

CITATION: *Zurich Insurance Company Ltd. v. Ison T.H. Auto Sales Inc.*, 2011 ONSC 1870
COURT FILE NO.: CV-10-408030
DATE: 20110325

SUPERIOR COURT OF JUSTICE – ONTARIO

RE: Zurich Insurance Company Ltd. et al., Applicants

AND:

Ison T.H. Auto Sales Inc., Respondent

BEFORE: G.R. Strathy J.

COUNSEL: *Hillel David*, for the Applicants

Theodore Charney, for the Respondent

HEARD: February 28, 2011

REASONS FOR JUDGMENT

[1] This is a dispute between an insurer and its insured concerning the right to control litigation against the third party allegedly responsible for the insured's loss. The portion of the loss covered by the insurance policy has been paid by the insurer. The insured retains an uninsured claim and a claim for its deductible. The insured has commenced an action against the third party asserting its own claim as well as the insurer's claim. The insurer wants to have carriage of the action.

[2] The analysis of this issue requires an examination of the terms of the policy, the principles applicable to subrogation and the governing authorities. I will begin with some brief background.

1. The Facts

[3] On July 20, 2008, an explosion and fire occurred at an apartment building at 2 Second Avenue in Toronto. The insured, an automobile dealer called Toronto Honda, was storing 71 new cars in rented space in the underground parking lot of the building. The cars were damaged and could not be sold as new. Toronto Honda made a claim under its policy and was paid approximately \$1.9 million in October 2008. This represented the factory invoice price of the vehicles, less a deductible of \$10,000. The insurers were subsequently able to recover about \$900,000 in salvage for the cars, so they have a net subrogated claim of about \$1 million.

[4] In addition, Toronto Honda claimed that it had suffered a loss of profits as a result of the damage to the cars – namely, the difference between the manufacturer's price and the price at which the vehicles could be sold to customers. As well, Toronto Honda lost the ability to service

the 71 new automobiles and the opportunity to resell trade-ins on those vehicles. It also claimed a loss of goodwill.

[5] As a result of the fire, a class action was commenced on October 2, 2008, on behalf of residents and owners of property at 2 Secord Avenue. Class counsel in that action were the firms of Falconer Charney and Sutts Strosberg.

[6] Toronto Honda also retained these two firms to represent it and commenced this action on April 21, 2009.

[7] The class action was certified on April 23, 2009. Notice of certification was published in a Toronto paper and was communicated to all residents of 2 Secord Avenue. The opt-out date was August 19, 2009.

[8] Toronto Honda opted out of the class action on July 6, 2009, as it wished to prosecute this action separately.

[9] On July 7, 2009, an order was made directing that this action and the class action be tried together or one after the other. The parties agreed to common production and discoveries in the two actions.

[10] Toronto Honda's insurers took no steps in relation to the class action. They did not opt out and, indeed, probably had no right to opt out as the insured had already done so. Nor did the insurers commence a proceeding of their own.

[11] The insurers had been aware, since June 2009, that Toronto Honda had commenced an action as a result of the fire and that Toronto Honda was including the insurers' subrogated property claim in its action. There were communications between Falconer Charney and the insurers or their adjuster in June, July and October 2009, informing the insurers that the property claim was being included in the action brought by the insured. Falconer Charney was asking for the insurers' file with respect to the property claim so that it could prepare for discoveries.

[12] A letter from Mr. Charney to the adjuster dated October 29, 2009, and marked "URGENT", requested subrogation documents for the upcoming discoveries, which were scheduled to commence on December 4, 2009. This finally provoked a response from the insurers.

[13] In November 2009, the insurers retained the firm of McCague Borlack. That firm asked to be added as counsel of record in the insured's action. That request was denied, as was a request by McCague Borlack to participate in the discoveries. Falconer Charney took the position that they would keep the insurers advised of developments and would consult with them, but that the ultimate control of the litigation would remain in the hands of Toronto Honda.

[14] Six days of discoveries took place in December 2009. There had been extensive productions. There were numerous undertakings and considerable efforts have been made since that time to answer the undertakings. It is likely that there will be follow-up discoveries. Falconer Charney and Sutts Strosberg have engaged and consulted with experts.

[15] This proceeding was commenced by Notice of Application served on August 19, 2010. The insurers seek an order that they are entitled to have carriage and control of this action "with a right of full and meaningful participation in the conduct of the ... action ... and full control by them of the uninsured claim advanced ... [in this action]." Alternatively, they ask for an order that they, through their counsel, are entitled to have "full and meaningful participation" in the conduct of this action and full control of the subrogated claim advanced in the action.

