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# Does a Course of Construction Policy Cover Damage to an Existing Structure?

by David Strand

## Introduction

The Alberta case of *Medicine Hat College v. Starks Plumbing & Heating Ltd.*<sup>1</sup> (“*Medicine Hat College*”) examined the issue of whether a course of construction insurance policy (“COC policy”) covered damage to an existing structure during the construction of an addition to a building.



The coverage dispute in *Medicine Hat College* could easily have been avoided if the COC had excluded any damage to the existing structures. Alternatively, the entire subrogated action could have been avoided if Lombard had agreed under its already existing property policy to waive subrogation for property damage resulting from the expansion work.

## Facts

Medicine Hat College (“the College”) undertook an addition to its facilities. It already had property insurance. The same insurer (Lombard) issued a COC policy for the addition. A natural gas explosion occurred during construction. Improper installation of a new gas line allowed natural gas to migrate to the existing mechanical room. The explosion occurred there, damaging the mechanical room. The College’s claim for damage (approximately \$350,000) to the mechanical room was paid under its property policy (not the COC policy). Lombard then brought a subrogated action against several contractors and consultants, alleging their negligence caused the explosion.

## The Issue

The Defendants claimed that the damage caused by the explosion was covered by the COC policy. If there was coverage, all parties agreed that the insurers had no right of subrogation against the defendants. Justice McDonald (as he then was) heard a trial of this preliminary coverage issue.

## Discussion

In coming to his decision, Justice McDonald relied on the Supreme Court of Canada’s decision in *Commonwealth Construction v. Imperial Oil* (“*Commonwealth*”).<sup>2</sup> In that decision the Supreme Court of Canada found that:

- (1) persons working on a construction project have an insurable interest (because they all have an interest in avoiding litigation if an accident occurs) in the entire project, and
- (2) the COC insurer had no right of subrogation against them.

In *Commonwealth* the damage in question occurred to the structure under construction. Justice McDonald notes this fact. He then considers whether it makes any difference where the damage occurs to an existing structure (the existing mechanical room) rather than one under construction (the expansion).

In the result, Justice McDonald finds it does not make a difference. In his view, it is a logical extension of the reasoning in *Commonwealth* to recognize that the trades involved in the expansion work have an

insurable interest in the entire interconnected structure. Their insurable interest is not limited merely to the new addition they are working on. On this basis, Justice McDonald concluded that the loss in question was covered by the COC policy.

Although the decision has not been appealed, another court, in another case, may have to consider whether its reasoning is correct. Does the fact the contractors have an insurable interest in the entire interconnected project (including existing buildings) mean that the COC insurer has agreed to insure not only the expansion but the existing buildings as well? Insurable interest by itself does not entail coverage.

Consider, for example, a new building under construction, sandwiched between existing buildings with different owners. A COC policy taken out by the owner of the new building will only cover the building under construction, not the adjacent buildings as well. Yet the contractors working on the new building would seem to have an insurable interest in the existing, adjacent buildings as well—it is easy to imagine a fire spreading from the building under construction to the existing buildings, and easy to conclude that the contractors have an interest in avoiding litigation resulting from damage to the existing buildings. Coverage under the COC for damage to the existing buildings however does not follow. And the property insurers of the adjacent buildings would not be precluded from subrogation against the contractors.

## Concluding Thoughts

The coverage dispute in *Medicine Hat College* could easily have been avoided if the COC had excluded any damage to the existing structures. Alternatively, the entire subrogated action could have been avoided if Lombard had agreed under its already existing property policy to waive subrogation for property damage resulting from the expansion work. Most importantly for owners, the action could also have been avoided if the College had obtained a wrap-up liability policy from Lombard for the expansion project in addition to the COC policy. Where construction project insurance is obtained, a prudent owner will typically obtain both COC and wrap-up liability policies.

## Footnotes

<sup>1</sup>2007 ABQB 691

<sup>2</sup>[1978] 1 S.C.R.317

# A Review of the Pierringer Agreement

by David Strand and Scott Tallman, Student-at-Law

## Introduction

The Pierringer form of release (“Peirring Agreement”) is a settlement agreement between the plaintiff and another party to the action adverse in interest to the plaintiff. The settling party may be a defendant or third party. What is legally significant about the Pierringer Agreement is its effect on the non-settling defendants in the action. It allows a settling defendant or third party to escape the action completely.

