IN THE MATTER OF THE *INSURANCE ACT*, R.S.O. 1990,
c. I. 8, section 268 and *REGULATION 283/95*

AND IN THE MATTER OF THE *ARBITRATION ACT*,
S.O. 1991, c. 17;

AND IN THE MATTER OF AN ARBITRATION

BETWEEN:

STATE FARM MUTUAL INSURANCE COMPANY

Applicant

- and -

ECHELON GENERAL INSURANCE COMPANY

Respondent

DECISION ON A PRELIMINARY ISSUE (AMENDED)

COUNSEL:

Martin E. Tiidus for the Applicant

Jamie R. Pollack and Amanda M. Lennox for the Respondent

PRELIMINARY ISSUE:

1. Is State Farm barred from pursuing its priority dispute against Echelon General for failure to initiate arbitration within one year from the date that it first gave notice that it intended to dispute its obligation to pay benefits, pursuant to section 7(2) of Regulation 283/95 of the *Insurance Act*?

The parties filed detailed written submissions on the above issue.

RESULT:

State Farm did not initiate arbitration within one year from the date it first gave notice that it intended to dispute its obligation to pay benefits, and is consequently barred from pursuing its priority dispute against Echelon General.

BACKGROUND:

April McNutt was seriously injured when she was struck by a motor vehicle on October 7, 2005. Ms. McNutt had been using her father's vehicle to deliver newspapers, and was struck after pulling over onto the shoulder of the road, and exiting the vehicle to drop off a paper. The car she was driving was insured by State Farm. Ms. McNutt subsequently applied to and has been receiving accident benefits from State Farm.

At the time of the accident Ms. McNutt was living with Jason Carrigg, with whom she has a child. Mr. Carrigg drives a vehicle that is insured by Echelon. State Farm seeks reimbursement from Echelon for the benefits it has paid out to Ms. McNutt on the basis that Ms. McNutt is a "spouse" of Mr. Carrigg, and that Echelon is therefore in higher priority to pay benefits pursuant to subsection 268(2) of the *Insurance Act*.

Echelon has raised a preliminary objection to State Farm's claim. It alleges that this arbitration was not initiated within one year of State Farm having provided notice of its intention to dispute its obligation to pay benefits to Ms. McNutt, as required by section 7(2) of Regulation 283/95.

At the initial pre-hearing teleconference counsel agreed to have this matter decided as a preliminary issue by way of written submissions, prior to the other issues in the case being determined.

RELEVANT PROVISIONS:

The following sections of Regulation 283/95 are relevant to this issue:

> **2.** The first insurer that receives a completed application for benefits is responsible for paying benefits to an insured person pending the resolution of any dispute as to which insurer is required to pay benefits under section 268 of the Act.
>
> **3.** (1) No insurer may dispute its obligation to pay benefits under section 268 of the Act unless it gives written notice within 90 days of receipt of a completed application for benefits to every insurer who it claims is required to pay under that section.
>
> **7.** (1) If the insurers cannot agree as to who is required to pay benefits or if the insured person disagrees with an agreement among insurers that an insurer other than the insurer selected by the insured person should pay the benefits, the dispute shall be resolved through an arbitration under the *Arbitration Act, 1991*.
>
> (2) The insurer paying benefits under section 2, any other insurer against whom the obligation to pay benefits is claimed or the insured person who has given notice of an objection to a change in insurers under section 5 may initiate the arbitration but no arbitration may be initiated after one year from the time the insurer paying benefits under section 2 first gives notice under section 3.

Section 23 of the *Arbitration Act* provides :

> **23.** (1) An arbitration may be commenced in any way recognized by law, including the following:
>
> 1. A party to an arbitration agreement serves on the other parties notice to appoint or to participate in the appointment of an arbitrator under the agreement.
> 2. If the arbitration agreement gives a person who is not a party power to appoint an arbitrator, one party serves notice to exercise that power on the person and serves a copy of the notice on the other parties.
> 3. A party serves on the other parties a notice demanding arbitration under the agreement.

RELEVANT FACTS:

The parties agree on the following facts relevant to the determination of this preliminary issue:

State Farm acknowledged receipt of an application for accident benefits filed by Ms. McNutt's representative on November 11, 2005, some five weeks after the accident occurred. It appears that State Farm forwarded a Notice of Dispute Between Insurers to Eric McNutt, their insured, on that same day. It also appears that State Farm did not provide a copy of this Notice of Dispute to Echelon until February 2, 2006. The parties agreed that in accordance with section 7(2) of the Regulation, State Farm was therefore obliged to commence the arbitration by no later than February 2, 2007.

