



Whitelaw Twining
LAW CORPORATION

SUBROGATION: BASIC PRINCIPLES, EMERGING TRENDS AND PRACTICAL CONSIDERATIONS

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February 2006

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I. WHOSE CLAIM IS IT ANYWAY?

Subrogation is a doctrine by which one who has indemnified another for a loss suffered at the hands of a third party may pursue that third party for the amount of the indemnity. The process is achieved by a transfer of the rights of recovery against the third party from the person indemnified (the subrogor) to the one that made the indemnity (the subrogee). The subrogee then stands in the shoes of the subrogor and exercises all of the rights of the subrogor against the third party to recover what was paid out.

Subrogation is most commonly a vehicle through which insurers recover amounts paid to their insureds and place the responsibility for the loss with those that caused it. However, because a policy of insurance will not always fully indemnify the insured for the loss, difficulties arise respecting the extent, if any, to which the insured's rights against the wrongdoer pass to the insurer and the manner in which the insurer is able to exercise those rights. These difficulties lead to practical problems about who has the right to commence an action and control the litigation and who is to account to whom when a judgment is obtained or a claim is compromised.

A. ORIGIN AND BASIS OF SUBROGATION

The earliest known statement of the right of subrogation in the context of insurance came in the middle of the 18th century in the case *Randal v. Cockran* (1748), 27 E.R. 916 when the court recognized the right of insurers to assert a right in the name of their insureds.¹ That case arose out of a decree by King George II allowing compensation to be paid to those that suffered losses in a war with Spain. Some individuals had already been indemnified by their insurers for these losses, and the insurers successfully sought to be subrogated to the rights of their insureds to receive this compensation.

¹ S.R. Derham, *Subrogation in Insurance Law* (Melbourne, The Law Book Company Limited, 1985) at 4-5.

Moving forward by a century, the basis for the doctrine of subrogation was articulated by Brett L.J. in the seminal case of *Castellain v. Preston*, [1881-85] All E.R. 493 at 495 (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.

Thus the fundamental purpose of the doctrine was stated as being to prevent an insured from obtaining more than full indemnity for a loss. In exchange for full indemnity, the insured impliedly transfers his rights to obtain further indemnity from other sources.

There has been some disagreement in English courts about whether subrogation is an equitable or legal doctrine.² Canadian courts have treated it as the former. The leading case in Canada is *National Fire Insurance Co. v. McLaren* (1886), 12 O.R. 682 at 687 (H.C.J.) which states:

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.

Whether the doctrine is equitable or not, the Canadian and English jurisprudence is agreed that subrogated rights do not come from the contract of indemnity but arise by operation of the common law to govern the relationship that such a contract creates.

At common law, no subrogated rights arise until the insured is fully indemnified for its loss. Once full indemnity is made, the insurer has the right to commence proceedings against the wrongdoer in the insured's name and make all decisions in the litigation. The insured has a duty to co-operate in the litigation in matters such as giving evidence at trial. The insurer is entitled to recover no more than it paid out, and any excess goes to the insured: *Yorkshire Insurance Co. Ltd. v. Nisbet Shipping Co. Ltd.*, [1962] 2 Q.B. 330. In the event that the insured, after receiving full or partial indemnity, commences an action and makes a recovery in respect of the loss, the insured must account to the insurer.

B. STATUTORY MODIFICATION OF SUBROGATION PRINCIPLES

The principles of subrogation have been modified to some extent by statute and also by the wording of insurance policies. In British Columbia, the *Insurance Act*, R.S.B.C. 1996, c. 226 alters the operation of the doctrine of subrogation on fire insurance policies by removing the requirement that the insured be fully indemnified before the insurer gains a subrogated interest. Section 130 of that Act provides:

² See *Yorkshire Insurance Co. Ltd. v. Nisbet Shipping Co. Ltd.*, [1962] 2 Q.B. 330 at 339 per Lord Diplock; and *Lord Napier and Ettrick v. Hunter*, [1993] 1 All E.R. (H.L.) per Lord Goff.

130 (1) The insurer, on making any payment or assuming liability therefor under a contract of fire insurance 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) If 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 must be divided between the insurer and the insured in the proportions in which the loss or damage has been borne by them respectively.

Similar language is found in other legislation governing other types of insurance³ as well as in the policy wordings for many types of property policies.

The British Columbia Court of Appeal considered the language of section 130 in *Farrell Estates Ltd. v. Canadian Indemnity Co.* (1990), 45 B.C.L.R. (2d) 223 (C.A.) and determined that although the intent of the section was to allow an insurer to commence a subrogated action even where full indemnity had not been made, it did not afford the insurer the right to exclusive conduct of that action. Thus the result was that even if the insured had no uninsured losses but owed a deductible, control of the subrogated litigation rested with the insured and not the insurer.

Although it may seem unusual that the *Insurance Act* would give an insurer the right to commence subrogated litigation over which it would not have the right of conduct, the decision is no doubt based on the need to balance the interests of insurer and insured where both have separate claims arising out of the same loss and against the same wrongdoers.

C. APPORTIONMENT OF PROCEEDS: COMPROMISED CLAIMS

Another difficulty that can arise where subrogated and uninsured claims are pursued in the same action is how the proceeds of the action are to be apportioned between those claims. Where either the insurer or the insured has conduct of the action and the action is settled for a lump sum that is short of the full amount of the loss, confusion may result as to how the settlement funds are to be apportioned between insurer and insured. The utility of reaching some agreement beforehand on apportionment is illustrated in the case of *Affiliated FM Insurance Co. v. Quintette Coal Ltd.* (1998), 48 B.C.L.R. (3d) 8 (C.A.). Quintette had sued a company that supplied a conveyor system for its mine. The action was in contract and negligence for design defects and Quintette was seeking to recover losses in excess of \$40 million. After the action was commenced, a defect in the conveyor system caused a long tear in its belt which resulted in a further business interruption claim of \$2.857 million. This claim was covered by Quintette's insurer and Quintette amended its pleadings to include the business interruption claim. Quintette settled its action for considerably less than its actual losses. The settlement documentation did not set out how much of the settlement was apportioned to each of the various heads of damage.

Upon settlement, the insurer sought to recover the entire amount it had paid to Quintette for the business interruption claim and Quintette refused to pay that full amount. The insurer brought a special case. The Chambers Judge found that the insurer did have a subrogated interest in the settlement funds but found he was unable to determine the extent of that interest because the allocation between the business interruption claim and the other claims was not articulated in the settlement. He ordered that issue be set down for trial. The insurer appealed and in the Court of Appeal, Madam Justice Southin invoked the maxim "equality is equity" and found that "proportional equality" could be achieved in this case by the insurer taking a portion of the amount it paid Quintette

³ See *Insurance Act*, R.S.B.C. 1996, c. 226, s. 178 (regarding auto insurance); *Insurance (Marine) Act*, R.S.B.C. 1996, c. 230, s. 80; and *Insurance (Motor Vehicle) Act*, R.S.B.C. 1996, c. 231, s. 26.

that was proportionally equal to the amount Quintette actually recovered against its actual losses. This Madam Justice Southin found to be 48/406ths of the settlement amount.

D. SUBROGATION AGREEMENTS

Control over the litigation and apportionment of proceeds are two potential problems that have resulted from statutory and contractual modification of the common law principles of subrogation. A solution that parties may resort to in order to address those issues is a subrogation agreement. Assuming the insurer and the insured can agree on counsel, it is open to them to decide at the outset how to proceed, in particular who will instruct counsel and how proceeds of recovery and legal expenses are to be shared.

