SUBROGATING DISABILITY INSURERS AND PERSONAL INJURY CLAIMS: DOUBLE-RECOVERY REDUX[1]

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INTRODUCTION

[1] This presentation started out as an attempt to analyse the impact and application of s.113A of the *Insurance Act*. That section was introduced in the fall of 2003 as part of the "tort reform" instituted by a minority government in reaction to a perceived insurance crisis in the province.

[2] Section 113A provides that in an action for loss or damage arising from the use or operation of a motor vehicle "the damages to which a plaintiff is entitled for income loss and loss of earning capacity shall be reduced by all payments in respect of the incident that the plaintiff has received or that were available before the trial of the action for income loss or loss of earning capacity under the laws of any jurisdiction or under an income-continuation benefit plan if ... the provider of the benefit retains no right of subrogation."

[3] The original version of what was to become section 113A was introduced as section 12 of Bill No. 1 of the 1st Session of the 59th General Assembly of the Nova Scotia Legislature in the fall of 2003. It received its first reading on September 26, 2003. The wording of s.113A was substantially the same as its current incarnation, save for important difference: it did not contain a reference to subrogation. Bill No. 1 received its third reading on October 27th, 2003 and Royal Assent on October 30th. By this time

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s.12 (that is, s.113A) had been re-formatted, and the significant proviso–that the deductions were applied only if "the provider of the benefit retains no right of subrogation"–had been added.

[4] The oddity of a clause affecting the rights of people injured in motor vehicle accidents appearing in a piece of legislation dealing with insurance is perhaps explained by the genesis of Bill No. 1. As many of you will recall, Bill No. 1 grew out of what was perceived to be a crisis in the insurance industry. Insurers were requesting changes to the tort law surrounding motor vehicle accidents as a *quid pro quo* for keeping premiums low (or at least not increasing them as much), and the government of the day complied. In doing so it may not have devoted as much time as it could have to evaluating the nuances of the requested changes. And in my view this lack of careful review may account for some of the problems underlying the interpretation of the meaning, scope and application of s.113A.

[5] Section 113A raises two types of interpretive questions:

a. what payments does it catch?

b. what constitutes a "right of subrogation."

[6] The answer to the first question will determine the *prima facie* scope of s.113A. The answer to the second will determine whether a payment otherwise caught by s.113A is excepted because there is a right of subrogation. But, as we shall see, the scope of subrogation in fact extends beyond s.113A to reach payments that are not subject to s.113A.

[7] The answers to these questions are of interest to the following players in a motor vehicle action:

a. the defendant, whose interest lies in maximizing the amount of deductions from his or her liability to pay damages to the plaintiff and thereby minimizing the amount that has to be paid by way of a settlement or judgment;

b. the benefit provider, whose interest lies in maximizing its recovery from the plaintiff insured's settlement or judgment and thereby minimizing its obligation to pay benefits to the plaintiff insured; and

c. the plaintiff, whose interest lies in maximizing the amount of the settlement/judgment he or she receives from the defendant while at the same time minimizing the amount that he or she may have to repay to the benefit provider out of that settlement or judgment.

[8] My initial intent was to deal with the meaning and scope of the term "subrogation" in s.113A. However, as I struggled with the question of the scope, ambit and meaning of the word "subrogation" in s.113A it became apparent to me that there were now two overlapping areas of application for the concept of subrogation:

a. its application within the confines of s.113A, and

b. its application outside the confines of s.113A.

[9] What follows is my attempt to provide some guideposts if not a complete roadmap.

A: What Payments Fall Within Section 113A?

[10] For ease of reference I set out the salient parts of s.113A below:

> "In an action for loss or damage from bodily injury ... arising ... from the use or operation of an automobile, the damages to which a plaintiff is entitled for income loss and loss of earning capacity shall be reduced by all payments in respect of the incident that the plaintiff has received or that were available before the trial of the action for income loss or loss of earning capacity under the laws of any jurisdiction or under an income-continuation benefit plan if, under the law or the plan, the provider of the benefit retains no right of subrogation."

[11] If we break s.113A into its component parts, we can see that it applies to

a. all payments in respect of the incident that the plaintiff

   i. has received

   ii. or that were available before the trial of the action

b. for

   i. income loss

   ii. or loss of earning capacity

c. ***unless*** the provider of those payments retains a right of subrogation.

[12] Setting the issue of subrogation to one side for the moment, the first question that arises is this: what disability ("LTD") payments in respect of lost income fall within the scope of s.113A?

[13] Section 113A speaks of payments for both "income loss" and "loss of earning capacity." However, "loss of earning capacity" is a term traditionally understood to refer to an element of *general* damages paid in respect of damage to a *capital* asset–that is, damage to the ability to earn income in the future. It relates in other words to the possibility of ***future*** income loss. But no LTD insurer pays benefits for ***future*** loss–it only pays benefits in respect of losses that have already occurred as of the date of payment. LTD benefits are retrospective, not prospective, in nature.

[14] That being the case it would appear that the only payments which in practice are subject to s.113A are payments for "income loss" received by the plaintiff prior to the date of trial (or settlement) In other words, only LTD payments that predate the trial (or, *semble*, the settlement) fall within the ambit of s.113A.

[15] The reference to payments that "were available before the trial of the action" does not in my view change this conclusion. Payments that "were available" must refer to payments that the plaintiff ***could*** have applied for (and would have received had he or she done so) but for some reason did not.[2]

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[2] It is doubtful that "were available" could be stretched to include payments from an LTD insurer which had ***denied*** benefits to the plaintiff. By analogy to long-standing law respecting similar provisions that dealt with Section B or WCB benefits, a court would probably conclude that LTD benefits which had been denied the plaintiff were

[16] We conclude this initial analysis then with the following observation. At trial or, by analogy, at settlement a plaintiff will have to accept that pursuant to s.113A a defendant is entitled to deduct from its liability to pay:

a. all LTD benefits paid to the date of settlement or trial, and

b. all LTD benefits that *would* have been paid to the date of settlement or trial *if* the plaintiff had asked for them.

