its position with respect to the coverage issues" even though it was defending its insured on the liability claim.
- [34] It appears from the materials provided to me by XL's counsel that, unlike British Columbia, intervener status in Ontario accords full party rights. In British Columbia, an intervener does not enjoy the same rights as a party: *Kitimat (District) v. Alcan Inc.*, 2006 BCCA 562.
- [35] The reasons for judgment at paras. 1, 7, and 13 reveal that Blair J. took a "liberal" view towards the "concept of 'conflict'" and ordered Kansa to pay for the lawyers chosen by its insured, *Uniroyal*, to defend the case. He made that ruling in the face of argument from Kansa that the evidence showed that there was "no true 'conflict' in a real sense." The Court stated that "there was not a known existing state of facts on which it might be said that the insurer's solicitors might be able 'to skew' the evidence at trial in favour of the insurer to the prejudice of the insured": *Uniroyal* at para. 6.
- [36] In construing the rule permitting interveners (Rule 13.01(1)), Blair J. took a different approach from the cases decided in British Columbia. He determined, at para. 9, that Kansa had an "interest" in the subject matter of the proceeding sufficient to make the order because Kansa "could have been adversely affected by a judgment". His reasoning is found at para. 13:

Kansa has an obligation under the policy to defend or, in this case as a result of this Order, to pay for a defence by Uniroyal's solicitors. It also has a significant exposure, however, and there is a genuine dispute between the insured and insurer with respect to coverage under the policy. Just as the insured may feel uncomfortable at the prospect of its interests being left in the hands of the insurer, the insurer may legitimately be uncomfortable with the protection of its interests being left to the insured, if it is not allowed to intervene in the action. I don't think it is fair to the insurer that it should be put in this position simply because the insured exercises its right not to sign a non-waiver agreement. To allude to one of Mr. McNeil's submissions again, "those who are being asked to pay should be entitled to participate".

- [37] The appeal of the decision focused on the entirely different ground of whether the claim advanced in the underlying lawsuit triggered a duty to defend. In a split decision, the Ontario Court of Appeal found, at para. 4, that the order made by Blair J. "was correct". The reasons for judgment do not directly consider his decision to add Kansa as an intervener, however.
- [38] The other case from Ontario cited by XL is Hedrich. There, a liability insurer was added as an intervener to underlying litigation. The reasons for judgment disclose that there is no absolute rule in Ontario permitting an insurer to be added as an intervener to underlying litigation. The order is discretionary. The reasons for judgment, at paras. 13-14, suggest that resolution may depend on whether the interests of the applicant are already adequately protected.
- [39] The principle is said to derive from the decision of Mr. Justice Grange in *Re: Starr v. Township of Puslinch* (1976), 12 O.R. (2d) 40 at 44 (H.C.J.), who, in turn, quoted from the following passage in a decision of Lord Denning in *Gurtner v. Circuit*, [1968] 2 Q.B. 587:

It seems to me that when two parties are in dispute in an action of law, and the determination of that dispute will directly affect a third person in his legal rights or in his pocket, in that he will be bound to foot the bill, then the court in its discretion may allow him to be added as a party on such terms as it thinks fit.

- [40] Mr. Justice Grange made the following point at para. 46:

I can only conclude from these cases that there is no absolute rule that for a party to be added he must have a direct interest in the very issue to be determined. It is, I think, sufficient in the words of Lord Denning, *supra*, that the 'determination of that dispute will directly affect a third person in his legal rights or in his pocket'. I also believe that it is clear from the cases that even when the applicant satisfies that condition it is entirely discretionary in the Court whether he will be allowed to intervene or not, and the Court may always decline the application where it considers that the interest of the applicant is already adequately represented. I think we should adopt the caveat of Leiff J., *supra*, and lay down no fixed rule ...

[Emphasis added]

- [41] Even though the insurer was added as an intervener in Hedrich, its rights to participate in the underlying action were to be the subject of strict case management direction.
- [42] The case from Alberta cited by XL is *P.C.S. Investments Ltd. v. Dominion of Canada General Insurance Co.* (1996), 37 Alta. L.R. (3d) 38, 34 C.C.L.I. (2d) 113 (C.A.). There, in a memorandum of judgment, the Alberta Court of Appeal permitted the insurer to defend its own interests in the underlying action through its own counsel, without the necessity for it to be added as a party. The case involved claims made against the insured in the underlying action that the insurer said were not covered by the policy. The allegations made against the insured concerned the tort of conspiracy, criminal acts, and defamation motivated by malice. The insurer refused to defend the claim. The insured retained its own counsel and obtained an order from the chambers judge that the insurer pay for the defence because some of the claims, if proven true, would be covered under the policy. The chambers judge denied the insurer its normal right under the policy to appoint counsel of its own choice to defend the insured and denied the insurer's alternate request to have an independent lawyer appointed. The Court of Appeal agreed.
- [43] The Court of Appeal stated, at para. 12, that the chambers judge was right to deny the insurer's request to appoint its own choice of counsel to defend the insured. It also rejected the insurer's request for the appointment of independent counsel because it "likely would not work for long here", so that the "risk [was] too great that counsel would find herself caught in the conflict between the insured and insurer". The Court of Appeal did not view the insurer's failure to defend in the first instance to be a repudiation of its obligations under the policy. Therefore, the issue the Court of Appeal had to grapple with was how the insurer's own financial interests could be protected since it was paying for a lawyer chosen solely by the insured. In all, the Court of Appeal found special circumstances to exist, and found that the insurer had a right under the contract of insurance to "name its own counsel to participate in the defence".
- [44] The decision appears grounded in the words of the policy and on the desire to avoid a multiplicity of proceedings. Unfortunately, the reasons for judgment do not disclose the policy provision(s) conferring that right, nor do they set out any rule of civil procedure or case law upon which the decision was founded. Unlike the reasoning in the cases decided in British Columbia, the Court of Appeal remarked that the interests of the plaintiff as potential judgment creditor were a factor in its decision. Also unlike the approach taken in British Columbia, the Court of Appeal suggested that coverage issues could be tried at the same time as the trial of the underlying action. At para. 13, the Court stated:

In these special circumstances, however, we think that the insurer has a right under the contract of insurance to name its own counsel to participate in the defence. This would solve the problem posed by Mr. McGillivray that, otherwise, no party at the first trial would have any interest in a solution that would protect the insurer. But such a twist, one apparently not suggested to or considered by the learned chambers judge, also involves the rights of the third party plaintiff and could only be made on notice to it. We simply make the point that the insurer may choose to

apply to become a party, and the insured in a case like this arguably has a contractual obligation to respect and support the decision by the insurer. As an alternative, the insurer may choose to apply to have the third party suit and the insured's suit for indemnity tried at the same time. In any event, modern jurisprudence should abhor a rule whereby the insurer is locked out of the first suit, brought against it for recovery under the policy. That result, which requires a court to preside over a meaningless trial as a necessary prerequisite to a meaningful one, is too dickensian for serious thought. To this limited extent, the appeal is allowed.