Subrogation agreements can be drafted flexibly to accommodate the situation between the insurer and the particular insured. For example, if the insured is a homeowner with an uninsured claim arising out of a fire loss that is small in relation to the insured claim, the insurer will probably want to keep control of the litigation. The insurer may bargain for this right by offering to carry all the legal expenses while the litigation is ongoing and then apportion upon settlement or judgment. The insurer may also offer to absorb the risk of all legal expenses in the event of a dismissal. If the insured is a more sophisticated party and/or has a more significant uninsured claim, the provision respecting the right to instruct counsel and payment of fees would probably look quite different.

In either case, apportionment of recovery proceeds and fees must be agreed upon. The parties will typically want to wait until their counsel has provided enough information on recovery of the various heads of damage and the liability risks before settling this key provision. The agreement may also make provision for the parties to revisit apportionment if developments occur in the case that change counsel's assessment.

Attached to this paper as Appendix A is a sample subrogation agreement between an insurer and an insured homeowner seeking to recover their losses from a fire at the insured's home. The agreement illustrates the types of provisions that can be found in a subrogation agreement depending on the particular circumstances between the insurer and the insured.

As the agreement is typically drafted by counsel acting for both insurer and insured, counsel must be careful to provide thorough information on recoverability of damages, liability risks and legal expense forecasts to both insurer and insured. Counsel must also be careful not to offer any advice to either insurer and insured on their rights as against the other party. Independent legal advice should be recommended prior to entering into the agreement and it should be strongly recommended where the insured is an individual.

If the matter goes to trial and the results of the judgment vary significantly from the assessment, there is a possibility that one party or another to the subrogation agreement may challenge the agreed upon apportionment. This is particularly so where the insured and uninsured claims are actually separate heads of damage and the awards on the different heads are significantly better or worse than the assessment upon which the parties based their agreement.

Subrogation agreements are themselves a modification of the common law principles of subrogation. The parties are agreeing to participate in an inherently uncertain process – litigation. Assuming a recovery is made at trial, the result may not mirror the apportionment provision in the agreement. One party or another might challenge the application of the agreement to the proceeds. There do not appear to be any Canadian cases considering the validity of subrogation agreements in such situations. There is some useful authority on this issue from England and the United States.

In *L Lucas Ltd. v. Export Credits Guarantee Department*, [1973] 2 All E.R. 984 (C.A.)⁴ an exporter entered into a contract of guarantee under which the guarantor would indemnify it for up to 90% of the loss arising out of the failed payments for export shipments. The contract also provided that any sums recovered by the exporter or guarantor “in respect of a loss to which this guarantee applies” would be split between guarantor and exporter on the same 90/10 basis.

A loss occurred and the guarantor indemnified the exporter. The exporter later succeeded in recouping the payment but changes in exchange rates resulted in that payment becoming significantly larger when it was converted back into pounds sterling. The guarantor’s position was that it was entitled to 90% of the increased recovery while the exporter contended the guarantor was only entitled to what it had paid out as indemnity.

The Court of Appeal, recognizing that the contract was one of indemnity, treated it like a policy of insurance. The exporter relied on *Yorkshire Insurance Co. Ltd. v. Nisbet Shipping Co. Ltd.*, *supra* for the proposition that if there is recovery in a subrogated claim higher than the amount of the loss, the excess goes to the insured, and thus the guarantor should not be entitled to recover out of the proceeds more than it had paid out. The Court of Appeal ruled that the correct approach was to consider the contract by reference to its terms and, only if some real doubt or ambiguity in its construction was evident was it proper to invoke the general principles of subrogation as a guide or controlling authority.

In *L Lucas*, Megaw L.J. questioned the reliance that had been placed in the *Yorkshire* case on the language in *Castellain*, *supra* as the *Castellain* decision stated very clearly that the insured ought not receive more than full indemnity. Wilmer L.J., however, did not find it necessary to express any opinion on the *Yorkshire* case as there was no provision in that case governing the parties’ entitlement to proceeds whereas in the instant case they had “made precise provision for what is to happen in the event of sums being recovered” (at 991). In the result, the Court of Appeal held that the guarantor (*ie*, the insurer) was entitled to 90% of the increased recovery, just as the contract provided.

In the *L. Lucas* case, the parties had agreed to an apportionment formula in the contract of guarantee, before the loss occurred. The Supreme Court of New Jersey case of *Culver v. Insurance Co. of North America*, 559 A. 2d 400 (1989) dealt with a subrogation agreement entered into after the loss.

The *Culver* case involved a fire loss estimated at \$185,000. The insurer paid the policy limit of \$83,373.12 following which it instituted a subrogated action against the tortfeasor. The insureds had separate counsel claiming they were underinsured. Based on an analysis of the provable amount of the insured’s uncovered loss, the parties agreed to share any recovery at 80% for the insurer and 20% for the insureds. The insurer agreed to bear all the costs of litigation and be entitled to legal fees out of the proceeds. During the trial, the insurer achieved a settlement of \$160,000 and then attempted to distribute the proceeds according to the subrogation agreement and the insureds balked.

The court had the following to say about subrogation in general and the subrogation agreement in particular:

It is important to understand that subrogation rights do not arise spontaneously nor are they free-floating or open-ended. Subrogation rights are created in one of three ways: “(1) an agreement between the insurer and the insured, 44 *Am. Jur.2d Insurance* 1820 at 746, (2) a right created by

⁴ The *L Lucas* decision was reversed on other grounds by the House of Lords: [1974] 2 All E.R. 889. However, the Court of Appeal’s analysis of the interplay between subrogation principles and contractual provisions was not disturbed.

statute, 16 *Couch on Insurance* 2d 61:6 at 240 (1966), or (3) a judicial 'device of equity to compel the ultimate discharge of an obligation by the one who in good conscience ought to pay it.' *Aetna Ins. Co. v. Gilchrist Brothers, Inc.*, 85 N.J. 550, 560 (1981). While the doctrine has an equitable foundation, the attitude of courts toward subrogation has been described as "one of allowing complete freedom of contract and trying to determine and enforce the expressed intention of contracting parties." R. Keeton, *Insurance Law* 3.10 at 153. Indeed subrogation "is not applicable where its enforcement would be inconsistent with the terms of a contract or when the contract, either expressly or by implication, forbids its application." *Ganger v. Maffett*, 8 N.J. 73, 80 (1951).

The analysis of the Appellate Division appears to place emphasis only on the equitable nature of subrogation, discounting the contract basis for its application. Nevertheless, in this case the subrogation rights of INA were established in the insurance policy itself; further, INA and the Culvers negotiated and entered into a supplementary agreement defining their correlative subrogation interests.

Based on the reasoning in the *L. Lucas* and *Culver* cases, it is reasonable to expect that a British Columbia court would uphold a subrogation agreement provided the insurer and insured entered into it with the same information on which to assess their respective risks.

II. WAIVER OF SUBROGATION

It is a basic principle of insurance law that an insurer cannot bring a subrogated action against its own insured. This is a trite statement in circumstances where there is only one insured, because to allow the insurer to sue its insured after having indemnified its insured would seem to defeat the purpose of the insurance. However, the statement becomes more complex in circumstances where there are multiple insureds, whether they be named, additional, or unnamed. In these situations, the party against whom an insurer is bringing a subrogated action will often argue that the action cannot be maintained because there has been a waiver of the right of subrogation.

