

CITATION: Dunn v. Chubb Insurance Company of Canada, 2009 ONCA 538
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COURT OF APPEAL FOR ONTARIO

O'Connor A.C.J.O. and Lang and Watt JJ.A.

BETWEEN

Frank Andrew Dunn

Applicant (Appellant)

and

Chubb Insurance Company of Canada, Chubb Atlantic Indemnity Ltd.
Zurich Insurance Company, Liberty International Underwriters Canada,
a Division of Liberty Mutual Insurance Company, ACE INA Insurance,
ACE Bermuda Insurance Ltd., Continental Casualty Company, XL Insurance
(Bermuda) Ltd., and American Home Assurance Company

Respondents (Respondents)

AND BETWEEN

Douglas Beatty

Applicant (Appellant)

and

Chubb Insurance Company of Canada, Chubb Atlantic Indemnity Ltd.
Zurich Insurance Company, Liberty International Underwriters Canada,
a Division of Liberty Mutual Insurance Company, ACE INA Insurance,
and American Home Assurance Company

Respondents (Respondents)

Thomas G. Heintzman, Q.C., and Junior Sirivar, for the appellant, Frank Andrew Dunn

Bonnie A. Tough and Jennifer Lynch, for the appellant, Douglas Beatty

Gary H. Luftspring and Sam R. Sasso, for the respondent, Chubb Insurance Company of Canada

Richard H. Kremplec, Q.C., for the respondent, American Home Assurance Company

Heard: June 22, 2009

On appeal from the judgment of Justice Colin L. Campbell of the Superior Court of Justice dated February 11, 2009 and reported at 2009 CanLII 7083.

By the Court:

OVERVIEW

[1] These two appeals, heard together, concern the interpretation of provisions in a directors and officers liability insurance policy regarding the allocation of Defence Costs, a defined term in the policy, in proceedings brought against persons insured under the policy. The appellants challenge the decision of Campbell J. (the “application judge”), which dismissed their application for a declaration that the insurer is obligated to pay either 90 or 100 percent of their Defence Costs. The Defence Costs relate to proceedings brought after the expiry of the policy period and allege conduct occurring both prior to and after the end of the policy period.

[2] At the request of the appellants, these appeals were expedited, and counsel have requested that we deliver our reasons expeditiously.

[3] We have concluded that the insurance policy, as it relates to the allocation of Defence Costs, is ambiguous. The conclusion we have reached results from a submission first made in oral argument on this appeal. Were it not for that submission, we would have dismissed the appeal for the reasons set out below.

[4] However, the current state of the record provides little help in resolving the ambiguity. Moreover, the parties assert different facts, most of which are not in evidence, in arguing for and against the application of the doctrine of *contra proferentem*. In our view, it is desirable that this important case be decided on a more complete record.

[5] In the result, we have concluded that the preferable course is to order a new hearing of the application. We find this conclusion unfortunate because we are well aware of the urgency from the appellants' point of view of having the issues raised on this appeal resolved one way or the other. However, the delay is necessary to provide the parties with the opportunity to introduce evidence and provide argument that would assist with the resolution of the ambiguity.

[6] In order to narrow the future proceedings, we have decided all of the issues other than the one giving rise to the ambiguity. We expect that the parties will co-operate with one another in order to achieve a speedy resolution of the outstanding issue.

BACKGROUND

[7] The appellants are Frank Andrew Dunn and Douglas Beatty. Although we recognize that there are a number of insurers listed as respondents, for the purpose of the discussion in these reasons, we refer to the insurers simply as “Chubb” or the “insurers”.

[8] The insurance policy in issue (the “2001 Policy”) was one of many issued by Chubb to Northern Telecom Limited (now Nortel Networks Corporation). It covered the Policy Period from 1999 to 2001 (the “Policy Period”). The 2001 Policy is a variant of a “claims made” policy.

[9] During the Policy Period, the appellants participated in certain conduct that became the subject of civil proceedings commenced in 2001 and 2002 (the “2001 Proceedings”). Chubb acknowledges that the 2001 Proceedings triggered coverage under the 2001 Policy.

[10] In 2004 and subsequent years, further proceedings were brought against the appellants. These proceedings include civil cases as well as regulatory proceedings by the Ontario Securities Commission and the United States Securities and Exchange Commission. All of these proceedings include allegations against the appellants by reason of their conduct in 2001 (the “2001 Conduct”) as well as their conduct in 2003 to 2004 (the “2003 Conduct”). Counsel refer to these 2004 and subsequent civil and

regulatory proceedings as the Hybrid Proceedings. All of the Hybrid Proceedings were commenced after the expiration of the Policy Period.

