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

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## 1. Introduction

When adjusting, or after paying out, a first party loss claim, most insurers will be alert to the possibility of recovering their payout from the wrongdoer (if any) who caused the loss. That is known as a subrogated claim, and subrogated claims are becoming common and numerous. The insurer will often retain experts and investigators for that purpose. At the same time, where the policy does not fully indemnify the insured's loss, such as where a deductible is involved, the insured can have a parallel claim for that loss against the wrongdoer, who in turn will often have third party liability insurance coverage.

Hence, the payout of an insured loss may involve a number of parties with competing or parallel interests: the insurer seeking to recover the payment it has made under its policy; the insured seeking to recover an uninsured loss; and the wrongdoer and its insurer.

Very often, these separate interests are resolved without recourse to litigation through a settlement among the parties, but when that cannot be achieved, the first party insurer will typically commence an action in the name of the insured against the wrongdoer. Occasionally, it is the insured who will commence the action against the wrongdoer. If both the insurer and the insured have commenced separate actions, the rule against multiplicity of actions will dictate that only one of those actions can proceed and, while in most instances the parties proceed by way of agreement and cooperation, only one of the two (insurer and insured) can be entitled to have carriage and control of that action.

The right of subrogation originated in equity and is now a common feature of insurance contracts. Complexities and difficulties sometimes arise between the insurer and insured. This article is concerned with two of those: the first is the issue of which of the parties should have carriage and control of an action which includes

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both the insured's personal claim for uninsured loss and the insurer's subrogated claim on account of payment to the insured for insured losses. That issue has also been described as which party is *dominus litis* in the action against the wrongdoer. The second is whether and in what circumstances the insurer is entitled to independently settle its subrogated claim while the insured's personal claim remains outstanding. The first was the subject of a recent decision which we believe was incorrectly decided.[1] We are not aware of any case law regarding the second issue.

## 2. Carriage and Control of the Action

### (1) When Does the Right of Subrogation Arise?

At common law (adopting a principle established by equity), an insurer's right of subrogation did not arise until the insured had been fully indemnified for both insured and uninsured losses. The validity of that common law principle has been criticized,[2] the view being expressed that it has been disavowed in England by the House of Lords decision in *Lord Napier & Ettrick v. Hunter*.[3] Of the several Canadian decisions which have considered *Napier*, however, only

1. *Zurich Insurance Co. v. Ison T.H. Auto Sales Inc.*, 2011 ONSC 1870, 333 D.L.R. (4th) 696, 106 O.R. (3d) 201 (Ont. S.C.J.), affirmed 2011 ONCA 663, 342 D.L.R. (4th) 501, 2011 CarswellOnt 11273 (Ont. C.A.). Two of the authors of this paper acted for the insurer in that case.
2. In a paper titled "When Can an Insurer Exercise Its Right of Subrogation?" authored by Nicholas Pengelley, last revised at the time of preparation of this paper on March 31, 2013, and retrievable at <http://ssrn.com/abstract=2222167> or <http://dx.doi.org/10.2139/ssrn.2222167>.
3. *Lord Napier v. Hunter*, [1993] A.C. 713, [1993] 1 All E.R. 385 (H.L.). We do not entirely agree with that analysis. Two of the Law Lords there expressly made such comments. Lord Templeman said (at p. 731): "[When the insurers made payment to the insured under the policy, they] immediately became entitled to be subrogated". Referring to the *Castellain* decision, which is often relied upon for the common law rule, Lord Templeman said (at p. 734): "Clearly, Brett L.J. considered that an insurer was subrogated to any right of action subsisting when the insurer paid under the policy." Lord Jauncey said (at p. 747): "If an assured has suffered an insured loss and an uninsured loss full indemnification of the former subrogates the insurers irrespective of the fact that the assured has not yet recovered the uninsured loss." In other parts of the various judgments, however, it appears that the major question for consideration was the nature of the insurer's interest in any moneys recovered by the insured from the wrongdoer. The question whether (as put by Lord Goff at p. 745) the equitable proprietary interest of the insurer attaches only to the fund that comes into the hands of the insured, or also to the right of action vested in the insured which, if enforced, would yield such a fund, was left open for future consideration.

two appear to have accepted the proposition that the insurer's right of subrogation at common law is triggered by payment under the policy without any precondition regarding the insured's receipt of full indemnity for both insured and uninsured losses.[4] For the purposes of this paper, the validity of the common law principle is accepted because the weight of Canadian authority overwhelmingly supports it.[5]

## (2) The Common Law Rule Regarding Carriage and Control

One consequence of the common law principle regarding the time when the right of subrogation arose 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. The common law rule, and its foundation, were summarized as follows:

> [I]t has long been the law, in the absence of contractual terms to the contrary, that the insurer's right of subrogation will not arise until the insured has been fully indemnified . . . The insurer may not control the process of litigation until this full indemnity has been met.[6]
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> [T]he right of subrogation depends upon and is regulated by the broad underlying principle of securing full indemnity to the insured . . . The primary consideration is to see that the insured gets full compensation for the property destroyed and the expenses incurred in making good his loss.[7]

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4. The first is *Affiliated FM Insurance Co. v. Quintette Coal Ltd.* (1998), 156 D.L.R. (4th) 307, 50 C.C.L.I. (2d) 17, 48 B.C.L.R. (3d) 8 (B.C. C.A.), at paras. 37-39, quoting, with apparent approval, the statement made by Lord Jauncey in *Napier*. That position was followed in *Doyon v. Insurance Corp. of British Columbia*, 2004 BCSC 565, 239 D.L.R. (4th) 749 (B.C. S.C.), affirmed 2006 BCCA 313, 270 D.L.R. (4th) 425, 54 B.C.L.R. (4th) 201 (B.C. C.A.), at para. 43 (S.C.). A different view, however, appears to have been taken in para. 29 of *Affiliated*. In the following decisions, *Napier* was considered but was not said to overturn the conventional view: *Colonial Furniture Co. (Ottawa) Ltd. v. Saul Tanner Realty Ltd.* (2001), 196 D.L.R. (4th) 1, 12 B.L.R. (3d) 172, 52 O.R. (3d) 539 (Ont. C.A.); *Armstrong v. Lang*, 2011 BCCA 205, 76 C.B.R. (5th) 101, 18 B.C.L.R. (5th) 146 (B.C. C.A.); *Grebely v. Economical Mutual Insurance Co.*, 1999 ABQB 97, 10 C.C.L.I. (3d) 244, 239 A.R. 92 (Alta. Q.B.). A brief reference to *Napier* was also made in *Somersall v. Friedman*, 2002 SCC 59, [2002] 3 S.C.R. 109, 215 D.L.R. (4th) 577 (S.C.C.), at paras. 108-109, with no indication that *Napier* may have changed the common law approach that has been adopted in Canada.
5. Including the S.C.C. decision in *Somersall*. An earlier decision of that court is not quite as clear: *Ledingham v. Ontario (Hospital Services Commission)*, [1975] 1 S.C.R. 332, 46 D.L.R. (3d) 699, 2 N.R. 32 (S.C.C.).
6. *Somersall*, *supra* note 4 at para. 53.