A. LANDLORD AND TENANT: WAIVER OF SUBROGATION UNDER A LEASE

The issue of waiver of subrogation often arises in landlord and tenant relationships. A trilogy of Supreme Court of Canada decisions in the 1970's recognized that certain provisions in a commercial lease, and in particular a covenant by the landlord to insure the whole premises and an obligation of the tenant to contribute to the cost of that insurance, could give rise to the landlord being deemed to have waived the right of its insurer to bring a subrogated claim against the tenant. Since this trilogy, the law in Canada has developed to the point where Mr. Justice Hall of the B.C. Court of Appeal recently remarked in the case *North Newton Warehouse Ltd. v. Alliance Woodcraft Manufacturing Inc.* (2005), 44 B.C.L.R. (4th) 227 at 243 (C.A.)⁵ that, "One might properly say that there is something approaching a presumption in favour of a tenant benefiting from a landlord's covenant to insure."

1. The Supreme Court of Canada trilogy

The first of the trilogy of decisions from the Supreme Court of Canada concerning the right of an insurer to bring a subrogated claim in negligence against a tenant is *Agnew-Surpass Shoe Stores Ltd. v. Cummer-Yonge Investments Ltd.* (1975), 55 D.L.R. (3d) 676 (S.C.C.). The question in that case was whether the tenant of a shopping centre was liable to the landlord for loss from a fire originating in the tenant's premises and caused by the tenant's negligence. The lease required the landlord to insure the shopping centre "against all risk of loss or damage caused by or resulting from fire." The lease did not include what the court described as a "usual" tenant's covenant to

⁵ Leave to appeal to the Supreme Court of Canada was refused: [2005] S.C.C.A. No. 375.

repair, but it did contain a covenant requiring the tenant to, “take good and proper care of the interior of the leased premises... and make all needed repairs and replacements thereto except for... damage to the Building caused by perils against which the Lessor is obligated to insure hereunder.”

The majority decision of Pigeon J. and the minority decision of Laskin C.J.C. both agreed that when all of the provisions of the lease were read together, the landlord’s covenant to insure the building for loss by fire extended the benefit of insurance to the tenant, such that the landlord’s insurer had no right of subrogation against the tenant in relation to the claim for damage to the building.

Laskin C.J.C. was prepared to find that the waiver of subrogation also applied to the claim for loss of rental income because the insurance which the landlord obtained also included this coverage; however, the majority decision of Pigeon J. did not agree with this. Rather, Pigeon J. held that the waiver of subrogation applied only to the extent that the landlord was obligated to obtain insurance under the covenant to insure. In this case, the covenant to insure required the landlord to insure the building against loss by fire but did not require the landlord to obtain insurance for loss of rental income.

The second case in the trilogy is *Ross Southward Tire Ltd. v. Pyrotech Products Ltd.* (1975), 57 D.L.R. (3d) 248 (S.C.C.). The lease stated that the tenant, “shall pay... all insurance ...” The landlord bought a policy that insured the building against fire and other perils and the landlord then submitted an invoice to the tenant for the cost of the insurance, which the tenant paid. Writing for the majority, Laskin C.J.C. held that the provision respecting payment of insurance, in conjunction with the landlord presenting the bill to the tenant, passed the risk of loss by fire from the tenant to the landlord. The subrogated claim, therefore, could not be maintained.

The third case in the trilogy is *T. Eaton Co. v. Smith* (1977), 92 D.L.R. (3d) 425 (S.C.C.). In that case, the tenant leased two neighbouring properties from different landlords. Buildings on both properties were destroyed by a fire caused by the negligence of the tenant’s employee and the landlords’ insurers brought a subrogated claim against the tenant. In both leases, the landlords covenanted to insure the premises against fire. Further, both leases included what Chief Justice Laskin described as “the three standard repairing covenants” namely the covenant to repair, repair on notice, and leave in repair. All of these covenants also contained the qualification that damage by fire was excepted.

Writing for the majority, Laskin C.J.C. characterized the issue in the following terms (*T. Eaton Co.*, at 429-30):

... the matter at hand is not whether the insurers are being unjustly deprived of their subrogation rights (as they would be if there was some attempt by landlord and tenant to agree on alleviation of the tenant’s liability for a fire resulting from its negligence after the fire occurred). It is whether, in circumstances where, by the lease, the tenant is under an obligation to repair, and where its obligation to repair does not extend to repairing damage from accidental (as contrasted with negligent) fires, it is entitled, as between it and the landlord, to claim the benefit of a fire insurance policy (providing indemnity for loss arising from fires negligently caused), which the landlord had covenanted with the tenant to provide.

Chief Justice Laskin held that the covenants to insure in the two leases had the effect of transferring the risk of loss by fire from the tenant to the landlords, and just as in *Agnew-Surpass Shoe Stores Ltd. v. Cummer-Yonge Investments Ltd.*, the insurers were not permitted to maintain their subrogated claim. The following passage, or portions of it, have been frequently cited in subsequent cases as setting out the principle that a landlord’s covenant to insure against fire will result in a waiver of the right to subrogate against a tenant who caused the fire (*T. Eaton Co.*, at 428-29):

Had the landlord insured without giving a covenant to that effect in the lease, the tenant's risk of liability for fire resulting from negligence would be unquestionable; and if the landlord collected from his insurer, the latter would have an equally unquestionable right of recovery from the tenant in a subrogated action. The contention of the respondents is that the insuring covenant in the present case does not alter the result because, as I understand the submission of the respondents, the covenant to insure has subject-matter without relating it to coverage against the risk of fires caused by the tenant's negligence. The appellant, although recognizing the differences in the repairing and insuring covenants of lessee and lessor respectively in the *Cummer-Yonge* case, urges that where the covenant to insure is not at large but is, as in this case, a covenant with the lessee that the landlord will keep the buildings on the premises insured against loss by fire, it must be given effect against liability for fires arising from the tenant's negligence because otherwise, as a covenant expressly running to the benefit of the tenant, it would have no subject-matter.

Counsel for the appellant seeks to draw support from the judgment of this Court in the *Pyrotech* case where the lease contained repairing covenants similar to those in the present case. There the tenant was also under a covenant to pay insurance premiums immediately when due, and did pay them on being billed by the landlord. This Court held that the effect of this insurance obligation was to entitle the tenant to protection against the risk of loss by fire caused by its negligence, and this notwithstanding the repairing covenants which, if they stood alone, would have saddled the tenant with liability for losses from such fires. In short, the tenant was entitled to the advantage of its payment of insurance premiums for a policy under which indemnity was given for loss by fire, including fire arising from some person's negligence, be it that of the tenant or someone else. Counsel asked this Court to apply the principle here in respect of a covenant to insure given by the two landlords for the benefit of the tenant. There was no need for the covenant, so it was contended, if it was only for the benefit of the two landlords.

I think this contention should prevail unless there is another explanation for the landlords' covenant to insure which would dispel it.

In the circumstances, the only other possible explanation for the existence of the covenant to insure related to option to purchase clauses in the lease which required the landlords to bear the risk of loss by fire until final closing of a sale. However, upon examination, Laskin C.J.C. held that the clauses protected the tenant, as purchaser, from bearing the risk of loss by fire which would otherwise have passed to it on the exercise of the option and before closing. In other words, the clauses reinforced the view that the tenant was to have the benefit of insurance arising from the landlords' obligation to insure the premises

2. The decline of the trilogy

An important aspect regarding two cases in the trilogy, *Agnew-Surpass* and *T. Eaton Co.*, was that the language in the leases clearly stated that the landlords had a positive obligation to obtain fire insurance for the premises. Since the trilogy, litigants and courts have attempted to distinguish those cases on the basis that the language in the lease under consideration, and in particular the landlord's covenant to insure, was not clear, thereby not transferring the risk of loss by fire from the tenant to the landlord and not giving rise to a waiver of subrogation.