[11] Chubb acknowledges that the 2001 Conduct pleaded in the Hybrid Proceedings triggers coverage under the 2001 Policy because a claim was made regarding the appellants' 2001 Conduct during the Policy Period. Thus, Chubb accepts that it is responsible for 100 percent of the Defence Costs incurred by the appellants in the Hybrid Proceedings to the extent that those proceedings relate to the 2001 Conduct. However, Chubb takes the position that it is not responsible for the appellants' Defence Costs in the Hybrid Proceedings to the extent that those costs relate exclusively to the appellants' 2003 Conduct. As a result of taking the above position, Chubb has been paying 50 percent of the appellants' Defence Costs for the Hybrid Proceedings.

[12] The application judge dismissed the appellants' application for a declaration that Chubb is responsible to pay either 90 or 100 percent of the Defence Costs relating to the Hybrid Proceedings.

ISSUES

[13] On this appeal, the appellants advance three arguments.

[14] First, they argue that the application judge erred in failing to give effect to the allocation provisions contained in two endorsements to the 2001 Policy, which provide a specific allocation for Defence Costs in the case of claims that include both covered and

uncovered matters. The appellants submit that the endorsements are clear on their face and entitle them to either 100 percent of their Defence Costs for the Hybrid Proceedings (assuming the claims are based on, arising from or in consequence of a “Securities Transaction”), or 90 percent otherwise.

[15] Second, they argue that the application judge erred in failing to find that the particulars of the 2003 Conduct alleged in the Hybrid Proceedings were “Interrelated Wrongful Acts” with the 2001 Conduct and, as such, were all covered under the terms of the 2001 Policy.

[16] Third, in the alternative to their first and second arguments, the appellants submit that the application judge erred in holding that the appellants had the burden of proving that a greater proportion than 50 percent of the Defence Costs was appropriate for coverage under the 2001 Policy.

ANALYSIS

1. The Allocation Provisions Issue

[17] Chubb’s responsibility for Defence Costs relating to the 2003 Conduct in the Hybrid Proceedings turns on the interpretation of Endorsements 3 and 10 of the 2001 Policy.

[18] Both endorsements became effective on the same date and replaced s. 12 of the 2001 Policy. Section 12 was entitled “Allocation”. It provided that if both “**Loss**

covered and loss not covered” were incurred, “because a **Claim** against the **Insured Persons** includes both covered and uncovered matters”, the parties would use best efforts to agree upon a fair and proper allocation between “covered **Loss** and uncovered loss” (emphasis in original). Section 12 further provided that if the parties could not agree on an allocation, Chubb would advance Defence Costs that it believed to be covered until a different allocation was negotiated, arbitrated or judicially determined.

[19] Endorsements 3 and 10 replaced the allocation scheme set out in s. 12 of the 2001 Policy. Both endorsements provide for a fixed percentage allocation of Defence Costs for claims that include both covered and uncovered matters. Endorsement 10 allocates 100 percent of Defence Costs to covered loss in the case of a claim based on, arising from or in consequence of a “Securities Transaction”, as that term is defined in s. 2 of Endorsement 10. Endorsement 3 allocates 90 percent of Defence Costs to covered matters in the case of claims that do not fall within the definition of a “Securities Transaction”.

a) *Ambiguity in Endorsement 3*

[20] The relevant part of Endorsement 3 reads as follows:

If both **Loss** covered by this coverage section and **Loss** not covered by this coverage section are incurred, either because a **Claim** against an **Insured Person** includes both covered and uncovered matters or because a **Claim** is made against both an **Insured Person** and others, including the **Insured Organization**, the **Insureds** and the Company shall allocate such amounts as follows:

- (a) with respect to **Defence Costs**, to create certainty in determining a fair and proper allocation of **Defence Costs**, 90 % of all **Defence Costs** which must otherwise be allocated as described above shall be allocated to covered **Loss** and shall be advanced by the Company on a current basis.... [Emphasis in original.]

[21] The interpretation of Endorsement 3 and its application to the Hybrid Proceedings depends in part on the meaning of the term “Loss”. Indeed, Chubb acknowledges that, but for the definition of “Loss” in the 2001 Policy, Endorsement 3 would require Chubb to pay 90 percent of the appellants’ Defence Costs of the Hybrid Proceedings, including those aspects of the proceedings that relate to the 2003 Conduct.

