Rights and Remedies Between Primary and Excess Insurers

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With the rise in the value and number of insurance claims, instances where the exposure reaches into excess layers of insurance will be more common. As such, it is anticipated that the number and nature of disputes between primary and excess carriers will increase.

In the American context, the law regarding duties owed between primary and excess insurers is well developed. Conversely, there are very few reported Canadian decisions on the topic.

This article examines the nature and scope of the duties owed between primary and excess insurers from a Canadian perspective, including a consideration of common issues that arise when multiple layers of insurance are potentially applicable to a claim.

As elaborated below, it is the authors' view that, regardless of the context in which the remedy arises (equitable contribution, equitable subrogation, or a duty of care in tort), the law requires that, where an excess insurer is harmed by the unreasonable conduct or actions of a primary insurer, the primary insurer be held accountable to the excess insurer for the financial losses caused.

Similarly, where there is a concurrent duty to defend, and an excess insurer is put at risk by a claim, then the excess insurer should be involved in the investigation and adjusting of the claim, and to contribute to defence costs accordingly.

In short, there is a relationship of proximity between primary and excess insurers such that the parties know, or ought to know, that a failure on its part could result in financial loss to the other. It is the writers' view that these losses should be recoverable, so long as they are reasonably foreseeable.

We will begin our analysis with a review of the key authorities and publications on the issue, starting with an agreement that has been reached with several insurance companies regarding guiding principles for primary and excess liability insurers.

The Agreement of Guiding Principles

The Insurance Bureau of Canada has implemented the "Agreement of Guiding Principles Between Primary and Excess Liability Insurers Respecting Claims, 1996."

The Agreement outlines various duties owed between primary and excess insurers such as: the duty to act prudently in negotiating towards settlement, the duty to make reasonable efforts to investigate all facts relevant to the evaluation of the claim, and the duty to provide relevant information to assist in an insurer's assessment of exposure.

The Agreement also outlines various duties owed by the excess insurer to the primary insurer where the excess insurer elects, or is required, to become involved in the defence and investigation of a claim.

These duties include a duty to share all information and to contribute to the proportionate costs of adjusting the claim, regardless of the ultimate value of a settlement or judgment.

The Agreement has received little judicial attention and has been cited by only two reported Canadian decisions.[1]

In both cases, although the Court seemed to accept that the Agreement had application to disputes between certain insurers, it did not engage in a meaningful analysis of the Agreement as the disputes in question involved insurers that were not signatories to the Agreement.

Notably, some large insurers operating in Canada are not signatories to the Agreement and, as such, it will be of limited assistance in resolving disputes involving these insurers.

Nevertheless, whether applicable or not in any given case, the principles outlined in the document provide a useful analytical framework for any dispute between insurers.

At the very least, the Agreement can serve as a base understanding of the nature of the primary and excess insurer relationship and the rights and remedies each might expect or intend had the parties actually sat down to negotiate a defence handling agreement as between them.

Indeed, the core duties, such as the duty to negotiate prudently in settlement, the duty to investigate all relevant facts, and the duty to share all relevant information, seem quite sensible and are likely what the parties would have agreed to had they turned their minds to the issue.

Equitable Contribution: Allocation of Defence Costs

In the context of disputes regarding the allocation of defence costs, given that there is usually no actual contractual relationship between primary and excess insurers, Canadian courts have applied the principle of **equitable contribution** in order to resolve disputes between insurers.

In *Broadhurst & Ball v American Home Insurance Co.*, the Court of Appeal for Ontario held:

> Since these insurers have no agreement between themselves with respect to the defence, their respective obligations cannot be a matter of contract. Nonetheless, their **obligations** should be subject to and **governed by principles of equity** and good conscience, which, in my opinion, dictate that the **costs of litigation should be equitably distributed** between them.[2] [*emphasis added*]

This principle was followed by the Ontario Court of Appeal in *Alie v Bertrand & Frère Construction Co.*[3] wherein the Court held that, where there is a concurrent duty to defend between primary and excess insurers, and the excess insurer is put at risk by the claim, then the excess insurer should contribute to defence costs.[4] The Court stated that the nature of the contribution will depend on the equities of each case.[5]

In other decisions, the Court has made clear that, where there is no concurrent duty, such as when the primary limits have been exhausted,[6] or when the excess policy expressly excludes a duty to defend, there may be no liability for contribution to defence costs.