2. The Policy of Insurance

[16] The insurance policy in force at the time of the fire was issued by Zurich Insurance Company Ltd. and Chartis Insurance Company of Canada, each of which subscribed to 50% of the risk. The insured is the Bank of Nova Scotia, which provides floor plan financing for Honda dealers. Toronto Honda is also an insured under the policy. The policy provided coverage for property damage, but not for business losses or consequential losses.

[17] The policy was designed to provide coverage for automobile dealerships and for financial institutions, such as the Bank of Nova Scotia, that finance dealerships. It provided first party coverage on an all-risks basis. For new vehicles, the insurance was based on the factory invoice price, as opposed to the dealer's selling price.

[18] The policy appears to be a manuscript policy, as opposed to a standard form, prepared by Marsh Canada Limited, the insurance broker on behalf of the Bank of Nova Scotia.

[19] The policy contains the following provision, under the heading "Release from Liability and Subrogation Clause":

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.

... [This paragraph waives subrogation against affiliates or subsidiaries of the named insured and against other named insureds and dealers] ...

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.

Any release from liability entered into by the Insured prior to loss hereunder shall not affect this Policy or the right of the Insured to recover hereunder.

[20] I will consider the features of this clause (the "Subrogation Clause") later in these reasons when I consider the plain language of the policy. I will note, however, that this clause serves an important practical purpose for the insurer. By making the insurer's subrogation right available

on making any payment or on assuming liability to make payment, it becomes possible for the insurer to bring suit in the name of the insured, and therefore to interrupt a limitation period, before the insurance claim has been fully adjusted, settled or paid.

[21] I also note that, in this case, there is no evidence of the insured entering into any agreement with the insurer, at the time the indemnity was paid, having to do with recovery and subrogation.

3. The Positions of the Parties

(a) Insurers' Position

[22] The insurers' position on this motion is that the Subrogation Clause, properly interpreted, changes the common law rule and gives the insurer control of any litigation commenced against the third party. Counsel for the insurers submits that this is confirmed by the decision of the Supreme Court of Canada in *Sommersal v. Friedman*, 2002 SCC 59, [2002] 3 S.C.R. 109 ("*Sommersal*"). He submits that the main appellate decision relied upon by Toronto Honda, the decision of the British Columbia Court of Appeal in *Farrell Estates Ltd. v. Canadian Indemnity Co.* (1990), 45 B.C.L.R. (2d) 223, [1990] B.C.J. No. 720, aff'g (1989), 59 D.L.R. (4th) 67, [1989] B.C.J. No. 889 (B.C.S.C.) ("*Farrell Estates*"), was wrongly decided.

(b) Toronto Honda's Position

[23] Toronto Honda says that it is well-settled law that until the insured has been fully indemnified for all its losses, insured and uninsured, it is entitled to control any litigation against the tortfeasor – the insured is, as the expression goes, *dominus litis*. Toronto Honda says that nothing in the Subrogation Clause alters this position. It says that this is established by many decisions of the Ontario courts and is confirmed by *Farrell Estates*. It says that, properly interpreted, *Sommersal* had nothing to do with the issue of carriage or control of the litigation.

[24] The resolution of this issue will require an analysis of both *Farrell Estates* and *Sommersal*, but first it will be helpful to consider some general principles.

4. Framework and Analysis

[25] In *Sommersal*, at para. 45, Iacobucci J., speaking for the majority, set out a methodology for the analysis of the issue before the court. He suggested that the court should consider:

- (a) the plain language of the insurance contract;
- (b) in relation to the terms of that contract:
 - (i) the special principles of interpretation; and
 - (ii) the general principles of law applicable to insurance contracts;
- (c) the views of other courts; and

- (d) particularly in the case of publicly regulated insurance contracts, the wisdom of the policy that will result from the interpretation adopted by the court.

[26] I will adopt a similar analysis, although in slightly different order. I will begin with item b(ii), the general principles of law applicable to insurance contracts, because in my view the Subrogation Clause can best be understood in the context of the common law background.

(a) Principles of Insurance Law

[27] The principle of subrogation is one of the four cornerstones of insurance law. The others are insurable interest, good faith and indemnity. Not all of these principles come into play in this case, but it will be helpful to briefly mention them.

(i) *Insurable Interest*

[28] In order to recover under a policy of property insurance, the insured must have an insurable interest in the subject matter. He or she must be so placed with respect to the property as to have benefited from its existence and prejudiced by its destruction: *Kosmopoulos v. Constitution Insurance Co. of Canada*, [1987] 1 S.C.R. 2, [1987] S.C.J. No. 2. Toronto Honda clearly has an insurable interest.

