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# Subrogation: Pitfalls and Pointers

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## 1. Introduction

Subrogation claims have a layer of complexity that is not present in other claims, and it is important that all examiners, not just subrogation specialists, understand what to look for when analyzing new subrogated claims. Whether you are a property examiner assessing a new loss for subrogation potential, or a casualty examiner receiving a new subrogated claim, there are some factors to consider which impact directly upon subrogation rights.

This paper discusses some of the legal issues that affect subrogation rights. We are not focusing on various practical subrogation considerations, like maintaining privilege, retaining experts or evidence retention. We would be pleased to discuss these or any other topics at your convenience.

## 2. The right to subrogate

An insurer's right to subrogate depends on whether its insured has been indemnified for the loss. Full reimbursement for the loss was required for the right to subrogate to arise

under the common law[1]. However, this has been modified by provincial legislation to give insurers the right to subrogate on making partial payment[2]. For instance, in British Columbia, an insurer's right to subrogate arises "on making a payment or assuming liability under a contract"[3].

## 3. Suing in the name of the insured

The insurer steps into the shoes of the insured when claiming against the party responsible for the loss. In almost all cases, the name of the plaintiff in a subrogated action is properly the insured[4]. Some exceptions to this rule are when the insured has "double insurance" for a loss, and one insurer sues the other for contribution[5]; express statutory exceptions[6]; and when the insured sues the insurer for coverage, and the insurer commences third party proceedings[7].

Complications can arise when the insured is indemnified and then ceases to exist. Since an action can only be maintained by an existing party, an insurer who subrogates in the name of a deceased person or defunct company runs the risk of the claim being struck. If an insurer discovers the insured is on its way out, one solution might be to have the insured assign the cause of action to the insurer[8]. The insurer can also apply to restore a company and thereafter maintain the action.

## 4. Bars to subrogation

As an insurer sues in the name of the insured, the insurer cannot claim against a party who cannot be sued by the insured. Likewise, an insurer cannot indemnify one insured and then seek to recover against another insured under the same policy. This means that an insurer cannot maintain a subrogation action against unnamed insureds, co-insureds, or parties whom the insured has agreed to indemnify or insure.

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[1] *Ontario Health Insurance Plan v. United States Fidelity & Guarantee Co.* (1989), 68 O.R. (2nd) 190 (ONCA), leave den 68 O.R. (2nd) 190 (note) (SCC).
[2] *Insurance Act*, RSBC 2012, c 1, s.36(1); *Insurance Act*, RSO 1990, c I.8, s.152; *Insurance Act*, RSA 2000, c I-3, s.546(1); *The Saskatchewan Insurance Act*, RSS 1978, c S-26, ss.132, 225; *The Insurance Act*, RSM c I40, ss.136.9(1), 273(1), *Insurance Act*, RSPEI 1988, c I-4, ss.118(1), 255(1); *Insurance Act*, RSNS 1989, c 231, ss.149, 171, 306; *Insurance Act*, RSNB 1973, c I-12, ss.131(1), 266(1); *Fire Insurance Act*, RSNL 1990, c F-10, s.14; *Insurance Act*, RSY 2002, c 119, ss.75, 173(1); *Insurance Act*, RSNWT 1988, c I-4, ss.68, 156, 166(1); *Insurance Act*, RSNWT (Nu) 1988, c I-4, ss.68, 156, 166(1).
[3] *Insurance Act*, RSBC 2012, c 1, s.36(1).
[4] *U.S.A. v. Bulley* (1991), 79 D.L.R. (4th) 108, 55 B.C.L.R. (2d) 212 (BCCA).
[5] *Pacific Forest Products Ltd. v. AXA Pacific Insurance Co.*, 2003 BCCA 241.
[6] For example, see *Health Insurance Act*, R.S.O. 1990 c H-6, s.30.
[7] *Freudmann-Cohen v. Tran* (2004), 70 O.R. (3d) 667 (ONCA).
[8] *AL-Qahtani-Shaw-Leonard Ltd. v. Crossworld Freight Ltd.* (1987), 60 O.R. (2d) 565 (Ont. H.C.J.), var'd. 66 O.R. (2d) 256 (ONCA). Note that subrogation and assignment are conceptually similar but not identical. Assignment requires an express agreement transferring the rights of the insured: *Bank of Montreal v. Guarantee Company of North America* (1991), 60 B.C.L.R. (2d) 327 (BCCA).