[22] The relevant part of the definition of “Loss” in the 2001 Policy reads as follows:

[T]he total amount which any **Insured Person** becomes legally obligated to pay on account of each **Claim** and for all **Claims** in each **Policy Period** and the Extended Reporting Period, if exercised, made against them for **Wrongful Acts** for which coverage applies, including, but not limited to, damages, judgments, settlements, costs and **Defence Costs**. [Emphasis in original.]

[23] Chubb argues that this definition limits the application of Endorsement 3 to claims made during the Policy Period and does not, therefore, cover claims arising from the 2003 Conduct. Chubb sets out its argument in its factum as follows:

The 90% Allocation Provision is inapplicable to the Hybrid Proceedings because it applies only to **Claims** first made during the 2001 Policy Period that give rise to **Loss** covered by the 2001 Policy and loss not covered by the 2001 Policy.

None of the Hybrid Proceedings were **Claims** first made during that policy period.

By its terms, the 90% Allocation Provision applies only “[i]f both **Loss** covered by this coverage section and **Loss** not covered by this coverage section are incurred” **Loss** is defined to include only those amounts which the **Insured** is legally obligated to pay “on account of each **Claim** and for all **Claims in each Policy Period and the Extended Reporting Period, if exercised.**”¹ [Emphasis added] Amounts incurred defending the Hybrid Proceedings are not amounts Dunn and Beatty are obligated to pay “on account of” a **Claim** in the 2001 Policy Period because the Hybrid Proceedings are not **Claims** made during the 2001 Policy Period. Accordingly, the 90% Allocation Provision simply has no application to defence costs incurred in the Hybrid Proceedings.

[24] The appellants respond by arguing that the application of the definition of “Loss” to Endorsement 3 would render Endorsement 3 meaningless. The definition of “Loss” in the 2001 Policy includes only amounts that an insured person becomes legally obligated to pay “*for which coverage applies*” (emphasis added). Endorsement 3 specifically provides for the allocation of costs in situations where there is a “Loss” for which there is no coverage. Indeed, the whole purpose of Endorsement 3 is to allocate Defence Costs between covered and uncovered losses. Thus, interpreting the contract as Chubb suggests would mean that there could be no “**Loss not covered**” and therefore no allocation. The appellants submit that this interpretation would negate the overall purpose of the allocation provision, a result that could not have reflected the intention of the parties.²

¹ The Extended Reporting Period was not exercised and, therefore, is irrelevant.

² It is important to point out that it does not appear that this issue was addressed before the application judge.

[25] Chubb acknowledges the difficulty in interpretation that is posed when applying the definition of “Loss” in the 2001 Policy to Endorsement 3. However, it submits that the difficulty could be resolved by removing the words “for which coverage applies” from the definition of “Loss” when interpreting Endorsement 3. Indeed, this is the only solution that Chubb proposes to the interpretation dilemma. Effectively, Chubb is asking the court to amend the definition of “Loss” in the 2001 Policy.

[26] Chubb points out that the interpretation urged by the appellants would require ignoring a defined term in the 2001 Policy. In this respect, it is interesting to note that the previous allocation provision – s. 12 of the 2001 Policy – referred to “**Loss** covered by this coverage section and loss not covered by this coverage section” and provided an allocation scheme for “covered **Loss** and uncovered loss” (emphasis in original). Thus, in the original 2001 Policy, the word “loss”, as it related to uncovered losses, was neither bolded nor capitalized. Hence, one could read into the term “**Loss**” in Endorsement 3 some support, if any is needed, for the position that the parties intended the definition of “Loss” to be relied upon when interpreting the allocation provisions.

[27] Chubb argues that the only way the definition makes sense is if it is amended as set out above. The commercial reality, according to Chubb, is that once the parties moved to a fixed allocation for covered and uncovered matters, it made sense to limit the allocation to claims made during the Policy Period. Otherwise, the allocation provision

would be open-ended and would cover Defence Costs for claims against an insured brought years after the Policy Period had expired.

[28] Thus, the parties' positions lead to one of two possible results:

- Interpret Endorsement 3 without reference to the definition of "Loss" because to do so would render Endorsement 3 meaningless. This would require ignoring the definition of the term "Loss" in Endorsement 3 (the appellants' position); or
- Interpret Endorsement 3 by referring to the definition of "Loss" but delete from the definition the phrase "for which coverage applies" (Chubb's position).