(ii) *Utmost Good Faith*

[29] A contract of insurance is a contract of the utmost good faith: *Whiten v. Pilot Insurance Co.*, [2002] 1 S.C.R. 595, [2002] S.C.J. No. 19. 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. The insurers in this case say that Toronto Honda breached its duty of good faith by excluding the insurer from meaningful participation in the litigation.

(iii) *Contract of Indemnity*

[30] A policy of insurance is a contract of indemnity. That principle was expressed in the frequently-cited decision of Brett L.J. in *Castellain v. Preston* (1883), 11 Q.B.D. 380 at 386, 52 L.J.Q.B. 366 (C.A.):

The very foundation, in my opinion, of every rule which has been applied to insurance law is this, namely, that the contract of insurance contained in a marine or fire policy is a contract of indemnity, and of indemnity only, and that this contract means that the assured, in case of a loss against which the policy has been made, shall be fully indemnified, but shall never be more than fully indemnified. That is the fundamental principle of insurance, and if ever a proposition is brought forward which is at variance with it, that is to say, which either will prevent the assured from obtaining a full indemnity, or which will give to the assured more than a full indemnity, that proposition must certainly be wrong.

[31] That being said, an 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. I will return to the policy terms shortly.

(iv) *Subrogation*

[32] The real battleground of this application is about the consequences of the principle of subrogation. This principle mandates that, having indemnified the insured, the insurer is subrogated to its rights and is entitled to exercise those rights in the name of the insured. The nature of the right of subrogation was described by Chancellor Boyd in the case of *National Fire Insurance Co. v. McLaren* (1886), 12 O.R. 682 at 687, [1886] O.J. No. 98 at para. 10:

The doctrine of subrogation is a creature of equity not founded on contract, but arising out of the relations of the parties. In causes of insurance where a third party is liable to make good the loss, the right of subrogation depends upon and is regulated by the broad underlying principle of securing full indemnity to the insured, on the one hand, and on the other of holding him accountable as trustee for any advantage he may obtain over and above compensation for his loss. Being an equitable right, it partakes of all the ordinary incidents of such rights, one of which is that in administering relief the Court will regard not so much the form as the substance of the transaction. 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. The next thing is to see that he holds any surplus for the benefit of the insurance company. In the case in hand the plaintiffs are in some sense surties, by way of contrast with the wrongdoers, who are primarily liable, just as the defendant may be in some sense a trustee for the insurers of any such overplus. But it appears to me to be a begging of the question to assert that he is a trustee from the time of payment by the insurers.

[33] In the same case, at para. 13, Chancellor Boyd confirmed the principle that the insurer has no right of subrogation until the insured has been fully indemnified:

It is laid down in *Kyner v. Kyner*, 6 Watts (Penn.) 221, that there can be no such thing as subrogation to the right of a party whose claim is not wholly satisfied. The Court it is said cannot interfere with his security while part of his debt remains unpaid. Many other cases to the like effect are to be found in *Sheldon on Subrogation*, sec. 127. This principle appears to have guided the decision of the Court of Appeal in *Commercial Union Assurance Co. v. Lister*, L.R. 9 Ch. 483. I find it is stated in Mr. Bunyon's book on *Fire*

Insurance, 3rd ed. p. 128, that the right to subrogation does not arise until full payment, satisfaction or indemnity is provided for.

[34] "Fully indemnified" means not only indemnified for all losses covered by the policy, but also indemnified for uninsured losses, such as the insured's deductible, losses in excess of the policy limits, and losses (such as business losses) that are not covered by the policy. This principle has been followed, in the case of non-marine insurance, in numerous Canadian cases: see *Globe & Rutgers Fire Insurance Co. v. Truedell* (1927), 60 O.L.R. 227, [1927] O.J. No. 24 (S.C. (A.D.)), rev'g (1926), 59 O.L.R. 444, [1926] O.J. No. 54 (S.C.); *Ledingham v. Ontario (Hospital Services Commission)*, [1975] 1 S.C.R. 332

[35] At common law, it was well-settled that until the insured was fully indemnified for all losses, the insurer had no rights of subrogation. The law on this issue was summarized by the Supreme Court of Canada in *Somersall* at para. 53:

... it 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: *Pacific Coyle Navigation Co. v. Ruby General Insurance Co.* (1954), 12 W.W.R. (N.S.) 715 (B.C.S.C.); *Ontario Health Insurance Plan v. United States Fidelity and Guaranty Co.* (1989), 68 O.R. (2d) 190 (C.A.); *Confederation Life Insurance Co. v. Causton* (1989), 38 C.C.L.I. 1 (B.C.C.A.). The insurer may not control the process of litigation until this full indemnity has been met: *Globe & Rutgers Fire Insurance Co. v. Truedell* (1927), 60 O.L.R. 227 (S.C., App. Div.). Thus, in equity, Scottish & York would not yet be entitled to assert or pursue a subrogated claim in this case since they have not indemnified the insured fully.

