

## *Hanis v. Teevan*: The Ontario Court of Appeal Addresses the Apportionment of Defence Costs

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By Michael Teitelbaum

In *Hanis v. Teevan*, 2008 ONCA 678<sup>1</sup>, a long-anticipated decision released on October 8th, 2008, 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. The Court found that 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 ("Hanis") was hired by the University of Western Ontario ("Western") 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 ("Guardian") 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 declaration that the insurer had to defend, which action was

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1. 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).

## Noteworthy

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held in abeyance pending the outcome in 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 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 Power J. found Guardian had a duty to defend some of the claims under Guardian Policy II<sup>2</sup>. Justice 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 J. 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 5% of the defence costs related exclusively to uncovered claims. Guardian was held liable for 95% of the costs, quantified at slightly more than two million dollars. Guardian argued on appeal that it should only be liable for 20% of the defence costs.

### *The Parties' Positions*

Doherty J.A., on behalf of a three member panel that included Sharpe and Gillese J.J.A., noted that Guardian's position on appeal was that 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 that 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 that 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, based on the policy wording, 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.

### *The Court of Appeal's Analysis*

Justice 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 pri-

marily 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:

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

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

3. *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.).

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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 J.A. noted that there is no unfairness in this approach as the insurer’s liability exposure for defence costs is not increased just because they also assist 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]

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 J.’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 J. 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 J.A. noted that 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.”

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4. *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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3.) Justice 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 that 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 that only a small fraction of the defence costs related exclusively to uncovered claims.

#### Comment

Based on its reasons, it is our view that 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:

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

2.) 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.

3.) 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 that 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 de-

fence related solely to uncovered claims.

4.) 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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