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ONTARIO COURT OF APPEAL CONFIRMS A STRICT CONTRACT-BASED DUTY TO DEFEND ANALYSIS OF "MIXED CLAIMS" UNDER CGL POLICIES

Marcus B. Snowden

In *Hanis v. Teevan* , released on October 8, 2008, the Ontario Court of Appeal has confirmed its preference for a primarily contract-focused analysis of an insurer's duty to defend. This case considered a so-called "mixed claim" of covered and uncovered allegations against the policyholder. The contract-centred approach, following a previous trend by this Court, the B.C. Court of Appeal and the English Privy Council, marks a clear preference for focusing on contract language. This case, along with *Bridgewood* and other decisions of the Court in this decade, confirm a move away from a more principle-based analysis in insurance coverage cases, at least as between policyholder and insurer. In doing so, the Court has specifically rejected a competing "fairness" analysis, suggesting this is more appropriate in the equitable context of inter-insurer disputes over allocation issues.

The Court has provided some guidance on the distinction between intertwined and distinct classes of covered and uncovered claims, an insurer's right to be wrong, the policyholder's ultimate burden of proof in coverage cases and the focus required for trigger analysis under Personal Injury or Coverage B "offence" based claims.

The Court's ruling should inform an insurer's decision making process in the face of a mixed claim alleging intertwined covered and uncovered events pleaded against the policyholder. It should also influence risk management professionals' recommendations on this issue.

The Facts

In the main action, Dr. Edward Hanis, a professor hired as director of the Social Science Computing Laboratory by the University of Western Ontario in 1972, was fired in October 1986. In March of 1987, as a result of a police investigation initiated by the university, Dr. Hanis was charged with a criminal offence arising out of his alleged misuse of the computer system. He sued the university and certain of its senior employees in June of 1987. He alleged a number of claims against them including one for malicious prosecution.

Professor Hanis was ultimately acquitted of all criminal charges in October of 1988. His suit against the university, although dismissed at trial, was later partly successful on appeal in June of 1998. He was awarded certain damages for wrongful dismissal. Twenty years to the month after his criminal charges were dismissed, his former employer has received an appellate ruling on coverage for about $2 million in defence cost funding.

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The university had CGL policies with Guardian both at the time professor Hanis was fired and at the time he was charged. When Guardian declined the university's invitation to take up the defence, the university commenced a third party action seeking a declaration that Guardian owed it a defence. By later agreement, the coverage proceedings were stayed while the university defended professor Hanis' claims.

The Trial Judge's Decision

In 2002 the university moved for summary judgment in the third party action. Justice Power ruled in October of 2004 that Guardian had no duty under the first policy but did have a duty under the second policy and should have done so subject to a reservation of rights on the allocation issue. He ordered a trial of the following questions:

(i) Is Guardian entitled to allocation of defence costs incurred and, if so, what is the proper allocation?

(ii) What is the proper quantum of defence costs?

(iii) What, if any, prejudgment interest applies to any amounts owed by Guardian?

The Court of Appeal concisely summarized Justice Power's decision released in December of 2005 following the trial in the following passage:

> [9] Following the trial of these issues, 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: see *Hanis v. University of Western Ontario* (2005), 32 C.C.L.I. (4th) 255, at para. 198.

Guardian appealed, contending it should be liable for only 20% of the defence costs.

The Issue on Appeal

Justice Doherty, writing for the unanimous panel, put the question and answer succinctly in the first paragraph of his judgement as follows:

> [1] How, if at all, should the costs of defending a lawsuit be apportioned between the insurer and insured when some, but not all, of the claims made in the lawsuit are covered by the applicable insurance policy?
>
> [2] I would hold that the question of apportionment of costs should be determined by the operative language in the policy. Where there is an unqualified obligation to pay for the defence of claims covered by the policy, as in this case, the insurer is required to pay all reasonable costs associated with the defence of those claims even if those costs further the defence of uncovered claims. The insurer is not obliged to pay costs related solely to the defence of uncovered claims.

In the course of his reasons, Justice Doherty concluded that an insurer's duty to defend its policyholder in such circumstances ought not to include a "fairness" analysis.

This latter approach had informed previous trial level Ontario and Saskatchewan decisions as well as at least one lower appellate level decision in New Zealand in the context of pleadings alleging events partly covered and not covered.

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The "Mixed Claim" Considered

In paragraph 25, Justice Doherty was careful to distinguish between different types of pleadings involving covered and uncovered claims as follows:

> …[I]n 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. [emphasis added]

The so-called "mixed claim" with both covered and uncovered claims intertwined and pleaded together in the context of the same factual matrix must still be treated strictly under the contract wording. Any duty to defend analysis which departs from the contract-based relationship, Justice Doherty concluded, is inappropriate. In mixed claims, this may result in the insurer paying for work which coincidentally assists both the covered part of the claim and the policyholder's defence of uncovered claims.

