CITATION: Loblaw Companies Limited v. Royal & Sun Alliance Insurance Company of Canada, 2022 ONSC 449
COURT FILE NO.: CV-20-00649597-0000
DATE: 20220119

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:	
LOBLAW COMPANIES LIMITED, SHOPPERS DRUG MART INC. and SANIS HEALTH INC. Applicants	*Lawrence G. Theall and Jeffrey A. Brown*, for the Applicants
– and –	*Mark O'Donnell and Cameron Foster*, for the Respondent Royal & Sun Alliance Insurance Company of Canada
ROYAL & SUN ALLIANCE INSURANCE COMPANY OF CANADA, AIG INSURANCE COMPANY OF CANADA, AVIVA INSURANCE COMPANY OF CANADA, LIBERTY MUTUAL INSURANCE COMPANY, ZURICH INSURANCE COMPANY LTD., CHUBB INSURANCE COMPANY OF CANADA, CERTAIN UNDERWRITERS AT LLOYD'S as represented by their coverholder MARKEL CANADA LIMITED, ALLIANZ GLOBAL RISKS US INSURANCE COMPANY, CERTAIN UNDERWRITERS AT LLOYD'S as represented by their coverholder ELLIOTT SPECIAL RISKS, CERTAIN UNDERWRITERS AT LLOYD'S as represented by their coverholder CATLIN CANADA INC., XL INSURANCE COMPANY SE, TEMPLE INSURANCE COMPANY, SENTRY INSURANCE COMPANY, NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA., TEVA CANADA LIMITED and QBE SYNDICATE 1886 AT LLOYD'S OF LONDON Respondents	*Nina Bombier and Sean Lewis*, for the Respondent AIG Insurance Company of Canada *Steven Stieber*, for the Respondent Aviva Insurance Company of Canada *James P. Thomson and Ronald Silverson*, for the Respondent Liberty Mutual Insurance Company *Jamie Macdonald*, for the Respondent Zurich Insurance Company Ltd. *John Nicholl, Heather Gray and Emma Nicholl*, for the Respondent Chubb Insurance Company of Canada *Marcus Snowden and Akash D. Brijpaul*, for the Respondent Certain Underwriters at Lloyd's as represented by their coverholder Markel Canada Limited *Douglas Stewart*, for the Respondents XL Insurance Company SE and Certain Underwriters at Lloyd's as represented by their coverholder Catlin Canada Inc.

) *Dominic T. Clarke and Anthony Gatensby*,
) for the Respondent QBE Syndicate 1886 at
) Lloyd's of London
)
) *Alan P. Gardner, Christine Viney and Meg*
) *Bennett*, for Teva Canada Limited
)
) *Debbie Orth*, for Sentry Insurance Company
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)
)
) **HEARD:** July 5-8, 2021, with supplementary
) written submissions delivered on December
) 20, 2021

REASONS FOR JUDGMENT

VERMETTE J.

[1] The Applicants make application for:

a. declarations that various insurers have a duty to defend certain claims against some or all of the Applicants, and that this duty has been breached;

b. a declaration that each of the Applicants is entitled to select any single policy under which there is a duty to defend that Applicant and require the Respondent insurer to defend or, in the alternative, an order allocating the respective share of defence costs that should be paid by each Respondent insurer;

c. a declaration that only those insurers who provide the disclosure, and sign the undertaking, contemplated by the Defence Reporting Agreement (defined below), will be entitled to associate in the defence of the claims in issue and receive defence-side reporting;

d. if necessary, an order directing a trial as to whether the aggregate deductible or self-insured retention ("**SIR**") under any applicable insurance policy has been exhausted.

[2] Certain Underwriters at Lloyd's as represented by their coverholder Markel Canada Limited ("**Markel**") have also commenced a separate but related Application (Court File No. CV-20-651208-0000) which addresses issues similar to those raised by the Applicants' request for a Defence Reporting Agreement, and seeks certain declarations about the disclosure of information and the right to participate in the Applicants' defence.

[3] A third and related Application was brought by Markel against Aviva Insurance Company of Canada ("**Aviva**"), Shoppers Drug Mart Corporation, Shoppers Drug Mart Inc. ("**SDM**") and Sanis Health Inc. ("**Sanis**") (Court File No. CV-20-00646236-0000). On January 26, 2021, Justice Chalmers signed an order on consent that resolved Markel's Application, except for the issue of the costs sought by Aviva, which were reserved to be spoken to at the hearing of this Application. I was advised at the hearing that the issue of costs had been dealt with and no longer needed to be spoken to.

[4] The Applicants' Application was heard over the course of four days. Counsel agreed to organize the issues into three categories: (1) the duty to defend and the issue of equitable allocation as between insurers; (2) the exhaustion of SIRs/deductibles; and (3) the defence protocol/defence reporting agreement. Markel's Application was dealt with as part of the third category of issues.

[5] My reasons below follow a similar organization. I first review the relevant factual background.

A. FACTUAL BACKGROUND

1. The Applicants

[6] Loblaw Companies Limited ("**Loblaw**") is a Canadian grocery retailer, which operates pharmacies at various locations throughout Canada. Loblaw opened its first pharmacy in 1979. Prior to May 1997, Loblaw was insured separately from its parent, George Weston Limited ("**Weston**"). Since May 1, 1997, Loblaw has been a named insured under insurance policies issued to Weston.

[7] SDM is primarily a Canadian franchisor for retail pharmacies, but also had some company-owned pharmacies that operated in Canada from time to time. SDM was initially a subsidiary of Imasco Limited ("**Imasco**") and was an insured under policies issued to Imasco. As of February 4, 2000, SDM was no longer owned by Imasco and became insured under policies issued to SDM.

[8] Sanis was incorporated in 2009. It is a wholly-owned subsidiary of SDM and is a generic drug manufacturer. Sanis manufactures and sells Sanis-branded generic drug products in Canada in accordance with contract fabrication agreements entered into with several generic drug manufacturers acting as contract fabricators. Sanis has manufactured and sold two drugs classified by Health Canada as opioids. Both drugs were manufactured under a contract fabrication agreement with Teva Canada Limited ("**Teva**"). Sanis has been insured under SDM's insurance policies since Sanis was formed in 2009.

[9] On March 28, 2014, Loblaw acquired all the issued and outstanding shares of SDM. At the time of the acquisition, SDM retained the insurance coverage it then had in place, until those policies expired at the end of their terms on July 1, 2014. At that time, SDM and Sanis became insured entities under Weston's insurance policies.

2. The Underlying Claims

[10] Loblaw, SDM and Sanis have each been named as defendants in one or more class action lawsuit(s) relating to the alleged negligent manufacturing, distribution and/or sale of opioid drugs in Canada. The five class actions in issue are the following:

a. Her Majesty the Queen in Right of the Province of British Columbia commenced a class action against Loblaw, SDM, Sanis and others on August 29, 2018 in the Supreme Court of British Columbia ("**BC HMQ Action**"). It seeks damages from Loblaw, SDM, Sanis and others arising from the alleged negligent manufacturing, marketing, distribution and sale of opioid drugs or opioid products. In addition to negligence, other causes of action are pleaded, including breach of the *Competition Act*, R.S.C. 1985, c. C-34, fraudulent misrepresentation and deceit, unjust enrichment and fraudulent concealment. The BC HMQ Action is brought on behalf of all federal, provincial and territorial governments and agencies that paid healthcare, pharmaceutical and treatment costs related to opioids during the class period, which is the period from 1996 to the present. The BC HMQ Action was discontinued as against Loblaw on July 6, 2021, i.e. on the second day of the hearing of this Application. Compared to the other actions in issue on this Application, the BC HMQ Action is the action with respect to which the Applicants have incurred the highest amount of legal costs.

b. An anonymous representative plaintiff (M.W.) commenced a class action on December 18, 2019 in the Supreme Court of British Columbia against Loblaw, SDM, Sanis and others for damages related to the alleged negligent manufacturing, marketing, distribution and sale of opioid drugs or opioid products ("**BC MW Action**"). In addition to negligence, other causes of action are pleaded, including breach of the *Competition Act*, breaches of the B.C. *Business Practices and Consumer Protection Act*, S.B.C. 2004, c. 2, fraudulent misrepresentation and deceit, unjust enrichment and fraudulent concealment. The BC MW Action is brought on behalf of all Canadians or, alternatively, all British Columbians who consumed any one or more of the opioids manufactured, marketed, distributed and sold by the defendants during the class period, which is the period from 1996 to the present, as well as the direct heirs of any deceased persons who met this description.

c. On May 15, 2019, Darryl Gebien commenced a class action in the Ontario Superior Court of Justice against Sanis and others for damages arising from the alleged negligent research, development, manufacture, testing, regulatory licensing, distribution, sale and marketing of opioids ("**Ontario Action**"). In addition to negligence, other causes of action are pleaded, including breach of the *Competition Act*, fraudulent misrepresentation and deceit, unjust enrichment and fraudulent concealment. The Ontario Action is brought on behalf of all persons in Canada who were prescribed opioids and subsequently developed an addiction to opioids, as well as all persons in Canada who by reason of their relationship to a class member have standing pursuant to section 61(1) of the *Family Law Act*, R.S.O. 1990, c. F.3. The statement of claim does not define the class period, but the allegations it

contains are very similar to the allegations in the other actions. Loblaw and SDM are not parties to the Ontario Action.

d. On May 23, 2019, an anonymous representative plaintiff (E.V.) commenced a class action in the Superior Court of Quebec against Sanis and others for damages arising from the alleged negligent research, development, manufacturing, testing, regulatory licensing, distribution, sale, marketing, and after-market surveillance of opioids in Quebec ("**Quebec Action**"). In addition to negligence, other causes of action are pleaded, including breaches of the *Competition Act*, breaches of the *Civil Code of Quebec* and breaches of the Quebec *Charter of Human Rights and Freedoms*. The Quebec Action is brought on behalf of all persons in Quebec who have been prescribed and consumed any one or more of the opioids manufactured, marketed, distributed and/or sold by the defendants during the class period, which is the period from 1996 to the present, and who suffer or have suffered from opioid use disorder, as well as the direct heirs of any deceased persons who met this description. Loblaw and SDM are not parties to the Quebec Action.

e. On June 3, 2020, the City of Grande Prairie commenced a class action in the Court of Queen's Bench of Alberta against Loblaw, SDM, Sanis and others for damages arising from the alleged negligent manufacturing, marketing, distribution and sale of opioid drugs or opioid products ("**Alberta Action**"). In addition to negligence, other causes of action are pleaded, including conspiracy, common law public nuisance, common law fraud and unjust enrichment. The Alberta Action is brought on behalf of all Canadian municipalities and local governments who collect taxes and/or provide services to their communities. The statement of claim does not define the class period, but the allegations it contains are similar to the allegations in the other actions, although more detailed.

[11] Collectively, the BC HMQ Action, the BC MW Action, the Ontario Action, the Quebec Action and the Alberta Action are referred to as the "**Underlying Claims**".

[12] The Underlying Claims seek billions of dollars in damages. There are 45 defendants in the BC HMQ Action, 38 defendants in the BC MW Action, 37 defendants in the Ontario Action, 25 defendants in the Quebec Action and 42 defendants in the Alberta Action. In addition, similar litigation is pursued in the United States of America.

3. The insurance policies

[13] Aside from Teva and its insurers (discussed below), the Respondents are all licensed insurance companies that issued commercial/comprehensive general liability ("**CGL**"), umbrella, excess and integrated insurance policies that insured one or more of Loblaw, SDM and/or Sanis for some period between January 1, 1996 and the present.

[14] Five of the Respondents issued primary CGL policies that covered one or more Applicants during the relevant period ("**Primary Insurers**"):

a. Liberty Mutual Insurance Company ("**Liberty**") insured SDM for the period April 1, 1995 to February 4, 2000;

b. Aviva insured SDM and Sanis for the period February 4, 2000 to July 1, 2014;

c. AIG Insurance Company of Canada ("**AIG**") insured Loblaw for the period July 1, 1995 to May 1, 1997;

d. Royal & Sun Alliance Insurance Company of Canada ("**RSA**") insured Loblaw for the period May 1, 1997 to January 1, 1998; and

e. Zurich Insurance Company Ltd. ("**Zurich**") insured Loblaw for the period January 1, 1998 until January 1, 2019,[1] and SDM and Sanis for the period July 1, 2014 (i.e. after they were acquired by Loblaw) to January 1, 2019.

[15] Each of the Primary Insurers also issued excess liability policies to one or more of the Applicants from time to time. The other Respondents (who are not related to Teva) issued excess liability policies which covered one or more of the Applicants during the relevant period.

[16] The Applicants are also insured under policies issued to Teva by QBE Syndicate 1886 at Lloyd's of London ("**QBE**") and potentially by other insurers, i.e. Sentry Insurance Company and National Union Fire Insurance Company of Pittsburgh, PA. These policies are not discussed in this decision as it was agreed that the issues related to these insurers would be dealt with at a subsequent date. However, QBE did take a position and participate in the argument regarding the defence protocol/defence reporting agreement sought by the Applicants.

[17] Except for two policies issued by Zurich for the policy periods 1998-2000 and 2001-2003, each primary insurance policy contains an express duty to defend any claim for bodily injury against an insured. The specific wording in the relevant policies is as follows:

a. Liberty: "With respect to such insurance as is afforded by this policy, [Liberty] shall: (a) If claim is made or suit brought within Canada or the United States of America, their territories or possessions, defend any such claim or suit against the Insured […]."

b. Aviva: "As respects such Insurance as is afforded by this policy the Insurer also agrees: (1) To defend in the name of and on behalf of the Insured, allegations, claims, demands or suits, which may at any time be instituted against the Insured even if such allegations, claims, demands or suits may be groundless [sic] false or fraudulent; or to make settlement of such claims as may be deemed expedient by the Insurer, or if the Insurer is prevented by law or otherwise from defending the

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[1] Some qualifications apply with respect to the policy periods 1998-2000 and 2001-2004. These are discussed below.

Insured as aforesaid, the Insurer will reimburse the Insured for defense costs and expenses incurred with the consent of the Insurer; but the Insurer shall not be obligated to pay any claim or judgement or to defend suit after applicable limit of Insurer's liability has been exhausted by payment of judgements or settlements."[2]

c. AIG: "With respect to such insurance as is afforded by this policy, [AIG] shall: (A) Defend any suit against the Insured alleging such injury, sickness, disease or destruction and seeking damages on account thereof, even if such suit is groundless, false or fraudulent; but [AIG] may make such investigation, negotiation and settlement of any claim or suit as it deems expedient;"

d. RSA: "With respect to such insurance as is afforded by this policy, [RSA] shall: (A) Defend any suit against the Insured alleging Bodily Injury, Personal Injury or Property Damage and seeking damages on account thereof, even if such suit is groundless, false or fraudulent; but [RSA] may make such investigation, negotiation and settlement of any claim or suit as it deems expedient;"

e. Zurich, for the policy period 2004-2006 and subsequent periods (with minor changes that do not change the substance of the clause): "As respects such Insurance as is afforded by this policy Zurich also agrees: a) to defend in the name of or on behalf of the Insured, allegations, claims, demands, suits or other proceedings which may at any time be instituted against the Insured for any accident or 'Occurrence', even if such allegations, claims, demands or suits may be wholly groundless, false, or fraudulent; or to make settlement of such claims as may be deemed expedient by Zurich."

As stated above, Zurich's policies for the policy periods 1998-2000 and 2001-2003 do not include a duty to defend. However, these policies provide that Zurich is liable to pay for "ultimate net loss" in excess of the SIR and/or underlying insurance. "Ultimate net loss" includes defence expenses incurred by the insured.

4. Notice of the Underlying Claims and insurers' responses

[18] The Applicants provided notice of the Underlying Claims to the Respondents and asked the Primary Insurers to defend the litigation as required by their respective policies. By June 2020, none of the Primary Insurers had made any contributions to defence costs. At that time, the Applicants had incurred more than $1 million in defence costs. The Applicants are represented by a single law firm, Osler, Hoskin & Harcourt LLP ("**Osler**"), with respect to all Underlying Claims.