For example, in *ACE INA Insurance v Associates Electric & Gas Services Ltd.*, the primary insurer, ACE INA, sought contribution for defence costs from the excess insurer, AEGIS. The claim arose out of an explosion and fire, following which damages were claimed in excess of $50 million. The limits of the (primary) ACE INA policy, were $1 million and the AEGIS (excess) policy provided for $45 million in coverage.[7]

ACE INA argued that, since AEGIS would bear the majority of liability, it should share in defence costs. AEGIS argued that, as stipulated in the AEGIS policy, it would only become liable for defence costs once the limits of the primary policy had been exhausted.

The AEGIS policy expressly stated that there was no duty to defend unless defence costs were not covered by other insurance. Specifically, the policy stipulated:

> the COMPANY shall not be liable for expenses as aforesaid when such expenses are included in other valid and collectible insurance[…].

The Court of Appeal held that "in insurance contracts not governed by statute, the obligation of an excess insurer to contribute to defence costs must either flow from a duty to defend or from the express language of the policy."[8]

The Court concluded that, **as the policies question did not insure the same risk, the doctrine of equitable contribution did not apply** and AEGIS was not obligated to contribute to defence costs.

Equitable Subrogation: Duty to Settle Within the Primary Limits

Another principle that has been applied in the context of disputes between insurers is the principle of **equitable subrogation**. This principle is most commonly applied in the context of disputes with respect to settlement within the primary layer of insurance.

Courts in Ontario, British Columbia and Saskatchewan have recognized a duty owed by insurers to their insureds to act in good faith and to use reasonable care in settling a claim where the claim may exceed the policy limits.[9]

However, when an insured obtains excess insurance, and an excess insurer is exposed to liability for indemnification due to a primary insurer's failure to settle reasonably, what, if any, remedy is available to the excess insurer?

In the United States, some courts have adopted the principle of "equitable subrogation" to remedy this situation. Equitable subrogation operates to allow an excess insurer to subrogate the rights of its insured against a primary insurer.[10]

In essence, the principle of equitable subrogation operates such that an insurer can subrogate any right owed to an insured and enforce it as against another insurer.

The Ontario Court of Appeal in *Hampton v. Traders General Insurance Co.* discussed the doctrine of equitable subrogation as follows:

> In such a situation, the American courts have recognized that the insured has a cause of action against the insurer for breach of its duty to settle in good faith, […citation omitted]. Where an insured has purchased excess liability insurance and where the excess liability insurer has paid the amount of the judgment in excess of the primary policy limits, the American courts have applied "equitable subrogation" to allow the excess insurer to stand *in the place of the insured* and pursue a claim against the primary insurer for the breach of its duty *to the insured* to settle in good faith [citations omitted].[11]

The Ontario Court of Appeal also cited a decision by the Minnesota Supreme Court in *Continental Casualty Co. v. Reserve Ins. Co.*, 238 N.W. 2d 862, at 864 (Minn. 1976):

> When there is no excess insurer, the insured becomes his own excess insurer, and his single, primary, insurer owes him a duty of good faith in protecting him from an excess judgment and personal liability. If the insured purchases excess coverage, he in effect substitutes an excess insurer for himself. **It follows that the excess insurer should assume the rights as well as the obligations of the insured in that position**.[12]

The Ontario Court of Appeal implicitly approved of the approach adopted by the Minnesota Supreme Court, however, the principle of equitable subrogation did not apply to the facts of the case at bar and it was therefore not applied.