[Emphasis added]

[45] XL also relies on *Tichit v. Jones*, 2002 BCSC 1888. There, the Court permitted an out-of-province automobile insurer, Guardian Insurance Company of Canada ("Guardian"), to be added as a party to an underlying automobile action in view of its residual interest to provide underinsured motorist benefits. In my opinion, that case is of no assistance to the facts of this case. The order was made in the context of a statutory regime that permitted, as it does now, automobile insurers to add themselves as parties: s. 161, Insurance Act, R.S.B.C. 1996, c. 226 (that section was subsequently repealed by 2003-94-56, effective June 1, 2007 (B.C. Reg. 166/2006)).

[46] Further, Mr. Justice Brooke construed the policy wording (endorsement S.E.F. 44) to allow Guardian to be added as a party. He said at para. 7:

Moreover, I note that under the language of the S.E.F. no. 44 endorsement upon which Guardian relies, it contemplates Guardian being added as a party and that would not have been its status simply as the insurer entitled to or perhaps obliged to appoint counsel in respect of the third party claim.

S.E.F. 44, entitled "Family Protection Endorsement", provided at para. 5(f):

No findings of a Court with respect to issues of quantum or liability are binding on the Insurer unless the Insurer was provided with a reasonable opportunity to participate in those proceedings as a party.

[47] Brooke J. took a broad view of whether prejudice would result when considering whether to add Guardian as a party pursuant to Rule 15(5)(a) of the former Rules of Court. His analysis concerned all of the parties and was not limited to whether prejudice would result to only Guardian's insured. At para. 11, he said:

I am not satisfied there is any prejudice to the defendant, the estate of Mr. Simmons, or to the other parties if Guardian is added as a party. However, in exercising a judicial discretion, the court may restrict Guardian's participation such that the trial date, now fixed for November of this year, will not be lost by reason of Guardian's late entry into this action. I do so.

[Emphasis added]

- [48] No case from British Columbia has been cited in which an insurer has been permitted to be added as a party to underlying litigation in a non-automobile context. Nor has any case decided in this province permitting an insurer to be added as an intervener to underlying litigation been cited.
- [49] In my opinion, the cases cited by XL from Ontario and Alberta take a different approach than have the courts in British Columbia because they effectively conclude that an insurer's interest in an underlying action is more than a "commercial interest". The insurer's interests are seen as directly affected by the allegations in an underlying action, such that its rights may not be adequately protected by counsel retained to defend the insured. In Ontario, an insurer's interests may be protected by adding it to the underlying litigation as an intervener. In Alberta, as a result of P.C.S., an insurer's interests may be protected by its own counsel regardless of whether the insurer is added as a party.
- [50] Further, and contrary to the approach taken in this province, P.C.S. specifically recognizes, at para. 13, the propriety of having the coverage issues decided at the same time as the issues in the underlying action.

Key Background Facts

- [51] I will now discuss the facts that inform the application of the legal authorities to the issues to this application.

Insolvency Proceedings

- [52] The Harmac action is the last stage of longstanding insolvency proceedings involving the Pope & Talbot group of companies, which include P&T Inc. and P&T Ltd. P&T Inc. was a forest-products company, incorporated in Delaware, which maintained its head office in Portland, Oregon. P&T Ltd. was incorporated in Ontario, but the bulk of its operations, as well as its head office, were located in British Columbia.
- [53] Pricewaterhouse Coopers ("PwC") was the monitor for P&T Inc. and P&T Ltd. under proceedings brought pursuant to the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 ("CCAA"). On October 29, 2007, P&T Inc. and P&T Ltd., among others, obtained an initial order in the Ontario Superior Court of Justice for protection pursuant to the CCAA. PwC was appointed monitor. On November 21, 2007, this Court issued an amended and restated and confirmed initial order, which effectively transferred the CCAA proceedings from Ontario to British Columbia.
- [54] Also on November 21, 2007, P&T Inc. and P&T Ltd. filed a voluntary petition in the United States Bankruptcy Court for the District of Delaware ("U.S. Bankruptcy Court") for relief under Chapter 11 of the United States Bankruptcy Code.

- [55] On February 26, 2008, the U.S. Bankruptcy Court and this Court issued orders approving a cross-border claims protocol ("Cross-Border Protocol") and establishing April 3, 2008 as the general bar date by which all claims against the debtors, including P&T Inc. and P&T Ltd., had to be filed. Claims not received by the bar date were expressly extinguished forever.
- [56] Subsequently, P&T Inc. and P&T Ltd. became bankrupt. PwC now acts as receiver for their bankrupt estates.
- [57] On or about May 9, 2008, the U.S. Bankruptcy Court issued an order converting the case from Chapter 11 to Chapter 7 (those chapters are akin to Canadian CCAA and bankruptcy legislation, respectively).
- [58] On May 10, 2008, this Court issued an order, inter alia, appointing PwC as interim receiver of P&T Inc. and P&T Ltd. On September 23, 2008, those two companies were assigned into bankruptcy.
- [59] On November 21, 2007, Brenner C.J.S.C. issued an order in what were then proceedings brought pursuant to the CCAA. Paragraph 23 of his order required the petitioners, including P&T Inc. and P&T Ltd., to indemnify their directors and officers from "all claims, costs, charges and expenses relating to the failure of the [p]etitioners" to make payment of vacation entitlement pursuant to s. 119 of the CBCA (unless a director and officer had actively participated in the breach of any related fiduciary duty or had been guilty of gross negligence or wilful misconduct).
- [60] In his order, Brenner C.J.S.C. also created a directors' charge in the amount of \$13 million over the assets of the estate to provide security for, inter alia, s. 119 claims advanced against the directors and officers.
- [61] The court order went on, however, to limit the exposure of the directors' charge by subordinating it to any valid and collectible insurance. Paragraph 25 of the order states:

THIS COURT ORDERS that, notwithstanding any language in any applicable insurance policy to the contrary, (a) no insurer shall be entitled to be subrogated to or claim the benefit of the Directors' Charge, and (b) the Petitioners' directors and officers shall only be entitled to the benefit of the Director's Charge to the extent that they do not have coverage under any directors' and officers' insurance policy, or to the extent that such coverage is insufficient to pay amounts in accordance with paragraph 23 of this Order.

- [62] On April 22, 2008, this Court issued a D&O Claims Procedure Order ("Claims Procedure Order") establishing procedures for the filing and the determination of claims made against the directors and officers. The Claims Procedure Order set a bar date of July 30, 2008 for submitting claims. The unionized and salaried employees of the Harmac Mill submitted post-filing creditors' proof of claims in the CCAA proceedings for, inter alia, payment of wages.