[36] See also *Kellar v. Jackson*, [1962] O.J. No. 78 at para. 4 (H.C.J.) in which this quote from the 4th edition of *MacGillivray on Insurance Law* was referred to:

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. The assured must conduct the litigation with the proper regard for the insurer's interest and will be liable in damages for any misconduct for any abandonment of rights.

[37] In many areas of insurance, the rigours of the common law are frequently softened by contract, by statute, or by both. The requirement that the insurer cannot subrogate until the insured has been fully indemnified can lead to practical concerns where the insured is

disinterested or dilatory in pursuing legal action. The insured has an obligation to pursue the claim against the third party until such time as the insurer is entitled to and in fact does control the claim (see *Sommersal* at para. 54), but the insurer's subrogation rights may be put in jeopardy if the insured fails to do so.

[38] In the case of fire insurance policies, s. 152 of the *Insurance Act*, R.S.O. 1990, c. I.8, a provision that is not dissimilar to the wording of the Subrogation Clause, states:

(1) The insurer, upon making a payment or assuming liability therefor under a contract to which this Part applies, is 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.

(2) 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 proportions in which the loss or damage has been borne by them respectively.

[39] In the case of automobile insurance, the provisions are even more extensive:

278. (1) An insurer who makes any payment or assumes liability therefor under a contract is subrogated to all rights of recovery of the insured against any person and may bring action in the name of the insured to enforce those rights.

(2) Where the net amount recovered whether by action or on settlement is, after deduction of the costs of the recovery, not sufficient to provide complete indemnity for the loss or damage suffered, the amount remaining shall be divided between the insurer and the insured in the proportion in which the loss or damage has been borne by them.

(3) Where the interest of an insured in any recovery is limited to the amount provided under a clause in the contract to which section 261 applies, the insurer shall have control of the action.

(4) Where the interest of an insured in any recovery exceeds that referred to in subsection (3) and the insured and the insurer cannot agree as to,

(a) the solicitors to be instructed to bring the action in the name of the insured;

(b) the conduct and carriage of the action or any matters pertaining thereto;

(c) any offer of settlement or the apportionment thereof, whether action has been commenced or not;

(d) the acceptance of any money paid into court or the apportionment thereof;

(e) the apportionment of costs; or

(f) the launching or prosecution of an appeal,

either party may apply to the Superior Court of Justice for the determination of the matters in question, and the court shall make such order as it considers reasonable having regard to the interests of the insured and the insurer in any recovery in the action or proposed action or in any offer of settlement.

(5) On an application under subsection (4), the only parties entitled to notice and to be heard thereon are the insured and the insurer, and no material or evidence used or taken upon the application is admissible upon the trial of an action brought by or against the insured or the insurer.

(6) A settlement or release given before or after an action is brought does not bar the rights of the insured or the insurer, as the case may be, unless they have concurred therein. [Emphasis added]¹

[40] While the policy in issue is an all-risks policy, as opposed to a fire insurance policy, the Subrogation Clause effectively copies the language of s. 152 of the *Insurance Act*.

[41] The issue is also frequently addressed by contract. I turn to the contractual language used in this case.

(b) The Plain Language of the Contract

[42] I have set out the Subrogation Clause at para. 19, above. There are two operative aspects to this clause;

(a) the insurer is subrogated to the rights of recovery of the insured and may bring action in the name of the insured on making any payment or assuming liability therefor under the policy; and

(b) where there is less than a full recovery of insured and uninsured losses, the amount recovered is pro-rated between insurer and insured.

[43] Both provisions alter the common law. The first permits the insurer to commence an action against the third party 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

¹ The reference to s. 261 refers to co-insurance and deductibles.

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.

[44] As I have noted earlier, the policy contains no express provision about the right of either party to control the litigation. In particular, there is no provision, such as s. 278(3) of the *Insurance Act*, giving the insurer a right of control. The question, therefore, is whether the insurer's entitlement to be "subrogated to all rights of recovery of the Insured" and to "bring action in the name of the Insured" to enforce such rights, carries with it the right to control the litigation.

[45] This takes me to the principles of interpretation of insurance policies and the applicable case law on the issue.

(c) Interpretation of Insurance Contracts

[46] The starting place for the interpretation of an insurance policy is the language of the contract itself, described by Iacobucci J. in *Sommersall* at para. 46 as the "first and most important matter to be examined in interpreting its terms."