## Typical Situation

Consider for example a common situation that arises for defence counsel. A multiple car accident is caused by drivers D1 and D2 resulting in injury to a person in a third vehicle. The injured party sues D1 and D2 alleging each one is liable in negligence. Each of the defendants in turn issues a Rule 77 Notice to Co-Defendant against the other defendant. D1 becomes willing to settle with the plaintiff but D2 is not. This presents a problem for D1 as even if the plaintiff discontinues against D1, it is still subject to the third-party action of D2. Unless the plaintiff is willing to provide an indemnity covering not only the legal expenses of D1 but also covering any liability D1 may be found to have to D2 in the third-party action, no settlement is likely. The Pierringer Agreement solves the problem. It allows D1 to settle with the plaintiff and use the terms of the settlement as the basis to strike the third-party action by D2 against it. D1 is then out of the action completely.

## Joint and Several Liability

The key to a Pierringer Agreement is understanding the basis of law for D2’s third party action against D1. D1 and D2 are concurrent tortfeasors who have caused the damage or loss suffered by the plaintiff and each are jointly and severally liable for the plaintiff’s loss, no matter the degree in which they are respectively found to be at fault or negligent. In Alberta, it is section 2 of the

*Contributory Negligence Act*<sup>1</sup> that makes all concurrent tortfeasors jointly and severally liable to the injured person. The result is that the plaintiff injured in the automobile accident could have sued and recovered all of its damage from D1 so long as D1 was found to have been at fault to some degree.

## Distinguishing Feature from Ordinary Release

With a Pierringer Agreement, the plaintiff gives up its right of action against D1, with whom it is settling, but it also gives up the right it has to recover from D2, any portion of the losses it claims from D2 that the Court attributes to the fault of D1.

## Enforceability in Alberta

Pierringer Agreements are named after one of the parties in the 1963 Wisconsin case *Pierringer v. Hoger*,<sup>2</sup> in which case such a settlement was effected. The Alberta Court of Appeal confirmed that Pierringer Agreements are legally enforceable in Alberta in the case of *Amoco Canada Petroleum Co. v. Propak Systems Ltd.*<sup>3</sup> (“*Amoco Canada*”). The Court of Appeal in *Amoco Canada* set out some guidelines for approval of a Peirring Agreement as follows:<sup>4</sup>

In summary, in evaluating proportionate share settlement agreements:

- A court must keep in mind the strong public policy reason which encourages settlement;
- The fact that a non-settling defendant has restricted rights of third party disclosure under the Alberta Rules of Court does not justify refusing to give effect to a proportionate share settlement agreement;
- A court need not approve a proportionate share settlement agreement containing contractual provisions that directly limit the procedural rights a non-settling defendant would otherwise have; and

- A proportionate share settlement agreement should be disclosed to the non-settling party. To further reduce potential prejudice, the terms of the agreement, although not necessarily the amount of the settlement, should also be disclosed to the court.

### Possible Shortfall of Windfall Situations

Looking at our hypothetical case, one can see that the result can be either a windfall or a shortfall to the plaintiff. To describe a shortfall situation, let's assume D1 settles with the plaintiff pursuant to a Pierringer Agreement on the basis that D1 was only 10% at fault. At trial, D2 persuades the court that D1 was actually 40% at fault. The result under the Pierringer Agreement is that the plaintiff can only recover 60% from D2, that portion for which D2 is liable. Since the plaintiff settled with D1 for 10% rather than the 40%, the plaintiff is left without any party from which it can claim 30% of its damages. This is the risk the plaintiff takes in settling in advance of trial.

Conversely, a windfall situation may occur. Assume D1 settles with the plaintiff on the basis it was 50% at fault. At trial, however, D1 is found to have been only 10% at fault whereas D2 is found to be 90% at fault. Does the plaintiff get the benefit of the extra 40% paid by D1 or does D2 receive a credit for the excess 40% paid by D1?

This windfall situation was very recently addressed in the case of *Bedard (next Friend of) v. Martyn*<sup>5</sup> (“*Martyn*”) wherein the Alberta Court of Appeal decided that the while encouraging settlement is important, the principle of proper compensation in tort was paramount. Therefore, the amounts paid to settling defendants under a Pierringer Agreement may be used to offset the liability of the non-settling defendant to eliminate any windfall.