. . . . .

> The assured is entitled to control any proceedings brought in his name until he has received complete indemnity, that is to say, if the insurer has not paid what is in fact a complete indemnity for all damage insured or uninsured arising from the same cause of action as the damage in respect of which payment has been paid, the assured remains *dominus litis* until he has recovered a complete indemnity and if he undertakes to prosecute his claim for the whole damage, the insurers cannot interfere.[8]

## (3) Alteration of the Common Law Rule by Contract

As indicated in the following passages in *Somersall*, however, that common law rule can be altered by the terms of the contract made between the parties (*i.e.*, the insurance policy):[9]

> [A]s this right of subrogation is governed by a contract, I must now turn to the contract's own language, while keeping in mind these principles as background to the rights thereby created.
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> . . . . .
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> Equitable principles of subrogation, though not the principle of interpretation *contra proferentem*, may be altered by the terms of the contract between the parties.

Similar comments were made in the *Ison* decision:[10]

> [A]n insurance policy is a contract of indemnity "according to its terms". The terms of the policy invariably address the circumstances in which indemnity is required, the extent of the indemnity provided, and the consequences flowing from the indemnification. The terms of the policy must be examined to determine these matters.
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> [In *Somersall*, Iacobucci J.] then observed that as the right to subrogation in the particular case before him was governed by contract, the language of the contract itself should be examined.

## (4) Typical Contractual and Statutory Subrogation Provisions

Subrogation clauses in insurance policies are not in standard form, but they generally contain language similar in effect, if not precisely in

7. *National Fire Insurance Co. v. McLaren* (1886), 12 O.R. 682, [1886] O.J. No. 98 (Ont. Ch.), at para. 10.
8. *Kellar v. Jackson*, [1962] O.W.N. 106, [1962] O.J. No. 78 (Ont. H.C.), at para. 4.
9. *Somersall*, *supra* note 4 at paras. 55-56.
10. *Ison*, *supra* note 1 at paras. 31 and 63 in the application decision.

wording, to the typically worded clause in *Ison*, which provided (in relevant part) as follows:

> The Insurer, upon making any payment or assuming liability therefor under this Policy, shall be subrogated to all rights of recovery of the Insured against any person, and may bring action in the name of the Insured to enforce such rights.
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> . . . . .
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> Where the net amount recovered after deducting the costs of recovery is not sufficient to provide a complete indemnity for the loss or damage suffered, that amount shall be divided between the Insurer and the Insured in the proportion in which the loss or damage has been borne by them respectively.

Sections 152 and 278 of the *Insurance Act*[11] (Ontario) statutorily provide, in the cases of fire and automobile insurance respectively, rights of subrogation in terms virtually identical to those in the typically worded policy subrogation clause reproduced above[12] (although s. 278(3) expressly confers on the insurer the right to control the action against the wrongdoer in certain circumstances, a matter that will be considered later). The language of the subrogation clause in *Somersall*, which involved a regulated automobile policy Family Protection Endorsement (underinsured motorist coverage) was slightly different:[13]

> Where a claim is made under this endorsement, the Insurer is subrogated to the rights of the eligible claimant by whom a claim is made, and may maintain an action in the name of that person against the inadequately insured motorist and the persons referred to in paragraph 4(b).

The following comments were made in *Ison*:[14]

> Both provisions [in the subrogation clause] alter the common law. The first permits the insurer to commence an action against the third party [wrongdoer] even before the loss has been fully paid, as long as it has either paid part of the loss or has assumed an obligation to do so. The second provision modifies the insured's common law entitlement to a complete indemnity for all insured and uninsured losses before the insurer is entitled to recover anything. The Subrogation Clause alters the common law, discussed below, by permitting the insurer to share the amount recovered with the insured, on a *pro rata* basis, where there has been less than a full recovery.

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11. R.S.O. 1990, c. I.8.
12. Most insurance policy subrogation clauses mirror that statutory language. It might also be noted that the B.C. statutory clause considered in the *Farrell* decision referenced below also had virtually identical language.
13. The application judge in *Ison*, *supra* note 1 said (at para. 63): "The clause in [*Somersall*] is similar to the clause at issue in the case before me."
14. *Ibid.* at para. 42 in the application decision.

An insurer's rights to commence an action and to share in recovery can exist only if there first is a right of subrogation. The acknowledgement that the insurer has a contractual right to share *pro rata* in a recovery prior to receipt by the insured of full indemnity[15] is effectively a recognition that the right of subrogation exists regardless of whether the insured has received full indemnity. An insured cannot be entitled to full recovery while at the same time be obligated to share in a recovery on a *pro rata* basis if there are insufficient funds to satisfy both the insured's and the insurer's claims.

### (5) The Farrell Decision

Prior to the decisions in *Somersall* and *Ison*, one of the leading Canadian decisions on the issue of carriage and control was *Farrell Estates Ltd. v. Canadian Indemnity Co.*,[16] although, even before *Somersall*, the authority of *Farrell* was questionable. It was said in the decision cited below that the case law, including a specific reference to *Farrell*, was unsettled on the matter of which party had the right to control the action against the wrongdoer.[17]

In *Farrell*, the insurers agreed to pay approximately $174,000 to the insured on account of the insured loss following a fire. The insurers then commenced a subrogation action against the wrongdoer. The insured commenced a separate action against the wrongdoer to recover both its uninsured loss, which it estimated to have a value between $65,000 and $85,000, and the insured loss. An application was made to determine which party was *dominus litis* in the single action that would be permitted to proceed. The insurers relied both on s. 224(1) of the *Insurance Act*[18] (B.C.), a provision that was virtually identical to the typically worded policy subrogation clause and to the statutory clauses in the *Insurance Act* (Ontario), and on a provision in the interim proof of loss that the insured had delivered to the insurers.[19]