One such case is *Leung v. Takatsu* (1980), [1992] 3 W.W.R. 129 (B.C.C.A.). In that case, a fire caused by the negligence of the tenant's wife destroyed the house they were renting. The landlord's insurer brought a subrogated action against the tenants. The tenants argued that the landlord had agreed to waive subrogation on the basis of the following provision in the lease: "owner to pay property taxes and building insurance." The court held that this provision did not constitute a covenant to insure with the effect of waiving subrogation as against the tenants. The court wrote (at 130):

The circumstances of the lease, including this particular wording, as distinct from the circumstances in the authorities cited to us ... do not persuade me that the extended meaning of the wording in

question was intended by the parties to be the covenant to insure as claimed; that is, a covenant by the owner to insure in such manner as to exculpate both the tenant and the wife from fire liability.

Subsequent decisions in B.C. have followed the *Leung v. Takatsu* decision. In *Ruge v. Kennedy* (1991), 6 C.C.L.I. (2d) 156 (B.C.S.C.), a fire destroyed a mobile home and the owner's insurer commenced a subrogated action. The rental agreement stated that the owners, "...are to pay all mobile home insurance and property taxes." The court considered the *T. Eaton Co.* case and noted that the insuring covenant in that case was very clear that the landlord had an express obligation to obtain fire insurance. In contrast, the court was of the view that the provision in the instant case was not a clear and express covenant to insure, and as a result, there was no waiver of subrogation.

In *Perlitz v. Nan* (1997), 51 B.C.L.R. (3d) 130 (S.C.), a fire caused by the tenant's negligence destroyed a building on his leased premises. The lease included a tenant's covenant to repair, and it further provided that, "... fire insurance... fees are to be paid by the Lessor." The court held that the insuring provision in this case fell far short of a covenant by the landlord to insure the premises against the risk of fire. Rather, the insuring provision only obligated the landlord to pay for fire insurance if it was obtained but it did not require the landlord to actually obtain fire insurance, let alone obtain it for the benefit of the tenant.

In *Lee-Mar Developments Ltd. v. Monto Industries Ltd.* (2000), 18 C.C.L.I. (3d) 224 (Ont. S.C.J.) aff'd [2002] I.L.R. I- 4066 (Ont. C.A.) the landlord's insurer brought a subrogated action against the tenant after an explosion and fire caused substantial damage to a building. The lease was described as a "net lease" meaning that, except where expressly set out, the tenant was to pay for all charges and expense in relation to the premises including the cost incurred by the landlord in maintaining insurance coverage. The lease did not contain a covenant requiring the landlord to insure the premises; however, it did contain a provision requiring the tenant to take out the following types of insurance in the name of the landlord and itself: Contents insurance, property damage insurance, and legal liability insurance for the full replacement cost of the premises.

The court concluded that the terms of the lease reflected an intention by the parties that the risk of fire loss was to be allocated to the tenant, not the landlord, and that the landlord's insurer could maintain a subrogated action against the tenant. In reaching this decision, the court emphasized the following factors:

In this case, there are specific mandated provisions which place the risk of loss by fire caused by negligence on the tenant. This allocation of risk is reinforced by reason of the following provisions in the lease:

- (1) there is no covenant obligating the landlord to take out insurance on the property; and the reference to the landlord's insurance does not appear in the section dealing with insurance on the property. Rather, it appears in Part II of the lease under the heading, "Lease, Term, Rent, Additional Rent and Taxes";
- (2) although there is an express bar against subrogation by the tenant's insurers, there is no similar provision in respect of the landlord or its insurers;
- (3) the lease contains an "entire agreement" clause; and
- (4) it is a "completely carefree" net lease to the landlord.

3. The trilogy strikes back

Not all cases decided since the trilogy have attempted to distinguish those three decisions of the Supreme Court of Canada. For instance, in *Rebello v. Nugget Equipment Ltd.* (1997), 32 B.C.L.R. (3d) 326 (S.C.) the lease provided that the landlord was, "responsible for placing and paying the

premiums for replacement cost insurance on the building...” Relying on *T. Eaton Co.* and *Agnew-Surpass*, the court held that the risk of loss against fire was allocated to the landlord and therefore the landlord’s insurer was estopped from bringing a subrogated claim against the tenant for a fire loss caused by the tenant. The significance of the decision lies in the court’s finding that it was not necessary for the insuring covenant to specifically require the landlord to obtain fire insurance; rather, the court was prepared to infer that fire insurance would be included with any insurance that provided replacement cost coverage.

Rebello did not refer to the third case in the trilogy, *Ross Southward Tire*; however, the result can also be justified by reliance on that third case. This is because coupled with the provision saying the landlord was responsible for placing and paying for insurance was a provision that the cost of such insurance was to be included in the monthly rent. As such, just as in *Ross Southward Tire*, the tenant was paying for the cost of fire insurance on the building and ought to have been entitled to the benefit of that insurance.

Arguably, the post-trilogy decision which most strongly upholds the principle of waiver of subrogation in landlord and tenant relationships is the recent B.C. Court of Appeal decision in *North Newton Warehouse Ltd. v. Alliance Woodcraft Manufacturing Inc.*, *supra*. Following a fire at a warehouse, the landlord’s insurer brought a subrogated action against the tenant alleging that the tenant’s employees negligently caused the fire. The tenant brought a Special Case under Rule 33 seeking a declaration that the landlord was precluded from advancing the claim because of the provisions of the lease.

The lease required the landlord to, “take out and maintain in full force and effect insurance against all risks of physical loss or damage to the Building” The premiums for this insurance were ultimately paid by the tenant as a component of additional rent under the lease. Read in isolation, these provisions are similar to those in the Supreme Court of Canada trilogy of cases and support the view that the risk of loss by fire was allocated to the insurer and that there was a waiver of subrogation against the tenant.

The landlord argued that the trilogy did not apply because of several additional provisions in the lease. First, the lease stated that despite the tenant paying for the landlord’s insurance as part of additional rent, “...no insurable interest shall be conferred upon the Tenant under policies carried by the Landlord.” Writing for the majority, Mr. Justice Hall noted that it is not the issue of insurable interest which determines if there is a waiver of subrogation, but rather whether the insurance policy extends coverage to the tenant. In support of this proposition, Mr. Justice Hall cited a passage from the Ontario Court of Appeal case *Amexon Realty Inc. v. Comcheq Services Ltd.* (1998), 37 O.R. (3d) 575 at 576 (C.A.) which stated (*North Newton* at 241):

It is true that the lease provides that the tenant has no insurable interest under the landlord’s policy. While this provision would presumably preclude the tenant from asserting a claim for his own loss under that policy, it does not speak to the claim asserted by the appellant in this case. It is the bargain I have referred to rather than the tenant having an insurable interest under the landlord’s policy that is the basis upon which this action is precluded.

The landlord also relied on a provision in the lease which stated that the landlord’s insurance, “...shall not cover any property of the Tenant.” Hall J.A. held that this provision was not relevant because the action dealt with damage to the building, not damage to the tenant’s property.

The landlord further argued that there was no waiver of subrogation because under the lease the tenant agreed to obtain, “Tenant’s all-risk legal liability insurance in an amount not less than the replacement cost of the Premises.” Hall J.A. held that this insurance had a different purpose than the landlord’s all-risk property insurance; namely it protected the tenant from negligence claims. As such, the tenant’s liability insurance did not affect the landlord’s covenant to insure.

In the result, Mr. Justice Hall held that the provisions relied upon by the landlord did not have the effect of allowing a subrogated action to be maintained against the tenant. However, he did acknowledge (at 243) that “quite clear language” in a lease could yield a different result.

