

ASSAYING ALLOCATION: HANIS v. U.W.O.

by Michael Teitelbaum

In a decision released in December 2005, Power J. of the Ontario Superior Court makes one of the first attempts in Ontario at addressing the issue of apportionment of defence costs subsequent to the disposition of the underlying claim.

The court found in *Hanis v. University of Western Ontario*, 2005 CanLII 47727, that even though it was difficult to assess apportionment in this “rather peculiar” case, it was the court’s duty to “reach a reasonable result” and arrive at some allocation formula when “there is evidence that justifies a finding that the insurer has demonstrated that it should not be held liable for the payment of some of the work concerning uncovered claims”.

In the circumstances, Power J. held that the insurer had to pay 95% of the over \$2 Million in defence costs, with the insured responsible for the remaining 5%.

BACKGROUND

This decision is further to

Justice Power’s earlier decision, (reported at [2003] O.J. No.), finding that the insurer, Guardian, was obliged to fully defend, subject to the trial of the apportionment issue in respect of covered and uncovered claims.

During the trial of this issue, testimony of defence counsel in the underlying action was adduced.

Briefly, the insurer’s position was that the only claim that attracted coverage and for which defence costs should be paid was the claim for malicious prosecution. Otherwise, the insured defendants should absorb the costs of defending the uncovered claims. The insurer did not accept the insured’s submission that it is “nearly impossible to apportion or allocate”, and argued that it was up to the court to “decide on the evidence what is a reasonable, informed method to share the costs”, i.e., the court should make a fair apportionment.

In the insured’s submission, Guardian was not entitled to

(Continued on page 2)

IN THIS ISSUE

ASSAYING
ALLOCATION: HANIS
v. U.W.O.

Michael Teitelbaum

FIRM NEWS

Noteworthy

(Continued from page 1)

any allocation whatsoever with respect to defence costs even though many of the claims asserted were not claims for which the insurance policy in question stipulates a duty to defend. The insurer, in accordance with the existing case law, is subject to an obligation to propose a “principled and rationale” method to allocate defence costs between covered and uncovered claims. Moreover, the insurer was obliged to identify any specific legal expense incurred by the insureds that is “solidly and undeniably” referable exclusively to uncovered claims. It also submitted that it was neither possible, nor practical, to allocate in the peculiar circumstances of this case.

The court accepted the testimony of trial counsel in the underlying action that throughout the pre-trial proceedings and the trial itself, they had to deal with the plaintiff’s reliance on what he called the “corpus of defamatory material” which created a “blight on his career” and that the core of his case concerned allegations of conflict of interest. The existence, or non-existence, of this conflict of interest triggered the plaintiff’s success or lack of success on his claims in defamation, wrongful dismissal, malicious

prosecution, detainee, ownership of software, humiliation and other claims. The court accepted that the approach of defence counsel was to destroy Dr. Hanis’ story which was the underpinning of all his claims.

The court did not find persuasive the insurer’s argument that the claim for malicious prosecution can be isolated from the other claims in the circumstances.

The plaintiff’s story was that as an upstanding member of the University community and as a person who had never done anything wrong, he was subjected to treatment by the University and its officials that was designed to ruin him. The plaintiff contended that he was denied the right to properly defend himself from their attacks; false information was provided to the police giving rise to the malicious prosecution claim against him; they defamed him; they stole his life’s work; they destroyed his reputation; and denied him access to his body of work.

The plaintiff alleged that a great deal of his damage claim was common to all his allegations, i.e., to all his causes of action. Accordingly, it was “impossible for the defence to pin down the damages to any particular

cause of action even though the trial judge ordered Mr. Hanis to do so and even though an attempt was made to do so”. The court found that “given this state of affairs, it was reasonable for the defendants to treat the damages as being attributable to all causes of action”.

THE COURT’S ANALYSIS

Justice Power summarized what he understands to be, or should be, the existing law with respect to apportionment, or allocation, in cases where some of the claims are covered by a duty to defend and some are not, at paragraph 193 of his Reasons. Given their significance, they are, in their entirety, as follows:

“(a) The insurer, as the wrongdoer, is not relieved from its obligation to compensate the insured for its losses simply because it is impossible to measure its damages with mathematical accuracy. On the other hand, the insured, as the innocent party, must furnish such assistance to the court by proof of relevant facts as it may, under the circumstances, reasonably be expected to afford. The test is: what is reasonable having regard to all the relevant circumstances? The focus must be on the temporal aspects - i.e., what was reasonable in the insured’s state of mind when

(Continued on page 3)

(Continued from page 2)

the expenses were incurred?