Notably, the Agreement of Guiding Principles Between Primary and Excess Liability Insurers Respecting Claims, 1996, outlines the duty of an excess insurer to "conduct itself in a manner so as to avoid delay in reaching settlement, and not to cause the primary insurer to incur unreasonable defence costs."

Accordingly, the duty to act reasonably in settlement negotiations is a reciprocal one, both by operation of the Agreement, and presumably at common law.

Although Canadian courts have often conflated the principles of equitable contribution and equitable subrogation,[13] it is the opinion of the authors that these principles should be understood as distinct.

The principle of equitable subrogation allows insurer A who has indemnified the insured for a loss caused by insurer B, to step into the shoes of the insured and subrogate the rights owed to the insured by insurer B.

This framework is useful in resolving disputes regarding improvident settlement, and perhaps others, such as the right to receive notice and the right to be informed of litigation.

However, subrogation is not necessarily a suitable analytical framework for resolving claims for contribution for defence costs. Where there is a concurrent duty to defend on both a primary and excess insurer, the principle of equitable subrogation would operate such that either the excess insurer or primary insurer could subrogate the rights of the insured and, in theory, recover the entirety of defence costs.

In these circumstances, the more appropriate, and equitable result, as recognized by the Court of Appeal for Ontario in *Broadhurst & Ball* and *Alie v Bertrand & Frère Construction*

Co. through their application of the doctrine of equitable contribution, is that each insurer contribute to defence on an equitable basis that is in proportion to their respective indemnity payments.

Equitable contribution therefore, operates independent of any subrogation of the rights of the insured and is based principally on the equities of each case.

It is useful to note that in the automobile insurance context, there are a number of provisions in the *Insurance Act* which speak to the allocation of costs between primary and excess insurers as well as the duty to settle reasonably.[14] These provisions will be discussed at greater length later on in this article.

Tort: A Duty of Care Owed Between Primary and Excess Insurers

The law of negligence has also been applied in the context of disputes between primary and excess insurers. In this regard, some American courts have found there to be an independent duty, similar to the one owed to an insured, owed by a primary insurer to an excess insurer such that an excess insurer may have a direct right of action against the primary insurer.[15]

This approach, despite its firm grounding in the basis of negligence law, has thus far found support in only one reported Canadian decision.

In *Hollinger International Inc. v American Home Assurance Co.*[16] Hollinger's primary insurers entered into a settlement with the plaintiffs in only one of a number of the actions brought against the insured for $50 million dollars, which was the limits of the primary insurer's policy. As a result, the excess insurers were exposed to defence costs as well as any indemnification for liability born out in the other actions brought against the insured.

On the motion for approval of the settlement, the excess insurers argued that the settlement should not be approved on the grounds that they were not involved in the settlement process, that a summary judgment motion should have been brought as there was a reasonable chance of its success, and that there was no explanation as to why $50 million was a reasonable settlement amount.

The Court considered whether there was a reasonable basis for the settlement, taking into account the competing interests of the various constituents. The Court held that the fact that the excess insurers were not directly consulted was reasonable as the settlement did not include exposure to the excess insurers for indemnity.

The Court further found that the primary insurers were reasonable in concluding that there was a risk that a summary judgment motion would not succeed, and that $50 million was not an unreasonable settlement amount in all of the circumstances.[17]

The Court further considered the decision of the California Court of Appeal in *Transit Casualty Co. v. Spink Corp.*[18] in which the Court held that:

> The parties [being insured, primary and excess insurers] occupy a three-way relationship, which regardless of privity gap may engender reciprocal duties of care in the conduct of settlement negotiations; when a damage claim threatens to exceed the primary coverage, the reasonable foreseeability of impingement on the excess policy creates a three-way duty of care...