[19] Some of the insurers have taken the position that they have deductibles or SIRs that would apply to the Underlying Claims. All the Primary Insurers as well as some excess insurers have

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[2] Minor changes that do not change the substance of this clause were made to this wording in the 2006-2007 policy and appear in the subsequent policies.

reserved their rights to deny coverage based on "intentional acts" exclusions, among others. Some insurers have yet to take a coverage position.

[20] Sanis and SDM have chosen to require Aviva to defend the Underlying Claims, subject to any order the Court may make with respect to equitable allocation as between insurers. Loblaw has chosen to require RSA or, in the alternative, AIG, to defend the Underlying Claims, subject to any order the Court may make with respect to equitable allocation as between insurers.

[21] By February 2021, the Applicants had paid more than $2.6 million to Osler to defend the Underlying Claims.

[22] At the time of the hearing, Aviva and Liberty had made payments for a share of defence costs.

5. Defence reporting agreement

[23] On July 14, 2020, counsel for the Applicants wrote to the Respondents, noting that all the Primary Insurers had reserved their rights to later deny coverage based on certain exclusions, including intentional acts exclusions. He also noted that the Applicants understood that many insurers were involved with the defence of other parties in the Underlying Claims. As a result, the Applicants proposed a detailed defence protocol involving two levels of reporting (coverage-side and defence-side) and requiring all insurers that have potential conflicts issues to erect ethical screens that include employees or officers of the insurer, with the full authority to authorize all payments under the respective policies, to their full limits, without having to consult anyone who is not included in the ethical screen.

[24] The Applicants have entered into defence reporting agreements with a number of insurers, including Zurich, Aviva and Allianz Global Risks US Insurance Company. Further, some, like Liberty, have indicated a willingness to sign a similar agreement. However, some insurers have rejected the Applicants' proposed terms and suggested that their internal systems were adequate to address any concerns ("**Non-DRA Insurers**").

[25] The main terms of the Defence Reporting Agreement with Zurich ("**DRA**"), which the Applicants are putting forward as the model DRA that other insurers should have to enter into, are the following:

a. The Applicants agree that they will provide "Privileged Defence Information" (defined below) to Zurich's authorized representatives, and that the authorized representatives will be entitled to participate in the defence of the Underlying Claims, including negotiating settlement.

b. An "authorized representative" is a person designated in writing by Zurich, who will associate in the defence of the Underlying Claims, and who will receive and/or have access to Privileged Defence Information.

c. "**Privileged Defence Information**" means "information and documents of any kind, whether verbal, electronic or in writing, developed by the [Applicants] and/or

their legal counsel in the defence of the Underlying Claims and/or the Opioid Claims, that are subject to litigation privilege and/or solicitor-client privilege as between the [Applicants] and their legal counsel." This includes reports from defence counsel on the status of the litigation, assessments of the claims and evidence, legal analysis, proposed strategies and anticipated future steps. Privileged Defence Information also includes any other documents or information that are created from or in relation to Privileged Defence Information, including documents and information of any kind created by Zurich's authorized representatives.

d. Privileged Defence Information does not include "public-facing information". Public-facing information means documents and information relating to the Underlying Claims that are not privileged and confidential, and includes, for example, information regarding procedural steps, documentary productions, discovery transcripts, expert reports that have been served, motion records, mediation briefs, pretrial briefs and decisions of the Court and any related judgments and orders.

e. The Applicants agree that they will make public-facing information available to Zurich without restriction to authorized representatives, as requested.

f. Zurich will maintain ethical screens to ensure that Privileged Defence Information is not received by or available to any person or entity other than the authorized representatives.

g. In the event of a development in the Underlying Claims that would require a substantial reserve change or a payment (for example, the scheduling of a mediation or in anticipation of an offer to settle), and upon request from an authorized representative, the Applicants agree to provide a "reserve report" that would support such a reserve change or payment. The reserve report will be used solely to support a reserve and/or payment request in excess of the authorized representatives' financial authority, and for no other purpose (including, but not limited to, the determination of coverage for the Underlying Claims).

h. Zurich and the authorized representatives agree not to use any Privileged Defence Information or any reserve report for any purpose other than the defence and/or settlement of the Underlying Claims against the Applicants. This includes establishing appropriate legal and indemnity reserves, including obtaining reserve and settlement authority as required.

i. The authorized representatives will not have any involvement of any kind with respect to the assessment or determination of coverage issues or the defence of any other person or entity in relation to the Underlying Claims, unless the Applicants provide their prior written consent.

j. In the event of any dispute between Zurich and the Applicants with respect to insurance coverage for the Underlying Claims, Zurich will never seek to use or rely on Privileged Defence Information or any reserve report in any way, including but not limited to attempting to have Privileged Defence Information or any reserve report admitted into evidence in a proceeding.

k. The Defendants agree that they will continue to provide "coverage reporting" to Zurich in respect of all Underlying Claims whenever a major step occurs in any of the Underlying Claims, such as, but not limited to, the completion of pleadings, the scheduling or completion of discoveries, the scheduling or completion of any motion, trial or other hearing, or the scheduling of mediation. The Applicants also agree to provide additional coverage reporting to Zurich from time to time as reasonably requested. "Coverage reporting" means the provision of public-facing information to Zurich without restriction of access to only authorized representatives.

l. The DRA does not modify or restrict any obligations owed under the Zurich Policies, or any rights available under the Zurich Policies, nor may it be relied upon in respect of any dispute regarding the interpretation or application of any of the Zurich Policies or in any proceeding related thereto.

B. DISCUSSION

1. Duty to defend and equitable allocation of defence costs as between insurers

a. Positions of the parties

[26] The Applicants' position is that they are entitled to a defence from each Primary Insurer, subject to the deductibles/SIRs. They state that since more than one policy provides defence coverage, they are entitled to select any one policy and that insurer is contractually bound to provide a full defence of all covered claims, even if this furthers the defence of uncovered claims. That insurer is then entitled to seek equitable contribution from other insurers with overlapping or concurrent defence obligations.

[27] Aviva has acknowledged that it owes SDM and Sanis a duty to defend all five Underlying Claims with respect to its "years on risk", i.e. for the period it provided coverage to SDM and Sanis (February 1, 2000 to July 1, 2014). Aviva's position is that it has no obligation to defend Loblaw, who it never insured, and no obligation to defend claims that fall outside its coverage period. Aviva submits that where the Underlying Claim allege injury that may have occurred in one or more successive policy periods, defence obligations should be allocated in proportion to the insurer's number of years on risk. It further submits that the insured does not have the right to choose which policy ought to defend as the case law relied upon by the Applicants on this point does not apply to a case where different insurers were on risk for different timeframes. Finally, Aviva argues that the SIRs under the policies issued by other insurers should not alter these insurers' obligation to contribute to the defence costs and the allocation of such costs. Subject to the defence obligations of Teva and its insurers (which are not before me at this time), Aviva

proposes a time-on-risk allocation between Aviva and Zurich for Sanis, and between Liberty, Aviva and Zurich for SDM. The proposed allocations have been agreed upon by Zurich and Liberty.

[28] Liberty submits that it does not have any duty to defend or contribute to the defence costs of any entity other than SDM, nor any duty to defend or contribute to the defence costs of SDM for damages for bodily injury which allegedly occurred either before or after Liberty was on risk (i.e. from January 1, 1996 to February 4, 2000). Liberty further submits that the allocation of defence costs should include SDM in that SDM should have to contribute to its defence for the years when its insurance contracts provide for an SIR (with respect to Liberty, $1 million SIR under Liberty's 1998-1999 policy).

[29] Zurich has acknowledged that, in relation to the Underlying Claims: (a) it has an obligation to indemnify Loblaw for defence costs for the 1998-2000 and 2001-2003 policy periods, upon the exhaustion of the applicable SIRs; (b) it has a duty to defend Loblaw for the 2004, 2007, 2010, 2013 and 2016 policy periods, upon the exhaustion of the applicable SIRs; and (c) it has a duty to defend SDM and Sanis from July 2014 for the 2013 and 2016 policy periods, upon the exhaustion of the applicable SIRs. Zurich disagrees that the Applicants are entitled at law to select a single insurer to defend and that it is the responsibility of the selected insurer to look to the other insurers for equitable contribution. With respect to the proper allocation of defence costs as between insurers, Zurich's position is that the Court should use the "time-on-risk" approach, and that insurers should not be responsible for those policy years in which the Applicants failed to obtain any primary CGL coverage.

[30] RSA's position is that it has an obligation to contribute to the costs of the appropriate defence of Loblaw alone – with respect to the three Underlying Claims to which Loblaw is a party – for only eight months out of the total 272-month "time-on-risk period". This is because its duty to defend arises solely with respect to bodily injuries alleged to have been occurring during the policy period. Further, this obligation is subject to a deductible that applies to defence costs. According to RSA, the law in Canada for complex multi-year exposure cases is that the appropriate allocation approach is time-on-risk. It argues that the Applicants are proposing an "all-sums approach"[3] and that the Court should not give any consideration to such an approach, which, according to RSA, is arbitrary, inequitable and unprincipled. RSA states that the case law relied upon by the Applicants regarding the scope of the duty to defend does not apply to cases involving allocation of defence costs over multiple years of risk. It also submits that Loblaw must participate in funding the defence costs in respect of all the months for which liability insurance coverage is

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[3] The Court of Appeal described the "all-sums approach" as follows in *Goodyear Canada Inc. v. American International Companies (American Home Assurance Company)*, 2013 ONCA 395 at para. 17:

> Under this "all-sums approach" to liability allocation, a single insurer could be required to pay the entire amount of an asbestos injury claim, notwithstanding that multiple policy periods are triggered by the applicable claim. In effect, the all-sums approach imposes joint and several liability on all insurers whose policies have been triggered.

unavailable or not responding for any reason, including (but not limited to) deductibles or SIRs. It argues that the defence costs incurred by the Applicants prior to RSA receiving first notice of the Underlying Claims are not covered by RSA's policy.

[31] AIG does not dispute that the three Underlying Claims to which Loblaw is a party contain allegations that would trigger possible coverage under its policy and a duty to defend. However, AIG's position is that the policy has a significant SIR that must be satisfied by Loblaw before any liabilities, including the duty to defend, arise for AIG. AIG also submits that its duty to defend is not unqualified and must be equitably allocated with other Primary Insurers for Loblaw. It argues that the case law relied upon by the Applicants does not apply to this case as it deals with defence of "mixed claims" by a single insurer as opposed to a trigger of multiple responsive insurance policies over time. AIG also argues that the Applicants' "all-sums approach" to defence obligations should be rejected and that, in any event, the issue of whether the Applicants have a unilateral right to select a single policy for defence duties is moot because the issue of the fair and equitable allocation for defence duties over multiple policy periods is before this Court. According to AIG, where a loss is alleged to span multiple policies and policy periods, the prevailing approach to equitable allocation in Canada is time-on-risk, where insurers contribute to defence based on their respective policy periods relative to the total allocation period. AIG states that it is only "on risk" for less than 6% of the total period, and that any greater allocation of defence costs to AIG (including an equal-shares approach) would be grossly unjust. Finally, AIG takes the position that Loblaw is not entitled to "pre-tender defence costs", i.e. defence costs incurred prior to providing notice to AIG, and that relief from forfeiture should not be granted.

[32] At the hearing, I was advised that the Primary Insurers agree that, with respect to the defence costs incurred as of the date of the hearing, one third should be allocated to each of the Applicants, subject to reallocation at a later time. The discontinuance of the BC HMQ Action as against Loblaw during the hearing may affect the insurers' position for the period between the hearing and the release of this decision. I was also advised that AIG, RSA and Zurich are prepared to fund Loblaw's defence costs on the basis of the following time-on-risk allocation, subject to SIRs and the appointment of independent, unconflicted counsel for Loblaw: AIG – 6%, RSA – 3%, Zurich – 91%.

b. General principles regarding the interpretation of insurance policies and the duty to defend

[33] The relationship between an insured and an insurer is a contractual one that is primarily governed by the terms of the insurance policy. The proper instrument to determine the liability of each insurer is the contract itself: see *Markham (City) v. AIG Insurance Company of Canada*, 2020 ONCA 239 at para. 44; leave to appeal refused: [2020] S.C.C.A. No. 170 ("***Markham***").

[34] The Supreme Court of Canada has outlined general principles that apply when interpreting an insurance policy. The primary interpretive principle is that when the language of the policy is unambiguous, the court should give effect to clear language, reading the contract as a whole. Where the language of the insurance policy is ambiguous, general rules of contract construction apply. For example, courts should prefer interpretations that are consistent with the reasonable expectations of the parties, so long as such an interpretation can be supported by the text of the

policy. Courts should avoid interpretations that would give rise to an unrealistic result or that would not have been in the contemplation of the parties at the time the policy was concluded. Courts should also strive to ensure that similar insurance policies are construed consistently. When these rules of construction fail to resolve the ambiguity, courts will construe the policy *contra proferentem* – against the insurer. One corollary of the *contra proferentem* rule is that coverage provisions are interpreted broadly, and exclusion clauses narrowly. See *Progressive Homes Ltd. v. Lombard General Insurance Co. of Canada*, 2010 SCC 33 at paras. 21-24 ("***Progressive Homes***").

[35] Thus, the language of an insurance policy is to be construed in accordance with the usual rules of construction, rather than inferred expectations unapparent on a fair reading of the document. This is particularly so in the case of commercial insurance policies involving sophisticated parties. The insurer must explicitly state the basis on which coverage may be limited. See *Family and Children's Services of Lanark, Leeds and Grenville v. Co-operators General Insurance Company*, 2021 ONCA 159 at para. 55.

[36] The duty to defend is broader than the duty to indemnify and constitutes a separate and independent contractual obligation. The outcome of the trial is irrelevant to the duty to defend. The duty would be a hollow one if the insurer's only obligation were to indemnify its insured at the end of the day. Thus, issues related to the duty to defend must be determined expeditiously, on the basis of the allegations in the underlying litigation, read with the insurance coverage. See *Carneiro v. Durham (Regional Municipality)*, 2015 ONCA 909 at paras. 26, 29 ("***Carneiro***").

[37] An insurer is required to defend a claim where the facts alleged in the pleadings, if proven to be true, would require the insurer to indemnify the insured for the claim. It is irrelevant whether the allegations in the pleadings can be proven in evidence. That is to say, the duty to defend is not dependent on the insured actually being liable and the insurer actually being obligated to indemnify. What is required is the mere possibility that a claim falls within the insurance policy. Where it is clear that the claim falls outside the policy, either because it does not come within the initial grant of coverage or is excluded by an exclusion clause, there will be no duty to defend. See *Progressive Homes* at para. 19. Any doubt as to whether the pleadings bring the incident within the coverage of the policy ought to be resolved in favour of the insured: *Monenco Ltd. v. Commonwealth Insurance Co.*, 2001 SCC 49 at para. 31.

[38] Where two insurers have an obligation to defend the same claim, the insured is entitled to select the policy under which to claim indemnity, subject to any conditions in the policy to the contrary: see *Markham* at para. 78. See also *Family Insurance Corp. v. Lombard Canada Ltd.*, 2002 SCC 48 at para. 14 ("***Family Insurance***"). The insurer selected by the insured to defend the claim may be entitled to contribution from all other insurers who have a concurrent duty to defend the insured: *Markham* at para. 79. The allocation of defence costs as among insurers who have a concurrent obligation to defend is essentially a matter of fairness as among those insurers. As such, the allocation of costs is not an exact science: see *Markham* at para. 83.

c. Discussion of cases on duty to defend referred to by the parties

[39] The Applicants' submissions regarding the scope of the duty to defend in this case are largely based on the decision of the Court of Appeal in *Hanis v. Teevan*, 2008 ONCA 678, 82 O.R. (3d) 594; leave to appeal refused: [2008] S.C.C.A. 504 ("***Hanis***").

[40] In *Hanis*, the Court of Appeal summarized the issue before the court and its answer as follows:

> [1] How, if at all, should the costs of defending a lawsuit be apportioned between the insurer and insured when some, but not all, of the claims made in the lawsuit are covered by the applicable insurance policy?
>
> [2] I would hold that the question of apportionment of costs should be determined by the operative language in the policy. Where there is an unqualified obligation to pay for the defence of claims covered by the policy, as in this case, 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 insurer is not obliged to pay costs related solely to the defence of uncovered claims.