[47] It is well-settled that in the interpretation of insurance contracts, any ambiguity in the policy will be construed against the insurer. In *Sommersall* at para. 47, Iacobucci J. stated at para. 47:

The applicable principle of interpretation is that we interpret insurance contracts *contra proferentem*, or in favour of the insured. In *Non-Marine Underwriters, Lloyd's of London v. Scalera*, [2000] 1 S.C.R. 551, 2000 SCC 24, at para. 70, in comments reaffirmed in *Derksen v. 539938 Ontario Ltd.*, [2001] 3 S.C.R. 398, 2001 SCC 72, the Court said :

Since insurance contracts are essentially adhesionary, the standard practice is to construe ambiguities against the insurer. . . . A corollary of this principle is that "coverage provisions should be construed broadly and exclusion clauses narrowly". . . . Therefore one must always be alert to the unequal bargaining power at work in insurance contracts, and interpret such policies accordingly.

[48] The *contra proferentem* principle is a rule of interpretation and not a rule of law. The court should begin by considering the language of the policy and endeavour to give effect to the plain meaning. Only in cases of ambiguity should the *contra proferentem* rule be applied.

[49] One might ask whether, in the case of a manuscript policy prepared by the insured's broker, the rule should be applied at all. By signing the policy, however, the insurers adopt the wording as their own. In my view, the *contra proferentem* rule does not come into play in this

case, since the language of the policy is not ambiguous. The policy simply does not address the issue of which party has control of litigation against the third party.

(d) The Authorities

(i) *Farrell Estates*

[50] In *Farrell Estates*, a fire broke out in the plaintiff's building as a result of the negligence of roofers who were doing repairs. The insurers paid the claim under their policy, but the plaintiff had an uninsured claim. The insurers commenced an action for their subrogated loss. Not realizing that this had taken place, the insured commenced an action for its uninsured damages. The issue before the court was which party had the right to control the litigation.

[51] In particular, the question was whether s. 224 of the *Insurance Act*, R.S.B.C. 1979, c. 200 had changed the common law with respect to subrogation. That section was in substantially the same language as s. 152 of the Ontario *Insurance Act*.

[52] Prowse J., as she then was, of the British Columbia Supreme Court, observed that there was no doubt that s. 224 had effected a change in the common law by providing for a right of subrogation where there had been only partial indemnity of the insured. She noted, however, that certain other provisions of the B.C. *Insurance Act*, dealing with motor vehicle insurance, expressly dealt with circumstances in which the insurer would be given conduct of the action. These appear to be similar to the provisions of s. 278 of the Ontario *Insurance Act*, which I have highlighted above. Justice Prowse noted that in light of these provisions, the absence of a specific provision in s. 224 giving control of the litigation to the insurer suggested that the insurer did not have such a right.

[53] After reviewing the authorities, Prowse J. concluded that s. 224 had not changed the common law position that the insured was *dominus litis* until paid in full. She stated at para. 81:

The Legislature, in enacting s. 224 of the *Insurance Act*, has unquestionably changed the common law with respect to subrogation. In particular, s. 224 has given the insurer the right to commence action in the name of the insured "on making any payment or assuming liability therefor" under a contract of fire insurance. Thus the insurer could, in theory, pay the insured \$10.00 on a one million dollar loss, and the insurer would then be entitled to commence action for "all rights of recovery" to which the insured was entitled. But I am unable to conclude that the insurer's right to commence action under s. 224(1) was intended to abrogate the insured's right to control the litigation, should he choose to do so, until he is fully indemnified. Thus, while I do not agree with the statements in cases such as *Sheridan*, that s. 224(1) did not change the common law, I share the view that express and precise language is required to take away rights which the insured enjoyed at common law. In my view, the insured's right at common law to be *dominus litis* until fully indemnified has not been abrogated by

s. 224. The word "subrogation" in s. 224 cannot be given its common law meaning, since the effect of s. 224 is to change the common law meaning in certain respects. Those changes are, firstly, to permit the insurer to take action without first indemnifying the insured, and, secondly, to allow the insurer to share in the proceeds of recovery without indemnifying the insured. This conclusion is strengthened by reference to sections 271(3) of the *Insurance Act*, and s. 225(3) of the *Insurance (Motor Vehicle) Act*, for the reasons I have already given.

In this case, therefore, I conclude that the insured, who is actively asserting his right to control the proceedings, is *dominus litis*. However, in order to avoid the prejudice referred to in the *Arrow* decision, and to preserve any potential right of recovery against the additional defendant in the action commenced by the insurer, I conclude that the action which should proceed is that commenced by the insurer. I am advised that a limitation period has intervened which would preclude the insured, in the action he commenced, from adding the second defendant. I, therefore, conclude that the insured is *dominus litis* in the action commenced in his name by the insurer, and, as such, he is entitled to instruct his own counsel and carry on accordingly. Obviously he is obliged to protect the interests of the insurer in proceeding with his litigation. His counsel is fully aware of that fact and has stated his intention to do so, and to cooperate with counsel for the defendants.