[63] The U.S. Bankruptcy Court issued an order recognizing and giving effect to the Claims Procedure Order.

[64] In July 2008, in connection with the sale of the Harmac Mill, and subject to court approval, the Harmac union employees agreed to waive their wage claims against present and former directors and officers of P&T Inc. and P&T Ltd. The pertinent wording of that waiver stated:

... PPWC, Local 8, on behalf of its members, shall not pursue any claim against the present or former officers and directors of Pope & Talbot Ltd. for any wage, including vacation pay and severance pay to the extent that such claims result in a claim by any present or former officer or director of Pope & Talbot Ltd. against the Directors & Officers Charge created by the Amended and Restated Initial Order of the Court dated November 21, 2007 and/or by the carve-out provisions referenced in the Debtor In Possession Credit Agreement.

[65] The salaried employees did not provide a waiver.

[66] The sale of the Harmac Mill to Nanaimo Forest Products Ltd. ("NFP") and the waiver was approved by Brenner C.J.S.C. on July 30, 2008. As a result, the Harmac unionized employees waived their rights to pursue the directors' charge. Thus, the directors and officers do not face any personal financial exposure (alleged to be over \$5 million) in respect of the unionized Harmac employees.

[67] Although para. 12 of the order approving the sale of the Harmac Mill gave effect to the waiver, it also preserved the right of the unionized Harmac employees to advance claims for wages and other employee-related payments (including vacation pay) that are covered by directors and officers liability insurance ("D&O insurance"):

The Pulp, Paper and Woodworkers of Canada, Local 8 on behalf of all of its members has waived, and shall not have or pursue, any and all claims now and in the future against the present and former directors and officers of the Petitioners [including P & T Inc. and P & T Ltd.] for wages and other employee-related payments or liabilities, including without limitation vacation pay and severance pay, where and to the extent any such claim would otherwise result in a claim by any present or former director or officer of the Petitioners or the Receiver [PwC], for indemnity which is, or would be, payable from the funds secured by the Directors' Charge ... provided that: ... (ii) nothing in this Order precludes the Pulp, Paper and Woodworkers of Canada, Local 8, or any members from advancing a claim for wages and other employee-related payments or liabilities, including without limiting vacation pay and severance pay, where and to the extent that such claim results in a claim by any present or former director or officer of the Petitioners for indemnity which is, or would be, payable from or under any insurance policy indemnifying any present or former director or officer of the Petitioners for such claims.

[68] In a letter of understanding dated August 29, 2008, which was signed as part of the sale of the Harmac Mill, NFP agreed to pay the claims of the former unionized Harmac employees not covered by directors and officers insurance up to a maximum of \$6 million.

- [69] NFP also agreed to indemnify PwC for the wage claims of any former salaried Harmac employees not covered by D&O insurance. The indemnity was an amount not in excess of \$1 million. The claim of the salaried Harmac employees is alleged to be approximately \$260,000.
- [70] The automatic stay was lifted by court order to permit the Harmac employees to pursue their claims against the directors and officers, including P&T Inc. as an alleged de facto director of P&T Ltd. The defence of the individual directors and officers is being funded, for the time being, and up to a certain dollar amount, by one of the liability insurers, Federal Insurance Company ("Federal").
- [71] On November 6, 2009, the former union and salaried Harmac Employees commenced the Harmac action by filing an endorsed writ of summons pursuant to the Class Proceedings Act, R.S.B.C. 1996, c. 50.
- [72] Following the enactment of the new Rules of Court on July 1, 2010, the former Harmac employees filed a notice of civil claim on July 28, 2010 and an amended notice of civil claim on January 25, 2011. The claim that P&T Inc. acted as a de facto director of P&T Ltd. pursuant to the CBCA was maintained.
- [73] The relief sought against P&T Inc. as a de facto director is set out in the amended notice of civil claim:

Part 2: RELIEF SOUGHT

1. A declaration that one or more of the Individual Directors and P&T Inc., as directors of P&T Ltd., is or are liable to pay the Wage Obligation owing to each of the Harmac Employees up to and including May 10, 2008, or such other date as may be determined by the court with respect to each of the Individual Directors and P&T Inc., in an amount to be assessed with respect to each individual Harmac Employee;
- [74] The factual underpinning and the legal basis for the claim against P&T Inc. as a de facto director is alleged to arise from a resolution of the board of directors of P&T Ltd. dated November 16, 2007. The facts alleged in the amended notice of civil claim as well as the legal basis for relief show that the claim against P&T Inc. is bound up with the claim against the individual directors and officers of P&T Ltd.
- [75] Further, the individual directors and officers of P&T Ltd. and P&T Inc., as a de facto director of P&T Ltd., are alleged by the Harmac employees to be jointly and severally liable:

Part 1: STATEMENT OF FACTS

...

19. At various times presently unknown to the Harmac Employees but between January 1, 2004 and May 10, 2008, the following persons were or became directors of P&T Ltd., acted in the position of a director of P&T Ltd. or otherwise managed or supervised the management of the business and affairs of P&T Ltd., including Harmac: ...
20. At no time prior to May 10, 2008 did any of the Individual Directors send to P&T Ltd. a written resignation of their position as a director of P&T Ltd.
21. On November 16, 2007, P & T Inc. purportedly made a written declaration ("Declaration"), pursuant to section 146(2) of the Canada Business Corporations Act [citation omitted], which reads:
 1. During the term of this declaration, the powers of the directors of the Corporation [P & T Ltd.] to manage, or supervise the management of, the business and affairs of the Corporation are restricted to the fullest extent permitted by law. All powers of the directors of the Corporation are restricted by this declaration whether they arise from the Act, the articles or the by-laws of the Corporation, or otherwise. Reference to the "directors of the Corporation" in this declaration means the directors of the Corporation from time to time while this declaration is in effect.
 2. The Shareholder [P&T Inc.] assumes and shall have all the powers to manage, or supervise the management of, the business and affairs of the Corporation during the term of this declaration. The Shareholder shall have such powers whether they arise under the Act or otherwise. For greater certainty, only the Shareholder may elect directors of the Corporation, including filling any vacancies, notwithstanding any contrary provision in the articles or by-laws of the Corporation.
 3. During the term of this declaration, the Shareholder assumes and shall have all the rights powers, duties and liabilities of the directors of the Corporation whether they arise under the Act or otherwise. During the term of this declaration the directors of the Corporation are relieved of the rights, powers, duties and liabilities that would otherwise be imposed upon them as directors of the Corporation.
 4. This declaration shall continue in full force and effect until the Shareholder terminates it by an instrument in writing that is signed [sic] by the Shareholder and delivered to the registered office of the Corporation.
22. At no time did P&T Ltd., the Individual Directors of P&T Inc. advise the Harmac Employees of any change in the management or supervision of the business and affairs of P&T Ltd. or of the Declaration.
23. On May 10, 2008, the [Court] granted an order in the CCAA Proceeding which, among other things, appointed PWC as receiver of P&T Ltd. and P&T Inc. (the "Receivership Order"). Pursuant of the terms of the Receivership Order, the employment of the Harmac Employees was terminated.