[41] Writing for the Court, Doherty J.A. anchored his analysis in the contract between the parties and rejected an approach that turned on considerations of fairness or equity:

> [22] I also favour the contractual analysis. The relationship between an insured and an insurer is contractual and must be governed primarily by the terms of the relevant policy of insurance. The insurer's obligations are found first and foremost in the policy. Those obligations may include the obligation to pay all or some of the costs associated with the defence of covered claims. It makes eminent sense that any inquiry as to the nature and scope of the insurer's duty to pay those costs should start with the language of the policy. I agree with the observations of Newbury J.A. in *Coronation Insurance*, at para. 42, where, in the course of approving the contractual analysis approach, she stated:
>
> > In my view this approach construes the language of the policy in a manner consistent with the usual rules of construction rather than according to some inferred "expectations" not apparent on a fair reading of the document; and it provides insureds with the full benefit of their policy. It requires an insurer to state explicitly the basis, if any, on which coverage may be limited, and it avoids lengthy hearings designed to explore "metaphysical" underpinnings of why a corporation or its directors and officers might have acted as they did. (Citation omitted)
>
> [23] I see no unfairness to the insurer in holding it responsible for all reasonable costs related to the defence of covered claims if that is what is provided for by the language of the policy. If the insurer has contracted to cover all defence costs

> relating to a claim, those costs do not increase because they also assist the insured in the defence of an uncovered claim. The insurer's exposure for liability for defence costs is not increased. Similarly, the insured receives nothing more than what it bargained for -- payment of all defence costs related to a covered claim.
>
> [24] An analysis based on an interpretation of the language of the policy also demonstrates the inappropriateness of the analogy drawn by the New Zealand Court of Appeal to cases involving apportionment issues between insurers. Apportionment between insurers does not arise in the context of a contractual relationship that specifically addresses the obligation of one party to pay the defence costs of the other party.
>
> [25] […] However, in the context of defending covered and uncovered claims in the same suit, a distinction must be drawn between cases where defence costs are related exclusively to the defence of either covered or uncovered claims, and cases where the same costs are incurred in the defence of both covered and uncovered claims. In the former circumstance, an allocation of costs would be required, barring a policy which provided for payment of defence costs relating to uncovered claims. In the latter case, allocation would not be necessary unless the policy provided for allocation where the costs related to both covered and uncovered claims. […]
>
> [29] For the reasons set out above, I do not think that the nature and extent of the insurer's obligation to pay defence costs is a question of fairness or unfairness. Rather, it is a question of what the insurer has agreed to do in the policy. The answer to that question lies in the language of the policy, not in judicial notions of fairness.

[42] I pause to note that as reflected in paragraph 17 above, none of the policies of the Primary Insurers provide for allocation where the defence costs relate to both covered and uncovered claims.

[43] *Hanis* was applied by the Court of Appeal in *Tedford v. TD Insurance Meloche Monnex*, 2012 ONCA 429, 112 O.R. (3d) 144 ("***Tedford***"). In that case, the insured was sued for negligent misrepresentations that were alleged to have caused both repair costs and health consequences. Only the health consequences were covered by the insurance policy. The Court of Appeal concluded that an apportionment of the costs of the defence between covered and uncovered claims was appropriate in that case, but it did not order a particular allocation. The Court held as follows:

> [24] I would direct, unless the parties otherwise agree, that the [insurer]'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 [insured] bear the costs of the defence, to the extent 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.
>
> [25] 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.

[44] Thus, in *Tedford*, in the event the parties could not agree on an allocation of the defence costs between covered and uncovered claims, the insurer was to pay all defence costs and apply for a determination of the allocation after the matter was concluded.

[45] *Hanis* and *Tedford* were both considered by the Court of Appeal in *Carneiro*. In that case, the Court of Appeal ordered the insurer to defend the action in its entirety, but stated that the insurer was entitled to seek an apportionment of the defence costs at the end of the proceedings, "to the extent they deal solely with uncovered claims, or exceed the reasonable costs associated with the defence of the covered claims" (para. 28). [Emphasis in the original.]

[46] The *Hanis*, *Tedford* and *Carneiro* cases dealt with claims that were not covered by the insurance policy because of their "nature" and not because they fell outside of the policy period. In the present case, the insurers have not attempted to demonstrate that any defence costs have been or will be spent defending solely claims that are not covered by the policies because of their nature. While one insurer emphasized in oral argument that the Underlying Claims alleged many types of claims that could not possibly be covered by the insurance policies, none of the insurers proposed a way in which the defence of the claims set out in the pleadings could be reasonably, practically and realistically separated or allocated between covered and uncovered claims. The argument that an apportionment of defence costs between covered and uncovered claims is possible remains open to the Primary Insurers in the future based on the principles set out in *Hanis* and *Carneiro*, but there is no evidence supporting such an argument before me at this stage of the class actions. Based on the pleadings in the Underlying Claims, I agree with the Applicants that allegations of intentional acts, which some insurers may seek to exclude, are inextricably interwoven with the negligence claims.

[47] While some insurers argued that their liability was likely to be non-existent or very restricted given the limited role of their insured (Loblaw) and/or the fact that their coverage period was at the very beginning of the class period, this type of analysis is not permitted at this stage to determine whether a duty to defend exists because, as stated above, such determination is based on the pleadings and it is irrelevant whether the allegations in the pleadings can be proven in evidence.

[48] Rather than being focused on the nature of the claims alleged against the Applicants, most of the insurers' arguments on this Application were focused on the temporal scope of the Underlying Claims which is broader than their respective coverage periods. In their view, the principles set out in *Hanis* do not apply to this kind of situation.

[49] A similar situation was discussed in *Lombard General Insurance Company of Canada v. 328354 B.C. Ltd.*, 2012 BCSC 431 ("***Lombard***"), where Butler J. of the Supreme Court of British Columbia (as he then was) applied the principles set out in *Hanis* in the context of an action where the damage was alleged to have occurred over a period of time that was, in part, outside of the coverage period and uninsured. Butler J. stated that the issue before him was whether "an insurer's obligation to fund the costs of the defence can be apportioned prospectively prior to trial on a 'time on risk' basis." (para. 4)

[50] Butler J. found that some of the property damage claims in the action were covered and some were not because they occurred outside of the coverage period. In his view, the principles set out in *Hanis* applied to this situation. He stated the following:

> [57] Although the circumstances in *Hanis* involved a different sort of "mixed" claim than in the instant case, the approach to the basic principles regarding apportionment is persuasive. In my view, the contractual interpretation analysis is particularly well suited to the circumstances of a pre-trial application for apportionment between an insurer and an insured, at which stage there is only limited information available. Moreover, this approach embraces all of the established principles regarding the duty to defend and the rules of construction – just as an insured cannot expect to receive any greater benefit than what he or she contracted for, an insurer cannot seek to limit its defence obligation beyond what is expressly stated in the policy.
>
> [58] I do not accept Lombard's submission that *Hanis* is limited to claims involving separate but overlapping causes of action, and inapplicable to cases in which the pleadings allege continuous or progressive damage, where the essential cause of action is the same but the occurrence of damage is alleged to have taken place both within and outside the policy period. That distinction is irrelevant to the issue before this Court. What is important is that in both situations, defence costs are intertwined and it is difficult to separate them as between covered and uncovered claims – in one situation because the essential causes of action are intertwined, and in the other, because the defence costs may be incurred regardless of the length of the period during which damage was caused.
>
> [59] In summary on this issue, I conclude that the equitable concept of fairness does not require a court to order an apportionment of defence costs in all cases of continuous or progressive damage. Rather, an insurer's duty to defend and the extent to which it must pay for or contribute to the cost of that defence are to be determined according to the terms of coverage and the circumstances of the underlying litigation.

[51] Ultimately, Butler J. declined to apportion defence costs. He concluded as follows:

> [67] I conclude on the basis of the material before me that there is no reasonable or practical means of apportioning defence costs at this stage of the

> proceedings. The pleadings do not specify the extent to which damage is alleged to have occurred within or outside the policy period, and there is no useful evidence regarding the costs associated with defending the claims falling within coverage and those not. Accordingly, there is no basis upon which I can infer that the defence costs bear a direct proportion to the parties' time on risk. Indeed, it is evident to me that this proposition is without merit. All of the property damage claims have their genesis in the same allegations of water ingress due to construction deficiencies and defects. The fact that some of the damage is alleged to have occurred outside the period of coverage does not necessarily lead to separate and readily ascertainable costs of defence. Rather, I conclude it is likely that a substantial amount of the defence costs that will be incurred would have been incurred even if the period of continuous or progressive damage ended when the insurance coverage terminated. Furthermore, there is no evidence before the Court that allows me to fairly apportion the costs of defence on any other basis. In my view, any apportionment at this time would be arbitrary and premature.
>
> […]
>
> [70] As the express wording of the Policies provides that Lombard has a duty to defend any action seeking compensatory damages because of property damage occurring within the policy period, it follows that Lombard must pay all reasonable costs of defending such claims, regardless of whether they also assist in the defence of claims in respect of damage falling outside the policy period. This conclusion imposes no greater obligation on Lombard than what it contracted for in the first place. This interpretation accords with the clear language in the insuring agreements.
>
> [71] This conclusion does not amount to providing the Developers with a "free defence" for the claims in respect of damage falling outside the period of coverage. To the extent that the defence of those claims results in separate and readily ascertainable costs of defence, it will be open to Lombard to seek reimbursement for such costs as they are incurred or at a later stage in the proceedings. Accordingly, there is no unfairness to Lombard in requiring it to provide a full defence at this time.

[52] The Primary Insurers describe *Lombard* as an "outlier" and seek to rely on different cases which allowed an apportionment of defence costs. Before turning to these cases, I will discuss briefly a few other decisions of the Court of Appeal for Ontario that are relied upon by the Applicants.

[53] In *St. Paul Fire & Marine Insurance Co. v. Durabla Canada Ltd.*, 1996 CanLII 494, 29 O.R. (3d) 737 (C.A.) ("***Durabla***"), the insurer was seeking to pay defence costs on some *pro rata* basis with respect to a large number of claims alleging injuries caused by exposure to asbestos products manufactured by the insured. The Court of Appeal refused to order the insured to pay a

portion of the defence costs, even though it was uninsured for part of the relevant period. The Court stated the following:

> Having regard to the fact that the insured did not have insurance coverage throughout the entire period covered by the claims asserted against it, we can see an element of fairness in the appellants' submission that the respondent should be obliged to make some contribution to the costs of its defence. But it is clear that, unlike as in some of the American authorities to which we were referred, a simple declaration of the fairness of proration will not suffice. Rather, the court would have to devise some mathematical formula as a basis for such proration. We do not find ourselves in a position to articulate an equitable formula for such proration at this stage of the proceedings. The impediments to a formulation that would fairly reflect the competing interests of the insurer and the insured at this stage of the proceedings are the imprecision of the allegations asserted by the claimants in the underlying actions and the absence of any firm factual foundation for whatever proration formula might be selected. In these circumstances, we have concluded that the [insurers] should bear the sole cost of discharging their duty to defend, subject to such entitlement as they have in law to recover all or an appropriate portion of their costs of defence from the insured following the ultimate disposition of the underlying actions.

[54] Later that same year, the Court of Appeal also declined to apportion defence costs between an insurer and an insured in *Daher v. Economical Mutual Insurance Co.*, 1996 CanLII 639, 31 O.R. (3d) 472 (C.A.) ("***Daher***"). The Court of Appeal referred to its conclusion in *Durabla* and found that the same considerations applied in *Daher*. Writing for the Court, Rosenberg J.A. stated the following:

> The appellant submits that, even if there was a duty to defend the third party claim, the costs of the defence should be apportioned between it and the respondents. The appellant argues that, even if the claim alleges negligence on the part of the respondents as shopkeepers, the principal claim is against the respondents in their role as parents. The appellant submits that the issue should be referred to the assessment officer at Windsor to hear evidence and then apportion the defence costs.
>
> In a proper case it may be possible to apportion the defence costs where only certain claims fall within the terms of the policy […]. This is not a case, however, of multiple causes of action where it is possible to divide the costs of defending the various causes of action. The third party claim alleges only a single cause of action with different theories of liability. The facts giving rise to the multiple theories of liability are so intertwined that I cannot see any principled basis upon which this court or an assessment officer could unravel them to apportion costs to one theory rather than another. The appellant did not place before us any material to demonstrate how this might be done and offered no theory upon which the assessment officer could fairly apportion the costs.

[…]

> In my view, it is simply not practical to divide the defence costs in these circumstances. As Harding L.J.S.C. observed in *St. Andrew's Service Co. v. McCubbin* (1988), 1988 CanLII 2926 (BC SC), 31 C.C.L.I. 161 at p. 165 (B.C.S.C.), "**there is no means of readily distinguishing the costs of defence between the covered and not covered items**. The possible ways to apportion an expense between two parties submitted by the third party cannot apply in these circumstances" […]. [Emphasis added.]

[55] In my view, the principles that informed the decisions in *Durabla* and *Daher* are the same than those set out in *Hanis*. An argument that a particular allocation (or absence thereof) is fair or unfair is insufficient in the face of a contract. Any proposed allocation between an insured and an insurer must be principled, based on the allegations in the claim, have a factual foundation and be consistent with the terms of the policy, including the insurer's duty to defend covered claims.

[56] It is important to distinguish the issue of the duty to defend between the insured and the insurer(s), which is a contractual issue, and the issue of the allocation of defence costs among multiple insurers under a concurrent obligation to defend, which is dealt with based on equitable principles as a result of the absence of a contractual nexus between them. This was made clear by the Court of Appeal back in 1990 in *Broadhurst & Ball v. American Home Assurance Co.*, 1990 CanLII 6981, 1 O.R. (3d) 225 (C.A.) ("***Broadhurst***"):

> This brings me to the question raised by the cross-appeal. Accepting that Guardian, as the excess insurer, and American Home, as the primary insurer, are under concurrent obligations to defend the respondents against the claims asserted in the Lumsden Building action, should the costs of defending the action be apportioned between these insurers, as American Home contends, and if so in what proportions?
>
> In dealing with this issue, Anderson J. recognized that it would be "consistent with equity and good conscience, to say that because both insurers have a duty to defend, albeit a duty arising under separate contracts with the plaintiff, to each of which the other is a stranger, each should contribute to the costs of defence". Nevertheless he concluded that, since American Home and Guardian are separate insurers with no contractual nexus between them, there is no legal basis for such contribution. He accordingly refused the order sought by American Home requiring Guardian to share in the costs of the defence.
>
> There are few Canadian or English decisions that offer any assistance on this subject. There are, however, numerous American decisions in which the reciprocal obligations of several insurers to bear the costs of defending a common insured have been considered. […]
>
> Some of the cases to which we have been referred involve multiple insurers, each providing primary coverage and each bound under its policy to defend the

> insured. The traditional view in these cases has been that, even among two or more primary insurers, an insurer that has paid defence costs cannot recover them from a co-insurer on the rationale that the duty to defend is personal to the particular insurer. However, in a growing number of cases, the courts have invoked the principle of equitable subrogation to allow the insurer who has performed the duty to provide a defence to compel contribution for a share of the cost of the defence from another insurer who has a similar obligation to the same insured but fails to perform it.
>
> […]
>
> Returning to the instant case, I am persuaded that the absence of any contractual nexus between the primary and excess insurers should not, in the present circumstances, preclude the court from ordering the excess insurer to pay its fair share of the costs of defence of the Lumsden Building action. […]
>
> On the facts of the present case, it appears to me that, as a simple matter of fairness between insurers under concurrent obligations to defend, and, as well, in fairness to the insured, Guardian should pay a proper share of the costs of defence. It follows that American Home should be able to compel such payment. Since these insurers have no agreement between themselves with respect to the defence, their respective obligations cannot be a matter of contract. Nonetheless, their obligations should be subject to and governed by principles of equity and good conscience, which, in my opinion, dictate that the costs of litigation should be equitably distributed between them.
>
> […]
>
> On what basis, then, should the costs of defending the Lumsden Building action be apportioned between these insurers? In American Home's submission, they should be shared pro rata in proportion to the coverages afforded by each insurer, that is, 95 per cent of costs should be borne by Guardian and 5 per cent by American Home. I cannot accept that submission. The underlying action here, unlike the situation in most of the American cases, has not yet been tried or settled; it remains outstanding and its final outcome will not likely be known for some time. In this situation, I do not think it appropriate to allocate costs simply by reference to the respective policy limits, although I would add, in other situations, this may well be a fitting basis for the allocation. The costs of providing the defence here are clearly not necessarily related to the monetary limits of the policies. It seems to me, in viewing the matter broadly and as best I can, that the fairest, most reasonable and most equitable allocation of costs that can be made in the overall circumstances of this case is to apportion them equally between the insurers.