[54] The British Columbia Court of Appeal dismissed an appeal from the decision of Prowse J., and held that s. 224 of the British Columbia *Insurance Act* did not alter the common law position — at para. 228:

So, it is, in my opinion, the sounder view, as well as the better view under the wording to conclude that the common law position as to entitlement to control of the action for recovery remains unchanged by s. 224. 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 result is that if the insurance contract provides for a deductible then the insured rather than the insurer will control the litigation. I suppose the insurer could gain control by waiving the deductible, if that seemed worthwhile.

[55] The Court of Appeal observed that there were provisions in the contract of insurance that were in substantially the same terms as s. 224 and held that they should be given the same interpretation. Lambert J.A., who delivered the judgment of the Court of Appeal, stated, at 229:

In my opinion, where statutory language is tracked in the insurance contract it should be given the same meaning in the contract as in

the statute unless there is something which compels a different meaning. I do not think in this case that the parties could have intended otherwise. I would reject this argument.

[56] I respectfully agree with this observation as concerns the interpretation of the language of the contract in the case before me. It appears to "track" the statutory language of s. 152 of the *Insurance Act* and should be given a similar interpretation. I recognize that the policy in this case is an all-risks policy as opposed to a fire policy, but it appears to have adopted the language of s. 152.

[57] I also respectfully adopt the conclusion of Prowse J. and of the British Columbia Court of Appeal that the omission in s. 152 of language similar to what appears in s. 288(3) of the Ontario *Insurance Act* suggests that the legislature did not intend the insurer to have control of the litigation in the case of fire insurance, unless the insured had been fully indemnified.

[58] The question then, is whether the common law has been changed as a result of *Sommersal*. I turn now to that decision.

(ii) *Sommersal*

[59] In *Sommersal*, the insureds had been in an automobile accident with a motorist who was underinsured. They sued that motorist and entered into a settlement agreement, referred to as a "limits agreement" whereby they undertook not to proceed against that party for any amount in excess of the insurance limits. The insureds also had their own insurance policy, which contained a "Family Protection Endorsement", providing insurance for damages caused by underinsured motorists. The policy gave coverage if the insured was "legally entitled to recover" from the uninsured motorist. The insureds made a claim under their policy and when the insurer refused to pay, they commenced an action.

[60] The majority of the Supreme Court of Canada, Binnie J. dissenting, held that the plaintiffs had not breached the insurance contract and that the limits agreement was not a violation of their obligations to the insurer. The insurer had, at that time, no subrogation rights, since the insured had not been fully indemnified. No subrogation rights had therefore been impaired. The words "legally entitled to recover" had to be read as being the rights that existed at the time of the motor vehicle accident.

[61] The majority of the Supreme Court, having concluded that the language of the policy did not preclude the limits agreement, dealt with the insurer's arguments that the limits agreement interfered with the insurer's rights of subrogation and was a breach of the insurance contract. To this extent, the observations are *obiter*, although it is clear that Iacobucci J. (and Binnie J., who dissented on this issue) regarded it as an important point of principle.

[62] After discussing the appropriate analytical approach and reviewing the applicable principles of insurance law, Iacobucci J. discussed the substantive law of subrogation, and noted the following principles, at paras. 50 and 53-54:

First, it 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: see *Birds' Modern Insurance Law* (5th ed. 2001), at pp. 289-90; R. H. Jerry, *Understanding Insurance Law* (2nd ed. 1996), at p. 602. The doctrine of subrogation operates to ensure that the insured received only a just indemnity and does not profit from the insurance.

Second, it 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: *Pacific Coyle Navigation Co. v. Ruby General Insurance Co.* (1954), 12 W.W.R. (N.S.) 715 (B.C.S.C.); *Ontario Health Insurance Plan v. United States Fidelity and Guaranty Co.* (1989), 68 O.R. (2d) 190 (C.A.); *Confederation Life Insurance Co. v. Causton* (1989), 38 C.C.I.I. 1 (B.C.C.A.). The insurer may not control the process of litigation until this full indemnity has been met: *Globe & Rutgers Fire Insurance Co. v. Truedell* (1927), 60 O.L.R. 227 (S.C., App. Div.). Thus, in equity, Scottish & York would not yet be entitled to assert or pursue a subrogated claim in this case since they have not indemnified the insured fully.

