Recent Developments in Liability Insurance Case Law: The Consequence of Policy Language

By Michael S. Teitelbaum and Ryan O'Leary, Hughes Amys LLP, a member of The ARC Group Canada Inc.

The language used in insurance policies is often critical to judicial determination of whether or not a loss is covered. Over the last year or so, the Ontario courts[1] have decided cases that illustrate the importance of the wording of policies, including decisions about:

1) who is entitled to give notice under a liability policy, (*Sovereign General v. Walker*);

2) whether the insured or insurer has control of an action in which a subrogated claim is being advanced, (*Zurich Insurance v. Ison*); and

3) whether a property vendor is entitled to coverage under their homeowner's policy, (*Hector v. Piazza).*

What was decided, and how might those decisions be addressed?

This paper and the accompanying presentation will consider this question, while also touching upon the Ontario courts' finding that full indemnity costs are payable by insurers who unsuccessfully deny a duty to defend, (for example, *Savage v. Belecque*), coupled with the latest judicial consideration of the allocation of defence costs, and what might be attempted in terms of policy wording to counter exposure to full indemnity costs or whether given the trend in the case law, this is necessary at least insofar as allocation is concerned.

Giving Notice

In *Walker v. Sovereign General Insurance Co.*[2], the Ontario Court of Appeal expanded the class of persons capable of properly giving notice in accordance with the terms of the notice conditions in a policy of insurance. The "reach" of the phrase "by or for the insured" was expanded to include a co-defendant in the action. As the property owner in a slip and fall case (the insured was the contractor responsible for maintenance), the co-defendant was held to be a person with "sufficient proximity to the claim to have knowledge of the information required."[3]

---

[1] While this paper focuses on Ontario case law, the policy interpretation principles and policy provisions are generally the same in all common law provinces and, therefore, the issues raised have general application and relevance.

[2] [2011] O.J. No. 4106 (C.A.)

[3] *Ibid.* at para. 36.

The initial action arose as a result of a slip and fall that occurred at the Power Centre in Burlington, Ontario. The plaintiffs issued a statement of claim against the owner of the property, Emshih Developments ("Emshih") and the contractor responsible for maintenance, Sun Shelter Industries Inc. ("Sun Shelter"). Emshih also cross-claimed against Sun Shelter. Before delivering a statement of defence or a statement of defence to crossclaim, Sun Shelter went bankrupt. The company was noted in default.

In the weeks before the scheduled trial date, counsel for Emshih discovered that Sovereign General Insurance Company ("Sovereign") was Sun Shelter's liability insurer. Sovereign was contacted by counsel for Emshih and informed of the claims against its insured and the imminent trial date. The trial was adjourned to give Sovereign the opportunity to participate, which they declined to do. Judgment was awarded to the plaintiffs who then commenced a second action against Sovereign seeking payment under s. 132 of the *Insurance Act*. A motion for summary judgment was brought for the amount of the plaintiffs' judgment against Sun Shelter less Emshih's contribution. Sovereign brought a cross-motion for summary judgment to dismiss the action. [4]

Sovereign took the position that Sun Shelter was in breach of the policy conditions as Sovereign had not received proper notice of the claim. The plaintiffs submitted that proper notice of the claim was given by counsel for Emshih, the insured's co-defendant in the action. In making this argument, the plaintiffs relied on the following statutory condition in the commercial insurance policy issued by Sovereign to Sun Shelter:

> WHO MAY GIVE NOTICE AND PROOF
>
> 8. Notice of loss may be given, and proof of loss may be made by the agent of the Insured named in the contract in case of absence or inability of the Insured to give the notice or make the proof, and absence or inability being satisfactorily accounted for, or in the like case, or if the insured refuses to so, *by a person to whom a part of the insurance money is payable.* [Emphasis added][5]

The motion judge held that Emshih, as a result of its cross-claim against Sun Shelter, was a "person to whom a part of the insurance money is payable". As a result, Emshih's notice to Sovereign was deemed to be in compliance with the terms of the policy. Sovereign submitted that the plaintiff's reliance on this statutory condition was misplaced. This was a liability claim, and the notice provision was in a part of the commercial insurance policy that specifically applied to property coverage and the peril of fire. The motion judge disagreed and stated as follows:

---

[4] *Walker v. Sovereign General Insurance Co.,* [2010] O.J. No. 2776 (Sup. Ct.)
[5] *Ibid.* at para. 32.