[17] There is one important caveat, which flows from s.113A. The deductions mandated by s.113A apply *only* if the payor retains no right of subrogation.

[18] So, having established what payments s.113A might apply to counsel will have to address the second major question: does the LTD payor have a right of subrogation?

[19] To answer that question counsel will have to address two different situations:

a. the common law of subrogation (that is, the law that applies absent any statutory or contractual provision attached to the payments in question), and

b. the interpretation of any statutory or contractual wording dealing with the payor's right to seek reimbursement of some or all of its payments in the event that the plaintiff/insured recovers damages by

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not "available" to him or her: see, by analogy, the following .....

> way of judgment or settlement from the third party who caused the loss in the first place.

[20] An understanding of both situations is important. First, it will help determine whether or not the past LTD payments can be deducted from the damage award or settlement. Second, because the law of subrogation ***outside of*** s.113A ***may*** apply so as to permit an LTD insurer to seek reimbursement not only of *past* LTD payments but also of that part of any judgment or settlement that relates to future income loss.

B: What Is A Right of Subrogation?

[21] The deductions mandated by s.113A apply *only* if the payor retains no right of subrogation. That leads us to the second question: in any given case does a "right of subrogation" exist and, if so, to what does it extend and to what degree?

[22] The determination of whether a right of subrogation exists is complicated by a number of things.

[23] First, the plaintiff's claim may be problematic to some degree. There may be issues of liability or contributory negligence, as well as issues of causation and mitigation. These, together with the cost and time of litigation, may force a plaintiff to compromise his or her claim–but fearful that if he or she does they stand exposed to a claim by the benefit provider for full reimbursement regardless of the discount.

[24] Second, the three parties are rarely in the same room when settlement discussions between the plaintiff and defendant take place. The plaintiff is uncertain as to amount and extent of the benefit provider's subrogation claim. He or she is hence reluctant to commit to a settlement without the LTD carrier's agreement,

which in turn may not be forthcoming unless the plaintiff agrees to the full subrogation demand. In the days before the enactment of s.113A defendants could ignore the issue to some degree. They were dealing with the "full" claim and did not have a direct interest in the issue of subrogation. With the enactment of s.113A they are perforce drawn more fully into the debate between the plaintiff and his or her LTD carrier. Defendants now too have an interest in knowing what the answer is.

[25] Third, the case law in this area abounds with statements of general principle. These principles can be easily applied in cases involving single, discrete losses (for e.g., a building destroyed by a fire). Their application becomes almost impossibly complicated when dealing with cases involving personal injuries that combine disparate damage claims and losses that comprise not only definite past losses but also future *possible* losses.

[26] This presentation is an attempt to provide the three players with a road map. As you will see, definitive answers cannot be given. Each case falls to be determined by both the nature of the LTD contract and the facts.

PART I: THE PRINCIPLE OF SUBROGATION AT COMMON LAW (THAT IS, ABSENT CONTRACT OR STATUTE WORDING)

[27] One of the difficulties in this area is the tendency to use the phrase "right of subrogation" to refer to two related but distinct principles.

[28] The first concerns that of subrogation proper. By that is meant the right of an insurer, upon full payment of the insured's complete loss, to sue in the name of the insured to recover such loss as damages from a third party who caused the loss.

[29] The second concerns the equitable rights or interests of an insurer who has made a payment in respect of a loss insured under a contract of indemnity. The "ordinary meaning" of subrogation in this sense was described by Boyd, C in *National Fire Insurance v. McLaren*[3] as follows:

> "The doctrine of subrogation is a creature of equity not founded on contract, but arising out of the relations of the parties. In cases 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."[4]

[30] In short, the principle is that an insured is entitled to full indemnity with respect to his or her loss, but no more. Where the insured receives more than his or her loss equity steps in and says that the excess must be paid back to the insurer.

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3 (1986) 12 OR 682 at 687.

4 Cited with approval in *Ledingham v. Ontario Hospital Services Commission* [1975] 1 SCR 332, per Judson, J at 337.

[31] There are a few important points to keep always in mind when dealing with the concept of subrogation.

[32] First, it only applies to contracts of indemnity–that is, contracts that insure (indemnify) an insured against an actual (in the sense of quantifiable) loss. While most contracts of insurance are contracts of indemnity,[5] not *all* are. In some cases the insurer agrees to pay a sum of money upon the happening of an event, regardless of whether or not an insured has sustained a quantifiable loss. Life insurance contracts are one such example. So too are accidental dismemberment contracts, where an insured is paid a pre-determined sum for the loss of a particular body part. Because there is no obligation to establish an actual loss on the event there can be no issue of indemnity–and hence no subrogation.[6]

[33] Second, it only applies when the insured has been fully indemnified in respect of his *entire* loss. The loss includes not just the loss itself but the cost of pursuing the third party responsible for the loss.[7]

[34] Third, absent contractual or statute wording to the contrary, an insured is not required to share any recovery from a third party

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[5] And hence the doctrine of subrogation can be "presumed" to apply in most contrats of insurance: *Glynn v. Scottish Union & National Insurance Co. Ltd.* [1963] 2 OR 705 (CA) at 6/10.

[6] *Ibid*. at 5-6/10. Kelly, JA for the court suggested that the principle of non-indemnity in these types of contracts flowed from the "impossibility or the extreme difficulty of the insured ever proving any pecuniary loss:" p.8/10.

[7] *Globe & Rutgers Fire Insurance v. Truedell* [1927] OJ No. 24 (CA) at 7/11; *Confederation Life v. Causton* [1989] BCJ No. 1172 (CA) at 9-10/12.

pro rata with the insurer.[8] Where there is only partial recovery the insured is under no obligation to share that recovery with the insurer on a *pro rata* basis.[9] The insurer's right to subrogate is triggered only once the insured is fully indemnified–and applies only to any surplus after that point.

[35] Fourth, unless and until an insured is fully indemnified he remains in full control of any right of action he has against a third party who caused the loss. He controls the litigation and can settle or compromise his claim for less than its full value.