[29] The result would be either that the appellants are entitled to the 90 percent allocation under Endorsement 3,³ or that Endorsement 3 does not apply to that portion of the Hybrid Proceedings relating to the 2003 Conduct because the claims relating to that conduct were not made during the Policy Period as required by the definition of "Loss" in the 2001 Policy.

[30] In short, we conclude that the meaning of Endorsement 3 when read in conjunction with the definition of "Loss" is ambiguous.

[31] In our view, it is impossible to resolve the ambiguity in this case on the factual record before us. In order to explain our position, it is necessary to review some of the basic principles of contractual interpretation.

³ Assuming that the claims are not based on, arising from or in consequence of a "Securities Transaction".

[32] The primary goal of contractual interpretation is to give effect to the intentions of the parties. As Estey J. explained in *Consolidated-Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance*, [1980] 1 S.C.R. 888, at p. 901, “the normal rules of construction lead a court to search for an interpretation which, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time of entry into the contract.”

[33] Where a contract is clear and unambiguous on its face, it is unnecessary to consider extrinsic evidence in order to interpret its terms: *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129, at para. 55; *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*, [1999] 3 S.C.R. 108, at para. 32. Thus, it has been said that courts should give effect to clear and unambiguous language in an insurance policy, having regard to the contract as a whole: *Non-Marine Underwriters, Lloyd's of London v. Scalera*, [2000] 1 S.C.R. 551, at para. 71; *Brisette Estate v. Westbury Life Insurance Co.*, [1992] 3 S.C.R. 87, at p. 92. That being said, the terms of an insurance policy, like all contractual terms, must be examined in light of the surrounding circumstances – or what is sometimes called the “factual matrix” – in order to determine the intent of the parties and the scope of their understanding: *Jesuit Fathers of Upper Canada v. Guardian Insurance Co. of Canada*, [2006] 1 S.C.R. 744, at para. 27.

[34] A contractual provision is ambiguous if it is reasonably susceptible of more than one meaning: *Hi-Tech Group Inc. v. Sears Canada Inc.* (2001), 52 O.R. (3d) 97 (C.A.), at

para. 18. Extrinsic or parol evidence may be admitted to assist in resolving an ambiguity: *United Brotherhood of Carpenters and Joiners of America, Local 579 v. Bradco Construction Ltd.*, [1993] 2 S.C.R. 316, at p. 342; *Eli Lilly* at para. 55. For example, extrinsic evidence regarding the negotiations leading up to an agreement may be admitted if the contract is ambiguous, but not if the language of the contract is clear: see *Canadian Premier Holdings Ltd. v. Winterthur Canada Financial Corp.* (2000), 132 O.A.C. 172 (C.A.), at para. 15; *SimEx Inc. v. IMAX Corp.* (2005), 206 O.A.C. 3 (C.A.), at para. 23.⁴

[35] Further, where an insurance policy is ambiguous, the court should adopt the interpretation that gives effect to the reasonable expectations or intentions of the parties: *Non-Marine Underwriters* at para. 71; *Reid Crowther & Partners Ltd. v. Simcoe & Erie General Insurance Co.*, [1993] 1 S.C.R. 252, at p. 269. As Estey J. explained in *Consolidated-Bathurst* at pp. 901-902:

[L]iteral meaning should not be applied where to do so would bring about an unrealistic result or a result which would not be contemplated in the commercial atmosphere in which the insurance was contracted. *Where words may bear two constructions, the more reasonable one, that which produces a fair result, must certainly be taken as the interpretation which would promote the intention of the parties.* Similarly, an interpretation which defeats the intentions of the parties and their objective in entering into the commercial transaction in the first place should be discarded in favour of an

⁴ Regardless of ambiguity, however, as noted above, courts may have regard to the context or the factual matrix. This court has said that commercial contracts are to be interpreted “with regard to objective evidence of the factual matrix underlying the negotiation of the contract, but without reference to the subjective intention of the parties”: see *Ventas, Inc. v. Sunrise Senior Living Real Estate Investment Trust* (2007), 85 O.R. (3d) 254 (C.A.), at para. 24, citing *Eli Lilly* at para. 54 and *Kentucky Fried Chicken v. Scott’s Food Services Inc.* (1998), 114 O.A.C. 357 (C.A.), at paras. 25-27.

interpretation of the policy which promotes a sensible commercial result. It is trite to observe that *an interpretation of an ambiguous contractual provision which would render the endeavour on the part of the insured to obtain insurance protection nugatory, should be avoided*. Said another way, the courts should be loath to support a construction which would either enable the insurer to pocket the premium without risk or the insured to achieve a recovery which could neither be sensibly sought nor anticipated at the time of the contract. [Emphasis added.]