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15. The following statement was made in *Ison*, *ibid.* at para. 1 in the application decision: "The insured has commenced an action against the third party asserting its own claim *as well as the insurer's claim*" (emphasis added).
16. *Farrell Estates Ltd. v. Canadian Indemnity Co.* (1989), 59 D.L.R. (4th) 67, 44 C.C.L.I. 153, [1989] I.L.R. 1-2478 (B.C. S.C.), affirmed (1990), 69 D.L.R. (4th) 735, 44 C.C.L.I. 173, [1990] I.L.R. 1-2599 (B.C. C.A.).
17. *Nova Scotia Public Service Long Term Disability Plan Trust Fund v. McNally*, 1999 NSCA 129, 17 C.C.L.I. (3d) 215, 179 N.S.R. (2d) 314 (N.S. C.A.), at paras. 39-40.
18. R.S.B.C. 1979, c. 200 (in effect at the time).
19. That provision read: "All rights to recovery from any other person are

The application judge in *Farrell* made the following comment:[20]

> In the cases relied upon by the plaintiff [the insured] the interpretation of the equivalent of s. 224(1) was not the *ratio decidendi* of the decisions. *Sheridan*, which was followed in the other two cases, simply stated that s. 224(1) could not mean what it appeared to say. In rejecting the plain wording of that section, the court in *Sheridan* relied on the fact that the entire underpinning of subrogation rested upon indemnity having been made to the insured. Without indemnity, subrogation did not exist.

The application judge failed to appreciate that the common law precondition of receipt of full indemnity by the insured had been removed in the same way in which it has been eliminated by a typical contractual subrogation clause by s. 224, with the result that there was no longer a foundation for the common law rule.

The application judge said that the "plain wording" of the statute could be ignored, because the right to control the litigation process is a "very significant right"[21] which could be removed only by "express and precise" language.[22] Apart from the acknowledgment that the language of the statute and, therefore, of the similarly worded typical policy provision, is "plain", there is more than one way to contractually eliminate a common law right, regardless of the significance of that right. Instead of eliminating the right itself, the understructure on which that right rests can be eliminated. A basic flaw in the reasoning of the application judge in *Farrell* was the incorrect assumption that the insured remained automatically entitled to the "very significant right" of carriage and control despite the removal, by way of "plain" language in the subrogation clause,[23] of the footing for the common law rule which provided that entitlement. The fact that the right of general control is a "very

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hereby transferred to the Insurer which is authorized to bring action in the Insured's name to enforce such rights."

20. *Farrell*, *supra* note 16 at para. 32 of the application decision. The internal reference is to *Sheridan v. Tynes* (1971), 19 D.L.R. (3d) 277, [1971] I.L.R. 1-441, 4 N.S.R. (2d) 143 (N.S. T.D.).
21. The importance of the right of carriage and control is considered in greater detail in the Pengelley paper, *supra* note 2. It was also the subject of the following comment by Binnie J., dissenting on other grounds in *Somersall*, *supra* note 4 at para. 106: "The accelerated rights under clause 9 [in an SEF 44, or Family Protection, endorsement in an automobile policy] signal the importance placed on the right of subrogation in general, and in particular on putting the insurer in charge of the claim over against the tortfeasor at the earliest practicable date."
22. *Farrell*, *supra* note 16 at paras. 44-45 of the application decision.
23. In *Farrell*, it was a statutory rather than contractual clause, but, as previously indicated, containing virtually the same wording.

significant right" should, in fact, have led to precisely the opposite result. The disappearance of any valid and persuasive rationale for the anomalous bestowal of that important right on the party with the smaller claim was a reason for eliminating, not maintaining, the common law rule.

The appeal court in *Farrell* largely relied on the reasoning of the application judge and made the following comment:[24]

> If the insurer wishes to control the litigation then the contract of insurance must provide for complete indemnity of the insured, and the complete indemnity must be paid.

The decision of the appeal court therefore appears to have similarly been 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 the statutory equivalent of a typically worded subrogation clause.

A subsidiary basis for the decision of the application judge in *Farrell* (and one that was adopted by the application judge in *Ison*)[25] was the fact that there was an express right to control the litigation against the wrongdoer in certain circumstances in the section of the statute that dealt with automobile insurance[26] while there was no such express provision in the section that dealt with fire insurance. The application judge in *Farrell* said that "this would suggest that the common law right of the insured to control the litigation pending full indemnification has not been destroyed by the enactment of s. 224(1) [of the *Insurance Act* (B.C.)]".[27] Regardless of the presence or absence of such a provision, there is simply no longer any rational basis for the continuation of the common law rule where a contractual or statutory subrogation clause removes the understructure on which that rule rests. The absence of such a provision does not reestablish the foundation for the common law rule. It does not alter the fact that there is no longer any justification for an insured to have the "very significant right" of general control of an action in which it has the smaller (and in most cases, in our experience, the much smaller) claim.

Furthermore, the reasoning of the application judge in *Farrell* invokes the *expressio unius est exclusio alterius* maxim of interpretation. That maxim is inapplicable for the reason expressed in the following comment:[28]

24. *Farrell*, *supra* note 16 at para. 18 of the appeal decision.
25. At paras. 44 and 57 [**Farrell or Ison**?]
26. As there is in s. 261(3) in the *Insurance Act*, Ontario.
27. *Farrell*, *supra* note 16 at para. 23 of the application decision.

> [T]he maxim ought not to be applied when its application, having regard to the subject-matter to which it is to be applied, leads to inconsistency or injustice

The continued application of the common law rule would do just that.

At both court levels in *Farrell* the argument was made that, in theory, a very small payment by the insurer to the insured – the example given was $10 on a $1 million loss – would entitle the insurer to control of the litigation against the wrongdoer.[29] That argument, however, is more realistic when reversed, in which case it applies in the insurer's favour. Where, for example, an insured has a personal uninsured claim against the wrongdoer for a deductible of, say, $10,000, while the insurer has a subrogated claim for its payment to the insured of the remaining $990,000 on a $1 million loss, why should the insured have carriage and general control of the action? That type of example is far more likely to occur than the one given in *Farrell* which is not realistic. Were a situation such as that envisaged in the *Farrell* example to occur, or even some more realistic scenario where the insured's personal claim for uninsured loss has a value greater than that of the subrogated claim, we would not hesitate to agree that the insured ought to have carriage and control of the action but generally that is not the case.

