Limitation of insurer’s duty to defend: The Draft Regulation specifying the categories of contracts covered is published

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On September 8, 2021, Mr. Éric Girard, Minister of Finance, presented his Draft Regulation specifying the classes of liability insurance contracts that may derogate from public policy rules previously applicable to liability insurance (the “**Draft Regulation**”), namely those set out in articles 2500 and 2503 of the *Civil Code of Québec* (“**CCQ”**) concerning the insurer’s duty to defend and the exclusive application of insurance coverage to injured third parties.

Background

Since May 27, 2021, article 2503 CCQ reads as follows:

> The insurer is bound to take up the interest of any person entitled to the benefit of the insurance and assume his defence in any action brought against him.
>
> Legal costs and expenses resulting from actions against the insured, including those of the defence, and interest on the proceeds of the insurance are borne by the insurer over and above the proceeds of the insurance.
>
> However, the Government may, by regulation, determine categories of insurance contracts that may depart from those rules and from the rule set out in article 2500, as well as classes of insureds that may be covered by such contracts. The Government may also prescribe any standard applicable to those contracts.

When Bill 82 was introduced for adoption, the Minister of Finance seemed to suggest that the categories that would benefit would be public companies and liability insurance for directors and officers. Although small and medium-sized enterprises are not covered by the Draft Regulation, it does provide for several categories of insureds that may benefit from exemptions.

Draft Regulation – covered categories

The Draft Regulation appears to cover “any liability insurance contract,” but sets out conditions that must be met by an insured in order to benefit from exemptions. Finally, many businesses and their directors and officers will be entitled to subscribe to policies that do not comply with articles 2500 and 2503 CCQ.

Here is a summary of exemptions:

Section 1

Category of insured	**Exemptions**
Drug manufacturers under the Act respecting	

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prescription drug insurance; Certain **corporations incorporated under a private bill**;[1] and Directors, officers and trustees of such businesses, except for their activities as members of a pension committee.	These insureds may subscribe to policies that depart from the rules set out in article 2500 CCQ and those set out in the first and second paragraphs of article 2503 CCQ.[2]

Section 2

Category of insured Companies not referred to in section 1, but meeting one of the following conditions "where the total coverage under all the civil liability insurance contracts subscribed by that insured is at least $5,000,000": **Large businesses** for the purpose of the *Act respecting the Québec sales tax*; that is, businesses that have total taxable sales in a given fiscal year in excess of $10 million; A **reporting issuer** or subsidiary of such reporting issuer within the meaning of the *Securities Act;* A **foreign business corporation** within the meaning of the *Taxation Act* (chapter I-3) or the *Income Tax Act*; that is, a company that is not resident in Canada; and A **corporation that pursues an activity outside Canada** and derives income from that activity. Directors, officers and trustees of such businesses, except for their activities as members of a pension committee.	**Exemptions** These insureds may subscribe to policies that depart from the rules set out in article 2500 CCQ and those set out in the first and second paragraphs of article 2503 CCQ.

Section 3

Category of insured Businesses not referred to in sections 1 and 2 that conduct activities to provide services provided for in the *Act respecting health services and social services* as: An **intermediate resource not referred to in the *Act respecting the representation of family-type resources* and certain intermediate resources and the negotiation process for their group agreements** (chapter R-24.0.2) and who is a support for elderly autonomy-type resource; A **private seniors' residence**; or A **private health and social services institution operating a residential and long-term care centre or rehabilitation centre**. Directors, officers and trustees of such businesses, except for their activities as members of a pension committee.	**Exemptions** These insureds may subscribe to policies that depart from the rules set out in article 2500 CCQ and those set out in the second paragraph of article 2503 CCQ only.

Section 4

Category of insured Businesses that are not covered by section 2, for example because they do not have total coverage of at least $5,000,000, and that have operations outside of Canada and earn income from them. However, exemptions are possible only for coverage of these foreign activities. Policies covering the Canadian operations of businesses must comply with the rules set out in the public interest.	**Exemptions** These insureds may purchase policies that depart from the rules set out in article 2500 CCQ and those set out in the first and second paragraphs of article 2503 CCQ.

Section 6

Category of insured **Businesses not referred to in any of sections 1 to 3 having**	**Exemptions**

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primary liability insurance contracts in accordance with the provisions of articles 2500 and 2503 CCQ, covering legal costs and expenses resulting from actions against them, including those of the defence, and interest on the proceeds of the insurance.

These insureds may subscribe to complementary policies that depart from the rules set out in article 2500 CCQ and those set out in the first and second paragraphs of article 2503 CCQ.

The Draft Regulation also stipulates that where an insurance policy does not provide for an obligation for an insurer to assume an insured's defence (first paragraph of article 2503 CCQ), the insured retains the right to select counsel, but must keep the insurer informed of the progress of the proceedings and allow it to participate in the defence.

Finally, the government, in article 8 of the Draft Regulation, provides that the proceeds of the insurance that are not applied exclusively to the payment of injured third parties may not exceed 50% of the proceeds of the insurance, unless the insured is found not to be liable or unless the payments to injured third parties do not reach such 50%. However, where a minimum amount of liability insurance coverage is required by law, that amount must be applied in full to the payment of injured third parties without regard to the exceptions discussed above.

What to expect

While some will welcome the government's openness in allowing policyholders and insurers to relax certain obligations that may have contributed to a tightening insurance market in Quebec, others will fear the consequences that these changes may have, in particular on the availability of "non-exempt" insurance policies for insureds covered by the Draft Regulation.

In any case, this is a significant change that will generate much discussion between risk managers, market intermediaries and underwriters.

Also, some may be interested in obtaining additional information or commenting on the Draft Regulation. Information requests may be directed to the Direction générale du droit corporatif et des politiques relatives au secteur financier, Ministère des Finances, and comments may be made in writing to the attention of the Minister of Finance before October 23, 2021.

Do not hesitate to contact a member of Lavery's insurance team in connection with the above.

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1. *Act constituting Capital régional et coopératif Desjardins* (C-6.1), *Act to establish Fondaction*, *le Fonds de développement de la Confédération des Syndicats Nationaux pour la Coopération et l'emploi* (F-3.1.2) and *Act to establish the Fonds de solidarité des travailleurs du Québec* (F-3.2.1).
2. As reproduced above, the first paragraph of article 2500 CCQ concerns the insurer's obligation to assume the defence of the insured with respect to covered claims, and the second paragraph specifies that the insurer assumes the legal costs, interest and expenses, over and above the proceeds of the insurance.

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