[36] Finally, if all other rules of construction are inadequate, the doctrine of *contra proferentem* may be applicable to resolve an ambiguity against the party who drafted the contract. *Contra proferentem* is a rule of last resort and will only apply “when all other rules of construction fail”: *Canadian National Railway Co. v. Royal and Sun Alliance Insurance Co. of Canada*, [2008] 3 S.C.R. 53, at para. 33, citing *Stevenson v. Reliance Petroleum Ltd.*, [1956] S.C.R. 936, at p. 953.

[37] Without being critical, there is little evidence in the record to assist the court in resolving the interpretation dilemma identified on this appeal. There is virtually no evidence about the context or the factual matrix within which the 2001 Policy or the endorsements were agreed to. While both sides have urged that “commercial realities” support their interpretation, there is little in the record, by way of either facts or argument, to assist the court in assessing the relative commercial practicality of the

approaches advocated by each party.⁵ Indeed, we can think of benefits and problems with both interpretations depending from whose vantage point the situation is considered.

[38] We do not know whether there is further evidence available that would assist in resolving the ambiguity. However, we do know that the parties take differing positions as to whether the doctrine of *contra proferentem* is available to assist with the resolution of the ambiguity. Significantly, the difference in the parties' positions results primarily from the different facts that the parties assert relating to the negotiations and the terms of the insurance contract.

[39] The appellants accept that the parties appear to have negotiated the removal of the previous allocation clauses and replaced them with Endorsements 3 and 10. They also accept that there may have been negotiations with respect to the premiums to be paid for the new arrangements. However, the appellants go on to assert that there is no suggestion that Nortel or anyone on behalf of Nortel negotiated any of the contractual language in the body of the standard insurance policy, including the definition of "Loss". Nor is there any evidence that the parties negotiated the specific language used in Endorsements 3 and 10. Thus, the appellants' position is that there may have been negotiations, but those negotiations were limited to the issues of percentages and premiums. The appellants assert that the 2001 Policy is a standard policy, as are each of Endorsements 3 and 10. As

⁵ Having said this, we note that the application of a standard of commercial reasonableness does not necessarily require the consideration of any evidence, extrinsic or otherwise: see *Lauren International, Inc. v. Reichert* (2008), 237 O.A.C. 94 (C.A.), at para. 23, leave to appeal to S.C.C. refused [2008] S.C.C.A. No. 327.

such, they argue that the 2001 Policy is a contract of adhesion. They rely on case law,⁶ which, in their submission, stands for the proposition that the doctrine of *contra proferentem* applies to contracts of adhesion, and that the ambiguity should be resolved against the insurers.

[40] Chubb takes the opposite position. It says that the appellants' arguments on the facts relating to the scope of the negotiations are inappropriate because there is no evidence about those negotiations. Chubb relies on Canadian⁷ and American⁸ authorities for the proposition that *contra proferentem* should not be applied against an insurer where the insured has participated in the negotiations of endorsements to an insurance policy. Chubb also relies upon the passage from the Supreme Court of Canada's decision in *Canadian National Railway* at para. 33. There, the court spoke of the doctrine being inapplicable where the entire policy had been negotiated between sophisticated parties and pointed out the difference between a manuscript (or fully negotiated) policy and a policy of adhesion.

⁶ *Indemnity Insurance Co. of North America v. Excel Cleaning Service*, [1954] S.C.R. 169; *Consolidated-Bathurst; Fletcher v. Manitoba Public Insurance Co.*, [1990] 3 S.C.R. 191; *Canadian National Railway Co. v. Royal and SunAlliance Insurance Co. of Canada* (2004), 15 C.C.L.I. (4th) 1 (Ont. S.C.), rev'd (2007), 85 O.R. (3d) 186 (C.A.), rev'd [2008] 3 S.C.R. 53.