In *Martyn*, the Plaintiff was injured days after birth and suffered from cerebral palsy as well as developmental and physical disabilities as a result. The Calgary Health Region and Foothills Medical Centre settled under a Pierringer Agreement, and the two doctors involved remained as defendants and went to trial. At trial, the doctors were found to be 25% liable and damages of \$700,000 were awarded. Importantly, no liability at all was assessed against the settling Defendants. The non-settling doctors applied to have the settlement amount given to the Plaintiff by the settling Defendants applied against the damage award.

The Court decided that as the primary goal of tort law is to compensate the victim for the loss, but no more, the settlement amount would be deducted from the \$700,000 damage award against the non-settling doctors. The unfairness of the result—that the non-settling parties who were found at fault benefited from parties who settled before trial and were found to be not at fault—was recognized. However, as the application of the general result meant that no plaintiff would be under-compensated for a loss, it was not unfair in a broader sense. It was also made clear that only the net settlement proceeds (after an appropriate deduction for legal fees -the legal costs incurred by the plaintiff in connection with the settled claim) should be set off against the damage award at trial.

### Recent Alberta Decisions on Discovery Issues

In a couple of recent cases the Alberta Court of Queen's Bench had to decide whether to impose conditions on Pierringer Agreements as requested by a Non-Settling Defendant in relation to entitlement to further examination for discovery and transcript use.

In *Murphy Canada Exploration Co. v. Novagas Canada Ltd.*<sup>6</sup> (“*Murphy*”), the non-settling Defendant Novagas argued that letting one of the settling defendants (“Gould”) out of the action had the potential of prejudicing Novagas. At the time of the Pierringer settlement, Novagas had not yet examined Gould in the Examination for Discovery process. The ability to examine a party to the litigation in Alberta is much broader than the ability to examine a non-party.

Justice Graesser in *Murphy* provided a compromise. Novagas would be able to conduct a thorough examination of Gould's officer, but Novagas could not examine other employees of Gould. Gould would remain a party to the litigation until the examination was complete. Once complete, the Agreement would be approved and Gould would no longer be a party. However it must be noted that *Murphy* would appear to be restricted to its unique facts. This was the opinion expressed by Mr. Justice Ross in a subsequent Alberta case, *Condominium Plan 9320022 v. Acta General Inc.*<sup>7</sup> (“*Acta*”) wherein he stated that it was “because of the unusual contractual relationship, including an indemnity provision, as between the Non-Settling Defendant Novagas and a Settling Defendant Gould”<sup>8</sup> that further examination for discoveries of the one Settling Defendant were allowed.

In *Acta*, the Non-settling Defendant requested that the Court impose certain conditions before approving the Pierringer Agreement. The conditions included enabling the Non-Settling Defendant to discover an officer of a Settling Defendant who had yet to be discovered and enabling the Non-Settling Defendant to read in at trial portions from the transcripts of completed examinations of the officers of the Settling Defendants.

Justice Ross distinguished *Murphy* on its unique facts. He held that all issues of liability between the Settling Defendants and the Non-Settling Defendant in *Acta* arose (as in the *Amoco Canada* decision) from their position as joint tortfeasors. In such a situation, any prejudice to the Non-Settling Defendant must be weighed against prejudice to the Plaintiff and the benefits of settlement agreements in general. Justice Ross held that the benefits of settlement outweighed prejudice to the Non-Settling Defendant by the loss of discovery rights. Accordingly he refused to make the approval of the Pierringer agreement conditional upon the discovery of an officer of a Settling Defendant. Further, as to the request by the Non-Settling Defendant for the right to read in transcripts of officers of Settling Defendants at trial, Justice Ross held that the trial judge should make such discretionary evidentiary rulings in due course.

### Concluding Thoughts

Pierringer Agreements are an effective settlement tool in multi-party actions. The guiding principle from *Amoco Canada* continues to govern in Alberta in most cases, namely that public policy in favour of settlement outweighs procedural prejudice to a non-settling defendant.

#### Footnotes

<sup>1</sup>RSA 1980, c.C-23

<sup>2</sup>(1963) 124 N.W. 2d 106 (U.S. Wis. S.C.)