> In my view, on the wording of the policy all perils insured by the policy are subject to the statutory conditions. Sovereign's case at its highest is that there is an ambiguity regarding whether statutory condition 8 is applicable. It is well established that where an ambiguity is found to exist in an insurance contract, the language in issue shall be construed against the insurance carrier (see *Consolidated Bathurst v. Mutual Boiler,* [1980] 1 S.C.R. 888 (S.C.C.))[6]

On appeal, Justice Laskin disagreed with the motion judge's holding that Statutory Condition 8 was the notice provision applicable to the plaintiffs' loss. His Honour explained:

> Perhaps in isolation, the word "perils" is broad enough or ambiguous enough to support the motion judge's conclusion. But the policy must be read as a whole. And when it is read as a whole, there is no ambiguity. The policy contains two separate sets of conditions. Each set must be given scope and meaning.[7]

Sovereign's policy with Sun Shelter contained two stand-alone coverages each with its own set of conditions. The statutory notice conditions applied to property coverage while the policy conditions applied to liability coverage. As such, the relevant notice of loss requirement was contained in the policy conditions. This provision read as follows:

> 3. …
> (a) In the event of an accident or occurrence, written notice containing particulars sufficient to identify the Insured and also reasonably obtainable information with respect to the time, place and circumstances thereof, and the names and addresses of the injured and of available witnesses, shall be given promptly *by or for the insured* to the insurer or any of its authorized agents. [Emphasis added][8]

In determining the class of people that should be entitled to give notice *for* the insured, Laskin J.A. continued as follows:

> Given its purpose and importance, if the notice is to be given for an insured instead of by the insured itself, the person giving it should have sufficient proximity to the claim to have knowledge of the information required by s. 3(a). Emshih was just such a person. It owned the property where the accident occurred; it was a defendant in the original action; and it cross-claimed against Sovereign's insured. In giving notice to Sovereign, Emshih was giving notice *for* Sun Shelters as contemplated by s. 3(a) of the policy. [9]

---

[6] *Ibid.* at para. 48.
[7] *Walker v. Sovereign General Insurance Co., supra* note 2 at para. 27
[8] *Ibid.* at para. 21.
[9] *Ibid.* at para. 36. As a matter of interest, the Court did not address one of the other notice provisions which provided that the insured be required to forward any court process served on it to the insurer, which had not been done. The language in that provision does not indicate that the process can be forwarded on behalf of the insured.

Notice provided "by or for the insured", has generally been understood to apply mainly to brokers giving notice on behalf of the insured. This has now been expanded to include any persons with "sufficient proximity to the claim to have knowledge of the information required."[10]

Following Laskin J.A.'s reasoning, a notice provision must be interpreted in light of its purpose. Notice is to provide the insurer with sufficient awareness of a claim so that it can respond in a timely and appropriate fashion. It follows that anyone close enough to have sufficient knowledge of the claim should be seen as capable of giving notice for the insured. As the property owner in a slip and fall action, the co-defendant was held to be just such a person.

The potential implications for insurers in terms of who can give notice of a claim are clear. If insurers wish to continue with the historical understanding that the insured and a representative of the insured are the persons who are obliged to provide notice (and not plaintiffs or co-defendants), then changes to the wording of notice provisions are required.

Subrogation

Similarly, it appears as though changes to the wording of subrogation clauses may be necessary if an insurer wishes to pursue subrogation by controlling (or taking control of) an action commenced by its insured. The issue of control over a claim being advanced by the insured, which includes subrogated aspects, must be specifically addressed by the terms of the policy.

In *Zurich Insurance Co. v. Ison T.H. Auto Sales,*[11] Zurich unsuccessfully applied for an order permitting them to pursue subrogation by controlling the action commenced by their insured, Toronto Honda, for both its insured and uninsured losses. Justice Strathy of the Ontario Superior Court concluded that until an insured is fully indemnified, *i.e.*, it recovers its deductible and any of its uninsured losses, it can control the litigation against third parties allegedly responsible for its losses, including the insured portion of those losses, unless the policy of insurance dictates otherwise. Justice Stathy's reasons were upheld by the Ontario Court of Appeal.