Third, the insured is obliged to pursue any claim it has against a third party, up until such time as the insurer is entitled to and does assert control of the claim, in good faith. . .

[63] He 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. The clause in question is similar to the clause at issue in the case before me. It provided:

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).

[64] Iacobucci J. then made the following observations about this clause, which are particularly relied upon by Mr. David on behalf of the insurers in this case, at paras. 57-59:

Clause 9 of this contract provides that, upon the making of a claim by the insured under the SEF 44 coverage, the insurer (a) "is subrogated" to the insured's rights, and (b) "may maintain" an action in that person's name. This clause sets out, in the first place, the relationship between the insurer's rights and the claimant's right as identical upon the making of a claim. In the second place, it

permits the insurer to maintain whatever action exists at law as a result of this identity of rights between insurer and insured. What it does not appear to do is impose any obligation upon the insured to himself maintain or preserve the viability of that action. In fact, nowhere in clause 9 is there language that could reasonably appear to impose any obligation upon the insured at all. The subject of the entire clause is the insurer.

Having noted that, this clause clearly means to avoid part of the common law *status quo* and its embodiment, in the present context, in s. 278(1) of the *Insurance Act*. By making the subrogation right of the insurer contingent upon the making of a claim, the requirement of indemnity is clearly meant to be waived. The insurer need not wait until it has agreed to cover the insured's damages before asserting its subrogation rights and directing an action in the name of the insured. It may begin as soon as the insured makes the claim.

At the same time, it 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. The insurer "may maintain" an action in the insured's name. Thus, if the insured were to bring an action, even while the insurer is processing the claim, and recover successfully, the insurer would not be able to claim any interference with its subrogation rights. The situation is no different in respect of reaching a settlement such as the Limits Agreement. So long as the insured acts in the good faith equity requires of him, the insurer cannot complain of the insured's own diligence in speedily and successfully resolving the underlying dispute. [Emphasis in original.]

[65] Iacobucci J. found that neither this clause, nor an assignment clause, provided a basis for arguing that the limits agreement was a breach of any contractual right of the insurer.

[66] In my respectful view, there is nothing in the reasons of Iacobucci J., or for that matter in the dissent of Binnie J., 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 third party for recovery of both insured and uninsured claims. The question was simply not at issue.

[67] 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 would have said so.

(iii) *Other Cases*

[68] The weight of authority supports the conclusion, expressed in *Farrell Estates*, that the insured is *dominus litis* until fully indemnified: *Kellar v. Jackson*, above; *Wellington Insurance Co. v. Beaudoin* (1992), 11 C.C.L.I. (2d) 129, [1992] O.J. No. 938 (Gen Div.); *Provencher et al. v. Temelini, et al.* (1982), 35 O.R. (2d) 645 (H.C.J.); *Cleveland v. Yukish*, [1965] 2 O.R. 497, [1965] O.J. No. 1001 (Co. Ct.); *Mayer v. 1314312 Ontario Inc.* (2002), 58 O.R. (3d) 226, [2002] O.J. No. 457 (S.C.J.); *Portuguese Canadian (Toronto) Credit Union Ltd. v. Cimis General Insurance Co.* (2006), 41 C.C.L.I. (4th) 124, [2006] O.J. No. 3488 (S.C.J.).

5. **Application to this Case**

[69] Having considered the foregoing principles and authorities, I come to the following conclusions.

[70] *First*, the case law in Ontario, as well as the decision of the British Columbia Court of Appeal in *Farrell Estates*, confirms that the insured is in control of the litigation, or *dominus litis*, until it has been fully indemnified for its insured and uninsured losses.

[71] *Second*, there is nothing in the plain language of the Subrogation Clause to alter the insured's right to control the litigation until such time as it has been fully indemnified. The Subrogation Clause is simply silent on the issue.

[72] *Third*, there is no reason to imply a provision giving the insurer the right of control in order to give business efficacy to the contract. Nor does an entitlement to control the litigation follow by necessary implication from the insurers' right to be subrogated to the rights of the insured and to bring action in the name of the insured. In this regard, I agree with the observation of Melvin J. of the British Columbia Supreme Court in *Affiliated FM Insurance Co. v. Quintette Coal Ltd.* (1995), 33 C.C.L.I. (2d) 187, [1995] B.C.J. No. 2312 (B.C.S.C.) at para. 15:

an insurer cannot be subrogated to rights which have no connection with the subject-matter of insurance; see *MacGillivray & Parkington on Insurance Law*, 11th ed., para. 1158. I note, in this respect, that Lord Justice Brett in *Castellain v. Preston*, *supra*, as quoted in *Confederation Life Co. Ltd. v. Causton*, *supra*, refers to the right of subrogation to recovery for the loss "against which the assured is insured". See also Ivamy, *General Principles of Insurance Law*, 6th ed., p. 501:

The effect of payment is to subrogate the insurers to the rights of the assured in respect of the subject-matter [of the policy].