The documentation filed indicates that there were regular telephone calls and written correspondence between the adjusters from both companies in the weeks that followed Echelon's receipt of the Notice of Dispute. Echelon sought further information relating to Ms. McNutt's application, and State Farm provided it. Echelon then requested the adjusters' log notes and State Farm advised that they were unable to provide them without a signed authorization from Ms. McNutt. There were various exchanges between the parties around this issue. On July 20, 2006 the State Farm adjuster wrote:

> *Dear Olga:*
> *Further to our conversation today.*
>
> *State Farm Insurance is unable to provide you with copies of our log notes regarding this dispute. However, we are requesting a formal response to the Dispute Between Insurers within 30 days or (sic) this letter. If there is not Response we will proceed to Arbitration on this issue.*

When no response was received to this letter, a further note was sent on September 15, 2006 as follows:

> *Dear Olga:*
>
> *Further to our letter dated July 20, 2006*
>
> *State Farm Insurance has still not received a formal response to the Dispute Between Insurers.*
>
> *Please provide your response by October 15, 2006. If we do not have your response, we will proceed with Arbitration on this matter.*
>
> *Your response may be faxed to 1-888-633-0405.*

The Echelon adjuster acknowledged receipt of the above letter a few days later, and reiterated her position that Echelon was unable to make a decision regarding the priority issue without access to State Farm's file and log notes.

Finally, on September 26, 2006, the State Farm adjuster wrote –

> *Dear Olga:*
>
> *Thank you for your letter dated September 22, 2006.*
>
> *I refer you to our letter of April 13, 2006. We do not have the authorization to release the file log notes to your company.*
>
> *Please note that we are now proceeding to file for Arbitration on this issue.*

The log notes filed reveal that there were internal discussions between the adjuster and his supervisor during the months of November and December 2006 regarding the file being sent to counsel to pursue arbitration. However, there was no further activity on the matter until October 5, 2007, when Robert Franklin of the law firm Reisler Franklin LLP wrote the following letter to Olga Kouritsyna of State Farm:

Please be advised that I have been retained by State Farm in regards to the priority dispute.

I understand that State Farm has provided a copy of its claim file, but no log notes, for your consideration. State Farm's information is that April McNutt was living at the time of the accident at 1184 Montreal Street in Kingston, Ontario. She was living with your named insured, Jason Carrigg. Mr. Carrigg has confirmed that he owned a motor vehicle insured under your policy. It is our information that this is the only policy in the household. It is for this reason that State Farm sent you the Notice of Dispute Between Insurers.

It is unclear to me why you think there is any issue as the priority. Please clarify your position as soon as possible.

Are you denying that there is a policy? What evidence do you have suggesting priority is with State Farm and not with Echelon?

I note that you have asked for State Farm's log notes. It seems you want State Farm to provide you with information, but as yet you have not even stated your position.

We would be pleased to discuss these issues with you. I am prepared to seek instructions to share my client's log notes with you, but only on the condition that you are prepared to share all of your information with us.

I look forward to hearing from you. If I do not hear from you within a reasonable period of time, I will initiate an arbitration proceeding.

If you wish to go straight into dispute process, please confirm. I would ask that you appoint counsel immediately. Please confirm that you consent to using Mr. Bruce Robinson as arbitrator.

If we do not hear from you, we will have no alternative but to bring an Application to commence an arbitration proceeding. If we are obliged to incur these unnecessary expenses, we will be seeking our complete indemnity costs in respect to the Application.

I look forward to discussing his case with you or your counsel.

I was subsequently contacted by the parties on January 2, 2008 and asked to conduct the arbitration.

PARTIES' ARGUMENTS:

The parties agree that 23(3) of the *Arbitration Act* requires that two basic steps be followed in order to commence an arbitration – there must be an agreement to arbitrate, and pursuant to that, a notice demanding arbitration. The parties also agree that in accordance with Justice Archibald's comments in *Gore Mutual Insurance Co. v. Markel Insurance Co*. 12 C.C. L. I (3d) 313 (Ont. Sup. Ct.), the provisions of the *Insurance Act* and of Regulation 283/95 constitute the agreement to arbitrate in this context. The sole question then becomes whether State Farm has provided "notice demanding arbitration" to Echelon prior to February 2, 2007.