[36] The only *caveat* to the insured's power to control the litigation is that it must be exercised *bona fide*. The insured in pursuing his claim is required to keep the insurer's subrogated interest in mind and not to ignore it arbitrarily or capriciously. An insurer cannot complain of a good faith settlement that, together with the insurance proceeds, nets the insured with less than full indemnity (and hence the insurer nothing). But if the insured acts in *bad faith*, and compromises his claim in such a way as to prejudice unreasonably the insurer's right of subrogation, then the insurer does have a right of action against the insured for "any loss occasioned by them by his lack of good faith, honesty and diligence."[10]

[37] For example, in *Davis v. MacRitchie*[11] the insured's car was destroyed in an accident by another motorist. It was valued at $1,084.00. It was insured for $755.00. He received that amount

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8 *Ibid*.

9 *Globe & Rutgers Fire Insurance v. Truedell* [1927] OJ No. 24 (CA).

10 *Globe & Rutgers*, per Ferguson, JA at p.7/11.

11 [1938] 4 DLR 187 (NSSC).

from the insurer and then, on the same day, settled and released his claim against the other motorist for $265.00. When the insurer discovered the settlement it sued the insured for the loss occasioned to it by the settlement.

[38] The trial judge held first that the insurer's right to subrogate had not arisen since full indemnity had not been paid under the policy. The insured was entitled to settle with the other motorist. However, it had to be done in good faith. Here the judge found that the insured had not acted in good faith. The settlement figure of $265.00 could not be justified on the basis of liability (the other motorist being wholly at fault); and was obviously arrived with the insurance proceeds already in mind. The judge awarded damages of $755.00 to the insurer, being the amount the insurer had paid out to the insured in the first place.

[39] Of course, the insurer would have to establish that the insured's conduct did in fact cause a loss to it. If, for example, an insured who settled for a small amount could establish that he or she would have lost had they gone to trial then the insurer has no loss; the settlement did not prejudice its subrogated interest since it was valueless.[12]

[40] So, applying the principle as discussed above, and by way of example, supposed an insured under a contract of indemnity suffers a loss of property valued at $100,000.00. He is indemnified by his insurer to the extent of $70,000.00. He then sues the third party tortfeasor who caused the loss. He recovers $60,000.00 in damages. His legal costs were $20,000.00.

[41] In this case the insured's total loss stemming from the incident is $120,000.00–$100,000.00 in respect of the damage and

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[12] See, for example, *Traders General Insurance Co. v. Noel* (1956) 8 DLR (2d) 341 (NBCA).

$20,000.00 in legal costs to recover against the tortfeasor. He has received $130,000.00–$70,000.00 from the insurer and $60,000.00 from the tortfeasor. In other words, he has recovered $10,000.00 more than his total loss. If he were allowed to keep that $10,000.00 he would receive a windfall–he would be more than fully indemnified. Equity steps in at that point. It says that since the insured has been more than fully indemnified he must pay the excess (the $10,000.00) to his insurer.

[42] By the same token, if in this example the insured's case against the tortfeasor was less than solid (if liability were in doubt or if there were issues of contributory negligence) and the insured decided to settle for $25,000.00 then his recovery would have been only $95,000.00–$70,000 from the insurer and $25,000 from the settlement. He has not been fully indemnifed and so need not pay anything to the insurer. Nor can the insurer complain about the settlement, provided that it was effected in good faith.

PART II: APPLICATION OF THE PRINCIPLE OF SUBROGATION TO LTD CONTRACTS WHERE THERE IS NO *EXPRESS* WORDING DEALING WITH SUBROGATION OR REIMBURSEMENT

[43] The principle of subrogation arose out of various types of property insurance. As the 20th-century wore on insurers moved into and developed various types of disability insurance. Disability insurance, often provided by way of group policies of insurance, generally provide benefits in the event of loss of income due to sickness or accident. The question then arose: can the principle be applied to cases where loss of *income* rather than loss of property is insured? The fact that the benefits are triggered by an event that causes an inability to work (and hence a loss of income) suggests that the contract is one of indemnity. And, in point of fact, the law has evolved in that direction–albeit with many pitfalls (primarily for insurers) along the way.

[44] The touchstone decision in this area is the decision of decision of Henry, J in *Gibson v. Sun Life Assurance Co. of Canada*.[13]

[45] Sun Life was the insurer under a group disability plan with the federal government. The contract wording was silent with respect to the issue of subrogation. Gibson was an employee who was injured in a motor vehicle accident. Sun Life had paid her benefits until July 1980. It then terminated benefits on the ground that she was no longer totally disabled. In the meantime Ms Gibson had sued the driver of the car responsible for the accident that injured her. She also sued Sun Life for its denial of benefits to her. Sun Life defended on the ground that she was not totally disabled, and also counterclaimed for:

a. recovery of benefits paid to her under the policy in the event she was successful in her personal injury action, and

b. a declaration that it was entitled to withhold future payments under the policy to which she might otherwise be entitled until any settlement or judgment was used up.

[46] Mr Justice Henry heard the personal injury action. He found in the plaintiff's favour, and made the following awards:

a. general damages of $75,000.00;

b. past income to the date of trial (as agreed) of $127,251.31, and

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[13] (1984) 45 OR (2d) 326 (HCJ).

c. future income loss of $80,000.00, calculated on the basis of the present value of five years future income at $25,000.00 a year, reduced by $15,000 for contingencies.[14]

[47] Mr Justice Henry then heard the action against Sun Life. He ruled that the plaintiff *was* totally disabled and was hence entitled to benefits. However, he also determined that the policy was in fact one of "partial indemnity."[15] That being the case Sun Life was entitled:

a. to recover the past benefits it had paid to her, and

b. withhold any future benefits it might otherwise be required to pay her until those benefits equaled the amount awarded to her in the personal injury action "on account of future lost wages."[16]

[48] It is important to keep three points in mind.