### *(a) Unnamed insureds and co-insureds*

Generally, an insurer cannot sue one insured for losses reimbursed to another. This is illustrated by *Condominium Corporation No. 9813678 v. Statesman Corporation*[9]. There, the subrogating insurer sued a condominium developer for a fire allegedly caused by a subcontractor. The insurer reimbursed the full $25,000,000 loss to the insured condo owners, and then sought to recover from the developer. The developer owned one of the condo units, two parking spaces, and common areas. The developer was also, by law, on the board of the condo corporation that purchased the insurance. The policy did not have the developer as a named insured, but the policy insured unnamed directors, owners of common property, unit holders, and managers, all of which applied to the developer.

The developer argued that there was no right of subrogation. While the insurer argued for an exception on the basis that the developer was only co-incidentally an insured, the Court found no reason to deviate from the usual rule that the insurer could not pursue a subrogated claim against its own insured[10]. The Court noted there was no concern about violating the underlying principle of subrogation, which was to prevent the insured from having double recovery.

One type of policy with specific subrogation issues is a builders' risk policy. Builders' risk policies are broadly interpreted to include contractors and subcontractors as unnamed insureds, as there is a "community of interest" between project participants.

This raises several issues: after indemnifying the insured owner for a loss, can the insurer ever subrogate against the at-fault negligent contractor? Likewise, owners and general contractors often require their subcontractors to obtain insurance coverage for their benefit. If the insurer indemnifies the subcontractor, can the insurer subrogate against the at-fault owner? A further complication is when, regardless of who is an insured under the policy, the insured waives any right to sue the at-fault party.

In general, an insurer has no right of subrogation against an insured, named or not. Likewise, by releasing or otherwise agreeing to insure a third party, an insured can unilaterally waive an insurer's right of subrogation. This means that in most cases, a builders' risk underwriter has no right of subrogation against project participants.

An exception may be when an insured is indemnified for a loss by its property insurer, rather than its builders' risk underwriter. In such cases, an at-fault contractor is probably not an insured under the property policy. The right of subrogation could still be waived if the insured agrees to obtain insurance for the at-fault project participant.

Finally, when the subrogation is on behalf of a British Columbian strata, you need to be aware of the deeming provisions in B.C.'s provincial legislation[11], which state that "Despite the terms of the insurance policy, named insureds in a strata corporation's

[9] 2007 ABCA 216, leave den. 2008 CanLII 3192 (SCC).
[10] See also *Owners, Strata Plan No. NW 651 v. Beck's Mechanical Ltd.* (1980), 20 B.C.L.R. (BCSC), where the insurer had no right of subrogation against a contractor who was coincidentally a unit owner.
[11] *Strata Property Act*, SBC 1998, c 43, s.155.

insurance policy include (a) the strata corporation, (b) the owners and tenants from time to time of the strata lots shown on the strata plan, and (c) the persons who normally occupy the strata lots." Also, an owner of a strata lot can insure for liability for property damage and bodily injury, whether occurring on the owner's strata lot or on the common property[12]. In these instances there is a bar to subrogation by the strata corporation against unitowners and there may be a bar for an individual unitowner against the strata, depending on the policy wording.

### *(b) Covenants to insure*

There may be situations where the insured has waived the right to subrogate against a potential defendant, preventing the insurer from recovering against that party. The insured may have done so without the insurer being a party to the waiver, or even being aware of the waiver until after the loss.