<sup>3</sup>2001 ABCA 110

<sup>4</sup>*Supra*, note 4, at para.41

<sup>5</sup>2010 ABCA 3

<sup>6</sup>2009 ABQB 455

<sup>7</sup>[2009] A.J. No. 1210

<sup>8</sup>*Supra*, Note 7, at para. 11

# The Erlton Fire Case: Selected Issues

by Donald Chernichen, Q.C.

In late August of this year a lengthy written decision was rendered by Mr. Justice Bruce McDonald, that of Condominium Corporation No. 9013678 v. Statesman Corporation.<sup>1</sup>

The action was substantially a subrogated action arising out of what has been described as “the worst fire in the City of Calgary”, most commonly known as “the Erlton fire”, with damages in excess of \$30 million. The fire originated in the Waterford D building, being the fourth of four buildings comprising the condominium project (“the Waterford project”). At the time of the fire, Waterford D was under construction. In addition to the damages to the four Waterford buildings, significant damages were sustained to the residences to the west and north of the Waterford project.

The developer and general contractor for the Waterford project was the Statesman Corporation (“the Statesman”). Advanced Group Calgary Ltd. (“Advanced”) was a subcontractor who was retained by Statesman to provide waterproofing services. In turn, Advanced without the knowledge of Statesman, further subcontracted a portion of the waterproofing work on Building D to Cactus Waterproofing and Roofing (“Cactus”).

The Court found that the fire was caused by the negligence of a Cactus employee during the course of utilization of a torch in applying waterproofing membrane.

In the final result, Justice McDonald, although dismissing the claim of the Plaintiffs against the City of Calgary, found liability against

Statesman, Advanced and Cactus defendants. In turn, Justice McDonald found that Statesman was entitled to indemnity from Advanced, which in turn was entitled to indemnity from Cactus.

The Reasons for Judgment (“the Reasons”) are important for a number of reasons, which include the following:

1. The litigation presented a reasonably typical situation where a number of the Defendants (“the Settling Defendants”) entered into a Pierringer agreement with the Plaintiffs prior to trial. A Pierringer Agreement essentially allows the Settling Defendants to escape the action and the remaining Defendants (“the Non-Settling Defendants”) are apportioned only that percentage of liability attributable to them. The Court remains obligated to assess the percentage of liability against the Settling Defendants even though they are no longer part of the action. However in this case, the Court found no liability against the Settling Defendants, BKDI Architects and its sub-consultant, GHL and, accordingly, there was no reduction in the award made against the Non-Settling Defendants, Statesman, Advanced and Cactus.
2. Although a number of arguments were advanced against the City of Calgary, no liability was found against it. The portion of the Reasons dealing with the issues relative to the City of Calgary is important for a number of reasons, including the fact

that this was the first decision in Alberta to consider the provisions of the Alberta Safety Codes Act and the requirement of proof of bad faith against a municipality. In addition, the Reasons provide important commentary on the current law of causation in Alberta including a review of the “but for” and “material contribution” tests as confirmed in recent Supreme Court of Canada cases.

3. Although Cactus and Advanced were independent contractors, the Court found that because of the inherently dangerous nature of the torching activity, Statesman, which was not even aware of the involvement of Cactus on the project, and in turn Advanced, were found liable for the negligence of the defendant Cactus.
4. Apart from the issue of vicarious liability relative to the Cactus and Advanced defendants, the Reasons also contain some interesting commentary on the issue of liability arising out of the circumstances of hiring a sub-contractor in relation to activities viewed as inherently dangerous.

As yet, no decision has been taken by any of the parties in relation to a possible appeal to the Alberta Court of Appeal. We will report in a future issue on On Record: Insurance Matters in the event an appeal is launched.

## Footnotes

<sup>1</sup>2009 ABQB 491



# Social Networking Sites:

by Patricia Olyslager

## Introduction

By now most people have heard of or are users of the social networking website of Facebook. After a simple registration process, users create a Facebook profile on which they can post and view, among other things, text, photographs and videos. The Facebook user then adjusts the privacy settings to allow unfettered access to one's profile or the user can limit access to a very restricted group. A user can opt to make his/her private profile information available to other users ("friends") on Facebook by simply granting access upon request.