Turning the argument made in *Farrell* on its head, 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. A purposive interpretation of the subrogation clause must take into account the *Somersall* concept of an "identity of rights" between the insured and the insurer upon satisfaction of the condition in the subrogation clause. The *Farrell* approach defeats, rather than furthers, that principle by automatically providing to the insured the "very significant right" of carriage and control regardless of the circumstances.

## (6) Somersall: The Effects of a Subrogation Clause

The *Somersall* decision came after *Farrell* and before *Ison*. 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 *Somersall*, where the court said:[30]

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28. *Nicholson v. Haldimand-Norfolk (Regional Municipality) Commissioners of Police*, [1979] 1 S.C.R. 311, 88 D.L.R. (3d) 671, 78 C.L.L.C. 14,181 (S.C.C.).
29. *Farrell*, *supra* note 16 at para. 45 of the application decision and para. 18 of the appeal decision.

> By making the subrogation rights of the insurer contingent upon the *making* of a claim, the requirement of indemnity is clearly meant to be waived. [Emphasis in original.]

Adapting that statement to the language of the typically worded subrogation clause reproduced above:

> By making the subrogation rights of the insurer contingent upon the making of any payment or assuming liability therefor under the policy, the requirement of indemnity is clearly meant to be waived.

An insurer's right of subrogation, therefore, is no longer dependent, as it was at common law, on the insured first having received full indemnity. 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:[31]

> This [subrogation] clause sets out, in the first place, the relationship between the insurer's rights and the claimant's right as identical upon making the claim. In the second place, it permits the insurer to maintain whatever action exists at law as a result of the identity of rights between insurer and insured.

The first part of the typically worded subrogation clause similarly creates an "identity of rights", because it likewise eliminates the common law precondition of full indemnity and replaces it with a different condition. That "identity of rights" (upon satisfaction of the contractual condition) means 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.

## (7) The Ison Decision

*Ison* was decided after *Somersall*. The application judge in *Ison* rejected the insurer's reliance on *Somersall* with the following comments:[32]

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30. *Somersall*, *supra* note 4 at para. 58.
31. *Ibid*. at para. 57.
32. *Ison*, *supra* note 1 at paras. 66-67.

> In my respectful view, there is nothing in the reasons [in *Somersall*] to suggest that the Supreme Court gave consideration, in any way, to the issue of the insurer's right, having provided an indemnity, to control the prosecution of an action against the party for recovery of both insured and uninsured claims. The question was simply not at issue.
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> Had it been the intention of the Supreme Court to overrule the principle that the insured is *dominus litis* until fully indemnified, or to effectively overrule the decision of the Court of Appeal of British Columbia in *Farrell Estates*, I would expect the court to have said so.

On the appeal in *Ison*, the court said they "agree with the application judge's careful discussion of the relationship between the decision . . . in *Farrell* . . . and the subsequent decision . . . in *Somersall*".[33]

The application judge also said that the weight of authority supports the position expressed in *Farrell* that the insured is *dominus litis* until fully indemnified.[34] Almost all of the cases that were cited, however, essentially regurgitated the common law rule and failed to consider the impact of a contractual subrogation clause, and they furthermore pre-dated *Somersall*.[35] *Farrell* and *Ison* render much of the subrogation clause nugatory. They "effectively denude the clause of any meaning".[36]

Regarding the application judge's comment that there was no reference to *Farrell* in *Somersall*, while *Farrell* was not expressly overruled, neither was it confirmed. Perhaps *Farrell* was not brought to the court's attention. For reasons already given, it is our view that the decision in *Farrell* is incorrect on the merits, not a sensible result, and is inconsistent with the reasoning, the principles, and the approach adopted in *Somersall*, and, therefore, should be considered to have been impliedly overruled.

We suggest that both the application judge and the Court of Appeal in *Ison* failed to take into account that *Somersall* established that:[37]

a. contrary to the position at common law, a typically worded subrogation clause contractually confers on the

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33. *Ibid.* at para. 6 of the appeal decision.
34. *Ibid.* at para. 68 of the application decision.
35. Reference might also be made to the *McNally* decision on this issue. See *supra* note 17.
36. *ING Insurance Co. of Canada v. Miracle*, 2011 ONCA 321, 334 D.L.R. (4th) 150, 94 C.C.L.I. (4th) 1 (Ont. C.A.), at para. 23.
37. *Ison* was criticized in the Pengelley paper, although for reasons different than those expressed here.

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, and thereby nullified, 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.

## (8) Toward a More Reasoned Approach

The justification for the common law rule that the insured was entitled to carriage and control having been contractually eliminated, it is no longer the case that that right automatically belongs to the insured, with the insurer being obligated to wait in the wings until what, under the common law, was merely an inchoate right materialized.

The contract made between the parties supplants the common law rule. Upon satisfaction of the condition in the subrogation clause, the right of subrogation immediately comes into being and the rights of the insured and the insurer are now on an equal footing. As stated above, this was described in *Somersall* as the two parties having an "identity of rights".[38] The language of the subrogation clause should be considered in conjunction with the following fundamental issue: what is the fair and sensible result? In *Somersall*, that consideration was stated in the following terms: "[W]e must pay heed to the wisdom of the policy that will result from whatever interpretation of the subrogation clauses is adopted."[39]

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

38. In the same paragraph of *Somersall*, *supra* note 4 (para. 57), the court said "This [subrogation] clause sets out, in the first place, the relationship between the insurer's rights and the claimant's right as identical".
39. *Ibid.* at para. 45.

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. It is ironic that the application judge in *Ison* relied on a rule established by equity which will lead in such cases to an inequitable result.

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. No such factor or consideration is evident in the usual situation where the value of the subrogated claim is considerably larger than that of the insured's personal claim.

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,[40] 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 been expended, and one which has not been tested by adjustment. The insured's personal claim in *Ison*, for example, was for loss of profits, loss of the ability to service damaged vehicles, loss of the opportunity to resell trade-ins, and loss of goodwill.[41]

In most cases, the determination of which party has the claim with the larger real value is not one that presents difficulty. Where it does, however, the balance should be tipped in favour of the insurer for several reasons. First is the language of the typically worded subrogation clause;[42] second, because the insurer's claim will, as

40. The application decision in *Farrell*, *supra* note 16 quotes (at para. 29) the following remark from an annotation to another case: "As a practical matter, in such fire insurance situations, the insured is usually seeking to protect only a deductible amount".
41. *Ison*, *supra* note 1 at para. 4 of the application decision.
42. The first part of the typically worded subrogation clause plainly assigns to the insurer *all* of the insured's rights of recovery. As one of the insured's "rights of recovery" under the common law rule is the right of carriage and general control of the litigation against the wrongdoer, the clause confers that right on the insurer. The word "all" makes the typically worded

described above, normally be a "hard" claim, whereas the insured's personal claim for uninsured loss is often a "soft" claim; third, because the insurer will normally have significantly greater resources and expertise for the pursuit of the claims.[43]

The application judge in *Ison* said that there was no evidence which showed that the insured's personal business loss claim was any less recoverable than the insurer's subrogated property loss claim.[44] The resolution of a contest regarding carriage and control of the action is not, however, the appropriate occasion or forum for assessing damages. It is our experience that in many (probably most) cases, even a cursory examination of the claims of the two parties will indicate with some measure of assurance that the claim of one has a lower real value than the claim of the other.