[57] The difference between the contractual approach applicable to the insured-insurer relationship and the equitable approach applicable among multiple insurers with no contractual

nexus was at the center of the analysis in *St. Paul Fire and Marine Insurance Company v. AIG Insurance Company of Canada*, 2019 ONSC 6489 ("***St. Paul***"), one of the cases relied upon by the insurers. In *St. Paul*, Sossin J. (as he then was) addressed the issue of how defence costs should be allocated where sequential insurers of a defendant have a duty to defend a single claim. The application before Sossin J. was brought by one of the insurers for a declaration that other insurers had a duty to defend the insured, and for a declaration that the costs of defending the action were to be allocated among the insurers involved in proportion to their time on risk.

[58] Sossin J. noted at paragraph 77 that the allocation of defence costs among insurers was a question of fairness within the Court's equitable jurisdiction. After reviewing a number of authorities, he found that the time-on-risk approach was an appropriate approach to allocate defence costs in this case at first instance. He stated the following:

> [90] In light of this analysis, and relying on *Hay Bay* and *Goodyear*, I find the time on risk approach to be appropriate as an allocative approach for defence costs at first instance. Assuming the damage is continuous, this approach reflects a proportionate *pro rata* calculation of which insurer will be responsible for defence costs based on the months or years of covered damage under its policies.
>
> [91] This approach, however, does not represent a final allocation of defence costs. Based on evidence in the trial, or findings on interlocutory motions, the actual damage occurring during actual time periods may clarify the proportion of damage for which each insurer actually was responsible. At that time, such findings may well merit a recalculation of defence costs.

[59] Sossin J. was also asked to determine whether an insurer (Zurich) was entitled to apply the SIR under its insurance policy to its obligation to contribute to defence costs so that any duty to defend would only be triggered after the SIR clause was satisfied. The insured's position was that the SIR only applied to the duty to indemnify, not the duty to defend. Ultimately, Sossin J. declined to determine the SIR issue in the context of this particular application. He stated the following:

> [96] Lockerbie [the insured] further argues that St. Paul's application against the other insurers for contributions to the defence costs is a claim in equity, not contract, and therefore the SIR provision, and the contractual rights or burdens to which it gives rise, does not constitute a basis on which to alter the allocation of defence costs as between the various insurers.
>
> [97] I share this view. I find that St. Paul's application is not the appropriate proceeding to address the possibility of a contractual dispute between Zurich and Lockerbie respecting the SIR. For purposes of this application, the only issues are whether Zurich has a duty to defend and what its allocation of defence costs should be.
>
> [98] 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.

[60] Thus, Sossin J. granted St. Paul's application with respect to the time-on-risk approach for allocating the defence costs among the four insurers who had a duty to defend, and found that Zurich's obligation under this allocation scheme was not affected by the SIR in its policy. However, this finding was without prejudice to this issue being the subject of a separate proceeding between Zurich and the insured: see paras. 99-100.

[61] Aside from the issue of the SIR, which is discussed further below, it is my view that *St. Paul* does not assist the Primary Insurers with respect to their arguments vis-à-vis the Applicants. In *St. Paul*, Sossin J. was dealing with an issue of apportionment among insurers, based on an equitable approach. He expressly declined to deal with issues of contractual rights between the insured and individual insurers because such issues were not before him. Thus, *St. Paul* is not authority for the proposition that the principles set out in *Hanis* do not apply between an insured and an insurer in a situation where sequential insurers have a duty to defend the same claim. To the contrary, the insurer who brought the application in *St. Paul* acknowledged its duty to defend and, prior to bringing its application against the other insurers, covered all expenses relating to the insured's defence even though it was only responsible for approximately seven per cent of the defence costs under a time-on-risk approach. As for the issue of equitable allocation among insurers, all the Primary Insurers in this case agree on a time-on-risk allocation, so the relevant principles set out in *St. Paul* are not in dispute.

[62] Many of the Primary Insurers rely heavily on the case *Goodyear Canada Inc. v. American International Companies (American Home Assurance Company)*, 2013 ONCA 395 ("***Goodyear***"). In *Goodyear*, the parties agreed to have certain interpretive issues regarding the relevant insurance policies determined on a motion prior to trial. The underlying litigation in this case was asbestos-related. The bodily injuries at issue potentially spanned the period from 1969 to the present, but Goodyear only had insurance coverage between 1969 and 1980. The evidence showed that after 1985, Goodyear was unable to obtain insurance coverage at commercially reasonable rates for asbestos-related liability due to a decision by the insurance industry to cease underwriting such risks ("**Coverage Cut-off**"). Based on a U.S. decision dealing with similar circumstances, Goodyear argued that the insurers should be held responsible for any asbestos injuries that occurred after 1986, i.e. after the Coverage Cut-off (the so-called *Stonewall* principle).

[63] The Court of Appeal rejected Goodyear's argument and refused to follow the U.S. decision in question and to import the *Stonewall* principle into Ontario law, primarily because adopting this principle would offend the express terms of the insurance policies and expand the scope of the coverage that was contractually agreed upon. As noted by the Court of Appeal, there was no contractual foundation or consideration for the deemed transfer of risk argued by Goodyear (para .71).

[64] For the purpose of the motion in *Goodyear*, the parties agreed that the *pro rata* approach and the continuous trigger theory would apply with respect to the allocation of losses spanning multiple policy years (see para. 23). Given this agreed-upon assumption, the Court of Appeal did not have to make any ruling with respect to this issue, but it discussed briefly certain liability allocation approaches, including the "all-sums approach", at paragraphs 14-21. See also *Alie v. Bertrand & Frere Construction Co. Ltd.*, 2002 CanLII 31835 at paras. 93-104 (C.A.) ("***Alie***").

The Respondents argue that rules governing the duty to defend and the allocation of defence costs should be inferred from the Court of Appeal's general discussion. I disagree.

[65] As a preliminary matter, it is important to note, as did the motion judge in *Goodyear*, that the adoption of a particular trigger theory to determine which insurance policies responded and how responsibility for payment of the claims should be allocated amongst the parties is an issue for the trial judge: see *Goodyear Canada Inc. v. American International Companies (American Home Assurance Company)*, 2011 ONSC 5422 at para. 4. In *Alie*, the Court of Appeal suggested that the appropriate trigger theory in a particular case should be selected based on "the requirements of the policy language together with the facts of the specific case, including the evidence of when the injury actually occurred, when it was manifest and how many insurance policies are potentially available and liable to respond": see para. 104. In *Durabla*, the Court of Appeal held that it was neither appropriate nor essential to the disposition of the determination of a duty to defend issue to determine the appropriate theory of liability and choose among competing theories. See also *Royal & Sun Alliance Insurance Co. of Canada v. Fiberglass Canada Inc.*, 1999 CarswellOnt 977 at para. 13 (Gen. Div.). As stated above, the Court of Appeal in *Goodyear* did not select a trigger theory or allocation approach – they were agreed-upon assumptions for the purpose of the motion.

[66] It is my view that the discussion in *Goodyear* is not directly relevant to the issues before me regarding the duty to defend and that the Respondents give to this case an unjustifiably broad interpretation that is unsupported. *Goodyear* relates to the allocation of loss and the duty to indemnify, and does not discuss the scope of the duty to defend owed by an insurer to an insured. The issue before the Court was quite narrow – whether the *Stonewall* principle applied in Ontario – and the Court did not discuss defence costs nor any of the appellate case law dealing with the duty to defend. Further, there is nothing in *Goodyear* that contradicts the general principles set out in *Hanis*. To the contrary, the Court of Appeal in *Goodyear* once again emphasized that the contract governs the relationship between the insurer and the insured and that arguments based on fairness are insufficient to change the parties' contractual obligations.

[67] Some of the Respondents also rely on decisions of this Court that precede *Hanis* where insurers were ordered to pay defence costs based on their "time on risk": see, e.g., *Royal & Sun Alliance Insurance Co. of Canada v. Fiberglass Canada Inc.*, 1999 CarswellOnt 977 at para. 34 (Gen. Div.) and *Hay Bay Genetics Inc. v. MacGregor Concrete Products (Beachburg) Ltd.*, 2003 CarswellOnt 3355 at paras. 46-47 (S.C.J.) ("***Hay Bay***"). These cases contain very limited discussion as to the legal basis for the allocation decision, and they do not refer to the insured's contractual rights. As a result, I give them very little weight as I prefer the principled approach set out in *Hanis*, which, in my view, is more consistent with "first principles" and the contractual approach (as opposed to an equitable approach) adopted by the Supreme Court of Canada in *Family Insurance* and other cases with respect to the relationship between the insurer and the insured.

[68] *International Comfort Products Corp. (Canada) v. Royal Insurance Co. of Canada*, 2000 CarswellOnt 806 (S.C.J.) ("***International Comfort***") is another case that is referred to by some Respondents. This case dealt with the allocation of defence costs among a number of policies issued by the same insurer after the litigation ended. The main issue concerned the deductibles

under these policies. I similarly give little weight to this case given that it was decided before *Hanis* and its circumstances are significantly different from the circumstances here (e.g., there was only one insurer and the allocation took place after the end of the litigation).

[69] Finally, *General Electric Canada Co. v. Aviva Canada Inc.*, 2010 ONSC 6806; aff'd on other grounds: 2012 ONCA 525 ("***General Electric***") is also cited in support of the Primary Insurers' position. In that case, the application judge performed an equitable allocation of defence costs: see paras. 66, 82. This is clear from his reference, among other things, to *Broadhurst*. The judge concluded that it was inappropriate in that case to base the allocation purely on the number of "years on risk": see para. 81. He held that "the fairest, most reasonable and most equitable allocation of defence costs that can be done in the circumstances is to apportion the costs equally" between the two insurers and the insured, who was uninsured for part of the relevant period. This preliminary allocation was without prejudice to the parties' ability to revisit the issue after the conclusion of the matter or before in the event that further evidence leading to a different conclusion became available: see para. 84.

[70] In my view, *General Electric* is of limited utility on this Application. The application judge in that case adopted an equitable approach to allocation which does not apply between an insured and an insurer. Further, he did not perform any contractual analysis of the duty to defend and did not refer to *Hanis*. The discussion in support of his decision to include the insured in the equitable allocation is very short and appears to be based on *Hay Bay* (discussed briefly above). I also note that while the insurers attempt to rely on this case for certain purposes, it does not support their position regarding the broad adoption and application of a time-on-risk approach, which was rejected by the application judge.

[71] In light of the above, I conclude that the general principles set out in *Hanis* apply to this case and in the context of sequential insurers with a duty to defend. There is no principled or logical basis, in my view, to find that the discussion of covered and uncovered claims in *Hanis* does not apply to cases where the reason for which claims are uncovered is because they fall outside of the coverage period as opposed to another reason. Thus, I agree with the reasoning in *Lombard* on this point.

[72] Applying the principles set out in *Hanis,* the Primary Insurers have not argued that certain defence costs relate solely to uncovered claims that fall outside of a particular insurer's coverage period. They have not proposed a way that is based on the pleadings or facts in which the defence of the Underlying Claims could be reasonably, practically and realistically separated or allocated between claims/damages that fall within a particular coverage period and claims/damages that fall outside of that period. The reality is that the allegations in the Underlying Claims do not allow for a temporal segregation that would have the necessary degree of precision. The defence costs are intertwined and are not based on a particular period. The proposed time-on-risk allocation is not based on the pleadings, a factual foundation or the relevant policies: it is based on equity and fairness and not on the contractual relationships between the parties.

[73] As a result, I conclude that each of the Applicants is entitled to select any single policy under which there is a duty to defend that Applicant and require the Respondent insurer to defend: see *Hanis* and *Markham* at para. 78. The selected insurer is entitled to seek an apportionment of

the defence costs at the end of the proceedings to the extent that they deal solely with uncovered claims, or exceed the reasonable costs associated with the defence of the covered claims: see *Carneiro* at para. 28. The selected insurer can also seek an equitable allocation of defence costs among the insurers who have a concurrent obligation to defend the insured.

[74] I reject the submission of some of the Respondents that this approach to the duty to defend is the "all-sums approach". The "all-sums approach" relates to the duty to indemnify. This approach is based on the words "all sums" that often appear in indemnity provisions. Here, the Applicants are simply asking the Court to apply the principles set out in *Hanis* regarding the duty to defend, and the unqualified promise to defend any action where there is the mere possibility that any of the allegations, if proven, would trigger the duty to indemnify. While there cannot be an obligation on the part of the insurer to indemnify an insured for an uncovered claim, there may be an obligation to pay costs that further the defence of uncovered claims if those costs are also associated with the defence of covered claims. Again, the duty to defend is broader than the duty to indemnify. It does not depend on whether the insurer is ultimately required to indemnify the insured or the quantum of such indemnity.

d. Other Insurance Clause

[75] AIG argues that the "Other Insurance" clause in its policy prevents an "all-sums approach" and has the effect of excluding the *Hanis* principles. It states that this clause requires consideration of other policies and provides that AIG's liabilities will be limited to its proportionate share of total limits of liability of all valid and collectible insurance against such loss. That provision reads as follows:

> Other Insurance If the Insured has other insurance against a loss covered by this Policy the Company shall not be liable under this policy for a greater proportion of such loss than the applicable limit of liability stated in the declarations bears to the total applicable limit of liability of all valid and collectible insurance against such loss. [Emphasis in the original.]

[76] I have already addressed the "all-sums" argument above, and I disagree that this clause somehow overrides the principles set out in *Hanis*.

[77] First, it is not possible to apply this clause at this stage of the litigation, when the value of any "loss" is unknown. Second, this clause does not refer to the duty to defend which, again, is broader than the duty to indemnify In the duty to defend clause, AIG undertakes the obligation to defend any suit against Loblaw alleging such injury, sickness, etc., for which insurance is afforded under the policy. This obligation is unqualified and, as acknowledged by AIG, it has been triggered in this case (subject to the SIR issue). This duty is triggered even when there may be no loss at the end of the day because it applies to lawsuits that are groundless, false of fraudulent. Further, as stated above, the duty to defend clause does not provide for allocation where the defence costs relate to both covered and uncovered claims.

[78] In addition, I do not interpret the word "loss" in the "Other Insurance" clause as including defence costs. "Loss" is not defined in the policy and is used loosely throughout. In any event, if

there is any ambiguity regarding the meaning of "loss", the "Other Insurance" clause should be interpreted narrowly, based on the rules of interpretation set out above, and as not impacting the duty to defend.

[79] I also note that the "Other Insurance" clause does not put forward a "time-on-risk" allocation, contrary to AIG's position on this Application. Rather, the proportional approach set out in this clause is based on the limits of liability. AIG cannot rely on this clause partially and only when it suits it.

[80] Ultimately, as discussed further below, this decision does not represent a final allocation of defence costs. AIG may seek to rely on its "Other Insurance" and ask for a rateable proportion sharing of liability at the end of the proceedings.

e. Duty to defend an uninsured entity

[81] The Applicants argue that the Primary Insurers may be required to fund the defence of all three Applicants as a result of their duty to defend one or more Applicants.

[82] The two cases relied upon by the Applicants on this point are *Coronation Insurance v. Clearly Canadian Beverage*, 1999 BCCA 11 ("***Coronation Insurance***") and *New Zealand Forest Products Ltd. v. New Zealand Insurance Co. Ltd.*, [1997] 3 N.Z.L.R. 1 (J.C.P.C.) ("***New Zealand***") (both referred to in *Hanis*). These cases dealt with situations where: (a) the same law firm represented both a corporation and directors/officers; and (b) the issue of allocation arose after the underlying litigation had settled. In both cases, the same conclusions were reached:

a. costs which wholly and exclusively related to the insured's defence fell within the scope of the policy;

b. costs which in no way related to the defence of the claim against the insured were not covered by the policy; and

c. costs which reasonably related to the defence of the claim against the insured but did not exclusively do so were covered by the policy even though they also related to the defence of some other party who was not insured.

