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Common Law Exception to Settlements by an Insured

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In the recent decision of *Stairs v. CFM Corporation*, 2017 NBCA 8, the New Brunswick Court of Appeal was asked to consider the effect of a release signed by an insured on his/her insurer's subrogated claim.

In *Stairs*, the insurer for the plaintiffs commenced an action to recover damages in the amount of \$320,000 resulting from an explosion at a neighbouring home. The insurer advised the defendants of its intention to advance a subrogated claim relating to this loss. After the incident, the plaintiffs filed a separate lawsuit on their own relating to personal injuries they suffered. This action was solely in respect of the plaintiffs' personal losses. The plaintiffs were specifically instructed that they did not have authority to settle the insurer's subrogated claim, as the insurers would be advancing that claim itself.

Before the subrogated action was commenced, the plaintiffs settled their personal injury action. As a term of the settlement, the plaintiffs executed a release of all claims arising out of the explosion and a discontinuance was filed. The insurer did not receive any of the proceeds from this settlement.

When the insurer commenced its subrogated claim, the defendants raised the release and discontinuance as a defence and successfully applied to have the subrogated claim dismissed on the basis of issue estoppel i.e. the issues were resolved already in the personal injury action through the settlement and the discontinuance. The insurer appealed.

The New Brunswick Court of Appeal framed the issue at paragraph 5:

The principal question of law in this appeal is whether the common law recognizes an exception in cases where the insurer paid its insured before any settlement or release with the tortfeasor and where the party liable had, prior to settling with the insured, notice of the insurer's consequential right of subrogation.

The Court conducted an analysis of the underlying principles of subrogation including:

- an insurer's right to pursue a claim against a third party after indemnifying its own insured;
- an insurer's entitlement to every right of the insured after indemnification;
- that the insurer cannot be any better position than its own insured;
- that the insured receives no more and no less than full indemnity; and
- that the loss falls on the person who is legally responsible for causing it.

Against this background, the New Brunswick Court of Appeal examined a number of leading texts and cases (some conflicting) from Canada, the UK, the US, and Australia. From this analysis, the Court noted that these decisions all supported a finding that a settlement and release would not bar a subrogated claim where prior notice of the subrogated claim was given to the third party. The Court essentially held that it would be unfair for a defendant to take advantage of the situation by having an insured sign a full release. The Court further found that it could be to the detriment of an insured, who may be liable to pay some of its settlement proceeds to his insurer; at the same time, it

would benefit the tortfeasor, who would no longer be required to account for the loss to the insurer.

The unanimous Court of Appeal, therefore, held that a common law exception to the effect of a settlement agreement and release by an insured in a subrogated claim exists in Canada finding at paragraph 52:

“A settlement between an injured party and a tortfeasor does not destroy the subrogation claim of the injured party’s insurer if prior to the release the tortfeasor has knowledge of those rights.”

The Court of Appeal found that the defendant had actual knowledge of the insurer’s intent to pursue a subrogated action prior to the settlement of the personal injury claim and found that this settlement and release did not bar the subrogated claim.

Although some provinces have enacted legislation dealing with similar situations, this is an important case in subrogation because it offers a definitive statement of the common law concerning settlements and releases signed by insureds when there is an ongoing subrogated claim, of which the third party has notice. This is the first appellate court in Canada to weigh in on this specific issue and, absent an appeal to the Supreme Court of Canada, we expect that this will be the leading decision.