[49] First, Ms Gibson had recovered *full* indemnity in respect of her past wage loss claim. She had also recovered *full* indemnity with respect to her future income loss (at least to the extent of five years). Given such an award she in effect had no income loss–she

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[14] See *Gibson v. Watson* [1983] OJ No. 1153 (HCJ).

[15] He did this on the basis that the benefits were calculated on the basis of 70% of the employee's earnings, albeit subject to various income- or employment-related payments from other sources, all of which led him to conclude that the contract's intent was to indemnify the insured against a real loss–that is, loss of income, albeit at a rate less than 100%.

[16] See *Gibson v. Sun Life*, per Henry, J at p.10/11.

had been full indemnified by the tortfeasor and hence was required to pay the benefits she had received back to the insurer. Nor could she claim any benefits from the insurer until the future loss component of her judgment ran out because, again, in effect she had no future loss of income until that point.[17]

[50] Again, because the findings of fact resulted in a judgment that fully indemnified the insured Henry, J did not have to deal with the impact of a finding of *partial* indemnity on the extent and scope of Sun Life's claim. For example, suppose Ms Gibson had been found 50% contributorily negligent. In such a case she would recover only 50% of her past and future loss. What would that mean to Sun Life's claim? Could it still recover *all* of its benefits? Or *any* of its benefits? Or only 50% of its benefits?

[51] Second, the issues rested on *trials* based on *findings of fact*. Hence the decision did not deal with the exercise of an insured's power to compromise a claim in good faith, and how far any such compromise might limit, restrict or avoid Sun Life's claim for reimbursement.

[52] Third, the decision turned on a finding that the contract, properly construed, was a contract of indemnity. In this regard the

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[17] What is not entirely clear is whether the period of future withholding was based on five years (the presumed period of future total disability) or on the total amounts of benefits payable equaling $80,000.00. The latter formulation would result in a withholding period of greater than five years because the benefits were calculated not on full income loss (which was the basis of the PI judgment) but on the basis of 70% of the income loss. However, given the repeated emphasis on the insured's right to be fully indemnified before the insurer could assert a right to subrogation it strikes me that the former was the more likely intent.

fact that the benefit was calculated on the basis of a certain percentage (in this case, 70%) of the employee's salary prior to the accident was not in and of itself conclusive. Mr Justice Henry also took into account the fact that under the policy the benefit otherwise payable was reduced by:

a. 50% of any earnings from any gainful employment in which the employee engaged during the first two years;[18]

b. 100% of any benefits from any other disability income.

[53] In Henry, J's opinion a consideration "of the scheme of this policy *as a whole* leads me irresistably to the conclusion that it is intended to provide a form of income replacement, limited to 70% of the employee's insured earnings. The group policy is therefore a contract of partial indemnity."[19]

[54] What this means is that one cannot automatically assume that as a result of *Gibson v. Sun Life* ***every*** policy of disability insurance is one of indemnity (and hence subject to subrogation). Policies that pay benefits that are calculated only on the basis of a

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[18] The first two years of the benefit was based on the insured being unable to perform *her* occupation, not *any* occupation. Hence employment at some other job during the first two years would not necessarily preclude her from collecting benefits under the Sun Life policy.

[19] *Gibson v. Sun Life,* p.10/11 (emphasis added). If the various deductions had not been included the conclusion could have been that the policy was not one of indemnification because–absent the deductions–the insured could end up with more than his or her actual loss.

percentage of the pre-incident earnings may not be policies of indemnity even though they are tied to a percentage of income.

[55] So, for example, in *Maritime Life Assurance Co. v Mullenix*[20] the court considered two types of indemnity payments: weekly benefits under a short-term disability ("STD") provision and monthly benefits under a long-term disability ("LTD") provision. The latter were based on contract wording virtually identical to *Gibson v. Sun Life* and, not surprisingly, were found to be payments pursuant to a contract of indemnity and hence subject to subrogation.

[56] On the other hand, the weekly benefits were tied to a percentage of the pre-incident income but were not made subject to deductions for CPP, Employment Insurance or other income, though there was a deduction for benefits from any other employment disability plans. In other words, because the STD were paid on the basis of an "own-occupation" disability and because they contemplated an insured receiving income from some other form of employment as long as he was disabled from his *own* occupation the court concluded that the STD weekly benefits were not paid on the basis of an indemnity. Hence the insurer was not entitled to subrogate with respect to the STD weekly indemnity payments.[21]

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[20] [1986] NSJ No. 479 (TD).

[21] To similar effect see the decision in *London Life Insurance Co. v. Raitsinis* (1990) 72 OR (2d) 278 (OC(GD)) where the court held that the STD benefits were not paid as an indemnity (and hence were not subject to subrogation) because "there were too many circumstances under which the insured could make double recovery:" per Granger, J in *London Life Insurance Co. v. Forget* [1991] OJ No. 856 (OC(GD)) at p.9/11. By way of contrast, see the *Forget* decision where the court concluded,

Global Settlements of Plaintiff's Claims Where There Was An LTD Insurer Asserting a Subrogated Interest

[57] As noted above, the decision in *Gibson v. Sun Life* sprang from a judgment that resulted in a full recovery by the plaintiff of all her income loss, both past and future. It did not deal with a settlement for an amount *less than* the plaintiff's full loss, particularly where the settlement was expressed as a global figure.

[58] One early line of authority appeared to take the view that in cases of global settlements for discounted amounts it was too difficult to separate the income component of the settlement from that attributable to general damages or costs. As noted by Rogers, J in *Mullinex*[22] in such settlements "any amount attributed to loss of income would become buried and unidentifiable in any event and be incapable of attracting subrogation rights." Since the right of subrogation did not arise until the insured had been *fully* indemnified he or she could not be compelled to share an lesser recovery with the insurer on a *pro rata* basis.

[59] Moreover, and as noted by Freeman, JA in *Tucker*, it would be a "daunting" task to try to separate the income component from the non-income component of a global settlement. It was a task that the court was reluctant to undertake given that the insurer could have avoided it through the use of the appropriate language in the policy:

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based on the wording of the policy, that *both* the STD *and* the LTD benefits were paid as an indemnity and hence *both* were subject to subrogation.