24. By May 10, 2008, P&T Ltd. was indebted to the individual Harmac Employees in various amounts for unpaid wages and salaries, including vacation pay, in amounts exceeding six months wages payable to the individual Harmac Employees.

...

Part 3: LEGAL BASIS

5. Pursuant to section 119 of the CBCA, the Individual Directors and P&T Inc., as directors of P&T Ltd., are jointly and severally, or solidarily, liable to the Harmac Employees for all debts not exceeding six (6) months wages for services performed by them for P&T Ltd. up to May 10, 2008 ...

[Emphasis added]

- [76] On December 14, 2010, I ordered in place a litigation protocol ("Litigation Protocol") so that the claims of the Harmac employees could be determined in an effective, expeditious, and cost effective manner. My reasons for judgment are indexed at 2010 BCSC 1902. The Litigation Protocol is coverage neutral even though the insurers are parties to it.
- [77] The determination of the insurers' coverage obligations in respect of the claims of the Harmac employees is currently pending before the Court.

The D&O Insurers

- [78] The insurers maintain their head offices in different states in the United States.
- [79] P&T Inc. purchased primary and excess D&O insurance from various insurers for its directors and officers, as well as those of its subsidiary and affiliated companies, including P&T Ltd.
- [80] Two different types of D&O insurance were purchased. The first provides coverage to the individual directors and officers. The primary insurer is Federal. The limits under its policy are \$5 million. National Union Fire Insurance Company of Pittsburgh, PA, XL, and ACE American Insurance Company provide excess coverage through excess insurance policies.
- [81] Those D&O insurance policies do not require the insurers to defend. Rather, they require the insurers to fund the defence of directors and officers on certain conditions (including pre-approval of defence costs).
- [82] The other type of policy was issued by XL. It is known as a "Cornerstone A-Side Management Liability Insurance Policy" ("Cornerstone policy"). It provides coverage for claims made against directors and officers between July 30, 2007 and July 30, 2008. It provides primary coverage to directors and officers when there is a gap in coverage in the first group of policies. The Cornerstone policy is also a funding policy, as opposed to a duty to defend policy. XL's obligation is not to unreasonably withhold its consent to settlement and to pay covered defence expenses upon request by an insured. The policy limits are \$5 million.

[83] Coverage is afforded under the insuring agreements found in the various policies for a "wrongful act". The insuring agreement provides the following coverage:

The insurer will pay on behalf of the Insured Persons Loss resulting from a Claim first made against the Insured Persons during the Policy Period or, if applicable, the Optional Extension Period, for a Wrongful Act ...

[Emphasis in original]

[84] The definition of wrongful act in the Cornerstone policy is similar to the one contained in Federal's D&O insurance policy. Federal's definition is, in turn, incorporated into the excess policies because they are "follow form" policies. The definition found in the Cornerstone policy states:

"Wrongful Act" means:

- (1) any actual or alleged act, error, or omission, misstatement, misleading statement, neglect, or breach of duty by any Insured Person, as defined in DEFINITION (I)(1), while acting in his or her capacity as a director, officer, general counsel, or member of the Board of Managers of the Company or a functionally equivalent role for the Parent Company or any Subsidiary operating or Incorporated outside the United States;
- (2) any matter asserted against an Insured Person solely by reason of his or her status as a director, officer, general counsel, or member of the Board of Managers of the Company;
- (3) any Employment Practices Wrongful Act; and
- (4) any Outside Capacity Wrongful Act.

[Emphasis in original]

[85] If coverage exists for the claims made by the Harmac employees against P&T Inc. as a de facto director, it would arise under the Cornerstone policy because of the particular definition of insured in that policy. The definition of "insured person" includes "any past, present, or future director or officer ... and any person serving in a functionally equivalent role." The other policies define an insured to mean a "natural person".

[86] Notice of the claim of the Harmac employees was served on XL in the latter part of 2010. Service of that notice was facilitated by court order when it became apparent that XL was not prepared to acknowledge that it had been provided with notice of the lawsuit, even though it was well aware of it and had attended court hearings where the Harmac action was the subject of applications or requests for directions. My order allowed PwC to send notice of the claim to XL's coverage counsel in Vancouver by letter. My order permitted delivery of such notice to constitute formal notice under the Cornerstone policy to XL of the claim against P&T Inc.

- [87] Previously, and in opposition to an application brought by PwC seeking coverage determinations in the CCAA proceedings, Federal, National Union, and XL brought their own applications seeking a declaration that the Court lacked jurisdiction over the policies, or alternatively, that it should decline jurisdiction. I determined that the Court had jurisdiction, and that it should not be declined. My reasons for judgment are indexed at 2009 BCSC 1014.
- [88] Subsequently, those insurers brought an application to determine the proper law in respect of their policies. I rejected their position that Oregon law was the proper law of the policies. I held that in respect of the claims arising in the Canadian insolvency proceedings the proper law was the law of British Columbia. My reasons for judgment are indexed at 2009 BCSC 1552.
- [89] There is, presently, a live issue as to whether my decision concerning jurisdiction and proper law applied to the claims of the Harmac employees against P&T Inc. The Cornerstone policy was the subject of XL's jurisdiction and proper law applications. Although the issue of whether P&T Inc. was liable as a de facto director of P&T Ltd. was mentioned in oral submissions during the jurisdiction hearing, the insurers assert that the claim was not formally before me on that or the proper law application. Other parties, including the Harmac employees, assert that those claims are caught within the breadth and scope of the insurers' application materials. That issue remains to be determined at a later stage. I make no comment as to its merits at this time.

XL's Policy Wordings

- [90] The Cornerstone policy wording contains several provisions that concern the rights and obligations of XL and the insureds in the event of an insolvency of one or more of its insureds.
- [91] Further, the policy recognizes the obligation of XL to fund the defence of the estate of an insured person who becomes bankrupt. The defence obligation is set out at clause IV.(E)(1) and (2) under the heading "Defense and Settlement of Claims":
- (1) It shall be the duty of the Insured Persons and not the duty of the Insurer to defend Claims. No Insured Person may incur any Defense Expenses or admit liability for, make any settlement offer with respect to, or settle any Claim without the Insurer's consent, such consent not to be unreasonably withheld.
 - (2) Upon written request, the Insurer will pay on a current basis any covered Defense Expenses before the disposition of the Claim for which this Policy provides coverage. In the event of such advancement, the Insured Persons agree that they shall repay the Insurer, severally accounting to their interests, any Loss, including Defense Expenses, paid to or on behalf of the Insured Persons if it is finally determined that the Loss incurred is not covered under this Policy.

