ABSTRACT OF SUBROGATION: CARRIAGE AND CONTROL OF THE ACTION AND INDEPENDENT SETTLEMENT OF THE SUBROGATED CLAIM

A. CARRIAGE AND CONTROL OF THE ACTION

We believe that *Farrell Estates Ltd. v Canadian Indemnity Co.*[1] and *Zurich Insurance Co. v Ison T.H. Auto Sales Inc.*[2] were incorrectly decided.

At common law, an insurer's right of subrogation did not arise until the insured had been fully indemnified for both insured and uninsured losses. One consequence was the subsidiary rule that the insurer had no right to control the action against the wrongdoer until that full indemnity had been achieved by the insured. That common law rule has, however, typically been altered by the terms of the insurance policy and by statute.

Farrell was based on the incorrect premise that the right of subrogation did not arise until the insured had received full indemnity, ignoring the fact that that common law precondition had been removed by statute. The principle that an insurer's right of subrogation comes into existence by contract prior to the insured having received full indemnity is conclusively confirmed in the SCC decision in *Somersall.*[3] The typical contractual condition for the insurer's right of subrogation, which replaces the common law condition of full indemnity received by the insured, is that the insurer has either made a payment to the insured under the policy or has assumed liability to do so. *Somersall* established not only that a subrogation clause contractually supersedes the common law rule regarding the time when a right of subrogation comes into existence, but also the equality of the rights of the insured and the insurer. The first part of the typically-worded subrogation clause similarly creates an "identity of rights", with the result that any superior position granted by the common law to the insured no longer exists and other factors must be considered when determining which party should have carriage and control of the action.

The argument in *Farrell* that a very small payment by the insurer to the insured would entitle the insurer to control of the litigation against the wrongdoer is more realistic when reversed, in which case it applies in the insurer's favour. It is neither fair nor sensible that carriage and general control of the action against the wrongdoer be given to the insured in those cases where the insurer's claim is greater in real value (and in most cases, considerably greater) than the personal claim of the insured. The *Farrell* approach defeats, rather than furthers, a purposive interpretation of the subrogation clause by automatically providing to the insured the "very significant right" of carriage and control regardless of the circumstances.

Ison adopted *Farrell*, but failed to take into account that *Somersall,* which was decided after *Farrell*, established that:

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[1] (1989) 59 D.L.R. (4th) 67, B.C.S.C., affirmed (1990) 69 D.L.R. (4th) 735, B.C.C.A.
[2] (2011) 106 O.R. (3d) 201, S.C.J., affirmed 2011 ONCA 663.
[3] *Somersall v Friedman* [2002] 3 S.C.R. 109.

a. contrary to the position at common law, a typically-worded subrogation clause contractually confers on the insurer a right of subrogation *before* the insured has received full indemnity. The right is vested as soon as the condition set out in the subrogation clause has been satisfied, the condition usually being that the insurer has either made a payment to the insured under the policy or has assumed liability to do so; and

b. there is an "identity of rights" between the insured and the insurer upon fruition of the right of subrogation.

While the neat question whether a subrogation clause provides to the insurer the right of carriage and control may not have been directly addressed in *Somersall*, the considerations listed above effectively removed the foundation for the common law rule, and should have set the stage for a fresh consideration of how to deal with the issue, rather than merely falling back on the position that the common law rule remains in place because *Somersall* did not expressly say otherwise. The language of the subrogation clause should be considered in conjunction with the following fundamental issue: What is the fair and sensible result?

In determining which party in any particular case ought to have carriage and control, the obvious factor for consideration is a comparison of the real values of the claims of the two parties. That is the factor referenced in the second part of the typically-worded subrogation clause. It is not sensible, either from a logical or a commercial standpoint, for the party with the smaller claim (and in most cases, in our experience, a much smaller claim) to have general control of the action. It is also unfair. In a nutshell, why should an insured continue to be entitled to control an action in which it has the (often, much) smaller claim, when the justification for that position of superiority has been contractually (or statutorily) removed? Entitlement to control of the action must be based on some rational and justifiable factor or consideration, and not merely an historical common law rule that no longer has its foundational rationale.