The action arose as a result of an explosion and fire at a Toronto apartment building on July 20, 2008. Toronto Honda had stored 71 cars in the building's underground parking lot. The insured was paid approximately $1.9 million, representing the factory invoice price of the vehicles (the amount payable pursuant to the policy,) less a $10,000 deductible. The insurers recovered $900,000 in salvage, resulting in a net subrogated claim of about $1 million. Toronto Honda also had an additional $700,000 in uninsured losses, which included a loss of profits (the

---

[10] *Ibid.*

[11] [2011] O.J. No. 1487 (Sup. Ct.), aff'd [2011] O.J. No 4729 (C.A.). See also Strathy J.'s supplementary reasons at *Zurich Insurance Co. v. Ison T.H. Auto Sales,* [2011] O.J. No. 2482.

difference between the manufacturer's price and the retail price), a loss of the ability to service the vehicles and to re-sell trade-ins, and a loss of goodwill.

Toronto Honda retained counsel and started an action on April 21, 2009 claiming both its insured and uninsured losses. The insurers were aware since June 2009 of Toronto Honda's action and that the claims included the insurer's subrogated property claim. In November 2009, a firm retained by the insurers asked to be added as counsel of record in the insured's action and this request was denied. The insured's counsel advised it would keep them apprised of developments but that the ultimate control of the litigation would stay in Toronto Honda's hands.

The "Release from Liability and Subrogation Clause" in the subject policy read as follows:

> The Insurer, upon making any payment or assuming liability therefore under this Policy, shall be subrogated to all rights of recovery of the Insured against any person and may bring action in the name of the Insured to enforce such rights.
>
> … [This paragraph waives subrogation against affiliates or subsidiaries of the named insured and against other named insureds and dealers]…
>
> Where the net amount recovered after deducting the costs of recovery is not sufficient to provide a complete indemnity of the loss or damage suffered, that amount shall be divided between the Insurer and the Insured in the proportion in which the loss or damage has been borne by them respectively.
>
> Any Release from liability entered into by the Insured prior to loss hereunder shall not affect this policy.[12]

At common law, it is well settled that the insurer has no rights of subrogation until after the insured is fully indemnified. This means indemnified not only for all losses covered by the policy, but also for uninsured losses such as the insured's deductible, losses in excess of the policy limits, and losses (such as business losses) not covered by the policy.[13]

The insurers argued that "the Subrogation Clause, properly interpreted, changes the common law rule and gives the insurer control of any litigation commenced against the third party".[14] The insured asserted that "it is well settled law that until the insured has been fully indemnified for all its losses, insured and uninsured, it is entitled to control any litigation against the tortfeasor".[15] Justice Strathy agreed with the insured. He explained that the instant subrogation clause had two operative aspects:

---

[12] *Zurich Insurance Co. v. Ison T.H. Auto Sales Inc.,* [2011] O.J. No. 1487 (Sup. Ct.) at para. 19.
[13] *Ibid.* at paras. 34-35.
[14] *Ibid.* at para. 22.
[15] *Ibid.* at para. 23.

a) the insurer is subrogated to the rights of recovery of the insured and may bring action in the name of the insured on making any payment or assuming liability therefor under the policy; and

b) where there is less than a full recovery of insured and uninsured losses, the amount recovered is pro-rated between insurer and insured.[16]

His Honour continued:

> Both provisions alter the common law. The first permits the insurer to commence an action against the third party even before the loss has been fully paid, as long as it has either paid part of the loss or has assumed an obligation to do so. The second provision modifies the insured's common law entitlement to a complete indemnity for all insured and uninsured losses before the insurer is entitled to recover anything. The Subrogation Clause alters the common law, discussed below, by permitting the insurer to share the amount recovered with the insured, on a pro rata basis, where there has been less than a full recovery.
>
> As I have noted earlier, the policy contains no express provision about the right of either party to control the litigation. In particular, there is no provision, such as s. 278(3) of the *Insurance Act,*[17] giving the insurer a right of control. The question, therefore, is whether the insurer's entitlement to be "subrogated to all rights of recovery of the Insured" and to "bring action in the name of the Insured" to enforce such rights, carries with it the right to control the litigation.[18]