Counsel for State Farm contends that the references to arbitration in the three letters from the State Farm adjuster, set out above, constitute the required notice. He argues that when these letters are read together with the Notice of Dispute Between Insurers, the requirements for clear notice that an arbitration is to be held, and the rationale behind it are satisfied.

State Farm also submits that the Echelon adjuster's log notes filed indicate that Echelon was fully aware that State Farm intended to pursue "the priority issue" to arbitration. Counsel noted that Echelon's outside adjuster's notes even indicate that Echelon was the priority insurer, and that reserves were set based on an evaluation of their exposure. Counsel contended that this awareness should be taken into account when evaluating whether the references to arbitration in the correspondence are adequate to constitute a demand for arbitration under section 23.

State Farm also argues that there is a distinction between "commencing an arbitration" pursuant to section 23 of the Act, and initiating an application to the court for the appointment of an arbitrator, which appears in section 10 of the *Arbitration Act*. That section provides as follows –

10. (1) The court may appoint the arbitral tribunal, on a party's application, if,

(a) the arbitration agreement provides no procedure for appointing the arbitral tribunal; or

(b) a person with power to appoint the arbitral tribunal has not done so after a party has given the person seven days notice to do so.

Counsel submits that an arbitration can be "commenced simply by a demand for such, in no particular form and not even necessarily in writing", but that if this demand fails to further the arbitration process, a party must then apply to the court for the appointment of an arbitrator under section 10. State Farm essentially contends that the log notes and the letters set out above relate to a court application under section 10 of the Act, which it was required to pursue as a result of Echelon's continued refusal to state its position on the priority issue.

Finally, counsel for State farm contends that as arbitrators have historically taken a broad and liberal approach to what constitutes adequate notice regarding disputes between insurers, the same approach should be taken to considering the form and substance of what constitutes a demand for arbitration under section 23(3) of the *Arbitration Act*.

Counsel for Echelon takes the contrary view. He submits that the references to arbitration in the correspondence from the State Farm adjuster are insufficient to comply with the requirement to initiate an arbitration, as they do not contain a clear demand to proceed to arbitration, as required by the case law. He notes that the letters do not reference the regulation, do not mention the selection of an arbitrator, nor provide that if Echelon does not co-operate, State Farm will bring an application to commence an arbitration proceeding. Counsel contends that these requirements are either explicitly required or impliedly found in the reasoning in the arbitration decisions in *State Farm Mutual Insurance Company v. Dominion of Canada General Insurance Company* (unreported decision of M. Guy Jones, March 2004), *Aviva Insurance Company v. Lombard Insurance Company* (unreported decision of M. Guy Jones, September 15,

2004) and *Lloyd's of London Insurance Company v. Wawanesa Insurance Company* (unreported decision of M. Guy Jones, March 2004).

Counsel essentially contends that the mere mention of the word arbitration in a letter is not enough to constitute a clear demand that the Respondents submit to arbitration of the dispute in question.

Echelon also contends that the adjusters' log notes that postdate the letters referred to above, explicitly acknowledge that State Farm did not consider the arbitration to have been initiated. Counsel referred to a note dated November 15, 2006, which states –

> *advise Echelon we are pursuing Arb on the priority issue – we want their position. Prepare file and cover letter to send file to Joanna Chadwick at Chadwick and Assoc to pursue priority issue. Please complete and return to me by 11-23-006*

A further note on December 13, 2006 states –

> *Where is the file and cover to send to counsel to pursue ARB*

Counsel highlighted the two references in Mr. Franklin's letter of October 5, 2007 to arbitration proceedings being initiated or commenced if "we do not hear from you", and contended that this is clear evidence of an acknowledgement by State Farm that an arbitration had not yet been commenced as of that date. Counsel for Echelon also disputes State Farm's contention that the references to arbitration in Mr. Franklin's letter relate to bringing a court application under section 10 of the Act, as opposed to the commencement of an arbitration under section 23(3), and contends that the wording of the letter simply does not support this contention.

Finally, Echelon submits that State Farm's argument that a broad approach should be adopted when interpreting the form and substance of communications between insurers in the context of priority disputes should be rejected, in light of the Court of Appeal's comments in *Kingsway General Insurance Co. v. West Wawanosh Insurance Co.* [2002]

58 O.R. (3d) 251 to the effect that insurers are sophisticated litigants who are regularly involved in these types of disputes and that "clarity and certainty of application are of primary concern".