In our experience, the subrogated claim is generally both larger and more readily provable than the personal claim advanced by the insured for uninsured loss. The latter often consists of a claim for a deductible, and at times involves claims that are difficult to assess. The insurer's subrogated claim is generally a "hard" claim in the sense that it represents moneys that have actually been paid out for a claim that has been (often, independently) adjusted, while the insured's personal claim (apart from a claim for a deductible) often can fairly be described as a "soft" claim, one which does not involve moneys that have expended, and one which has not been tested by adjustment. In most cases, the determination of which party has the claim with the larger real value is not one that presents difficulty.

We disagree with the comment in *Ison* that the insured should have control of the action unless the insurer's interest is "vastly disproportionate" to the insured's. That is not a test that is fair and sensible. Apart from its failure to take into account the contractual elimination of "the entire underpinning" of the common law rule, a recent decision of the SCC has emphasized the importance of the "principle of proportionality".[4] The application of the principle was found to be one of the necessary means for the attainment of the overriding goal of achieving "fair and just results" (in the context of the use of summary judgment motions to avoid unnecessary trials).

[4] *Hryniak v Mauldin* 2014 SCC 7.

Proportionality is equally a factor in attaining that goal in the management of actions that include both subrogated and uninsured loss claims, particularly where the contract has amended the common law by placing the insured and the insurer on an equal footing upon satisfaction of the contractual condition. The view expressed in *Ison* that the insured should have control of the action unless the insurer's interest is "vastly disproportionate" to that of the insured stands the principle of proportionality on its head. Stated briefly: The tail should not be wagging the dog.

Another issue not adequately considered in *Ison* is that of participation by both the insured and the insurer in the action. We believe that the issue should be directly addressed and the principle firmly established that, while the party with the claim having the larger real value should generally be entitled to carriage and control of the action, the junior party should be entitled to control its own claim and to have meaningful participation in the action for purposes related to its claim.

B. INDEPENDENT SETTLEMENT BY THE INSURER OF THE SUBROGATED CLAIM

The insured's personal claim and the insurer's subrogated claim are distinct and separate claims that belong to each respectively. The insurer has no proprietary interest in the insured's personal claim, nor does the insured have any such interest in the subrogated claim contractually afforded to the insurer. Regardless of what the common law position may have been, a subrogation clause provides to the insurer, subject to satisfaction of whatever condition the clause may contain and whatever limitations may be expressed in it, a right to pursue its own recovery on a subrogated claim. Neither party should have either a unilateral right to settle the other's claim, or a right to exercise a veto of a settlement made in good faith by the other party of its claim.

What about the situation where the wrongdoer makes settlement of one claim, whether the subrogated claim or the claim for the uninsured loss, conditional on settlement of both claims? If the insurer does not agree to the terms of the settlement of the subrogated claim that have been negotiated between the insured and the defendant, can the insured unilaterally settle both its personal claim and the subrogated claim? The short answer in our view is, or at least should be, No. It would be absurd for a party with a claim, say, one-fifth or one-tenth the size of the other party's claim to have the right to unilaterally settle the entire action on a basis it considers to be favourable to its own claim, but which the other party considers to be unfavourable to its much larger claim.

The inability to independently settle the subrogated claim would not only expose both the insurer and the defendant to the uncertainty and risk of a judgment less favourable than the settlement, but would also prevent the saving of time, expense, and judicial resources related to the continuation of the subrogated claim. The inability to settle would, in many cases, have a serious negative impact.

The SCC decision in *Sable Offshore Energy*[5] emphasizes the importance of the public policy of encouraging settlements. Even were there some legitimate basis for an insured's (or an insurer's) right to interfere in the contractual relations of the other, the insured should, at a

[5] *Sable Offshore Energy Inc. v Ameron International Corp.* 2013 SCC 37.

minimum, be required to show that a veto of the settlement of the subrogated claim is based on a competing public interest which outweighs the interest in encouraging settlement. It should also be noted that the underlying objectives of the common law rule do not support the position that the insured is entitled to veto a settlement of the subrogated claim.

The duty of good faith is a two-way street. An insured should not be entitled to arbitrarily block the settlement of a subrogated claim made in good faith by the insurer. A veto of the settlement of the subrogated claim would not advance any legitimate purpose. It would instead hinder the important policy goal of encouraging settlements. There is neither any basis in law or justification for entitlement of the insured to block a settlement of the subrogated claim made independently and in good faith by the insurer. To the contrary, any such veto power would seriously undermine the important policy goal of encouragement of settlements.