The Ontario Superior Court accepted the above statement as a general proposition.[19]

The Court also noted that the *Agreement of Guiding Principles Between Primary and Excess Liability Insurers Respecting Claims* in the Canadian context elaborated upon the good faith principle as between insurers.[20]

The Court further noted that at least two Canadian decisions at the appellate level recognized that the relationship and duties as between primary and excess insurers may extend beyond contract: *Broadhurst & Ball v American Home Insurance Co.,* [*Infra*] and *Aetna Insurance Co. v. Canadian Surety Co.*[21]

In *Aetna*, the Alberta Court of Appeal, in the absence of contract between insurers, held that "duties may flow from a primary insurer to an excess insurer under certain circumstances."[22]

On the facts of the case, the Court found that the primary insurers did not breach the duty of good faith owed to the excess insurers. The Court cited the following factors, among others, in support of this conclusion:

- The excess insurers were aware that settlement discussions were undertaken by the primary insurers.
- The primary insurers proceeded in good faith in the belief that settlement could be achieved without risk to the excess layers.
- The settlement was made in circumstances where, given the number of claims to which they were exposed in multiple jurisdictions, there could be little doubt that the limits of the primary layers would be exhausted.[23]

Given the decision in *Hollinger*, it appears that the sate of Canadian law is such that duties owed between primary and excess insurers include a duty of care based in the law of negligence.

This approach seems sensible, as all elements of a cause of action in negligence could well apply to disputes between primary and excess insures, as outlined below.

1. **Duty of Care**: the court in *Hollinger*, supra, accepted that there is a sufficient relationship of proximity between primary and excess insurers such that a duty of care exists.
2. **Standard of Care**: the likely standard of care will be of a reasonable liability insurer in similar circumstances.
3. **Causation – cause in fact**: if "but for" the actions of the defendant-insurer, the plaintiff-insurer would not have suffered harm, then the causation element will be satisfied.
4. **Remoteness/foreseeability – cause in law**: If the harm complained of was a reasonably foreseeable consequence of the actions of the defendant-insurer, then this element will be satisfied.
5. **Damages**: If the plaintiff-insurer suffered actual financial (and not potential or hypothetical) damages, this element will be satisfied.

A General Duty to Act Reasonably

As such, it appears that there are a number of different approaches, and causes of action, that can be said to govern the relationship between primary and excess carriers and the nature of the rights and remedies that may be invoked as between them, including:

- Equitable subrogation;
- Equitable contribution; and
- A tort based duty of care.

Although the cause of action may be characterized in different ways, all of the approaches share a common theme; the guiding principle at law as it relates to the relationship between primary and excess insurers is one of equity, fairness, and reasonableness. The law recognises that the actions and file handling of a primary insurer can have a direct and adverse impact on an excess insurer.

Similarly, once an excess insurer is put at risk by a claim, they too will likely have a duty to become involved in the adjusting of the claim, to act reasonably, and to contribute towards defence costs.

As such, an excess insurer can likely, through one or more of the mechanisms set out above, hold a primary insurer to account (financially) in terms of the following non-exhaustive list of potential missteps:

- Failure to promptly investigate the liability and damages aspect of a claim as presented against the insured;
- Failure to take proper steps to control and adjust the loss in terms of due diligence, loss control measures, and expert retention;
- Failure to advance defenses reasonably available to the insured including limitation periods or other legal defenses to the claims advanced;
- Failure to contribute to a proportionate share of the defence and the plaintiff's costs of a claim in excess of the primary limits, with the contribution of each in proportion to the indemnity payments made, or to be made, by each insurer;
- Improperly eroding the limits by making *ex gratia* payments for claims not representing viable third party liability claims as against the insured; and
- Failure to take reasonable steps to ensure the claim or claims are settled within the primary limits.

Similarly, a primary insurer should have a remedy against an excess insurer where the excess insurer (assuming it is put at risk by the claim) refused to share relevant information, acted unreasonably in the adjusting of the loss or in the conduct of settlement negotiations, or failed to contribute a proportionate share of defence costs.

Although it is likely that an excess insurer is entitled to receive a copy of the primary insurer's file (and vice versa) and to seek and review the support available for all payments made,[24] the actual level of permissible scrutiny has not been well outlined at law.

