Allocation of Defence Costs Among Insurers

Brian Sunohara
December 2019

How are defence costs allocated among multiple insurance companies that each insured a defendant over various periods? This issue was addressed in *St. Paul Fire & Marine Insurance Company v. AIG Insurance Company of Canada et al*, 2019 ONSC 6489.

Facts

Lockerbie & Hole Eastern Inc. ("Lockerbie") is a construction company. Its predecessor was contracted by York University to build a steam heating and cooling pipe system (a mechanical system) in 2002.

York University alleged that construction defects in the mechanical system led to various failures requiring repairs and remediation after construction, including specific failures in July 2003, February 2005, and April 2011, culminating in a leak in the cooling system in December 2013.

In 2013, York University sued Lockerbie and an engineering company for $8.5 million.

There were four insurers that insured Lockerbie during different time periods:

- Northbridge: March 1, 2003 to March 1, 2009
- St. Paul: April 1, 2009 to January 31, 2010
- AIG: January 31, 2010 to July 1, 2014
- Zurich: July 1, 2014 to July 1, 2016

St. Paul acknowledged that it had a duty to defend Lockerbie, and Northbridge and Zurich eventually also acknowledged a duty to defend. AIG denied that it had a duty to defend, but Justice Sossin held that AIG was required to defend Lockerbie.

Allocation of Defence Costs

There was disagreement regarding how defence costs should be allocated among the four insurers. St. Paul and Zurich sought an allocation based on a "time on risk" approach. Northbridge sought an equal allocation of defence costs. AIG took no position on this issue.

Justice Sossin noted that the allocation of defence costs among insurers is a question of fairness within the court's equitable jurisdiction.

In order to determine the appropriate approach to allocating defence costs, it is necessary to determine the "trigger" theory which fits the circumstances of the case. Justice Sossin held that the "continuous trigger" theory was most appropriate, based on the facts of the case.

Under this theory, the property damage is effectively deemed to have occurred from the initial exposure to the time when the damage became manifest or ought to have become manifest to the plaintiff, and, if alerted, to the insurer. In such a situation, all insurance policies in effect over that period are called upon to respond to the loss.

In other words, the "continuous trigger" theory applies where the damage occurs continuously throughout the various policy periods.

Justice Sossin indicated that the time on risk approach appears to reflect the preferred approach in Canadian courts in cases involving multiple insurers and continuous damage.

However, the time on risk approach may not be fair and equitable when there is uncertainty with respect to the start and end point of the damage period or uncertainty as to the period of each insurer's coverage.

In the case at bar, Justice Sossin found that there was no guesswork with respect to these issues (the period of damage and the time each insurer was on risk). Therefore, His Honour held that the time on risk approach is appropriate.

As a result, each of the four insurers is responsible for defence costs on a *pro rata* basis, calculated by the months or years of covered damage under its policies.

However, Justice Sossin noted that this approach does not necessarily represent a final allocation of defence costs. Based on the evidence at trial, or findings on interlocutory motions, the actual damage occurring during actual time periods may clarify the portion of damage for which each insurer is actually responsible. Such findings could merit a reallocation of defence costs.

Effect of Self-Insured Retention

Another issue that arose in this case is whether a self-insured retention ("SIR") impacts an insurer's duty to contribute to defence costs.

Zurich argued that the SIR provision in its policy meant that its duty to contribute to defence costs only arose after the first $50,000 of its obligations were paid by Lockerbie.

Justice Sossin rejected this argument, stating that an application against other insurers for contribution to defence costs is a claim in equity, not contract. Therefore, an SIR provision, and the contractual rights or burdens to which it gives rise, do not constitute a basis on which to alter the allocation of defence costs as between various insurers.

Justice Sossin held that, if Zurich seeks to invoke the SIR against Lockerbie, this may be the subject of a separate proceeding between those parties at some point in time.

Conclusion

In claims involving continuous damage over multiple policy periods with different insurers on risk, the time on risk approach is generally favoured, as opposed to an equal sharing of defence costs among insurers.

The time on risk approach utilizes a *pro rata* calculation of which insurer will be reasonable for defence costs based on the months or years of covered damage under its policies. This is subject to reallocation based on factual findings on when the damage actually occurred.

If there is uncertainty over the start and end point of the damage or uncertainty on the period of each insurer's coverage, then the court may find the equal sharing approach to be the most appropriate.