[Emphasis in original]

[92] The policy defines an "Insured Person" in clause II.(i) to include that person's estate in the event of bankruptcy:

"Insured Person" means:

...

In the event of the death, incapacity or bankruptcy of an Insured Person, any Claim against the estate, heirs, legal representatives or assigns of such Insured Person will be deemed to be a Claim against such Insured Person.

[Emphasis in original]

[93] The Cornerstone policy is silent as to any right XL may have to satisfy its obligation to fund the defence of an insured who is bankrupt by having its coverage counsel defend the underlying claim. Nor does the Cornerstone policy address any right XL may have to intervene or participate as a party in underlying proceedings in order to protect its own coverage interests when its insured is bankrupt. XL did not seek to afford those rights to itself as Guardian did in Tichit.

Reservation of Rights

[94] The defence of the individual directors and officers is being funded by the insurers on a reservation of rights basis. The individual directors and officers face many but not all of the coverage issues engaged in the dispute between the Harmac employees and P&T Inc. as an alleged de facto director (e.g., whether a s. 119 claim in the circumstances of this case amounts to a "wrongful act" under the policies).

[95] XL disclosed its reservation of rights letter in oral submissions during its reply on this application. As a result, the hearing was adjourned to permit the other parties to consider the conditions of the coverage reservation and their effect on the application. XL wished the specific contents of its letter to be kept confidential in the litigation, and was content to rely on the implied undertaking rule.

[96] XL's reservation of rights in respect of the claims advanced against P&T Inc. is very broad. The specific coverage reservations in the letter are stated to be neither exhaustive nor exclusive with respect to the defenses to coverage that XL may assert. In addition to listing eight different coverage reservations that arise from policy wording, XL advised that its reservation was not limited to policy wordings. It has reserved all of its rights, remedies, and defenses under the law. One of the coverage defenses asserted that is not tied to policy wording is XL's right to void the policy ab initio based on misrepresentation or non-disclosure of material facts at the time of policy inception.

Present Status of P&T Inc.

- [97] P&T Inc. is insolvent. It is no longer in operation. It does not have any current directors, officers, or employees. There is no director or officer who is empowered to speak for the company.
- [98] P&T Inc.'s documents, which are contained in approximately 6,000 boxes, are being stored at a warehouse facility in or near Portland, Oregon. The cost is being attended to by PwC at the expense of P&T Inc.'s estate. P&T Inc.'s computer server is being maintained by PwC on the same basis.
- [99] PwC's position at this stage of the insolvency proceedings is that its interests are to reduce costs to the estate. It says that it has no direct interest in the claim of the Harmac employees against P&T Inc. As a result, it has chosen, as is its right, not to speak for, or represent, the interests of P&T Inc. in that dispute.

Proceedings Leading Up to XL's Present Application

- [100] XL has only recently sought to add itself as a party to the action brought by the Harmac employees.
- [101] Previously, XL declined to involve itself in the proceedings that led up to the determination of the Litigation Protocol. It has, in the past, also taken the position that it is not a party to the insolvency proceedings because no claim has been advanced against it.
- [102] I issued reasons for judgment on December 14, 2010, in relation to a costs application brought against XL. Those reasons are indexed at 2010 BCSC 1889. There, I set out some of the history of the insolvency proceedings that involved the insurers, at paras. 2-7 and 9:
- [2] Since the inception of the insolvency concerning the Pope & Talbot companies, starting with the CCAA regime through to the current bankruptcy, nearly all parties having an interest in the insolvency have sought to have the issues determined by the most cost effective and efficient processes possible. They have done so for their benefit and in order to promote judicial economy in the Courts in Canada and the United States.
- [3] All of the insurers who issued directors and officers' liability policies have participated throughout the proceedings. The insurers attorned to the jurisdiction of this Court by the applications that they brought in this Court, concerning the issues of jurisdiction simpliciter, forums conveniens, and choice of law, which were preliminary to the determination of whether coverage is afforded under any of their policies.
- [4] The issue of whether Pope & Talbot, Inc. ("P & T, Inc.") stood as a de facto director of Pope & Talbot Ltd. ("P & T Ltd.") was raised during the course of one of the hearings concerning jurisdiction; it was then subsequently and formally raised when the class action proceeding was commenced on behalf of certain former employees of the Harmac Mill, which is located near Nanaimo, British Columbia (I am not aware if the issue was formally raised by the parties prior to the issuance of the class action proceeding).

- [5] For some time, many of the parties have appeared in this Court to participate in what I will describe as the lead-up to the hearing scheduled to take place in this Court tomorrow. That hearing concerns the appropriate process to be applied by the Court to determine the liability of any or all of the directors and officers of P & T Ltd., including the issue of the liability of P & T, Inc. as a de facto director of P & T Ltd. ("the process dispute").
- [6] The insurers have been asked repeatedly by the parties involved in the process dispute and by the Court to identify all procedural or substantive issues related to the process dispute that would impact upon them. The insurers have been asked to provide their submissions as to whether a determination of liability under one of the proposed processes would not be sufficient to trigger the contractual obligations under their policies. For example, the insurers have been asked to advise whether the Court's determination following any of the proposed processes could be said not to constitute a "judgment" such that their policies would not be engaged. The parties and the Court asked the insurers to provide their submissions concerning these procedural issues in advance of the hearing of the process dispute to prevent the parties and the Court from engaging in a hearing that is a waste of resources and the parties' time and expense.
- [7] I am satisfied that XL has been aware, in a formal way, of the claim that P & T, Inc. acted as a de facto director of P & T Ltd. since at least the writ of summons was issued in the class action proceeding in 2009. I am also satisfied that the issue was raised before the Court, in the presence of XL, during the jurisdiction hearing that took place in June 2009.
- ...
- [9] I have invited XL to advise me of any procedural or substantive concerns that it may have that bear upon the process dispute and its policy. I was advised by XL's counsel in July 2010 that it would return to Court once instructions were obtained. XL committed to provide the Court with any concerns that it had. It did not.
- [103] In November 2011, XL initiated proceedings in the U.S. Bankruptcy Court. The U.S. Bankruptcy Court had previously recognized this Court as the "foreign main proceedings", which effectively meant that it deferred to this Court to manage the bulk of the Pope & Talbot insolvency proceedings.
- [104] The document filed by XL that initiated its new proceeding, known as a "Complaint", set out three counts which, on their face, sought declarations from the U.S. Bankruptcy Court concerning XL's coverage obligations under the Cornerstone policy. The relief sought by XL was broad in scope, and was said to be in respect of all of its coverage obligations for all of the directors and officers of P&T Inc. and P&T Ltd. as well as its alleged coverage obligations for P&T Inc. as an alleged de facto director. The specific counts contained in the Complaint are set out at para. 13 of my reasons for judgment indexed at 2010 BCSC 1889.

