



Solving the Defence Cost Allocation Dispute Through ADR

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The “DCA Dispute”

- Insured is sued
- Underlying action contains both covered and non-covered claims
- In most cases, insurer has the right and duty to defend
- How are costs for defence allocated between covered and non-covered claims?



The “Conflict” Issue

- Where there are covered and non-covered claims alleged, it is in the insurer’s interest that liability be found to rest in the non-covered claims
- Having the insured appoint counsel and bill the insurer, would result in the insurer signing a “blank cheque”



The “Conflict” Issue cont’d

SCC in *Nichols*:

“The practice is for the insurer to defend only those claims which potentially fall under the policy, while calling upon the insured to obtain independent counsel with respect to those which clearly fall outside its terms.”



The Practical Difficulties

- Two or more counsel defending the same action is often not economically efficient
- Often cumbersome
- Who conducts examinations?
- Coordination of strategy?
- Mass tort litigation where the loss occurs over time and involves several insurers



The Practical Question

- How to allocate the cost of one defence counsel among two or more interested parties for covered and non-covered claims?



Why ADR?

- Often such an issue is well suited to a prompt mediation
- Different jurisdictions deal with the question of defence cost allocation differently - uncertainty
- SCC has yet to comment on the issue of defence cost allocation between insurer and insured



Why ADR? cont'd

- The underlying statement of claim may be poorly drafted making precise allocation difficult or even impossible
- Allows for an early resolution of the coverage issue before conclusion of the underlying action
- Can save the insurer / insured relationship



The Underlying Action

- The starting point is the duty to defend
- The Statement of Claim may contain:
 - Multiple causes of action, each with its own theory of liability
 - One cause of action with various theories of liability
 - A “story” containing the factual underpinnings of all of the causes of action
 - A combination of the above



The Underlying Action cont'd

- How a court might determine the issue of what is covered and what is not covered is often not clear especially in complex cases



Timing

- Often easier to determine allocation of defence costs if the underlying action is resolved
- Allows for build-up of animosity, increased costs and inefficiency, continued uncertainty, and entrenchment of positions



Timing cont'd

- Courts in some jurisdictions may defer allocation until underlying action is resolved - insurer continues to defend all allegations
- Difficulty in determining allocation ought not to be a bar to mediating a solution
- Ontario case: (2005) *Sommerfield v. Lombard Insurance Group* - allowed an allocation to take place before conclusion of underlying action



General Principles of DCA That May Drive Parties to Mediate



Kansa v. Modern Livestock **(1993 Alta C.A.)**

- Insurer cannot act arbitrarily
- Insurer cannot “wrongfully” deny a defence where some allegations are within coverage
- If Insurer does so, Insurer will pay all defence costs - even for non-covered claims
- The onus is on Insurer to bring forward clear evidence of a sensible allocation formula



PCS Investments Ltd. v. Dominion of Canada General Ins. Co. (1996 Alta. C.A.)

- Underlying action made several claims, at least one of which was clearly not covered
- Alta C.A. - not necessary to resolve all points of coverage arising by virtue of a poor pleading as the vast majority of claims fell within coverage



PCS Investments Ltd. v. Dominion of Canada General Ins. Co. (1996 Alta. C.A.)

- Overwhelming majority of allegations fell within coverage so Insurer bore the cost of the defence
- Insurer's conduct carefully scrutinized
- Insured's defence counsel given carriage of the defence and was directed to divide his bill with Insurer paying the covered tasks and the Insured paying the non-covered tasks



Daher v. Economical Mutual Ins. Co. **(1996 Ont. C.A.)**

- Single cause of action with different theories of liability
- Facts giving rise to multiple theories of liability so intertwined that there was no principled basis on which to allocate costs
- Insurer offered no formula
- Insurer must pay all defence costs
- *Hanis v. University of Western Ontario* (2005)



Continental Insurance Co. v. Dia Met Minerals Ltd. (1997 BCCA)

- Allocation sought before conclusion of the underlying action
- Court recognized reasonableness of Insurer and refused to make it pay all defence costs until underlying action resolved
- Allocated defence costs on an interim basis, subject to reallocation at conclusion of the underlying action
- Not embraced by most other jurisdictions



Kelly Panteluk Construction Ltd. v. Axa Pacific Ins. Co. (2005 Sask. Q.B.)

- Underlying action alleged causes of action falling within policy coverage and within an exemption to coverage
- Court held: Generally, defence costs should be apportioned between the Insurer (claims within coverage) and the Insured (claims outside coverage)



Kelly Panteluk Construction Ltd. v. Axa Pacific Ins. Co. (2005 Sask. Q.B.) cont'd

- Three exceptions:
 - No apportionment where a claim alleges one cause of action with different theories of liability.
 - Where an action raises claims within and outside coverage that overlap to the degree that apportionment is impractical or impossible.
 - Where the Insurer has failed to discharge its obligation to defend or share in the cost of defending a claim covered by its policy.



The Message

- This area is “under construction”
- Different courts deal with the issue differently
- Insurer’s conduct is closely scrutinized
- Insurer can’t act arbitrarily
- Insurer must bring forward clear evidence of a sensible allocation formula - do the pleadings allow for it?



The Message cont'd

- To await the resolution of the underlying action:
 - is costly
 - continues the uncertainty for all
 - leaves the insured and the insurer with two unresolved actions: underlying action and coverage action
 - breeds disharmony between insurer and insured
- Mediate and do it sooner rather than later
- You may be securing the insured's future premiums



QUESTIONS?