22 Supra, fn.5 at p.130.

> "When he [the insured] has not been fully indemnified by the insurer, and negotiates a global settlement in which the lost income factor, if any, is not specified, the difficulties become daunting. That is the present situation. It could have been averted if the insurer had provided in the policy for any rights of compensation or subrogation rights it might require, and the insured had agreed to them. The policy dealt with other predictable contingencies; it must be assumed that its silence respecting third party claims was intentional."[23]

[60] There were two "problems" with this line of authority insofar as the issue of global settlements is concerned.

[61] First, it placed too little emphasis on the insured's good faith duty to the insurer. How could an insured who buried the income component of a settlement in a global number be said to have discharged his or her duty to the insurer? After all, the insured as plaintiff would have *some* idea of what the income component was, even if only on an approximate basis. And so long as the income component could be reasonably teased out of the global settlement why shouldn't *that* amount be available, at least for consideration, by way of subrogation?

[62] And in fact, as the law has developed in this area, it has become clear that assuming a benefit has been paid under a contract of indemnity the resulting subrogated interest of the insurer cannot be defeated by a global settlement. In such cases all the insurer has to do is prove that a settlement took place. The onus then shifts to the insured to explain or account for that part of the

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[23] *Tucker*, supra, fn.5 at p.427.

global figure that related to income loss (and hence might be available for subrogation).[24]

[63] Second, and in any event, the issue could be addressed by clear contract language to the effect that the insurer was subrogated to *all* of the settlement amount, regardless of whether its individual components were broken out or collapsed into one global figure. And in fact, that is what insurers have tried to do.

PART III: ASSERTIONS OF SUBROGATION RIGHTS BY WAY OF EXPRESS WORDINGS, STATUTORY OR CONTRACTUAL

[64] We have so far been dealing with the right of subrogation absent express words in the contract dealing with the right. The courts have noted a number of times however that rights of subrogation (or, as it is sometimes called, "reimbursement") can be created through the use of appropriate language in the insurance contract. And insurers appear increasingly to have taken the courts up on their suggestion and to have created wordings designed:

a. to require the insured to sign or agree to a separate subrogation or indemnification "agreement" or "acknowledgment" as a condition of receiving any benefits;

b. to create an express right of subrogation in the plan itself;

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[24] See *NS Long Term Disability Plan Trust Fund v. McNally* [1999] NSJ No. 367 (CA) at paras.53, 56; and *Ryan v. Sun Life Assurance Co. of Canada* [2003] NSJ No. 480 (TD) at para.52; appeal dismissed [2005] NSJ No. 24 (CA).

c. to include wording that provides not only an express claim of subrogation or indemnity, but also the right to assert that claim against *all* parts of the insured's settlement or judgment (not just its income component); and

d. include wording that purports to deem any settlement (whether discounted or not) as an admission by the insured that the settlement represents total recovery of their full loss.

[65] As we shall see, these efforts have met with varying degrees of success.

Contract Interpretation Principles

[66] When dealing with express subrogation or reimbursement provisions in an LTD contract one should bear in mind the following observations:

a. the "interpretation of the contract clauses should always be conducted within the matrix of all the relevant facts;"[25] and

b. "slightly different wording can have marked consequences."[26]

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[25] *Kobzey v. Sun Life of Canada* [2001] BCJ No. 1840 (CA), per Donald, JA at para.14.

[26] *Melanson v. Co-Operators General Insurance Co.* [1996] NBJ No. 381 (QB), per Turnbull, J at para.12.

[67] It is likely too that a court in construing the meaning, scope and intent of any particular subrogation or reimbursement wording will apply the following principles of interpretation:

a. the principle that coverage provisions should be construed broadly and exclusion clauses narrowly;

b. the contra proferentum rule;

c. the interpretation should give effect to the parties' reasonable expectations, at least where there is an ambiguity;[27]

d. the court should "search for an interpretation which, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time of entry into the contract;"[28] and

e. "literal meaning should not be applied where to do so would bring about an unrealistic result or a result that would not be contemplated in the commercial atmosphere in which the insurance was contracted."[29]

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27 See, in general, *Reid Crowther & Partners Ltd v. Simcoe & Erie General Insurance Co.* [1993] 1 SCR 252 at 268-69.

28 *Consolidated-Bathurst Export Ltd. v. Mutual Boiler & Machinery Insurance Co.* [1980] 1 SCR 888, per Estey, J at 901.

29 *Ibid*.

A: Separate Subrogation or Indemnification "Agreements" or "Acknowledgments"

[68] Some LTD insurers have plans that lack express rights of subrogation;[30] or they may have such rights but out of an abundance of caution want to make such express rights "crystal clear" to the insured. In either case they will require the insured to sign an agreement or acknowledgment that purports to grant the insurer a right of subrogation.[31]

[69] It is submitted that such acknowledgments or "agreements" are of no force or effect and ought not to be signed by the insured or requested by the insurer.

[70] If the right of subrogation exists it stems from the contract wording. If the right exists then the insurer does not need a separate agreement from its insured to that effect.[32]

[71] On the other hand, if the right does *not* exist, then the insurer has no right to ask for it or to make payment of benefits conditional on the execution of such a document. An "agreement" or "acknowledgment" signed in such a case lacks consideration and so cannot be binding in any event.[33] Moreover, to make payment of

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30 As was the case, for example, in *Gibson v. Sun Life*.

31 See for example the AIG Subrogation Agreement that appears at the back of this paper.

32 There is of course nothing wrong with–and everything to be lauded in–early notice on the part of the insurer of its *position* that it has a subrogated interest. But that is different from insisting that the insured *agree* with that position.

33 *Mutual Life Assurance Co. v. Tucker* [1993] NSJ No. 56 (CA) at p.3/10.

benefits conditional on the execution of such "agreeements" only raises the possibility of a bad faith claim against the LTD insurer. LTD policies are designed to secure peace of mind to the insured. For an LTD insurer to demand something it is not entitled to demand as a condition of paying what it is required to pay does not fit that design.[34] Such conduct risks censure by the court or, at the very least, lack of sympathy on its part when construing the contract as a whole.