[105] XL did not provide notice of that proceeding to the Court or to the parties involved in the insolvency proceedings in British Columbia. Once PwC learned of the Complaint and that XL had scheduled a hearing to take place before the U.S. Bankruptcy Court in January 2011, it arranged for a hearing to take place before this Court on November 30, 2010. During that hearing, I raised with XL my concern that it sought a complete determination of its obligations under the Cornerstone policy from the U.S. Bankruptcy Court even though that issue was pending before this Court. Counsel for XL advised that its purpose in filing the Complaint was to avoid falling afoul of United States bankruptcy law. I was advised of XL's position in the following submissions:

Now, as I understand it, the assertion is made that it is here. The receiver is asserting that, well, this is an asset of the estate as I understand it. So there is an issue about how this is properly characterized. And that characterization relates, My Lord, to the application of the stay. And I'm instructed that this is not an unusual thing for an insurer to have to address as to whether -- because as I understand it under U.S. law an insurer can't do anything in relation to a policy that may be subject to the automatic stay without potentially being in violation of that stay. So we're in a position where if PTI is an insured person, then the automatic stay governs, and XL, as any insurer, is at risk if it deals in any way with the policy without first seeking relief from the automatic stay. So that's why we're here. That's the fundamental essence of the complaint.

[106] I issued an order enjoining XL from proceeding with the hearing of its Complaint pending a joint hearing conference between this Court and the U.S. Bankruptcy Court pursuant to the Cross-Border Protocol.

[107] The joint hearing conference took place on December 13, 2010. At that hearing, XL would not confirm that it would not proceed to seek relief from the U.S. Bankruptcy Court in respect of its coverage obligations to the individual directors and officers of P&T Inc. and P&T Ltd. Instead, XL's position was that it wished to leave the issue in abeyance.

[108] At the conclusion of the joint hearing conference, Judge Sontchi, who presided in the U.S. Bankruptcy Court, ordered that the hearing of XL's Complaint should not proceed in that Court pending a full hearing of the issues concerning jurisdiction and stay relief. That hearing was scheduled for January 24, 2011. The joint decision of both Courts from December 13, 2010 is indexed at 2010 BCSC 1885.

[109] In my reasons for judgment from the application heard on December 13, 2010, I said that I was satisfied that had XL come before the Court and expressed its concern that it did not wish to fall afoul of United States bankruptcy law and practice, the matter could have been dealt with by the Court and Judge Sontchi (who has been the case management judge presiding over the Pope & Talbot insolvency proceedings in the United States since their inception). At paras. 18-19, I said:

[18] As Judge Sontchi noted in his colloquy with counsel for XL this morning during the joint hearing conference, it is striking, that despite the statements made by its counsel to this Court on November 30, 2010, XL never specifically asked the United States District Court for relief from the provisions of the automatic stay.

[19] In my opinion, the position taken by XL this morning, and the relief it seeks in the complaint, appear to be an attempt to circumvent the effect of the jurisdiction rulings I previously made following applications that XL participated in (and which were, in some cases, applications that they had brought before this Court). The position that XL took this morning is not consistent with the position that it took before this Court on November 30, 2010.

[110] During the next joint hearing conference, on January 24, 2011, counsel for XL appearing in the United States before the U.S. Bankruptcy Court sought to have it determine the question of whether P&T Inc. is an "insured person" under the Cornerstone policy determined by that Court. The following submission was made on XL's behalf (at p. 18 of the transcript):

So, the question of whether PTI is an insured person or whether any claim against PTI is or may be covered, or whether PTI has a right to advancement of defense expenses, is not before the Canadian Court in any action, whatsoever.

[111] In support of its position, counsel for XL in the U.S. proceedings remarked that "there is no action against XL" in the Canadian proceedings. Canadian counsel for XL made a similar submission (at p. 64 of the transcript):

I really only wanted to respond to one point and that's this, XL takes the position that the claim, as alleged against PTI, and I use that because, of course, there is no claim as against XL in these proceedings. The claim that's against PTI was not raised directly on any pleading in your jurisdictional decision. And, in fact, as my colleague in the Delaware proceedings has pointed out, nor was there any claim under the D & O claims procedure against PTI in the CCAA proceedings.

[112] XL also confirmed that it wished to leave in abeyance the determination of its coverage obligations by the U.S. Bankruptcy Court to individual directors and officers under the Cornerstone policy.

[113] At the conclusion of the joint hearing conference, Judge Sontchi dismissed XL's complaint. His reasons for judgment are included at 2011 BCSC 139. After setting out the law, Judge Sontchi said that the "overwhelming reason" for the U.S. Bankruptcy Court to abstain from exercising its jurisdiction over XL's complaint was forum shopping on the part of XL:

Given the context and history over the last two years of what was going on in Canada, I have no doubt whatsoever in my mind that this is nothing more than forum shopping, by XL especially, and I will not countenance that whatsoever. That is the overwhelming reason for abstaining and also the efficient administration of justice begs for the issues related to these claims to be decided in the same forum. Clearly I am not going to decide anything other than, at most the coverage

issue, and given the fact that all of those other issues have to be decided and will be decided by another court of competent jurisdiction, who could also decide this issue in the exercise of its competent jurisdiction, that is another overwhelming reason for the court to discretionarily abstain.

[114] A case management conference was conducted in the Canadian insolvency proceedings immediately following the conclusion of the joint hearing conference on January 24, 2011. The issues canvassed included whether the claim of the Harmac employees was covered under any or all of the D&O insurance policies, and whether it should proceed before the liability issues in the Harmac action were determined. It was agreed that before that procedural issue was determined, XL should be given an opportunity to decide if it would appoint counsel to defend P&T Inc. XL asked for, and was given, two weeks to consider its position, which included weighing the risks to it of a default judgment against P&T Inc. if it did not fund a defence.

[115] XL subsequently confirmed to the parties, in writing, and in oral submissions to the Court that it would defend P&T Inc. against the claims advanced in the Harmac action on a reservation of rights basis. That coverage reservation was expressed only as a general statement; no particulars were provided at that time.

[116] The Harmac employees then sought to argue their application that certain coverage issues should be determined prior to the liability issues in the Harmac action. The hearing of that application was to commence on March 14, 2011 ("Process Hearing").

