Duty to Defend

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"Mere Possibility". End of analysis? No.

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1. What's the "right", what's the "duty"
2. Duty to Defend vs. Duty to Indemnify
3. Duty to Defend Test / Onus
4. What are the "Pleadings"
5. Ambiguity in the Pleadings or Policy
6. Derivative Claims
7. Manipulated Pleadings
8. Apportionment of Defence Costs
9. Extrinsic Evidence
10. Breach of Condition
11. Reservation of Rights
12. Termination of Duty to Defend

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1. Right, Duty

- Policy: “We have the right and duty to defend”
- The actual defending is the “duty”
- What’s the “right”?
  - Appoint counsel
  - Control the defence
- Why the “right”?
  - It’s the insurer that will be the one who pays
- Some E&O and D&O policies allow insured to select and instruct counsel

2. Duty to Defend vs. Duty to Indemnify

- Duty to Defend (“**DTD**”):
  - hire and pay for a lawyer to defend insured for allegations that may be covered
- Duty to Indemnify:
  - actually pay for settlement/judgment of things that *are* covered under policy
- You defend the allegations but *pay* (indemnity) for the facts

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2. Duty to Defend vs. Duty to Indemnify

- DTD broader than duty to indemnify
  - DTD where it's possible that insurer *may* owe indemnity for an allegation
  - Means: plenty of times you'll have to hire and pay for a lawyer to defend the insured, when:
    - Some or most or nearly all of the claim is probably not covered
    - The covered portions ultimately turn out not to be true
  - No DTD where you're sure that no indemnity will be possible
    - Ex. Insured sued for damages for breaking a contract early
    - Ex. Insured sued for fraud

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3. The Test / The Onus

- Test for trigger of duty to defend:
  - "Pleadings Rule": mere possibility that an allegation in a pleading issued against the insured is covered under the policy
- Onus to prove coverage / no coverage
  - Done almost exclusively through analysis of pleadings and policy
  - On insured to prove claim falls within Insuring Agreement
    - Ex. Plaintiff alleges bodily injury due to carbon monoxide leaking from building's malfunctioning furnace (Insuring Agreement triggered)
  - On insurer to prove exclusion applies
    - Ex. Carbon monoxide is a "pollutant" (pollution exclusion applies)
  - On insured to prove exception applies
    - Ex. Injury caused by smoke from heating system
    - (exception applies)

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3. The Test / The Onus

- It is the allegations in the "pleadings" that must be considered in DTD analysis
  - Can't look at anything other than pleadings (with certain exceptions)
- Begs the question: what constitutes the "pleadings"?

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4. What are the "Pleadings"?

- What are the "pleadings"?
  - Those filed against Insured
    - Statement of Claim: Yes
    - Amended Statement of Claim: Yes
    - Crossclaim: Yes
    - Third party claim: Yes
    - Counterclaim: Yes
  - Statement of defence filed by insured?
    - No (but some courts have looked at these in determining DTD)
  - Statement of defence filed by other parties (co-defendants)
    - Probably not - unless helpful in understanding nature of claim

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4. What are the “Pleadings”?

- *Keys v. Intact* (2015, Ont. C.A.)
  - Facts: Keys was sued for defamation for making and posting a video on the internet (bad mouthing a competing student federation)
  - His employer’s policy provided coverage for employees who were acting in course of employment
  - SoC said nothing about Keys being an employee or acting in course of employment so insurer denied coverage
  - Keys wanted to introduce other pleadings and ED evidence
  - Application Judge held: can only look at pleadings against insured
  - Court of Appeal:
    - “Our view of the authorities is that all the pleadings may be considered with the most weight placed on pleadings against potential insured”

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5. Ambiguity

- Ambiguity:
  - *Something is open to two or more reasonable interpretations*
- Ambiguity could be in the:
  - Pleadings
  - Policy

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5. Ambiguity

- Ambiguity in the pleading?
  - Pleadings given "widest latitude"
    - Ex. SoC states "insured negligently broke plaintiff's window in 2007"
      - Insurer came on risk on December 30, 2007
      - So insurer probably came on risk after accident took place but it's unclear. There is ambiguity.
      - Ambiguity = DTD

5. Ambiguity

- Ambiguity in the policy?
- Principles of Interpretation
  - *Progressive Homes v. Lombard* (2010, SCC)
    - Facts: General contractor was sued for defective workmanship which led to the "leaky condo" fiasco in BC
    - Insurer denied on basis that:
      - "property damage" means only damage to property of others and not damage to insured's own work
        - Held: not borne out by policy wording
      - "Accident" can't include defective workmanship of insured
    - Held: defective workmanship can be an accident

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5. Ambiguity

- Principles of Interpretation:
  - If policy unambiguous, then go with the wording
    - Possible exception: where interpretation renders coverage <u>illusory</u>
  - If policy ambiguous, then:
    - Consider reasonable expectations
    - Avoid unrealistic results
  - If there is still ambiguity:
    - *Contra Proferentum*
      - go with interpretation that favours insured