⁷ *Hillis Oil & Sales v. Wynn's Canada*, [1986] 1 S.C.R. 57; *McClelland & Stewart Ltd. v. Mutual Life*, [1981] 2 S.C.R. 6; *Showmart Management Ltd. v. 853436 Ontario Ltd. (c.o.b. Features Cafe)* (1998), 18 R.P.R. (3d) 128 (Ont. S.C.); *Canadian Crude Separators Ltd. v. W.A. (Wes) Jacobson* (1998), 226 A.R. 171 (Q.B.).

⁸ *Chubb Custom Ins. Co. v. Prudential Ins. Co. of America*, 948 A.2d 1285 (N.J. 2008); *Six Flags, Inc. v. Westchester Surplus Lines Ins. Co.*, 565 F.3d 948 (5th Cir. 2009); *F.D.I.C. v. Ins. Co. of North America*, 105 F.3d 778 (1st Cir. 1997); *Eagle Leasing Corp. v. Hartford Fire Ins. Co.*, 540 F.2d 1257 (5th Cir. 1976); *Fountain Powerboat Industries, Inc. v. Reliance Ins. Co.*, 119 F.Supp.2d 552 (E.D.N.C. 2000).

[41] The difficulty in both parties' submissions is the lack of evidence necessary to resolve this point. There is virtually no evidence about the negotiations, if any, leading to Endorsements 3 and 10; the definition of Loss in the 2001 Policy or other relevant terms; what matters were covered in the negotiations; the parties involved; or any other information that would assist in determining whether the resulting contract is a policy of adhesion or a manuscript policy.

[42] Whether or not there is further evidence to assist with resolving the ambiguity, it seems obvious that the doctrine of *contra proferentem* will play an important role in the resolution of the interpretive issue arising from the allocation provisions in Endorsement 3. Clearly, this is an important issue for these parties. It is also an important issue for other cases where large and sophisticated parties contract for insurance coverage.

[43] In our view, it is undesirable to resolve the ambiguity in this case without providing the parties an opportunity to call evidence regarding the factual matrix of the agreement, as well as extrinsic evidence and evidence that would inform the *contra proferentem* issue. It is for that reason that we have decided that there must be a new hearing on this issue only.

[44] We wish to stress that the remedy in this case is unusual. As noted, it arises from a submission that was advanced for the first time in oral argument on this appeal and from the parties' different interpretation of facts that were not in evidence. In our view, it

would be inappropriate to decide this issue in the absence of a complete factual record that would enable the parties to develop the relevant facts and arguments.

b) *Endorsement 10*

[45] The appellants also argue that Chubb is required to pay 100 percent of their Defence Costs pursuant to Endorsement 10, which as discussed above, provides for a 100 percent reimbursement for Defence Costs for claims based on, arising from or in consequence of a “Securities Transaction”. Section 7 of Endorsement 10 reads as follows:

The first paragraph of subsection 12, **Allocation**, is deleted in its entirety and the following is inserted:

- (a) If a **Claim** based on, arising from or in consequence of a **Securities Transaction** results in both **Loss** covered by this coverage section and **Loss** not covered by this coverage section, because such **Claim** includes both covered and uncovered matters or is made against both covered and uncovered parties, the **Insureds** and the Company shall allocate such amount to **Loss** as follows:
 - (i) 100% of such amount constitute defense costs shall be allocated to covered **Loss**; and
 - (ii) 100% of such amount other than defense costs shall be allocated to covered **Loss**. [Emphasis in original.]

[46] “Securities Transaction” is defined in s. 2 of Endorsement 10 to mean “the purchase or sale of, or offer to purchase or sell, any securities issued by any **Insured Organization**” (emphasis in original).

[47] In our view, the allocation process described in Endorsement 10 does not apply to the Hybrid Proceedings. We agree with Chubb’s submission that the Hybrid Proceedings are not “based on, arising from, or in consequence of” the purchase or sale of Nortel securities. Rather, as Chubb argues, the Hybrid Proceedings are based on the appellants’ alleged improper accounting treatment of Nortel’s revenues and reserves.

c) *Other Issues*

[48] The appellants also relied on ss. 8 and 10 of the 2001 Policy to counter Chubb’s argument that the definition of “Loss” limits Endorsement 3 to allocating losses for covered and uncovered matters to claims made during the Policy Period. In effect, the appellants argue that the 2001 Conduct and the 2003 Conduct are “Interrelated Wrongful Acts” (s. 8) or claims arising from the same circumstances (s. 10). As such, they argue that the Hybrid Proceedings include only claims made during the Policy Period. That being the case, the appellants argue that the definition of “Loss” does not operate to exclude the claims in the Hybrid Proceedings relating to the 2003 Conduct from the operation of Endorsement 3.