While Facebook is the most popular social networking site there are other similar sites, including "MySpace," "Twitter," "LinkedIn," "Bebo," "YouTube," and "Flickr." MySpace is similar to Facebook in that it allows users to create personal profiles that can be used to interact with other users by posting pictures, videos, music and blogs. Twitter allows its users to communicate via quick "tweets"—messages a maximum of 140 characters in length—receivable via cell phone or through the Twitter website.

It may be surprising to many that comments made on a user's profile or photos, video, notes and other relevant information posted on Twitter, Facebook and MySpace constitute "data" and "information" in electronic form, producible as documents under the rules of civil procedure in most jurisdictions, including Alberta. Hence, social networking sites have become a valuable resource or tool in many civil lawsuits involving personal injury actions, disability claims and employment disputes.

Consider these statistics: Mark Zuckerberg (CEO of Facebook) posted on its website that as of April 2009 there were more than 200 million active users; more than 100 million users logged on to Facebook at least once per day; the average user has 120 friends on the site; more than 20 million users update their status each day; 3.5 billion minutes are spent on Facebook each day (worldwide); and the fastest growing demographic is those comprised of 35 years old and older.

## Discussion

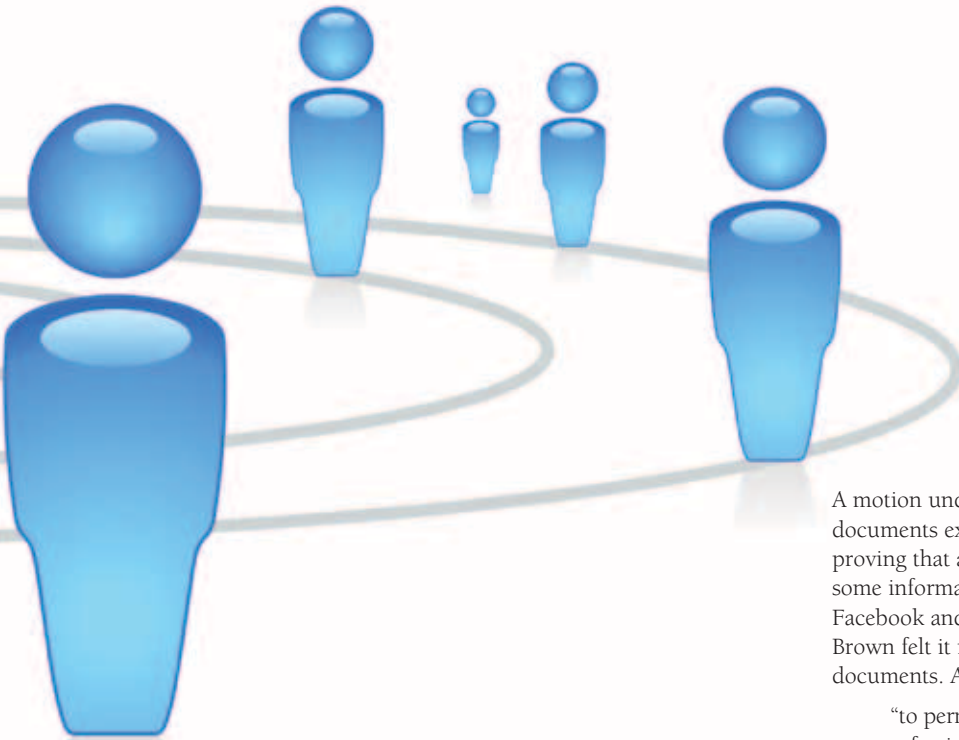
With the current state of the law there are few barriers that could prevent photographs and other relevant information posted on a public or open Facebook or Myspace profile, from being producible in the course of a civil proceeding. They are records that ought to be at the very least listed in an Affidavit of Records, as records that are relevant and material to the issues raised in the pleadings. Production of such records is of course subject to privilege, disclosure and production obligations outlined in the Rules of Court, and cannot be used to simply test credibility.

Some courts have weighed in on this issue and ruled that information posted on a private Facebook profile can be produced.

In *Murphy v Perger*<sup>2</sup> ("*Murphy*"), the Plaintiff Jill Murphy ("*Murphy*") brought a personal injury action for injuries she sustained in a motor vehicle accident, including claims for damages for loss of enjoyment of life. During the course of the action, Murphy had produced numerous photographs of herself traveling and playing sports prior to the accident.