In rejecting the "fairness" analysis, Justice Doherty placed the insurer's defence obligation squarely in the context of the contract:

> [29] …I do not think that the nature and extent of the insurer's obligation to pay defence costs is a question of fairness or unfairness. Rather, it is a question of what the insurer has agreed to do in the policy. The answer to that question lies in the language of the policy, not in judicial notions of fairness.

Readers who might detect a shift to the approach taken by most U.S. courts (when even one count is covered, the whole of the claim must be defended at the expense of the insurer), should be careful to note the restriction Justice Doherty put on his reasoning.

He concluded on a plain reading of the policy's defence clause that defence costs reasonably associated with covered claims were the insurer's obligation. However, he broadly hinted to underwriters that a contractual solution is readily at hand:

> [32] …If the costs were reasonably associated with the defence of the malicious prosecution claim, nothing in the policy exempts Guardian from paying those costs simply because they also assisted Western in the defence of uncovered claims. 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, if that had been intended. It chose not to do so. The court cannot do so for Guardian [citations omitted]…

The Right to be Wrong

In upholding the trial judge's findings, Justice Doherty's contract-based analysis led him to make three observations about the principles to be drawn from the case law put forward by the parties in the appeal in light of Justice Powers' decision following the trial:

1. An insurer's failure to defend a claim does not result in a penalty by imposing the defence costs of all claims, both covered and uncovered;

2. Requiring an insurer to assume defence costs incurred for both covered and uncovered claims is consistent with the obligation stated in the policy; and

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3. The general rule that the party claiming damages bears the ultimate or legal burden of proof including quantum is preferred, that onus resting with the policyholder in cases involving proof of amounts within the coverage.

These observations are all arguably *obiter dicta* and so may be considered persuasive but not binding. It is respectfully submitted they still provide valuable guidance to risk management professionals employed by insurers, policyholders, brokers, independent adjusting firms and law firms with opining counsel, who are routinely called upon to assist in difficult factual matrices.

The first observation perhaps most strongly militates against any suggestion that the Ontario approach to defence cost funding is moving to the predominant model south of the border. Freedom of contract does include freedom to be mistaken about one's obligations. As Justice Doherty observed, this merely means an insurer "may have a very difficult time in a subsequent proceeding refuting" the policyholder's position on an allocation of defence costs, particularly if they are found to be reasonable in the circumstances.

The second observation reiterates the earlier mentioned distinction between claims with a clear "either or" delineation of allegations on the one hand, and those which are largely "mixed claims" intertwined within the same factual matrix on the other. The former are readily amenable to allocation and, as Justice Doherty observed in an earlier passage quoted above, they must be allocated "barring a policy which provided for payment of defence costs relating to uncovered claims".

The third observation is perhaps a breath of fresh air for insurers. It was of no use to Guardian in this case since, as Justice Doherty found, the university had met its onus in any event. However, it does suggest that the ultimate burden rests in each case on the policyholder to prove the coverage and the amounts owed under that coverage. The previous trend towards reversing this onus where the insurer incorrectly denies coverage should be considered discredited absent higher authority to the contrary. It is respectfully submitted this removes the "fault-based" tension from the analysis and, puts the contract-based analysis on a more dispassionate business and commercial foundation.

Answering the Coverage "B" Question: When?

Finally, Justice Doherty addressed the temporal issue of triggering events for the purposes of a defence obligation under Personal Injury or IBC Coverage B insuring agreements. The underlying facts showed that "almost all of the relevant events predated the coverage provided by" Guardian's second policy.

However, Justice Doherty observed that the second policy was on at a crucial point in time:

> [46] …As Guardian was on risk when the alleged malicious prosecution occurred, the timing of the events germane to the proof or defence of that claim is irrelevant to Guardian's duty to defend and its obligation to pay defence costs related to the malicious prosecution claim.

This finding suggests that, in claims alleging an "offence" under the Personal Injury (or Coverage B) insuring agreement language of most CGL policies (e.g., wrongful arrest, mali-

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cious prosecution, invasion of privacy, etc.), the relevant triggering event will be when the "offence" is found to have taken place. Any precipitating event or background factual history leading up to the offence event is "irrelevant".

Subject always to the policy language, it is respectfully submitted Justice Doherty's observation serves to give insurers and risk management professionals better guidance on the question of "when" a Personal Injury or IBC Form 2100 Coverage B "offence" occurs. This should assist insurers in better determining whether there has been a triggering event in a given policy year. ■

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