

Covering Uncovered Claims: the Language of the Policy Still Rules

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The following provides a summary of the Court of Appeal for Ontario's October 8, 2008 decision in *Hanis v. Teevan*¹ in which it considered how, if at all, the costs of defending an action should be apportioned between an insurer and an insured when some, but not all, of the claims are covered by the policy.

The plaintiff commenced an action against the University of Western Ontario (the "University") and a number of its senior employees, advancing various claims, including malicious prosecution and wrongful dismissal. The University sought coverage from Guardian Insurance Company of Canada ("Guardian") pursuant to two comprehensive general liability policies. Guardian, however, denied its duty to defend under either policy, prompting a third party claim by the University.

By agreement, the third party action was held in abeyance pending the outcome of the main action and, in the meantime, the University retained its own defence counsel.

The main action was dismissed at trial, but the Court of Appeal overturned the decision in part, awarding the plaintiff damages for wrongful dismissal. The University subsequently moved for summary judgment on the third party claim.

The Honourable Justice Power granted summary judgment, finding that there was a duty to defend at least some of the claims under the second Guardian policy and that Guardian ought to have defended the University with respect to all claims, covered or not, subject to a reservation of rights, if any, of apportionment.

Justice Power ordered a trial of three issues, including whether Guardian was entitled to any allocation of the legal defence costs incurred by the University and, if so, what that allocation ought to be. Following the trial, Power J. held that although Guardian was not required to pay defence costs solely related to uncovered claims, it was obligated to pay all defence costs related to claims covered by the policy *even if those same costs furthered the defence of uncovered claims*. Justice Power further held that where there is no practical means of readily distinguishing between costs attributable to covered and uncovered claims, the insurer should pay all of those costs. On the basis of these findings, Power J. ordered Guardian to pay 95% of the University's defence costs and, in turn, the University was held responsible for 5% of its defence costs, which costs were related exclusively to the defence of uncovered claims.

Guardian appealed the decision, arguing that it should not be responsible for the majority of the defence costs since the majority of the plaintiff's claims were neither covered by a policy nor connected to covered claims. Guardian further argued that any costs associated with both covered and uncovered claims ("mixed claims") should be allocated between the University and Guardian on a "fair and equitable"

¹ 2008 ONCA 679

basis. The University, on the other hand, argued that the issue of allocation is one of contractual interpretation. On this basis, it argued, defence costs relating to covered claims are not taken out of the coverage simply because they also assist in the defence of uncovered claims. It further argued that since its defence costs could not be attributed to one claim as opposed to another given the manner in which the multiple claims were advanced and prosecuted, Guardian was obligated to compensate for all defence costs unless it could demonstrate that some part of those costs was attributed exclusively to an uncovered claim.

Following a consideration of case law, most notably from the New Zealand Privy Council and the British Columbia Court of Appeal, the court agreed with the University's contractual analysis approach. Citing the British Columbia Court of Appeal's decision in *Coronation Insurance Co. v. Clearly Canadian Beverage Corp.*², the court found that the question of apportionment of costs should be determined by the operative language of the policy and not by applying general principles or judicial notions of fairness:

... [T]his approach construes the language of the policy in a manner consistent with the usual rules of construction rather than according to some inferred "expectations" not apparent on a fair reading of the document; and it provides insureds with the full benefit of their policy. It requires an insurer to state explicitly the basis, if any, on which coverage may be limited ... (emphasis added).

Applying the contractual interpretation approach in this case, the court considered the language of the second Guardian policy, which read:

[T]he insurer shall:

- (1) defend in the name and on behalf of the Insured *and at the costs of the Insurer any civil action which may at any time be brought against the Insured* on account of such bodily injury or property damage but the Insurer shall have the right to make such investigation, negotiation and settlement of any claim as may be deemed expedient by the Insurer. (Court's emphasis).

On the basis of this language, the court found that Guardian had an unqualified obligation to pay for the defence of covered claims and, therefore, that it was required to pay all reasonable costs associated with the defence of those claims even if they furthered the defence of uncovered claims.

The court reasoned that if an insurer has contracted to cover all defence costs relating to a claim, as here, those costs do not increase just because they also assist the insured in the defence of an uncovered claim. Indeed, reasoned the court, the insurer's exposure for liability for defence costs is not increased and, in turn, the insured receives nothing more than what it bargained for – payment of all defence costs related to a covered claim. The court added that Guardian could have written qualifying words into its policy providing for an allocation of "mixed costs" or requiring that the costs relate principally to a covered claim, but it chose not to do so, and "the court cannot do so for Guardian".

² (1999), 168 D.L.R. (4th) 366 at paras. 41-42

Having determined that coverage was triggered by the malicious prosecution claim and that the policy did not limit coverage for mixed claims, the court went on to consider whether any allocation ought to be made on the basis that certain defence costs related exclusively to uncovered claims. In doing so, the court deferred to the trial judge's observations that the plaintiff's testimony confirmed that a great deal of his damage claim was common to all his allegations and that it was "impossible" for the University to pin down the damages to any particular cause of action. In the circumstances, the Court of Appeal agreed, the University's defence strategy was reasonable.

With all of these findings in mind, ultimately the court acknowledged that a small part of the defence costs related exclusively to uncovered claims, thus upholding the trial judge's allocation of 5% of the defence costs to the University. In turn, the court affirmed that 95% of the costs related to the defence of a covered claim and, as such, were properly allocated to Guardian.

Having come to this conclusion, the court noted that clearly there are repercussions for an insurer if it denies coverage and the insured is left to defend the case on its own, namely that the insurer may have a very difficult time later refuting the insured's position as to the allocation of defence costs. Indeed, the Court of Appeal made clear by this decision that an insurer cannot escape its obligation to pay reasonable defence costs by demonstrating that the litigation could have been conducted differently or that with the benefit of hindsight certain costs were unnecessary. That being said, the court clarified that this case does *not* stand for the proposition that as a consequence of denying coverage, insurers will be obligated to pay defence costs that are clearly not covered by the policy. The Court of Appeal observed that, in fact, a contractual interpretation approach rejects the position taken in some cases that where the insurer fails to defend a covered claim it must, by way of some form of penalty, assume the defence costs of all claims, both covered and uncovered.