While the Court of Appeal in *Ison* adopted the analysis and conclusions of the application judge "in their entirety", and went so far as to describe them as "masterful",[45] they also said:[46]

> Accepting, without necessarily agreeing with, the appellants' proposed test, we think that the appellants' focus on the factor of the monetary amount of the competing claims is too narrow. If considerations relating to "the fair and sensible result" come into play, then attention must be paid to the conduct of the insured and the insurer in the context of the entire legislation.

The court then agreed with comments made by the application judge relating to various factual matters which largely involved the insured's diligence, its efforts regarding and expenses incurred by it in prosecuting the action, and the insurer's delay in becoming involved

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subrogation clause even more encompassing than the clause in *Somersall*, *supra* note 4 at para. 59 where it was held that the subrogation clause conferred on the insurer the right of control: "[I]t is also clear that the insurer's right of subrogation is not *required* to be exercised, and that the insured may herself maintain the right of action *until such time as the insurer assumes control*" (first emphasis in original; second emphasis added). It should be noted that, while the subrogation clause does not expressly confer on the insurer the right of carriage and control, neither does it do so for the insured. An express right of control is no more necessary in the typically worded subrogation clause than it was in *Somersall*.

43. Reference may again be made to the following comment by Binnie J., dissenting on other grounds in *Somersall*, *ibid.* at para. 106: "The accelerated rights under clause 9 [in an SEF 44, or Family Protection, endorsement in an automobile policy] signal the importance placed on the right of subrogation in general, and in particular on putting the insurer in charge of the claim over against the tortfeasor at the earliest practicable date."
44. *Ison*, *supra* note 1 at para. 76 of application decision, and quoted with approval at para. 10 of the appeal decision.
45. *Ibid.* at para. 6 of the appeal decision.
46. *Ibid.* at para. 9.

in the action. Those comments ended with the following conclusion:[47]

> There may be cases where the insurer's interest is so vastly disproportionate to the insured's interest that it would be unreasonable to allow the latter to have control of the litigation. This is not such a case.

We agree that the conduct of the insured and the insurer is a relevant consideration in determining the fair and sensible result. In most cases, that conduct will be a neutral factor. In *Ison*, the court found that the conduct weighed in the insured's favour, although it is our view that consideration was not adequately given to the conduct of the insured in that case which, as indicated below, was seen by the insurer as amounting to a breach by the insured of its duty of good faith to the insurer. The insurer's conduct in *Ison* furthermore did not qualify, nor was it treated as, a waiver or estoppel,[48] although it should be said that the issue in this context more involves equitable, than legal, considerations.

More important is the last comment made by the application judge and adopted by the Court of Appeal, which was that the insured should have control of the action unless the insurer's interest is "vastly disproportionate" to the insured's. For reasons already stated, that is not a test that we consider to be fair and sensible, nor does it take into account the contractual elimination of "the entire underpinning" (to borrow a term employed by the application judge in *Farrell* when describing the origin of the equitable, as opposed to contractual, right of subrogation) of the common law rule.

A recent decision of the SCC has emphasized the importance of the "principle of proportionality", albeit in a different context (the use of summary judgment motions to avoid unnecessary trials).[49] It was said there that "If the process is disproportionate to the nature of the dispute and the interests involved, then it will not achieve a fair and just result . . . judges [are required] to actively manage the legal process in line with the principle of proportionality".[50] The application of the

47. Reproduced *ibid*. at para. 10 of the appeal decision.
48. See *Gu v. Tai Foong International Ltd.* (2003), 30 C.P.C. (5th) 260, 168 O.A.C. 47, 2003 CarswellOnt 232 (Ont. C.A.), leave to appeal refused (2003), 194 O.A.C. 197 (note), 326 N.R. 198 (note), 2003 CarswellOnt 4493 (S.C.C.), at paras. 41-42, and *Penn-Co Construction Canada (2003) Ltd. v. Constance Lake First Nation*, 2012 ONCA 430, 13 C.L.R. (4th) 1, 292 O.A.C. 370 (Ont. C.A.), at para. 14 regarding the necessary elements for waiver and estoppels respectively.
49. *Hryniak v. Mauldin*, 2014 SCC 7, 366 D.L.R. (4th) 641, 27 C.L.R. (4th) 1 (S.C.C.).
50. *Ibid*. at paras. 29 and 32 respectively.

principle was found to be one of the necessary means for the attainment of the overriding goal of achieving "fair and just results". Proportionality is equally a factor in attaining that goal in the context of 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. Both instances involve procedural matters on which the principle of proportionality justifiably has a large bearing. 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 is an approach precisely the opposite to the principle of proportionality.

Stated briefly: the tail should not be wagging the dog.

### (9) The Right of Subrogation Is Limited

Once the condition for the investment of a right of subrogation has been satisfied, the right is subject to limitations. The nature and extent of the limitations depend on the language of the subrogation clause. In the typically worded clause reproduced above, the limitation is that, in the event there are insufficient funds available after payment of expenses to satisfy both the insured's personal claim for uninsured loss and the insurer's subrogated claim, recovery will be shared between them on a *pro rata* basis. The subrogation clause in *Somersall* did not expressly impose any limitation.

### (10) Meaningful Participation by Both Parties in the Action

So long as the rule against multiplicity of proceedings precludes separate actions for subrogated and uninsured claims, one of the two parties must be given the right of carriage and control of the action. There should be only one counsel of record; otherwise, the litigation might become unmanageable. Regardless of which party has that right, difficulties can arise and for that reason a set of ground rules should be established.

In *Ison*, counsel for the insured sent a letter to counsel for the insurer containing the following comment:

> Please do not attend the discoveries. The Rules forbid you from doing so. We will object and the discoveries will be delayed until you depart.