See *New Zealand* at 9 and *Coronation Insurance* at para. 43. These principles mirror the principles set out in *Hanis* with respect to "mixed claims".

[83] Contrary to the situation in *New Zealand* and *Coronation Insurance*, this Application is not taking place after the conclusion of the litigation. While I accept the principles set out in *New Zealand* and *Coronation Insurance*, I do not find any basis in this case to apply them in a presumptive manner. Based on the pleadings, I am unable to conclude – as I did with respect to covered claims and potentially excluded claims – that the allegations against each Applicant are inextricably interwoven with the allegations against the other Applicants. This is not a situation similar to a corporation and its directors/officers. The three Applicants had different and separate operations. This would require separate factual investigations on the part of counsel and could give rise to separate defences. Given the absence of evidence on this point, I do not accept that

most or even the majority of the costs associated with the defence of one Applicant would further the defence of the other two Applicants. Thus, an insurer cannot be obligated, on a going-forward basis and without an agreement to do so, to pay for the defence costs of a party who is not an insured under the insurance policy issued by the insurer.[4] Given this, the insurers can insist on separate representation for their respective insureds.

[84] However, with respect to the legal fees that have already been incurred by the Applicants as a result of the Primary Insurers' failure to defend the Underlying Claims on behalf of the Applicants, I conclude that it is open to the Applicants to argue, based on the principles set out in *New Zealand* and *Coronation Insurance*, that some of these fees should be paid by one insurer even though such fees also related to the defence of an uninsured entity, as long as the fees reasonably related to the defence of the claim against the insured.[5] Such arguments would require evidence and, to some extent, a dissection of the work done by the Applicants' counsel so far in response to the Underlying Claims. The record before me is insufficient to deal with this kind of argument and it may not be necessary to do so if the Primary Insurers agree on how the fees incurred so far should be apportioned as among the three groups of insurers (i.e. insurers for Loblaw, SMD and Sanis).

f. Equitable allocation among insurers

[85] As stated above, all Primary Insurers agree that, as amongst the insurers for each insured Applicant, a time-on-risk allocation is appropriate and equitable. I agree as well in the circumstances of this case.

[86] As Sossin J. noted in *St. Paul* at paragraph 91, this decision does not represent a final allocation of defence costs. Based on evidence in the trial, or findings on interlocutory motions, the actual damage occurring during actual time periods may clarify the proportion of damage for which each insurer was actually responsible. At that time, the Primary Insurers may seek a different calculation of defence costs.

[87] This decision is also subject to any future determination of the issues raised regarding any obligation to contribute to defence costs that may be owed by Teva's insurers.

[88] I now turn to the question of the impact of SIRs and deductibles on the allocation of defence costs.

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[4] This decision does not represent a final allocation of defence costs and the Applicants may seek a different allocation at a later time.

[5] I note that such arguments would not be possible with respect to the Ontario Action and the Quebec Action which only name Sanis as a defendant.

g. Impact of SIRs and deductibles on equitable allocation among insurers

[89] The Primary Insurers' positions on this issue were unclear and not always consistent. Some argued that this Court should follow *St. Paul* and find that SIRs and deductibles have no impact on the allocation of defence costs among insurers. However, some also argued in the same breath, and contrary to the situation in *St. Paul*, that an insurer should not have to pay for his time-on-risk share of the defence costs until its SIR was exhausted, thereby forcing the insured to pay itself part of the defence costs until the relevant SIR has been exhausted. Some insurers were adamant that defence costs paid by another insurer could not contribute to the exhaustion of another insurer's SIR.

[90] I reject this position.

[91] In my view, *St. Paul* is not determinative of the issue before me. The issue of the SIR was not properly before Sossin J. in *St. Paul* as the only application before him was St. Paul's application for a time-on-risk allocation among the insurers. The insurer who raised the issue of the SIR, Zurich, had not brought a separate application for the determination of the contractual dispute between Zurich and the insured regarding the SIR. Sossin J.'s conclusion that Zurich's obligation under the allocation scheme of defence costs was not affected by the SIR in its policy was expressly without prejudice to the SIR issue being the subject of separate, subsequent proceedings between Zurich and the insured.

[92] Here, all issues are before me – the contractual relationships between the insureds and the insurers, and the equitable allocation of defence costs among insurers.[6] Thus, it is my view that the issue of the impact of the SIRs on the allocation of defence costs should not be deferred.

[93] As stated above, the issue of the allocation of defence costs among multiple insurers under a concurrent obligation to defend is based on equitable principles as a result of the absence of a contractual nexus between them. In my view, if a particular insurer's duty to defend has yet to be triggered because its SIR has not been exhausted, there is no basis to impose on that insurer an obligation to contribute to defence costs until the SIR has been exhausted. There is no contractual basis to impose such an obligation. Further, I am of the opinion that it would not be equitable to impose on an insurer an obligation vis-à-vis other insurers when it owes no obligation in law to these other insurers and still owes no obligation to its insured. I do not see why fairness and equity would require a contribution to defence costs on the part of an insurer who does not yet have a concurrent obligation to defend: see *Markham* at para. 83. While the other insurers may want to have their respective shares of defence costs reduced by having as many insurers as possible participate in the payment of defence costs, these insurers have independent contractual obligations to pay defence costs to their insured, which they voluntarily assumed.

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[6] While none of the insurers brought a separate application requesting an equitable allocation of defence costs among the Primary Insurers, it was agreed by all parties before the hearing of the Application that this issue was going to be determined on this Application without the need for a separate application.

[94] The fact that an insurer whose SIR has not been exhausted does not have to contribute to defence costs does not mean that the insured has to pay for defence costs if another insurer has a contractual obligation to do so. Based on the principles set out in *Hanis*, if defence costs are associated with the defence of a covered claim, a Primary Insurer whose SIR has been exhausted has an obligation to pay them, even if those costs further the defence of claims covered by another insurer whose SIR has not been exhausted. Thus, I reject the position that the insured has to pay defence costs on account of SIRs if another insurer already has a contractual obligation to pay for the defence costs. As stated in *Hanis*, holding an insurer responsible for all reasonable costs related to the defence of covered claims does not increase that insurer's exposure and only provides to the insured what it bargained for, i.e. payment of all defence costs related to a covered claim (after the exhaustion of that insurer's SIR). An insured should not be in a worst position because they contracted and paid for more insurance. That would be the case if the Primary Insurers' position was accepted: they are arguing, in effect, that even though the insured would be contractually entitled to full defence costs under a policy with one insurer, it should be denied this benefit because it has an SIR under a different policy with a different insurer.

[95] I also find that, for the purpose of triggering the duty to defend, defence costs incurred by the Applicants contribute toward the exhaustion of SIRs, even if they are reimbursed by another insurer.[7] In my view, the governing factor is whether the Applicants were liable to pay the defence costs; if they were, it does not matter that someone else paid on their behalf or that they were later reimbursed for such costs. No authority was provided in support of the position that an insured had to pay itself the entire amount of the retained limit and/or could not be reimbursed for such payments. This is not required by the wording of the insurance policies. For instance:

a. The endorsement in Liberty's policy with respect to the SIR provides that the SIR shall be eroded by payments for covered damages and defense, legal and loss adjustment costs. It does not require that the payments be made by the insured itself or that the insured cannot be reimbursed for such payments.

b. The language in AIG's policy with respect to the SIR provides that the policy shall not attach until the insured "becomes legally obligated to pay the amount of the Retained Limit as damages and/or Expenses [which include defence costs] resulting from an event to which this policy otherwise applies." The Applicants have been contractually obligated to pay the defence costs incurred to far.

c. The deductible endorsement in RSA's policy provides that a certain sum "shall be deducted for claims arising from any one occurrence including the costs of legal investigation and adjusting fees and other expenses incurred in connection therewith and which sum shall be payable by the Insured." As stated above, the

[7] Further to the discussion above regarding the duty to defend an uninsured entity, only the defence costs that reasonably related to the defence of a particular insured can contribute to the exhaustion of the SIRs applicable to that particular insured.

> Applicants have been liable to pay the defence costs incurred so far. Further, a sum that is payable by a person can be paid on that person's behalf by someone else or can later be reimbursed to that person.

[96] In light of the foregoing, the percentages for the "time-on-risk" allocation among the insurers will have to be adjusted for periods where a particular insurer does not have an obligation to contribute to defence costs as a result of a non-exhausted SIR.

[97] The Applicants' position is that they only have to exhaust the SIR under one policy to trigger an insurer's duty to defend, even if a particular insurer may have issued more than one policy with different SIRs. The Applicants submit that the other SIRs may have to be exhausted at the time of indemnity.

[98] I agree with this position. In my view, this flows from the principles set out in *Hanis* and the fact that each policy is a separate contract.

[99] At the hearing, it was agreed that counsel would work cooperatively to do the relevant calculations based on this Court's decision on the general issues raised by this case. If counsel are not able to agree, they can contact my assistant to schedule a case conference with me.

h. Issues specific to Zurich

[100] One issue was raised regarding the policies issued by Zurich for 1998-2000 and 2001-2003 periods. Zurich argues that Loblaw did not have any primary CGL coverage for those policy periods and that Zurich's integrated policies act as excess insurance.

[101] When analyzing this issue, it is important to look at the wording of the policies themselves. The policies state that the limits of liability, which are inclusive of defence expenses, "shall be excess of Retained Amount(s) **and/or** underlying insurance…" [Emphasis added.] The policies also state: "Our liability under this policy for 'ultimate net loss' in excess of the 'retained amount' **and/or** underlying insurance […]. [Emphasis added.]

[102] The policies provide coverage for "Third Party Liability Damages for General Liability", including bodily injury and personal injury. The policies state the following with respect to this coverage:

> We will pay on behalf of the "Insured" that part of "ultimate net loss" in excess of the "retained amount" **and/or** underlying insurance that comprises any of the following "third party liability damages" and/or covered payments (and/or "defense expenses" relating thereto): […] [Emphasis added.]

[103] Based on the language of the policies, in the absence of "underlying insurance", Zurich has an obligation to pay as soon as the applicable SIR has been exhausted. Given that there was no other primary CGL coverage for Loblaw for the 1998 and 2001 policy periods, Zurich's policies effectively acted as such after the satisfaction of the "retained amount". Thus, I disagree with Zurich's submission that Loblaw has to be treated as "self-insured" for the period 1998-2003.

[104] While I find that Zurich's 1998 and 2001 policies, based on their wording, are engaged in the absence of other insurance (subject to the exhaustion of the SIR), we also have to look at the wording of the policies themselves to determine Zurich's obligations with respect to defence costs. As stated above, Zurich's policies for the policy periods 1998-2000 and 2001-2003 do not include a duty to defend. Rather, they provide that Zurich is liable to pay defence expenses incurred by the insured as part of the "ultimate net loss".

[105] Another issue involving Zurich relates to the applicable SIRs. The Applicants and Zurich disagree on the number of SIRs upon which Zurich can rely due to a "Single Retention Endorsement" found in each of the Integrated Policies issued by Zurich starting with the 2007-2009 policy period.

[106] The Single Retention Endorsement in issue provides as follows:

> Notwithstanding anything expressed to the contrary in the General Terms and Conditions, it is agreed that only one **Retention** shall apply to a single **Loss** which is covered under two or more individual **Policies Involved**, and such **Retention** shall be equal to the highest of the **Retentions** provided for in the **Policies Involved**.
>
> For the purpose of this endorsement,
>
> **Policies Involved** shall mean the following policies including their subsequent renewals:
>
> 1) Policies Number 8833432 […].
>
> **Retention** shall mean deductible and/or self-insured retention as more fully described in the **Controlling Policies** issued by Zurich. [Emphasis in the original.]

[107] The Single Retention Endorsements in the Integrated Policies covering the period 2007-2019 each provide for an effective date, which corresponds to the beginning of the policy period, i.e. January 1, 2007; January 1, 2010; January 1, 2013; and January 1, 2016.

[108] The Applicants take the position that the Single Retention Endorsement applies retroactively, more specifically that it applies to policy number 8833432 issued in 2004. As a result, they say that only one SIR applies for the 2004-2019 period. While Zurich accepts that there is a single $1 million SIR for the 2007, 2010, 2013 and 2016 policy periods, its position is that Loblaw has additional SIRS for the 2004 policy period, as well as for the 1998 and 2001 policy periods.

[109] I find that there is no basis to apply the Single Retention Endorsement to the 1998 and 2001 policy periods as the policies for these two periods are not listed as "Policies Involved" in the Single Retention Endorsement.

[110] The answer is less clear with respect to the 2004 policy period. Starting in 2004, Zurich issued CGL policies covering a three-year period, each bearing the policy number 8833432. This policy number is listed as a "Policy Involved" in the Single Retention Endorsement. While this is the case, I conclude that the Single Retention Endorsement does not apply to the 2004-2006 policy period. The various Single Retention Endorsements have an effective date and provide that they apply to certain policies and "their subsequent renewals". In light of this language, I am of the view that they cannot be applied retroactively to policies that precede the first Single Retention Endorsement. As a result, the terms of the 2004-2006 policy apply, unchanged by the Single Retention Endorsement subsequently entered into by the parties.

[111] This finding may not have an impact at the duty to defend stage given my earlier finding that the Applicants only have to exhaust the SIR under one policy to trigger an insurer's duty to defend, even if a particular insurer may have issued more than one policy with different SIRs.

i. Pre-tender defence costs

[112] Both RSA and AIG have taken the position that Loblaw is not entitled to "pre-tender defence costs", i.e. defence costs incurred prior to providing notice. However, only AIG has included arguments on this point in its Factum, including on the issue of whether relief from forfeiture can and/or should be granted. Accordingly, the discussion below focuses on AIG, but it would apply *mutatis mutandis* to RSA.

[113] After being served with the Statement of Claim in the BC HMQ Action, Loblaw searched its historical files to locate all relevant policies and was initially unable to locate CGL policies for 1996-1998. Loblaw gave notice under these policies once they were "tracked down". Thus, Loblaw only gave notice of the BC HMQ Action to AIG and RSA under their CGL policies on July 25, 2019. However, Loblaw had given them prior notice of this claim pursuant to other excess policies issued by them. There is no evidence that the delay in giving notice under the AIG and RSA CGL policies was intentional or that Loblaw knew about these policies and chose not to give notice earlier.

[114] AIG only responded to Loblaw's request for coverage on March 9, 2020, more than seven months after receiving notice. Among other things, AIG took the position that AIG's liability "under the Policy does not attach until the Insured becomes legally obligated to pay the amount of the Retained Limit [SIR] as damages and/or Expenses resulting from an event to which the Policy otherwise applies." AIG has also indicated that it does not intend to control the defence.

[115] Under AIG's policy, Loblaw has the obligation to give notice to AIG "as soon as practicable" in the event of an occurrence which is reasonably likely to involve any coverage under the policy in excess of $200,000.00. Further, Loblaw "shall not, except at his own cost, voluntarily make any payment, assume any obligation or incur any expense" other than a few exceptions that are irrelevant in this case.

[116] In *Monk v. Farmers' Mutual Insurance Company (Lindsay)*, 2019 ONCA 616 at para. 79 ("***Monk***"), the Court of Appeal for Ontario summarized as follows the principles regarding relief from forfeiture in the circumstances of a claim under an insurance policy:

a. Relief from forfeiture under s. 129 of the *Insurance Act*, R.S.O. 1990, c. I.8 is available where there has been "imperfect compliance with a statutory condition as to the proof of loss to be given by the insured or other matter or thing required to be done or omitted by the insured with respect to the loss", thereby restricting the availability of the section to instances of imperfect compliance with terms of a policy after a loss;

b. Relief from forfeiture pursuant to s. 98 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43 is available to contracts regulated by the *Insurance Act*;

c. Section 98 of the *Courts of Justice Act* generally operates where the breach of the policy occurred before the loss took place;

d. Although relief under s. 129 of the *Insurance Act* and s. 98 of the *Courts of Justice Act* are not available where the breach consists of non-compliance with a condition precedent to coverage, a court should find that an insured's breach constitutes noncompliance with a condition precedent only in rare cases where the breach is substantial and prejudices the insurer. In all other instances, the breach will be deemed imperfect compliance, and relief against forfeiture will be available.

e. Where relief from forfeiture is available, an insured must still make three showings – that his or her conduct was reasonable, that the breach was not grave, and that there is a disparity between the value of the property forfeited and the damage caused by the breach – in order to prevail.

