THE LAWYER'S DAILY

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Insurance

Rights, remedies between primary, excess insurers: Equitable subrogation, duty of care

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(May 8, 2020, 11:49 AM EDT) -- 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.

The article is divided into three parts. Part two explores the common law doctrine of equitable subrogation, which may operate to allow an excess insurer to subrogate the rights of its insured against a primary insurer or vice versa. This part also considers the law regarding a duty of care owed between primary and excess insurers in tort.

Equitable subrogation: Duty to settle within 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.

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.

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*. [1997] O.J. No. 400 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]. [Emphasis added.]

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*. [Emphasis added.]

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 (the agreement), 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, 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 v. American Home Insurance Co*., [1990] O.J. No. 2317 and *Alie v. Bertrand & Frère Construction Co*. [2002] O.J. No. 4697 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* that speak to the allocation of costs between primary and excess insurers as well as the duty to settle reasonably. These provisions will be discussed at greater length later on in this article.

Tort: 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 U.S. 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.

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*. [2006] O.J. No. 140, 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, which was the limit of the primary insurer's policy. As a result, the excess insurers were exposed to defence costs as well as any indemnification for liability borne 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.

The court further considered the decision of the California Court of Appeal in *Transit Casualty Co. v. Spink Corp*., 94 Cal. App. 3d 124 (U.S. Cal. Ct. App. 3 Dist. 1979), 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 (see *Hollinger*, paragraph 87).

The court also noted that the agreement in the Canadian context elaborated upon the good faith principle as between insurers.

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*. [1994], A.J. 399.

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

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 (see *Hollinger*, paragraph 87).

Given the decision in *Hollinger*, it appears that the state 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.

This is part two of a three-part series. Part one: Rights, remedies between primary and excess insurers: Introduction, guiding principles.

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