[73] The right to be "subrogated to the rights of the insured" means that the insurer is entitled to stand in the shoes of the insured for the purpose of asserting the insured's legal rights against the third party. It does not mean that the insurer is entitled to assert claims of the insured in which it has no interest.

[74] *Fourth*, the effect of the Subrogation Clause, including the right of the insurer to share proportionately in recoveries, coupled with the duty of good faith, will require the insured, although in control of the litigation, to consider the insurer's interests, to keep the insurer informed concerning the status of the litigation and concerning major issues in the litigation, and to consult with the insurer with respect to the prosecution of the litigation.

[75] *Fifth*, for the reasons below, it is not necessary for me to consider whether the court has a residual discretion, in appropriate circumstances, to give the insurer control of the litigation, even where there is no express contractual or statutory provision.

[76] Counsel for the insurers submits that if I have discretion as to which party has carriage, it should be given to the insurers who have a larger (\$1 million) "hard" claim for property damage as opposed to Toronto Honda's smaller (\$700,000) "soft" claim for business losses. There is no evidence before me to show that Toronto Honda's business loss claim is any less recoverable than the property claim.

[77] There are, as well, other factors, including:

- the insured has been diligent in pursuing claims on behalf of itself and the insurers – this action was commenced almost two years ago and is well advanced;
- the insurers delayed for over 15 months after the fire before opening up discussions about subrogation and these were prompted by the initiative of counsel for the insured;
- this application was not commenced until August 4, 2010, more than two years after the fire;
- a great deal of time and effort has already been expended by Toronto Honda, and its counsel, in pursuing the claim;
- Toronto Honda, and the insurers, will benefit from the fact that Falconer Charney and Suttis Strosberg act as class counsel and have control of that litigation as well, resulting in cost-saving and other synergies; and
- there is no suggestion that the insurers' position has been or will be prejudiced in any way by leaving carriage with Falconer Charney and Suttis Strosberg, who are unquestionably qualified to act as counsel.

[78] 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.

[79] *Sixth*, as this is not a regulated contract, the policy considerations referred to by Iacobucci J. in *Sommersal* are not particularly pertinent. I do note, however, that in *Portuguese Canadian (Toronto) Credit Union Ltd. v. Cumis General Insurance Co.*, above, Perell J. observed that there are sound policy reasons for the principle that the insured is in charge of the litigation – at para. 45:

It seems to me that the underlying principle to this rule that makes the plaintiff *dominus litis* when there is competing claims against a third party is salutary for at least three reasons. First, until fully indemnified, it seems just and fair that the insured should be able to control his or her claims. Second, the rule protects a third party who would otherwise be subjected to the same claim being brought by the insured and also being brought by the insurer in the name of the insured. Third, the rule avoids the evil of a multiplicity of proceedings.

[80] *Seventh*, it would be a simple matter for the insurers to amend the Subrogation Clause to alter the common law position and to give carriage to the insurers, if they wished to do so. This very point was made nearly 50 years ago by Schatz J. in *Kellar v. Jackson*, above, at para. 5. I suspect that, at least in the case of sophisticated and powerful insureds such as Bank of Nova Scotia, there might be resistance to such a provision. Nevertheless, the choice belongs to the underwriters and if their pens are not prepared to write such a clause into the policy, they should not ask the court to do so.

[81] There is, of course, another commonly employed alternative. In the case of large losses such as this, it is prudent and common for the insurers and the insured to discuss subrogation at the time the insurance claim is paid, and to agree on such matters as legal counsel, sharing of costs, and procedures for the resolution of any disagreements. If the insurers have failed to take these simple and basic steps, they can hardly complain if their insured insists on its common law rights.

Disposition

[82] For these reasons, the application is dismissed. I see no reason to disturb the current arrangement. Toronto Honda will remain in control of the litigation and Falconer Charney and Sutts Strosberg will remain as counsel. 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.



G.R. Strathy J.

Date: March 25, 2011.

CITATION: *Zurich Insurance Company Ltd. v. Ison T.H. Auto Sales Inc.*, 2011 ONSC 1870
COURT FILE NO.: CV-10-408030
DATE: 20110325

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:

Zurich Insurance Company Ltd. et al

Applicants

- and -

Ison T.H. Auto Sales Inc.

Respondent

REASONS FOR JUDGMENT

G. R. Strathy J.

Released: March 25, 2011