It was argued by the insurer that the insured had no basis or justification to exclude the insurer's counsel from attendance at the examinations for discovery, and that the insured's position constituted a violation of the subrogation clause because it rendered meaningless the rights conferred on the insurer by that clause. It was argued that the conduct of the insured constituted a breach of its duty of utmost good faith to the insurer. The issue was dealt with only in an indirect manner. The application judge said:[51]

> If the parties, exercising common sense and good faith, are unable to agree on appropriate procedures for the protection of the insurers' interests, written submissions on the issue may be made to me. I will then issue supplementary reasons dealing with the matter.

The parties were unable to agree and written submissions were made. In supplementary reasons, the application judge declined, as he put it, to "micromanage the ongoing relationship between the insurer and the insured", and said "they are best left to their common law obligations, however they may interpret them, and to their common law remedies".[52] The position of the Court of Appeal was that the application judge was case-managing and was well-positioned to deal with any complaints about the insured's carriage and control of, and the insurer's participation in, the action as it moved forward.[53]

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. Where an issue that is common to both claims is involved, such as the issue of liability, the junior party must defer to the party having carriage and control of the action, subject of course to the duty to act in good faith. At a practical level, the degree of cooperation and participation would vary with the circumstances. Where one party's claim is greatly in excess of the other's, the latter will not require the same level of cooperation and participation as would be the case where the claims are closer to equal in size, or where the junior party is advancing a substantial claim, even if it is one that is small in comparison to the other party's claim.

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51. *Ison*, *supra* note 1 at para. 82.
52. *Zurich Insurance Co. v. Ison T.H. Auto Sales Inc.*, 2011 ONSC 2511, 333 D.L.R. (4th) 718, 98 C.C.L.I. (4th) 146 (Ont. S.C.J.), at para. 6.
53. *Ison*, *supra* note 1 at para. 11 of the appeal decision.

The rationale for one of the two parties having the right of carriage and control does not extend to the right to exclude the other party from meaningful cooperation and participation in the litigation insofar as its claim is concerned, and from controlling its own independent claim, except on issues, the main one being liability, that are common to both parties.

### 3. Independent Settlement by the Insurer of the Subrogated Claim

As indicated above, we are not aware of any case law on the question whether the insurer is entitled to independently settle its subrogated claim while the insured's personal claim for uninsured loss remains outstanding.

#### (1) Separate Claims Belonging to Separate Parties

There should be no dispute that the insured's personal claim and the insurer's subrogated claim are distinct and separate claims that belong to each respectively. While the claims both arise from the same circumstances and the same cause of action and in that sense are not independent, they are undoubtedly separate insofar as the insured and insurer are concerned, and just as clearly the insurer has no property or other 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 (that claim involving moneys that the insured has received from the insurer). Regardless of what the common law position may have been, a subrogation clause in the insurance contract clearly 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.

An analogy may be drawn to the claims of an injured person and of *Family Law Act* claimants, where the claims arise from the same underlying fact situation (although not the same cause of action) but are separate and belong separately to each party. The fact that FLA claims are created by statute rather than by contract is not a principled distinction.

The issue of the measure of recovery by the insurer on its subrogated claim, however, is not as straightforward. The typical subrogation clause requires that, in the event of insufficient funds to satisfy both the insured's personal claim and the insurer's subrogated claim, those funds be shared between them on a *pro rata* basis. This

means that the insurer cannot make full recovery on a settlement of its subrogated claim if the insured's personal claim remains outstanding and there is a real possibility that there will be insufficient funds to satisfy both claims. In that situation, the insurer should hold the funds paid in settlement of the subrogated claim in escrow, or at least such part of those funds as will be sufficient to result in *pro rata* recovery by both the insured and the insurer, until the true value of the insured's personal claim becomes known, either through settlement or judgment. It is only where there is no doubt that sufficient funds will be available to satisfy the insured's personal claim that the insurer can take for its own account the funds received in settlement of the subrogated claim.

### (2) Neither Party Should Have the Right to Settle the Other's Claim

It is important not to lose sight of the basic principle that a subrogated claim belongs to the insurer, not the insured, and conversely that the claim for uninsured loss belongs to the insured, not the insurer. 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 by the other party of its claim. There is no justification for the entitlement at large (meaning in the absence of contractual or statutory grounds) of one party to interfere with a substantive property right belonging to another.

In *Somersall*, the insured was held entitled to settle the action against the wrongdoer without the input or consent of the insurer. That was so, however, because the insurer was not asserting a claim against the wrongdoer, having denied coverage and having made no payment to the insured.[54] The insured was therefore the only player on the field insofar as the action against the wrongdoer was concerned, and the only obligation to which the insured was subject was the obligation to act in good faith. The insurer having made no payment to the insured, there was nothing that could be the subject of subrogation. Another way of looking at the situation was that the insurer had essentially waived its subrogation rights. Settlement in those circumstances was not a breach of the insured's duty of good faith. In the type of situation encompassed by this paper, however, the insurer does not deny coverage to the insured; to the contrary, it has made payment to the insured under the policy and is asserting a subrogated claim against the wrongdoer. The insured should have no entitlement in those circumstances to arrogate to itself

54. *Somersall*, *supra* note 4 at para. 59.

control of the settlement of the insurer's subrogated claim; nor should the insurer be entitled to do so were the situation reversed.

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? For simplicity, we assume that the insured has carriage and control of the action in accordance with the decisions in *Ison* and *Farrell*. 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. Even if the insured's claim were larger in terms of real value than the subrogated claim, the insured should not have the right to treat the insurer's property as if it were its own. While there is an important policy consideration regarding the encouragement of settlements that will be considered in detail later, the distinction between encouraging and unilateral settlement is a difference in kind and in principle, not degree. The encouragement of settlements is a matter of policy involving the public interest; the transfer from one person to another of the right to settle a claim belonging to the former is a matter involving substantive property rights, not policy, and it does not involve the public interest. In addition, the goal of reducing litigation would likely not be served in cases where a party's claim has been settled without its consent for an amount that it considers improvident. That situation invites further litigation. Legislation, such as that relating to class actions, would be necessary in our view to assign to one person the right to make a unilateral decision regarding this substantive property right belonging to another. Even in a class action, each person having a claim has the right to opt out (albeit at an early stage) so as to retain control of its own claim.