The decision in *North Newton* recognizes a presumption of public policy that under a lease where the landlord gives a covenant to insure, and where the tenant agrees to pay for the cost of that insurance, the tenant will be entitled to the benefit of that insurance and thus a subrogated claim cannot be brought against the tenant. As Mr. Justice Hall concluded (at 243):

Ultimately, the policy rule underpinning the proposition that the insurer cannot pursue a tenant for damages in circumstances such as those present in the instant case is based on the proposition that it makes little business sense for a landlord to covenant to insure and for a tenant to pay the premiums if the tenant is not to derive some benefit from the insurance. One might properly say that there is something approaching a presumption in favour of a tenant benefiting from a landlord's covenant to insure. That is the legal principle that I take to be established from the trilogy of cases decided by the Supreme Court of Canada.

B. CONTRACTOR AND SUB-CONTRACTOR: WAIVER OF SUBROGATION UNDER A BUILDER'S RISK INSURANCE POLICY

Over the past few decades, Canadian courts have been expanding the scope of coverage under builder's risk insurance policies, also sometimes referred to as course of construction policies. The law has developed to the point that today, if an owner or general contractor of a construction project purchases a builder's risk policy, that policy by necessary implication will in most instances include as unnamed insureds all contractors and sub-contractors who supply materials or labour to the project. As a consequence, the builder's risk insurer typically cannot bring a subrogated claim against any of the contractors or sub-contractors involved in the project.

1. The origin of waiver of subrogation in construction cases

The starting point for the analysis is the Supreme Court of Canada case *Commonwealth Construction Company v. Imperial Oil Limited* (1976), 69 D.L.R. (3d) 558 (S.C.C.) which held that all contractors and subcontractors have an insurable interest in a construction project, and as a result, they may be considered unnamed insureds in a builder's risk policy. In that case, de Grandpre J. wrote (at 562):

On any construction site, and especially when the building being erected is a complex chemical plant, there is ever present the possibility of damage by one tradesman to the property of another and to the construction as a whole. Should this possibility become reality, the question of negligence in the absence of complete property coverage would have to be debated in court. By recognizing in all tradesmen an insurable interest based on that very real possibility, which itself has its source in the contractual arrangements opening the doors of the job site to the tradesmen, the courts would apply to the construction field the principle expressed so long ago in the area of bailment. Thus all parties whose joint efforts have one common goal, e.g. the completion of the construction, would be spared the necessity of fighting between themselves should an accident occur involving the possible responsibility of one of them.

De Grandpre J. further wrote (at 566):

As already noted, the multi-peril policy under consideration is called in the contract between Imperial and Wellman-Lord a course of construction insurance. In England, it is usually called a “Contractors’ all risks insurance” and in the United States, it is referred to as “Builders’ risk policy”. Whatever its label, its function is to provide to the owner the promise that the contractors will have the funds to rebuild in case of loss and to the contractors the protection against the crippling cost of starting afresh in such an event, the whole without resort to litigation in case of negligence by anyone connected with the construction, a risk accepted by the insurers at the outset.

It is significant to note that the policy under consideration in *Commonwealth Construction* listed the named insured as "Imperial Oil... and any of their contractors and sub-contractors." As a result, the case does not stand for the general proposition that all contractors will be included as unnamed insureds in all builder's risk policies. Nevertheless, the finding that contractors have an insurable interest in a construction project, and the public policy considerations discussed by the court are significant.

2. Expanding the scope of waiver of subrogation in construction cases

The next significant case on this topic was *C.P. Limited v. Base-Fort Security Services (B.C.) Ltd.* (1991), 52 B.C.L.R. (2d) 393 (C.A.). In that case, a company hired to provide security services to a construction site sought to be included as an unnamed insured in a builder's risk policy. The court held that the security company was not an unnamed insured because its services were not an integral part of the project. The court stated that only those persons whose contributions were "an integral and necessary part of the construction process" were included in the definition of insured. This case created an exception which proves the rule that contractors and sub-contractors involved in construction will likely be included as unnamed insureds in a builder's risk policy.

Next came the B.C. Court of Appeal decision in *Sylvan Industries Ltd. v. Fairview Sheet Metal Works Ltd.* (1994), 89 B.C.L.R. (2d) 18 (C.A.). This case arose out of a fire at a mushroom barn. The owner Sylvan was indemnified for the loss under its builder's risk policy. The insurer then brought a subrogated action against the mechanical contractor Zenith and its sheet metal sub-contractor Fairview. The main contract between the owner and Zenith required Zenith to obtain all risk property coverage. Zenith failed to do this; however, the owner did purchase its own builder's risk policy. The only named insured on this policy was the owner. The policy did not make any express reference to contractors.

The court looked at what the intention of the insurer and owner had been at the time that the builder's risk policy was issued, but found the evidence to be equivocal. On the issue of intention, the court held that intention must be looked at in the legal context in which the policy was written. The court then concluded (*Sylvan* at 26):

Given the special nature of builders' risk policies, the judicial pronouncements on the commercial necessity for inclusiveness, and the language of this policy, I am of the opinion that the trial judge reached the right conclusion when he found that contractors and subcontractors were unnamed insureds by necessary implication.

One possibly significant fact in *Sylvan* was that the two contractors lost some of their own property in the fire, specifically scaffolding and a quantity of sealant. Although this fact did not attract much comment by the court, other cases have held that where the contractor owns property which is part of the entire project, then that property is generally included as part of the "insured property" as specified in the insuring provision of the builder's risk policy. This was the case in *Esagonal Construction Ltd. v. Traina*, [1994] I.L.R. 2965 (Ont. Gen. Div.), in which the court held that Sacco, a supplier of steel beams to a construction project, was an unnamed insured under a builder's risk policy. The court concluded that at the time of the loss, Sacco still retained title to the steel beam which it was installing. Because all material on the project was insured by the policy, the policy covered the contractor's interest in the beam. The court then held that the full benefit of the policy extended to the contractor, and that the word "other" in the waiver of subrogation clause included Sacco. The court's conclusion was set out as follows (*Esagonal Construction* at 2970-71):

Clearly, Sacco is an "other" against which the insurance company is a subrogee. However, under this particular policy wording the insurance company has apparently undertaken to go not half measure, but full measure. The wording states that "all rights of subrogation are hereby waived" (emphasis added) if the "other" falls within the exception. Thus it is obvious that the insurance

company cannot take the position if the exception applies, that it will not subrogate only to the extent of the property value that is covered under clause 1(a)(ii) since it is waiving all rights of subrogation. Thus it would not appear to matter that whether the "other's" involvement under the policy was \$100 and the subrogated loss was \$1 million – the "other" is entitled to the \$1 million waiver.

Another example where a sub-contractor was found to be an unnamed insured because it owned some of the property insured by the builder's risk policy was *Earl A. Redmond Inc. v. Blair LaPierre Inc.* (1995), 27 C.C.L.I. (2d) 201 (P.E.I.S.C.T.D.). In that case, a builder's risk policy was issued to the owner and general contractor. When a fire damaged the building under construction, the insurer paid the claim; however, the insurer also paid about \$6,000 to a sub-contractor who had lost some property in the fire. It was that same sub-contractor that the insurer brought a subrogated action against. Because the sub-contractor was an unnamed insured, the court dismissed the subrogated action.

