

## Duty to Defend - “Illegal Operation” Exclusion A Commentary on *Haryett v. Lloyd’s Canada*

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I don’t often comment on lower court decisions, but in this case I could not resist.

*Haryett v. Lloyd’s Canada*, [2015 ONSC 853 \(CanLII\)](#), 124 O.R. (3d) 557, was an application by an estate for an order that Lloyd’s owed it a duty to defend a law suit against it arising from a boating accident.

The Lloyd’s now deceased insured was operating the boat in question with a blood alcohol level of .277. The Lloyd’s policy contained the following exclusion:

### *Duty to indemnify*

We will not be liable if your vessel is ... operated illegally or used for any illicit or prohibited trade or transportation.

The policy further provided:

### *Limit of Liability*

We will pay up to our limit of liability for any one occurrence. We will settle or defend, as we consider appropriate, any claim or suit asking for these damages. Our duty to settle or defend ends when the limit of liability is exhausted.

The applications court judge held:

[5] In my view, this provision does not oblige the insurer to defend every action. The language is clear that the insurer will only defend a claim or suit where in its determination it is “appropriate” to do so. The insurer’s exercise of its discretion in this regard must be “reasonable”, but this does not amount to a binding contractual obligation to always defend or fund the defence costs.

Surely this is wrong. The wording clearly obliges the insurer either to defend or to indemnify. It must do one or the other and its discretion is limited to which option it chooses. It does not have the discretion to refuse to do both.

If there is any ambiguity, the contra proferentum rule requires this wording to be construed against the insurer.

Further, the applications court judge seems to have ignored *Nichols v. American Home Assurance Co.*, [1990] 1 S.C.R. 801, which requires the issue of the duty to defend to be determined solely on the pleadings. Even if the insurer owed no duty to defend if the boat operator was under the influence, as long as an alternative source of liability was pleaded, the insurer would owe a duty to defend until the issue of whether the boater was under the influence was determined.

Further, it is not clear to me that the exclusion, “We will not be liable if your vessel is ... operated illegally or used for any illicit or prohibited trade or transportation” necessarily excludes liability arising while the boat operator was under the influence.

As the applications judge notes:

[9] I agree that the “operated illegally” language is broad. One can imagine a boating accident situation where the owner of the vessel is found to be in breach of a boating regulation that is unrelated to the actual operation of the boat. For example, a breach of a regulation requiring the lettering on the hull to be a specific size or colour. No reasonable insured would think that the boat was being “operated illegally” at the time of the accident just because there was a technical breach of the lettering regulation and no reasonable judge would deny coverage in those circumstances.

What follows logically from the first two sentences above is that the exclusion is too vague to be enforceable.

In fact, it is arguable than operating a boat negligently is operating it “illegally”, in which case the exclusion would obviate coverage entirely, since it excludes the very thing the policy is purporting to cover. It is trite law that an exclusion that obviates all coverage completely is not enforceable.

Further, the *contra proferentem* would be applicable. If the insurer had intended to exclude the consequences of boating under the influence, it could have spelled that out. After all, it did spell out the consequences of using the boat for an “illicit trade or transportation”.

Finally, the addition of the words, “operated illegally or used for any illicit or prohibited trade or transportation” weakens the broad application of the words “operated illegally”. If the words, “operated illegally” were meant to have a broad general application beyond “illicit trade or transportation”, the latter words would be redundant.

Unfortunately, the applicant chose not to appeal for economic reasons so the further construction of this policy wording will have to await another date.

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