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Insurance Defence Group

The Duty to Defend and the Apportionment of Defence Costs
Tedford v. TD Insurance Meloche Monnex – Case Comment

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This recent decision of the Ontario Court of Appeal considers the duty of an insurer to defend its insured and the circumstances in which that insurer can seek to apportion the costs of the defence where some, but not all, claims made in a lawsuit are covered by that policy of insurance.

Background

Mr. Tedford ("Tedford") was sued by the purchaser of his home (the "plaintiff") who alleged that Tedford made negligent misrepresentations in the Seller Property Information Statement completed at the time of the sale. The plaintiff claimed against Tedford for the costs of repairing the home and alleged that due to these unforeseen repair costs, she suffered anxiety, stress, sleep disturbances, fatigue, headaches and depression. While the plaintiff's claim for repair costs represented the substantial majority of the damages claimed, the claim for damages arising from her health consequences was considerably more modest.

Tedford was insured under a homeowner's policy issued with TD Insurance Meloche Monnex ("TD"). The policy provided coverage for liability imposed by law upon the insured "…because of Bodily Injury or Property Damage". While Tedford asked TD to defend the action on his behalf, TD denied that it had a duty to defend.

The Initial Application by the Insured

Tedford sought a Declaration that TD had a duty to defend the plaintiff's claim. While there was no dispute that the TD policy would not cover the claim for repair costs, the parties disagreed as to whether the health consequences alleged to be the result of Tedford's misrepresentations could amount to "bodily injury" within the meaning of the policy.

Before the application judge, TD argued that the true nature of the plaintiff's claim was for economic loss and that the claim for health consequences arising from that commercial transaction was derivative in nature. Relying on *Non-Marine Underwriters, Lloyd's of London v. Scalera*, [2000] 1 S.C.R. 551 (S.C.C.) ["*Scalera*"], TD argued that as the only covered portion of the claim was derivative, no duty to defend arose.

In a brief endorsement, the application judge concluded that the plaintiff's claim for bodily injury arising from the misrepresentations of Tedford was covered and, therefore, a duty to defend arose. Citing Power J. in the case of *Hanis v. The University of Western Ontario et al* [2005] O.J. No. 5289 at para. 13, for the proposition that the duty to defend is wider than the duty to indemnify an insured, the application judge held:

> If there is a duty on an Insurer to defend some, or only one, of the claims made against an Insured, a duty to defend the entire claim arises in most situations. This is so even where such causes of action are only potentially within the policy coverage…

Accordingly, the application judge found that the duty to defend owed by TD to Tedford extended to the entire court action and ordered TD to fully reimburse Tedford for all legal expenses incurred to defend himself up to that time.

The Court of Appeal Decision

TD appealed the decision of the application judge to the Ontario Court of Appeal. On appeal, TD renewed its argument that no duty to defend arose as the true nature of the plaintiff's claim was for economic loss not covered by the policy. TD also argued that if it had a duty to defend, it should not be responsible for 100% of the defence costs due to the fact that substantially all of the amounts being claimed against Tedford were for the uncovered repair costs.

While the Court of Appeal upheld the decision at first instance that TD had a duty to defend Tedford, TD was partially-successful as the Court of Appeal ordered that the costs of Tedford's defence be apportioned between insurer and insured.

The Duty to Defend

Hoy J.A., writing for the Court of Appeal, began by reviewing the principles applicable to determining an insurer's duty to defend:

> 1. The insurer has a duty to defend if the pleadings filed against the insured allege facts which, if true, would require the insurer to indemnify the insured.
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> 2. If there is any possibility that the claim falls within the liability coverage, the insurer must defend.
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> 3. The court must look beyond the labels used by the plaintiff to ascertain the "substance" and "true nature" of the claims. It must determine whether the factual allegations, if true, could possibly support the plaintiff's legal claims.
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> 4. The court should determine if any claims pleaded are entirely "derivative" in nature, within the meaning of that term as set out in *Scalera*. A derivative claim will not trigger a duty to defend.
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> 5. If the pleadings are not sufficiently precise to determine whether the claims would be covered by the policy, "the insurer's obligation to defend will be triggered where, on a reasonable reading of the pleadings, a claim within coverage can be inferred.
> 6. In determining whether the policy would cover the claim, the usual principles governing the construction of insurance contracts apply, namely: the *contra proferentem* rule and the principle that coverage clauses should be construed broadly and exclusion clauses narrowly...As well, the desirability, where the policy is ambiguous, of giving effect to the reasonable expectations of the parties.
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> 7. Extrinsic evidence that has been explicitly referred to in the pleadings may be considered to determine the substance and true nature of the allegations.