Prior to trial the Defendant determined that Murphy had a private Facebook profile. Murphy's privacy settings allowed the Defendant to ascertain that Murphy had 366 friends. Further searching led the Defendant to discover a publicly accessible website created by Murphy's sister, the "Jill Murphy Fan Club". The site contained photographs of Murphy engaged in various social pursuits. This discovery led the Defendant to bring a motion for production of Murphy's Facebook page.

Murphy argued that the Defendant was "fishing" for information, given that Murphy's Facebook page was private. Justice Rady rejected this notion and provided two arguments why relevant information would likely be found on Murphy's Facebook profile. First, she found it was likely that relevant photographs existed, given that Facebook is a social networking site where millions of pictures are posted. Second, she felt that it was reasonable to infer that if the Jill Murphy fan-page contained relevant photos, Murphy's own Facebook page would as well.



## A Tool for the Defence

Justice Rady also held that because Murphy had produced pre-accident photographs of her engagement in social activities, then photographs of similar activities, post-accident, would be relevant as well. Justice Rady was not persuaded that such photographs should be withheld on privacy grounds. The fact that Murphy had allowed 366 friends to access her profile meant that she did not enjoy a reasonable expectation of privacy. Consequently, Justice Rady ordered production of the relevant information posted on the Facebook page, finding that this material was documentation within the meaning of Rule 30.01(1)(a) of the Ontario *Rules of Civil Procedure*.

In the leading Canadian case, out of Ontario, *Leduc v. Roman* (“*Leduc*”)<sup>3</sup>, Justice D.M. Brown explains that:

Facebook’s Terms of Use and Principles make it clear that a person’s postings fall under that party’s control or power since the account user may post or remove content. If a party to an action posts on Facebook content that “relates to any matter in issue in an action”, that party must identify such content in his affidavit of documents.

In *Leduc*, it was further confirmed that information contained on a private profile is fair game. In this case, shortly after the Examination for Discovery, the defence learned that the Plaintiff Leduc (“Leduc”) had a Facebook page. Concerned that Leduc had not complied with its disclosure obligations; the Defendant sought an order under Rule 30.06 to secure production of Leduc’s Facebook profile.

### Rule 30.06 (in Ontario) provides:

Where the court is satisfied by any evidence that a relevant document in a party’s possession, control or power may have been omitted from the party’s affidavit of documents...the court may:

- order cross-examination on the affidavit of documents
- order service of a further and better affidavit of documents
- order the disclosure or production for inspection of the document, or part of the document, if it is not privileged...

A motion under Rule 30.06 requires evidence that potentially relevant documents exist and are in the plaintiff’s possession or control. Simply proving that a party has a Facebook account will not be sufficient as some information may be relevant and some not. Given the nature of Facebook and the fact that Leduc had control over his profile, Justice Brown felt it reasonable to infer that Leduc’s profile contained relevant documents. As Justice Brown explained,

“to permit a party claiming very substantial damages for loss of enjoyment of life to hide behind self-set privacy controls on a website, the primary purpose of which is to enable people to share information about how they lead their social lives, risks depriving the opposite party of access to material that may be relevant to ensuring a fair trial.”<sup>4</sup>

In cases where questions are not asked at Examination for Discovery regarding Facebook, as was the case in both *Murphy* and *Leduc*, “trial fairness dictates that the party who discovers the Facebook profile should enjoy some opportunity to ascertain and test whether the Facebook profile contains content relevant to any manner in issue in an action<sup>5</sup>.” For Justice Brown, this could entail requiring a plaintiff to print out and preserve content on his/her Facebook page, swear a supplementary Affidavit of Documents, and then submit to cross-examination of that Affidavit.

Consequently, Justice Brown granted leave for the Defendant to cross-examine Leduc on his supplementary Affidavit of Documents as to the content posted on his Facebook profile. Ultimately, this case stands for the proposition that there should be no distinction between a party who has a private or limited access profile and a party who has an open profile.