On this question, His Honour found that the clause was not ambiguous; it "simply does not address the issue of which party has control of litigation against the third party".[19] Furthermore, there was no reason to imply a provision giving the right to control in order to give business efficacy to the contract. The entitlement to control the litigation does not necessarily follow the insurer's right to be subrogated to the rights of the insured. Nor does it mean that the insurer is entitled to assert claims of the insured in which it has no interest. [20]

Counsel for the insurer submitted that, in any event, the Court should use its discretion to award carriage of the litigation to the insurers who have a larger ($1 million) "hard" claim for property damage as opposed to Toronto Honda's smaller ($700,000) "soft" claim for business losses. This submission was rejected. Justice Strathy stated as follows:

---

[16] *Ibid.* at para. 42.
[17] S. 278(3) of the *Insurance Act* specifically provides that where the insured's interest is limited to the amounts provided for co-insurance and deductibles, the insurer shall have control of the action.
[18] *Zurich Insurance Co. v. Ison T.H. Auto Sales Inc., supra* note 12, at paras. 43-44.
[19] *Ibid.* at para. 49.
[20] *Ibid.* at paras. 71-73.

> There may be cases where the insurer's interest is so vastly disproportionate to the insured's interest that it would be unreasonable to allow the latter to have control of the litigation. This is not such a case. [21]

In his concluding remarks, Justice Strathy noted that "it would be a simple matter for the insurers to amend the Subrogation Clause to alter the common law position if they wished to do so."[22] He continued:

> Nevertheless, the choice belongs to the underwriters and if their pens are not prepared to write such a clause into the policy, they should not ask the court to do so.
>
> There is, of course, another commonly employed alternative. In the case of large losses such as this, it is prudent and common for the insurers and the insured to discuss subrogation at the time the insurance claim is paid, and to agree on such matters as legal counsel, sharing of costs, and procedures for the resolution of any disagreements. If the insurers have failed to take these simple and basic steps, they can hardly complain if their insured insists on its common law rights.[23]

As all insurers and counsel know, the issue of control over the litigation frequently arises in a subrogation scenario. Most of the time, it will be the insurer that starts the action in its insured's name, and counsel retained to do so will determine whether the insured has any uninsured losses, for example, its deductible, and whether it wishes to include its uninsured claims in the action. This is done on the understanding that the insurer will decide how to conduct the litigation.

This decision makes it clear, however, that if the insured wishes to pursue and control the litigation, and an agreement cannot be reached as to whether and how this will be done, it is within the insured's purview to do so, subject to the *proviso* in paragraph 78 of Strathy J.'s reasons regarding disproportionate interests. Ultimately, if insurers wish to make subrogation arrangements in all their policies clearer, they can and may wish to do so.

Property Sale Coverage

The importance of clear policy wording was also addressed in *Hector v. Piazza*[24] in the context of an exclusion clause. The insured had sold an apartment building to the plaintiff after it had been renovated. The plaintiff sued for damages alleging, *inter alia*, negligent supervision of construction and breach of contract. The insurer, AXA, denied coverage and relied on an exclusion clause in the Comprehensive General Liability Policy which excluded:

---

[21] *Ibid.* at para. 78.
[22] *Ibid.* at para. 80.
[23] *Ibid.* at paras. 80-81.
[24] [2011] O.J. No. 971 (Sup. Ct.), aff'd [2012] O.J. No. 111 (C.A.)

(y) property damage –

…

(z) to property *owned* or occupied by or rented to the Insured, or, except with respect to the use of the elevators, to property held by the Insured for sale or entrusted to the Insured for storage or safekeeping. [Emphasis added.][25]

The insurer argued that property "owned" by the insured referred to property owned in the past tense. The apartment building at issue was previously owned by the insured and should, accordingly, be excluded from coverage. The insured took the position that "owned" could refer to past or present tense. As such, the exclusion clause could not be said to "clearly and unambiguously" exclude coverage.

