

# Hanis v. Teevan



## The Ontario Court of Appeal Addresses the Apportionment of Defence Costs

BY MICHAEL TEITELBAUM

The Ontario Court of Appeal has clarified an insurer's obligation to pay defence costs by dealing with the issue of whether the costs of defending covered and uncovered claims should be apportioned between the insurer and insured, in *Hanis v. Teevan*, 2008 ONCA 678,<sup>1</sup> a long-anticipated decision released on Oct. 8, 2008. The Court found this question is governed by the language of the policy. Where there is an unqualified obligation to defend, the insurer is required to pay all reasonable costs associated with the defence of those claims even if those costs further the defence of the uncovered claims. There is no obligation to pay for the costs solely related to the defence of uncovered claims.

### Facts

Dr. Edward Hanis was hired by the University of Western Ontario as director of the university's Social Science Computing Laboratory (SSCL). After being fired, he was charged with a criminal offence arising out of his alleged misuse of the computing system at the SSCL. Western had initiated the police investigation. Hanis sued Western and later added individual university employees to the suit. His statement of claim advanced numerous allegations against Western and the individual defendants, including an allegation of malicious prosecution arising out of the criminal charge, in respect of which Hanis was acquitted.

Western had comprehensive general liability insurance policies with the appellant, Guardian Insurance Company of Canada in place, both when Hanis was fired in October 1986 (Guardian Policy I) and in March of 1987 when he was charged with the criminal offence (Guardian Policy II). Under the policies, Guardian undertook to defend actions brought against Western if the claims were covered by the policy. Guardian denied coverage under either policy. Western initiated a third party claim against Guardian seeking a



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declaration that the insurer had to defend. The action was held in abeyance pending the outcome of the main action. Western defended the main action using counsel it appointed.

Hanis was found entitled to damages for wrongful dismissal in the main action. Western then proceeded with its third party claim, and Justice Power found Guardian had a duty to defend some of the claims under Guardian Policy II.<sup>2</sup> Power held that Guardian should

have defended Western with respect to all of the claims, covered or not, subject to a reservation of rights for any apportionment of the defence costs. A trial was then held on Guardian's entitlement to allocation.

Following the trial, Power held that Guardian was obliged to pay all defence costs related to the defence of claims covered by the policy even if those same costs furthered the defence of uncovered claims. However, Guardian was not required to pay defence costs solely related to the defence of uncovered claims. The trial judge determined that five per cent of the defence costs related exclusively to uncovered claims. Guardian was held liable for 95 per cent of the costs, quantified at slightly more than two million dollars. Guardian argued on appeal it should only be liable for 20 per cent of the defence costs.

### Parties' positions

Justice Doherty, on behalf of a three member panel that included Justice Sharpe and Justice Gillese, noted Guardian's position on appeal was, because only the malicious prosecution claim was covered under its policy, it should not be responsible for any costs not connected to the covered claim. It also argued costs associated with both covered and uncovered claims (mixed claims) should be allocated between Western and Guardian on a "fair and equitable" basis. In response, Western submitted 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 by Hanis. Western contended that all defence costs had to be paid unless Guardian could demonstrate that some part of those costs could be attributed exclusively to an uncovered claim.

Doherty noted that Guardian framed the allocation issue as turning on a set of principles originating, for the most part, in American case law. His Honour continued:

*"The objective of these principles is to divide the costs associated with the defence of 'mixed claims' in a manner that is fair and equitable. A fair and equitable division of costs is determined by considering a variety of factors, such as the proportion and significance of the covered and uncovered claims, the benefit derived by the insurer and insured in advancing the defence, the extent to which the work of the defence appears to be reasonably related to covered or uncovered claims, and the extent to which the defence effort would reasonably have been necessary if the only claims advanced were the covered claims."*

On the other hand, Western characterized the allocation issue as one of contractual interpretation, contending any right to allocation must be found in the policy language. The key provision describes Guardian's duty to defend and its obligation to pay defence costs associated with that duty, and contains an unqualified promise by Guardian to pay defence costs for claims covered by the policy. Western submitted that defence costs relating to covered claims are not taken out of the coverage simply because they also assist in the defence of uncovered claims.

#### **Court of Appeal's analysis**

Doherty considered various cases, including a New Zealand decision appealed to the Privy Council,<sup>3</sup> and found in favour of the contractual analysis, stating:

*"The relationship between an insured and an insurer is contractual and must be governed primarily by the terms of the relevant policy of insurance. The insurer's obligations are found first and foremost in the policy. Those obligations may include the obligation to pay all or some of the costs associated with the defence of covered claims. It makes eminent sense that any inquiry as to the nature and scope of the insurer's duty to pay those costs should start with the language of the policy. I agree with the observations of Newbury J.A. in Coronation Insurance [Co. v. Clearly Canadian Beverage Corp. (1999), 168 D.L.R. (4th) 366] at para. 42 where, in the course of approving the contractual analysis approach, she stated:*



**The relationship between an insured and an insurer is contractual and must be governed primarily by the terms of the relevant policy of insurance.**

*In my view this 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, and it avoids lengthy hearings designed to explore "metaphysical" underpinnings of why a corporation or its directors and officers might have acted as they did. [Citation omitted.]*

Doherty noted there is no unfairness in this approach as the insurer's liability exposure for defence costs is not increased just because it also assists the insured in the defence of an uncovered claim.