There is a comment in the *Earl A. Redmond* case which suggests that unnamed insureds in a builder's risk policy include not only contractors that are supplying materials to the project, but also those contractors who are supplying labour (at 209):

...courts have clearly signalled that a property insurer having issued a Builders' All Risk policy cannot maintain a subrogated claim against a subtrade if the latter contributed materials or labour to the project and the policy contains a waiver of subrogation clause

The case *Janeland Development Inc. v. Michelin Masonry Inc.*, [1996] I.L.R. 3922 (Ont. Gen. Div.) appears to have further extended the scope of unnamed insureds under a builder's risk policy. This case involved the collapse of a wall during the construction of a commercial building. The general contractor obtained a builder's risk policy and after the loss, its insurer brought a subrogated action against the masonry sub-contractor. The policy did not expressly extend to sub-contractors. The court did not focus on whether the sub-contractor owned any of the property or not. Rather, the court simply summarized the law as set out in *Sylvan, supra* and *Esagonal Construction, supra* and then concluded that the sub-contractor was an unnamed insured under the builder's risk policy. In closing, the court wrote (*Janeland Development*, at 3925):

This determination is in keeping with the court's desire to reduce litigation which flows from losses of this type. It also recognizes the reality of complex industrial life and provides comfort and security to owners, builders and sub-contractors involved in commercial projects.

A further case which affirmed all of the foregoing cases is *Madison Developments Ltd. v. Plan Electric Co.* (1997), 152 D.L.R. (4th) 653 (Ont. C.A.). In that case, the general contractor took out a builder's risk policy as he was required to do under the terms of the construction contract with the owner. The builder's risk policy did not expressly extend to sub-contractors. The contract which the general contractor had with its sub-contractor required the latter to obtain its own insurance to cover its own materials. Notwithstanding this term in the sub-contract, the court still held that both the sub-contractor and its employees were unnamed insureds in the builder's risk policy.

The court in *Madison* addressed an argument by the subrogating insurer that the waiver of subrogation clause only extended to sub-contractors when the sub-contractor suffered its own property damage in the loss. This in essence was the principle set out in cases such as *Esagonal* and *Earl A. Redmond*. The Ontario Court of Appeal's response to this argument indicates that property damage sustained by a sub-contractor is not the only thing which will cause the sub-contractor to be deemed an unnamed insured. Rather, the court appears to suggest that all contractors and sub-contractors are unnamed insureds. The court wrote (*Madison* at 662):

The respondents urge that it is intended to waive subrogation only where the loss is incurred to the subcontractors' property. Another possible interpretation is that it is a general waiver against

persons whose property is covered by the policy. We are not forced to choose between these alternatives, but the latter would be consistent with my express views as to the general intent of the parties to avoid litigation over fire damage occasioned during the course of construction.

In *529198 Alberta Ltd. v. Thibeault Masonry Ltd.*, [2001] A.J. No. 1684 (QL) (Alta. Q.B.), the court held that a masonry sub-contractor was an unnamed insured in a builder's risk policy "by necessary implication" even though the policy did not specifically list contractors or sub-contractors as unnamed insureds. The significance of this decision is that it asserts a general proposition that all sub-contractors on all construction projects have the benefit of a builder's risk policy taken out by the owner or general contractor.

In *Thibeault Masonry* the plaintiff acted as its own general contractor respecting the construction of a two phase condominium complex. Thibeault was the masonry sub-contractor. A fire caused by Thibeault damaged phase two. The plaintiff had obtained a builder's risk policy from State Farm. The plaintiff purchased the policy to fulfill a requirement imposed by the bank who was financing the construction project. The policy listed the plaintiff as the named insured and the bank as the loss payee. The policy did not expressly extend coverage to contractors or sub-contractors. After the loss, State Farm paid out on this policy, then brought a subrogated action against Thibeault. The court concluded that Thibeault was an unnamed insured (*Thibeault Masonry* at paras. 22 and 27):

Turning then to the language of the policy, the property coverage - specifically the phrase "buildings while in the course of construction" - is at issue. A plain reading of the phrase "buildings while in the course of construction" would seem to include the work of the Defendant and other subcontractors on the Project. A construction project is necessarily the sum of materials, supplies and labour of the subcontractors performing work on the project. 529 always contemplated that the work on the Project would be completed by subcontractors, and any damage or loss to the property in the course of construction would therefore be at the hands of its subcontractors. Further, the entire value of the Project was insured. It is an agreed fact that the value of Thibeault's work on the Project was included in that amount. In my opinion this fact and the plain meaning of "buildings while in the course of construction", are sufficient to find that Thibeault is an unnamed insured under the State Farm Policy, especially in light of the commercial purposes of such policies.

...

A broad interpretation of the property coverages, which includes the work of subcontractors, is in harmony with the commercial context of builders' risk insurance. Finding that subcontractors are insured under the policy advances its purposes of avoiding multiple coverage and of quickly providing funds for rebuilding without resort to litigation amongst the numerous subcontractors who work on one particular project. If subcontractors are not insureds under builders' risk insurance policies, the absurd result would be that each subcontractor would be required to carry insurance for the value of the entire project, resulting in unnecessary multiple coverage. Eighteen subcontractors worked on Dana Village Phase II, which, if the Plaintiff's interpretation is followed, would result in the necessity of the full value of the Project being insured eighteen times.

3. Waiver of subrogation in construction cases in the absence of insurance

A glimpse of what the future may hold in terms of further expansion of the principle of waiver of subrogation in construction cases was provided in *Saskatchewan Institute of Applied Science and Technology v. Hagblom Construction (1984) Ltd.* (2003), [2005] 1 W.W.R. 390 (Sask. Q.B.). In that case, the court recognized a defendant's right to plead that custom and industry practice preclude subrogation, even in the absence of a builder's risk policy. That case dealt with an application by the defendants to amend their statement of defence to plead that there was a custom in the construction industry for the owner to carry insurance for the benefit of all parties involved in a project and that this custom included an agreement of waiver of subrogation.

Finally, a case that takes the waiver of subrogation principle outside the realm of subrogated claims by insurers is *Active Fire Protection 2000 Ltd. v. B.W.K. Construction Co.*, [2005] O.J. No. 2892

(QL) (Ont. C.A.). In that case, the court held that a contractor's contractual obligation to obtain insurance, even though it did not carry through with purchasing insurance coverage, precluded the contractor from bringing a claim against a sub-contractor in relation to a loss that occurred during construction.

In *Active Fire Protection*, the contractor entered into a contract with the Town of Whitby to renovate a building. The contractor then entered into a sub-contract with BWK for the installation of sprinkler equipment. During construction, a flood occurred which BWK admitted was caused by its negligence. The contractor paid the Town for the damage and then brought an action against BWK to recover the amount paid to the Town. BWK argued that the contractor's action was barred because of its contractual obligation to insure. Relying on *Madison*, *supra*, the Court of Appeal held that the contractor's commitment to obtain insurance acted as a voluntary assumption of the risk of loss or damage caused by the perils to be insured against and as a result, the contractor was barred from bringing this claim against the sub-contractor BWK.

The court's reasoning for extending the waiver of subrogation principle to a case which did not actually involve a subrogated insurance claim was as follows (*Active Fire Protection* at para. 29):

Finally, the appellant argues that the *Madison* principle does not apply here because, unlike in *Madison*, this case is not concerned with an insurer's subrogation rights. I disagree. Although the issues in *Madison* arose in the factual context of a dispute regarding subrogation rights, this court's interpretation in *Madison* of the ambit of the protection afforded by the insurance covenants in issue was not restricted to situations involving contested subrogation rights. The critical issue here, as also engaged in *Madison*, is whether the respondent subcontractor is entitled under the contractual bargain made between the parties to derive the benefit of the insurance obligations undertaken by the appellant general contractor. In my view, the contractual arrangements between the parties establish this entitlement.

4. Summary

In light of all the above cases, the emerging trend appears to be that in any case where there is a builder's risk policy, and where a loss occurs during construction, the insurer will typically not be able to bring a subrogated claim against contractors or sub-contractors involved in supplying materials or labour to the project. The overriding rationale for the prohibition of subrogation by a builder's risk insurer against those involved in a construction project appears to be linked to public policy considerations involving economics and business efficacy. Namely, by upholding a waiver of subrogation in construction cases, this is expected to promote insurance funds being made available quickly following a loss, it should limit the amount of litigation that arises from a loss; and it should avoid the need for each and every contractor and sub-contractor to purchase its own insurance for the value of the entire project.