The insurer similarly should have no right to unilaterally settle the insured's personal claim, even if its claim were substantially larger than that of the insured. Regardless of which party has carriage and control of the action, and whose claim is larger, neither should have the unilateral right to settle the other's claim without the latter's consent.

At common law, the insured had the unilateral right to settle the entire action, including the insurer's subrogated claim (although a

more accurate term would be the insurer's "subrogated interest", because the insurer had no right of subrogation until the insured recovered full indemnity). In one of the foundational common law decisions, it was said that "if the [insured] compromises, he must compromise *bona fide*".[55] That unilateral right, which was subject only to the duty to act in good faith, runs throughout the case law that considered the issue in the context of common law principles. Thus, the trial judge in *Affiliated FM Insurance*[56] held that the only issue was whether a settlement made by the insured had been made in good faith. On appeal, the following comment was made: "But to import issues of good and bad faith into what happened here is, in my opinion, to complicate the law quite unnecessarily and defeat the just claim of the appellant." The judgment on appeal was not, however, a finding that the insured did not have a unilateral right to settle the entire action, but rather that the settlement funds, which had not been allocated in the settlement agreement as between the uninsured loss and the subrogated claim, should be divided between the insured and the insurer on a *pro rata* basis.[57] The decision therefore involved the issue of division of settlement funds, not the insured's right at common law to unilaterally settle the entire action.

The allegation that a party has not acted in good faith is a difficult matter to prove. Even more onerous would be the allegation that an insured acted in bad faith (which is a step beyond not acting in good faith)[58] when unilaterally settling the entire action. The obligation to satisfy that onus is understandable in the context of the common law principle that the insurer had no right of subrogation until the insured had recovered full indemnity. The insured's right to unilaterally settle the entire action, subject only to the duty to act in good faith, flowed naturally from the principle that, until receipt of full indemnity, only it had a right to make a claim. The change occasioned by a typical contractual subrogation clause, however, removes the foundation not only for the common law principle that the insured should be *dominus litis* in the action against the wrongdoer, but also for the principle that the insured should have that unilateral right to settle the entire action. Given the insurer's right of subrogation from and after the time it satisfies the condition in the subrogation clause (which

55. *Commercial Union Assurance Co. v. Lister* (1874), 9 Ch. App. 483 (C.A.), quoted with approval in *Grebely*, *supra* note 4 at para. 41.
56. *Supra* note 4.
57. *Ibid.* at paras. 51-58.
58. Supplementary reasons in *Ison*, reported at *Zurich Insurance Co. v. Ison T.H. Auto Sales Inc.*, 2011 ONSC 3902, 98 C.C.L.I. (4th) 149, 2011 CarswellOnt 5369 (Ont. S.C.J.), at para. 14.

normally involves payment or promise of payment to the insured under the policy), there is no longer any rationale or justification for the insured to unilaterally impose upon the insurer, subject only to the duty to act in good faith, any compromise settlement of the insurer's claim that the insured (but not the insurer) considers appropriate. As stated above, the insured should not be entitled in those circumstances to unilaterally interfere with the insurer's property rights. The same holds true in the reverse situation where the insurer has carriage and control of the action.

While this will, on those occasions where a settlement of the whole action cannot be agreed among all three parties, result in continuing litigation, that is not a sufficient basis for a right to be accorded to one party to unilaterally bind the other to a settlement, particularly where the claim of the former is significantly lower than that of the latter. No one would suggest, for example, that a *Family Law Act* claimant with a much smaller claim than that of the injured plaintiff could enter into a settlement of the whole action without the latter's consent.

### (3) No Prejudice to the Insured

The settlement of the subrogated claim is subject to the settlement privilege, which prevents the defendants from relying on it in any way in their defence of the plaintiff's personal claim for an uninsured loss, unless it is shown that a competing public interest outweighs the public interest in encouraging settlement.[59]

An argument we have heard is that prejudice would be suffered by the insured from having to prosecute the action against the defendants alone. That position is based on the false premise that an insurer has a duty to assist the insured in prosecuting a claim for an uninsured loss. No litigant has any entitlement to assistance from another person in prosecuting a personal claim. The insurer does not have any such duty, either under the insurance contract, by statute, or under the common law. There is no case law or other authority that supports the existence of any such duty. An insurer undertakes to provide insurance coverage, not to assist in the prosecution of a claim for an uninsured loss. There is nothing in a typical insurance policy that obligates the insurer to provide such assistance. An insurer has no duty, for example, to assist in the prosecution of actions where the insurer has decided not to make a subrogated claim. The insured is in the same position following settlement of the subrogated claim that it would be in had the insurer decided not to pursue a subrogated claim

59. *Sable Offshore Energy Inc. v. Ameron International Corp.*, 2013 SCC 37, [2013] 2 S.C.R. 623, 359 D.L.R. (4th) 381 (S.C.C.), at paras. 18-20.

in the first place, or that the insured would have been in had there been no coverage for any part of the loss and therefore no subrogated claim.

Any such implied obligation on the insurer's part to assist the insured in the prosecution and recovery of the insured's personal claim would constitute an impermissible amendment of the insurance contract by creating an obligation on the part of the insurer to deal with an uninsured loss. That would be inconsistent with the basic scheme of, and the principles relating to, insurance contracts.

The insurer's duties, whether in respect of first party property loss claims or third party liability claims, relate only to insured losses. The insurer has no duties relating to uninsured losses other than the duty to act in good faith, a duty which does not require an insurer to assist its insured in the prosecution of the insured's personal claim. That is not a matter that has any connection to the duty of good faith. The duty of good faith applies only to existing contractual obligations; it does not create new contractual obligations.

The duty of good faith comes into play only if, in settling the subrogated claim, the insurer does something which prejudices the insured's ability to prosecute or recover on its personal claim for an uninsured loss. That situation is likely to arise only where the settlement of the subrogated claim results in insufficient funds being available to satisfy the personal claim of the insured.

### (4) Preference

Another argument we have heard is that the settlement of the subrogated claim gives a preference to the insurer. That, however, is not the case. The mere fact that one of two separate and distinct claims (notwithstanding the fact that both arise from the same circumstances and the same cause of action) is settled before the other, does not mean that the party making that settlement obtains any preference. The only exception, as noted above, is the situation where the settlement of that claim results in insufficient funds being available to satisfy the claim of the other party. That situation is addressed by the *pro rata* recoveries provision in the typical subrogation clause or, in the unlikely event there is no such provision, by the common law principle of *pro rata* recoveries as held in *Affiliated FM Insurance*.