[49] We do not accept this argument. For the reasons we set out below in dealing with the appellants' second ground of appeal, we are of the view that the 2001 Conduct and the 2003 Conduct are not "Interrelated Wrongful Acts" and did not arise out of the same circumstances. In our view, they are two separate and distinct sets of conduct.

[50] Finally, before leaving the allocation issue, we point out that an exchange took place between the court and counsel during oral argument with respect to the definition of "Loss". The panel observed that the following sentence appears at the end of the definition of "Loss", as it is reproduced in Appendix A to the application judge's reasons:

Loss does not include any amount allocated to uncovered loss pursuant to subsection 12, **Allocation**. [Emphasis in original.]

[51] After oral argument, the court's Senior Legal Officer wrote to counsel advising that it appeared that this part of the definition of "Loss" was added by Endorsement 10.⁹ Counsel were asked whether or not they had any submissions as to the applicability of the above sentence to the interpretation of the definition of "Loss" as it applied to Endorsement 3. For different reasons, counsel said that it did not. As a result, we have not taken into consideration the amendment to the definition of "Loss" found in Endorsement 10.

⁹ Section 2(c) of Endorsement 10 provides that the definition of **Loss** is amended by adding the following: **Loss** does not include any amount allocated to uncovered loss pursuant to subsection 12, **Allocation**. For purposes of coverage under Insuring Clause 3, **Loss** includes punitive or exemplary damages which any **Insured Organization** becomes legally obligated to pay, provided the punitive or exemplary damages are otherwise covered under Insuring Clause 3 and are insurable under the law pursuant to which this coverage section is construed.

[52] We raise this point at this stage to say that we thought it might be argued that the amendment to the definition of “Loss” forms part of the entire 2001 Policy. If that were the case, it also might be argued that the definition of “Loss”, as amended, is consistent with an approach that when Defence Costs are being allocated between covered and uncovered losses, the definition of “Loss” in the 2001 Policy should not be applied to uncovered losses. If that were the case, uncovered losses would not be limited by the requirement in the definition of “Loss” that they be on account of claims made in the Policy Period.

[53] We do not raise this point at this time to suggest that the amendment to the definition of “Loss” in Endorsement 10 should determine the issue or even that it is relevant to the resolution of the ambiguity. We do so only so that the parties and the court hearing the reapplication may consider whether or not there is any assistance to be gleaned from that amendment.

2. Interrelated Wrongful Acts

[54] On this ground of appeal, the appellants argue that the 2003 Conduct that is pleaded in the Hybrid Proceedings is covered by the 2001 Policy on two bases.

[55] First, they argue that the 2003 Conduct is the same as, or is interrelated to, the 2001 Conduct on the basis of s. 8 of the 2001 Policy. Section 8 provides coverage for “all **Loss** arising out of the same **Wrongful Act** and all **Interrelated Wrongful Acts**”

(emphasis in original). “Wrongful Act” is broadly defined to include the type of conduct at issue in the Hybrid Proceedings, including misleading statements. “Interrelated Wrongful Act” is defined to mean “all causally connected **Wrongful Acts**” (emphasis in original).

[56] Second, the appellants argue that the 2003 Conduct is conduct that was “subsequently arising from” the 2001 Conduct within the meaning of s. 10 of the 2001 Policy. Section 10 provides for coverage where a claim after the Policy Period arises from circumstances about which the insured gave notice during the Policy Period.

[57] In essence, these arguments are both based on the premise that the 2003 Conduct arose out of, was causally connected to, or was the same as the 2001 Conduct. In support, the appellants point to various broad-based allegations in the Hybrid Proceedings, including the Ontario Securities Commission’s allegation that the appellants displayed a “culture of non-compliance” throughout the whole period.

[58] Broad language can usually be chosen to describe a wide variety of allegations of misconduct. However, in our view, a reading of the allegations in the Hybrid Proceedings shows that the 2003 Conduct is different in nature, in kind, and in time from the 2001 Conduct alleged in the same proceedings.