C. STRATA CORPORATION AND OWNER: WAIVER OF SUBROGATION UNDER THE STRATA PROPERTY ACT

It is not unheard of in a condominium complex for a loss arising in one unit to cause damage to other units or common property. Typical examples may include a fire that originates in one unit and spreads causing fire or smoke damage, or a hot water tank that leaks causing water damage to other units and common property. In these instances, if the occupant of a strata unit has purchased property insurance covering his or her contents, the insurer will often cover the cost of repairing or replacing the damaged contents. Likewise, the Strata Corporation's property insurer will often cover

the cost of repairing damage to the common property.⁶ The question becomes whether these insurers can bring a subrogated claim against the individual from within whose unit the cause of the loss originated?

1. The legislative framework under the *Strata Property Act*

Any loss which occurred on or after July 1, 2000 will be governed by the provisions of the *Strata Property Act*, S.B.C. 1998, c. 43.⁷ Several provisions of the Act have a bearing on whether a subrogated claim can be brought against a strata unit owner.

First, a strata unit owner owns his or her proportionate share of the Strata's common property as tenants in common. Section 66 of the Act states:

66. An owner owns the common property and common assets of the strata corporation as a tenant in common in a share equal to the unit entitlement of the owner's strata lot divided by the total unit entitlement of all the strata lots.

The phrase "common property" is defined in section 1(1) of the Act as follows:

1(1) ..."common property" means

(a) that part of the land and buildings shown on a strata plan that is not part of a strata lot, and

(b) pipes, wires, cables, chutes, ducts and other facilities for the passage or provision of water, sewage, drainage, gas, oil, electricity, telephone, radio, television, garbage, heating and cooling systems, or other similar services, if they are located

(i) within a floor, wall or ceiling that forms a boundary

(A) between a strata lot and another strata lot,

(B) between a strata lot and the common property, or

(C) between a strata lot or common property and another parcel of land, or

(ii) wholly or partially within a strata lot, if they are capable of being and intended to be used in connection with the enjoyment of another strata lot or the common property;

Second, a Strata Corporation is required to maintain full replacement insurance on the Strata's common property, common assets and certain fixtures. The provisions which apply to this requirement are section 149(a) of the Act and section 9.1 of the *Strata Property Regulation*, B.C. Reg. 43/2000 which state:

⁶ For guidelines suggesting what property is insured by a Strata Corporation's policy and what property is insured by a strata unit owner's policy, see Rule 10 of the Insurance Bureau of Canada's *Agreement of Guiding Principles (Property Insurance)*, 1984.

⁷ The *Condominium Act*, R.S.B.C. 1996, c. 64 applied prior to July 1, 2000.

149(1) The strata corporation must obtain and maintain property insurance on

- (a) common property,
- (b) common assets,
- (c) buildings shown on the strata plan, and
- (d) fixtures built or installed on a strata lot, if the fixtures are built or installed by the owner developer as part of the original construction on the strata lot.

(2) For the purposes of subsection (1) (d) and section 152 (b), "fixtures" has the meaning set out in the regulations.

(3) Subsection (1) (d) does not apply to a bare land strata plan.

(4) The property insurance must

- (a) be on the basis of full replacement value, and
- (b) insure against major perils, as set out in the regulations, and any other perils specified in the bylaws.

9.1 (1) For the purposes of sections 149 (1) (d) and 152 (b) of the Act, "fixtures" means items attached to a building, including floor and wall coverings and electrical and plumbing fixtures, but does not include, if they can be removed without damage to the building, refrigerators, stoves, dishwashers, microwaves, washers, dryers or other items.

(2) For the purposes of section 149 (4) (b) of the Act, "major perils" means the perils of fire, lightning, smoke, windstorm, hail, explosion, water escape, strikes, riots or civil commotion, impact by aircraft and vehicles, vandalism and malicious acts.

Third, although not mandatory, under section 152 of the Act, a Strata Corporation has the option of insuring the property listed in section 149 for additional perils which would allow the Strata Corporation to purchase all-risks property coverage, or coverage against other specified perils such as earthquake or flood. A Strata Corporation is also able to insure additional fixtures. Section 152 states:

152 The strata corporation may obtain and maintain insurance in respect of the following:

- (a) a peril or liability of the strata corporation that is not referred to in section 149 or 150;
- (b) fixtures built or installed on a strata lot that were not built or installed by the owner developer as part of the original construction on the strata lot.

Fourth, under section 153 of the Act, the Strata Corporation is deemed to have an insurable interest in all of the property it insures. Section 153 states:

153 The strata corporation has an insurable interest in any property insured under section 149 or 152.

Fifth, even though an insurance policy may list the Strata Corporation as the only named insured, section 155 of the Act deems strata unit owners, tenants and others who “normally occupy” a unit as being named insureds on the Strata Corporation’s policy. Section 155 states:

155 Despite the terms of the insurance policy, named insureds in a strata corporation's insurance policy include

- (a) the strata corporation,
- (b) the owners and tenants from time to time of the strata lots shown on the strata plan, and
- (c) the persons who normally occupy the strata lots.

Sixth, section 158 of the Act recognizes a Strata Corporation’s right to sue a strata unit owner to recover an insurance deductible it has paid in relation to a property damage claim provided that the owner was responsible for the loss. The meaning of “responsible” as it appears in the Act has not been judicially considered. The relevant portions of the section provide:

158 (1) Subject to the regulations, the payment of an insurance deductible in respect of a claim on the strata corporation's insurance is a common expense to be contributed to by means of strata fees calculated in accordance with section 99 (2) or 100 (1).

(2) Subsection (1) does not limit the capacity of the strata corporation to sue an owner in order to recover the deductible portion of an insurance claim if the owner is responsible for the loss or damage that gave rise to the claim...

Finally, sections 170 and 171 of the Act permit a Strata Corporation to sue a Strata unit owner for, among other things, damage to common property. These sections provide:

170 The strata corporation may sue an owner.

171 (1) The strata corporation may sue as representative of all owners, except any who are being sued, about any matter affecting the strata corporation, including any of the following matters:...

- (b) the common property or common assets;...

2. Waiver of subrogation against strata unit owners

The basic principle set out in *Commonwealth Construction Co. v. Imperial Oil Ltd.*, *supra* that an insurer cannot subrogate against its own insured applies to the insurers of Strata Corporations.

In *Strata Plan No. NW 651 v. Beck's Mechanical Ltd.* (1980), 20 B.C.L.R. 12 (S.C.), the Strata Corporation’s insurer commenced a subrogated action against those allegedly responsible for a fire. One of the defendants was Anthea Development Corp., a strata unit owner and an unnamed insured pursuant to the terms of the policy. The insurer ultimately discontinued the action against Anthea and proceeded against the remaining defendants. Those defendants then commenced third party proceedings against Anthea. The issue for the court was whether the subrogation rights were

affected by the third party proceedings. The court held that because Anthea was an unnamed insured, it was immune from subrogation because of the general law of insurance.

In *Lalji-Samji v. Strata Plan VR-2135*, [1992] B.C.J. No. 176 (QL) (B.C.S.C.), the court held that the waiver of subrogation principle precluding subrogation against an owner for damage to common property extended to circumstances in which the Strata Corporation did not, but ought to have had insurance coverage. In that case, an owner spilled bleach, causing damage to a rug which constituted common property. The Strata Corporation did not have adequate insurance, contrary to the applicable legislation. The owner successfully argued that if there had been proper insurance, it would have been an unnamed insured by virtue of the legislation and thus there could be no subrogated claim against him.