B: Inclusion of an Express Right of "Subrogation" in an LTD Contract or Statute

[72] The term "subrogation" will, absent wording to the contrary, generally be taken as implying the "ordinary meaning" of subrogation, being the one set out in Boyd, C's judgment (cited above at para.?).[35] What that means, in other words, is that there will be a tendency to assume that the parties intended subrogation to apply only to that part of a settlement or judgment that can reasonably be attributed to income loss; and only in the event that the insured has been fully indemnified.[36] Nevertheless, the true meaning and scope of any subrogation clause will turn on its place within the entire contract.

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[34] See, for e.g., *Fidler v. Sun Life Assurance Co. of Canada* [2006] 2 SCR 3 at para.56.

[35] *Ledingham v. Ontario Hospital Services Commission* [1975] 1 SCR 332 at p.337.

[36] *Ledingham*, *supra*, where the court held that a statutory right to "subrogation" did not, *without more*, give the benefit payer the right to recover a *pro rata* share of a particular recovery where there had not been full indemnity of the insured.

C: Express Subrogation Rights Against *All* Components of a Settlement or Judgment, Not Just the Lost Income Component

[73] Some insurers create subrogation rights against *all* aspects of an insured's settlement or judgment as against a third party tortfeasor. Such clauses purport to place both general damages and damages in respect of lost income (past and future) into one fund, out of which the insurer is entitled to recover all of its past and future benefits until that fund is exhausted.

[74] The professed reason for such clauses is to prevent insureds from attempting to frustrate the insurer's subrogated interests by entering into global settlements; or to avoid the expense of litigation over what part of a settlement relates to lost income (and hence is notionally available for subrogation) and which relates to non-pecuniary losses (and hence not normally considered as suitable for subrogation).[37]

[75] The initial difficulty with such provisions of course is that on their face they appear harsh as well as over-reaching. An LTD insurer pays benefits in respect of income loss, not in respect of pain and suffering. How is it fair then that the insurer can claim reimbursement of its benefits from that part of the settlement or judgment that relates to pain and suffering? Or, for that matter, how is it fair that an insurer recover all of *its* benefit payments in respect of, say, past income if the insured has only recovered 50% of his or her past loss (because of contributory negligence or failure of mitigation)?

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[37] See the history of one such provision (the wording of which can be found at the back of this paper) in a Sun Life LTD policy as discussed in the chambers decision in *Ryan v. Sun Life*.

[76] Mr Justice Chipman touched on this problem, albeit *obiter*, in *NS Long Term Disability Plan Trust Fund v. McNally*.[38]

[77] At issue in *McNally* was the meaning and scope of certain subrogation provisions of the NS Long Term Disability Plan. The plaintiff employee/insured in *McNally* had been injured in a motor vehicle accident. He made a claim for LTD benefits and also sued the third party driver. He was paid a total of $45,500.00 in disability benefits by the Plan. He settled his claim against the driver for a global amount of $155,000.00, with no breakdown. The Trustees of the Plan sought recovery of *only* the $45,000.00 in past benefits it had paid. The court noted that the global figure could, on the facts before it, be determine to include at least $107,000.00 in income loss, with the balance being made up of general damages and other non-pecuniary amounts.

[78] The Trustees of the Plan rested their claim on s.18 of the Plan which provided as follows:

> 18(1) Where a long-term disability benefit is payable for an injury or illness for which any third party is, or may be, legally liable, the Trustees will be subrogated to ***all*** rights and remedies of the employee against the third party, ***to recover damages*** in respect of the injury or death, and may maintain an action in the name of such employee against any person against whom such action lies, and ***any*** amount recovered by the Trustees shall be applied to
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> (a) payment of the costs actually incurred in respect of the action, and

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[38] [1999] NSJ No. 367 (CA).

(b) reimbursement to the Trustees of any disability benefits paid,

and the balance, if any, shall be paid to the employee whose rights were subrogated.[39]

[79] The wording of section 18(1) was, on least on its face, broad enough to entitle the Trustees to subrogate against the employee's *entire* settlement, not just that part of it which related to income loss. Mr Justice Chipman was of the view that it was not necessary to decide whether or not such wording *in fact* meant what it appeared to say.[40]

[80] In so ruling Chipman, JA acknowledged that it was at least theoretically possible to draft wording that led to such a "harsh" result. However, in such cases the result could also be a conclusion that "the true intent of the parties leads to a construction of the language in s.18 of the Plan that would not permit subrogation respecting recovery that the insured can show does not relate to his income loss."[41]

[81] He added that the justice of such an interpretation

"is particularly plain where, for example, an insured was contributorily negligent and received but a small percentage of his various losses. If, for example, he received only 10% of his total claim fairly assessed, a court should not favour

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[39] Emphasis added.

[40] This is because on the facts of the case the Trustees were seeking recovery of only the past benefits; and the settlement amount could easily be seen to cover that claim without trenching on the injured employee's general damages.

[41] *Ibid*, para.47.

> an interpretation which would require him to pay to the Trustees more than what was recovered for loss of earnings. Such a result would take away some or perhaps even all of the other components of the settlement such as pain and suffering, loss of amenities, disability, special damages and so forth."[42]

[82] It is submitted that the decision in *McNally* is a sign that any court is going to be reluctant to reach a conclusion that permits an LTD insurer to subrogate against any part of a settlement or judgment that can be demonstrated to relate to non-income related losses. It will be reluctant to give effect to a "harsh" result. One way or another a court will rely upon the equitable principles of subrogation, aided and abetted by the principles of interpretation, to arrive at a result that limits the broadest of subrogation claims to only that part of a settlement or judgment that relates to income loss.

[83] An example of this process of "reading down" can be found in the chambers and appeal decisions in *Ryan v. Sun Life*.