## (5) Policy Considerations

Policy considerations are always relevant, although not necessarily governing, as shown by the statement in *Somersall* that it was "worthwhile to consider the policy results of this conclusion as opposed to the contrary".[60]

As previously stated, subject to the possibility of insufficient funds ultimately being available to satisfy both the insured's personal claim and the subrogated claim, there does not appear to be any prejudice arising from the settlement of a subrogated claim that would be attributable to the breach of any duty owed by the insurer to the insured (and more particularly, the duty of good faith). Conversely, however, there would be serious prejudice arising from an inability to settle the subrogated claim not just to the insurer and to the defendant, but to the administration of justice generally.

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. As previously mentioned, it is our experience that the subrogated claim is generally larger than the insured's personal claim and therefore would take up the greater share of time, expenses, and judicial resources. The inability to settle would, in many cases, have a serious negative impact.

## (6) The Public Policy of Encouraging Settlement

The previously referenced *Sable Offshore Energy* decision[61] emphasizes the importance of the public policy of encouraging settlements. Following are some of the relevant passages:[62]

> The justice system is on a constant quest for ameliorative strategies that reduce litigation's stubbornly endemic delays, expenses and stress. In this evolving mission to confront barriers to access to justice, some strategies for resolving disputes have proven to be more enduringly successful than others. Of these, few can claim the tradition of success rightfully attributed to settlements.
>
> . . . . .
>
> Settlements allow parties to reach a mutually acceptable resolution of their dispute without prolonging the personal and public expense and time involved in

60. *Somersall*, *supra* note 4 at para. 70.
61. *Supra* note 59.
62. *Ibid*. at paras. 1, 11-12.

litigation. The benefits of settlement were summarized by Callaghan A.C.J.H.C. in *Sparling v. Southam Inc.* (1988) 66 O.R. (2d) 225 (Ont. H.C.):

> [T]he courts consistently favour the settlement of lawsuits in general. To put it another way, there is an overriding public interest in favour of settlement. This policy promotes the interest of litigants generally by saving them the expense of trial of disputed issues, and it reduces the strain upon an already overburdened provincial Court system.
>
> This observation was cited with approval in *Loewen, Ondaatje, McCutcheon & Co. c. Sparling* [1992] 3 S.C.R. 235 (S.C.C.), at p. 259, where L'Heureux-Dube J. acknowledged that promoting settlement was "sound judicial policy" that "contributes to the effective administration of justice".

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 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. That requirement should be imposed for the same underlying reason that the settlement privilege will apply unless it is shown that some "competing public interest outweighs the public interest in encouraging settlement".[63] In our view, there is no competing public interest. An insured's desire for assistance from its insurer in the prosecution and recovery of its personal claim for an uninsured loss is, to begin with, a private not a public interest. Furthermore, the significance of the public interest in encouraging settlement of claims makes it highly unlikely that any other public interest that might come into play in relation to an insurer's independent settlement of its subrogated claim would outweigh the former.

The following statements were made in *Somersall* which are relevant to this issue:[64]

> [T]here is no good policy reason for this Court to read into the contract a provision that will so gravely prejudice the [insurer and the administration of justice generally].
>
> . . . . .
>
> [I]t would be foolhardy to disregard the common sense results of an interpretation of a contract that would . . . I am convinced that the interpretation here adopted is not only the most natural view of the terms of the contract, but sound and equitable public policy as well.
>
> . . . . .

63. *Ibid.* at paras. 19 and 30.
64. *Somersall*, *supra* note 4 at paras. 71, 74 and 45.

> [W]e must pay heed to the wisdom of the policy that will result from whatever interpretation of the subrogation clauses is adopted.

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. Those objectives are summarized in the following statement:[65]

> [I]t is important to keep in mind the underlying objectives of the doctrine of subrogation which are to ensure (i) that the insured receives no more and no less than a full indemnity and (ii) that the loss falls on the person who is legally responsible for causing it . . . The doctrine of subrogation operates to ensure that the insured received only a just indemnity and does not profit from the insurance.

After settlement of the subrogated claim, the insured will ultimately "receive [either by way of settlement or judgment] no more and no less than a full indemnity", and "the loss will fall on the person(s) who is/are legally responsible for causing it". The settlement of the subrogated claim would have no impact on whether the insured would receive "only a just indemnity and does not profit from the insurance". Even without taking into consideration the changes to the common law resulting from a contractual subrogation clause, the underlying objectives of the common law rule would not be affected by a settlement of the subrogated claim made independently and in good faith by the insurer.

The following statement was made in *Somersall*:[66]

> The objectives that the doctrine of subrogation are intended to advance are not prejudiced by the [insurer's] inability to be subrogated . . . Absent any evidence of actual or probable loss, insurers should not be allowed to raise an alleged breach of subrogation rights in order to bar a claim made in good faith by the insured.

Applying that comment to the situation where the insurer has *not* denied coverage, has made payment to the insured under the policy, and is asserting a subrogated claim against the wrongdoer:

> The objectives that the doctrine of subrogation are intended to advance are not prejudiced by the [insurer's right to independently settle its subrogated claim] . . . Absent any evidence of actual or probable loss [to the insured], insurers should [be permitted to settle, independently and in good faith, their subrogated claims].

65. *Ibid.* at para. 50.
66. *Ibid.* at paras. 51 and 52.

No legitimate and fruitful purpose would be served by enabling the insured to veto a settlement of the subrogated claim made independently and in good faith by the insurer.

### (7) The Insured's Obligation to Act in Good Faith

The duty of good faith is a two-way street:[67]

> A contract of insurance is a contract of the utmost good faith . . . The duty of good faith is reciprocal. It is generally accepted that the duty of good faith exists both before the making of the contract and in its performance.

An insured should not be entitled to arbitrarily block the settlement of a subrogated claim made in good faith by the insurer. To satisfy its obligation to act in good faith, the insured requires a legitimate reason for seeking to prevent such a settlement, one that involves prejudice attributable to the breach of a duty owed to it by the insurer and one that involves a "competing public interest [which] outweighs the public interest in encouraging settlement".

As stated above, the insurer owes no duty to assist the insured in the prosecution or recovery of its uninsured loss claim. 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. Furthermore, "[i]t would be impossible to reconcile barring [an insurer's right to settle independently and in good faith its subrogated claim] on such grounds with the nature of insurance policies as good faith contracts".[68]

In conclusion, 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.

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67. *Ison*, *supra* note 1 at para. 29 of the application decision.
68. *Somersall*, *supra* note 4 at para. 52.