[117] It is argued that Loblaw did not comply with the policy and lost the benefit of the insurer's obligation to defend for the period preceding July 25, 2019 as a result of the late notice of the claim. Assuming that Loblaw did not provide notice to AIG "as soon as practicable", as required, it is my view that this case is not one of the rare cases where the insured's breach constitutes noncompliance with a condition precedent. This is because, further to point (d) above, there is no evidence of prejudice in this case. AIG has filed no evidence on this Application and has not argued that it has been prejudiced by the late notice. Accordingly, relief against forfeiture is available.

[118] AIG relies on the decision of the British Columbia Court of Appeal in *Lloyd's Underwriters v. Blue Mountain Log Sales Ltd.*, 2016 BCCA 352 ("***Blue Mountain***") to argue that an insured is not entitled to defence costs incurred prior to providing notice to its insurer, and that relief from forfeiture should not be granted where an insured has incurred such costs.

[119] I have not been referred to any Ontario decision holding that relief from forfeiture is not available for pre-tender defence costs. While *Blue Mountain* was referred to in *HMQ v. AIG Insurance*, 2019 ONSC 2964 at footnote 3, relief from forfeiture is not discussed and does not appear to have been requested by the insured in that case.

[120] In my view, *Blue Mountain* can be distinguished on a number of grounds, including the following:

a. Contrary to the insurer in *Blue Mountain*, AIG did not immediately provide a defence going forward after receiving notice of the claim and it has not contributed to the defence costs.

b. Relief from forfeiture in Ontario is not only available under section 129 of the *Insurance Act* [the provision in Ontario equivalent to the provision in issue in *Blue Mountain*], but also under section 98 of the *Courts of Justice Act*. Section 98 is "a remedial section and merits a correspondingly broad interpretation." See *Kozel v. Personal Insurance Co.*, 2014 ONCA 130, 119 O.R. (3d) 55 at paras. 52-58.

c. It is unclear whether the principles set out by the Ontario Court of Appeal in *Monk* with respect to the availability of relief from forfeiture also apply in British Columbia. I am bound by *Monk*, which was decided a few years after *Blue Mountain*.

[121] As stated above, where relief from forfeiture is available, an insured must still show that: (1) their conduct was reasonable; (2) the breach was not grave; and (3) there is a disparity between the value of the property forfeited and the damage caused by the breach. In my view, these three conditions have been satisfied.

[122] Loblaw's conduct was reasonable and, as stated above, there is no evidence that the delay was willful or intentional: see *Monk* at para. 82. It is understandable that there could be difficulties locating documents that are more than 20 years old in a large organization with employees who come and go. Loblaw certainly did not conceal the action as it gave notice to AIG pursuant to an excess policy.

[123] With respect to the second factor, i.e. gravity of the breach, it needs to be assessed by looking at both the nature of the breach itself and the impact of that breach on the contractual rights of the other party: see *Monk* at para. 95. Here, there is no evidence of prejudice, and the breach has not had any serious impact on AIG's rights as it is its position that it does not currently have a duty to defend as a result of the applicable SIRs and it has not contributed to the defence costs. There is no reason to believe that AIG would have behaved any differently had it received notice earlier. Thus, I conclude that the breach was not grave. See *International Comfort* at para. 17.

[124] The third factor, the disparity between the value of the property forfeited and the damage caused by the breach, requires a court to conduct a kind of proportionality analysis which, in an insurance case, involves comparing the disparity between the loss of coverage and the extent of the damage caused by the insured's breach: *Monk* at para. 104. Since there is no evidence of any prejudice or damage to AIG in this case, the proportionality analysis favours Loblaw.

[125] Accordingly, Loblaw is entitled to relief from forfeiture with respect to pre-tender defence costs. Thus, these costs should either be reimbursed or contribute to the exhaustion of SIRs.

j. Conclusion on the duty to defend and the equitable allocation of defence costs as between insurers

[126] In summary, my main findings on this issue are as follows:

a. Subject to the exhaustion of the relevant SIRs/deductibles, Primary Insurers are required to pay all reasonable costs associated with the defence of the Underlying Claims, even if those costs further the defence of uncovered claims (including claims that fall outside of an insurer's coverage period).

b. As a result, in the circumstances of this case and in light of the allegations in the Underlying Claims, each Applicant is entitled to select any single policy under which there is a duty to defend that Applicant and require the Respondent insurer to defend. The selected insurer is entitled to seek an apportionment of the defence costs at the end of the proceedings to the extent that they deal solely with uncovered claims, or exceed the reasonable costs associated with the defence of the covered claims: see *Carneiro* at para. 28. The selected insurer can also seek an equitable allocation of defence costs among the insurers who have a concurrent obligation to defend the insured.

c. On a going-forward basis, and unless there is an agreement to the contrary, the Primary Insurers cannot be obligated to pay for the defence costs of a party who is not an insured under their insurance policy. With respect to legal fees already incurred by the Applicants, it is open to the Applicants to argue that some of these fees should be paid by one insurer even though such fees also related to the defence of an uninsured entity, as long as the fees reasonably related to the defence of the claim against the insured entity.

d. As amongst the Primary Insurers for each insured Applicant, a time-on-risk equitable allocation of defence costs is appropriate. The Primary Insurers may seek a different calculation of defence costs at a later stage, based on the evidence in the trial or findings on interlocutory motions.

e. A Primary Insurer whose SIR/deductible has not been exhausted does not have to contribute to the defence costs, either contractually or equitably, until the SIR/deductible has been exhausted. However, an insurer's duty to defend and to contribute to the defence costs is triggered once its SIR/deductible has been exhausted under one policy only, not all its policies for all policy periods. The other SIRs/deductibles under the other policies may have to be exhausted at the time of indemnity.

f. The percentages for the time-on-risk allocation among the insurers will have to be adjusted for the periods where a particular insurer does not have an obligation to contribute to defence costs as a result of a non-exhausted SIR/deductible.

g. Defence costs incurred by each of the Applicants contribute toward the exhaustion of SIRs of their respective insurers, even if they are reimbursed by another insurer.

h. The fact that an insurer whose SIR has not been exhausted does not have to contribute to defence costs does not mean that the insured has to pay defence costs

if another insurer has a contractual obligation to do so under the principles set out in *Hanis.*

i. A reallocation of defence costs based on "Other Insurance" clauses can also be sought at the end of the proceedings.

j. Zurich's Single Retention Endorsement only applies to the 2007-2009, 2010-2012, 2013-2015, and 2016-2018 policy periods.

k. Loblaw is entitled to relief from forfeiture with respect to pre-tender defence costs, and these costs should be reimbursed or contribute to the exhaustion of SIRs.

l. This decision is subject to any future determination of the issues raised regarding any obligation that may be owed by Teva's insurers to contribute to defence costs.

[127] As stated above, if counsel do not agree on the specific relief that flows from the conclusions above or are unable to agree on the relevant calculations, they can contact my assistant to schedule a case conference with me.

2. Exhaustion of the SIRs/deductibles of AIG, RSA and Liberty

[128] There is a dispute between the Applicants and certain Respondents as to whether some of the applicable SIRs/deductibles have been exhausted.

[129] RSA and Loblaw disagree as to whether RSA's aggregate deductible has been exhausted and about the total amount incurred by Loblaw for covered losses during RSA's coverage period (i.e. between May 1, 1997 and January 1, 1998). Further, RSA and Loblaw disagree with respect to the applicable amount of the aggregate deductible as there are two versions of the relevant endorsement attached to the policy: the signed original version provides for an aggregate deductible for Loblaw in the amount of $3,750,000, and an unsigned version provides for an aggregate deductible in the amount of $3,355,000.

[130] In addition, SDM and Liberty disagree as to whether Liberty's SIR under its 1998-1999 policy has been exhausted, and AIG and Loblaw disagree as to whether AIG's aggregate SIR has been exhausted.

[131] The parties differ as to whether certain records put forward by the Applicants are admissible as business records and/or constitute reliable evidence. Among other things, the Applicants rely on data extracted from claims management software systems for which underlying supporting records no longer exist. The first version of this data, which was in a spreadsheet format, included a series of errors and irrelevant claims. Further, the meaning of some of the fields/information is not always clear.

[132] The issues related to the spreadsheet do not apply to Liberty because, following the acquisition of SDM by Loblaw, the Applicants do not have records that contain detailed claims history from the time period when Liberty's policies were in force. However, the Applicants rely

on other documents or evidence in support of their position that the SIR in Liberty's policy has been exhausted. Liberty disputes the sufficiency and the reliability of this evidence.

[133] While the evidentiary issues regarding the records put forward by the Applicants are the most significant issues in relation to the exhaustion of the SIRs, some of the relevant insurers have raised additional issues, including the failure to report claims in non-compliance with the policies, whether relief from forfeiture is available in the circumstances, and the application of the 15-year ultimate limitation period in section 15 of the *Limitations Act, 2002*, S.O. 2002, c. 24, Sched. B.

[134] The extent to which the relevant insurers have disclosed what they know and have in their files with respect to the exhaustion of the SIRs/deductibles varies from insurer to insurer. On one end of the spectrum, Liberty produced its underwriting and claims records, while on the other end of the spectrum, AIG has not filed any evidence on this Application.

[135] Under Rule 38.10 of the *Rules of Civil Procedure*, a judge may, on the hearing of an application, order that any issue proceed to trial and give such directions as are just. The following factors are relevant to the determination of whether an application should proceed as an action: (1) whether there are material facts in dispute; (2) the presence of complex issues requiring expert evidence and/or a weighing of the evidence; (3) whether there is a need for the exchange of pleadings and for discoveries; and (4) the importance and impact of the application and of the relief sought. See *Collins v. Canada (Attorney General)* (2005), 76 O.R. (3d) 228, 2005 CanLII 19819 at para. 5 (S.C.J.) ("***Collins***") and *Family and Children's Services of Lanark, Leeds and Grenville v. Co-operators General Insurance Company*, 2021 ONCA 159 at para. 48.

[136] Here, there are material facts in dispute regarding the exhaustion of the SIRs/deductibles and the evidence put forward by the Applicant. Some of the factual issues raised are complex, require the weighing of the evidence and would benefit from further documentary and oral discovery. Efforts could also be made to locate individuals who are more knowledgeable or have direct knowledge about certain matters. Finally, the relief sought has a significant economic impact given the amounts in issue.

[137] I am not confident that I can make the necessary findings of fact required in order to fairly resolve the dispute on the basis of the record filed and the evidence relied upon by the parties: see *Hazelton Homes Corporation v. Katebian*, 2019 ONSC 4015 at para. 13 and *Jansari v. Jansari*, 2020 ONSC 2473 at para. 39. In my view, the issue of the exhaustion of the SIRs has been presented like a "trial in a box", which has been described as follows (*RNC Corp. v. Johnstone*, 2020 ONSC 7751 at paras. 4, 17):

> In those cases, the motion judge is asked to make findings on some or all the same facts and evidence as would be before the trial judge -- but with no trial. The judge hears a few hours of submissions at a high level of abstraction. He or she is then left to wade through the banker's box(es) of material [here, hundreds and hundreds of pages on CaseLines] to make detailed findings on contested evidence without having heard the detailed evidence led by counsel and contextualized by the trial narrative unfolding over several days.

[…]

> [W]here a judge is required to make detailed findings on contested evidence of years of human conduct, the process of counsel leading evidence through live witnesses over several days gives order and context to the complexities and nuances of the interactions. It is not fairly replicated by the judge rooting through decontextualized boxes on his or her own, in chambers, after a quick motion hearing at 30,000 feet.

See also *Henry Hill & Associates Inc. v. Santos*, 2021 ONSC 6051 at paras. 31-32.

[138] I conclude that the issue of the exhaustion of the SIRs/deductibles cannot be resolved fairly without a trial, and that it should proceed to trial. Counsel should contact my assistant to schedule a case conference with me after they have had the opportunity to discuss a detailed trial plan/schedule.

3. Defence Protocol/DRA

[139] The Applicants seek an order that only those insurers who sign a DRA will be entitled to associate in the defence of the Underlying Claims and receive defence-side reporting, which includes Privileged Defence Information, i.e. information and documents subject to litigation privilege and/or solicitor-client privilege as between the Applicants and defence counsel.

[140] As stated above, Markel commenced a separate Application addressing the same issue and seeking, among other things, a declaration that, with the exception of coverage-related inquiries or advice contained in lawyer-client privileged communications with SDM's coverage counsel, Markel is entitled to full unfettered disclosure of all relevant information, documentation, facts and reports in the possession, power or control of SDM and Sanis. It also seeks a declaration that it is entitled to instruct and have its own counsel participate with SDM in the defence of the Underlying Claims, provided that such counsel: (i) is funded solely by Markel for such participation; (ii) acts in a cooperative manner which honours the joint litigation privilege attaching to all data disclosed; and (iii) gives input only but otherwise does not attempt to direct SDM and appointed defence counsel in regard to defence strategy.

[141] Given the overlap between the two Applications and the fact that they are two sides of the same coin, they are dealt with together below.

a. Positions of the parties

[142] **The Applicants.** The Applicants' position is that some or all of the Respondents have actual or perceived conflicts of interest arising from: (a) insuring other entities adverse or potentially adverse to the Applicants in the Underlying Claims (i.e. party-based conflict); and/or (b) reservations of rights on coverage issues (i.e. coverage-based conflict). According to the Applicants, the central management of the Underlying Claims by the insurers and their reservations regarding intentional acts create a reasonable apprehension of a conflict of interest. While such a conflict may entitle the insured to require the appointment of independent defence counsel who would not report to the insurers, the Applicants have proposed a protocol in an effort

to achieve an appropriate balance between the right of the insured to a conflict-free defence and the insurers' right to participate in the defence of the Underlying Claims.

[143] In the Applicants' view, the internal systems of most insurers are inadequate because, despite having something in place at the lower levels, all defence and coverage information eventually flows to the same decision-maker. Further, Markel and other insurers have taken the position that they would use Privileged Defence Information obtained from litigation counsel to assess their coverage position, including to deny coverage if the information received provided grounds to do so. The Applicants submit that the DRA reflects a reasonable approach to balancing the interests of the insured and insurers and that each insurer that wishes to associate in the defence should be required to sign a DRA on the same terms. The Applicants further submit that if an insurer is unable or unwilling to do so, then that insurer should not be entitled to associate in the defence, but will still otherwise be bound by its obligations under the policy and be entitled to receive "coverage-side" reporting, which includes full disclosure of all non-privileged materials, e.g. the documents, motions, affidavits, orders and discovery transcripts.

[144] **AIG.** AIG denies that there is any coverage-based conflict. It submits that an early reservation of rights regarding coverage by an insurer does not automatically give rise to a conflict. Further, AIG points out that the case law on conflicts is focused on any impairment of the conduct of the defence, as opposed to information that will be shared with the insurer in the defence. AIG notes that it only seeks to associate with Loblaw's defence and does not seek to direct or control it. It also stresses the fact that an insured has a duty to disclose all facts material to the insurer's risk, and that disclosure is required to fulfil the insured's duty to cooperate in connection with a claim for which coverage is sought.

[145] With respect to party-based conflicts, AIG has confirmed in a letter to the Applicants' counsel and in its Factum that it will implement its "split-file protocol" in its administration of Loblaw's defence at the handler level, which includes "an ethical wall at the handler level between insured files, separate instruction by the handlers, and relevant protection of confidential information at that level (where it might influence instructions given to defence counsel)." While AIG did not adduce any affidavit evidence on this Application, it pointed out that its protocol had been accepted by Ontario courts in the past, notably in *Markham*. In addition to implementing its split-file protocol, AIG is prepared to enter into a confidentiality agreement to confirm that all information from Loblaw will be protected and kept confidential. AIG argues that the additional requirements and safeguards sought in Loblaw's proposed DRA are unnecessary and excessive because they will unduly and improperly interfere with the business and operations of AIG and its right to: (a) administer the claims; (b) reasonably expect ongoing cooperation and disclosure from the insured regarding the material facts of the claim and risks; and (c) be able to assess its indemnity exposure on an ongoing basis.