3. Waiver of subrogation against tenants of strata units

It is less clear under the *Strata Property Act* if the prohibition of subrogation which applies against strata unit owners also applies to claims against tenants. Section 155 of the Act deems tenants and “persons who normally occupy the strata lot” to be named insureds on a Strata Corporation’s property insurance policy; however, tenants and occupants do not own the common property and therefore, arguably, do not have an insurable interest in the common property.

The answer to whether subrogation is precluded against a tenant of a strata unit may lie in the recent B.C. Court of Appeal decision in *North Newton Warehouse Ltd., supra*. As explained in that case, it is not the issue of insurable interest which determines if there is a waiver of subrogation, but rather whether the insurance policy extends coverage to the tenant.

4. Claims by Strata Corporation to recover its insurance deductible

In *Strata Corp. VR 2673 v. Commssiona*, [2000] B.C.J. 1681 (QL) (B.C.S.C.), the court held that there is no legal bar to a Strata Corporation claiming against a strata unit owner to recover the deductible that the Strata Corporation has paid in respect of a claim for property damage to common property. Regarding s. 158(2) of the *Strata Property Act*, the court held that the section did not change the common law which already allowed a Strata to sue an owner to recover the deductible.

III. PROVING THE CLAIM

One of the challenges that counsel representing insurers will experience on a regular basis is that of receiving instructions to commence a subrogated action within days of the expiry of the limitation period. As insurers continue in their efforts to reduce legal expenses by retaining the file longer before assigning counsel, the greater the frequency of the last minute retainer to commence a subrogated claim. The last minute claim poses a number of practical issues. Quite often the proper defendant or defendants have not been accurately identified in the course of the investigation. A potential party identified as “Acme Construction” or “John Doe & Son” may in fact be a numbered company carrying on business under one of those names. Sometimes these business names have been registered with the appropriate authority and the proper defendant can be ascertained by a search. In other cases, an individual carrying on business under the name identified during the investigation will not have taken steps to register the proprietorship and an additional investigation will be required to identify the proper party.

Another issue which arises frequently is where a corporate search of a party identified as the appropriate defendant discloses dozens (and in some cases hundreds) of corporate entities registered under essentially the same name. This frequently occurs where contractors incorporate a separate company for each project undertaken. This situation may place

counsel in a position where they have a choice of attempting to identify the proper party within the limited time available prior to the deadline for issuing the Writ or naming dozens of unnecessary parties as defendants in an action.

The other difficulty often faced by counsel who receive instructions shortly before the expiry of a limitation period is where there are either significant gaps in the investigation or where evidence has either been discarded, tampered with or where the chain of custody of the evidence is difficult to establish. A case comes to mind in which a claim involving hundreds of thousands of dollars ultimately had to be abandoned where the component which caused the loss was left with the insured and was returned by the insured to a distributor for a small credit.

Frequently, insurers endeavoring to resolve claims without involving counsel will permit critical real evidence to be removed from the scene and handled by numerous parties before counsel is retained and steps are taken to document the chain of custody and properly preserve the evidence. Shortcomings in the manner in which the chain of custody is documented and the evidence preserved will often create significant impediments and, occasionally, insurmountable hurdles to the successful prosecution of a subrogated claim. In one instance a ruptured water main retained by a municipality was moved to a large storage facility where, prior to being properly identified, it was stored with hundreds of other segments of pipe. When counsel was engaged two years after the loss to advance a subrogated claim, the evidence required to prove a breach of duty on the part of the municipality could not be identified. While it is certainly open to counsel to invite a court to draw an adverse inference in these circumstances, the failure to take steps to preserve the evidence in the early stages can often be explained by inadvertence or inattention which may negate the adverse inference. There are very few circumstances in which an adverse inference will have the same impact as the evidence itself.

To address these issues, counsel should maintain an ongoing dialogue with insurers, supported by in-house training seminars, which focus on the importance of preserving real evidence, establishing a proper protocol before permitting the inspection of the evidence by others and documenting the chain of custody of the evidence. While the retainer of counsel at an early stage will often be of significant value in addressing these issues, budgetary constraints and the cost associated with the early retainer of counsel is likely to counter balance this option. With insurers relying increasingly on road adjusters and in-house personnel to investigate property losses in which subrogation possibilities exist, there is a greater need for expanded communication between insurers and counsel on the steps which must be taken to preserve and document the chain of custody of the evidence which will be required to prove the claim.

Other measures which will assist counsels' ability to successfully advance a subrogated claim include:

- (a) taking steps early on in the investigation to properly identify the potential parties;
- (b) taking steps annually to review and identify the appropriate experts to be engaged in a variety of situations so that insurers are kept abreast of the leading experts in a number of disciplines;
- (c) working with insurers to establish an appropriate protocol for the preservation of evidence and for documenting the chain of custody of real evidence;

- (d) inviting insurers to consult with counsel regarding the engagement of experts and to address issues arising in connection with the preservation of evidence earlier in the process;
- (e) encouraging insurers to engage counsel sufficiently in advance of the expiry of the limitation period to permit counsel to review the theory of liability with the retained experts, to identify the proper parties to be named as defendants in the action and to address any gaps in the investigation.

APPENDIX "A"

SAMPLE SUBROGATION AGREEMENT

THIS AGREEMENT is made as of the ____ day of _____, 2006.

BETWEEN:

JANE DOE
("the Insured")

OF THE FIRST PART

AND:

ABC INSURANCE CO.
("the Insurer")

OF THE SECOND PART

WHEREAS: on May 1, 2005, the Insured's home located at 1234 Anywhere Road, Vancouver, British Columbia was destroyed by fire (the "Fire").

AND WHEREAS the Insurer insures the Insured and has paid claims to the Insured arising from the Fire.

AND WHEREAS the Insured sustained some losses that were not covered by insurance.

AND WHEREAS the Insurer has commenced an action in the Insured's name against Richard Roe Contracting Ltd. (the "Action") to recover the amounts it paid to the Insured.

AND WHEREAS the parties have agreed to jointly instruct Perry Mason, Barrister & Solicitor ("Perry Mason") to continue the Action and recover their respective losses arising from the Fire on the terms set out herein.

THE PARTIES AGREE AS FOLLOWS:

1. The parties agree to pay the reasonable legal fees and disbursements (the "Legal Costs") billed by Perry Mason in the prosecution of the Action and to allocate the proceeds, if any, of the Action on a pro rata basis in the following proportions:

The Insurer	-	84%
The Insured	-	16%

2. The Insurer will maintain complete control over the conduct of the Action, including any decision to pursue, settle or abandon the Action.
3. In exchange, the Insurer agrees to pay all the Legal Costs throughout the lawsuit as they are billed and the Insured will pay its pro rata share of the Legal Costs only when the Action is settled or judgment is awarded, and only then if proceeds are actually recovered.
4. If the Action is dismissed with costs, those costs will be payable by the Insurer.
5. If the Insurer elects to abandon the Action, the Insured will have no liability for Legal Costs to the date of abandonment and will only have liability for the Legal Costs from the date of abandonment if the Insured elects to continue the Action.
6. If the Insured decides not to pursue her uninsured losses in the Action, the Insured will still cooperate with the Insurer in its pursuit of the Action, including, but not limited to, attending examinations for discovery and giving evidence at trial.
7. The parties agree that they have been advised to seek independent legal advice prior to and entering into this Agreement.

The parties hereto have executed this Agreement as of the day and year first above written.

JANE DOE

ABC INSURANCE CO.
Per:

**John M. Moshonas is a director,
John A. Vamplew and Sean R. Lerner
are associates with Whitelaw Twining
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