### Using Facebook as a Tool

The increasing use of MySpace, Twitter and Facebook mean that there is an ever-increasing amount of potentially useful information available to parties in litigation. Accordingly, social networking sites should now be considered an essential tool for the defence in personal injury actions. The following general thoughts flow from recent Canadian case law:

#### Researching on Facebook

Consider searching a plaintiff’s Facebook Friend list. This has two values:

- Identification of potential witnesses for use at trial
- Photographs or other information regarding the plaintiff might be posted on a Friend’s Facebook Profile

However, caution must be used. Clearly, it is inappropriate and unethical for counsel or an investigator to ask to be a plaintiff’s friend, attempt to contact the plaintiff or attempt to gain access directly or indirectly to the plaintiff’s private Facebook pages.

If the plaintiff were to initiate contact with the defendant, such as providing access to their Facebook pages, information acquired could be used in certain limited circumstances.

# Current issues

by Sarah Weingarten

## Strategies at Discovery

Make enquiries of the plaintiff regarding whether he/she has a Facebook profile or belongs to other similar social networking sites and if so, determine what type of information the plaintiff posts on his/her profile.

Ask the plaintiff for an undertaking to preserve the content from his/her account, including photographs and dialogue for a reasonable period prior to and after the accident. This can assist in attaining an order for production of relevant information and pictures posted subsequent to the accident.

## Standard advice to clients regarding the use of social networking sites

As part of the standard instructions to clients, counsel for plaintiffs and defendants will want to advise of the finding in *Leduc* that documents posted on their Facebook profiles may be relevant to allegations made in pleadings and therefore producible.

## Disclosure

In *Knight v. Barrett*<sup>2</sup> the Plaintiff's counsel realized during an Examination for Discovery that the defendant had gained access to the Plaintiff's profile. The Defendant refused to answer questions put to him from Plaintiff's counsel regarding how the Defendant had gained access to the Plaintiff's profile and for what purpose the defence intended to put the material into evidence. Justice McLellan found that Defendant had an obligation to disclose the source of the Facebook profile materials, the authenticity of these materials, and how the Defendant accessed the materials in question. In other words, the Defendant should not attempt to ambush a Plaintiff with his /her own Facebook information.

## Service of Documents

The only Alberta case dealing with Facebook is *Knott v. Sutherland*<sup>3</sup> in which Master Breitkreuz allowed the plaintiff to serve a defendant's Facebook profile with notice of an action as one method of Substitutional Service. Precedent for service in civil matters via Facebook exists from Australia and New Zealand, but has not been previously allowed in Canada.

## Concluding Thoughts

From investigating claims early on, through the litigation process, and right up to trial, social networking sites, such as Facebook and MySpace are essential tools or potential sources of valuable information in cases involving personal injury matters, disability claims and employment disputes. This area of law will continue to evolve along with the social networking sites themselves.

## Footnotes

<sup>2</sup> [2007] O.J. 5511 (S.C.)

<sup>3</sup> [2009] O.J. No.681 (S.C.) at para.27

<sup>4</sup> *Supra* note 3, at para.35

<sup>5</sup> *Supra* Note 3, para. 34

<sup>6</sup> [2008] N.B.J. No. 102

<sup>7</sup> (5 February 2009), Edmonton 0803 02267 (Alta. Q.B.M.)



# affecting directors' and officers' liability insurance

Ensuring that directors and officers are adequately protected from liability through proper directors' and officers' liability insurance ("D&O insurance") is an important issue and priority for corporations, actors in the non-profit sector, or individuals who serve on boards. This article identifies some relatively recent issues relating to D&O coverage that may be of interest to our readers.

## 1. D&O insurance and changes in the income trust sector

Changes in the tax structure for income trusts have been an important issue for the Calgary business community in recent years. Key changes in this area include amendments to the *Income Tax Act*<sup>1</sup> initially proposed as draft legislation on July 14, 2008, and enacted into law on March 12, 2009. The new rules have been extensively publicized, but their interrelationship with D&O insurance may be less well known and worth noting. Some key points are as follows:

- D&O insurance policy wording may have tax implications which should be considered as part of a corporation's tax strategy, as corporations seek to put themselves in the best possible tax position under the changed rules relating to income trusts.
- If a change of control is effected under the new rules, incorporation of a waiver of control provision in current D&O insurance may be advisable, or directors and officers may wish to consider run-off insurance.
- An income trust conversion, merger or acquisition may affect D&O risk exposures and consequently, insurance coverage. For example, if a decision is made to enter into a merger or acquisition instead of converting an income trust to a corporation, that merger or acquisition may raise increased risks, which in turn may require higher limits on insurance policies (D&O and otherwise).<sup>2</sup>

## 2. D&O insurance and corporation insolvency

Though the economy appears to be improving, corporate insolvency remains an important feature of the current corporate and legal landscape in Calgary. Again, the phenomenon is well known and well publicized, but its relationship with issues relating to D&O insurance may not be.