[146] **Chubb Group.** AIG also joined in a common brief submitted by Chubb Insurance Company of Canada ("**Chubb**"), QBE and Markel ("**Chubb Group**"). The Chubb Group submits that the Applicants fail to distinguish primary insurers with a duty to defend, umbrella/excess insurers with no such duty but which have a right to associate, and insurers who are merely reimbursing defence costs and do not seek to associate in the defence (like QBE). The Chubb Group argues that there can be no reasonable apprehension of coverage-based conflict with respect

to an insurer which associates in but does not seek to control the defence of an action or an insurer who is only reimbursing defence costs. They assert that, with the exception of privileged advice or communications between the Applicants and their coverage counsel regarding insurance coverage, they[8] have a contractual entitlement to full disclosure, which they define as follows:

> all documents or information of any kind, in whatever form, whether verbal, electronic or in writing, relevant to the [Underlying Claims] SDM and [Loblaw] currently face and any others that may surface, including defence counsel's strategic and analytical quantum and liability assessment reports on the status of, evidence developed in and anticipated future steps in the litigation of the [Underlying Claims].
>
> ("**Full Disclosure Information**")

[147] The Chubb Group argues that the true purpose of the DRA proposed by the Applicants is to improperly restrict the insurers' ability to take all Full Disclosure Information into account when considering coverage under their respective policies. They state that in addition to being contractually entitled to Full Disclosure Information, they reasonably require such disclosure in order to assess their contractual obligations to one or more Applicants, and as a matter of law to comply with the statutory and regulatory obligations imposed on all property and casualty insurers in Canada to maintain an adequate margin of assets over liabilities.

[148] The Chubb Group states that they have the right and good faith duty to use Full Disclosure Information for all purposes, including the assessment of insurance coverage, and the good faith duty to update their respective policyholders on that assessment for indemnity under their respective policies. They also submit that to assess "liabilities", an insurer must understand its exposure to potential indemnity, and that this is of particular importance when assessing a very large potential exposure. The Chubb Group asserts that notwithstanding internal silos and split-file protocols, Full Disclosure Information (including privileged information) and coverage issues must ultimately come together at some level to permit insurers to assess their exposure and update the policyholders on that exposure. They state that an insurer's exposure and reserves are necessarily informed by its coverage position.

[149] According to the Chubb Group, the DRA proposed by the Applicants would be new law as it would in effect require that all liability insurers in Canada, regardless of their role, maintain entirely independent silos for (a) Full Disclosure Information and (b) a subset excluding privileged information for assessing coverage issues, right up to and through the senior management level.

[150] **Chubb.** Chubb has confirmed that its internal files have been split between: (a) the claims handler handling the Underlying Claims as against the Applicants and the claims handler handling the Underlying Claims as against one other insured; and (b) the claims handler handling the

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[8] This includes insurers who associate in the defence and insurers who are merely reimbursing defence costs.

coverage portion and the claims handler handling the defence portion. However, Chubb acknowledges that the defence and coverage information for all insureds is available to one person who is one or two steps removed from the handler in the hierarchy. Chubb argues that this person has a "legitimate need to know" Full Disclosure Information in order to obtain authority with respect to Chubb's policy obligations and to set appropriate financial reserves. Chubb's position is that its internal procedures are a reasonable and appropriate response to the Applicants' concerns, and that the Applicants' proposed DRA is unnecessary, unprecedented and unsupported by any authority.

[151] **Markel.** Markel has not implemented split-handling between coverage and defence. It argues that its handling protocols address party-based conflicts and that, on the evidence, there is no coverage-based conflict. Markel submits that its remoteness (i.e. Markel seeks no control over the defence), its code of conduct and the involvement of its coverage counsel protect against the risk of coverage assessment steering the defence in Markel's favour. Markel has confirmed that it intends to use any Full Disclosure Information to inform, update and convey Markel's coverage position, including advising if there is a potential basis for a coverage denial. It argues that the Applicants' proposed DRA constitutes partial performance of their obligations under the policy and impedes Markel's good faith duty to timely, accurately and effectively update and convey its indemnity position to its policyholders.

[152] Markel acknowledges that the claims examiners who handle the files of Markel's two insureds who are involved in the Underlying Claims report to the same person, who has access to all the information. However, it points out that the claims examiners are required to sign a document acknowledging their review of, and agreement to abide by, a claims-handling manual and associated code of conduct (which are not in evidence).

[153] **QBE.** QBE argues that concerns related to coverage-based conflict do not apply to it as its involvement is limited to the reimbursement of defence costs, and there will be no influence whatsoever by QBE on how legal counsel who are currently defending the Applicants conduct the defence of the Underlying Claims, now or in the future. Thus, QBE is further removed from the defence than other insurers. Despite its limited involvement, QBE's position is that it requires Full Disclosure Information in order to provide it with: (a) an understanding of the risk assessment in the Underlying Claims, (b) candid dialogue on the chances of any successful defences, and (c) an understanding of the basis for a reasonable compromise of the Underlying Claims.

[154] QBE submits that it has addressed party-based conflicts, notably conflicts related to Teva, by implementing a protocol internally. It has proposed a defence reporting agreement that provides that Privileged Defence Information will only be received by or available to persons designated as authorized representatives, and no-one else. QBE's proposed defence reporting agreement also provides that in the event of any dispute between QBE and the Applicants respecting coverage in relation to the Underlying Claims, QBE will never seek to use or rely on Privileged Defence Information in any way in that dispute, including but not limited to attempting to have Privileged Defence Information admitted into evidence in a proceeding. The main difference between the DRA and QBE's proposed defence reporting agreement is that QBE's proposed agreement does not include a term that QBE's authorized representatives will not have any involvement of any

kind with respect to the assessment or determination of coverage issues in relation to the Underlying Claims, unless the Applicants provide their prior written consent.

[155] **RSA.** RSA did not expressly take a position on the issue of the proposed DRA, but its position is that Loblaw should be represented by unconflicted independent legal counsel going forward.

b. General principles regarding the reciprocal duty of utmost good faith

[156] An insured and an insurer owe each other a reciprocal duty of utmost good faith. The duty of utmost good faith and fair dealing between insurer and insured has developed with a view to facilitating the honest, fair, and expeditious resolution of insurance claims: *Trial Lawyers Association of British Columbia v. Royal & Sun Alliance Insurance Company of Canada*, 2021 SCC 47 at para. 36 ("***TLABC***").

[157] Pursuant to this duty, an insured must act in good faith by disclosing facts material to the insurance policy and the claim, including all the facts that are material to the risk: see *Bhasin v. Hrynew*, 2014 SCC 71 at paras. 55, 86; *TLABC* at para. 35; and *Canadian Newspapers Co. v. Kansa General Insurance Co.* (1996), 30 O.R. (3d) 257, 1996 CanLII 2482 (C.A.) ("***Kansa***"). In *TLABC*, the Supreme Court indicated that an insured has a duty to disclose any information in his possession which might have voided their coverage (the consumption of alcohol in that case): see para. 36.

[158] In *Kansa*, the Court of Appeal stated that the insured's duty of co-operation required that it inform an insurer with a right to defend the action of significant developments in the litigation so as to allow the insurer to make an informed decision about the continued defence of the action.

c. General principles regarding conflicts between the interests of the insured and the interests of the insurer

[159] Where a lawyer is appointed by an insurer to defend its insured, the lawyer's primary duty is to the insured, even though the lawyer is paid by the insurer and the insurer may eventually have to pay the claim against its insured. The lawyer owes a duty to fully represent and protect the interest of the insured and must represent and act on behalf of the insured with the utmost loyalty. See *Hoang v. Vicentini*, 2015 ONCA 780 at para. 14 ("***Hoang***"). See also *Reeb v. The Guarantee Company of North America*, 2017 ONCA 771 at para. 13 and *Mallory v. Werkmann Estate*, 2015 ONCA 71 at para. 29.

[160] The case law recognizes that the potential for conflict between the interests of an insurer and its insured invariably exists because of the insurer's separate obligations to defend and to indemnify. However, not every potential conflict between the interests of the insurer and its insured requires the insurer to yield the right to control the defence, a right it contracted for in the policy of insurance. To require the insurer to yield control, the insured must meet the reasonable apprehension of conflict of interest test. See *Hoang* at paras. 15-16.

[161] The issue of conflict of interest between an insurer and an insured was discussed in detail by the Court of Appeal in *Brockton (Municipality) v. Frank Cowan Co.*, 2002 CanLII 7392, 57 O.R. (3d) 447 (C.A.) ("***Brockton***"). In that case, the central issue was whether the insured had the right to take over the control of the defence of civil actions from its insurer and had the corollary right to appoint counsel for this purpose at the insurer's expense (see para. 3). The insured argued that the circumstances, including a reservation of rights by the insurer, created an appearance of impropriety requiring the insurer to surrender control of the defence. The Court of Appeal disagreed with the insured's position.

[162] The Court of Appeal stated that, in the first instance, the insurer has the right to control the defence, which includes the appointment of counsel. However, the insurer's right to control the defence is not absolute – as stated above, it can be removed if there is a reasonable apprehension of conflict of interest on the part of counsel appointed by the insurer. See *Brockton* at paras. 31-32, 38, 43.

[163] After discussing the decision of LeBel J.A. (as he then was) in *Zurich of Canada v. Renaud & Jacob*, 1996 CanLII 5801 (Que. C.A.), Goudge J.A. stated the following:

> [42] In coming to this conclusion, LeBel J.A. noted that American jurisprudence had moved towards a similar position and away from the broader basis for shifting control of the defence to the insured that was articulated in *Cumis*. For example, after *Cumis*, in *Foremost Insurance Co. v. Wilks*, 253 Cal. Rptr. 596 (1988), the California Court of Appeal made clear that not every case where the insurer elects to defend the insured under a reservation of rights creates a conflict of interest requiring the insurer to furnish independent counsel. If the reservation of rights arises because of coverage questions which depend upon an aspect of the insured's own conduct that is in issue in the underlying litigation, a conflict exists. On the other hand, where the reservation of rights is based on coverage disputes which have nothing to do with the issues being litigated in the underlying action, there is no conflict of interest requiring independent counsel paid for by the insurer.
>
> [43] I agree with the approach taken in *Zurich* and *Foremost*. The issue is the degree of divergence of interest that must exist before the insurer can be required to surrender control of the defence and pay for counsel retained by the insured. The balance is between the insured's right to a full and fair defence of the civil action against it and the insurer's right to control that defence because of its potential ultimate obligation to indemnify. In my view, that balance is appropriately struck by requiring that there be, in the circumstances of the particular case, a reasonable apprehension of conflict of interest on the part of counsel appointed by the insurer before the insured is entitled to independent counsel at the insurer's expense. The question is whether counsel's mandate from the insurer can reasonably be said to conflict with his mandate to defend the insured in the civil action. Until that point is reached, the insured's right to a defence and the insurer's right to control that defence can satisfactorily co-exist.

[…]

> [47] The reservation of rights by the respondents was based on the monetary limits of the policy and its exclusion of punitive and exemplary damages. The reservation was not based on any conduct of the insured that would be in issue in the underlying litigation. Hence, defence counsel was under no mandate to show that the insured had acted in a way which would remove the insurer's indemnity obligation. Moreover, the insurer had appointed separate coverage counsel, thereby removing any conflict that could have arisen from the reservation of rights in this case.
>
> [48] Counsel appointed by the respondents to defend the civil action was not under any set of contradictory mandates in defending the civil actions. Counsel's single mandate was simply to provide a sound defence to those actions. This counsel proceeded to do.
>
> [49] The appellant's complaint is really about the way counsel proposed to conduct that defence. However, the tactics used in the defence remain the province of the insurer where the insurer retains the right to control that defence. One can sympathize with the appellant, given the catastrophic circumstances which faced the community of Walkerton. However, absent an insurance contract providing specific terms (for example, allowing the insured to direct counsel appointed by the insurer in defence of claims arising from an environmental disaster) the insurer's right to control the defence remains unless there is a reasonable apprehension of conflict of interest.
>
> [50] I would therefore conclude that in the circumstances of this case the respondents had not surrendered the right to control the defence of the civil actions and were not obliged to pay for independent counsel retained by the appellant.

[164] Based on *Brockton*, it was found in a number of cases that an insured was permitted to appoint counsel of its choice and to conduct its own defence as a result of a reasonable apprehension of conflict arising out of coverage issues which depended upon an aspect of the insured's own conduct that was in question in the underlying litigation,: see, e.g., *Glassford v. TD Home and Auto Insurance Co.*, 2009 CanLII 10397, 94 O.R. (3d) 630 at paras. 28, 30-31 (Ont. S.C.J.); *Coakley v. Allstate Insurance Company of Canada*, 2009 CanLII 22549 at paras. 31-34 (Ont. S.C.J.); and *Pabla v City of Mississauga*, 2015 ONSC 5156 at para. 13.

[165] The Court of Appeal applied the principles set out in *Brockton* in *Markham*. The Court noted that the issue in *Markham* was not whether the City had coverage for some or all of the claims in the action, but which of two insurers was responsible to cover which claims in accordance with their respective policies of insurance. Consequently, the Court of Appeal found that cases that addressed the question of whether there was coverage for all or part of a claim, including the cases referred to in the preceding paragraph, were distinguishable. See *Markham* at para. 98.

[166] The Court of Appeal found that each of the insured and the two insurers had conflicting interests, and stated that the court must endeavour to balance the insured's right to a full and fair defence of the civil action with the insurers' right to control the defence such that one insurer did not abuse its right to defend and settle the claim to the detriment of the other insurer and/or the insured: *Markham* at paras. 102-103. The Court of Appeal held that "[i]n situations such as this, it is important to have in place mechanisms to minimize conflicts of interest and provide meaningful protections to the party not having control of the defence": see para. 104.

[167] Ultimately, the Court of Appeal approved the following protocol, which was the "split file" protocol proposed by AIG with a few additional requirements (paras. 106 and 114):

a. The City's defence as an additional insured would be handled and screened internally so that [the other insured's] information is held separately and kept confidential from information in respect of the City claim;

b. Physical files would be scanned and converted into digital format upon receipt;

c. A file subject to the "split file" protocol would be digitally marked confidential and would not be accessed by any other handler, including the handler responsible for the defence of another adverse insured party. This is to protect confidential information and avoid any perceived or actual "party-based" conflict of interest between the insured interests;

d. The handlers for the City defence would be different from those handling the [other insured's] defence. **Similarly, the handlers for coverage issues would be different from the handlers for liability issues**;

e. A claims handler in breach of the "split file" protocol would be subject to disciplinary action and could be dismissed if confidential information is disclosed;

f. AIG agrees to work cooperatively with Lloyd's to agree upon, appoint/instruct, and pay for an independent defence counsel. That counsel will be different from AIG's coverage counsel;

g. AIG commits to sharing funding costs incurred in the City's defence;

[The following terms were added by the Court of Appeal:]

h. The terms of this proposal must be provided in writing to those involved in managing the defence;

i. Counsel appointed would be instructed to fully and promptly inform the City and Lloyd's of all steps taken in the defence of the litigation against the City such that each would be in a position to monitor the defence effectively and address any concerns;

j. Defence counsel must have no discussion about the case with either coverage counsel; and

k. Counsel must provide identical and concurrent reports to the insured and both insurers regarding the defence of the main action. [Emphasis added.]

[168] The Court of Appeal concluded as follows:

> [116] Given the multiple conflicting interests, this protocol and the safeguards it provides, albeit not without any concerns, recognize the legitimate interests of both the insured and the insurers and address the concern that AIG may abuse its right to defend and settle to the prejudice of the insured.

d. The right to associate in the defence

[169] *Brockton* and *Markham* deal with insurers who had a duty to defend and a right to instruct counsel. They do not discuss the situation of an insurer who wants to associate in the defence, but not direct or control the defence.