[117] On March 14, 2011, at the commencement of the Process Hearing, XL asked to be made an intervener in the Harmac action and to allow its Canadian coverage counsel to defend P&T Inc. in the Harmac action. The application was adjourned to allow XL the opportunity to bring a formal application and to brief the issue.

[118] In the meantime, and in the face of ongoing delays in proceeding with the determination of the Harmac action and as a consequence of XL's commitment to defend P&T Inc., I ordered XL to appoint counsel to defend P&T Inc. in order to facilitate document production from P&T Inc. (which had been impeded to date by the lack of defence counsel).

Determination

Should XL be added as a party or intervener in the underlying action?

[119] XL's position in this case is that it should be added as a party or intervener with full party rights to defend itself by its own coverage counsel because:

- (a) the Cornerstone policy is the only asset available to the plaintiffs in the Harmac action that can be realized if they become judgment creditors;
- (b) there is no one from P&T Inc. available to give instructions to defence counsel (that XL has appointed to defend P&T Inc.); and

(c) there are no divergent interests between it and P&T Inc.

[120] XL concedes that the circumstances of this case are unique. XL argues that they arise from the combined effect of the de facto director provisions of the CBCA and the bankruptcy of P&T Inc.

[121] XL also concedes that it cannot defend the individual directors and officers with its coverage counsel, even though the plaintiffs in the Harmac action may only recover the insurance proceeds. XL acknowledges that a divergence of interests exists because the individual directors and officers have a reputational interest at stake. XL's position is that no such interest exists in respect of P&T Inc.

[122] There is no case decided in this province adding an insurer as a party or intervener to underlying litigation in a non-auto context. Except for the statutory regime dealing with auto policies, an insurer's interests in underlying litigation are seen as commercial interests that do not engage Rule 6-2(7).

[123] In British Columbia, putative judgment creditors in other related proceedings are not permitted to participate in insurance coverage litigation because the construction of a policy is a matter of contractual interpretation between the insurer and insured: AXA Pacific Insurance Co.

[124] In my opinion, the converse should not be allowed. The Court should not permit an insurer the right to defend its own coverage interests against allegations in an underlying suit. The results in Uniroyal and Hedrich are premised upon a rule that permits the addition of interveners. That rule has not been applied in British Columbia. The approach taken in P.C.S. seems to arise from unspecified contractual language and is not stated to be premised upon any rule of civil procedure or existing case law. The decision is also inconsistent with case law decided in this province because it permits coverage issues to be determined at the same time as the issues raised in the underlying action.

[125] XL did not specifically reserve for itself in the Cornerstone policy the right to defend an insured with the choice of its counsel in the event of insolvency. No argument was made that its right to do so is implied in the Cornerstone policy.

[126] I do not accept XL's assertion that the lack of any reputational interest for P&T Inc. should permit it to be added as a party.

[127] In Tichit, the Court considered, as part of its analysis, the interests of all of the parties in the underlying action even where Guardian's policy contained the S.E.F. endorsement giving it the right to participate in underlying proceedings as a party. In the present case, the factual and coverage issues surrounding the alleged appointment of P&T Inc. as a de facto director are of great moment to the individual directors and officers. Depending on the chronology of events that give rise to liability, some or all of the individual directors and officers may not be liable to the plaintiffs if P&T Inc. is proven to be a de facto director. Further, the defence of the individual directors and officers is being funded by the liability

insurers, including XL, albeit at the moment by Federal, on a reservation of rights basis. If the individual directors and officers are found liable in the Harmac action, they will look to their insurers, including XL, for indemnity. Many of the coverage issues they face, e.g., whether the claim is in respect of a "wrongful act", also arise on the claim advanced against P&T Inc. by the plaintiffs in the Harmac action.

- [128] If XL were added as a party or intervener to the litigation, it would be allowed the opportunity to sculpt or "sway" the presentation of the evidence and findings of fact in the underlying action that could vitiate coverage for P&T Inc. as well as the individual directors and officers. XL's direct participation in the underlying action could prejudice the individual directors and officers, who would, in addition to defending against the claims in the Harmac action, have to defend against the off-coverage opportunities now being afforded to XL. This would allow XL to participate in the underlying litigation to the detriment of the reputational interests of the individual directors and officers.
- [129] In my opinion, XL should not be allowed the opportunity to sculpt or sway the findings of fact in the underlying action to the prejudice of the coverage rights of the individual directors and officers. Nor should that opportunity be afforded to XL where to do so might potentially prejudice any s. 24 action brought by the Harmac employees, who have no standing to address coverage issues in the underlying action.
- [130] Relying on *Adelaide Capital Corp. v. Sethi* (1996), 6 C.B.R. (4th) 22 (Ont. C.J.), XL argues that it should be added to the underlying action because when an insured is bankrupt, the insurance proceeds do not vest in the estate where the liability policy, as it does in the Cornerstone policy, requires the insurer to "pay on behalf of" the insured. No case has been cited to show that this particular consequence affords XL something more than a private commercial interest that was described in *Schiffskommerz*. Nor has any case been cited to show that it affords XL the right to participate in the underlying action as a party, an intervener, or by defending P&T Inc. with XL's coverage counsel. Even if it could be said that the holding from *Adelaide* gives XL an equitable or legal interest contemplated by AXA Pacific (at para. 26), I would not permit XL to participate in the underlying action in any of these ways.
- [131] I do not see any principled basis to depart from the line of authority established in this province simply because P&T Inc. is in bankruptcy.
- [132] Further, adding XL as a party to the Harmac action does not provide it greater access to evidence than it would otherwise have to defend P&T Inc. on the merits of the Harmac action. XL presently has access to all of P&T Inc.'s documents through the defence counsel that it has retained to represent P&T Inc. Difficulties speaking with and obtaining instructions from someone on behalf of P&T Inc. will exist whether or not XL is added as a party to the litigation. In my opinion, adding XL as a party in the circumstances would only serve to present it with the opportunity to influence coverage to the detriment of the individual directors and officers.

[133] Even if I were persuaded that the reasoning from Uniroyal, Hedrich, and P.C.S. should be applied, I would not exercise my discretion to add XL as a party or an intervener for the reasons set out in the preceding paragraph, and because:

- (a) XL has not demonstrated that P&T Inc.'s interests cannot be properly defended by the defence counsel that it has retained;
- (b) there is no policy wording affording XL the right to participate as a party or through its coverage counsel;
- (c) I would be obliged, applying P.C.S., to consider the interests of the Harmac employees as putative judgment creditors and, in doing so, I would conclude that an opportunity would be afforded to XL to affect or pre-determine the outcome of any s. 24 action in circumstances where the Harmac employees have no right or standing in this province to engage in the coverage dispute until they become judgment creditors; and
- (d) XL's conduct to date suggests that it is likely to engage the opportunity referred to in the preceding subparagraph and in paras. 128 and 129 herein.