One example is when a lease requires a tenant to obtain insurance for the benefit of the landlord.[13] Courts interpret a contractual covenant to insure as a waiver of the right to sue. In this context, the agreement to obtain insurance is what is under consideration, not whether a policy was actually taken out for the landlord. If an insured tenant agrees to obtain insurance for the benefit of the landlord, then the tenant's insurer cannot maintain a subrogated claim against the landlord. If the tenant's insurer claims against third parties, then they will also be unable to claim for contribution against the landlord. Similarly, where an owner of a gold mine agreed to obtain insurance for the benefit of a subcontractor cargo transporter, the owner waived any right to sue, and its insurer lost any right of subrogation it may have had against the subcontractor.[14]

Under certain circumstances, third parties to a contract may also rely on a covenant to insure as a bar to a subrogated claim. In *Sanofi Pasteur Limited*[15], a subrogated claim was dismissed where a pharmaceutical company contracted to store its vaccines in the defendant's temperature controlled warehouse. When the cooling system malfunctioned, the vaccines became unsaleable, and the pharmaceutical company's insurer commenced a subrogated claim against the warehouse owner and all parties associated with the temperature control system.

The plaintiff's contract with the warehouse owner required the plaintiff to insure its own vaccines under an all-risks policy. The claim against the warehouse owner was dismissed due to the covenant to insure, save for a $100,000 limit contractually reserved. The other defendants were able to rely on the contract between the insured and warehouse owner as beneficiaries of the covenant to insure. Accordingly, the claims against the other defendants were also dismissed.

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[12] *Ibid*, s.161(e).
[13] *Orange Julius Canada Ltd. v. Surrey (City of)* (2000), 190 D.L.R. (4th) 1 (BCCA); see also *Williams-Sonoma Inc. v. Oxford Properties Group Inc.*, 2013 ONCA 441, where the tenant insurer's subrogated claim failed against the landlord's contractor because the lease required the tenant to insure both the landlord and persons for whom the landlord was responsible.
[14] *De Beers Canada Inc. v. Ootahpan Company Limited*, 2014 ONCA 723.
[15] *Sanofi Pasteur Limited v. UPS SCS Inc.*, 2015 ONCA 88.

Another way the insured could undermine the insurer's right of subrogation is by settling a claim with a third party without the consent of the insurer[16] (although if the third party is impecunious or settles for its own policy limits, then there may be no point in pursuing a subrogated claim anyways[17]). Casualty examiners should be alive to references to previous claims by the subrogating insured, because they sometimes give releases to the party they have sued and the release bars the action of the subrogating insurer.

An insurer may be able to protect itself by including a term in the policy allowing the insurer to deny a claim when the insured waives a right of subrogation.

### *(c) Waiver of subrogation*

Some policies contain explicit waivers of subrogation. Even though a third party is not a party to the insurance contract, a third party may still be able to rely on a policy waiver to defeat a subrogated claim. In *Fraser River Pile & Dredge*[18], the Supreme Court of Canada held that a third party to a contract can rely on the terms of the contract where:

(i) The parties to the contract intended the benefit to extend to the third party seeking to rely on the contractual provision; and
(ii) The activities performed by the third party are the very activities contemplated as coming within the scope of the contract.

Under (i), in order for the third party to be an intended beneficiary, the parties to the contract do not need to have had the third party specifically in mind when executing the policy. The third party only needs to meet the class of parties the insurer has agreed not to sue.

Third parties have relied on waiver of subrogation clauses in insurance policies in motor vehicle accidents[19], sinking barges[20], and even the loss of logs in transport[21].

### *(d) Insurer as volunteer*

Generally, a right of subrogation only arises if an insurer's payment to its insured is compulsory. If an insurer is not required to indemnify its insured, then the insurer is a mere volunteer who cannot commence a subrogated claim on behalf of its insured[22].

