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BRIEFING NOTE

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Special Costs Imposed for Breach of Duty to Defend by Insurer

In *Williams v. Canales* 2016 BCSC 1811, a recent B.C. Supreme Court costs application, the Court awarded special costs against an insurer despite the fact that the insurer's conduct was not in issue.

Background

Amazing Personal Training Studio Ltd., owned by Jeff Weltman, leases space from Arbutus Village Holdings Ltd., which it makes available to personal trainers. Intact Insurance Company insured Amazing Personal Training Studio Ltd. under a liability policy through which Jeff Weltman and Arbutus Village Holdings Ltd. were additional insureds. These three parties were sued by a plaintiff, Klaudia Williams, who allegedly suffered injuries while taking lessons at the facility with a personal trainer. The insured reported the claim to Intact, which relied on an exclusion clause and denied coverage. The insureds brought third party proceedings against Intact and sought judgment by way of a summary trial. In an unreported decision dated June 17, 2016, judgment was granted in favour of the insureds, and Intact was ordered to defend its insureds in the action. The insureds then brought an application seeking special costs against Intact.

Special Costs – General Overview

When a party succeeds at an application or at trial the court may award costs to indemnify the party for costs incurred during the litigation. These costs, called party and party costs, are generally awarded pursuant to a tariff established in the B.C. Supreme Court Rules. As a rough rule of thumb, these costs represent about 20-35% of the actual expense incurred by the party.

In certain circumstances a court will award "special costs", by which one party is ordered to pay the entire legal fees of the other party. Special costs are awarded on a higher scale as a penalty or deterrent, for conduct deserving of rebuke. There are exceptions to this general rule, such as estate litigation where special costs may be payable out of the estate, or for "matters of public interest that are truly exceptional" with "widespread societal impact" (*Carter v. Canada (Attorney General)* 2015 SCC 5 – the SCC case on physician assisted dying). The court in *Williams v. Canales* has now carved out another exception: where insureds succeed in proceedings brought against insurers for a defence under the insurance policy.

Williams v. Canales – Costs Hearing

In their application for special costs, the insureds submitted that while the question had not been expressly considered in B.C., in other jurisdictions it was settled law that if an insured had to bring a proceeding to enforce a duty to defend, the court would award a complete indemnity for the expense of that proceeding. Intact agreed that the question had not been addressed conclusively in B.C. but disagreed it

was settled law in other jurisdictions. Intact argued special costs awards should be confined to misconduct or other behaviour deserving of sanction.

The Court accepted the insureds' position. It was settled law in other jurisdictions. It referred to three Ontario Court of Appeal decisions from 2000, 2001 and 2003, each of which awarded special costs, as representing the current state of the law. The Court noted that the Courts of Appeal in Newfoundland and New Brunswick had also adopted the Ontario approach, as had the trial level in Manitoba. The Court further noted that one of the three Ontario decisions, *E.M. v. Reed*, 2003 CanLII 52150 (Ont. C.A.) mentioned that English and American law favoured full indemnity costs for successful insureds in coverage cases.

Intact cited B.C. decisions which demonstrated a different approach. The Court distinguished those cases and declared that since the issue had not been dealt with in a binding manner in BC, it was therefore a matter of "first impression".

The Court then referred to the following excerpt from *Reed*:

> "Entitlement to solicitor-and-client costs in the third party proceeding flows directly from the unique nature of the insurance contract which entails a duty to defend at no expense to the insured. The obligation to save harmless the insured from the costs of defending the action is sufficiently broad to encompass the third-party proceedings. It is the contractual basis for the claim to solicitor-and-client costs that justifies the award and therefore constitutes an exception to the usual rule that solicitor-and-client costs will not be awarded except in unusual circumstances."

In rejecting Intact's argument that special costs are limited to cases involving reprehensible conduct deserving of rebuke, the Court referred *to Carter v. Canada (Attorney General)*, and estate and trust litigation. The Court was persuaded by the reasoning in *Reed* and the weight of appellate authority in other provinces, and awarded special costs against Intact.

Commentary

The line of cases imposing this duty, to pay special costs for a successful application by an insured for a defence under a liability policy, begins with *Godonoaga v. Khatambakhsh*, 2000 CanLII 16891 (Ont. C.A.). The Court of Appeal in *Godonoaga* stated "The appellants were entitled to a defence by their insurer without expense to them." The decision did not provide a basis for this conclusion and it did not cite the relevant insurance policy terms establishing the duty to defend. *Reed*, which relied on *Godonoaga* and which stated the solicitor-and-client costs (called special costs in B.C.) are based in contract, also did not cite the duty to defend provisions of the relevant insurance policy.

A liability insurer has a contractual obligation to indemnify and a separate contractual obligation to defend. If the insurer refuses to indemnify and is proven wrong by a court, it is required to indemnify in full and pay to the insured on a party and party basis the costs of enforcing the obligation. However, if the insurer refuses to defend and is proven wrong by a court, it is required as per *Williams v. Canales* to pay the defence costs in full and pay to the insured on a special costs basis the costs of enforcing the obligation to defend.

Why is enforcing the duty to defend different from enforcing any other contractual obligation of an insurer? An answer can be found in *AXA Insurance (Canada) v. Ani-Wall Concrete Forming Inc.*, 2007 CanLII 56478 (Ont. S.C.), which says:

> "Ani-Wall argues that while *E.M. v. Reed* dealt with both the duty to defend and the duty to indemnify, there is no logical basis for distinguishing between the two situations, as the nature of the coverage is the same. However, there arguably is a distinguishing feature in the role of awarding substantial indemnity costs with respect to a breach of the duty to defend and with respect to a breach of the duty to indemnify. The distinguishing feature is that the award of substantial indemnity costs is somewhat compensatory for the failure to defend and that may explain what the Court of Appeal meant in the *E.M. v. Reed* case when it said that the entitlement to solicitor-and-client flows directly from the unique nature of the insurance contract which entails a duty to defend at no expense to the insured. In contrast, an award of costs against an insurer who must indemnify is ancillary to the indemnification."
>
> (underlining added)

The above answer does not provide an explanation, however; it simply reiterates the principle stated in the *Godonoaga* decision that a failure to provide a defence deserves greater compensation than a failure to provide indemnity. What is it about a contractual obligation to pay defence costs that attracts costs sanctions like no other contractual breach, including other insurance policy breaches?

If the distinction is based on contract, as the excerpt from *Reed* states, where in a standard CGL does one find a duty to defend at no expense to the insured? In a standard CGL wording the insurer has "the right and duty to defend" an action, and the insurer also agrees to certain supplementary payments, including all expenses it incurs, reasonable expenses of the insured incurred at the insurer's expense, and costs and interest in the underlying action. At no time does the insurer agree to fully indemnify an insured for an action to enforce a duty to defend.

The answers to these questions are not found in *Williams v. Canales*.

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