[134] XL argues that it needs to be added as a party to the underlying litigation in order to ensure that facts do not have to be re-litigated in subsequent coverage proceedings. That submission overlooks the holdings in Carwald and Qualiglass. Moreover, the possibility that further evidence in a subsequent coverage action may be required is a prospect faced by all liability insurers who defend on a reservation of rights basis. Liability insurers who defend on a coverage reservation must await the outcome of the underlying action. An insured's financial exposure, which may be covered by the insurer's policy, is defended by defence counsel without regard for the coverage issues.

[135] In this case, XL is provided with protection not normally afforded to liability insurers. It has the right, as do the other insurers who are parties to the Litigation Protocol, to raise its concerns during the interlocutory phase of the insolvency proceedings so that the requirement for additional evidence in the subsequent coverage proceeding can be minimized or obviated.

Should XL be permitted to defend P&T Inc. with its coverage counsel?

[136] Normally, absent an application objecting to choice of counsel, the Court will not involve itself in a party's choice of counsel. Here, XL has raised the issue directly on its application. Its notice of application seeks the declaration set out in para. 2 of these reasons for judgment.

- [137] Although the Court's jurisdiction is engaged by XL's application, XL objected to the standing of the Harmac employees to bring their own application to have independent counsel appointed to defend P&T Inc. XL did this on the basis that those plaintiffs lacked standing because they are strangers to the Cornerstone policy. According to XL, the only party with standing is P&T Inc., who exists only de jure. If XL's position is accepted, its application would be argued unopposed as a result.
- [138] Even if the application is unopposed because P&T Inc. is no longer a functioning entity, XL's position overlooks the Court's "greater concern" to preserve the integrity of its own process and the administration of justice, and to prevent mischief and impropriety: *Laurencine*; *Szebelledy*; and *MacDonald Estate*. In my opinion, the integrity of the Court's process should not be put at risk in the circumstances of this case. In addition, allowing XL to be added as a party or defend P&T Inc. with its coverage counsel would cause the insurance aspects of the insolvency proceeding to no longer be coverage neutral.
- [139] XL's application to defend P&T Inc. is not assisted by *Uniroyal*, *Hedrich*, and *P.C.S.*
- [140] The Court in *Uniroyal* took a very liberal view of the "conflict" issue. It cited the "appearance of impropriety" as the test to be applied. In my opinion, there would be an appearance of impropriety to permit XL's coverage counsel to defend the liability claims, given that they have been actively involved in advising XL on the coverage issues since at least the time XL and the other insurers brought their jurisdiction applications. Further, impropriety results when, in defending the case on liability, XL's coverage counsel takes instructions from a representative of XL whose focus is to secure a coverage denial. In my opinion, propriety and the interests of justice are secured where defence counsel retained to defend P&T Inc. are not associated with the defence of coverage and defence counsel takes instructions from a representative of the insurer whose sole focus is the defence of the liability claim.
- [141] The reasoning in *Uniroyal* and *Hedrich* involved an exercise of judicial discretion. In the present case, defence counsel retained by XL to defend P&T Inc., pending the outcome of this application, is experienced senior counsel who is competent to defend P&T Inc. The role of defence counsel is to defend P&T Inc. against all of the claims of the Harmac employees advanced in the Harmac action without regard to coverage.
- [142] Further, neither *Uniroyal* nor *Hedrich* permit the possibility for coverage issues to be considered or argued by the insurer's counsel in the defence of the underlying actions.
- [143] *P.C.S.* does not assist XL because the notion of conducting a coverage trial parallel with the trial of the underlying liability action runs contrary to the case law in this province. Further, in my respectful view, that notion appears inconsistent with the approach taken in the majority of insurance law decisions in Canada and the United States. The prohibition against deciding coverage issues before the underlying action is determined is pervasive, and goes so far as to prohibit their consideration on duty to defend applications where an insured has provided a statement which has the effect of vitiating coverage: e.g., *Halifax*

Insurance Co. of Canada v. Innopex Ltd. (2004), 72 O.R. (3d) 523, 15 C.C.L.I. (4th) 159 (C.A.).

[144] In my view, the only practical reasons for XL to seek to defend P&T Inc. by its coverage counsel are:

- (a) to use the opportunity to sway the outcome of the liability issues to vitiate coverage; and/or
- (b) to save the expense of paying for two sets of counsel (defence and coverage).

I have dealt with the former aspect in these reasons for judgment. As for the latter, insurers who underwrite liability policies, including CGL and D&O insurance, routinely retain more than one counsel when coverage is in issue. It is their right to retain their own coverage counsel in situations where they choose to raise coverage issues.

[145] Counsel advised during the hearing that the boxes of documents presently stored in Portland, Oregon contain documents that are privileged to P&T Inc. Those documents are not permitted to go to XL's representatives charged with assessing coverage. The confidential information contained within them remains within the purview of defence counsel and the XL examiner charged with the defence of P&T Inc. Those documents may impact upon the defence strategy employed to defend P&T Inc. They might also bear on some or all of the coverage issues, including XL's avoidance defence. So might privileged information given to defence counsel during witness interviews. If defence counsel passes those documents on to XL's coverage examiner, then a conflict is readily apparent. This is because, quite naturally, XL's coverage examiner would wish all evidence vitiating coverage to be led in the underlying action, even if it worked to the prejudice of the coverage position of the individual directors and officers (who may be insured by XL under the Cornerstone policy and XL's excess policy). While XL's coverage examiner has the right to ask for and review documents produced by P&T Inc. and the other parties in the underlying litigation, as well as the discovery and trial transcripts and the exhibits marked at trial, the coverage examiner does not have the right to access the insured's privileged documents, especially given XL's very broad coverage reservation that suggests an indefinite range of coverage defenses.

[146] Granting XL's application would also provide XL's coverage examiner with an opportunity to access privileged documents that concern the avoidance defence but have nothing to do with the issues raised in the Harmac action. But for their defence of P&T Inc., XL would not otherwise have access to those documents that are reviewed by defence counsel in the course of providing P&T Inc.'s document production in the underlying action. Permitting XL to defend P&T Inc. with its coverage counsel would place counsel in the invidious position of advising XL qua coverage about the effect of privileged documents on a avoidance defence that XL would otherwise not have been entitled to see.

[147] Therefore, I would not permit XL to defend P&T Inc. with its coverage counsel in the circumstances of this case.

[148] The application brought by XL to be added as a party or intervener to the Harmac action and to defend P&T Inc. by its coverage counsel is dismissed.

[149] Lastly, I wish to emphasize that I have not intended to remark upon the breadth and scope of the right, if any, of a judgment creditor to stand in the shoes of an insured when bringing an action under s. 24 of the Insurance Act. That issue will have to be dealt with on a subsequent application.

"P. WALKER, J."

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