This complicates things when considering settlement with the insured. If the insured executes a release whereby the insurer denies liability, then the insurer may lose any right to subrogate. Even if the insured successfully pursues a claim against the party that

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[16] For example see *Sweeny v. Insurance Corp. of Newfoundland*, 2002 NLCA 75; also *Balsevicius v. U-Haul Co. (Canada) Ltd.* (2009), 99 O.R. (3d) 316 (Ont. S.C.J.).
[17] *Somersall v. Friedman*, 2002 SCC 59.
[18] *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*, [1999] 3 S.C.R. 108 ("*Fraser River*").
[19] *Kingsway General Insurance Co. v. Canada Life Assurance Co.* (2001), 149 O.A.C. 303 (ONCA), where the third party defendant was able to rely on a statutory waiver of subrogation.
[20] *Fraser River*, supra.
[21] *Timberwest Forest Corp. v. Pacific Link Ocean Services Corporation*, 2009 FCA 119.
[22] *ABB Inc. v. Domtar Inc.*, 2007 SCC 50 at para. 113.

caused the loss, the insurer may not be able to recover the money it paid to the insured. The qualification is that the right to subrogation remains if the payment was honestly intended to be in satisfaction of a loss under the policy[23]. If the insurer was instead paying for an agreement so that the insurer avoided a possible claim, then the insurer may lose its right to subrogate.

If an insurer anticipates subrogation and wishes to settle with its insured, the insurer should see to it that any release with the insured indicates that the payment is made pursuant to the insurance policy.

# 5. Limitation periods

After receiving notice of an insured's claim, an insurer should check the relevant limitation periods for commencing a subrogated claim.

## *(a) Limitation on underlying cause of action*

As a subrogated claim is derivative of the insured's right of action, the relevant limitation period is as between the insured and the defendant.[24] This means that the subrogation limitation 'clock' starts ticking at the time the loss was discovered. Inevitably, losses are reported to insurers some amount of time after they occur. An insurer will need to make payment to the insured in order to obtain the right to subrogate and file commencement pleadings before the limitation period passes. If a subrogated claim is not started within time, it is at risk of being struck.[25]

## *(b) Putting municipalities on notice*

Insurers should be aware that there are often shorter limitation periods and notice requirements for claims against municipalities.[26] This makes it imperative to determine the relevant limitation periods immediately upon receiving notice of an insured loss, especially where municipalities may be involved. It also forces an insurer to consider how a municipality may be liable, e.g. negligent building inspections, signage, municipal works, etc.

# 6. What damages can be recovered?

A claim against a defendant is for the losses suffered by the plaintiff as a result of the defendant's conduct. As a subrogated action is derivative, the insurer gains no better position than the insured would have been in, had the insured commenced the claim

[23] *Wellington Ins. Co. v. Armac Diving Services Ltd.* (1987), 37 D.L.R. (4th) 462 (BCCA).
[24] *Freudmann-Cohen v. Tran* (2004), 70 O.R. (3d) 667 (ONCA) at para. 41.
[25] See *Royal Insurance Co. of Canada v. Aguiar* (1984), 48 O.R. (2d) 705 (ONCA).
[26] See *Local Government Act*, RSBC 1996, c 323, ss.285 – 286; also *Municipal Act*, 2001, SO 2001, c 25, s.44(10).

itself.[27] Thus, the amount that can be recovered in a subrogated action depends on the losses suffered by the insured as a result of the defendant.

In at least one case, an insurer has unsuccessfully tried to argue that assessment of damages should be based on the amount it reimbursed to the plaintiffs for their losses under the insurance policy.[28] However, the insurer's loss is irrelevant to the damages award in a subrogated claim.

The principle that an insurer is in no better position than the insured comes into focus when considering a defendant's counterclaim for set-off. For instance, a defendant landlord has a defence of set-off for arrears of rent even where the "true" plaintiff is the subrogating insurer[29]. Conversely, where a subrogated claim was commenced in respect of a fire, a set-off defence was unavailable to a third party for debts owed by the insured to the third party[30].