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5. Ambiguity

- *Weston Ornamental v. Continental* (1981 Ont. C.A.)
  - Facts: Insured was in the business of maintaining and welding construction equipment
  - During one job an employee was working on a customer's bulldozer when fire broke out and destroyed the bulldozer
  - Customer sued for damage to bulldozer
  - Exclusion for damage to any personal property as a result of insured's work performed on that property
  - Held: Damage by fire to heavy equipment was the main risk being insured. Exclusion would exclude the main liability risk facing the insured. Even if exclusion was not ambiguous, it had the effect of nullifying coverage

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5. Ambiguity

- *Cabell v. Personal Insurance* (2011, Ont. C.A.)
  - Property policy
  - Facts: Insured had homeowner's policy with Personal
  - Policy excluded damage to pools. Also excluded damage resulting from settling, cracking, etc.
  - Insured purchased endorsement to specifically provide coverage for pool
  - Pool damaged due to build-up of groundwater underneath leading to cracking
  - Insurer denied based on settling, cracking exclusion
  - Held: Exclusion did not apply. It would render endorsement useless (it would "nullify coverage")
  - The application of the exclusion would not have been within "reasonable expectation of the parties"

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6. Derivative Claims

- Negligence claims too closely related to intentional claims
- Sometimes used by plaintiff to trigger coverage of defendant/insured
- "negligence" is a buzzword used to trigger coverage

6. Derivative Claims

- *Scalera* (2000, SCC)
  - Facts: SoC stated that insured committed intentional sexual battery, negligent sexual battery, negligent misprep, breach of fiduciary duty, all arising out of sexual assault allegations
  - Held: Intentional or criminal acts exclusion applied
  - Look at the substance, not the labels
  - Substance of the claim was intentional sexual battery and other claims were derivative of that claim
  - If both negligence and intentional claim arise from same actions and same harm, negligence claim is derivative

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6. Derivative Claims

- *Lee v. Townsend* (2002, Ont. Sup. Ct.)
  - Facts: Insured sued for malicious prosecution which is an intentional tort
  - SoC also alleged that statements made to police by insured were done negligently ("*ought to*" have known that statements would lead to criminal charges)
  - Held: Even if could be done negligently, negligence allegations so closely linked with intentional allegations, that
    - (1) they're tantamount to intentional conduct for the purposes of the intentional act exclusion; or
    - (2) a derivative claim within an intentional tort claim

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7. Manipulated Pleadings

- *Cooper v. Farmers'* (2002, Ont. C.A.)
  - Facts: Plaintiff sued insured and alleged that plaintiff was an employee of insured injured during course of employment (claim would fall within an exclusion)
  - Plaintiff then discontinued action and commenced another action not mentioning employee/employer relationship
  - Insurer refused to defend on the basis of plaintiff being an employee (as per first SoC) and alleging pleadings were manipulated to trigger insurance coverage
  - Held: Insurer can't look at original Statement of Claim. Have to look at current Statement of Claim

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7. Manipulated Pleadings

- *A.R.G. v. Allstate* (2004, Ont. Sup. Ct.)
  - Plaintiff and insured got together and amended pleading against insured to trigger coverage – insured even prepared the plaintiff's amendment motion material
  - Insurer alleged that pleadings were manipulated to attract coverage
  - Held: It's ok.
    - Yes, there was manipulation but insured had not provided false facts to trigger coverage

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8. Apportionment of Defence Costs

- Apportionment?
  - Insurer has to pay all defence costs that:
    - Benefit defence of covered claims
    - Benefit simultaneously defence of covered and uncovered claims
  - Insurer does not have to pay defence costs that:
    - Incurred solely for benefit of uncovered claim
  - Allocation timing?
    - Before Settlement/Judgment: difficult
    - After Settlement/Judgment: easier
      - Make sure you reserve right for allocation at outset

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8. Apportionment of Defence Costs

- *Hanis v. UWO* (2008, Ont. C.A.)
  - Facts: Hanis was fired by UWO. Criminally charged after investigation initiated by UWO. He sued UWO for malicious prosecution (covered) and numerous excluded causes of action. Following trial apportionment was at issue
  - Held: all the causes of actions arose out of one complex interconnected set of facts (one long complicated story). UWO defended all causes of action by going after the story, not each single cause of action. This was a reasonable strategy
  - 5% of defence costs related solely to uncovered claims

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9. Extrinsic Evidence

- "Pleadings rule"
  - Just the "pleading" though?
  - What about all this other stuff (extrinsic to the pleading) I know that's not in the pleading? Can I use those in deciding if there is a DTD?
- Extrinsic evidence can be referred to in very limited circumstances

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9. Extrinsic Evidence

- 1. Interpreting terms of the contract
  - *Grand & Toy v. Aviva* (2010, Ont. C.A.)
    - Facts: plaintiff fell in a parking lot of a G&T distribution center, as opposed to a retail location
    - Issue: Did policy provide liability coverage for only retail locations or all locations, including distribution centers?
    - Mixed messages between declarations and policy wording
    - Held: ambiguity as to scope of coverage. Can consider extrinsic evidence of the parties' intentions
    - Affidavit by G&T's broker evidenced that G&T never intended to obtain liability coverage for the distribution centers