His Honour also considered the two Ontario Court of Appeal decisions that previously addressed the allocation of defence costs where only some of the claims are covered by the policy,<sup>4</sup> and stated:

*"I recognize that these cases accept that it may be appropriate to allocate defence costs between the insurer and insured where only some of the claims are covered by the policy. I do not understand counsel for Western to suggest otherwise. However, in the context of defending covered and uncovered claims in the same suit, a distinction must be drawn between cases where defence costs are related exclusively to the defence of either covered or uncovered claims, and cases where the same costs are incurred in the defence of both covered and uncovered claims. In the former circumstance, an allocation of costs would be required, barring*

*a policy which provided for payment of defence costs relating to uncovered claims. In the latter case, allocation would not be necessary unless the policy provided for allocation where the costs related to both covered and uncovered claims. Neither St. Paul Fire & Marine Insurance Co. nor Daher refer to the allocation of costs where those costs have been found to have been directed to both covered and uncovered claims. That is the allocation issue raised on this appeal and that is the issue specifically addressed in New Zealand Forrest Products Ltd." [emphasis added]*

The Court also addressed decisions at first instance, (e.g., *Sommerfeld v. Lombard Insurance Group* (2005), 74 O.R. (3d) 571 (S.C.J.)), where allocation was ordered, apparently on the basis that the covered and uncovered claims were based on different factual allegations, and observed:

*"These cases can reasonably be read as broadly as counsel for Guardian would read them. If read that way I do not agree with them. The cases do not look to the language*

of the policy as the primary consideration when assessing an allocation claim. Instead, these cases assume that allocation is necessary where there are both covered and uncovered claims and impose what the court regards as a "fair" allocation. For example, in *Sommerfield*, after determining that the primary cause of action asserted against the insured was not covered by the policy, the court noted at para. 42 that "[t]o require the insurer to pay for the entire defence in these unique circumstances would be unfair."

Turning to the policy, the Court found the defence clause made Guardian responsible for all costs associated with the defence of the malicious prosecution claim, and there is nothing in the policy language that qualifies that obligation or suggests it does not apply to mixed claims (para. 32 of the Court's reasons).

In the result, the Court held that what part of the defence costs related to the defence of the malicious prosecution claim was a factual one to which the standard of appellate deference applies, and upheld Power's decision.

### The Court had three additional observations:

1. The contractual interpretation approach requires the rejection of the position taken in some cases that if the insurer wrongfully refuses to defend a covered claim, the defence costs for both covered and uncovered claims must be paid. However, there are consequences for failing to defend because the insurer may later find it difficult to refute the insured's position on allocation by arguing the case should have been defended differently, or that certain costs incurred were unnecessary.

2. It is potentially misleading to indicate as Power did that the insurer must pay the defence costs where there is no practical means of distinguishing between costs referable to the covered and uncovered claims. Doherty noted what this is in reference to is costs incurred for both covered and uncovered claims, and stated: "It is preferable to express the finding in that way, as it makes more obvious the insurer's obligation to pay those defence costs, assuming the policy requires payment of all costs related to the defence of a covered claim."

3. Doherty questioned whether there was any reason to depart from the general rule that the onus of proof as to what portion of the defence costs related exclusively to uncovered claims rests with the party making the claim, noting the trial judge appeared to place the burden on Guardian to demonstrate what portion of the defence costs related exclusively to uncovered claims. However, on the findings of fact, the Court was satisfied Western clearly established only a small fraction of the defence costs related exclusively to uncovered claims.

### Comment

Based on its reasons, it is our view the Court of Appeal has reinforced or established the following principles in respect of the duty to defend and allocation as between covered and uncovered claims:

If there is one covered allegation, the entire action must be defended, as long as the defence clause requires this.

It is not a matter of whether the mixed claims are so intermingled or intertwined that creates the defence obligation; rather, it is the obligation to defend the covered claims that also encompasses the uncovered claims, unless it can be shown the defence costs relate exclusively to uncovered claims.

At the outset of the action, when a defence is sought, allocation is only possible if it can be shown defence costs will be incurred exclusively for uncovered claims. As this seems unlikely if the facts overlap, the Court appears to be saying allocation must be addressed at the end of the underlying action, so it can be based on evidence as to how the defence was conducted, and what portion of the defence related solely to uncovered claims.

If insurers wish to attempt allocation at the end of the day, then they must reserve their right to do so, and to seek reimbursement for the defence costs paid. Given the Court's comment on the onus of proof, it will be the insurers which will be in the position of proving entitlement to allocation and reimbursement, and not the insured as was the case in *Hanis*. Insurers will also wish to instruct defence counsel to keep track of what their work relates to for the purposes of future proof.

While *Hanis* brings some clarity to the defence obligation, depending on how it is interpreted, it also creates new obligations and considerations for insurers when dealing with covered and uncovered claims. As always, this will make for interesting times. 🍁

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<sup>1</sup> At first instance, the decision was reported under the name *Hanis v. University of Western Ontario*, 32 C.C.L.I. (4th) 255 (S.C.J. 2005).

<sup>2</sup> *Hanis v. University of Western Ontario*, 67 O.R. (3d) 539 (S.C.J. 2003).

<sup>3</sup> *New Zealand Forest Products Ltd. v. New Zealand Insurance Co. Ltd.*, [1996] 2 N.Z.L.R. 20 (C.A.), rev'd 3 N.Z.L.R. 1 (P.C.).

<sup>4</sup> *St. Paul Fire & Marine Insurance Co. v. Durabla Canada Ltd.* (1996), 29 O.R. (3d) 737 and *Daher v. Economical Mutual Insurance Co.* (1996), 31 O.R. 93d 472.



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