It is the authors' view that an excess insurer should not be entitled to engage in an infinite retroactive analysis of all aspects of the primary carrier's file handling and payments. Different insurers may adjust the same claim differently and the law should concern itself with only major file handling issues or errors in judgment.

It is submitted that excess insurers should not be permitted to second guess every decision made by a primary insurer. Only when the primary insurer's conduct falls below the standard of care expected of a reasonable liability insurer in similar circumstances should an excess carrier be entitled to a remedy at law.

Where circumstances warrant, the same standard should apply to the conduct of an excess insurer – to act as a reasonable liability insurer when put at risk by a loss.

Duties Owed Between Primary and Excess Insurers in the Auto Insurance Context

The respective provincial *Insurance Acts* provide yet another source of law which may have implications in the context of disputes between primary and excess insurers, particularly in automobile insurance claims. For example, section 257(4) of the Ontario *Insurance Act* provides:

> Where indemnity is provided to the insured under two or more contracts and one or more of them are excess insurance, **the insurers shall**, **as between themselves, contribute to** the payment of expenses, **costs** and reimbursement for which provision is made in section 245 [costs of investigations, defence costs, costs assessed against the insured etc.] **in accordance** with their **respective liabilities** for **damages awarded against the insured.** [*emphasis added*]

As such, in the automobile context, the *Insurance Act* itself stipulates that primary and excess insurers should contribute proportionately to the costs of defending a claim.

Notably, there is some debate in the law regarding the circumstances to which this provision applies. In one decision, the Court of Appeal held that this provision only applies when a matter has proceeded to judgment, and not necessarily when a matter settles.[25]

However, it is the authors' view that the outcome in that case was driven by its fairly unique and extreme facts and that, otherwise, the provision would and should likely have more widespread application.

There are other *Insurance Act* provisions applicable to an insurer's file handling in the automobile insurance context.[26] If a primary insurer fails to follow the procedures as required by the *Act*, and the failure causes financial harm or prejudice to the excess insurer, it is likely that there are legal remedies available to the excess insurer.

In short, the duty owed by a primary insurer to an excess insurer is all the more robust in the automobile context given the heavily regulated and rather onerous nature of the obligations on third party liability insurers in that milieu.

Conclusion

Although the law in Canada governing disputes between primary and excess insurers is in its infancy, there are remedies available when an insurer's financial interests have been prejudiced by the actions of another insurer.

Whether the remedy arises out of the principle of equitable contribution, equitable subrogation, a duty of care in tort, or by operation of statute, the law recognizes that, where an excess insurer is harmed by the unreasonable actions of a primary insurer, equity and fairness dictates that a remedy be granted.

In such circumstances, the primary insurer should be held accountable to the excess insurer for financial losses caused by the primary insurer's unreasonable conduct.

However, it is not enough that the excess (or other) insurer would have adjusted the claim differently. It is the authors' view that, so long as the primary insurer's actions were reasonable and met the standard of care expected of a reasonable liability insurer in a similar situation, an excess insurer should not be entitled to a remedy.

In this respect, primary insurers should ensure that they promptly investigate a claim, take all proper steps to control a loss, and advance all defenses reasonably available on behalf of an insured.

Similarly, where an excess insurer is put at risk by a claim, they should be required to become involved in the adjusting of the claim and be held to a standard of reasonableness. In particular, an excess insurer should be sure to share all relevant information, to act reasonably in not delaying settlement, and contribute towards defence costs.

As stated at the outset, the law with respect to the rights and remedies as between primary and excess insurers is not well developed in Canada.

In this article, we explored the key authorities on point in the Canadian and American context and looked to draw some overarching themes or principles.

In the end, we conclude that there is clearly a relationship of proximity between primary and excess insurers such that one party knows, or ought to know, that a failure to act reasonably on its part could cause financial loss to the other.

It is the writers' view that where an insurer is put at risk by a loss, the reasonable foreseeable losses that flow from the failure to act as a reasonable liability insurer in similar circumstances should also be recoverable.