Justice Annis of the Ontario Superior Court found that there was a duty to defend and his Honour's decision was upheld by the Ontario Court of Appeal. The Court of Appeal agreed that the exclusion clause could refer to either past or present tense. This conclusion was supported by the words surrounding the at issue phrase which excluded property "occupied by or rented to the Insured or, except with respect to the use of the elevators, to property held by the Insured for sale or entrusted to the insured for storage and safekeeping", all of which can equally be read in the present tense.[26]

The Court of Appeal acknowledged that the policy as a whole was a third party liability policy and was drafted with the intention of excluding coverage for items that would be the subject of first party coverage. Counsel for the insurer argued that a third party claim could only be made with respect to property that was owned in the past by the insured. Unexpected property damage could never give rise to a third party liability claim against the insured while the insured still owns the property. As such, if the exclusion clause is to have any purpose, "property owned" must be read in the past tense. In response, the Court stated as follows:

> The answer to this submission is that while a CGL policy is intended to insure against third party liability and is not intended to respond to first party claims, strict rules of construction mean that this is not always the result. At times, there is an overlap of coverage: See Lichty and Snowden, supra at p. 20-5.
>
> We note that if the words "property owned" in the exclusion are interpreted as referring to the present tense, property that was owned by the insured in the past, and that is subject to a third party claim, could fall within the ambit of coverage under the policy. Contrary to the submission of the appellant, this is not inconsistent with the intention of the parties to exclude first party liability. [27]

---

[25] *Hector v. Piazza,* [2012] O.J. No. 111 (C.A.) at para . 10.
[26] *Ibid.* at para. 15.
[27] *Ibid.* at paras. 18-19.

As the exclusion was found to refer to both the past and present tense, it was, on its face, ambiguous and the insurer was obliged to defend. In his reasons, Justice Annis suggested that if insurers used both "own" and "owned" in the exclusion, any such ambiguity might be eliminated in the future. [28]

In terms of risk management for insurers, the significance of this decision is clear. It emphasizes, yet again, that an exclusion clause must be both clear and unambiguous if it is to be relied on. Moreover, even a third party liability policy clearly drafted with the intention to exclude first party claims, may result in an "overlap of coverage" if the exclusions are not sufficiently unambiguous.

Allocation of Defence Costs and Full Indemnity Costs

Another significant issue that has been the subject of recent judicial attention is the allocation of defence costs between insurer and insured in situations involving a combination of covered and uncovered claims. Specifically, given very recent decisions, it may or may not be necessary for insurers to endeavour to state in their policies that only claims covered by the policy need to be defended.[29]

As an example, in *Philadelphia Indemnity Insurance Company v. Chicago Title Insurance Company,*[30] an interesting American Federal Court case out of the Northern District in Illinois, an insurer attempted, unsuccessfully, to do just that.

The policy at issue contained a provision which stated "[Chicago Title] will not pay any fees, costs, or expenses incurred by the insured in the defence of those causes of action which allege matters not insured under the policy."[31] The Court

---

[28] *Hector v. Piazza* [2011] 105 O.R. (3d) 704 (Sup. Ct.) at para. 59.

[29] For another recent decision in which the Ontario Court of Appeal found the wording of an intentional or criminal act exclusion was ambiguous, see *Durham District School Board v. Grodesky*, [2012] O.J. No. 1826, rev'g 100 C.C.L.I. (4th) 145. The Court held that the words, "by any intentional or criminal act of failure to act" were capable of two meanings and could not be used to exclude negligent conduct.
And see the very recent decision of the Ontario Superior Court in *Belair Direct v. Shoup*, which follows *Grodesky* by finding two of the three insureds are owed a defence, (the parents but not the son who was convicted of a criminal offence). As a matter of interest, and *a propos* of the next topic, the court awarded partial indemnity, and not full indemnity, costs to the successful insureds. There is no indication whether this point was specifically addressed.
See also Royal *& Sun Alliance Insurance Co. v. Araujo*, [2012] B.C.J. No. 1677, a very recent decision of the British Columbia Supreme Court, which held the insurer owed a duty to defend after finding that, *inter alia*, the use of the definition of "you" and "your" in the exclusion clause of a homeowner's policy was ambiguous. The decision also observes that language used in a different context, i.e., the coverage grant as opposed to an exclusion, can have a different meaning because the former is to be interpreted broadly while the latter should be construed narrowly.