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9. Extrinsic Evidence

- 2. Documents referenced in pleadings
  - Not really considered "extrinsic"
  - Anything referenced in the pleading forms part of the pleading
    - Ex. Contract
    - Ex. Expert report

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9. Extrinsic Evidence

- <u>3. Underlying facts exception</u>
  - When determining DTD, <u>can you look at facts not mentioned in the pleading?</u>
    - <u>*Cooper v. Farmers'*</u> *("Manipulated Pleadings" section)*
      - Was the plaintiff an employee in which case her claim would be barred?
      - Deciding that issue on the coverage application would affect the underlying tort litigation, so not appropriate
  - The rule is controversial. BC friendly. Ontario not friendly. May not be part of Ontario law.
  - Courts more likely to look at underlying facts, if:
    - facts not in dispute in underlying action

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10. Breach of Condition

- What effect does breach of a condition have on DTD? Does it suspend the DTD?
  - Ex. Failure to give timely notice of claim
  - Caselaw on issue not consistent
    - Some courts: once insurer alleges breach of condition there is no longer a DTD

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10. Breach of Condition

- *Longo v. Maciorowski* (2000, Ont. C.A.)
  - Facts: insured involved in accident but failed to provide insurer with notice until SoC was issued. Insurer denied based on breach of condition to provide timely notice
  - Issue: DTD?
  - Ont. C.A. adopted flexible approach when allegations of breach of condition
  - Held: Whether DTD depends on:
    - Strength of allegation that condition was breached
    - Grounds for estoppel, relief from forfeiture
    - Does insured desperately need a defence

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10. Breach of Condition

- Does insurer proving breach prejudice insured in defence of underlying action?
  - (Related to “underlying facts exception”)
- If insurer’s attempt to prove the breach, touches on facts in underlying tort litigation, Court may not allow evidence of breach and order a DTD
  - Ex. Cooperation condition requires insured to not admit liability. Insured put forward a settlement offer in underlying litigation years ago. Insurer has evidence of this but insured denies this
  - Proving this breach may prejudice insured in underlying litigation

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11. Reservation of Rights

Ok, so you've decided to defend, but there are coverage issues. What do you do?

- Reservation of Rights Letter
  - Basically: we will defend you, but here are some coverage issues, and more may arise
  - Reserving right to deny later
  - Purpose of RoR: Prevent waiver or estoppel argument
    - i.e. prevent insured from claiming that insurer's conduct led insured to believe that there were no coverage issues or insurer was not going to rely on those issues

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11. Reservation of Rights

- <u>When to send RoR?</u>
  - (1) When claim comes in: "by investigating it doesn't mean we're waiving our rights under the policy"
  - (2) When deciding to defend but there are coverage issues
  - (3) Anywhere along the road where new issues arise
    - assuming you choose not to deny coverage at that point

11. Reservation of Rights

<u>Content of RoR</u>:

- Be clear what rights are being reserved – what are the coverage issues you know about
- State that there may be issues that you have not mentioned in the letter
- State that other issues may arise through investigation and defence of the claim

11. Reservation of Rights

- *Economical v. Fleming* (2008, Ont. Sup. Ct.)
  - ATV accident; homeowners policy; "motorized vehicle" exclusion at issue
  - Economical sent an initial thorough RoR, before SoC issued
  - SoC then issued. Economical sent letter acknowledging DTD. No coverage issues raised in that letter
  - Then another letter a few months later denying coverage based on motorized vehicle exclusion
  - Held: Insurer waived right to rely on exclusion. Letter acknowledging defence was too unequivocal
  - Lesson: be consistent

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12. Termination of Duty to Defend

- IBC 2100: "right and duty to defend ends when we have <u>used up the applicable limit of insurance in the *payment of judgments or settlements*</u>"
- Supplementary Payments: defence costs do not reduce limit
- Defence costs unlimited under CGL - do not erode limits

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12. Termination of Duty to Defend

- DTD ends when pay limit to satisfy judgment or settlement
- But, cannot simply pay limit into court
  - Not "Judgment or settlement"

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12. Termination of Duty to Defend

Examples

- (1) Already paid policy limit earlier in the year for another claim and now new claim → No DTD
- (2) Currently defending several actions at once; judgment in one exhausts policy limit
  - Technically, can stop defending other action if it does not prejudice Insured:
    - Presumably if insured agrees to take over the defence
    - Or perhaps there's an excess insurer whose DTD gets triggered upon exhaustion of primary insurer's limit

Conclusions

- Duty to defend if at least some of the claims are covered
- Can look at any pleading filed against insured
- Probably can't look at anything other than the pleadings
- Allocation of defence costs usually done after settlement/judgment
- Breach of condition can suspend DTD, in right circumstances
- Remember to send an RoR
- DTD terminates when limits are exhausted

THE END

QUESTIONS?

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