It is hoped that this article provides some assistance as it relates to the state of the law in this area, and as it may relate to the development of a general duty as between primary and excess insurer to act reasonably, or to make good on the financial losses that flow from the breach of such a duty.

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[1] *Hollinger International Inc. v American Home Assurance Co.,* [2006] O.J. No. 140, 144 A.C.W.S. (3d) 1098 (Ont. Sup Ct. J.*; Kansa General International Insurance Co., Re*, 2001 CarswellQue 5207, EYB 2001-26900.
[2] *Broadhurst & Ball v American Home Insurance Co.,* (1990) 1 OR 3d 225 at paras 41 and 42 (ON CA).
[3] *Alie v Bertrand & Frère Construction Co.,* [2002] O.J. No. 4697 (ON CA).
[4] *Ibid* at para 174 and 175.
[5] *Ibid* at para 175.

[6] *Boreal Insurance Inc. v Lafarge Canada Inc.*, (2004) 70 O.R. (3d) 502 (Ont. Sup Ct J) at para 45.
[7] *ACE INA Insurance v Associates Electric & Gas Services Ltd.*, 2013 ONCA 685.
[8] *Ibid* at paras 21 & 26.
[9] *Dillion v Guardian Insurance Co*, [1983] ILR 1-1706 (Ont H Ct); *Bullock v Trafalgar Insurance Co. of Canada*, [1996] OJ No 2566 at para 103; *Fredrikson v Insurance Corp. of British Columbia*, [1990] B.C.W.L.D. 991, 20 A.C.W.S. (3d) 421 (BC Sup. Ct.); *Shea v. Manitoba Public Insurance Corp.* [1991] I.L.R. 1-2721, [1991] B.C.W.L.D. 1147 (British Columbia Supreme Court) at para 149; *Wilson v Saskatchewan Government Insurance,* 2010 SKQB 211.
[10] *Valentine v Aetna Insurance Co.*, 564 FR. 2d 292 and 296 (9th Cir 1977).
[11] *Hampton v Traders General Insurance Co.*, [1997] OJ No 400 at para 11..
[12] *Ibid* at paras 10-12 (On CA).
[13] *Broadhurst & Ball v American Home Insurance Co.,* 1 OR 3d 225 at para 42; *American Home Assurance Co. v. Temple Insurance Co.*, [2009] OJ No 249, 174 ACWS (3d) 1157 at para 59.
[14] *Insurance Act*, RSO 1990, c I 8, ss. 257, 258.
[15] *Hartford Accident & Indemnity Co. v Michigan Mutual Insurance Co.,* 6161 NY 2d 569, 463 NE 2d 608 (NY 1984).
[16] *Hollinger International Inc. v American Home Assurance Co.*, [2006] O.J. No. 140, 144 A.C.W.S. (3d) 1098 (Ont. Sup Ct. J.).
[17] *Ibid* at paras 63 to 68.
[18] *Transit Casualty Co. v. Spink Corp.*, 94 Cal. App. 3d 124 (U.S. Cal. Ct. App. 3 Dist. 1979).
[19] *Hollinger International Inc. v American Home Assurance Co.*, [2006] O.J. No. 140, 144 A.C.W.S. (3d) 1098 (Ont. Sup Ct. J.) at para 87.
[20] *Ibid* at para 89.
[21] *Aetna Insurance Co. v. Canadian Surety Co.* (1994), 149 A.R. 321 (Alta. C.A.).
[22] *Ibid* at para 153.
[23] *Hollinger International Inc. v American Home Assurance Co.,* at para 92.
[24] Agreement of Guiding Principles Between Primary and Excess Liability Insurers Respecting Claims, 1996 at Section III.
[25] *ING Insurance Co. of Canada v. Federated Insurance Co. of Canada*, (2005) 138 A.C.W.S. (3d) 1159, 197 O.A.C. 324 (On CA) at para 33.
[26] *Insurance Act*, RSO 1990, c I 8, ss 258, 258.3.