The Court of Appeal was not persuaded by TD's argument that the health consequences suffered by the plaintiff were "derivative" because they flowed from the economic loss allegedly sustained and not from the misrepresentations themselves. Hoy J.A. referred to the Supreme Court of Canada decision in *Scalera*, *supra* where Iacobucci J. explained the meaning of "derivative claim" in a related context:

> … a court construing an insurer's duty to defend must decide whether the harm allegedly inflicted by the negligent conduct is derivative of that caused by the intentional conduct. In this context, a claim for negligence will not be derivative if the underlying elements of the negligence and of the intentional tort are sufficiently disparate to render the two claims unrelated. If both the negligence and intentional tort claims arise from the same actions and cause the same harm, the negligence claim is derivative, and it will be subsumed into the intentional tort for the purposes of the exclusion clause analysis. If, on the other hand, neither claim is derivative, the claim of negligence will survive and the duty to defend will apply … *A claim should only be treated as "derivative", for the purposes of this analysis, if it is an ostensibly separate claim which nonetheless is clearly inseparable from a claim of intentional tort.* [Emphasis added.]

In this case, Hoy J.A. pointed out that there was only one cause of action advanced, namely negligent misrepresentation and that the plaintiff had not alleged that Tedford committed an intentional tort. Hoy J.A. further reasoned that because the general damages claimed by the plaintiff for health consequences represented only a different category of damages resulting from the negligent misrepresentation, this claim was not derivative in nature.

Based on the Court's analysis, it was held that the application judge did not err in his assessment of the true nature of the bodily injury portion of the plaintiff's action and the duty of TD to defend Tedford was, accordingly, affirmed.

Apportionment of Defence Costs

As an alternative ground of appeal, TD argued that it should not be required to support the entire cost of defending the action because the plaintiff's claim for health consequences was only $25,000 of a total claim of $185,000—the rest of the damages were claimed in respect to repair costs.

Citing the previous Court of Appeal decision in *Hanis v. Teevan*, 2008 ONCA 678, Hoy J.A. noted that where there is an unqualified obligation to pay for the defence of claims covered by a policy, 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 Court of Appeal emphasized the word "reasonable" and concluded that in this case it would be unfair if TD was responsible for paying defence costs that were disproportionate to the extent of its potential liability for the covered claim.

As a solution, the Court of Appeal urged the parties to agree on an allocation of costs whereby TD would defend both the covered and uncovered portions of the claim. Under the arrangement suggested by the Court, Tedford would then bear the costs of the defence to the extent they exceeded the reasonable costs associated with the defence of the covered claims. If no agreement could be reached, TD was said to be entitled to apply for a determination of the allocation after the matter concluded.

Analysis and Conclusions

The decision of the Court of Appeal in this case provides an articulation of rational legal principles. Unfortunately, the decision will lead to inevitable difficulties in practical application.

While affirming the wide scope of an insurer's duty to defend, the Court acknowledges that an insurer may not be responsible for paying 100% of the costs associated with the defence of its insured. At the very least, the *Tedford* decision suggests that counsel for an insurer will be responsible for defending a case on its merits even where apportionment is contemplated.

Beyond this, however, it can be questioned how the actual apportionment of costs will be carried out and at what stage of an action this will occur? Who will make the initial decision whether the costs of defending an insured are unreasonable and what specific criteria will be utilized? Will it be necessary for the insured to retain his or her own legal counsel in the same way that an insured may retain coverage counsel? How will the payment of funds from the insured to its insurer be enforced? How will the possible apportionment of defence costs affect the issue of settlement? Can all of these issues be dealt with by amending the terms of an insuring agreement?

Due to the fact-specific nature of this inquiry, only a limited number of answers have been provided by the Court of Appeal in this instance. This suggests that more duty to defend litigation will result both during subsequent actions and after they have been concluded in order to resolve the remaining questions raised by the apportionment of defence costs where a third party claim against an insured is not covered in its entirety.

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