[84] Ms Ryan was a federal employee. She was injured in a car accident and developed chronic pain. She claimed and received LTD benefits under a group disability plan administered by Sun Life. She did not return to work and, as of the date of the settlement in issue, remained off work. She settled her claim for a global amount of $350,000.00. Sun Life, relying upon an express subrogation clause in its policy wording, took the position that:

> a. pursuant to the wording of the clause in question Ms Ryan had to pay 75% of her net recovery (that is, her total recovery minus costs) to Sun Life to a

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[42] *Ibid*., at para.47.

maximum of the benefits that had been paid to her, and

b. Sun Life was entitled to withhold an amount of future benefits payable under the policy equal to the balance left over after the past benefits had been deducted.

[85] The complete wording of the clause in question can be found at the end of this paper. Suffice it to say that on the wording of the provision Sun Life was entitled to subrogate against "any amount recovered by the Employee from the Third Party (***including general damages***, damages for loss of income, interest and legal costs, whether recovered through settlement or trial)," minus costs.[43]

[86] On its face then Sun Life had achieved the "harsh" result that Chipman, JA had suggested in *McNally* was at least theoretically possible. And yet both levels of court refused to read the clause in that fashion.

[87] In the chambers decision Davison, J concluded that "the true intent of the parties in including 'general damages' as a source of recovery was to prevent employees from getting paid twice for the same loss [that is, in context, the loss of income]."[44] In other words, the insurer was entitled to trench upon general damages only where an insured entered a global settlement and failed to demonstrate what part was general and what part was special. But if the insured could demonstrate what part of the settlement related to general damages and what to income loss (and the onus was on him or her) then the insurer would be limited only to the income

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[43] Emphasis added.

[44] See the chambers decision at para.36.

portion of the settlement. In short, it was not "the true intention of the parties to permit a recovery out of general damages in every case."[45]

[88] Both parties appealed to the Court of Appeal. Mr Justice Cromwell, as he then was, dismissed both appeals. In doing so he noted that the term "general damages" and "loss of income" had both "strict" and "loose" meanings and that in interpreting such terms "one must pay close attention to the context in which the terms are used."[46] In this case the fact that the reference to "general damages" was prefaced by wording that spoke of an insured who "has a right of action against a Third Party for recovery of loss of income" meant that "general damages" must be taken as referring only to income-related loss (and in particular, future loss).[47] His Lordship concluded a minutely detailed analysis of the clause with the observation that "the clause, while not a model of precision, makes it clear that the net recovery consists of damages fairly attributable to income loss."[48]

[89] In the result then Sun Life was entitled to recover past benefits paid out of the income related portion (both past and future) of the global settlement. It was not, however, entitled to

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45 *Ibid*, para.58.

46 Court of Appeal at para.33.

47 *Ibid*., para.47.

48 *Ibid*., para.50. This was no doubt came as a surprise to Sun Life, given that its express intent in drafting the clause *had been* to encroach upon general damages as a way of securing its full subrogation interest: see the account of the history of the drafting of the clause in the chambers decision.

offset any balance against future benefits that might become payable after the settlement.[49]

Impact of Reductions In Settlement/Judgment Amounts Because of Causation or Liability Issues

[90] One of the other difficulties with the "absolute" type of subrogation clauses is that they tend to ignore the impact of liability or causation issues. For example, and as posed by Chipman, JA in the *McNally* case, what happens if the insured settles for less than full recovery because of liability or causation concerns? Can the insurer still rely on the subrogation clause to give it full recovery of its benefits in the event of a settlement? Or will the clause be "read down" so as to restrict the subrogation claim to only a prorata portion of the settlement?

[91] This question was addressed in *Mutual Life Insurance Co. of Canada v. Marance*.[50]

[92] The plaintiff insured in that case was a passenger in a single-vehicle accident. He claimed LTD benefits under the Mutual Life policy. His past income loss was calculated at $72,106. He received disability benefits in respect of that loss in the total amount of $43,264.

[93] The insured had signed a "reimbursement" agreement wherein the insured agreed, *inter alia*, "[t]o pay Mutual Life any amounts recovered from the third party for loss of income, either under judgment or settlement, that exceed 100% of my income

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49 *Ibid*, paras.56-58.

50 [1996] AJ No. 578 (CA).

lost, and to the extent Wage Loss Replacement benefits paid by Mutual Life."

[94] The plaintiff's solicitor calculated the insured's total damages, inclusive of past and future income and general damages, in the range of $400-$450,000.00. However, during the course of the action he became concerned about significant liability issues. As a result of these concerns he settled for $178,000.00, being roughly 50% of his total claim.

[95] Notwithstanding the 50% discount, Mutual Life argued that because his settlement was greater than the $72,106 of his past income loss he must have received full indemnity in respect of that loss. It accordingly claimed full reimbursement of the $43,264.00 it had paid to the insured. The Alberta Court of Appeal did not agree. It made two things clear:

a. first, where an insured settles his or her third party claim for an "established" percentage discount then the insurer cannot be forced to take *less* than that percentage in respect of any subrogated claim it may have, ***but***

b. second, since the settlement included more than just income loss but also extended to other heads such as general damages, and since it was settled at a discount of 50%, then the insured's recovery clearly did not exceed 100% of his lost income–and hence the reimbursement agreement was not triggered.

[96] The issue was also addressed (though not answered conclusively) in *Kobzey v. Sun Life of Canada*.[51] In that case the

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[51] [2001] BCJ No. 1840 (CA).

British Columbia Court of Appeal allowed an appeal from a summary judgment in favour of Sun Life's claim for subrogation.

[97] In this case the insured was involved in a motor vehicle accident in 1991. LTD benefits were paid from 1991 until 1995, when Sun Life terminated benefits. The insured sued the tortfeasor. There was an issue of causation, since the insured had developed MS sometime after the accident. She eventually settled the personal injury action for $533,000.00 (of which counsel said approximately $200,000 was for "lost wages"). The insured also sued Sun Life for the benefits; Sun Life counterclaimed for (a) reimbursement of CPP benefits that had been paid to her, as per the contract, and (b) recovery of benefits paid to her during the period covered by the personal injury settlement.