(b) The burden is on the insurer, as the defaulting party (i.e., the party responsible for a breach of a special contract, one which places the insured in a vulnerable position) to clearly demonstrate what work and disbursements performed and incurred by the solicitors, or the insured itself, clearly do not relate to covered claims. This burden is a heavy one, but not an impossible one. It is a burden that requires the insurer to propose a consistent and rational basis for a just allocation of the defence costs;

(c) Where costs are incurred for both covered or uncovered claims (mixed claims), or where there is no practical means of readily distinguishing the costs of defence between the covered and not covered claims, or where it is impossible to do so, it is not appropriate to attempt to allocate defence costs and, therefore, the insurer should absorb them. This consequence does not flow from a situation where allocation is simply a difficult task but from situations in which there is a finding that it is not practical or is impossible to do so. Where it is simply a difficult process, the usual burden remains on an injured party to prove its damages, but the burden must be balanced or tempered by the difficulty that is attributable to the insured's [insurer's?] denial

of its duty to defend;

(d) Notwithstanding that it may be impractical or impossible to apportion the costs of defence, the court may refuse to order the insurer to pay all costs in relation to the ambiguous claims where the insured admits that there should be some apportionment or allocation;

(e) The insurer, of course, is responsible only for the payment of defence costs that are reasonable. The usual rules regarding the duty to mitigate apply;

(f) The insurer has no liability to reimburse the insured for any defence costs which can be identified by reliable evidence as relating solely to uncovered claims;

(g) Where there is any ambiguity regarding whether a claim is within coverage, the ambiguity must be resolved in favour of the insured;

(h) The insured, where there has been a denial of the duty to defend, should ensure, as far as is reasonably possible, that it and its counsel maintain appropriate records of the time and expenses incurred by them in the defence of the claims against the insured. This obligation should not be one of perfection;

(i) Where the duty to

defend an insured is denied and no preliminary ruling is sought from a court with respect to allocation, and where no agreement is reached between the insurer and the insured regarding allocation, the insurer, at an early date, would be well advised to apply to a court for directions on the allocation issue; and

(j) The court should not, after-the-fact, attempt to fashion some sort of equitable formula based on some undefined perception of fairness;”.

THE COURT'S DECISION

As noted above, Justice Power apportioned the payment of defence costs on a 95/5% basis, with the insurer being “liable for the overwhelming bulk of the legal expenses that were incurred”. The court noted that this finding is “despite that the claims of Dr. Hanis related to both covered and uncovered claims and despite that there might have been damages incurred that cannot be traced directly and exclusively to covered claims”.

The 5% allocated to the insured related “exclusively to non-covered claims”. With respect to mixed (covered and uncovered) claims, Power J. found there was no

(Continued on page 4)

(Continued from page 3)

evidence warranting apportionment, and that there was no basis for apportionment in respect of these claims. However, there was a rational basis for some apportionment of defence costs because there was evidence that some of the work done related solely to non-covered claims.

The court accepted that the insurer has an obligation to “propose a consistent and rational basis for a just allocation of the defence costs”.¹ Although the proposal made by Guardian in the course of counsel’s submissions was vague, it did propose a methodology.

The court also held that the test to be applied in determining whether there should be allocation is not “undeniable” evidence of the allocability of specific expenses to uncovered claims, as was held in, for example, California

decisions such as *Hogan v. Midland National Insurance Co.*, 476 P.2d (S.C. 1973), but “clear” evidence demonstrating that the work and expenses do not relate to covered claims.²

Interestingly, given the court’s 95/5 finding, the formula suggested by counsel for the insurer was that the *insured* should pay “somewhere between 66 2/3% and 80%” as being related to the defence of uncovered claims. Presumably, this formulation was affected by the mixed claims which the court found had to be fully defended.