[59] The allegations of the 2003 Conduct relate to different acts of non-compliance than the 2001 Conduct and to acts that took place at different time frames and in different

ways. The allegations are specific in describing the different acts. For example, the Securities and Exchange Commission proceedings allege that the appellants were involved in two fraudulent accounting schemes, which are explained as comprising a Revenue Recognition scheme based on the 2001 Conduct and a different Provisioning scheme based on the 2003 Conduct. The distinction between the parameters of the conduct and the two time frames is further illustrated by recent criminal charges which involve allegations restricted to the 2003 Conduct.

[60] Accordingly, we reject this ground of appeal.

3. Larger Costs Issue

[61] On this ground of appeal, the appellants challenge the application judge's finding that "in the absence of evidence to the contrary", it was reasonable for Chubb to pay them 50 percent of the Defence Costs of the Hybrid Proceedings in relation to the 2001 Conduct covered under the 2001 Policy. The application judge made this finding because the appellants did not call evidence that the 2001 Conduct consumed more than 50 percent of the costs of the Hybrid Proceedings.

[62] The appellants argue that the application judge erred in failing to apply the decision of this court in *Hanis v. Teevan* (2008), 92 O.R. (3d) 594. They submit, based on *Hanis*, that Chubb is obliged to pay any defence costs reasonably related to the

defence of the 2001 covered claims, even if those costs also relate to the defence of any 2003 uncovered claims.

[63] This argument is consistent with *Hanis* where Doherty J.A. stated at para. 2, “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.” However, Doherty J.A. continued to explain at para. 2 that the insurer “is not obliged to pay costs related solely to the defence of uncovered claims.”

[64] In our view, on the state of the current record, and for our reasons relating to the Interrelated Wrongful Act argument, this case appears to be one where the Defence Costs can be separated into costs relating to the 2001 Conduct and costs relating to the 2003 Conduct. This does not appear to be a case where the same costs are being incurred for both covered and uncovered claims: see *Hanis* at paras. 25, 42.

[65] Finally, the appellants argue that the onus was on Chubb to establish which Defence Costs relate to the covered claims and which relate to the uncovered claims. On this issue, we agree with the observation of Doherty J.A. in *Hanis* at para. 43, that there does not appear to be “any compelling reason to depart from the general rule that the party claiming damages bears the ultimate or legal burden of proof on that issue, including proving the quantum of damages suffered.”

[66] The application judge resolved this issue by observing that Chubb, in the absence of evidence to the contrary, had allocated 50 percent of the Defence Costs to the Policy Period. He left it open to the appellants to demonstrate, to the satisfaction of Chubb or the court, that a greater percentage was appropriate and stated in his reasons that his order could be amended accordingly. We are of the view that in the event that the appellants are ultimately unsuccessful on the allocation provisions issue, the approach taken by the application judge is appropriate.

[67] Thus, we reject this ground of appeal.

DISPOSITION

[68] In the result, we allow the appeal and direct a new hearing of the application to be limited in accordance with these reasons. Given the result, we make no order as to the costs of this appeal and leave that issue to the judge rehearing the application. However, to assist with respect to the amount of the costs to be awarded with respect to the appeal, we fix the costs as follows.

[69] If the appellants are eventually successful, we would have awarded costs on a partial indemnity basis. The appellants argued in their costs submissions that the insured “is entitled to all his or her costs on a substantial (or full) indemnity basis in an action against an insurer who denies coverage”. Substantial indemnity costs may be appropriate in cases where the issue on appeal is whether the insurer had a duty to defend: see *M.(E.)*

v. Reed, [2003] O.J. No. 1791 (C.A.). However, where the issue on appeal involves the allocation of costs between the insurer and the insured, as in this case, costs are awarded on a partial indemnity basis: see *Hanis v. University of Western Ontario*, 2008 ONCA 793; *Boliden Ltd. v. Liberty Mutual Insurance Co.*, 2008 ONCA 418.

[70] That said, the amount claimed must also be fair and reasonable having regard to the nature of the appeal: see *Boucher v. Public Accounts Council for the Province of Ontario* (2004), 71 O.R. (3d) 291 (C.A.). We would fix the costs for the appellant, Dunn, in the amount of \$35,000 and for the appellant, Beatty, in the amount of \$15,000. Both amounts are inclusive of disbursements and G.S.T. If an award is to be made in favour of Chubb, we would fix Chubb's costs on a partial indemnity basis in the amount of \$35,000, inclusive of disbursements and G.S.T.

RELEASED: July 2, 2009
"DRO"

"D. O'Connor A.C.J.O."
"S.E. Lang J.A."
"David Watt J.A."