One key issue in this area is whether the proceeds of D&O insurance policies (including advancement of defence costs during a bankruptcy) will be considered part of the bankrupt's estate available to creditors under the administration of the bankruptcy trustee, instead of the property of the directors and officers.

Directors and officers may believe that the proceeds of D&O policies purchased to protect them are their property. However, at least some commentators have identified a risk that the proceeds of a D&O policy would be considered part of the bankrupt estate (not the property of directors and officers), so that the directors and officers who are the beneficiaries of the D&O policy could lose priority over its proceeds to creditors.<sup>3</sup>

There are, however, some steps that can be taken to mitigate this risk.<sup>4</sup> For example:

- Directors and officers may wish to consider whether they want to purchase "dedicated policies" (policies typically purchased by the directors and officers separately from the company's D&O policies in order to ensure a separate, dedicated pool of insurance). If a dedicated insurance policy is purchased by a director or officer, it is likely that the proceeds of that policy would be protected from creditors. However, if a dedicated policy is purchased by the company, there is an increased risk that the proceeds of that policy would be considered bankrupt property and that the directors and officers named in that policy would lose priority over its proceeds to creditors.
- Directors and officers may wish to consider including a "priority of payments" clause (stating that policy proceeds will be paid out on the directors' account before the company's account) in the D&O insurance policy. These clauses have been upheld in favour of directors and officers and against creditors in US bankruptcy proceedings.

## 3. Expansion of liability risks

Directors and officers should be aware of developments in common law and legislation that may expand their potential liability risk under a D&O policy. For example:

- The federal *Competition Act*<sup>5</sup> was substantially amended in 2009 and directors and officers are now bound by the modified legislation.
- Recent case law suggests that persons appointed as directors or officers who take on other roles may be subject to liability in those other capacities in a bankruptcy situation, even in the face of an order releasing them from liability in their capacity as a director or officer.<sup>6</sup>
- Recent amendments to the federal *Bankruptcy and Insolvency Act*<sup>7</sup> define a "director" in a manner that probably includes individuals acting in the capacity of a director (a "person occupying the position of director", although not formally appointed as such).<sup>8</sup>

Overall, the effect of these changes to the law is to expand the liability risks of directors and officers by:

- broadening the scope of duties of care owed by directors and officers;
- expanding the set of individuals that may be held liable as directors or officers and the set circumstances in which those individuals may be held liable; and
- limiting the effect of indemnities and protections against liability for directors and officers.<sup>9</sup>

Directors and officers should ensure that D&O policies (either newly purchased or existing) protect against all liability risks touching on their roles, responsibilities and liabilities potentially arising from the ever-changing statutory and common law.

### Footnotes

<sup>1</sup> R.S.C. 1985, c. 1.

<sup>2</sup> See the publication of Marsh Canada Ltd entitled: *Income Trusts: Issues Impacting Directors, Officers, and Trustees Liability Insurance* (2008).

<sup>3</sup> See Steven Donley and Nigel Kent, *Directors and Officers: Liability in Canada: A Review of Exposures and Coverages Available Under D&O Policies* (Vancouver: Clark Wilson LLP, 2008) or at [www.cwilson.com](http://www.cwilson.com) at pp. 30-31; Edward A. Sellers and Andrea Amaral-Leblanc, *Director and Officer Liability: A Survey of Selected Developments from Canadian Insolvency Cases*, 21:1 *Commercial Insolvency Reporter*, October 2008 at pp. 9-10.

<sup>4</sup> See Donley and Kent, *supra* note 2, pp. 24, 31.

<sup>5</sup> R.S. 1985, c. C-34.

<sup>6</sup> See Sellers and Amaral-Leblanc, *supra* note 2, pp. 2-3.

<sup>7</sup> R.S.C. 1985, c. B-3.

<sup>8</sup> See Sellers and Amaral-Leblanc, *supra* note 2, pp. 1-2.

<sup>9</sup> See Sellers and Amaral-Leblanc, *supra* note 2, p. 10.



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