Ultimately, the court found that because “the evidence warrants a finding that not all of the work for which legal fees were billed relates only to covered or mixed claims”, the insurer was, therefore, “entitled to some consideration because of this”. The court continued:

“A formula or methodology that

forecloses such consideration is simply too harsh and does not do justice between the parties in a case where there is no bad faith on the insurer’s part. Therefore, I conclude that, even though the task is a difficult one, I must attempt to apportion some of the damages or expenses to the University’s side of the ledger. While the result I have reached is unscientific, I have tried to do justice between the parties . . . Five percent is my attempt at a reasonable assessment of the portion of all the time and expense expended in defence of Dr. Hanis’ claims that relates exclusively to non-covered claims. I have not been persuaded that, with respect to the mixed claims, there is a ‘body of factual evidence, documents and admissions of witnesses in cross-examinations’ that warrant apportionment. I find that the ‘body of evidence’ dictates, insofar as the mixed claims are concerned, a ratio of 100% to 0% in favour of the University or, put another way, that there

(Continued on page 5)

¹As indicated in *Daher v. Economical Insurance Co.*, (1996), 31 O.R. (3d) 472 (C.A.), and other decisions.

²The court did not address the distinction in California decisions between situations where the insurer wrongfully refused to defend, and the “undeniable evidence” test was used, and accepted the defence under a reservation of rights, and a test similar to the one adopted in *Hanis* was used; i.e., a preponderance of evidence that a reasonable allocation can be made.

Moreover, in terms of when allocation is appropriate, recent California case law indicates that reimbursement of defence costs, (i.e., after the insurer has initially paid for a full defence), may arise if a claim is “not even potentially covered” but an insurer is entitled to recover only those defence expenses that can be fairly and reasonably allocated solely to non-covered claims for which there was never any potential for coverage, and the insurer had reserved its rights to seek reimbursement and/or allocation. See *Buss v. Superior Court*, 939 P.2d 766 (Cal. S.C. 1997).

(Continued from page 4)

is no basis for apportionment. However, Guardian has met the onus on it to propose a consistent and rational basis for some allocation of defence costs. It has elicited evidence, partly through cross-examination, and made submissions that some of the preparatory work of counsel for the University, i.e., the pleadings, the examinations for discovery, and the legal research, relate solely to non-covered claims”.

It also appears that in deciding there should be some modicum of allocation, the court was influenced by the insured’s concession that “there might be some work that was performed that related only to uncovered causes of action” (para. 194).

The court also addressed two other issues. With respect to the insured’s claim for pre-judgment interest, the court found that an average interest rate should be used and that due to some delay in pursuing the claim for recovery of defence costs, interest should not be payable for two years. The court further found that it was reasonable for the insured to have also sued its umbrella insurer, Gerling Global, in light of Guardian’s denial. Accordingly, the court ordered that Guardian directly pay to Gerling Global the costs that were awarded to it as against the insureds.

COMMENT

This decision demonstrates that whether insurers can achieve apportionment of defence costs will turn on the unique facts of each case. If it can be shown that there were claims that were clearly not covered and that costs were incurred to defend those claims, this decision indicates that insurers are entitled to apportionment of the costs of those non-covered claims. The difficulty will be in establishing this, which was exacerbated by the nature of the claims made in this particular case.

Moreover, in terms of “mixed claims”, (that is, claims where the facts generate allegations or causes of action that may or may not be covered), the onus upon the insurer appears to be still more stringent, and it seems that it will be extremely difficult to secure the type of evidence that would produce any apportionment. The court’s suggestion that if agreement on allocation cannot be reached between the parties, an early motion for directions on the allocation issue is advisable, appears to represent a judicial suggestion that even if allocation may be premature, a request for an order that more detailed records on the work done be kept by defence counsel, (who is not defending at the insurer’s behest), might be

considered favourably.

Although the court cautions against taking an approach that results in too harsh a result, it appears that *caveat* is directed more at clearly uncovered claims, as opposed to mixed claims. We venture this view in light of the court’s statement at paragraph (j) of its summary of what it perceives to be the law of apportionment. While it might be “too harsh” to fail to apportion some costs to an insured in respect of clearly non-covered claims, the question is whether this reasoning also applies to the problems posed by a mixed claim situation. The admonition that a court should not “after-the-fact, attempt to fashion some sort of equitable formula based on some undefined perception of fairness” seems to most logically fit when dealing with what is the conundrum created by mixed allegations, particularly given the court’s decision here to allocate in respect of solely uncovered claims.

We understand that this decision is under appeal, and both insurers and insureds will be most anxious to see whether the Court of Appeal seizes upon this decision as the vehicle by which it will directly address the thorny issue of apportionment which, to date, it has only touched upon from time-to-time.