If the net amount recovered is less than the amount of the loss, then the recovered money is apportioned between insurer and insured in proportion to the loss borne by each of them[31]. This common law approach has been reinforced by provincial statutes[32].

## 7. Controlling the litigation: subrogation and joint prosecution agreements

Subrogation and joint prosecution agreements can be crucial to resolving who has control over the litigation process, and determining how settlements and litigation costs are resolved. Generally, a subrogation agreement defines the boundaries of a subrogated action as between insured and insurer, a joint prosecution agreement is between multiple insurers subrogating in respect of the same loss.

Insurers have a duty to, at the very least, not jeopardize uninsured losses or recovery of deductibles. This arises most frequently upon settlement of a subrogated claim when a release is drafted.

Insurers acquire subrogation rights via their policy wordings, but where there are uninsured claims the policy wording will not provide all the answers. Insurers usually control the recovery action and will pay for it, with expenses coming off the top before losses are shared with the insured pro rata to the respective losses. However, this right is not automatic depending on the size of the insured's claim.

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[27] *Madison Developments Ltd. v. Plan Electric Co.* (1997), 36 O.R. (3d) 80 (ONCA).
[28] *MacKean v. Royal & Sun Alliance Insurance Co. of Canada*, 2014 NSSC 33.
[29] *Best Buy Carpets Ltd. v. 281856 B.C. Ltd. et al*, [1987] I.L.R. 1-2197 (BCSC).
[30] *Colonial Furniture Company (Ottawa) Limited v. Saul Tanner Realty Limited* (2001), 52 O.R. (3d) 539, 196 D.L.R. (4th) 1 (ONCA).
[31] *Confederation Life Ins. Co. v. Causton* (1989), 60 D.L.R. (4th) 372.
[32] For example, see *Insurance Act*, RSBC 2012, c 1, s.36(2); *Insurance Act*, RSA 2000, c I-3, s.546(2); *Insurance Act*, RSO 1990, c I.8, s.152(2).

It may be necessary to have counsel (or the adjuster) assess the insured's claim for a true calculation of the loss, before negotiating a subrogation agreement. Within such an agreement the most important clause apart from the recovery percentages is the dispute resolution mechanisms in the event of disagreement over acceptance of a settlement offer.

Joint prosecution agreements have many similar preliminary issues. These agreements are useful for avoiding conflicts between co-insurers pursuing the same subrogated claim. Some of the bases to cover are (i) determining who pays for the costs of the litigation, (ii) who has control of the proceedings, (iii) dealing with offers to settle, and (iv) how to distribute any amounts recovered.[33] The lack of a joint prosecution agreement could lead to in-fighting and unnecessary applications.

# 8. Conclusion

The above comments are not meant to be an exhaustive checklist of the issues to consider when starting or defending a subrogated claim, but they represent issues that we have come across. As a property examiner you want to be aware of these issues when a claim is reported because of limitation periods and identifying parties you cannot sue – often a vital factor in deciding to invest in recovery. As a casualty examiner, we have found that opposing counsel do not always understand these subrogation issues. If you understand them you can fend off a claim in its infancy.

In summary, after receiving notice of a claim, an insurer should check the relevant limitation periods in case a subrogated claim is available. Strict limitation periods force an insurer to consider potential defendants early on. A right to subrogate only arises once the insurer has indemnified the insured for the loss. An insurer's right to subrogate may be limited by a waiver of subrogation, the at-fault party being an insured, or the insured may have unilaterally waived any right to sue.

An insurer should also consider the potential for recovery, given that it can be awarded what the insured would be able to recover. Subrogated actions are also complicated by claims for uninsured losses on behalf of the insured, as well as multiple insurers subrogating for the same loss. In such cases, subrogation and joint prosecution agreements are key to defining the parties' roles in the litigation.

[33] Krempulec, *Property Damage Claims Under Commercial Insurance Policies* (Toronto: Canada Law Book, December 2013 release) at 8-23.