[30] *Philadelphia Indemnity Insurance Company v. Chicago Title Insurance Co.,* 2012 U.S. Dist. Lexis 66595.

[31] *Ibid.* at 3.

held that the insurer was not permitted to "contract out" of its duty to defend, a duty which included defending aspects of the claim not covered by the policy.[32]

Recent jurisprudence from the Ontario Court of Appeal suggests that the Courts may be adopting an approach which allocates defence costs between insurer and insured without the need for a change in policy wording. The Ontario Court of Appeal addressed the issue of defence costs for covered and uncovered claims in *Hanis v. Teevan*[33] and found that the 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 costs solely related to the defence of uncovered claims.

More recently, in *Tedford v. TD Meloche Monnex*,[34] the Court of Appeal held that despite there being a duty to defend, the insurer was not responsible for 100% of the insured's defence costs.

The action involved a claim for misrepresentation in the sale of a property. On the allocation issue, the insurer argued that it would be unfair for it to have to defend the entire action. Out of the plaintiff's $185,000 damages claim, "at least $150,000 relate to repair costs. The plaintiff seeks damages of approximately $25,000 for Health Consequences. Since the amount of damages related to Health Consequences is small in comparison to the claim for repair costs, the appellant argues it would be unreasonable for it to bear the cost of defending the entire claim."[35] Hoy J.A. agreed and stated as follows:

> I would direct, unless the parties otherwise agree, that the appellant's counsel be instructed to defend both the covered and the uncovered claims, in a manner commensurate with the aggregate amount claimed and that the respondent [should] bear the costs of the defence to the extent that they exceed the reasonable costs associated with the defence of the covered claims. In determining the reasonable costs associated with the defence of the covered claims, it is appropriate to consider the quantum of the covered claims. It would be unfair to the insurer to fix it with defence costs that are disproportionate to the extent of its potential liability for the covered claim.

---

[32] The Court held that if the defence duty is imposed by law, as opposed to having been created by the policy language, the insurer is bound by the coverage rules and principles established by the courts. *Quaere* whether the same approach would be taken in Ontario and Canada where the courts have specifically stated that the policy wording is what governs; see, for example, the Supreme Court of Canada's decision in *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada* [2010] 2 S.C.R. 245 and the decision of the Ontario Court of Appeal in *Hanis v. Teevan* [2008] O.J. No. 3909 (C.A.).

[33] [2008] O.J. No. 3909 (C.A.)

[34] [2012] O.J. No. 2821 (C.A.)

[35] *Ibid.* at para. 5.

> If the parties are unable to agree on an allocation of the costs, the appellant insurer shall be entitled to apply to the Superior Court of Justice for a determination of the allocation, in accordance with *Hanis*, after the matter is concluded or at such other time as the parties agree. [36]

While this formulation is helpful to insurers, it also introduces some potential uncertainty into the equation of how defence costs should be allocated before an action has been concluded. Interestingly, the Court has suggested that quantum of the covered and uncovered claims is an appropriate consideration in determining what the reasonable costs should be for defending the covered claims. Ultimately, assuming that the parties cannot agree, it appears that, as suggested in *Hanis*, the insurer is obliged to fully defend but can seek reimbursement after the action is concluded.

A similar apportionment approach was applied in *Papapetrou v. 1054422 Ontario Ltd.*[37] A maintenance contractor who agreed to have the property owner named as an additional insured under its liability policy, but failed to do so, was ordered to pay for the cost of the property owner's defence pursuant to its contract "save for any costs incurred exclusively to defend claims that do not arise from [the contractor's] performance or non-performance of the service contract".[38] Relying on the decision in *Hanis*, the Court stated as follows:

> In this case, as [the contractor] failed to satisfy its insurance obligation under the service contract, it is unable to demonstrate that it should escape responsibility for paying [the owner's] costs of defending the action save for those costs incurred exclusively to defend uncovered claims.[39]

The Court made a point of saying that because of the contractor's failure to add the owner as an additional insured, what arises is not a duty to defend but rather a remedy in damages. The quantum of those damages was the amount of defence costs the owner was obliged to incur as a result of not being named an additional insured. Determining that quantum required an analysis of what the insurer's duty to defend would likely have been. The Court concluded that that duty would not have included costs related exclusively to uncovered claims. An apportionment of those defence costs, however, was not explicitly stated.