[98] The latter claim was based on an express subrogation clause that contained the following provisions:

a. "If an employee is entitled to recover ***damages for loss of income*** from another person as a result of personal injuries which are sustained by the employee and for which he is entitled to receive benefits under the Weekly Indemnity Insurance, under the terms and conditions of ... [this policy], Sun Life will be subrogated to all the rights of recovery of the employee for loss of income to the extent of the sum of the benefits paid or payable to him under those provisions."[52] and

b. "Upon recovery of an amount or amounts from another person or his insurer for loss of income, I will remit the amount (less costs) to Sun Life, to the

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[52] Emphasis added.

> extent of the sum of the disability benefits paid to me by Sun Life as at the date of recovery."

[99] On a summary trial the trial judge held for Sun Life on both points. On appeal, the BC Court of Appeal agreed with (a) but held that there was not enough evidence to permit a determination of (b).

[100] The Court of Appeal held that "the interpretation of the contract clauses should be conducted within the matrix of all the relevant facts."[53] The court also noted that future income losses could be a capital loss[54] and hence not easily translated into an "income loss" within the meaning of the subrogation clause. As importantly, Donald, JA suggested that where the past component of income loss was less than the total LTD benefits paid the insurer "would only be able to recover the actual amount allocated to past wage loss as overpayment."[55]

CONCLUSION–ADVICE TO THE INTERESTED PARTIES–AND WHERE DOES THIS LEAVE US SO FAR AS S.113A OF THE *INSURANCE ACT* IS CONCERNED?

[101] My basic advice to practioners who are struggling with this problem is to remember the origins of the principle of subrogation. It is a creature of equity, which means that the fundamental concern of the court will be to achieve a "fair" result. And a "fair" result will depend upon the matrix of facts of each particular case.

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[53] *Ibid*., per Donald, JA at para.14.

[54] Following *Andrews v. Grand & Toy* [1978] 2 SCR 229.

[55] *Ibid*., at para.15.

[102] With that in mind, I make the following comments.

[103] First, get a *complete* copy of the LTD policy, not just whatever clause the LTD insurer may be relying upon to assert a claim for subrogation.

[104] Second, if there is ***no*** express subrogation or reimbursement clause you will have to determine whether the benefits for which the LTD insurer claims a right of subrogation are paid pursuant to the principle of indemnity. You will do that by analysing the contract wording regarding both the calculation of the initial benefit *and* the deductions from that benefit. If the overall result is to make the benefit a partial indemnity of an actual loss then chances are that a subrogation interest will arise.[56] On the other hand, if the benefit appears to be one payable regardless of any actual income loss (or at least it is less concerned that there be an actual income loss) then chances are that it is not a partial indemnity benefit and no subrogation interest arises.[57]

[105] Third, ***if there is*** an express right of subrogation or reimbursement, then read the clause ***very carefully***. Do ***not*** assume that just because the clause purports to attach non-income damages (for example, general damages) that a court would interpret it that way. Chances are good that it won't.

[106] Fourth, if you are acting for a plaintiff don't play games with global settlements. A global settlement will not defeat a

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[56] I say "subrogation *interest*" rather than "right of subrogation" to emphasize the elastic nature of what may be claimed by way of subrogation in these types of cases.

[57] On the case law at least STD benefits are often more likely to be non-indemnity, but that is not invariably the case. It depends on the wording of the policy.

subrogation interest that otherwise exists. Much better to make your best efforts to quantify the various heads of damage and to keep track of the negotiations that lead you, eventually, to a global settlement. By doing that one increases the chance of sheltering the non-income loss components of a plaintiff's settlement from a subrogation claim.

[107] Fifth, if you are an LTD insurer don't insist on getting insureds to execute "agreements" or "acknowledgements" of right you say you have under an LTD contract. Either you already have those rights or you don't. "Agreements" executed after the fact cannot give you something you don't already have, and it only risks a bad faith claim against you.

[108] Sixth, if there are *bona fide* issues of liability or causation that force a discount of a plaintiff's claim against a third party you should approach any claim for subrogation with the knowledge that in all likelihood a court will want to give effect to the same types of discounts when evaluating a subrogation claim.[58] The difficult question–and one to which a clear answer can be given–is *how* that discount will be factored into the subrogation equation.

[109] One approach would be for the court to conclude that the discount means that there has not been complete recovery for the plaintiff and accordingly no repayment should be ordered.[59]

[110] Another approach might be to match like claims to like, so that, for example, past LTD benefits are matched to past income damage recovery. In that event the LTD insurer may recover something, albeit not its entire amount.[60]

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[58] If, indeed, not wipe out the claim altogether.

[59] See the following page.

[60] See the page next following.

[111] Arguments in favour of either approach can be found in the case law, although because the facts and wordings are always different it is impossible to arrive at a definitive answer.

[112] This, finally, brings us back to the beginning of this paper–and another question I cannot answer.

[113] Let us start with the proposition that if a plaintiff receives LTD benefits for which there is no right of subrogation the defendant can deduct the entire amount of those benefits from any settlement or judgment it must pay.

[114] The next step which seems reasonably clear concerns the situation where there *is* a right of subrogation *and* there is no issue as to liability. In that case it seems reasonably clear that the "old" practice remains in place. The receipt of LTD benefits must be ignored by the defendant–it is a collateral benefits.[61]

[115] But what happens if there *is* an issue of liability, the effect of which may be *in effect* to deprive the LTD insurer of any right of subrogation. Does that mean that the defendant can then deduct the LTD benefits that were paid, on the grounds that there is, in fact, no "right of subrogation" because the plaintiff has not been fully indemnified in respect of his loss? Or is the answer that the plaintiff's LTD insurer still has a "right of subrogation"–it just can't exercise it in the particular circumstances of the case–and

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[61] I assume here that the plaintiff contributed to the premiums paid in respect of the LTD benefits. If not, then a deduction may be possible under established principles.

hence no deduction is to be allowed? That is, unfortunately, another question to which I do not have the answer.[62]

[62] If pressed however I would place my bet on the latter result.