ANALYSIS AND FINDINGS:

As stated above, the sole issue to be determined at this stage is whether State Farm commenced this arbitration against Echelon by February 2, 2007. I do not agree with State Farm's contention that the letters from its adjuster to the Echelon adjuster reproduced above constitute either adequate notice of a demand for arbitration under section 23(3) of the *Arbitration Act,* or notice of an application to the court to appoint an arbitrator under section 10 of the Act. I would describe the first two letters as requests for a response on the priority question, which end with the caution that if no response is received, "we will proceed to arbitration". The phrase appearing in the third letter -"we are now proceeding to file for Arbitration on this issue"- evidences an intention to commence an arbitration proceeding but does not itself constitute a notice demanding arbitration under the Regulation, as required by section 23 of the *Arbitration Act*.

These letters are similar to the correspondence considered in both the *Aviva v. Lombard* and the *State Farm and Dominion* decisions cited by counsel, in which the arbitrator found that letters alleging that the other insurer is primary, and that the file will be passed on to counsel and costs will be sought were not enough to constitute "notice demanding arbitration". I find that they are neither specific enough, nor direct in their suggestion that State Farm has made the decision to arbitrate and wishes to formally notify Echelon of this intention.

These letters are quite different from the correspondence considered in the *Lloyd's v. Wawanesa* decision. In that case, the letter in question specified that counsel had been retained to proceed to arbitration and the other party was requested to submit. It referred to the arbitration being held pursuant to Regulation 283/95, and arbitrator's names were either requested or provided. That letter was found to be clear enough to constitute the

commencement of an arbitration. The letters relied on by State Farm in this case contain none of that necessary detail, nor the required clarity of intention to proceed to arbitration.

The log notes provided indicate that State Farm did intend to send the file to counsel to commence an arbitration. However, for reasons that are not clear, that step was not actually taken until October 5, 2007, when Robert Franklin wrote to Olga Kouritsyna at Echelon. While it is debatable whether this letter can be considered a notice demanding arbitration, it is sent more than eight months after the one year deadline. I note that after setting out State Farm's position on the priority issue and discussing the sharing of information, Mr. Franklin goes on to state –

> *I look forward to hearing from you**. If I do not hear from you within a reasonable period of time, I will initiate an arbitration proceeding.(emphasis added)***
>
> *If you wish to go straight into dispute process, please confirm. I would ask that you appoint counsel immediately. Please confirm that you consent to using Mr. Bruce Robinson as arbitrator.*
>
> *If we do not hear from you, we will have no alternative but to bring an Application **to commence an arbitration proceeding**. If we are obliged to incur these unnecessary expenses, we will be seeking our complete indemnity costs in respect to the Application. **(emphasis added)***
>
> *I look forward to discussing his case with you or your counsel.*

It is clear from this letter that Mr. Franklin is of the view that no arbitration had yet been commenced, and I so find.

The wording of section 7(2) of the Regulation is clear. It states that "no arbitration may be initiated after one year from the time the insurer paying benefits…first gives notice under section 3." The agreed upon deadline date that State Farm had to meet in this case is February 2, 2007. I am mindful of the Ontario Court of Appeal's comments in *Kingsway v. West Wawanosh, supra,* as follows –

> *The Regulation sets out in precise and specific terms a scheme for resolving disputes between insurers. Insurers are entitled to assume and rely upon the requirement for compliance with those provisions. Insurers subject to the Regulation are sophisticated litigants who deal with these disputes on a daily basis. The scheme applies to a specific type of dispute involving a limited number of parties who find themselves regularly involved in disputes with each other. In this context, it seems to me that clarity and certainty of application are of primary concern. Insurers need to make appropriate decisions with respect to conducting investigations, establishing reserves and maintaining records. Given this regulatory schedule, there is little room for creative interpretations or for carving out judicial exceptions designed to deal with the equities of particular cases.*

In light of these clear instructions, I cannot give effect to State Farm's argument that Echelon's awareness of the priority dispute, its evaluation of its exposure on the file, or even the fact that it set reserves for Ms. McNutt's application should mitigate against a finding that the arbitration was not commenced within the required time.

Consequently, I find that State Farm is barred from proceeding with its priority dispute against Echelon by virtue of its non-compliance with section 7(2) of Regulation 283/95.

DATED AT TORONTO, ONTARIO this _____ day of December 2008.

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Shari L. Novick

Arbitrator