[170] An insurer's right to associate in the defence has not been discussed in any detail in the case law. This right has been found to include considering the insured's position during the defence of the claim and the negotiations of the settlement, and the opportunity to give input: see *Sport Mart Discount Superstores Inc. v. Safeco Insurance Co. of America*, 1992 CanLII 297 (B.C. S.C.). Given a quasi-total absence of analysis of this right in the case law, there is no authority discussing the issue of bias or conflict in the context of the right to associate in the defence as opposed to the context of the duty to defend.

[171] The Oxford dictionary defines input as "time, knowledge, ideas, etc. that you put into work, a project, etc. in order to make it succeed; the act of putting something in." Success may mean different things to different people, including an insured and an insurer.

[172] While I agree with the Non-DRA Insurers that an insurer who merely seeks to associate in the defence does not direct/control the defence, it should be recognized, in my view, that the opportunity to give input constitutes an opportunity to try to influence the direction of the defence based on the insurer's views of how the defence should be conducted. However, given the conclusion that I reach below regarding the provision of Privileged Defence Information, I do not need to decide on this Application whether a reasonable apprehension of conflict on the part of counsel could arise in the context of an insurer exercising a right to associate in the defence.

[173] I will now address the main contentious points between the Applicants and the Non-DRA Insurers with respect to the proposed DRA.

e. Conflict of interest based on the use of privileged information

[174] As stated above, the Non-DRA Insurers' position is that they do not have a coverage-based conflict (which they refer to as "bias-based"). They argue that an early reservation of rights regarding coverage does not automatically give rise to a conflict. Further, and in any event, they

argue that there cannot be a reasonable apprehension of coverage-based conflict with respect to an insurer who does not control the defence as such an insurer cannot steer the defence in the insurer's favour.

[175] I disagree with the Non-DRA Insurers' position. The insurers' reservations of rights in this case are based, at least in part, on conduct of the insured that is in issue in the Underlying Claims, e.g. reservations regarding intentional acts. As stated above, this kind of reservation of rights has been found to give rise to a reasonable apprehension of conflict of interest entitling the insured to independent counsel at the insurer's expense: see *Brockton* at paras. 42-43, 47; *Glassford v. TD Home and Auto Insurance Co.*, 2009 CanLII 10397, 94 O.R. (3d) 630 at paras. 28, 30-31 (Ont. S.C.J.); *Coakley v. Allstate Insurance Company of Canada*, 2009 CanLII 22549 at paras. 31-34 (Ont. S.C.J.).

[176] Do these reservations also give rise to a reasonable apprehension of conflict with respect to insurers who do not control the defence, i.e. insurers who associate in the defence or merely reimburse defence costs? In my view, they do, unless measures are implemented to protect Privileged Defence Information (i.e. information subject to litigation privilege and/or solicitor-client privilege).

[177] As a preliminary matter, I note that it would not be logical for an insurer who does not have the main duty to defend and does not direct the defence to be able to receive more information than the insurer who does, for the reason that the former cannot steer the defence while the latter can. Insurers who play a smaller role in the conduct of the defence should not get more information than insurers who have larger responsibilities and rights in this regard. This would be inconsistent with the purpose for which the information is provided, i.e. the conduct of the defence.

[178] While concerns regarding "steering the defence" are often raised in the case law dealing with the issue of conflict, these are not the only concerns that can give rise to a reasonable apprehension of conflict of interest. I note that in *Brockton*, the Court of Appeal refers at paragraph 33 to the decision of the Supreme Court of Canada in *MacDonald Estate v. Martin*, [1990] 3 S.C.R. 1235, which deals with conflicts of interest arising out of the possession of confidential information.

[179] As stated by the Supreme Court of Canada in *Canadian National Railway Co. v. McKercher LLP*, 2013 SCC 39 at para. 23, "[t]he law of conflicts is mainly concerned with two types of prejudice: prejudice as a result of the lawyer's misuse of confidential information obtained from a client; and prejudice arising where the lawyer 'soft peddles' his representation of a client in order to serve his own interests, those of another client, or those of a third person." While I accept that by not controlling the defence, the Non-DRA Insurers will not be able to "steer the defence" or "soft peddle" the representation of the insured in order to serve their own interests, this does not mean that there cannot be a conflict of interest in relation to the use or misuse of confidential information.

[180] I agree with the Applicants that an insurer's request for disclosure of Privileged Defence Information that will cover issues with respect to which the insurer and insured are adverse in interest (e.g., allegations of intentional acts), which information the insurer can then use against or to the detriment of the client/insured, places defence counsel in a conflict of interest. As stated

above, the lawyer appointed to defend the insured must represent and act on behalf of the insured with the utmost loyalty and in the insured's best interest. By being asked to provide Privileged Defence Information to Non-DRA Insurers, which information the lawyer knows could be used for purposes unrelated to the defence and to the detriment of the insured, the lawyer is being put in a situation of conflict that is contrary to his duty of loyalty to the insured. This conclusion applies to both Non-DRA Insurers who associate in the defence and those who merely reimburse defence costs as the conflict arises out of the provision of Privileged Defence Information to insurers who are adverse in interest.

[181] While the discussion in *Brockton* was focused on the kind of conflict that was required before an insurer could be forced to surrender control of the defence, the decision of the Court of Appeal in *Markham* shows that the court can impose measures to alleviate concerns regarding conflicts even in a situation where the alleged conflict does not justify removing an insurer from the defence completely. See *Markham* at paras. 103-104, 108, 116, 120-121 and *Family and Children's Services of Lanark, Leeds and Grenville v. Co-operators General Insurance Company*, 2021 ONCA 159 at paras. 106-107. Thus, the fact that the conflict in issue in this case relates to a reasonable apprehension of misuse of confidential information as opposed to a reasonable apprehension that the insurer will attempt to steer the defence does not mean that the conflict should not be addressed and that measures should not be taken to alleviate it.

[182] In light of the foregoing, I conclude that there are both party-based conflicts (which are admitted) and coverage-based conflicts in relation to the Non-DRA Insurers, and that while the Applicants are not seeking to appoint independent counsel in this case, it is important to recognize the conflicts of interest at play so as to put in place appropriate mechanisms to minimize such conflicts and provide meaningful protections to all involved: see *Markham* at para. 104.

f. Alleged duty to disclose Privileged Defence Information

[183] The Non-DRA Insurers argue that the insurance policies (including the duty to cooperate found in them) and/or the insured's duty of good faith require that the insured provide to insurers who do not have a duty to defend Privileged Defence Information that the insurers can then freely use for the purpose of coverage assessment. However, they have not cited any authority in support of this position.

[184] Pursuant to the reciprocal duty of utmost good faith, the insured has the duty to disclose material **facts**, including significant developments in the litigation and information which might void the insured's coverage. However, there is no authority for the proposition that this duty to disclose extends to communications related to these facts that are subject to litigation privilege and/or solicitor-client privilege. While the DRA intends to protect these privileged communications, the Applicants have acknowledged that the facts underlying such communications are not privileged. Thus, if material, such facts must be disclosed to the insurers. If these facts are not covered by the definition of "coverage reporting" in the DRA, they would still need to be disclosed to the insurers under the DRA as the DRA provides that it does not modify or restrict any obligations owed under the insurance policies.

[185] Therefore, it is my view that the law regarding the duty of good faith does not assist the Non-DRA Insurers in this case.

[186] In any event, I note that restrictions have regularly been imposed by the courts with respect to the information that can be provided to insurers in a situation of conflict of interest, and how such information should be provided, despite the existence of the duty of good faith. This confirms that there is no overriding right to litigation information that can be used without limit and for any purpose, no matter the circumstances. For instance, the Court of Appeal in *Markham* ordered that the handlers for coverage issues be different from the handlers for liability issues, and that the files of one handler could not be accessed by any other handler. See also *Mori-Vines Inc. et al v. Northbridge General Insurance Corporation*, 2017 ONSC 5718 at para. 100. Thus, the scope of the duty of disclosure can be affected by conflicts of interest. This recognizes, in my view, that the duty of good faith is a reciprocal one, and that an insurer cannot benefit from its conflicted position.

[187] The Respondents rely on *Coco Paving Inc. v. Willms & Shier Environmental Lawyers LLP*, 2019 ONSC 6857 ("***Coco Paving***") for the proposition that there is a duty to disclose privileged information – in that case, a memorandum prepared by counsel strategically assessing the insured's defence – to the insurer. In my view, *Coco Paving* does not apply to the circumstances of this case. Among other things:

a. The motion judge found that the memorandum in issue was sent to the insurer pursuant to the insured's instructions: para. 123. He also found that the lawyer did not divulge confidential information without instruction from the insured: para. 106.

b. *Coco Paving* dealt with a situation where there was only one insurer, and that insurer had a duty to defend and was covering the defence costs. The motion judge found that both the insurer and the insured were clients of the lawyer, and the lawyer owed duties to both: paras. 100-101. Here, the Non-DRA Insurers are not going to be clients as they merely wish to associate in the defence, and not control/conduct the defence.

c. The motion judge found that there was no conflict of interest in that case: para. 105. There were no coverage issues in *Coco Paving*, i.e. there were no issues as to whether the claims were covered under the policy. Further, there were no party-based conflicts (i.e. only one insured was involved in the litigation).

[188] In light of the foregoing and the conflicts of interest in this case, I conclude that it is appropriate for the DRA to require "split-handling" between coverage and defence, and to provide for different levels of disclosure for each activity. I reiterate that the DRA expressly states that it does not modify or restrict any obligations owed under the insurance policy. Thus, in certain circumstances, the insured may need to "beef up" its coverage-side reporting so as to meet its obligation to cooperate and its duty of good faith. However, it is not possible to determine in the abstract when this might be required.

[189] This leads me to the issue of whether the ethical screens or split-file protocols proposed by the Non-DRA Insurers are adequate.

g. Adequacy of the ethical screens proposed by the Non-DRA Insurers

[190] All the Non-DRA Insurers have implemented ethical screens to deal with party-based conflicts since they insure more than one defendant in the Underlying Claims. QBE, Markel and AIG have not implemented ethical screens to deal with coverage-based conflicts.[9] For the reasons stated above, they must do so in order to alleviate the reasonable apprehension of conflict of interests outlined above. In addition to splitting its internal files between insureds, Chubb has implemented split-handling between coverage and defence, but only at the handler level. The sufficiency and adequacy of the ethical screens/split-file protocols implemented by the Non-DRA Insurers are disputed by the Applicants.

[191] The main issue before me is whether it is appropriate for the Non-DRA Insurers' ethical screens to be limited to handlers at the lower levels or whether they should include all persons who receive and have access to Privileged Defence Information.[10] In my view, in light of the circumstances of this case, ethical screens limited to handlers are inadequate.

[192] In order to illustrate some of the issues raised by the Non-DRA Insurers' split-file protocols, I include the chart below which shows how Chubb has split its internal files:

ACTIVITY	LOBLAW	OTHER INSURED INVOLVED IN THE UNDERLYING CLAIMS
DEFENCE	A reports to B who reports to L	D reports to C who reports to L
COVERAGE	C reports to L	B reports to L

[193] Thus, persons B, C and L are on both sides of the "screen" between the two insureds, and they are all involved with defence and coverage issues. Person L has access to all the information, both defence and coverage, for all insureds. Persons B and C have access to the information of the two insureds involved in the Underlying Claims, but they receive or have access to defence information for one insured and coverage information for the other insured. I also note that person

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[9] While AIG argued that its proposed protocol had been accepted by Ontario courts in the past, including in *Markham*, I note that the protocol ordered in *Markham* included split-handling between coverage and defence, which is not the case with the protocol proposed by AIG in this Application.

[10] Based on the evidence before me, it appears that this issue does not apply to QBE because QBE's proposed protocol provides that Privileged Defence Information will only be received by or available to persons designated as authorized representatives, and no-one else. However, QBE's proposed protocol does not provide for an ethical screen to deal with coverage-based conflicts.

L's "authority level" is $4 million and her superior's authority level is $6.5 million, which is significantly lower than the limits of liability under the relevant policies issued by Chubb. Chubb's Canadian authority is capped at this amount, and decision-making above this amount would involve Chubb senior management in the U.S.

[194] In my view, the Non-DRA Insurers' split-file protocols do not operate like ethical screens and do not constitute reasonable measures to ensure that no disclosure will occur between the separated two sides, be they two different insureds or defence and coverage. If the same persons are on both sides of the screen, or if the information can quickly and easily flow to one person who has access to information on both sides and can make decisions affecting both sides, then the ethical screen is inadequate and inefficient and fails to fulfill its raison d'être.

[195] The kind of "split-file" protocol that applies only at the adjuster or handler level may be a practical solution in a case involving small amounts that do not or are unlikely to exceed the settlement authority of the adjuster. Here, however, we are dealing with a number of class actions, potentially seeking billions of dollars in damages, with very significant defence costs. In light of the size of the exposure, it is my view that robust ethical screens are important in order to alleviate the conflicts and concerns identified above – the larger the exposure, the stronger the interest and the motivation to seek to reduce/eliminate one's exposure.

[196] The Non-DRA Insurers argue that there is no evidence that their employees will misuse or abuse the information received. They rely on their codes of conduct (none of which are in evidence), and argue that their employees are professionals who honour their employers' codes of conduct and that there is no evidence to the contrary. This is neither compelling nor sufficient. First, the appropriate legal test is a reasonable apprehension of conflict, not an actual, proven conflict. Second, I note that lawyers are, similarly, professionals with ethical obligations, but, nevertheless, stringent ethical screens are imposed on them to protect their clients' confidential information when they are in a situation of conflict of interest. In my view, the following passage from *MacDonald Estate v. Martin*, [1990] 3 S.C.R. 1235 at 1259, 1263, while drafted in the context of a lawyer's conflict of interest, also applies to the current context:

> In dealing with the question of the use of confidential information we are dealing with a matter that is usually not susceptible of proof. As pointed out by Fletcher Moulton L.J. in *Rakusen*, "that is a thing which you cannot prove" (p. 841). I would add "or disprove". […]
>
> *A fortiori* undertakings and conclusory statements in affidavits without more are not acceptable. These can be expected in every case of this kind that comes before the court. It is no more than the lawyer saying "trust me". This puts the court in the invidious position of deciding which lawyers are to be trusted and which are not. Furthermore, even if the courts found this acceptable, the public is not likely to be satisfied without some additional guarantees that confidential information will under no circumstances be used. […]

[197] I also reject the Non-DRA Insurers' argument that the DRA will prevent them from complying with their statutory and regulatory obligations and setting appropriate financial

reserves. This argument is seriously undermined by the fact that: (a) a number of other insurers, who are bound by the same requirements, have signed the DRA or a similar agreement; and (b) in cases where independent legal counsel is appointed, the insurer does not have access to Privileged Defence Information to deal with reserves, regulatory requirements, etc. Further, this argument was not supported by any concrete and specific evidence. Witnesses put forward by some of the Non-DRA Insurers acknowledged that the documents prepared to set appropriate financial reserves or to obtain authority are short (from one or two paragraphs to a page or two) and they "don't get into the substantive discussion of the evidence or provide detailed reports on opinions from lawyers." They are high-level documents that set out the conclusions reached by the handler or the author of the document. I also note that the DRA contemplates the provision of reserve reports to support a reserve or payment request in excess of the authorized representatives' financial authority.

[198] Thus, it is my view that, as required by the DRA, the Non-DRA Insurers must maintain ethical screens that ensure that Privileged Defence Information is not received by or available to any person or entity other than the designated authorized representatives, who cannot have any involvement with respect to the defence of any other defendants in the Underlying Claims or the assessment or determination of coverage issues. I find that the DRA strikes the right balance between the rights of the insureds and the insurers.

C. CONCLUSION

[199] In accordance with these Reasons, the Applicants' Application is granted in part and Markel's Application is dismissed. As stated above, if counsel cannot agree on the specific relief that flows from the conclusions above, they can contact my assistant to schedule a case conference with me.

[200] If costs cannot be agreed upon, the Applicants shall deliver submissions of not more than five pages (double-spaced), excluding the bill of costs, by February 7, 2022. The Respondents shall deliver their submissions (with the same page limit) by February 21. 2022. The Applicants can deliver reply submissions (with the same page limit) by February 28, 2022.

[201] When the parties are ready to schedule the hearing of the Application as against Teva and its insurers, counsel should contact my assistant to schedule a case conference with me.

Vermette J.

Released: January 19, 2022