In this type of situation, where a party is named as an additional insured but the claim includes allegations that fall outside of the scope of coverage, the most practical solution appears to be for insurers to defend their respective insureds and address allocation of defence costs at the end of the underlying action. A similar approach could also be applied in situations where a company is named as an insured but the nature of the coverage is qualified by an endorsement.

---

[36] *Ibid.* at paras. 24-25.
[37] [2012] O.J. No. 3373 (C.A.)
[38] *Ibid.* at para. 32.
[39] *Ibid.* at para. 52.

As a final point, it is now well established in the case law that full indemnity costs are payable by an insurer who unsuccessfully denies a duty to defend.[40] In *Savage v. Belecque,*[41] the Ontario Superior Court affirmed that full indemnity costs are payable not only for costs associated with the main action but also for costs of any third party applications started to determine the nature of the coverage. The decision was upheld by the Ontario Court of Appeal.[42] Elies, J. stated as follows:

> It is now well established that costs associated with defending the main action ought to be awarded on a full indemnity basis. This results from the fact that these costs actually represent the damages sought in the coverage action. Those damages arise as a consequence of the breach of an insurance contract and thus are designed to put the innocent party in the same position it would have been had the contract been fulfilled.
>
> It is also well established that the costs of the coverage claim and the motion for declaratory relief/summary judgment should also be paid on a full indemnity basis. [43]

Awarding full indemnity for costs associated with the defence of the main action makes sense as a remedy for breach of contract. The insured would not have been forced to incur those costs had the insurer honoured its contractual obligations to provide a defence. It is arguable that awarding full indemnity costs for the application to determine coverage is perhaps less supportable. The coverage determination is simply a contractual dispute between two parties. While one can submit that this should be no different from the contractual disputes that occur frequently outside the insurance context where a costs award for full indemnity is exceedingly rare, the courts do not accept this position. The state of the law in this area of insurance litigation is now well established.

It may prove challenging to avoid full indemnity costs. It remains to be seen whether this can be done through changes to the policy wording that attempt to restrict exposure to covered claims. If there is an issue as to whether a defence is owed for uncovered claims, a specific provision to that effect may avoid an award of full indemnity in the allocation of defence costs. We doubt, however, that a specific provision denying full indemnity costs would withstand the court's scrutiny. While the parties may agree, between them, the court is unlikely to be receptive to any interference with its discretionary power to award costs as it deems appropriate.

That said, at least with respect to the allocation of defence costs, if an insurer can establish that it is not fully responsible for those costs, in accordance with the recent *Tedford* and *Papapetrou* decisions then, presumably, it has a reasonable basis

---

[40] That said, our understanding is this is applicable only to Ontario. It appears that other provinces continue to award costs on what would be Ontario's partial indemnity scale unless the insurer's denial was, for some reason, blameworthy because, for example, it was made in a clear case.
[41] [2011] O.J. No. 4586 (Sup. Ct.)
[42] [2012] O.J. No. 2818 (C.A.)
[43] *Supra* note 41 at paras. 3-4.

for asserting that these types of cases should not attract a full indemnity costs award.[44]

Conclusion

As this brief overview of recent case law illustrates, how a policy is drafted is often a key factor when it is applied to any given fact situation. And, inevitably, different fact situations, and how they will affect policy interpretation, cannot always be predicted, thereby potentially necessitating revisions to policy wording.

[44] And, in support of this, rely upon *Coventree Inc. v. Lloyds Syndicate 1221 (Millenium Syndicate)* [2011] O.J. No. 6188 aff'd [2012] O.J. No. 2287 (C.A.), where the Court of Appeal agreed with an award of partial indemnity costs on an application to interpret a policy in relation to whether there was coverage for defence costs as opposed to whether there was a duty to defend.